Under the Buzz

Back to Basics in e-Business

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Under the Buzz is an electronic "viewsletter" authored by Philip Lay, managing director at the Chasm Group, a Silicon Valley strategy consulting firm. It is published each month, and delivered free to subscribers via e-mail. It is also posted on the Chasm Group website at: http://www.chasmgroup.com/underthebuzz.htm. Back issues can be downloaded from the site at: http://www.chasmgroup.com/underthebuzz_archives.htm.

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Quote of the Week: Opening statement by host speaker at Voyager Capital's Annual Investor Reception, Thursday, May 3: ***"If you're going through hell, keep going." - Winston Churchill***

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1. Collaborative e-Business Applications: Key Adoption Dynamics

Last month I described the short study I was initiating into inter-enterprise collaborative applications, and in particular the benefits that leading enterprise customers are realizing during the current early adoption phase. This past month, in my conversations with vendors, customers, and their customers and suppliers, I have heard some valuable anecdotes about how and where adoption is taking place, which I shall document here. In ensuing issues, I shall be discussing benefits realized by customers and suppliers. So, what are the factors that compel companies to consider online collaboration with their partner companies?

Drivers Influencing Adoption of Collaborative Solutions

With so much of a manufacturing company's operations dependent now on external suppliers that it does not directly control, effective communication beyond the firewall is a must. As Bryan Stolle, CEO of **Agile Software** , a leading collaborative-manufacturing solutions provider, says: *"As the value chain has shifted from make to buy, companies are now incredibly dependent on outside suppliers. And, these inter-enterprise work processes are all new! Companies like our* *customers make an average of 1,600 changes a week to existing orders. If something doesn't get communicated, one or more bad things happen: (i) the inventory of wrong components or products goes up, (ii) you can't deliver, because you're not buying what you need, and (iii) the manufacturing or assembly process may have to be interrupted, which costs a fortune."*

BlackHog, a direct-materials procurement provider, focuses on companies whose manufacturing pattern is highly volatile. Krishna Rangarajan, consultant to BlackHog recognizes that constraint-based forecasting and planning solutions such as those marketed by i2 and Manugistics are well suited for high-volume repetitive manufacturing, such as PC or auto assembly, whereas BlackHog's collaborative solutions address a different need: *"In high-volume manufacturing, forecasting and planning are a critical success/constraint factor, whereas in complex, volatile manufacturing – where as many as 75% of orders suffer some level of change order – the name of the game is eliminating friction related to engineering and production procurement."*

This focus is echoed by **RedSpark**, another direct materials sourcing company, partly owned by Autodesk, and focused on mechanical manufacturing companies. According to Dominic Gallello, CEO, RedSpark is prioritizing *"large mechanical-products companies that have widely-dispersed suppliers and suffer from a high frequency of change in engineering requirements, among which are medical equipment, industrial equipment, tool & die, and semiconductor manufacturers."*

As Usual, Adoption Happens in Stages

In general, it makes most sense to sell first to large enterprise customers who are willing to fund the software license, hardware purchases, and project implementation services to obtain a solution that addresses key mission-critical problems and opportunities. Among these, some are adventurous enough to follow a vision of what they want in order to achieve a clear competitive advantage, while some prefer to wait until others have shown how it's done. After addressing internal requirements, enterprise customers seek to influence their key suppliers to jump on board. Finally, mainstream suppliers jump in when they see the benefits of inclusion outweighing the advantages of holding back.

