

In less than a year the term "E-Business" has disappeared from the vanguard of corporate strategy, dragged down by lingering uncertainty about whether it will trigger the vast but unpredictable change it promised in the late 1990's.

How should companies respond to this development? They should react neither with optimism nor pessimism, but rather with common sense. E-Business, in other words, needs to make a fresh start. That emerged as the key message from the second Simon-Kucher Strategy Forum in Bonn, Germany, where over 250 corporate leaders and academics gathered to grapple with the question "E-Business – Quo vadis?".

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# e-business

## Making money in the second wave

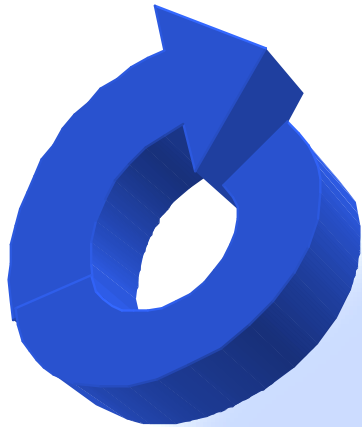
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***A summary of the 2nd  
Simon-Kucher & Partners  
Strategy Forum***

***July 2001***

CEO's in Europe are not discouraged by the scrap heap of failures and false starts that has piled up on the dark side of the New Economy, nor are they jumping headfirst onto the E-Business bandwagon in the false hope that they can quickly conquer new markets and exploit a first-mover advantage. Instead, their focus for the emerging second wave of E-Business is exactly where it should be: on making money.

"The euphoria of 1999 was unjustified and the gloom of 2001 is equally overstated," said Rajiv Lal, professor of retailing at the Harvard Business School and one of three keynote speakers at the forum. He noted that most so-called "e-tailers" mistakenly assumed that the low



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cost of reaching customers via the Internet made the medium an efficient way to reach the mass market.

This assumption is wrong.

"The cost of acquiring a customer is very high unless supported by an existing brand," Lal explained, adding that the Internet is better for customer retention than for acquisition. "The e-tailer amazon.com turns just \$2 profit per account, despite \$100 in revenue per customer. With acquisition costs per customer running at \$12, however, a customer needs to remain loyal to amazon.com for six years if the company is to break even." And profit - not revenues or name recognition - will be the ultimate measure of success.

"Whether it is the Old Economy or the New Economy, there is only one way to count success, and that is profitability in hard cash," Lal said. The mathematics have not worked for many Internet-based ventures, because "profitability is the lifetime value of the customer, taking acquisition costs and retention costs into account."

**N**onetheless, the Internet offers many companies new opportunities for approaching markets, which will result in significant changes in their internal organizations. For all the extremes of hype and doom-and-gloom, one clear fact has emerged in the first five years of the New Economy: the Internet is the most efficient platform for moving information. The degree of change will be a direct function of this fact. While information-intensive sectors like service will likely be influenced most, traditional businesses can likewise use this fact to their advantage.

"In many sectors of our economy, the physical flow of goods and the information flow are intertwined," Lal explained, pointing to the automotive industry as an example. Carmakers around the world are waking up to the fact that it is easy to twist and shape data than it is to twist and shape steel, which means they can switch from their traditional push strategy to a mixture of push and pull.



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The forum participants echoed this sentiment in the hour-long discussion which followed the three talks.

"We will make our ambitious profit goals this year thanks to the vast cost efficiencies we have gained with the Internet," said Bernhard Fink, CEO of General Electric Germany. He also stressed the external opportunities presented by the Internet, noting that GE Plastics will top over US\$1 bill. in worldwide online revenues in 2001.

"On any given day we have maybe 6,000 employees travelling on business," said Hermann-Josef Lamberti, board member and chief information officer of Deutsche Bank. "I can't even begin to tell you what we have saved by using an internal electronic platform to process and manage our travel."

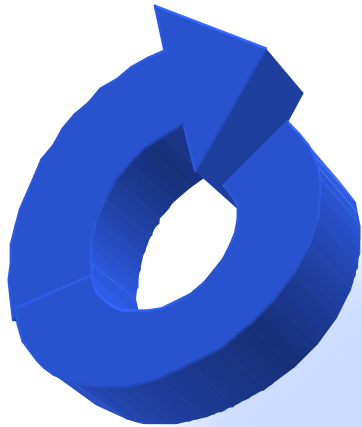
"The impact of the Internet and the changes it brings about will differ greatly from industry to industry," argued Professor Hermann Simon, chairman of Simon-Kucher & Partners. Understanding how this change will occur begins with a thorough grasp of the sources of confusion and uncertainty toward the Internet and its potential.

