Operating Strategies

E-Marketplace Survival Strategies

Business model innovation is overrated. Customizing conventional services online offers the surer path.

by Tim Laseter and Christopher Capers

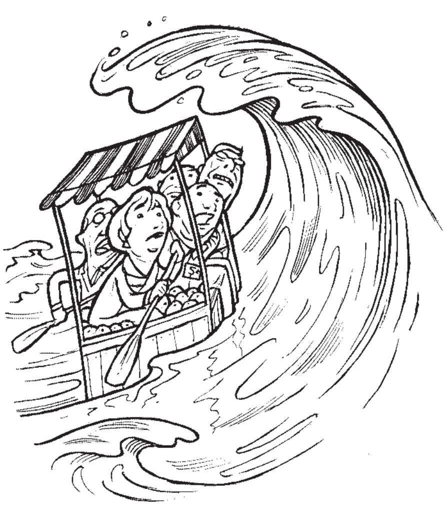

Illustration by Lars Leetaru

Internet visionaries prophesied a frictionless electronic marketplace where companies would communicate directly with customers and suppliers around the globe. The superheated capital markets then made the dream reality, financing the creation of business-to-business Web exchanges in industry after industry. When the Internet bubble burst in 2001, what had seemed a dream became, for most such e-Marketplaces, a hallucination — or at best a fantasy yet to be realized.

In early 2001, we began studying B2B e-Marketplaces, eventually profiling 1,802 existing and announced exchanges. Our research documented six basic service offerings across 24 traditional industry segments, and three different ownership models, as a first step toward uncovering the common ingredients of success and the conditions that lead to failure. This task was — and remains — daunting. Even with our extensive database, which captures a variety of critical variables, it's difficult to distinguish long-term survivors from those barely hanging on and to discern a pattern in the failures at the macro level. Only a detailed look at the survivors along many simultaneous dimensions offers any insight into drivers of success. Despite a staggering 45 percent failure rate overall, hundreds of e-Marketplaces continue to operate — and a few even thrive.

Investigating survivors and victims alike, we have concluded that the surest path to e-Marketplace endurance follows a rather traditional route. The clearest successes appear to have taken a traditional business in a fragmented industry — for example, custom printing — and offered it to targeted customers via the Internet.

Other sites have succeeded by abandoning many of their marketplace functions and transforming into Application Service Providers (ASPs), which sell exchange-facilitation software. Finally, a small number of successful e-Marketplaces remain true to the original vision: serving as intermediaries in the vast network of B2B transactions. It now appears clear that most of the entities succeeding with this original model will be backed by some sort of consortium.

Where We Started

Booz Allen Hamilton began compiling a global list of B2B e-Marketplaces in early 2001. Our research was based upon press releases, published reports, and simple Web surfing. Our initial results, published last year as "B2B Benchmark: The State of Electronic Exchanges" (*s+b*, Fourth Quarter 2001), examined more than 1,800 B2B e-Marketplaces. That initial report remains the most comprehensive baseline study of online B2B commerce. The hard statistics demonstrated that the U.S. and Europe had spawned the vast majority of B2B e-Marketplaces. It also documented the existence of three ownership models. While the most prevalent was independent entities funded by venture capitalists, our study highlighted an emerging group, e-Marketplace consortia — collectives of erstwhile competitors aiming to cash in on the B2B frenzy in the capital markets. Our research also found numerous private e-Marketplaces, operated by individual companies seeking revenue growth and/or efficiency rather than IPO riches.

"B2B Benchmark" also documented six services offered, singly or in combination, by e-Marketplaces. These are information exchange, digital catalogs, online auctions, logistics services, supply chain planning, and design collaboration. Our cluster analysis further segmented the e-Marketplaces according to the mix of services provided. Total Procurement was the largest segment, covering 32 percent of the entities and encompassing companies that offered both digital catalogs and online auctions, and, occasionally, logistics services, but not such services as collaborative supply chain planning and design collaboration. Twenty-seven percent were classified as Catalog Buying operations that did not offer online auctions. Conversely, 19 percent were identified as Auction Houses, which focused on auctions and eschewed fixed-price digital catalogs. Collaboration Facilitators (making up roughly 3 percent of the entities) focused on supply chain planning and design collaboration, and Full Service exchanges, which offered all the core services, represented another 5 percent. A final segment, Specialty Services (14 percent), offered none of the core services and was dropped from this year's second phase of analysis.

Despite a staggering 45 percent failure rate overall, some B2B exchanges are thriving.

With the help of the Darden Graduate School of Business at the University of Virginia, Booz Allen revisited a large sample of the e-Marketplace sites — approximately 1,100 of the 1,802 — to document the failure rates.

In more than 200 cases, the e-Marketplace had clearly failed: The Web address no longer exists and the Web browser returned an error message stating that the Uniform Resource Locator (URL) could not be found. For another 50-plus sites, the address routed to a generic Web site, such as www.BuyDomains.com or www.NamesDirect.com, that

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offers to sell URLs. In six instances, we were routed to a pornographic Web site that had apparently acquired the name of a defunct e-Marketplace to capture unsuspecting potential customers. (Other than for www.ActiveAssets.com, it wasn't obvious to us why the porn purveyors had wanted to acquire the particular site name.)

