

# SMOCK•STERLING

## *Strategic Management Consultants*

### WHATEVER.COM – STRATEGIC THINKING FOR THE E-ECONOMY

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The Internet is having a profound impact on the economy and how American companies do business. Some invoke hyperbole at the highest levels, stating that “*the Internet changes everything.*”

As a strategy firm, we have a keen interest in how and where the Internet and e-commerce are changing strategic imperatives, the nature of market opportunity, and the shape of competitive threats. We believe that the Internet will and is having a significant impact on competitive dynamics and underlying strategic issues. However, we do not agree with Andy Grove that, “*the Internet affects every part of every business.*”

This monograph provides an overview of Smock•Sterling’s opinions regarding the strategic importance of the Internet and e-commerce to the businesses in which our clients and friends are engaged. It includes a brief review of facts regarding the Internet and e-commerce, our views on what the Internet changes most dramatically, and a discussion of strategic imperatives and opportunities created by the rapid growth and acceptance of e-commerce (particularly in the U.S.).

#### **FACTUAL BACKGROUND**

As recently as two or three years ago, many senior managers, investment analysts, and strategists were dismissing the Internet as a fad or downplaying its importance for most businesses. Michael Porter, then told *Fortune* that e-commerce need only directly impact the business strategy of 20-25% of American companies. Even Bill Gates and Microsoft almost missed the importance of the Internet – in his book “*The Road Ahead*” Gates acknowledges that Microsoft had to dramatically shift resources and strategy to catch-up (after belatedly recognizing the importance of the Internet).

In the past few years, nearly every major and niche software developer has shifted its emphasis toward ensuring that their products are web-enabled. What that means for most of us is that new technology can be deployed much less expensively and much more quickly than in the past. In short, the Internet can and should be used as a backbone for communication, information management, and other data management and analytical functions. Simply, it is cheaper and easier to do things via the web than via closed-loop, proprietary systems.

Growth in Internet usage is staggering. By December 1998, 61 million adult Americans were using the Internet – 50% more than were online a year earlier. That number is expected to grow to over 100 million adults by 2000. Nearly half of all U.S. households have personal computers and 68% of American children live in a house with a PC. Other key growth statistics include:

- U.S. online sales totaled \$13 billion in 1998 and are expected to grow to \$50 billion this year. By 2002, all commercial online transactions are expected to exceed \$1 trillion.
- Online advertising revenue totaled only \$40 million in its first half year in 1995. By 1998 that figure rose to \$1.8 billion and it will rise to \$3.5 billion in 1999. Ad revenue is expected to reach \$10 billion by 2001 or 2002.
- The percentage of schools with Internet connections grew from 65% in 1996 to 85% in 1998.

Many are quick to downplay the present astronomical market valuations of small, unprofitable Internet companies (frankly, while we understand the rationale of those analysts who justify the high stock prices of .com companies, we are skeptical too). But, the fact remains that Internet companies are extremely well capitalized – even after the recent “*correction*” among technology stocks. One set of valuations underscores the point.

- In late July 1999, Amazon.com (which sells on razor thin margins and has yet to show a profit) had a market value of \$20 billion – ten times that of Barnes & Noble.
- Amazon.com had sales of \$610 million and lost \$125 million – Barnes & Noble, meanwhile, made a \$94 million profit on sales of \$3 billion in 1998.

These valuations may or may not be sustainable. Undeniably though, these valuations do give Internet companies remarkable degrees of freedom (to grow at all costs, to enter new channels and markets, to acquire needed technologies, etc.).

Finally, traditional “*bricks and mortar*” companies are beginning to realize enormous sales growth and/or cost savings by accepting and capitalizing upon the realities of a networked economy. Dell Computer is selling \$18 million of product via the Internet **every day**. IBM reportedly saved \$240 million in a single year by moving certain supplier and dealer activities to the web (direct supply chain management savings). In 1998, Intel moved product ordering activities for its mid-sized customers to the web. By the end of the year, Intel was booking \$1 billion in orders per month via the web – simultaneously generating top line growth and cost savings.