#### **The first step to Internet honesty: Ignore the numbers!**

"First, don't believe the numbers," Simon said. "They are misleading, pretentious, confusing, meaningless or outright wrong."

How many mobile Internet users will there be in the United States in 2005? That depends on whom you want to believe, he said. The Strategis Group says 17 million, while Merrill Lynch said 161 million. This is not the only example of where E-Business forecasts differ by a factor of nearly 10. The estimates for mobile-commerce advertising in the US in 2005 range from \$890 million (Forrester) to \$6.1 billion (Yankee Group).

"The trouble is, journalists publish these numbers, people believe them, and they stick as if written in stone," Simon remarked. He



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also noted further sources of confusion, such as the hypothesis that B2B in the Internet world is much larger than B2C. "This comparison is totally meaningless," Simon said. "The volume of B2B transactions in every economy is much greater than B2C, my guess by a factor of 5 to 10."

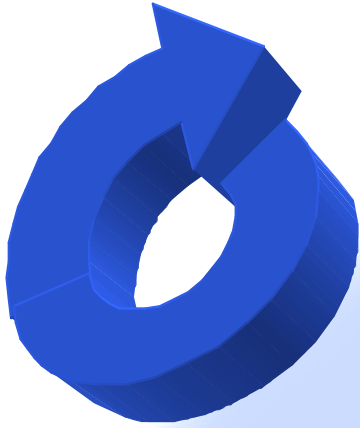
Finally, he doubted the claims that the Internet has directly led to huge savings in the purchase of physical goods such as auto parts and computer components. Much of these savings result from bundling of purchasing power, with the Internet itself having at best a marginal impact.

This means that E-Business needs to start all over again. But where and how?

**S**imon suggests focusing on the only two things the Internet does uniquely well: the ability to distribute digital products at close to zero costs to a large number of customers; and the ability to network, i.e. to connect large numbers of people. He sees the real revolution taking place in products that are currently physical but can be made digital. These include newspapers, books, entertainment, film, financial services, and knowledge management. The impact of the Internet depends on the extent to which business process takes advantage of these abilities. In automobiles in health care, he does not see a fundamental need for an entirely different business model, even if products such as automobiles are sold over the Internet.

None of this will happen overnight, however. The radical changes will take much longer than anticipated due to the time needed to develop devices and processes, and more importantly, to change ingrained habits.

"We've had electricity available for over 100 years, but most of the devices we use - which truly affect our lives - have been developed in the last 20 or 30 years," Simon stressed. The horizon for change will be 20 to 30 years, as the first generation with no memory of the world without the Internet reaches adulthood.



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This means that the "first-mover" advantage in the Internet is a myth.

Simon does not see this conclusion as a warning to approach the Internet slowly and cautiously. Rather, it is a call for extreme flexibility and the ability to anticipate change, then capitalize on it by being clear about what the Internet can and cannot deliver.

**The true measure: Like always, it all comes down to money**

"Intelligent revenue and pricing models will ultimately determine who wins and who loses on the Internet," said Georg Tacke, senior partner at Simon-Kucher & Partners.

**E**choing the other two speakers, he said that companies must determine how they can best use the true benefits the Internet offers. Established companies looking to use the Internet as an additional sales channel need to be aware that the Internet can be a powerful weapon for differentiated pricing. Citing data from the manufacturer Freudenberg, Tacke said that buyers and sellers cut both the processing costs and the time for an individual order by up to 70% by communicating electronically. This gives both sides a powerful incentive to steer business online, a situation companies should use to their advantage.

Price differences can be dramatic, with train tickets or car rentals costing half as much online as they do at the counter. Companies need to estimate correctly their customers' willingness-to-pay online and offline. They can also bill on a weekly or monthly basis instead of per order, in order to strengthen customer retention. Finally, they can use different conditions and discounts to extract additional value.

Refinements of revenue and pricing models are necessary not just in the manufacturing sector. The need is just as great for online retailers such as amazon.com and for content providers, internet service providers (ISP's), and networked marketplaces such as e-Bay.



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If profit is the true measure of success, many companies in these areas have their work cut out for them.

