

Under the Buzz

Insights into B2B Net Markets

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“Under the Buzz” 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> .

In this month’s issue:

1. Time for a Rethink: The Hype is Over – What’s Next?
2. From First Mover to First Prover – Creating Liquidity in B2B Net Markets
3. Transaction Satisfaction – Key Metrics for Crossing the Chasm
4. Further Note on ISM’s – Which Ones Will Succeed?
5. How European Net Market Makers Can Succeed Against U.S. Based Competitors?

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1. Time for a Rethink: The Hype is Over – What’s Next?

At the recent Net Market Makers Groundzero #3 Conference in Boston the mood of the almost two thousand attendees was in sharp contrast to the atmosphere just weeks before at Net Market Makers’ earlier 2000 event, The Valuation Game in New York City. Whereas in late February there was a palpable euphoria among the 350 or so CEO’s, busdev and marketing VP’s, and others, in relation to the astounding stock market valuations of B2B poster children such as Ariba, CommerceOne, VerticalNet, and ICG, in Boston there was a much more sober atmosphere.

At this event, the Chasm Group provided the keynote speaker (Geoffrey Moore) on day two, addressing the topic “Crossing the Chasm in Digital Markets”. Later in the same day, Philip Lay moderated a panel on “The Traction Game”, then Michael Tanner and Tom Kippola (both are managing directors in the same firm) collaborated on a double-panel session around the theme of gaining adoption by buyers and by suppliers.

April’s dramatic pull-back in stock prices - resulting in 70% reductions in valuation for companies such as Vestro, VerticalNet, and ICG in particular - had obviously exerted a powerful impact on everyone involved. Here the keynotes and panel sessions were focused on understanding the implications of the seventy-plus industry exchange announcements made since mid-February, figuring out how the financial climate had changed since the stock market correction, whether VC’s were still interested in funding B2B enterprises or not, and gauging how to gain traction in the marketplace in order to stay in business.

All of a sudden, what had been arguably the most “public” early market development phase ever seen in technology was over, to be replaced by a moment of reckoning. As suddenly as it began, the explosive growth of venture capital and stock market investment in pure-play B2B companies was substituted by a chill in the markets, as institutional investors withdrew large portions of their portfolio investments. What can net market makers do to recover their momentum?

Of all the b-to-b players, digital marketplaces are facing the toughest survival test against the industry-sponsored exchanges. Having watched the dotcom upstarts grab the limelight late last year and start attracting talent from their ranks, boardrooms in many large old-economy companies were afire with controversy, as CEO's attempted to defend themselves against the pointed inquiries of directors asking "So, what are you doing about the Dotcoms?"

Finally the more proactive ones like Jacques Nasser of Ford and others, spotted a convenient opportunity. Why not club together with your main competitors in an "industry-sponsored exchange" in order to economize individual corporate efforts, drive savings in parts procurement, and give the independents something to think about? So, after Ford and GM decided to join Daimler-Chrysler in the Automotive Exchange, Fortune 500 CEO's everywhere must have picked up the phone to confer with their competitors and produce their own exchange announcement.

Notwithstanding one's natural skepticism regarding how many of the announced "exchanges" will ever go beyond mere market-freezing press announcements and turn into viable businesses, it is clear that independent net market makers must now address the market with a new strategy. Even though many of these brick and mortar coalitions are showing signs of not yet having a real game plan to get their act together in time, independent net market makers must start focusing on engaging successfully with real customers in order to build out their portals and exchanges.

2. From First Mover to First Prover – Creating Liquidity in B2B Net Markets

In our vocabulary, the present challenge offered by the ISM's has forced the end of early market euphoria and pushed digital marketplaces into the chasm. It is time to demonstrate to the large block of pragmatist "voters" that the internet marketplace has serious feasibility, that we can gain real traction in the market. Thus, to extend the metaphor, it is time to cross (or exit) the chasm into the bowling alley.

To enter the bowling alley, the new strategy is to produce a repeatable offer specifically aimed at solving 100% an acute business problem common to a group of target customers in large companies. This customer problem cannot be just another opportunity for lowering costs or increasing productivity by 10 or 20%. It must look like a broken business process – much like customer service was seen as a broken process in the early nineties, among certain industry groupings such as airlines, credit-card companies, banks, telecom organizations, and high-tech companies. At the point when customer service was causing above-average customer defections and seriously affecting the bottom lines, the boards of these companies authorized VP's of operations or customer service to fix the problem at any (reasonable) cost, or else. When you hit the nerve in a group of customers with a sensitive issue like this, when it has reached the point of threatening the survival of an established company, you can be sure that the pragmatist managers there will be willing to go against their natural herd mentality and invest in the new offer – provided that it works!

