

# E-Commerce: Promise or Threat?

## ***A Brief Look at the Potential Impacts of Electronic Commerce in the Wholesale Wood Products Industry***

presented by the NAWLA Technology Committee, October 1999

"Somewhere out there is a bullet with your company's name on it...a competitor, unborn and unknown, that will render your business model obsolete....The hottest and most dangerous business models...today are on the Web."

— *Fortune*, Dec. 7, 1998

"The real B2B revolution is taking place outside the boundaries of individual firms, and this revolution involves the *creation* of new middlemen."

--- *Sept 16, 1999 Technology Review*  
*Merrill Lynch*

"The successful companies of the next decade will be the ones that use digital tools to reinvent the way they work."

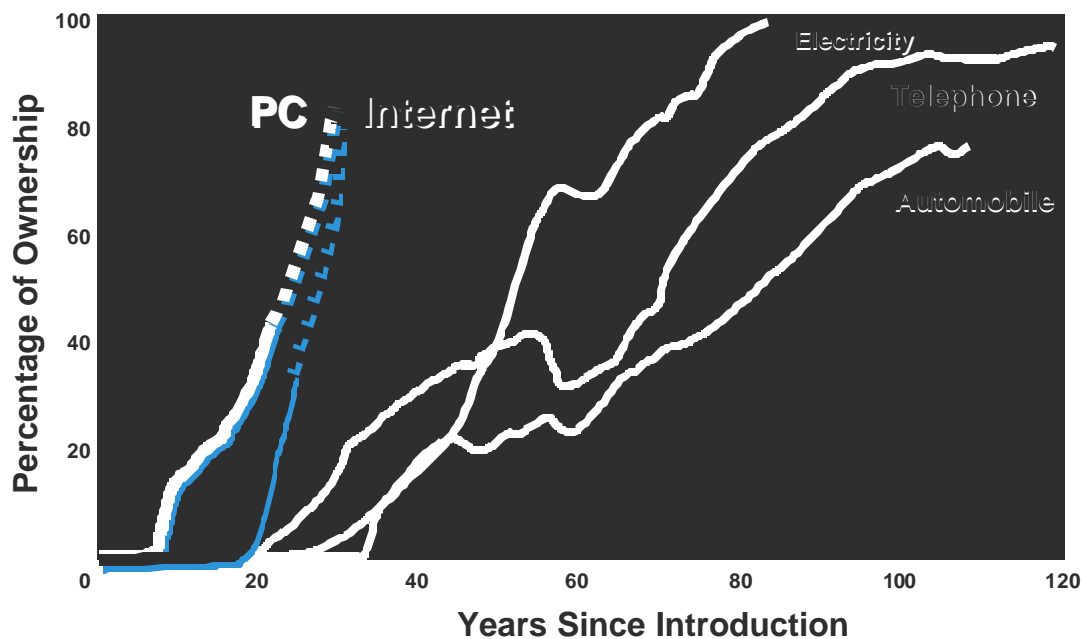
— *Business @ the Speed of Thought*, by Bill Gates

### **Part I:**

#### ***The Current State of Electronic Commerce in the Wood Products Industry***

Read any business or news publication and there it is—electronic commerce. After taking the business-to-consumer world by storm, business-to-*business* e-commerce now is all the buzz. To some, e-commerce represents the promise of new customers and new frontiers; to others, e-commerce represents a threat of unprecedented proportions. This economic change is coming quickly as the chart indicates. According to Bruce Merrifield 1989 was the year people stopped asking if you had a fax and instead asked for your fax number. 1998, last year, was the

transition year where everyone expects you to have e-mail. 2003 is the year that all of this E-Commerce transition will be over and done.



Source: The Economist

The wood products industry lags behind most others in terms of transactional e-commerce. According to recent NAWLA member interviews conducted on the Association's behalf, few companies in our industry currently see e-commerce as a viable means of marketing their products and transacting business—whether in addition or as an alternative to the more traditional methods of sales visits, advertising, and taking orders by phone and FAX.

