

e-commerce

***Old Economy
companies should
start small but smart***

***By Georg Tacke
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If you believe what you see and hear in the media, you would agree that every CEO needs a blockbuster E-Commerce strategy which will transform his or her business beyond recognition.

We don't.

We are not trying to dismiss or underestimate the market potential of E-Commerce, as people have shortsightedly done in the past with breakthroughs such as personal computers and wireless communications. E-Commerce obviously has many important uses and benefits. However, CEO's would also be well advised to take a closer look at the scrap heap of failures and false starts that is rapidly piling up on the dark side of the New Economy before they jump headfirst onto the E-Commerce bandwagon and damage their company in the process.

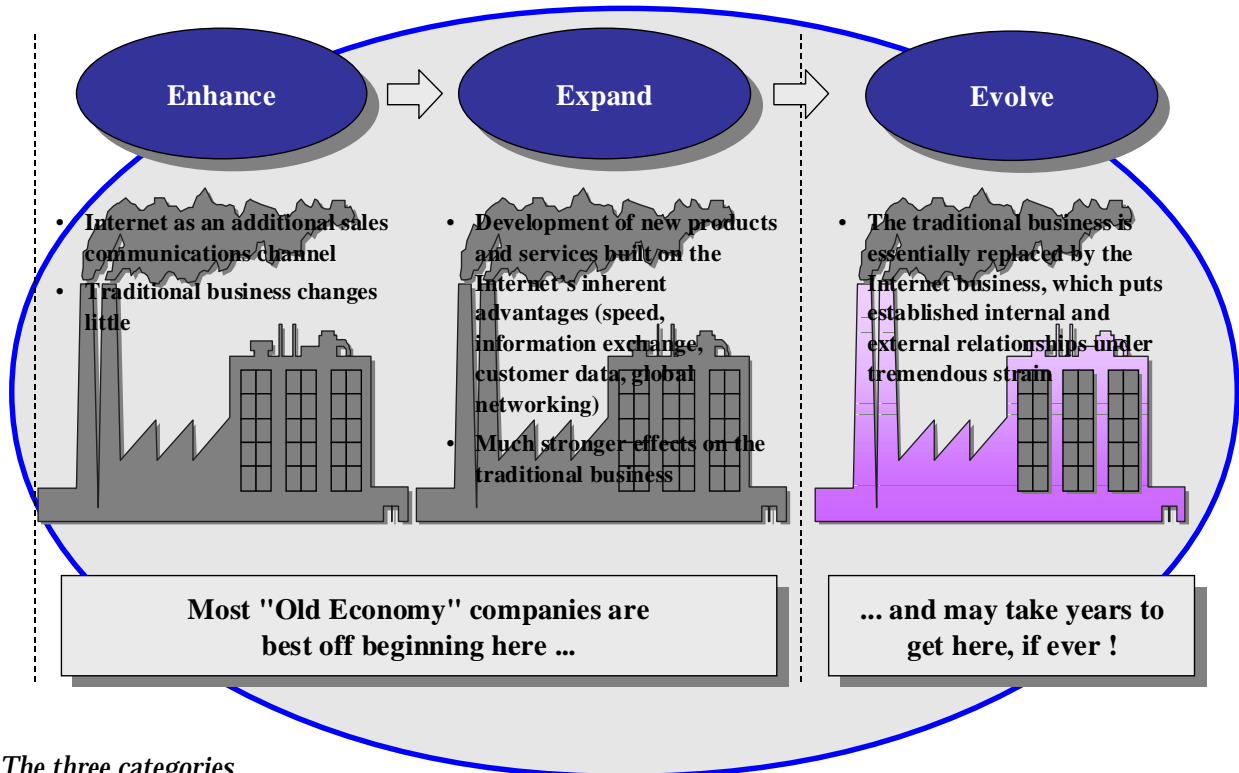
We would argue that the best E-Commerce strategies over the long haul might just be the ones that make investors yawn, not gasp. We admit that burning up other people's money by the bucketful brings an exhilarating rush. It has since money was invented a few millennia ago. But it does not make for sound business.

What has prevented many companies from making their E-Commerce dreams a reality? In our research of a broad range of multinational companies both large and small, we have found one common thread: a gross mismatch between the company's E-Commerce business model and the market's ability to understand and accept it. In the end, they were not able to generate enough revenue, because they could not convince enough customers to buy something or read something, or because they could not deliver when someone actually tried.

The overhyped success of Dell Computer and the once alluring attractiveness of amazon.com lead many companies to believe that they can emulate that kind of success

quickly. Taking the plunge, they behave like students in a high school class who think they can tackle calculus before they have mastered basic math. For that reason, we advised a major division of a multibillion dollar company in mid-1998 to scale back their E-Commerce plans in the short term, for the simple, practical, and sensible reason that neither they nor their customers were ready to handle the concept.

While such a recommendation would be



The three categories of E-Commerce initiatives

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sacrilege in Silicon Valley, it plays well in the rest of the world, which – believe it or not – is still struggling to come to grips with the possibilities that the Internet provides.