This challenge is further complicated for net market makers who are trying to operate a true many-to-many marketplace, because they need to figure out where the natural "pull" is – in other words, which constituencies will buy in first. Will it be buyer-centric, or seller-centric? What about other constituents, like credit institutions, logistics partners, distribution channels, technology and service providers? At the end of the day, what value is there for each member in

participating and, even more important to the early traction of the market, which one has the most interest and disposition to do something about it?

This, evidently, is a far cry from the early days of internet commerce, when companies like Yahoo, AOL, and especially eBay taught us the value of “first mover advantage”. The thought was – and still is, in many people’s minds – that it was critical to be first to evangelize a new business model, first to market, and first to IPO, in order to become the “gorilla” in your space.

Well, the time for B2B net market players of first-mover advantage counting for everything are definitely over. In crossing the chasm, it is critical now that the same companies switch strategies: First-mover is replaced by first-prover. This means first to identify a clear and addressable target market segment with a compelling reason to change, and for which you will be the first to put a complete solution together. This target customer must be the one with the most to gain from entering your marketplace. And remember, pragmatists are not attracted sufficiently by the sense of opportunity to be among the first to invest in high-tech solutions. They are more viscerally motivated by acute sense of pain. Furthermore, you must also be first to show them that your offer is applicable to other customers like them. In the case of marketplaces which aim to connect buyers and sellers, transaction satisfaction is a critical indicator of our chances of building a sustainable business over time.

At the beginning, many of the current net market makers that show signs of crossing the chasm successfully are either more buyer-focused or more seller-focused, but not both. This is not a negative. Every digital marketplace must start somewhere, and the constituent with the most compelling need and the wherewithal to do something about it, is the best place to start. If you think about it, it does not make sense to expect a many-to-many marketplace to spring up out of nowhere – even if the constituents all agree that such a marketplace is necessary. Every business must start at some point of pull, or gravity – or, to use another useful term, traction.

Thus, being “first prover” is the key at this stage: first to identify the target market, first to provide a clear 100% solution to the target constituent’s compelling problem, and first to achieve transaction satisfaction among a critical mass of the target market, say 20%-40% within a period of several months. These “firsts” are easy to state, more difficult to execute. This is the transition that most technology-focused companies find so traumatic that they eventually refuse to follow it through. At the risk of sounding facetious, this task takes actual work.

Of course we all worked feverishly hard during the early market stage, when gaining visibility was king. At that point, our business development efforts were focused on forging strategic alliances, playing an effective announcement game, and learning to give great road shows to investment banks. Now, our busdev focus needs to be almost entirely on building a complete value chain in order to address 100% of our target constituent’s problem. This involves detailed assessments of gaps in the solution, partnering for complementary product and service components, and packaging the whole thing into something largely repeatable for the entire target segment. All the while we must be driving price points to a level where it is worth while for your pragmatist customer to eliminate the source of the problem. If done properly, this activity can be quite profitable for the lead vendor – in this case, the net market maker. Nonetheless, it is important to recall that the immediate goal is not overall net profits as much as profitable operating revenues.

In our conference keynotes and workshops these days we warn our audiences that the present chasm-crossing challenge is truly a Darwinian moment for all independent net market makers. Create liquidity and you may survive the inevitable consolidation; continue playing the visibility

game, ignoring the liquidity imperative, and you *will* fail. For example, every dollar you spend now in the pursuit of liquidity deserves the backing of your customers, investors, partners, employees and other stakeholders. On the contrary, every dollar spent on forging one more “strategic alliance” in order to validate your vision to the world is money spent in the wrong cause, and deserves to be panned by your stakeholders.

The game now is for you to forge tactical partnering arrangements that effectively fill out your value chain for the selected target sub-segment you have decided to focus on. Any event you sponsor should be aimed at addressing issues that are dear to your target customer’s heart, without additional attention to the needs of other constituents in your network. While you don’t clearly understand the compelling reason to buy that is keeping this potential customer awake at night, you cannot be sure of building the right “whole product” for them. Therefore, your marketing budget should be allocated to achieving this intimacy and then responding to it by designing and completing the appropriate product/service combination.