Although many wood products wholesalers and manufacturers have web sites, most do not facilitate online business transactions, nor do they provide information on product availability and price. This is not to say that our members find no value in the Internet. An increasing number have discovered its powerful utility as a

prospecting tool and as a convenient, inexpensive means of written communication.

Even individuals who dismissed the first fax machines as non-essential gadgets now use e-mail attachments to transmit price sheets, P.O.s and the like. However, the wood products industry is far from a widespread acceptance of the same Internet e-commerce tools and business models that other industries have been quickly embracing.

Our member interviews revealed that most wholesalers and manufacturers that do have websites created them without first developing any kind of e-commerce strategy. Many jumped on the website bandwagon without really knowing what to expect, creating everything from simplistic to multi-layered vanity sites. Further, few members have actively promoted their websites. Both of these factors can explain in large part why most wood products companies' sites have not produced tangible benefits, but rather just exposure that is quantifiable only in terms of often-meaningless *hits*.

While software providers have gained much penetration into lumber wholesalers' businesses, they lag behind their counterparts in other industries in terms of offering web-based e-commerce capabilities. Few, if any, currently offer e-commerce functionality in their packages and, as our interviews revealed, not all of them plan to. This is attributable to the fact that many software providers are struggling for the time to serve their customers' *current* needs, coupled with the current low demand for e-commerce functionality.

At the same time, we are seeing an increasing number of wood products-dedicated websites emerging with offers of *handshake auctions*, *reverse auctions*, product locators and, in some cases the ability to conduct transactions online. Many of the companies behind these sites are not directly part of established wood products firms with traditional business models. While they may or may not be backed by or staffed by individuals with extensive wood products experience, these are new ventures that are looking to grab their piece of the marketplace. Some of these companies make no secret of their true intent to disintermediate wholesalers and perhaps retailers. We call these new players *infomediaries*.

These companies all share several characteristics that include:

- They offer a customer ONLY A PART of the wholesaler value proposition at a better price.
- They will frequently build alliances and partnership within a group of competitors.
- They typically are not bound by loyalty or existing relationships within a specific industry.

The total size of the wood products industry will grow based on a number of complex factors. A range of channels, i.e. office wholesalers has served our industry, and our customer base has been satisfied with these alternatives. As these infomediaries gain traction within our industry they will grow at the expense of existing market share incumbents. These new value propositions create new channels for product to market. Some customers, at some times, will choose to use the new channels.

No force can stop a channel from becoming more effective. These new entrants are simply adding additional channels within the wood products industry.

***The choice facing the NAWLA membership is simple, either lose volume to these new infomediaries, or create the new channel alternatives themselves.***

Each NAWLA member will make their own decisions and the variety of new alternatives is going to be quite large.

Over the past several months, many people within NAWLA have voiced strong concerns about infomediaries. Who are these companies, and how can they be allowed to do what they're doing? Others have acknowledged the existence of infomediaries but feel strongly that, because of the very special nature of our industry, these outsiders will not survive. After all, look how many have tried and failed in the past. Still other members have reached out to them, attempting to share in potential new opportunities.

Some wholesalers interviewed were not really aware of infomediaries' existence because these e-commerce companies are so new to the industry. And because they are so new, our committee feels that those who dismiss infomediaries' potential impact on this industry are making premature—and likely dangerous—judgements.

Based on the success that infomediaries are having within other industries (e.g., steel) it is safe to predict that, while many infomediaries will not survive, others will thrive, albeit not necessarily within their current business models. While many infomediaries strive to flatten the supply chain by rendering the incumbent players

irrelevant, we acknowledge that we know of no severe disruptions in other industries.

But the waves of change are present and we think it's simply a matter of time.

