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From Bricks to Clicks: The Four Stages of E-volution

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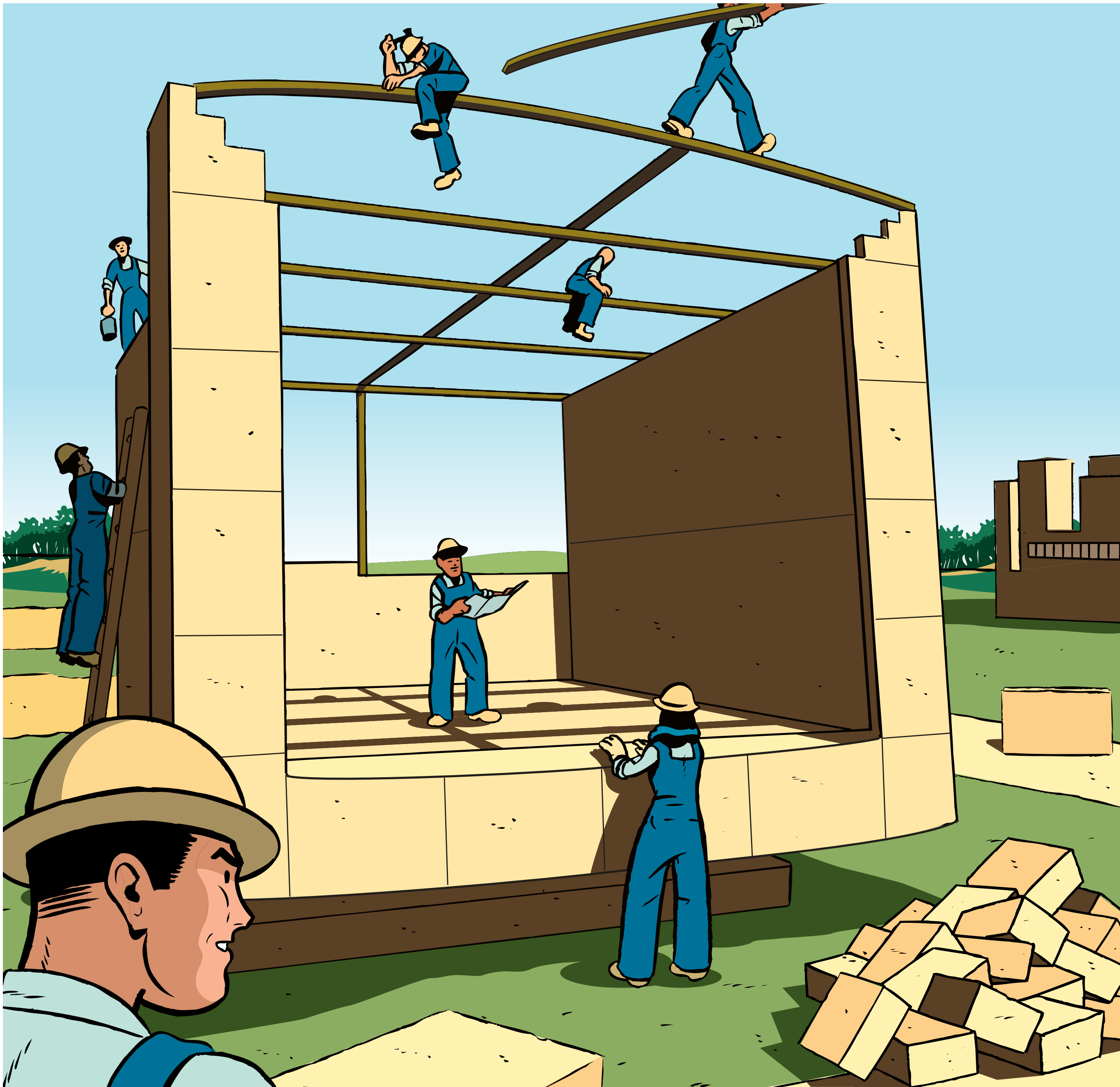

Illustration by Mark Matcho

While most U.S. companies have passed through their digital infancy, time is running out for critical decisions on mission, leadership, processes, structure, and talent.

by Jill Albrinck,
Gil Irwin, Gary Neilson,
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from Bricks to Clicks

The Four Stages of E-volution

Traditional companies no longer question whether the Internet will change their businesses. Neither do they debate whether e-business belongs on the CEO agenda. Most companies even have a firm grasp on what they want and need to get their e-business initiatives off the ground. Still, it's a long way from strategic intent to execution. Every day, it seems, another e-business task force or SWAT team is formed, as CEOs of large companies set "e-priorities" and create units that try to model the fast and focused entrepreneurial behaviors they hope the rest of the company will emulate.