Although for these and other reasons, external collaboration between key functions in different enterprises makes compelling sense for many businesses, there are still considerable barriers to adoption. As Rodney Babcock, president of **Next Intent** (a supplier to PRI Automation and Lam Research, and user of BlackHog's direct-materials procurement system) sees it: *"Others of my customers besides Lam Research and PRI Automation still aren't ready to do this (collaborate online). Their internal structures don't allow it, or they don't necessarily see the hidden costs of late incorrect products. In many cases, internal collaboration is in fact the predominant issue – buyers and engineers are at odds with each other, and there may be no performance metrics in place to measure themselves with respect to purchase order and other savings."*

One version of the staged approach to enabling adoption by the different target groups was cited by Paul Albright, CEO of **seeCommerce**, a supply chain performance management company: *"Typically, the first stage involves interacting with the ERP systems in company A in order to automate traditional operations. Even in well managed divisions of large companies, engineering and procurement do not have visibility into supply issues before they become problems; so then we focus on enabling two or three applications in order to align business processes between engineering and purchasing in the one company. Once we have got a single division up and running with these applications, we move on to external enablement aimed at providing online information on RFQ's to suppliers. This helps the company to begin enhancing supplier relations."*

In addition to these dynamics associated with adoption of inter-enterprise collaboration solutions, I have identified several key points to discuss in upcoming editions:

Benefits are Also Realized in Phases

Since it takes time to implement the most sophisticated systems, it also makes sense to shoot for quick hits, which can then lead to more far-reaching successes. The recommended approach has not changed much during the recent history of IT implementation. It goes something like this: first, achieve basic cost savings and efficiencies by automating existing manual-based processes; second, improve existing processes, sometimes with dramatic results; finally, create innovative ways of working together both inside the firewall and across enterprises into the supply or demand chain (collaboration fits well here).

There are Several Accelerators for Widespread Adoption

<u>Vendors need to de-emphasize technology justification and focus on business justification</u>: Smart vendors are establishing convincing ROI arguments way before asking customers to buy. In many cases, customers are finding it relatively easy, even during the current downturn, to make buying decisions informed by clear and compelling audits and feasibility studies developed consultatively. Those vendors that allow themselves to get tied up in technology justification will lag their more business-savvy competitors, and will lose valuable business opportunities.

<u>Enterprise adoption is no pushover, so vendors must be selective</u>: Many enterprises still operate in adversarial cultures, and this affects them internally before even considering how they manage their supplier relationships. If purchasing agents and design engineers are at each other's throats, you are probably facing an unfair challenge of introducing advanced management techniques into a relatively unmanaged corporate environment, so your chances of internet collaboration solutions are slim for the time being.

<u>Supplier adoption is a key obstacle, but can be accelerated</u>: It almost certainly makes more sense at the outset to target a few key suppliers with whom the enterprise already has a collaborative relationship, and influence this group to use the new collaborative technologies first.

<u>Strategic and implementation services are critical</u>: Smarter vendors are providing tactical implementation services, but with relatively few exceptions independent systems integrators have not yet geared up to pursue this opportunity, perhaps due to their ongoing ERP, CRM and supply chain optimization practices.

Future Applications Abound and Opportunities for Leading Players are Significant

Cross-enterprise collaboration is not a flash-in-the-pan. There is huge scope in existing supply chains for it, and the demand chain aspect has barely been explored yet. Consequently, I would argue that the first-provers among the many vendors flocking into this space will become key market players within a relatively short timeframe.

2. eMerge Interactive: Latest Status of the Business

Several months ago, in the October 2000 edition of *Under the Buzz*, I published an early assessment of eMerge Interactive, a Florida-based technology company providing value chain management solutions to the $40bn. U.S. beef production industry. At that time, I offered a definition of eMerge as a Value Chain Integrator, as compared to a seller-oriented or buyer-oriented market maker:

"Value-chain integrators aim to transform the shape of their target industry by facilitating cumulative and multiple economic benefits along the traditional value chain, by effectively turning the chain into a web of mutually beneficial relationships between all the main constituencies."