3. Further Note on ISM’s – Which Ones Will Succeed?

In the Q&A session at the end of a keynote presentation I delivered at the Net Market Makers GroundZero Conference in London this past week the question “Can the industry coalitions succeed in building digital exchanges?” was hotly debated. Perhaps not surprisingly, most opinions voiced favored the theory that large established corporations will find it difficult to move fast enough and, especially, to collaborate with each other effectively.

One dissonant voice, however, pointed out that certain industries have a history of positive collaboration between the leading companies, and this factor, combined with an increasing readiness to operate at “internet speed”, would lead to some ISM’s (industry-sponsored marketplaces) becoming successes. One such example is the U.S. oil industry, whose behavior contrasts sharply with that of the automotive industry. Talking of which, after much thought this original ISM initiative was finally baptized with the charming amalgam name of “Covisint” – an awkward mess of a word which apparently stands for “Collaboration, Vision, and Integration”.

Unfortunately, the collective business culture of the automotive industry is traditionally adversarial, as opposed to collaborative. Unfortunately for other ISM’s the poster child for ISM strategy in most people’s minds is Covisint. Three and a half months into the project, despite having managed to find a name, this major automotive exchange still has not defined its leadership structure. The three temporary co-CEO’s continue to preside over a power struggle between the participating industry, technology and service partners for influence in the project.

What would be interesting for the long-term interest of the “ISM movement” might be to select another ISM to represent the spirit of the old-economy investment in net marketplaces more positively. Otherwise, the entire trend is likely to be tarred with the brush of negative expectations, which will certainly hinder supplier adoption.

4. How European Net Market Makers Can Succeed Against U.S. Based Competitors?

Debating this week in London the issue of what strategy to adopt to compete effectively with their U.S. counterparts, executives from many European net market makers appeared to believe that, in most cases, they have some time to build their businesses before the expected invasion of U.S. companies into Europe.

Apart from a few early arrivals, such as Ventro, VerticalNet, and others, companies like Band-X - whose most visible rival in surplus telephone switching inventory disposal is Arbinet – expressed their expectation that American companies are still focused for the most part on achieving liquidity in their home markets, which in many cases represent 50% or more of the world-wide total market for their services. 2001 is expected to be a different story, but the general feeling echoed by other speakers, was that in 2000 the “chasm-crossing” challenge is the most critical one to execute on.

This being the case, I believe that European net market makers have three distinct advantages over most U.S. counterparts for purposes of winning marketshare outside the U.S.:

1. They recognize that Europe cannot be treated as a single market. In contrast, American companies tend to treat Europe as one big block, ignoring the still-huge cultural differences in the behavior of markets.
2. The U.S. market is so enormous that European companies can if they so desire focus on building their own global presence – especially in other non-U.S. countries – before their U.S. competitors are able to focus on their own international expansion.
3. When push comes to shove and the U.S. companies need to scale their operations with budgets in mind – as has occurred since the stock market correction in mid-April – the first investment they cut is their European subsidiary.

Having said this, there are exceptions. Ventro is making inroads in Europe, e-STEEL’s global business is growing fast, and ICG is already stimulating the entrance of six of its portfolio businesses into the European marketplace.

No one can afford to be complacent. The situation in the capital markets may change quickly, and M&A consolidation might accelerate in coming months.

In upcoming issues:

- Market Mapping: The Digital Market Ecosystem – Key Net Markets and Technology Enablers
- More on Metrics for Crossing the Chasm
- Ecosystem Pretenders: Eight Key Players Shooting for Tornado Market Dominance

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 will focus on developments and competition in digital markets and e-infrastructure.

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5. Transaction Satisfaction – Key Metrics for Crossing the Chasm

We have implied that metrics associated with the notion of *transaction satisfaction* is the key to sustainable liquidity in the bowling alley, leading to potential participation in a future tornado. In our vocabulary, transaction satisfaction implies that several positive outcomes will occur based on an original buy or sell transaction, as follows:

1. Your customer's customer was successfully attracted to the site with the expectation of buying (or selling) a product or service.
2. They successfully bought (or sold) the product or service.
3. They found the experience satisfactory, to the degree that they intend to repeat it at a future date.
4. They recommend the experience to their peers, resulting in additional customers coming to the site.
5. Your original customer proceeds to return to the site and buys/sells repeatedly.