As these companies attempt to reorient and reinvent themselves, they struggle with common challenges that revolve around two fundamental issues: organizational structure and the mobilization and motivation of people.

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We have seen these issues surfacing again and again over the past few years in our work with clients and in conversations with executives in many industries. Early this year we undertook a survey that included interviews with 25 CEOs and top e-business executives around the world as well as extensive secondary research on 25 additional companies. (See Exhibit 1.) Our latest research reaffirmed that organizational structure and people themes were top-of-mind for executives across industries.

The Internet presents a different set of opportunities for every company, and the range of e-business approaches is wide — from modest product and channel extensions (e.g., USA Today Online extends the *USA Today* brand) to radical departures from existing business models (e.g., Merrill Lynch's portal for institutional clients is transforming its entire capital markets business).

Still, our research shows that virtually all companies pursue e-business opportunities in a strikingly consistent way, passing through four consecutive stages of development. (See Exhibit 2.) These stages are:

I. Grassroots: Different e-initiatives are under way throughout the organization, but there is little central coordination.

II. Focal Point: A lead e-commerce executive is named and a centralized e-business group is formed to set priorities and organize the company's e-business efforts.

III. Structure and Deployment: The e-business group sets e-opportunity priorities, deploys those with the most promise, and then begins to develop their structures (embedded, independent business unit, IPO, joint venture).

IV. Endgame: E-opportunities mature to the point that specific structures are formalized to support each business and help it grow.

Stage I. Grassroots

In the Grassroots stage, companies take their first steps toward harnessing the Internet's potential. IT departments, product groups, and business units all begin to explore ideas, identify opportunities, and launch initiatives. The Internet has clearly registered on the CEO agenda, but it is not yet a priority.

Ideas propagate through the organization with little or no control. Resources are allocated independently, business unit by business unit, as each starts to pursue its own opportunities. This free-for-all is stimulating, and it can result in a frenzy of activity. As one e-business executive described the Grassroots stage at his company: "Our e-business started organically with several independent project teams working on specific e-projects. This allowed us to start an e-business quickly but resulted in a hodgepodge of e-activity across the company without an overall strategy, central coordination, or cross-communication."

The Internet, with the Web site as the vehicle, is still thought of during the Grassroots phase mainly as a technology tool and a marketing resource. But as opportunities are broadly and visibly exploited, more people become Internet believers, and an entrepreneurial zeal for new e-business models is palpable throughout the company.

As experiments in e-business unfold, lessons are learned but not necessarily shared because, among other reasons, there is a general lack of coordination and communication among business units. Consequently, many strategies are inconsistent or redundant — with frequent unpleasant surprises. One company in our survey discovered it was spending $50 million more on Internet initiatives across the company than the $5 million set aside in the budget.

Exhibit 1: **E-Business Benchmarking Research**

Industry	Companies	
Financial Services	American Express Chase Manhattan Bank Fleet Bank Charles Schwab CitiGroup	State Street Bank Washington Mutual Northern Trust Merrill Lynch
Health Care	Blue Shield of California Express Scripts Quicken Insurance/ InsureMarket MetLife	
Media and Entertainment	Globo Gruner+Jahr Elsevier Science USA Today	
Automotive	Ford General Motors Toyota DaimlerChrysler	Fiat Johnson Controls PACCAR
Industrials	W.W. Grainger Whirlpool Herman Miller GE	Federal Express UPS Cargill
Airlines/ Aerospace/Travel	Boeing United Airlines	Carlson Wagonlit
Telecommunications	Impsat Ascom	Freenet
Computing	Dell Computers IBM Cisco Systems National Semiconductor	Intel Gateway Oracle
Consumer Products	The Gillette Company Barnes & Noble	Lands' End
Energy	Enron Chevron BP Amoco	Shell Petroplus

Without any central coordination mechanism or top-down strategic direction, the Grassroots phase can quickly disintegrate into mayhem, confusing customers and compromising the brand. General Motors, as an example, had some 160 Web sites up and running during its Grassroots phase, each with a slightly different look and feel. Initially encouraged to pursue their own Internet marketing and product support initiatives, business units ended up spending millions of dollars on disparate product, division, and brand sites, which contributed to a highly fractured brand image on the Web.