Put differently, eMerge's focus is to transform an industry value chain, not merely act as a marketplace for it. So, in a marketplace that has become largely disbelieving of the sustainability of independent startup B2B market transformers, how well has eMerge performed during the past six months or so? Well, on Thursday April 26 the company announced first quarter revenues for the three-month period ending March 31, 2001. Revenues totaled $325m., a 750% increase over the prior year, as the company sold 659,000 head of cattle, 73,000 of which were sold online. These totals compare to 66,000 head of cattle sold in the comparable period a year ago and 676,000 head sold in the fourth quarter of 2000, of which only 26,500 head were sold online. Thus we see almost 100% increase in head of cattle sold year over year, and almost 300% of the previous quarter's online sales. Finally, first-quarter gross margin per head-of-cattle increased 100% to $6.05 from $3.02 in the comparable quarter a year earlier.

Sounds impressive, even discounting the fact that eMerge is still a young company and that large increases compared against small beginnings do not necessarily convey a reliable picture of future growth rates or volumes. So what is possibly not to like in these results? Well, it must be said that eMerge has acquired its own offline cattle sales facilities, which explains a good part of the increase in sales. Thus, not surprisingly, sales transactions were still overwhelmingly conducted offline (almost 90% in the last quarter). Nonetheless, the dramatic quarter-to-quarter increase in numbers of head sold online is an attention grabber, and may indicate an increasingly predictable trend, despite the recent ups and downs experienced in the cattle business, with remaining effects from the 2000 drought in the West, to February's harsh winter weather, both of which were widely reported to have reduced the availability of feeder cattle by as much as 17%.

This means that eMerge's recent growth is not a consequence purely of growth in its "internet-generated" business. But then the company does not bill itself as an online marketplace per se (although it does provide an online marketplace as one of its four main amenities), so perhaps this does not indicate a less impressive performance. In fact, what I am suggesting here is that far from fighting a religious war to prove the online model as a replacement for conventional "offline" business, eMerge appears to be successfully pioneering a hybrid offline-online market model that many industry consortia and independents aspire to – and are still finding hugely challenging to implement, in most cases. In other words, to its credit, the company appears to be paying more attention to building a unique new business than to impressing anyone with the purity or elegance of its "business model" – and I applaud the executive team for so doing.

Within the bounds of reasonable expectations, my perception is that eMerge is addressing the four main opportunities associated with becoming a transformational leader in its industry (the list below was first described in December 2000 - Vol 1, Number 8 edition):

1. "De-commoditize" products: Do they provide new opportunities for members of their marketplace to achieve profits by removing inefficiencies in the value chain that cause products to be treated as mere commodities? eMerge Interactive has set out on a path to effectively de-commoditizes beef products by tracking steer quality from birth to packer,

enabling beef to be differentiated based on certified quality, feed/vaccine regimen, and other factors (for more details, see October 2000 - Vol 1, Number 6).

2. Facilitate business process scalability: Do they automate business processes that have become costly and dysfunctional for companies, thus effectively differentiating their services from competing providers? The company's investment in process verification and pre-conditioning techniques, plus the cattle tracking system mentioned in item 1 above, in addition to its increasing ability to manage both sizable online and offline cattle auctions, should lead to considerable economies of scale.

3. Provide *intense* transaction satisfaction: Do they provide such a satisfying experience for buyers or sellers to execute purchases or sales online, that customers become reluctant to revert to offline transactions? In eMerge's case, it is building first-*prover* advantage by focusing on establishing a firm, upward trend in transaction frequency and satisfaction among the target constituencies in the value chain: (a) cattle ranchers, and (b) stockers and feedyards, (c) meat packers, and (d) corporate alliances such as Cargill/Kroger. eMerge's increasing traction is demonstrated in its latest financial results.

4. Create original and compelling communities: Are they building a unique community of sellers, buyers, and partners that could not derive the same value in a traditional offline medium – or in any competing online community? In particular, do they provide members with critical information that they could not easily find elsewhere? At this point, eMerge is sticking to its focus on providing different benefits to the specific constituencies within its "value web, including (a) an information management infrastructure providing instant real-time information on prices, etc., (b) an interactive marketplace hosting online cattle auctions, (c) online monitoring of key performance measures aimed at enhancing the quality of the end product (i.e., tracking each animal's growth from birth to harvesting), and (d) a nationwide network of livestock assimilation and marketing facilities.