Recognizing this likelihood, some wood products wholesalers are considering—or already forging—cooperative or financial partnerships with infomediaries or solution providers that can help them become or build their own infomediaries. These wholesalers recognize that this new way of doing business could gain them access to new kinds of customers without losing their traditional or existing customer bases

In a short period of time, wholesalers without a full-function, e-commerce-capable website— particularly wholesalers who sell in carload and truckload quantities— could be vulnerable to disintermediation. Yet wholesalers with sound e-commerce strategies and the appropriate website functionality eventually could find themselves at a strong competitive advantage (a la Amazon.com) over those who have turned a blind eye. Moreover, e-commerce-savvy wholesalers could possibly find themselves able to disintermediate their own downstream customers (perhaps by selling large less-than-truckload quantities directly to end-users). Indeed, the distribution of wood products is quite different than selling books to the public, but it certainly is not immune from disintermediation.

Understand that our total industry size with respect to wood product consumption will continue to grow. These companies will not replace distributors. In fact, a recent NAW Large Company study called Distribution.com makes a strong economic case that distribution, as an industry will benefit significantly from the e-commerce transition. Some one still needs to aggregate orders and deliver product in the physical world. Customers will continue to require immediate availability to satisfy

unanticipated demand. Our industry is a long way from seeing a company called [www.weguaranteedelivery.com](http://www.weguaranteedelivery.com). Traditional brick and mortar companies will transition to click and mortar companies. Producers can sell direct to end-users if the end user can live with large shipments and unreliable deliveries. Some end users will choose this alternative some of the time.

A recent E-Commerce Study from Bear Stearns cited that distribution has grown significantly faster than GNP and will continue to do so. The impact on traditional NAWLA members is that many of the free services that we provide to our customers will need new pricing models. We will no longer have the ability to bundle these value added services because customers will have new competitors to “skim the cream” that essentially paid for these services.

Here is what Arthur Andersen Company has to say about e-commerce in wholesale-distribution:

- The overall impact of e-commerce has been minimal but will have a tremendous impact over the next five years.
- Wholesaler distributor sales and purchases over the Internet will increase dramatically.
- E-commerce will quickly shift from a competitive advantage to a requirement over the next five years.
- E-commerce will increase competition and consolidation.
- E-commerce will change the wholesaler distributor's role in the channel.

So why has e-commerce not yet taken a firm hold in the lumber industry?

According to Arthur Andersen, wholesaler-distributors across all industries attribute their lack of resources and knowledge as primary barriers.

Add the facts that lumber is bulky and requires special handling, packing and shipping. Grading, drying, resurfacing and other value-added activities contribute

further complications. Also meaningful is there is little standardization for product data warehousing, coding and marking—factors that would enable channel participants to more efficiently sell, sort and track inventories. True free fall auctions won't happen until there is a rock solid way to absolutely identify grading and product quality issues from the producers. Perhaps the most important reason—for the time being—is the resistance of human beings in a *people* industry to replacing their functions, or themselves, with computers.

While these important factors have “shielded” our industry from the rapid advances of e-commerce seen elsewhere, it is only a matter of time before progress finds the pathway and logistical challenges are overcome. Perhaps it will take a cooperative effort by a few producers, wholesalers and e-commerce solution providers to crack the code and break the ice. Be guaranteed that all of the above are working on it—some backed by deep venture capital—and all want to be the first to the finish line. The numbers at stake make the opportunities and threats too large to be ignored—by anyone.

- **Part II:**  
***A Look Into the Future***  
**The E-Commerce Revolution**

It is now the year 2004. The longest and most significant period of North American economic growth ended with the last millennium. However, our digitally networked economy has been fast to respond to the technological progress that continues to abound. Faster, easier and less-costly access to that all-important commodity—Information— has facilitated unprecedented market efficiencies that have brought us closer to Adam Smith’s frictionless marketplace. Economic recovery came swiftly.

Entirely new business models emerged from the e-commerce revolution. Advances in communications and logistics have enabled—and required—wholesale-distributors to meet a higher-than-ever level of service demands. Techno-savvy wholesalers have realized great process enhancements, positioning themselves as key service providers to downstream and upstream channel members alike. Instead of being disintermediated, post-revolutionary wholesalers have blurred traditional customer-supplier lines with new approaches to and combinations of value-added services.

But as with any revolution, there have been casualties. Wholesaler firms are fewer in number than they were five years ago—either through consolidation or because their owners have found easier ways to earn return on their investments.