When people and funding are stretched thin, companies may find they're not putting enough resources behind the one, two, or 10 ideas that promise the greatest shareholder returns. The strain of being pulled in myriad directions can discourage employees or prompt them to leave. While Grassroots development is necessary to test new ideas, companies shouldn't (and generally don't) stay in this stage too long.

Stage II: Focal Point

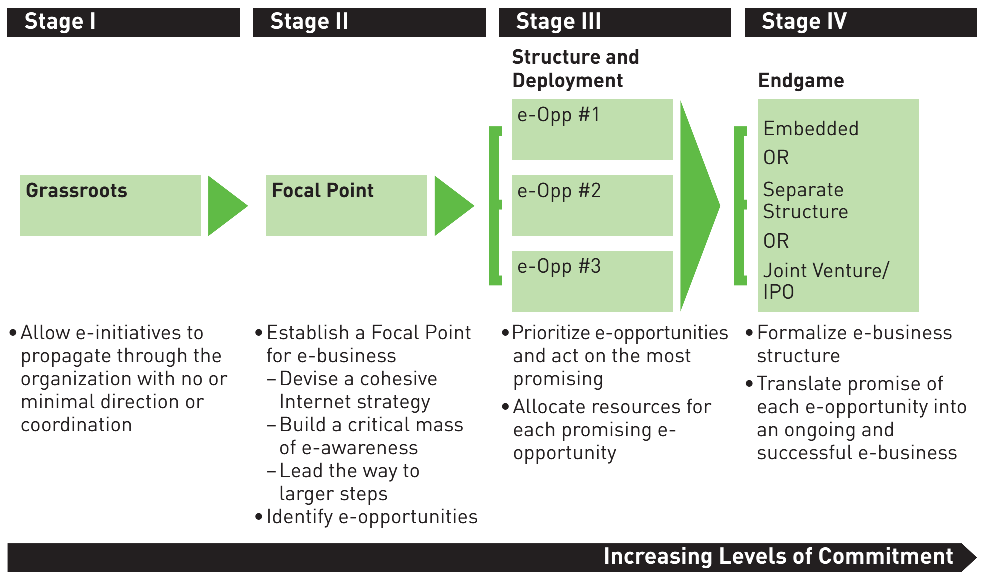
A key indicator that a firm has entered the Focal Point phase is when leaders openly acknowledge the need to bring more discipline to the company's e-business efforts and begin to formulate a strategy. By this time, companies have built up e-business skills and know the importance to their brand of establishing standards for technology systems, Web site designs, and other business elements.

Given the competitiveness of the labor market, this is the time to start impressing upon employees and potential recruits that there is an e-business career path for them. And as opportunities on the fringes of the CEO's agenda become priorities, there is increased support from the top for people, technology, and funding.

An energetic, visionary leader, often reporting to the CEO, is appointed to lead a centralized e-business group. (Seventy percent of the e-business leaders in our survey report to the CEO.) For example, in 1998 the newly appointed CEO of Lands' End, David F. Dyer, hired Bill Bass to take this job. Mr. Bass was a former director of consumer research at Forrester Research, the technology research firm based in Boston; prior to that he led *The Boston Globe*'s early Web initiatives. Similarly, Ford Motor Company recruited Brian Kelley, a young, talented sales executive from General Electric's appliance unit, for this role. The reporting line and a separate budget or P&L responsibility distinguish the e-business champion who has the support to get things done from a mere facilitator.

Additional people for the e-business team are assembled, with roughly 40 percent hired internally. The size of the typical e-business group in our survey ranged from about 30 to 50 people, plus Web development personnel who are typically from the IT department or staff from IT

Exhibit 2: **The Four Stages of E-volution**



outsourcers. Most e-executives we interviewed expressed their desire to keep the group lean and agile.