In conclusion, I would argue that the more eMerge is able to make tangible progress toward delivering on all four parts of its complex value proposition, it will not only assume the leadership role in the U.S. beef industry, but will then be able to consider four or more possible growth paths:

1) Extend its reach into remaining pins of its present based "bowling alley", such as the U.S. pork and poultry industries.
2) Franchise its know-how and technology to other beef, pork and poultry industries around the world.
3) Market the data collected through its tracking systems as a separate profit-source.
4) Become a significant channel for marketing additional ranch inputs – feeds, vaccines, by-products, and so on.

Although the stock price is quite low ($1.96 at the end of trading on May 7) and the company still has a long way to go to firmly establish itself as a leading player in the beef production industry, stock market analysts and investors may soon begin to recognize the Company's progress to date.

3. Core Competencies: "Because We're Good Enough, We're Smart Enough..."

Here's a brusque message, for starters: if as a manager you've learned over the years to participate in periodic detailed assessments of your organization's "core competencies," I have a suggestion: Stop it! For some time now, as a firm we have held a belief that time spent debating core competencies is frequently a waste of management energy. Earlier this week, at a conference in San Jose, Clay Christensen (respected author of the bestseller, *The Innovator's Dilemma*) provided his own caustic view of core competencies as a way of gaining real clarity about a company's effective areas of excellence. More about Christensen's ideas in a moment. First, I should justify my provocation, so that you can appreciate why this topic is this month's *"Back to Basics"* feature.

If you think about it, whenever a management team conducts a core competencies assessment – which many consulting firms will be eager to help you with – the focus of the discussion is unavoidably *inward* looking. From the get-go, lists are drawn up of "what we do well," and before you know it we are in the land of corporate mythology, as managers seek to pump up employee and customer morale (in this order!) by reciting the assumed pluses of the organization. Now, if this exercise is part of a legitimate SWOT (Strengths, Weaknesses, Opportunities, Threats) brainstorm process, it can definitely be helpful. However, the main problem with it is that constituencies external to the discussion – customers, partners, suppliers, and even employees not included in the brainstorm session – are rarely consulted for their input.

Each area of supposed core competence – whether related to technology architecture, software code base, specific product features, marketing programs, sales force coverage, customer service, administrative processes, or whatever – may actually be irrelevant to what key stakeholders, on whom the company depends for its success, see as value-adding contributions to their requirements. In summary, the likely sins of a core competencies assessment are threefold: (1) it often misleads a management team with respect to what value the company really adds to its marketplace, (2) it causes incorrect decision-making, because what customers, partners, and others need from the company is often ignored, and (3) worst of all, it is not actionable – instead, it can fool executives and employees into thinking the company is performing better than it is. More often than not, it reminds me of the self-absorbed soliloquy of Stuart Smalley, Al Franken's well-known Saturday Night Live character: *"…. because I'm good enough, I'm smart enough and, gosh darnit, people like me."*

Thus, I advocate that any assessment of core competencies must be tied to those business activities that clearly contribute to shareholder value. In fact, if a given activity does not contribute directly to increasing shareholder value, I would argue that it is not core at all. In our firm's new definition of "core" as opposed to "context" activities (see November 2000 - Vol 1, Number 7), certain activities that are fundamental to your company's activities may actually not be core. Or, put another way, "just because it's mission-critical does not mean that it is core". Sure, if it's mission-critical and it breaks, it could hurt you (and your company's valuation), much like eBay's occasional computer outages can hurt it in the marketplace. But that just means that such activities are "hygiene" factors – they need to function in line with customers' expectations, and you can be penalized if they don't. Nonetheless, they are still not core - they are what we term "context" activities, and your organization should cease doing them itself if at all possible, in order to preserve precious resources.