### **CHANGES WROUGHT BY THE INTERNET**

We believe the primary changes caused by the Internet can be sorted into three broad categories.

- First, the Internet is an ideal platform upon which to disrupt and/or reconfigure the supply chain.
- Second, the Internet enables dramatic change relative to the availability, distribution, use and application of information and knowledge.
- Third, the Internet has created a marketplace for products and services that are essentially entirely new and that are unique to the Internet environment.

A few examples of these three broad changes can help to illustrate what we are experiencing.

#### **Supply Chain Reconfiguration**

The list of Internet companies that have dislocated and reconfigured supply chains and markets is well known and reasonably well understood. Amazon.com changed book selling and is now moving on to compact discs, home electronics, and other product categories. Auction sites are changing the basic nature of secondary product markets (and classified advertising sales as well). Online brokerages are changing how and at what cost individual stockowners buy and sell their shares.

Couple these Internet companies with the many “*bricks and mortar*” companies that are using the Internet to transact business and introduce new efficiencies into the supply chain and the degree and speed of change are unprecedented. Ignoring the impact of e-commerce on supply chains, particularly if you are a traditional “*middle man,*” is tantamount to surrender. The scale of opportunity and the threat in supply chain reconfiguration is enormous. Simply stated, do not allow someone else – directly or indirectly – to take control of your customer relationships via electronic channels.

#### **Information Availability, Distribution, and Application**

Information is becoming cheaper and easier to get. It is both more available and, at times, less reliable (i.e. – since anyone can post anything on the Internet, not all information on the Internet is truthful or reliable). Anyone who has used WSJ.com (the *Wall Street Journal's* online service), Sidewalk.com (Microsoft's online entertainment guide), or ChicagoTribune.com (an online version of a traditional media outlet) knows that more information is available and that it is easy and cheap to access. Yet, the Internet also delivers a never-ending stream of pyramid schemes via e-mail and is a platform for highly unreliable gossip and scandal sheets.

Beyond the sheer availability of information, the Internet is also changing how consumers and businesses use information. Car buyers can get dealer invoices online and even solicit competing bids. Consumers can and do set up complaint and information sites about manufacturers (your web site likely represents a small fraction of the information available via the Internet about your company, its products, and its services). The Internet can be both a boon and a bane for corporate America vis-à-vis information access and how that information is used.

A critical lesson to learn is that information availability and how it is delivered can either positively or negatively affect your relationship(s) with customers, suppliers, and stakeholders. Over time, some companies will use the Internet as a tool to have information rich, two-way communication with customers. They will know more about their customers and their customers' needs. And, they will profit from the ability to deliver information, products, and services that are uniquely tailored to those needs. Other companies will simply "*miss the boat.*"

### **A Novel Marketplace**

Finally, the Internet is a novel marketplace for some companies – that is, some products and services simply would not exist at all were it not for the Internet. For example, Internet Service Providers (ISPs) like America Online, browser software products like Netscape, and "*portals*" like Yahoo! simply would not exist were it not for the Internet.

For most businesses, this last area of change may have a less direct impact. Keep in mind, however, that the value attached to portal companies like Yahoo! is in part driven by their ability to direct web users toward specific product and service suppliers. Thus, to the extent that this "*novel marketplace*" is steering potential customers toward or away from your company, you do need a strategy.

Further, the fact that it has created this "*novel marketplace*" underscores the fact that the Internet – ethereal as it may be to some – is creating real value and a unique and new dimension to the economy.

## **STRATEGIC IMPLICATIONS AND OPPORTUNITIES**

The good news is that for most companies the nature and scale of opportunity presented by e-commerce far outweighs the threats it creates. Three points need to be understood to capture the opportunities and manage the threats inherent in e-commerce. Each provides a basis for focused strategic thinking vis-à-vis e-business.

### **Internet-based Businesses**

Pure Internet companies have certain inherent advantages. They are usually very low overhead operations, are not capital intensive, are often designed to capture scale economies (within selected markets), and in some cases are able to change strategy and focus quickly.