As their e-business unit solidifies, companies are inclined to centralize functional resources, including human resources, information technology, business development, and finance staff, to better serve the specific needs of the unit. For example, a dedicated e-business human resources staff has more leeway to apply unique e-business recruiting techniques. Cisco Systems Inc. shops for talent at the Los Altos Wine & Art Festival and the Santa Clara Home & Garden Show, as well as at traditional job fairs. The company has even parked a mobile billboard alongside a California freeway suggesting to frustrated drivers that they can cut their commute by working for Cisco.

A company that recruits IT professionals directly into the e-business group, rather than into a corporate IT department, is attractive to technologists who want to expand their Web expertise rapidly and work with professionals with similar ambitions and interests. This is also the best way for a company to conserve and leverage its technology resources and meet the needs of a growing e-business endeavor. However, even though staff are located within a separate e-business unit, it is important they remain connected to the mainstream IT unit, because they still have to work with the same technical and process constraints as everyone else.

In addition to serving as an incubator for new ideas and a repository of business knowledge, the e-business Focal Point team sets priorities for the full range of e-business opportunities spanning all business lines. This is especially important since all e-opportunities are not created equal. Key variables that affect success include risk, capability requirements, urgency, complexity, cost, potential impact and value, and whether the changes will be evolutionary or revolutionary.

Evolutionary e-opportunities enable a company to make its existing business model more effective and valuable. An evolutionary step is an attempt to improve business performance incrementally. It could be new online products and services, a more cost-efficient distribution of the same products and services over the Net, use of the Internet to improve communication with customers, or any number of other business enhancement strategies.

For instance, Ford is now using a Web-based application to facilitate the use of its internal company lease program. A leading life insurer we surveyed used an e-business application to provide policy quotes online. Many banks are upgrading customer service processes on their Web sites; for example, adding Net-based bill presentment and payment to their list of standard services.

In general, evolutionary e-opportunities are easier to manage and are less risky than revolutionary ones.

Focus: The Talent Wars

Even with a gyrating Nasdaq throwing startup employees' stock options under water, recruitment and retention tension is here to stay for all types of companies. In a knowledge economy, it's a seller's market for talent. "Clickstarting" companies need to be clear about what they're looking for, to watch what competitors are offering for certain skills, and to understand what people want and need from their jobs.

The methods by which skilled people are retained and recruited vary depending on the company, the type of e-opportunity, and conditions in the marketplace at a given time. But whether the market is hot or not, traditional companies still need the ability to build long-term equity-based or equity-like compensation into their packages.

Not all business entities can offer stock options (e.g., privately held firms or startup divisions within large public companies). To replicate the options effect without spinning off a division, a company can issue phantom stock traded internally, or publicly traded tracking stock tied to the financial performance of the e-business.

One large multinational company we interviewed used a two-pronged approach to create a competitive base salary combined with an equity incentive. First, it benchmarked salaries at a venture capital firm and a dot-com startup to determine its own pay scale. Then it established a mutual fund for employees that tracks the performance of the company's e-business initiatives.

Traditional companies also need to be more responsive to individual needs. These days grade levels, job titles, and pay ranges bear little relationship to what an employee personally values. For instance, people want to feel a sense of mission — that they're making a difference to the organization as a whole. Employees also seek development opportunities, such as fast-track promotions, access to senior management, and training. They're attracted to companies with informal, empowering, and fast-paced cultures.

The new bottom line on attracting and retaining talent: All the elements that people value must be taken into account — compensation, lifestyle needs, career goals, and professional development. By crafting a comprehensive and tailored package, traditional firms can more effectively compete for talent, and win, against the dot-coms.
— JA, GI, GN, DS

Despite a limited upside, such evolutionary improvements can add top- and bottom-line value by raising revenues and lowering costs. These opportunities mostly draw on existing internal resources and capabilities and rely on traditional corporate structures and governance mechanisms. They're typically handed off to the appropriate business unit during implementation.

Revolutionary opportunities, on the other hand, are breakout ideas that radically reshape a company and may even change the rules of play in an entire industry, with a new business model or the creation of a new market. These opportunities become the leading candidates for IPOs. Although these moves can reap far greater financial rewards — increased market share, profits, and growth — than evolutionary opportunities can, they are also very risky and complex. Often revolutionary ideas emerge in an independent e-business group because its managers need, to a greater extent than others, to work outside the existing boundaries of business processes and governance procedures.