How do you avoid creating a mismatch between your expectations and your market's? We have three suggestions:

1. Know what you and your market can bear.

No matter what sort of E-Commerce initiative you have in mind, it will fall into one of three categories: enhancement, expansion, or evolution. Enhancement is the most straightforward E-Commerce approach. It involves using the Internet as an additional sales channel and an efficient means to exchange information. These on-line storefronts are the modern-day equivalent of the Sears, Roebuck

catalog a century ago, which allowed potential customers in the rural United States to buy products when there was no Sears store within hundreds of miles. Most "Old Economy" companies currently find themselves in this phase, and justifiably so.

Expansion means offering new products and services which could not exist without the Internet's capabilities for speed, interaction, global reach, and cost effectiveness. The creation of on-line exchanges or the use of on-line auctions is one example. New initiatives in customer service are another area. Cisco Systems' decision to place its technical manuals on-line has dramatically reduced its customer service workload and freed up engineers to use their time more productively.

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The third and most difficult phase is evolution. When a company takes an evolutionary approach, it sees E-Commerce as its primary driving force and builds - or rebuilds - itself from the ground up. For an Old Economy company, this shift marks a clean break with the company's traditional way of doing business, and often with the employees who built and ran that business.

The US-based industrial products wholesaler Grainger has been successful with its E-Commerce business efforts thus far precisely because it did not overshoot. It began with enhancement, in step with the capabilities and desires of its customers. The company's own surveys show that nearly 80 percent of Grainger's potential customers - the B2B customers CEO's should be losing sleep over - will probably buy absolutely nothing at all on-line in 2000. The surveys also revealed that the bulk of small and medium-sized business still prefer personal contact to the impersonal fax machine and the Internet.

Grainger's on-line business now generates revenue at an annualized rate of \$200 million per year, a stream of actual, measurable revenue that most E-Commerce start-ups would kill for. It succeeded by beginning where its customers were, namely, in a position to grow accustomed to shopping on-line without being overwhelmed. The company has now begun to enter the "expansion" phase by establishing on-line marketplaces. But it has not bet the company and has not thrown its old business model overboard by aiming for evolution when it knew that enhancement was the proper first step. Even now, Internet sales still represent only 4 percent of the company's revenue.

2. Know where your revenue will come from.

Probably the most basic tenet of management is that you can't make a profit if you have no money coming in. We would be embarrassed to say something so trite if we did not see companies so many companies floating E-Commerce ideas without any clear idea of where the revenue will come from. For all the talk about unique hits and share of eyeballs, E-Commerce will only work if the cash register rings loudly and often. Many on-line companies - both start-ups or traditional companies -

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either overestimate their ability to generate sales or forsake revenue opportunities entirely. An example of a forsaken revenue stream is the information on amazon.com's web site. It is debatable whether amazon.com is the best or least expensive way to buy books, but few can argue that Jeff Bezos and his team have assembled one of the largest and most sophisticated on-line library card catalogs the world has ever known. And they put in on-line free of charge ! We are aware of many people who now use amazon.com primarily as a research tool, not as a way to buy something, because of the richness of the available information and the opportunities to window shop.

The most common example of an overly optimistic revenue idea is what many have come to call "intermediation". The idea is simple. You play middleman over the Internet and charge one or both sides for linking up and interacting over your website. This approach can only work over the long-term if the connection you make available provides your customers either with unexpectedly high value in terms of speed and efficiency, or with an opportunity they would have never been able to find otherwise. The on-line auction house eBay makes money not because it discovered some magic formula, but because it scores well on both of those points.

3. Don't speak in tongues.

The Internet and the opportunities of E-Commerce are intimidating for many people, not because they fear the technology itself but because they are uncertain about how it will affect them. Can they keep up? Will it cost them their jobs? What do they need to learn? Any E-Commerce initiative needs to have a convincing and easily understood story to support it. This task is made easier by the fact that most of the "wonders" of the E-Commerce world have Old Economy counterparts like auctions, exchanges, buying groups, newspapers, supermarkets, and networks. These provide a rich source of analogies to help people appreciate what they are up against and act accordingly.

We have no doubt that E-Commerce will eventually transform the world the way merchant shipping, railways, and telecommunications did in past centuries. But the world will reach that point much faster – and profitably – by resisting the siren call of E-Commerce riches and instead re-adjusting their businesses as much as they can bear, but without overshooting. There will always be shooting stars and geniuses who will earn billions by building a profitable business on a breakthrough idea. The rest of us, though, would be best served by mastering the arithmetic and algebra of E-Commerce before cracking open the calculus books.

The so-called "Old Economy" companies need to keep three things in mind as they figure out what role E-Commerce should play within their organization.

1. Know what you and your market can bear.

Enhancement means using the Internet as an additional sales channel and an efficient means to exchange information. **Expansion** means offering products and services which could not exist without the Internet's capabilities. **Evolution** marks a clean break with traditional ways of doing business, and often with the employees who built and ran that business.

2. Know where your revenue will come from.

The cash register must ring loudly and often. Most revenue models work over the long-term if they provide your customers either with very high value in terms of speed and efficiency, or with an opportunity they would have never been able to find otherwise. Witness eBay.

3. Don't speak in tongues.

E-Commerce initiatives need convincing, easily understood stories. Old Economy elements such as auctions, exchanges, buying groups, newspapers, supermarkets, and networks provide a rich source of analogies to help people appreciate what they are up against.

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