On this basis, the overall key metric for this strategy is the success/failure ratio of transactions in our target market. Given that your target niche market will probably contain no more than a few hundred target customers, it should be feasible to track results with sufficient certainty to produce reliable statistics, within a reasonable variation. Over time, the chain of outcomes described above produces a virtuous cycle of increasing returns. A few initial customers at the outset becomes a large percentage – say, 20-40% or so – of the target customers in the niche, and this leads to the sustainable liquidity of the business.

As self-evident as the above description is, I am not convinced that every executive team has thought through the implications of executing to this goal. Another problem may be that we need to know how to pursue this objective, which we know is not the end game. Just to remind ourselves, the end game we promised to our investors was to achieve broad acceptance and adoption across our entire target universe, resulting in rapid growth and high-volume revenues. Therefore, the chasm-crossing exercise we are embarked on is a kind of dues-paying, preparatory test of our ability to build a value chain (or network) that will deliver a repeatable solution to many customers. In our experience it is much easier to do this in a niche market.

Or, to use a different example, it is much easier to fill the tables in a new restaurant if the restaurant is small, and if we know the type of food that will appeal to a small crowd, and furthermore if we prove our ability to prepare that food successfully in a smallish quantity, before attempting to do so at a larger scale. My colleague Geoffrey Moore customarily points out that the bowling alley phase is a highly staged exercise aimed at validating a deliverable to a “controlled group” of customers. In summary, we set out to achieve density in a niche market – and probably to repeat the achievement in a second and third niche market – before being pulled by the market into pursuing the volume we have hoped for once the herd of pragmatist buyers decides that they must buy now.

Finally, I think it is worth summarizing the checklist that defines our chasm-crossing focus, in stark contrast with Early Market and Tornado strategy:

Element	Early Market →	Crossing The Chasm →	Tornado
Overall objective	Gain visibility	Create liquidity	Achieve maximum scale
Technology application	Proof of concept project	Penetration app	Killer app

Market maker's goals:

Planned outcome	Validation via custom projects	Density in target segment	Volume in broad market
Specific penetration metric	Five successful projects	40% of target segment in 12 mo's	Be #1 or #/2 in mass market
<u>Customer's goals:</u>			
Planned outcomes	Competitive advantage gained	Transaction satisfaction achieved	Rapid deployment of platform
Specific business metric	% gain in market share	Success/failure ratio of transactions	Successful deployment in entire organization
<u>Market development strategy</u>			
Target customer sponsor	Visionary executive	Pragmatic dept. mgr.	Infrastructure buyer
Compelling reason to buy	Dramatic competitive advantage	Fix a broken business process	Convert to new platform
Whole product model	Custom project	Segment-specific application	General purpose infrastructure
Partners and allies	Integrators and consultants	Segment-specific value chain	De-facto-standard suppliers
Distribution	Global biz dev agreements	Direct sales into segment	Indirect high-volume channels
Pricing	Value-based, on upside gain	Value-based, on pain reduction	Competition-based
Competition	Other visionary projects	Status quo solutions	Substitutable offers
Positioning	Unique technology advantage	Unique segment-specific solution	Market share status
Next target customer	Visionary in some other domain	Dept. mgr in a related niche	New geography or channel

Thus, the transition from the Early Market across the Chasm to the Bowling Alley is based on transitioning from visionary customers who are willing—indeed, who relish—going first to pragmatic customers who insist on moving in herds. In contrast, the transition from the Bowling Alley to the Tornado occurs after you have incubated the new value chain, getting one or more niche markets up and running in the process, and can now scale the market to its maximum dimensions once the herd of pragmatist customers is ready to move.

Once again, it is critical to bear in mind that at each phase transition management needs to throw away the playbook from the prior stage and embrace a strategy that takes an entirely new direction. In the case of the current liquidity crisis in B2B exchanges, the current need is to release companies from their early market strategies and encourage them to replace them with ones designed specifically for crossing the chasm.

In this context the worst thing management can do is cling to an early market strategy that has become obsolete. Therefore, the worst thing that investors and investment analysts can do is to continue to measure company performance by the old playbook, holding management accountable to a set of metrics that are no longer valid, that indeed have become pernicious.