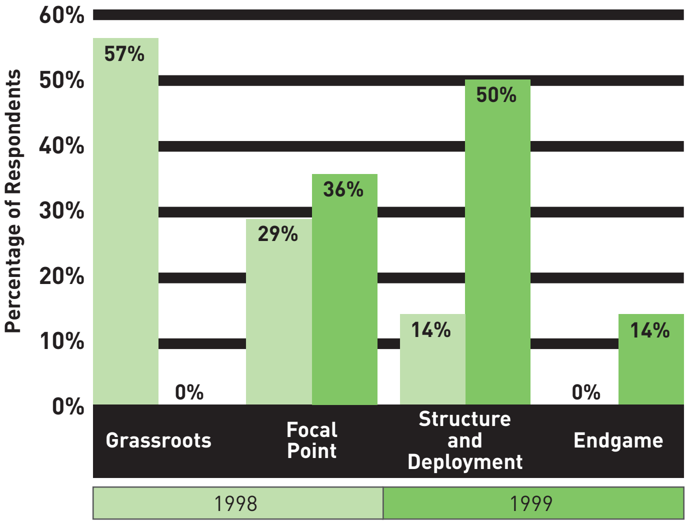
Discount broker Charles Schwab & Co. had a revolutionary idea, but it did not resolve to become an online trading company overnight. Its new business model emerged slowly and was prudently planned. It started with a special task force, and over time, as the IT systems migrated to the Internet, Schwab's e-task force began operating as a separate business unit. Gradually, however, as the distinctions between clicks and mortar disappeared, "e-Schwab" and Schwab became indistinguishable.

In contrast, Citigroup's full-service online bank, e-Citi, started big and is aiming high. To reach its goal of a billion customers, this new unit — formed in 1997 and headed by Ed Horowitz, a former media executive brought in from outside the financial services giant — has developed its own organization of 1,200 assorted employees (certainly not lean) and a lavish budget. As Mr. Horowitz says, "We're creating a company from scratch."

Most business-to-business e-commerce and clicks-and-mortar plays fall in between the extremes of cautious incremental improvements and radical reinvention. They are moderately innovative and are focused on accomplishing basic business goals like increasing value for the customer and cutting costs.

At some point, so many e-opportunities surface it becomes difficult for one central group to handle them all; each requires distinct management skills, funding lev-

Exhibit 3: **E-Business Organizational Evolution Progress**



els, and structures. Depending on the nature of an e-opportunity and its stage of development, it might migrate back into the existing corporate organization, or an entirely new structure might be created to support it.

Stage III: Structure and Deployment

While structures begin to take shape in the Focal Point stage, the environment is still fluid. In Stage III, companies begin seriously assessing their options and formulating strategies and tactics.

Nearly 65 percent of respondents in our survey have reached Stage III. (See Exhibit 3.) Here, e-businesses are moving into high gear as they mobilize project teams, put structures into place, form partnerships, and launch pilot programs. Experimentation, processes of elimination, and structural change abound during the Structure and Deployment phase as companies decide the fate of different e-business concepts.

During this stage, the e-business team determines which structure is best suited to address the variables that influence each opportunity (e.g., risk, urgency, capabilities). There are four typical endgame structures — embedded, separate, IPO, and joint venture.

E-opportunities are *embedded* when they are absorbed into an existing business structure, whether in a single business unit or across several lines of business or functional areas. These types of e-initiatives, as natural extensions of a firm's traditional offerings, are relatively easy to roll out in a straightforward manner.

Revolutionary e-opportunities can also be embedded. In these situations, the opportunity often overtakes the entire company, transforming every business unit and department. Consider Federal Express Corp., which has undergone internal and external strategic and operational changes to reposition itself as an e-commerce company. All this change is essentially occurring within its traditional corporate structure. Says one of its most senior e-commerce executives, "E-commerce is the future of our company. We can't pull it out and create a separate company or position, because it is where we are going."

IBM's Internet division, formed in 1995, is another example. Charged with fulfilling CEO Lou Gerstner's mandate — "every IBM product must be Internet friendly" — the company's Internet division has become an institutional focal point for developing e-opportunities across the firm, including business services, online offerings, procurement, and outsourcing.