However, most Internet companies have relatively few strategic tools with which to differentiate themselves. Pricing, timeliness, and customer service are among the few tools pure Internet companies have to compete with. Companies that actually manufacture something have more strategic levers and control more of the margin inherent in a given product. Thus, there are ways for traditional businesses to compete and win against their Internet competitors.

Regardless of whether you are an Internet company or a traditional company, you need to understand the underlying strategic levers that .com's have (and do not have) at their disposal. The specific implications these factors have for any given company's strategy will vary. But, every company must develop strategy that takes advantage of the inherent strengths and vulnerabilities of .com competitors. The smart and adroit will prosper regardless of whether they have a ".com" at the end of their name.

### **Going to Market and Managing the Supply Chain**

The Internet presents a tremendous opportunity to go to market differently. It is a potent distribution channel and enables companies to interact with customers in new and potentially value-adding ways (i.e. – e-commerce enables you to do more for your customers – often at attractive margins). Further, it can pull significant costs out of the marketing and sales functions. At Dell, the web is enabling the company to increase sales growth and reach a global market. At the same time, web sales close with greater frequency than phone inquiries, commissions are 25% lower, and customer satisfaction is higher.

In fact, these benefits can be extended not only downstream in the supply chain, but upstream as well. Supplier relationships can be streamlined, orders can be put out to bid more efficiently, and working capital demands can be greatly reduced via e-commerce solutions to supply chain management.

While the potential is enormous relative to going to market and managing the supply chain more effectively via the Internet, there is a major risk associated with a move to e-commerce solutions. Internet channels cannot be treated as “*unmanned operations*.” On the contrary, your e-commerce channel must be well supported, easier to use for customers, and highly responsive when questions, problems, or other disruptions arise. And, your e-commerce channel should pull together all the elements of the transaction or value chain that your customers will legitimately allow you to influence (e.g. – an online appliance distributor should go beyond the appliances to provide extended warranties, a help desk, referrals to parts and service providers, etc.)

Smock•Sterling believes that e-business initiatives focused on market channels and managing the supply chain must and can be integrated with overall corporate strategy. Just as the competitive drivers outlined in the previous section ought to inform strategy development, e-business strategy cannot be divorced from overall corporate strategy. On the contrary, it needs to be (or quickly become) a central consideration within your organization’s overall strategic plan.

### **Internal Efficiencies**

Finally, companies should not overlook the significant internal efficiencies that can be created by the use of web-enabled tools. Internal communication via Intranet sites and e-mail is “*just the tip of the iceberg*.” Data and voice communications can benefit from significant cost savings. New technology can be deployed quickly and relatively cheaply. Employee benefits can be managed less expensively and with higher levels of employee satisfaction. Paperwork in general can be dramatically streamlined. The list can and will go on and on.

We agree with Porter’s basic contention that operational effectiveness alone is not a winning strategy. In fact, we would argue that in a global economy, operational effectiveness is rapidly becoming the price of admission to many markets. Thus, it is a necessary element of strategy, but cannot be the entire strategy. In that context, web-enabled solutions and tools ought to be a given in the implementation of your organization’s pursuit of lower costs and operational excellence. If you are resisting becoming Internet savvy in this regard, you are being horrifically short sighted. You may as well tell *Wall Street* that you are not committed to managing effectively.

In summary, the Internet creates a strategic imperative for companies: to recognize the impact online businesses can have on the competitive dynamics in their core markets; to renew market channel and supply chain management strategies; and to wield a new weapon for gaining internal efficiencies. The Internet provides access to new markets, lower costs, and economies of scale. But, it also invites new competition, arms customers and suppliers with better information, and quickens the pace of change in most markets.

Does the Internet “*change everything?*” No. But, it changes some very fundamental things about how most of us do business. We implore our clients and friends to be on the winning side.

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Smock•Sterling focuses on helping our clients across a wide range of industries develop and execute strategy. We are keenly aware of the need to inject “*e-thinking*” into strategic thinking and are committed to helping our clients benefit from the changes underway in this area. Please call us if you would like to discuss these issues or general strategy development further.

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