For those context activities that are critical to the functioning of your product, services, or internal processes, someone will definitely need to do them. That's one of the reasons why outsourcers exist in such proliferation today – from contract manufacturers like Solectron and Flextronics, to systems integrators such as EDS and CSC, to xSPs such as Corio, USi, or Jamcracker. What's the penalty for not outsourcing – or shedding in some other way – context business activities? Well, if you have to allocate your most precious resources – time, talent, and management attention are the three most precious resources in business today – you have less resources left over to deal with time-to-market, time-to-volume, time-to-value, and time-to-profit activities. That's why BP recently outsourced its entire accounting function to PWC, why Dell Computer outsourced inventory management and distribution to Fedex, and why Wal-Mart outsources inventory management to Procter & Gamble.

Worse still, the speed of change for a given activity that was once core (i.e., a source of competitive advantage, difficult to imitate) to become context (no longer a source of advantage because it has been imitated by your competitors, or otherwise devalued) seems to be accelerating. After all, look how fast the trends have changed in internet business models: from e-tailing to auctions, to trading exchanges, to industry consortia, to infrastructure companies such as commerce platforms, and so on? Furthermore, many B2B companies, emulating the strategies adopted by the first B2C businesses, focused on developing excellence in one or two questionable, even counter-productive "core competencies", such as market research (which Christensen also roundly condemned in his talk). What use is the research that recounted so many suspect numbers relative to "total market size", if the disruptive innovations launched by B2B companies had no clear "total market" to start with? Did these regurgitations of dubious Gartner, Forrester and Jupiter statistics not directly cause untold millions of venture and public market funds to be diverted down the sinkhole, in the pursuit of instant market share?

Apart from holding an equivalent view about core competencies, Christensen suggests that a much more important assessment needs to be done into three areas: resources, processes, and values. Resources consist of capital, people, knowledge, products, service capabilities, and so on. Processes relate to how work is performed in response to customer requirements – product development, demand creation, order management and fulfillment, customer service, and so on. And, values relate to ethics, cost structures and size of opportunity. My pushback here is that resources and processes can still become too set and rigid, unless managers conduct periodic reviews of what is (still) core vs. what has become context. This is because, as we suggested earlier, markets are now so fluid that what is core one day can become context the following day, as competitors successfully emulate today's core.

So, in conclusion, if you are determined to conduct a core competence assessment, I strongly suggest that you accompany it with a brutal assessment of core *<u>in</u>competencies*, in order to keep yourselves honest. Secondly, when you're done, make sure to ask the question: "which of these competencies and incompetencies does the market care about?" When you've answered these two questions, you'll have a sense of whether your organization is really earning its place at the table.

In addition to distinguishing between core and context activities, I suggest you create a further split, between mission-critical and supporting activities. This produces a 2x2 grid, with core and context across the top and mission-critical vs. supporting down the left-hand side. With this grid in mind, here are some useful questions that you can ask every six months or so:

- Which business activities are (now/still) core, compared to several months ago?
- Which of your business activities that once were core has now become context? Of these, which activities are (still) mission-critical – i.e., if they malfunction, your business takes a direct hit, in terms of competitive (dis)advantage and thus shareholder value? These activities need to be outsourced or shed.
- Which supporting activities that contribute to your company's competitive advantage – such as market strategy development, key systems such as email, recruiting, and M&A activities – take too much time to manage and operate? These activities need to be handled by a single partner rather than just handed to an outsourcer, for the very reason that they can have a critical impact on your competitiveness.

4. **“…Yet We Have no Information on This” – Thoughts from Peter Drucker**

Speaking at a conference last week in San Jose, Peter Drucker, the ninety-three year-old “pope” of management thinking, spoke with his customary lucidity about the key scarcity facing management today: the lack of sufficient information to run the business, in today’s hard-pressed and competitive markets. In his resonant, cadenced voice, which is still tinged with his native Austrian accent, he also threw out one or two additional gems of wisdom about management by exception, and about key questions that managers should ask themselves on a regular basis in order to be sure that they are focused on the right results.

