



Glen T. Meakem, co-founder, FreeMarkets

2B or not 2B

The volume of business-to-business eCommerce could approach \$3 trillion in just four years' time. This industry pioneer explains why this is a force that will be difficult to resist.

Amazon.com, eBay, Priceline.com. Hard though it may be to accept, eCommerce, a way of doing business that is still in its infancy by most measures, already has a sector of companies that can be thought of as traditional. And although they undoubtedly remain names to be reckoned with, companies like these are yesterday's news. These three pioneers were part of the first wave of eCommerce: businesses selling products and services over the Internet to consumers, or, in shorthand, B2C.

These days B2C is overshadowed by B2B, or businesses interacting with and selling to one another over the Internet. Forrester Research expects the volume of online business-to-business commerce to grow from about \$400 billion today to a whopping \$2.7 trillion by 2004, or 17 percent of all business trade. By

Meakem: "We are giving power to the industrial buyer."

comparison, the size of the B2C market is expected to be \$184 billion in four years.

So far, most transactions have been one-on-one—a buyer using the Internet to expedite a purchase from an established supplier, for example. But the fastest growing segment of B2B is the so-called eMarketplaces, online auctions where a buyer can choose among bids from multiple suppliers, or a supplier can meet a variety of buyers.

At the moment, relatively few businesses could find their way to an eMarketplace if their bolts, knobs and fasteners depended on it. But Forrester calculates that the popularity of this means of exchange will grow so rapidly that 53 percent of the \$2.7 trillion in B2B eCommerce in 2004 will be conducted in eMarketplaces.

Perhaps the most influential innovator and wealthiest player in eMarketplaces is Glen T. Meakem, 36, co-founder of five-year-old FreeMarkets. Meakem,

a Harvard Business School graduate, a former consultant and an Army reservist who led a combat engineering platoon during the Gulf War, recently was named one of the 25 most influential people of the eEconomy by *BusinessWeek*.

In 1994 Meakem quit his job at General Electric Company because he couldn't convince his superiors to invest in his vision: electronic auctions for industrial supplies. So Meakem and his partner launched FreeMarkets. In 1999 the company's clients—including United Technologies Corporation, The Quaker Oats Company, Eaton Corporation, Emerson Electric, Owens Corning, FirstEnergy and SmithKline Beecham—bought more than \$2.7 billion in goods and services through FreeMarkets' online auctions, making it the world's largest eMarketplace for industrial parts, raw materials, commodities and services.

Recently Meakem spoke about the future of B2B eCommerce with

"If you're using the same [suppliers] year in and year out, I guarantee you're not buying from the most efficient, best managed companies in the industry."

Outlook Senior Contributing Editor Lee Smith.

Outlook: Where are we in the evolution of business-to-business eCommerce?

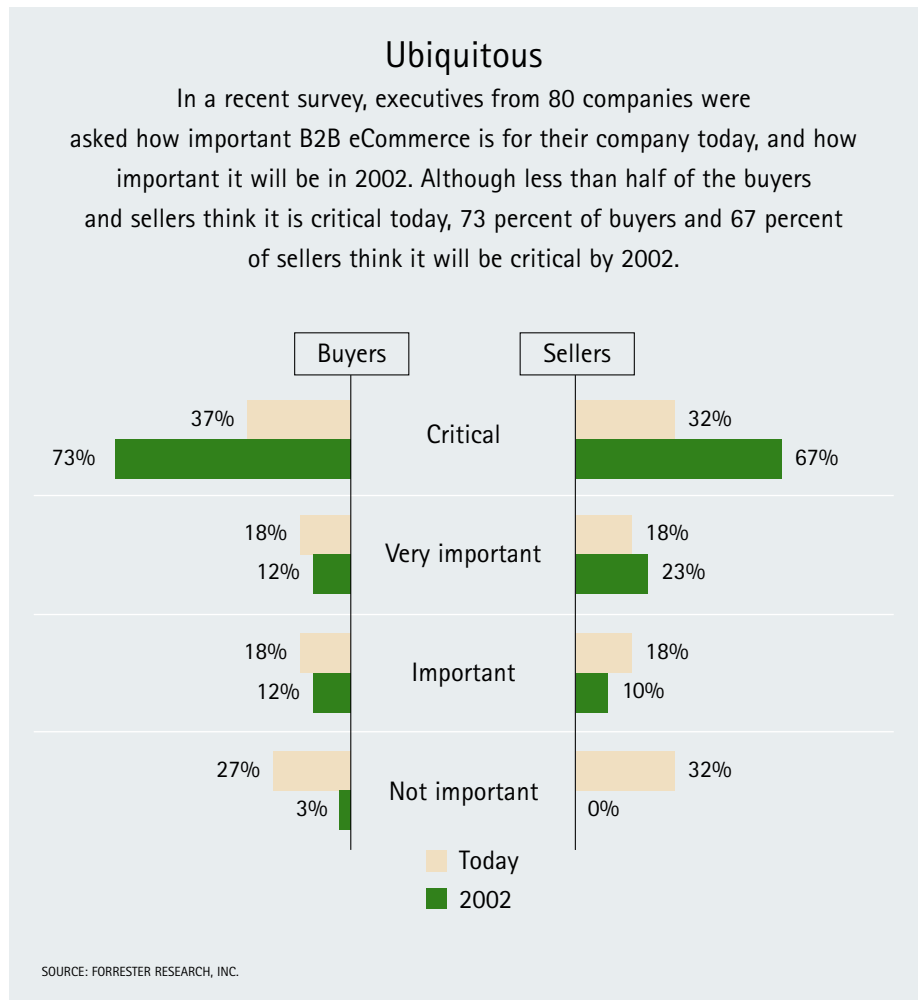
Meakem: Early. People still don't really understand the different pieces of eCommerce. There are a lot of new entrants right now into the B2B commerce space, and a tremendous number of entrants into that section of it that we compete in, the eMarketplace. It's going to take some time for that to get sorted out, for there to be some shakeout, for some of the strong companies to emerge, for the weaker players to fall.