URL acquisition for alternative purposes, in fact, seems to be a fairly common phenomenon. One former e-Marketplace employee had acquired his company's old URL for $25 and created a new Web site lampooning the executives and venture capitalists ostensibly responsible for the company's creation and demise. Another respondent with whom we made contact said he relaunched an exchange site as a joke. His reason: He planned to trick a friend — and former employee of the e-Marketplace — into believing the founders had gained new funding to resurrect the business.

Even if a site proved accessible, we still tried to verify its legitimacy by studying the most current press reports, news service information, active catalog listings, and copyright dates. We then identified a contact point and sent an e-mail with a short generic message requesting additional information. We logged the date of the inquiry and the reply date. Such detail helped us weed out the many sites that no longer have a business supporting them but continue to reside on a server somewhere in the World Wide Web.

By tracking press releases and follow-up e-mails, we tried to determine if the original e-Marketplace had changed its name, if it had been acquired, or if another entity had purchased the URL but not the company. For example, the URL for the failed B2B e-Marketplace Wine Buyer was acquired by eVineyard Inc. to attract incremental Web traffic. Now when Web surfers try to go to www.WineBuyer.com, they are routed directly to the Wine.com-branded retail site, which is operated by eVineyard. In the end, of our original 2001 sample of 1,802 sites, we've been able to classify 1,100 as either dead, active, or merged/acquired.

What Went Wrong?

Different e-Marketplace ownership models have experienced different failure rates. Of the full sample of exchanges, 45 percent have disappeared. Of the e-Marketplaces in the consortium-backed category, however, only 21 percent have failed. Yet it's difficult to discern the reasons for that qualified success. Some might argue that the lower failure rate proves the advantage of the immediate liquidity provided by established owner–customers. Others would say that because consortium exchanges were launched later, on average, than "pure play" sites, and backed by greater funding, they've been better positioned to

B2B e-Marketplace Glossary

Ownership Models

Independent: Developed by independent entities or pure-play operators.

Consortium: Various players in a single industry, including competitors, who combine forces to create a common forum for the exchange of goods.

Private Network: Private exchanges that facilitate commerce up and down a supply chain (e.g., the Dell Computer Corporation's e-Marketplace facilitates exchange between Dell, its corporate customers, and its suppliers).

e-Marketplace Segments

Total Procurement: Companies that concentrate on digital catalogs and online auctions, the two core Internet procurement services.

Catalog Buying: Operations that offer digital catalogs and sometimes information exchange.

Auction House: Exchanges that focus on auctions.

Collaboration Facilitator: E-Marketplaces that aid collaboration between buyers and sellers with supply chain planning and collaborative design tools.

Full Service: Companies that offer all six core services (information exchange, digital catalogs, online auctions, logistics services, supply chain planning, and design collaboration).

Application Service Providers: Companies that sell software through hosting services over the Web rather than for local installation.

withstand the collapse of e-business and the disappearance of venture capital financiers.

What's more, 15 percent of the consortium marketplaces we examined merged with or were acquired by others. With the average merger/acquisition rate for the total sample running at only 7 percent, this suggests that the consortia have recognized the value of standardization within an industry, and may indicate further consolidation in the months and years ahead. (The e-commerce rumor mill continues to speculate that the consumer products e-Marketplace Transora will merge with the retailer-sponsored WorldWide Retail Exchange.)

Across industries, we predict Full Service consortia will have the highest survival rate.

Among the venture capitalist–funded independent e-Marketplaces that have remained in private hands, the failure rate has slightly exceeded the overall average of 45 percent. Those that went public prior to the market peak managed to achieve a somewhat better success rate: A "mere" 38 percent of those failed. Observers ought to be careful not to conflate survival and success. Iprint Technologies Inc., which offers printed promotional material via the Web, went public on the Nasdaq with the symbol IPRT in March 2000 at $20 to $25 per share but hovered below 25¢ per share throughout this year, going as low as 6¢ in July 2002.

We also looked for differences across regions, but found little: Failure rates across North America, Europe, and Asia-Pacific varied by less than one percentage point. Since the U.S. serves as the base for 75 percent of the sample, we looked further and found major differences among the seven U.S. states that served as headquarters for at least 35 e-Marketplaces: California, New York, Massachusetts, Texas, Illinois, Pennsylvania, and Florida.

Involvement of the extensive network of technology entrepreneurs and venture capitalists in Silicon Valley did not improve the odds for survival. Though California is headquarters to three times as many e-Marketplaces as the state with the next largest number of e-Marketplaces, New York, its failure rate closely tracked the U.S. and global averages. Pennsylvania proved to be the most hospitable to e-Marketplaces, with failure rates that were one-fifth of the overall rate for the U.S. The results in Pennsylvania are largely attributable to VerticalNet Inc., an independent, publicly traded company based in Malvern, which operates 59 industry-specific e-Marketplaces ranging from Food Online for the food service/hospitality sector to Fiber Optics Online for the communications sector. VerticalNet's long-term survival remains open to debate, however. It conducted a reverse stock split last summer to lift its share price out of the penny-stock range. During the dot-com peak in early 2000, VerticalNet's stock had reached an adjusted price of $1,530 per share.