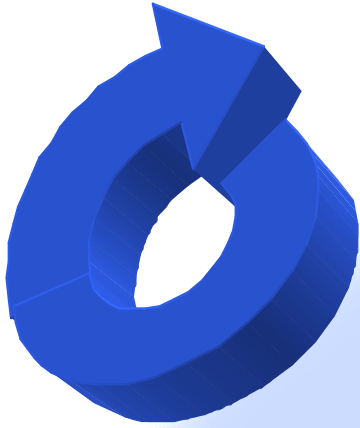
"If the online retailers taught us one lesson, it's that brutally low prices or customer-driven prices can lead to tremendous sales growth and name recognition, but little else," Tacke remarked. The profit-and-loss statements of priceline.com and amazon.com tell the story in black and white. Priceline.com posted revenues of US\$1.3 bill in 2000, but lost \$200 mill. The numbers for amazon.com in the first quarter of 2001 were not much better, as the company lost \$234 mill. on sales of around \$700 mill.

Tacke questioned whether the Internet retailers are really reaching their target segments, or simply making irresistible offers to extremely price-sensitive (and historically unprofitable) customers. He recommended that companies conduct price tests and use this information to determine profit-optimal prices. If a profitable price cannot be realized, the company should seriously consider abandoning the product segment altogether.

"The challenges faced by online retailers and content providers have shown us just how efficient our high evolved forms of distribution (like stores) and content delivery (like books) have become," Tacke said. "And the same applies to payment processes. What do you think is easier? Cash or credit card at the cash register, or typing and clicking your way through screens of information when you order online?"

**T**he downturn in the market for online advertising has made the challenge of ISP's and portal operators much harder. Especially hard hit are companies such as Yahoo!, which depends almost entirely on advertising revenues. Yahoo swung to a net loss of US\$ 48.5 mill. in the second quarter of 2001, compared to a profit of \$53.3 mill. a year earlier. Revenues, meanwhile, plunged by 33%, to US\$ 182.2 mill. from \$273.0 mill.

These companies need to quickly place much more emphasis on other sources of revenue,



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either in the form of subscriptions, pay-per-use content, or commissions for online sales and traffic generated. They could also benefit from a broad investigation into the concrete, measurable benefits of online advertising, in terms of brand building and secondary conversion.

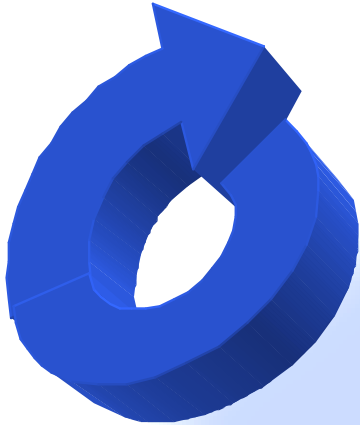
"The challenge with online advertising is especially tricky," Tacke commented. "The companies have trouble pricing it properly, and they have trouble convincing potential clients that it even works. "

Paid content is an especially promising area. As Professor Simon pointed out, the greatest potential on the Internet lies in converting currently physical products such as books, newspapers, etc, into digital form. But making money with paid content involves more than exclusivity. It is also a matter of billing.

As convenient as universal one-click payment would be, most micro-payment processes still fall short of that goal. People will overcome these hurdles to get erotic content online, and will usually overcome obstacles to find exclusive financial information as well. But their patience can wear thin if payment is a problem, Tacke pointed out, echoing the motto "if you can't bill it, kill it."

**D**oes anybody have a way to make money online in the B2C areas? eBay is a noteworthy exception, and with the gift of hindsight its strategy looks cleverly simple. eBay weds classified advertising - traditionally an indispensable revenue pillar for newspapers - with the incredible networking power of the Internet. The result was a pre-tax profit of \$81 mill. in 2000 on sales of \$431 mill. in sales.

The company's sites provide daily access to over 600,000 individual items, a reach which a physical newspaper could never achieve. Assuming 100 detailed classified ads per broad sheet page, a newspaper section with that kind of availability would need to be 6,000 pages long and would weigh in at approximately 50 pounds.



### **Summary: You don't need an E-Strategy**

The world needs to start all over again with E-Business. The forum offered the following advice for this fresh journey.

- Don't believe in numbers. Instead, try to understand.
- The Internet has two outstanding traits: the distribution of digital products at near zero cost, and networking effects
- In the long run B2C will be more important than B2B.
- Large process cost reductions in B2B.
- The radical changes will occur not in physical, but rather in digital products
- Selling content profitably will be a major challenge
- Everything will take longer. The first mover advantage is a myth.
- The internal impact of the Internet on corporations will be huge.

Companies don't need an E-Strategy. They need a strategy, and they need to know how to employ the Internet for this strategy. The Internet is a tool - nothing more, nothing less.

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