And it's going to take some time for corporations, who are the buyers of

these services and technologies, to sort out who the leaders are and whom they want to buy from. So right now I see it as the second or third inning of a nine-inning game.

What happened in the first inning?

A lot of competitors with a horizontal orientation—like ourselves—became successful to a degree and went public. By "horizontal orientation" I mean those companies that represent buyers of goods and services rather than sellers or suppliers. A manufacturer, a bank, a hotel chain—a company that purchases a range of products and services. A hotel buys food, linens, fuel, temporary help, tax preparation services, for example. A lot of eMarketplace folks who are vertically oriented—that is, have the suppliers as their customers—have not been commercially successful.



Why is the horizontal orientation more successful than the vertical?

Because buyers have the power. One fundamental thing that's happening as a result of the Internet is that power is being transferred from sellers to buyers. This began in the consumer world, and now it is happening in the industrial world too.

For 100 years companies have been buying goods and services by saying to themselves, "Gee, I need to buy \$10 million worth of metal parts this year. The parts break out into three different subsegments, so I need to choose three metal-parts suppliers." The natural default position is, "I'll just use the people I used last year."

What's wrong with that?

If there are 500 suppliers and you're using the same people year in and year out, I guarantee you're not buying from the most efficient, best managed companies in the industry. The chances that you have happened on the three best people in that industry are about zero.

So we are giving power to the industrial buyer, who didn't know there were 500 suppliers, who didn't know who had competed successfully in recent markets and who hadn't, who was ISO-certified and who wasn't. Buyers will be in a much stronger position to bargain.

The shift is already occurring. And eCommerce companies that have aligned themselves with that shift in power are more successful right now than companies that have tried to fight that shift or don't understand that shift.

Why should you—an outsider—be able to locate those suppliers more easily than a buyer that's actually part of the industry?

We start by looking at how the client is spending money on supplies and help them figure out where they might be

able to save money through a more efficient process, a market process. Perhaps we already have a database of suppliers that serves a new client's industry—we have a deep expertise in plastic injection molding, for example—but we also have a core competency in doing research, finding new suppliers.

So it's much more efficient to buy in an eMarketplace like yours?

Let's be clear: We are not reducing transaction costs, which is what most of eCommerce has been about so far. Early eCommerce focused on reducing paperwork, streamlining and reducing the cost of ordering goods and services, moving purchase orders back and forth, the releases of the parts and payments for shipments and so forth.

But what no one had ever thought about before was the cost and the quality of the decision-making process. The analogy I like to use is the stock market.