Wholesalers who successfully equipped themselves to ride the wave of e-commerce generally have outperformed and out-survived their competitors who didn’t take

action, with the very largest and smallest wholesalers having the highest survival rates.

The largest companies, with their significant financial resources and human talent, developed their own e-commerce solutions and purchased their way across the learning curve by acquiring infomediaries and other wholesalers who figured out how to play the game. Smaller companies that identified and protected their niche strongholds, and those that adopted the appropriate e-commerce solutions also came out on top. The small companies did not all build their own e-commerce solutions; many tap into the wealth of e-commerce packages offered by the many service providers that have sprouted up in the past few years. Medium-size companies—those too small to fight the e-commerce wave but too big to hide from it—have had the toughest time staying afloat. They have lost volume to larger companies but are carrying too much baggage to outmaneuver their more agile competitors.

As always, competitive advantage continues to go to those who provide the best quality products and services with the greatest reliability and the least customer pain. But today, because of the vast information infrastructure in place, there are few well-kept secrets in terms of the true cost of materials and services offered by every channel member. The question is which competitors can use the information most effectively to achieve their goals.

## **Customers and Suppliers**

The nature of wholesalers' customers has changed. Retailers are less involved than before in order fulfillment as wholesalers increasingly provide product training and

job-site delivery. Nearly all deliveries are made from a logistics center—or directly from the manufacturer—on an automatic and continuous replenishment basis per customer specifications. The transacting wholesaler may or may not be the logistics provider, as many now choose to outsource this function to other wholesalers or third-party specialists as their *order agents*. Because retailers' traditional customers have the ability to place electronic orders directly with suppliers further upstream, many do so.

Disintermediation and homecenters have contributed to the elimination or consolidation of nearly all but the strongest or most geographically remote independent retailers. Industrial customers such as original equipment manufacturers (OEMs) and maintenance, repair and operations (MRO) purchasers have consolidated. In construction, both commercial and residential projects utilize more factory-built and mechanized elements, which reduces the amount of individual job-site deliveries. In short, wholesalers now have fewer but larger customers to sell to and service.

Because of the enormous efficiencies and costs savings realized through on-line purchasing, most wholesalers' customers now require suppliers to be e-commerce compliant. Further, to better focus their buying power, customers have centralized their procurement functions and do most of their purchasing from short lists of preferred vendors.

Consolidation among manufacturers also has continued, spurred by the recent downturn, decreased access to domestic timber and increased pressure from alternative building materials. Some manufacturers, determined to focus on their

core competencies of production, have turned increasingly to wholesalers for meaningful and symbiotic alliances that capitalize on each other's true strengths. Rather than merely purchasing from these manufacturers, wholesalers often serve as *vendors* to them, providing marketing, logistics and other key services. And these relationships exist even in cases where the wholesaler is not the customer.

Because manufacturers' and wholesalers' costs and margins are, for the most part, mutually known, nearly all activities are performed at cost-justified levels. The multitudinous crossover of services between wholesalers and manufacturers has transformed this portion of the supply chain to a network of cooperative relationships. Conversely, manufacturers that long ago failed to recognize the value of wholesalers have moved even further from this sort of partnering.

## **Transactional Transformation**

Annual business-to-business e-commerce transactions, measured at only (US) \$8 billion in 1999, now top \$1 trillion dollars. Purchasing and sales functions have been greatly automated and systematized to function at management-specified parameters. Routine purchases are made directly from suppliers' computer systems via secure servers on the Internet.

Owners and managers make buy-sell decisions that are carried out with very little human intervention so long as transactions fall within prescribed constraints of market conditions, inventory levels, cash flow, customers' credit ratings and other dynamic factors. These factors are monitored and updated continuously with real-time data. In sophisticated systems, only certain will conditions trigger calls for

human decisions on specific transactions. With rare exception, payments are made and collected by electronic funds transfer (EFT) according to agreed-upon terms.

