BAIN & COMPANY

Second chance for e-business

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Building value on the web

Following the widespread failure of dotcom firms, many business leaders eased back on all things "e." That seemed to make sense. Yet research from Bain & Company finds that 62% of top managers say their companies don't take full advantage of the Internet.

Bain's Management Tools survey shows company leaders clearly want to benefit from "e-business"—using the Internet and related technologies to improve as many of their business operations as possible. The 2001 survey, which polled 451 senior executives worldwide on their satisfaction with 25 top management tools, also asked about Internet activities. Forty-nine percent said they were aggressively expanding their e-commerce capabilities. Only 11% thought their companies had spent too much on Internet initiatives.

Dell saved $50 million in parts inventory by allowing its suppliers to peer into its factories through a Web window.

Clearly, the Internet is here to stay. Despite the busted companies and business fallouts that resulted from failed speculation, online activity, including financial transactions, continues to accelerate. Research firm Gartner predicts that global business-to-business e-commerce will grow from more than $900 billion in 2001 to $3.6 trillion in 2003. The trend signals an important opportunity: in a tough business climate where companies are working hard to cut costs, e-business continues to deliver efficiencies that can boost productivity.

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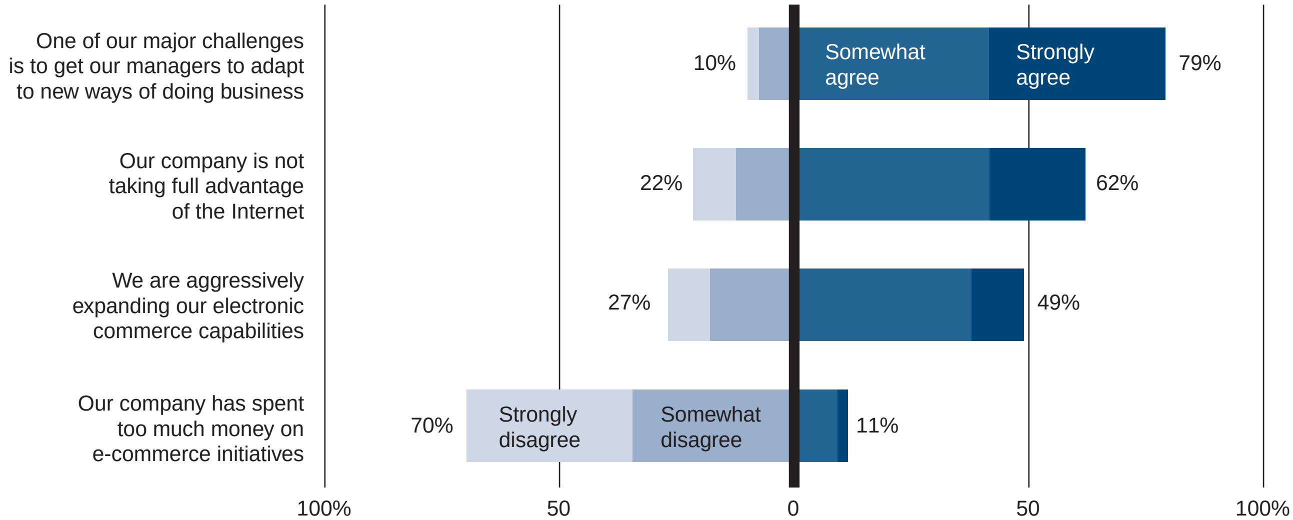
Figure 1: **Most firms still believe the Internet offers untapped value**



So what *does* work? Bain finds that the companies that are most successful with e-business stick closely to two key principles, and persevere with two significant practices.

Principle 1: Put thought before technology

The leaders in e-business know what their core businesses are—and what they are not. Leaders understand how the Internet affects those core activities, but they don't let technology fads cloud their thinking. Only after determining their business strategies do they start planning how the Internet can strengthen and accelerate the growth of their core businesses.