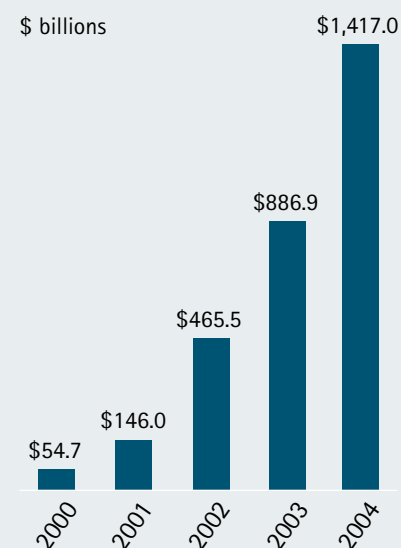
If you're going to buy shares of Intel, you're going to get them through your broker. Is your broker Schwab? If so, you're going to spend \$19.95 for that trade. If he's a full-service broker, you're going to spend \$200 for that trade. But if you bought Intel at the right time for the right price, whether the transaction cost was \$19.95 or \$200 probably doesn't matter very much. And if you bought the wrong stock at the wrong time, you're cooked. And that's what we are about: deciding who you are going to do business with and at what price.

How does this affect corporate supply chains and processes?

In two ways. First, the advent of B2B eMarketplaces is starting to show the world that supply chains are really very dynamic, that companies are constantly switching suppliers. And if you're buying from the wrong person, it's of much higher value to you

Explosive growth

The size of eMarketplaces—online B2B auctions where the buyer chooses among bids from multiple suppliers or where a supplier meets several buyers—is expected to increase by more than 2,000 percent by 2004, when it will represent almost \$1.5 trillion in business.



SOURCE: FORRESTER RESEARCH, INC.

"If a company can specify what it needs and there are multiple potential suppliers, then you can run a competitive online market."

to make sure you switch and buy from the right person than it is to reduce inventory with the wrong person.

Second—and traditionally this is better understood—once you have a supply chain, there is tremendous value in reducing inventories. You can transmit from the retail sales floor back into the factory very quickly what the real trends are, who's winning, who's losing. That gives you an opportunity to reduce inventory dramatically, because you're not producing the wrong thing. But you also have an opportunity to react to the market faster with the right thing.

Can I become one of your competitors in the eMarketplace? What's the investment required?

For us it was tens of millions. It may be hundreds of millions at this point because there are some barriers, and we are the first mover.

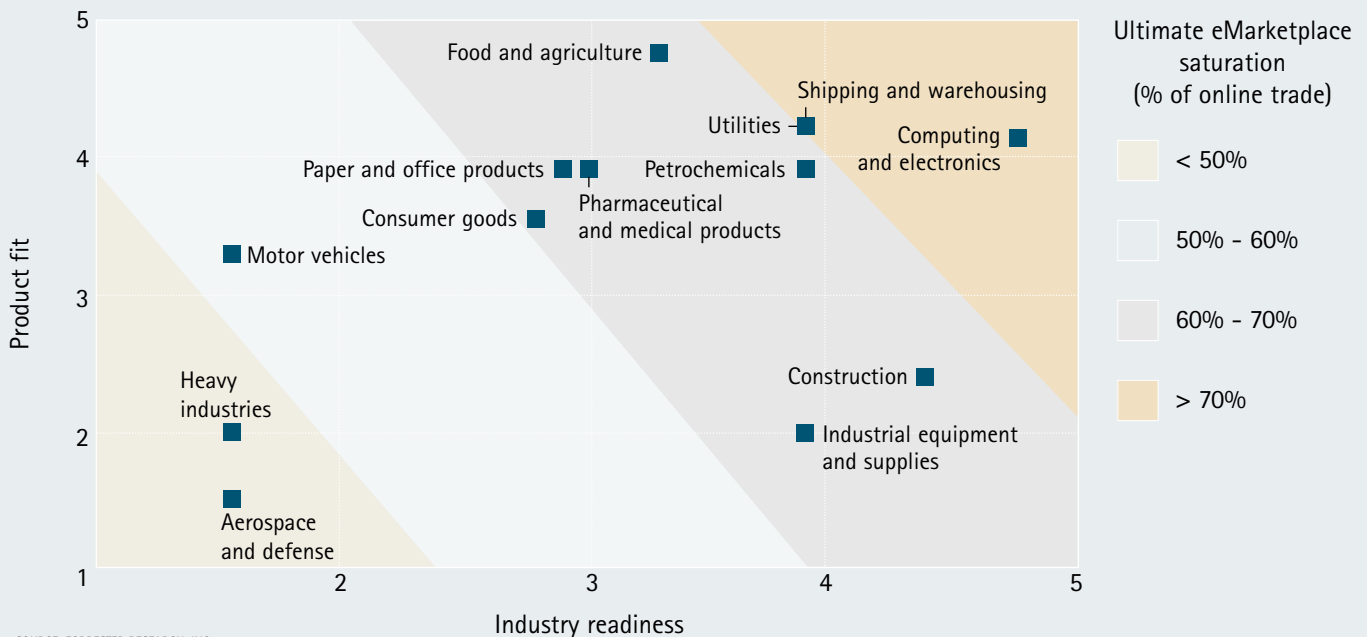
The barriers in our business start with auction software. We have 29 different auction formats, 12 of which we have patents pending on. So we've invented ways that companies will do business in the 21st century that nobody's ever done before.