Other leading companies, including Intel, Ford, and Charles Schwab, have revisited their core business strategies in light of the Internet. Ford, with the vision of a vastly streamlined build-to-order business model, is in the process of equipping its entire global work force — 350,000 people — with home computers, printers, and Internet service. Brian Kelley, the leader of Ford's ConsumerConnect e-business group, has recruited dozens of Internet-savvy employees from companies like Whirlpool Corp. and Procter & Gamble Co. Says one employee: "We see ourselves as a kind of alpha squad, here to lead change and help make the cultural difference required to bring Ford into the 21st century."

A *separate* structure is created when a company wants to nurture an e-opportunity with as little interference as possible from the rest of the organization. This quasi-independent structure allows the fledgling initiative to draw on the people, technology, and funds of the parent company as needed, while preserving its autonomy and agility.

Separate structures also signal to investors and analysts that the company wants its e-business initiatives to be valued separately. It's a deliberate strategy to unlock shareholder value. Establishing an autonomous e-group

Exhibit 4: **Choosing the Best Structure**

Embed into Existing Business		Build Separate Organization
• Value is in improving and enhancing existing businesses	**Value Creation Potential**	• Greater potential to unlock shareholder value
• Low channel conflict	**Cannibalization Potential**	• High channel conflict
• Product line extension • Similar target market • Complementary to existing offerings	**Product Expansion**	• New product offering • New market segment • Minimal similarities to existing offerings
• E-opportunity will impact the entire organization	**E-transformation**	• E-opportunity impact is localized, affecting a single business unit
• Can leverage existing resources and business processes to access the market quickly	**Speed**	• Need to fill capabilities gaps quickly • Need to operate under new business processes quickly
• Existing culture appropriate	**Culture Fit**	• Different culture needed
• Existing incentives appropriate	**Employee Retention**	• Incentives need to be adjusted to become more attractive

also sends an inviting message to employees who are looking for an e-business career path and a more entrepreneurial working environment. Separate structures are not typically constrained, for example, by traditional compensation formulas.

The skunkworks group that is building Merrill Lynch's Internet-based portal for its institutional clients is, at least for now, removed physically and culturally from Merrill Lynch's investment banking and sales and trading operations. This new e-business initiative will ultimately allow the firm's corporate clients to track their holdings and to buy and sell stocks, bonds, futures, and options directly online with the click of a mouse, much as individual investors do today on E-Trade.

Separate e-business units need to develop their own appropriate processes, skills, and technology capabilities. At the same time, the company as a whole must address such questions as: How does a company confer upon the separate structure the flexibility and independence it requires without alienating traditional lines of business? How does the organization promote inter-division coordination and establish universally fair and appropriate performance measures? Companies are wrestling with these issues, and, although the jury is still out, creative solutions are beginning to emerge.

Many companies make the decision to spin off revolutionary e-businesses to create a new entity through either an *IPO* or a *joint venture*.

In an IPO a new public company is formed, separate from the original organization, with its own identity, board, management team, performance objectives, and incentives. Companies take the IPO route to expose the value in their e-businesses to investors, analysts, employees, and other key constituencies. For instance, a consumer electronics retailer recently transferred its e-business assets to a wholly owned subsidiary, as an interim step to an anticipated IPO. A European food company established 10 different legal entities for the various e-opportunities it is pursuing. Those that bear fruit will eventually be taken public.

Microsoft's Expedia is another example of a thriving e-unit that gradually but rapidly made its way to an IPO. Microsoft launched Expedia as an online travel services product in 1996, then set it up as a separate operating unit, and finally spun it off in November 1999 as a separate company, raising $84 million in capital and retaining 85 percent of the common stock. With the full financial backing of Microsoft, an aggressive acquisition plan, and a clear business strategy, Expedia is so far flourishing in a competitive market.

Companies in a variety of industries are also turning to joint ventures to promote "co-opetition" and streamline their supply chains. Online trading exchanges — sometimes formed in partnership with e-business software vendors (e.g., Oracle, Commerce One, Ariba) — have been announced in the auto, retail, chemical, oil, paper, steel, pharmaceutical, and construction industries, among others. ChemConnect, formed in 1995 and one of the oldest such exchanges, includes nearly all of the 25 largest chemical producers. It has reduced product, transaction, and distribution costs across the industry.