In July 2000, for example, Imerys, a leading industrial minerals producer, began crafting its e-business strategy by recording all of its grassroots Internet activities. It found 52 projects, ranging from a corporate intranet to e-commerce portals. The next step was critical: Imerys focused on the few Internet projects that held the most potential for quickly improving its operations, communications or business prospects. Its managers then developed a business case for each high-potential initiative. In the process, they turned up potentially large savings from an e-procurement platform that Imerys shares with mining and minerals conglomerates, including Rio Tinto and Alcoa.

Principle 2: Do as the venture capitalists do

Leading companies that have exploited the Internet know how to generate and keep up momentum without investing blindly. They adopt the approach of venture capitalists, sifting for best ideas and assembling strong teams to manage the activities they choose to support. They set tough but realistic targets. Then they drip-feed funds based on business results, and act quickly to adapt or kill off initiatives that aren't working out.

That's how Tesco PLC built a thriving online grocery service business. The supermarket chain tiptoed into online grocery service in 1996 at a time when the concept was attracting plenty of attention. But it never let its Tesco.com venture outrun shoppers' acceptance of online buying.

It began by outfitting a single store in Osterley, England, to accept orders by phone, fax and over a crude Web site. It wasn't until September 1999 that Tesco offered web-based grocery services through 100 stores; today the figure is closing in on 1,000, according to the company's 2002 annual report. The result: Tesco has been able to demonstrate net operating margins from groceries of about 5%. Last summer, Tesco extended its online business model to North America, purchasing a stake in Safeway's online-grocery operation with deliveries coming from Safeway's stores.

Relying on Tesco's existing brand, suppliers and database of affinity cardholders, Tesco.com got started for $58 million. By contrast, Webvan, which planned to dominate 24 US urban markets for online groceries within three years, spent $1.2 billion to start from nothing. Fixed costs overwhelmed revenues and in the summer of 2001 Webvan shut down. Another sign of Tesco's success: imitation by a key rival. In January, British grocery chain ASDA shut down the dedicated depots that supplied its online service, opting instead to ship from its regular supermarkets, the way Tesco does.

Practice 1: Use the Internet to slash costs

E-business exemplars play to the Internet's strengths—cutting costs and streamlining operations. In purchasing, for example, GE expected savings of as much as $600 million in 2001 as its locomotive unit got suppliers to bid via Web-based exchanges. And Dell Computer has saved $50 million in parts inventory—reducing from 13 days' worth in 1997 to five days' worth in 2001—by allowing its suppliers to peer into its factories through a Web window.

Internally, intranets can improve a wide range of activities: enhance employee communications, reduce the cost of administering benefits and help employees share and manage knowledge. Database software provider Oracle has used web-enabled business processes to drive out costs and add $1 billion to its profit margins.

Practice 2: Use the Internet to build new assets

For all the hype surrounding e-business, the Internet still has the ability to create brand-new products that are valuable to existing customers and attractive to new ones. GE has done just that. With a huge installed base of equipment—from gas turbines to medical-imaging machines—GE has created a new service using the constant streams of information about how customers use the equipment. Customers can pay GE for real-time comparisons between the performance of their machines and that of similar equipment run by other GE customers. The service is profitable and the database itself becomes a reason to purchase new GE gear.

In the Internet's second phase, leading companies are redesigning their business systems thoughtfully to take advantage of the Internet. The same thing happened a century ago when alert business leaders realized what they could do with electricity. Before long, e-business initiatives such as online purchasing of components or employee intranets will be so commonplace that they will confer almost no advantages over competitors.

The companies that do outrun their rivals will be those that understand both their own core businesses and the Internet's potential well enough to identify hidden gems among their intangible assets—their networks, databases, brands and market share. The opportunity appears much richer than any dotcom *El Dorado*.

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Open-market innovation
Bain Strategy Brief by Darrell Rigby and Chris Zook

Strategic due diligence
Book Excerpt by Geoff Cullinan and Tom Holland

The limits of scale
Bain Strategy Brief by Ashish Singh and James L. Gilbert

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