Texas has achieved a lower failure rate (half that of the overall sample) because it serves as host to a disproportionate number of consortium e-Marketplaces. These include Pantellos, which serves the utility industry; Aeroxchange, which was formed by a group of airlines; and Trade-Ranger, an e-Marketplace serving the chemical processing sector. Seven of Texas's eight consortia still operate. EnronOnline.com, the only failure, was acquired by UBS Warburg earlier this year.

Who Went Right?

The advertising/media and textiles industry e-Marketplaces each generated failure rates in excess of 60 percent. On the positive side, aerospace, financial services, and paper and printing all produced failure rates below 35 percent. The generalist e-Marketplaces that lacked a focus on any particular industry failed at the average rate of 45 percent — despite our prediction a year ago that they were at the greatest risk.

When we looked at our data from the perspective of service-offering segmentation, the highest failure rate occurred among the Total Procurement e-Marketplaces — those offering digital catalogs and online auction services. Since this category was the largest segment in our sample, perhaps the model was too common to allow the players to demonstrate a differentiated position. The lowest failure rates came from the Full Service and Catalog Buying segments. Auction Houses, which we had expected to suffer the most, performed no better or worse than the overall sample.

It is hard to analyze industry segments and service offerings at the macro level because they involve multiple variables that fracture the data into samples too small for statistical modeling. For example, the

Catalog Buying segment works best in industries evolving from conventional, offline B2B sales to Web-based selling. This proves particularly true in fragmented industries with many small players.

Consider Branders.com, ePromos Inc., and IPromoteU, three e-Marketplaces offering promotional products (for example, your-logo-goes-here golf balls, coffee mugs, T-shirts, toy automobiles, and even desk-crumb sweepers). The traditional approach to selling promotional goods involves traveling salespeople who work for distributors with a network of Asian suppliers. A digital catalog with online tools allows customers to upload their artwork and immediately see digital pictures of the monogrammed golf balls — an easy evolutionary change that has dramatically increased efficiency and price transparency for the customer.

In one notable change, many e-Marketplaces now market themselves as technology/software providers, rather than as intermediaries in an existing supply chain. Consider e-Steel, a pioneering e-Marketplace launched with great promise in September 1998, which changed its name to NewView Technologies Inc. in November 2001 to mark the firm's shift to a licensed software model. Even VerticalNet, the operator of multiple e-Marketplaces, markets itself as a "collaborative supply chain solutions provider" on its corporate Web site, with barely a mention of the 59 individual exchanges it operates.

Only a handful of e-Marketplaces appear to be on track to fulfill the original promise of revolutionizing industries by becoming new intermediaries in the value chain. These Full Service e-Marketplaces must be highly customized to the needs of the industry they serve, and quickly gain the transaction volume needed to support the massive infrastructure investment. Consortia such as Aeroxchange (airlines), Covisint (automotive), and GlobalNetXchange (retailing) appear to have the customer commitment and staying power to survive. These Full Service consortium e-Marketplaces no longer see themselves as dot-coms, but rather as Web-based shared services driving dramatic improvements in industry efficiency.

Consider the recent executive change at Covisint. Company leader Kevin English, a high-profile executive recruited from the financial news Web site TheStreet.com Inc., passed the CEO title to Harold Kutner and the COO role to Bruce Swift, two experienced automotive-industry insiders. The move suggests that the car companies, at least, are ready to get down to the serious business of streamlining the complex processes of the automotive industry rather than responding to the hype of the software consultants and the capital markets.

Paying It Forward

Ultimately, we believe successful e-Marketplaces will be those that find the combination of ownership model and service-offering mix appropriate to their industry.

Across industries, we predict that Full Service consortia will continue to demonstrate the highest survival rate. Only one of the 11 from our sample has failed. Catalog Buying sites, whatever their ownership, should also continue their positive trajectory. Many e-Marketplaces will ultimately reposition themselves as Application Service Providers, as NewView Technologies and VerticalNet did, selling services to individual companies rather than seeking a place as an ongoing transactional marketplace.

Others will continue to seek success by exploring a range of options in hopes of finding a clear path. "We are still actively using the technology and the Internet to generate sales in the swine and cattle business," Joe Dales, a cofounder and vice president for business development at Farms.com Ltd., a North Carolina e-Marketplace, wrote us in an e-mail. "The adoption, which has been slow, continues to progress and more customers are online and becoming familiar with the technology."

Farms.com has covered its bets by purchasing several traditional software companies with products, sales, and staff, and is about to launch new Web-enabled applications for feed and grain procurement as well as swine production management. The acquisitions have provided cash flow and additional expertise. By reducing its marketing, business development, and programming expenses, Farms.com has finally achieved profitability.

"We are still excited about the future prospects but are more realistic in regards to market potential and timelines," Mr. Dales wrote us, expressing sentiments undoubtedly echoed by many e-Marketplace principals. "This past year has been a great learning experience, but I don't think I would want to do it again." ✚

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