AutoXchange, another trading exchange, is one of Ford ConsumerConnect's most promising efforts. This online trading site links Ford's 30,000 suppliers to the company for faster communications, better prices, and quicker delivery, potentially saving $8 billion in procurement costs. In March 2000, Ford, GM, and DaimlerChrysler announced they would combine their supplier exchange operations into a site to be called Covisint; the joint venture awaits federal antitrust approval. Other examples include Chevron and McLane Co., a unit of Wal-Mart, which have teamed up to create a convenience store supply network. Sears and Carrefour SA have joined forces on a procurement site for retailers.

IPO and joint venture structures face the same start-up challenges that separate structures do, and more. Not only do they have to establish a business model that works in short order, but they also have to contend with the legal and financial implications of the IPO or joint venture process, including the distribution of stock and stock options.

Choosing Your Structure

Choosing the right organizational structure for an e-business opportunity depends on numerous factors. (See Exhibit 4.)

In many instances, companies can unlock substantial shareholder value by spinning off their e-business or issuing a tracking stock for a separate unit. In other situations, where the goal is simply to create value by enhancing the existing business model, it makes more sense to keep the e-opportunity in-house.

Where there is low channel conflict, it is reasonable to embed. If it seems likely that an Internet-based venture will cannibalize a company's traditional revenues, then it's generally better to set it up as a separate structure, allowing it to develop its own value proposition and a distinct customer base.

If an e-opportunity involves expanding a current product or service offering, then leveraging the existing organizational structure may be most appropriate. Otherwise, a separate structure is in order (e.g., in cases of a new product offering, development of a new market).

If the e-opportunity will affect the whole organization, creating a new market, business model, or brand, it's best to embed it.

If a new e-business can effectively leverage existing resources and processes, then an organization can embed the new structure. If it needs to fill capability gaps or quickly introduce new processes, then the business should operate separately.

Developing an e-opportunity within the existing organization requires compatibility between the e-culture it needs to flourish and the company's traditional culture. If the Internet opportunity requires a dramatic shift in the culture of an organization, it's best to build it as a stand-alone entity.

Finally, if you need different incentives to motivate support for an e-opportunity, you should build a separate organization.

The biggest challenge for companies moving from the Grassroots to the Endgame is finding the right people for the positions.

Stage IV. The Endgame

While far from proven or permanent, business ideas at this stage have been validated in terms of their expected value and potential. Risky ideas have been weeded out, and the organizational structure has been formalized.

Leaders with strong operating skills often migrate from the Focal Point e-group to a new e-structure in which they run the business from day to day. The Focal Point group remains the guardian of the brand and customer experience and an incubator for new ideas, but its involvement in specific projects may diminish as the new unit takes the lead.

In many ways, this stage is the hardest to manage. Executives must allocate resources, motivate people, and produce results. In the Endgame phase, e-opportunities must be translated into concrete products or services. The incubation period is over. Speed, as always, is critical.

As traditional companies move farther toward and into the Endgame stage, the two management issues, organization and people, will become even more consuming for these firms and their senior executives.

Companies in Stage II often need the visionary who can defend the most promising opportunities. But the visionary executive may or may not have the operational skills to support a going concern. This is not unlike any startup where the creative risk takers deliver the spark, and other leaders impose management discipline.

The biggest challenge for traditional companies moving from the Grassroots into the Endgame is finding and positioning the right people in the right places to support a single opportunity or portfolio of e-business opportunities, whether the needs are entrepreneurial, operational, or both. (See "Focus: The Talent Wars," p. 68.)

Our research shows that the most highly sought-after management skills are business development, partnership and vendor negotiation, project management, marketing, and content management. Interestingly, though, technical skills don't seem to be as highly prized as an open mind, a bright intellect, and an eager attitude. In an interview last year with *Business Week*, Theresa Garza, a vice president and general manager of Dell Computer Corp.'s large corporate accounts business, called this spirit the hum in her organization. "You can tell when a company feels dead just by walking through its halls. We try to create hum. It's people who have momentum, who are working hard, and who are excited to be here."

Just because a structure has been defined and the right people have been chosen, it doesn't mean the Endgame phase is a final resting place. The Endgame is a dynamic and iterative process that changes as the market changes. Organizations pursuing e-business opportunities need to maintain a high degree of flexibility so they can retrench if things go wrong and be ready to find ways to do better when they are successful.

Internet strategy is now every company's dilemma, but the e-volutionary path is fast and ruthless. Indeed, the rule of the Internet Economy is survival of the fittest. +

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