On the Scarcity of Management Information …

At times sounding like a cross between Henry Kissinger and Arnold Schwarzenegger, Drucker annunciated several reasons for the information scarcity experienced by managers in their strategic and tactical decision-making. His starting point was the reasonably familiar, but accurate observation that data is too often confused with information, and that most corporate information systems typically produce large quantities of data, but not always very effective or clear information. Furthermore, he said, what information there is, is mainly focused on information from *within* the company.

Speaking with the gravitas of the pre-eminent thinker in modern management – and as originator of concepts that we take for granted today, such as “management by objectives”, “entrepreneurship”, and “knowledge workers” – Drucker utters his frequently contrarian thoughts with the profound authority of someone who has participated in the thick of modern business history. When he mentions, among other early twentieth century experiences, the time he worked with the reknowned management innovator, Alfred Sloan, at General Motors in the 1930’s, he gets your attention. And, as you listen to him, you are compelled to just take in what he says without interpreting his statements too literally, or questioning the occasional statistics he tosses out, because he just seems to have thought it through.

So, here are the main points Drucker registered with respect to information scarcity on key issues that influence management decision-making. To each point, he employed the same rhetorical ending:

(a) Two thirds of the information we need today in order to make sound decisions comes from outside the company, and only one third comes from within the company. In light of increasing moves toward inter-enterprise exchange and collaboration via the internet, he argues that we need more than ever to manage the flow of information from outside the organization, *“yet we have no information on this.”*

(b) The importance of key demographic changes for industrial/consumer product strategy and market development: according to Drucker, the U.S. is the only developed country with an expanding population of young people, *“yet we have no information on this.”*

(c) The decline in manufacturing today rivals the decline in agriculture of the past century and should be a concern for business organizations, *“yet we have no information on this.”*

(d) Telecoms innovations during the past twenty years have all come from outside the telecoms industries, *“yet we have no information on this.”*

(e) Seventy percent of every market is under-served or unserved, *“yet we have no information on this.”*

On Management Reporting Systems…

Drucker points out that ever since General Motors – the company that created know-how about organizational management just as Ford had led thinking in mass-production techniques – introduced the monthly report in 1926-27 (something Drucker termed a major breakthrough in management thinking), managers have learned to refine their use of it, culminating in the extensive use of exception reporting in today's organizations.

But, protests Drucker, by its very nature exception reporting is a negative experience, because it focuses on managing problems (the exceptions). As he suggests, "we need to analyze our *unanticipated successes* just as much as the exceptions, or even more." So, Drucker manages his own firm this way, and always recommends that his clients do the same. "You need two separate sessions in your management review process: one to analyze and learn from your unanticipated successes, and the other to deal with the unpleasant exceptions." In this way, he argues, managers are able to focus on managing positive events as well as negative ones, and everyone gains from this.

On the Most Important Questions that Managers Must Ask Themselves …

In order to obtain the information that executives need in order to manage effectively, Drucker recommends that each executive asks, and sets out to answer, these key questions:

(a) What information do I need in order to do my job?
(b) What information do I owe to others in the organization?
(c) What is the theory of our business?
(d) How can we obtain the information we need from outside sources?

Over and above his unique perspective, Peter Drucker live comes across as a genius still consumed by curiosity about the world, well into his tenth decade of life - and eighth decade as a management thinker.

Under the Buzz offers a monthly commentary on the business-to-business e-commerce sector. The goal is to provide provocative and accurate insights into the latest events and thinking shaping the rapidly evolving business-to-business marketplace. *Under the Buzz* focuses on strategies for building sustainable competitive differentiation and maximizing market valuations.