Due to the increase in centralized purchasing, sales functions are, for the most part, handled by top management. Key relationships and buy decisions have moved up the organization as owners and senior management forge agreements with their channel partners. These changes have altered the role of many field salespeople to that of *customer service specialist and educator*. Accordingly, these factors also have changed the compensation structures of these people who service the companies' accounts—and not without great turmoil.

These changes have proven to be substantial for wholesale companies who had before fought to keep sales superstars with margin-erosive compensation plans. With the automation and refinement of transactional processes that has taken place, wholesalers now are able to allocate a greater percentage of resources and time to customer-satisfaction issues. This refocusing of sales and service efforts has additionally resulted in greater profitability due to fewer credit losses, lower claim frequency and more favorable claim resolution.

## **Conclusion**

Since 1999, the lumber industry has seen many drastic changes. The threat of disintermediation has a brand new face. The old notion that wholesalers would be put out of business by mills selling direct or retailers buying direct has gone out the window. As it turned out, those wholesalers that failed were those that could not deal with the magnitude and velocity of change. Wholesalers that implemented e-

commerce in their business strategies and practices early on have realized a far better success rate than those that ignored it and later tried to catch up—or, worse, did nothing at all. While change can be difficult, it is inevitable and often beneficial.

### **Part III:** ***A Changing NAWLA***

Rewind to the present.

In light of our preceding forecast, it is logical to predict that NAWLA's membership—which has reached another significant peak of more than 600 members as of October 1999—will settle to a lower level after the upcoming turmoil. This doesn't mean that the Association won't remain strong; NAWLA is an organization that sees opportunity in change. The NAWLA Traders Market<sup>®</sup> will continue to be a mainstay, adapting to suit members' needs. The Association's educational offerings will continue to focus on both traditional and leading-edge topics, and its services will thrive.

NAWLA has stayed strong by anticipating and responding to changes in the industry and altering its programs and offerings accordingly. Given the sweeping changes we have before us, it is just as important that NAWLA prepare for them as it is that its members do. Therefore, we must consider what courses of action NAWLA might take—ranging from doing nothing (*not* our goal) to undertaking a major shift in the nature of this organization.

By the latter, we mean that the Association, currently a not-for-profit entity, could launch a separate, for-profit e-commerce enterprise that would facilitate its members buying and selling of wood products, building materials and related services. Given

NAWLA's centralized and trusted position within this industry, few, if any, organizations are better suited to be at the core of such an initiative.

Or, NAWLA's approach could be to offer selected business services to its members, primarily delivered via the NAWLA website.

Most any area in which NAWLA members have common functions or interests represent potential offerings by NAWLA, either directly or in cooperation with other organizations.

Here are some potential services that we have identified:

- **Online Purchasing and Selling**
- **Banking/Financial Services** (including EFT)
- **Freight Quoting/Tracking**
- **Credit Management and Credentialing**
- **Training and Education**
- **E-Commerce Consulting**

While this list is by no means complete, it is a starting place as we contemplate our Association's role in the changes ahead. We value your input and want to hear from you.

There are many courses that we can chart into our collective future. As an example the Associated Equipment Distributors put up a used equipment sales database as a benefit to membership. Anyone can go to the site and buy equipment. You must be an AED member to add equipment to the site. There are no fees, it is part of the association value package that comes with dues. The Air Conditioning and Refrigeration Distributors put up a website for member use only to share excess stock and obsolete, hard to get, products. The Health Industry

Distributors Association is in the process of building a seamless web portal for their members customers where each customer can choose their suppliers and the HIDA member maintains control over their own customer relationship.

These three examples are all cases where the trade association stepped out of the box to support their members. In all cases, they had many members who were unhappy with the change in role. The survey that follows seeks information in two areas. We are trying to understand the views within your own company with respect to your E-Commerce response and your own initiatives. We are also seeking your views as a NAWLA member as to what you want NAWLA to do in the future.

We will solicit input from our entire membership via this white paper and survey. We are also going to conduct several focus group meetings over the next several months to gain additional input. If you would like to participate in one of these sessions, please contact the NAWLA offices. When we have sorted through all of the opinions, ideas, and member input, we are going to publish a document that summarizes our findings and also the Board directed future direction of your association.