We've got this thing called transformational auction technology, where non-price factors are algorithmically calculated into a benchmark price, and the auction happens around the benchmark price [a price the buyer has set at which it makes sense to switch suppliers]. We have created a proprietary software called BidWare that allows stacked and ranked bidding, a real live interactive auction, in which the suppliers who are bidding see only their own bids and what place they're in. They don't see what their competitors are bidding.

Suppliers must hate you. Why the secrecy?

Industry fit

In some industries—like computing and electronics—the products lend themselves to eMarketplaces; those industries are prepared to move toward B2B auctions. More than 70 percent of the purchases of supplies in those industries can be expected to be carried out through eMarketplaces.



Suppliers collude. Not in every industry, but I've been amazed at how much unethical behavior there is in business. In certain concentrated industries, companies absolutely collude.

So we've developed auction software technology that prevents collusion because we give away so little. We have suppliers participate in a real-time auction using software that gives them very little information about what other people are doing. Technologically, we've figured out a lot of stuff other people haven't even started to think about.

It still doesn't seem that difficult. Outsiders think, "Oh, auctions. That's an easy business." But when you start to peel back the onion, there's a lot of complexity. To compete with our knowledge as a global supply base would require a lot of research and a global deployment of people.

We've got a lot of unique market-making skills that we've been developing for five years. For example, we're taking the knowledge we've accumulated and automating it into more of the requests for quote that we send to suppliers. We're introducing software for professional buyers. Through their desktop computers they'll have access to our databases of suppliers and will be able to compile their own evaluations of suppliers.

So all of that proprietary technology is a barrier to others trying to enter the market. To the extent our clients are happy and we're providing good systems and good information and great markets and they're saving money, it's hard to move us out of there.

But General Motors, one of your big clients, left you and has created an exchange with Ford and Daimler-Chrysler. How threatening is that? I don't think anybody right now has

a good definition of what it is they are trying to do. Are they just trying to reduce transaction costs? If so, their exchange will be tremendously successful. But I'm not sure their exchange will be a place for buyers to make better-quality decisions, as we were discussing before with the stock market analogy. What's important is not your transaction cost in buying Intel shares but whether Intel is what you want to buy. I think it is going to be very difficult for the marketplaces that only focus on one aspect of the purchasing decision—such as price or the transaction itself—to work and serve everyone's needs. So I still see huge opportunities for us and other people within automotive.

How much of its total purchases can a typical company buy in the eMarketplace?

Anywhere from 30 percent to 80 percent, but the amount varies greatly from company to company. The eMarketplace works very well for any material, service, component, subsystem that is characterized by the buyer being able to specify exactly what is needed—and where there's a competitive supply base.

For example, we have a database for tax preparation services. One of our clients, a major corporation, knew exactly what tax returns they had to have prepared, knew exactly what kind of work was involved. They specified exactly what they needed and bid the job out to the Big Five accounting firms.

What won't a company be able to buy in the eMarketplace?

If you're Compaq Computer and you're manufacturing PCs, you can't bid out the operating system, because there's only one Microsoft. You wouldn't be able to specify a new operating system and have

somebody build it. So there's no competitive supply market.

However, if you're Compaq, and you want to bid out plastic injection molded keys in a keyboard, you could bid those out. Or if Compaq needed relocation services for some of its employees, it could bid that out as well.

The bottom line is that if a company can specify what it needs and there are multiple potential suppliers, then you can run a competitive online market.

Are there industries that are going to resist doing business in the eMarketplace, or countries where it simply won't take hold?

I don't think the limits are going to be geographic. We have offices in Brussels, Hong Kong, New Delhi and Singapore. And I don't think that whole industries will keep themselves out of the eMarketplace.

The limits are going to be of the kind I mentioned, such as areas in which there are very few purchasing alternatives. If you want to buy high-pressure turbine blades for aircraft engines, there are only a couple of suppliers in the world that make them. Also, companies are never going to bid out some strategic, hard-to-define and highly confidential services, such as CEO-level legal advice and M&A guidance. ■