

BURSTING THE BUBBLE

*The Internet, E-Business, and the
Adhesives Industry*

Michael L. Gregus
Director

The ChemQuest Group, Inc.
Cincinnati, Ohio

Adhesive Technology

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First Think Strategically

The time has come to take a clearer view of the Internet. The key question is not whether to deploy it, rather how to deploy it. There is no choice but to deploy it to stay competitive. The challenge is to learn from the mistakes of those who failed.

The fundamental advantage of the Internet is “*making information readily and widely available.*” Unfortunately, that may come at the expense of profitability depending on *each value chain* your company participates in. A fundamental issue that dot-coms failed to account for.

Dot-coms distorted the view of fundamental business. They multiplied so rapidly, because of widely available capital, without demonstrating viability. In fact, their distortion of business principles began with expansive definitions of top line revenue growth. They offered free services for registered users to attract customers because they felt they could make money on the back end, e.g. click-through revenues, advertising, or a percentage of the transactions, etc. To generate revenue, reduce expenses, or provide services on the Internet, while useful, is not sufficient evidence that value has been created. In their rush to deploy, dot-coms failed to understand the true economic value of their business.

ITS TIME TO RETURN TO FUNDAMENTALS: The creation of economic value is the only true arbiter of business success. Sustained profitability is the only reliable measure of economic value.

So how can the Internet be used to create economic value? The answer lies in two fundamental factors that determine profitability:

Industry structure- which influences the degree of competition and hence the profitability of competitors, and
Sustainable competing advantage- which allows a company to outperform its competitors.



These two drivers transcend any technology or type of business. They are universal to fundamental business strategy.

The error made by many businesses is the delegation of the Internet strategy to their IT department, or viewing it as somehow separate from their daily strategic decisions related to customers and competitors. The Internet is a great channel, it needs to be incorporated into your existing strategic thinking. Use it as a tool to deploy strategies.

The basic value chains for companies provide a framework of activities through which a product or service is created and delivered to customers. Each value chain may be uniquely different. Each discrete activity has a cost. Understanding how the influence of the Internet will impact such costs will provide leads as to how to use it in your strategy.

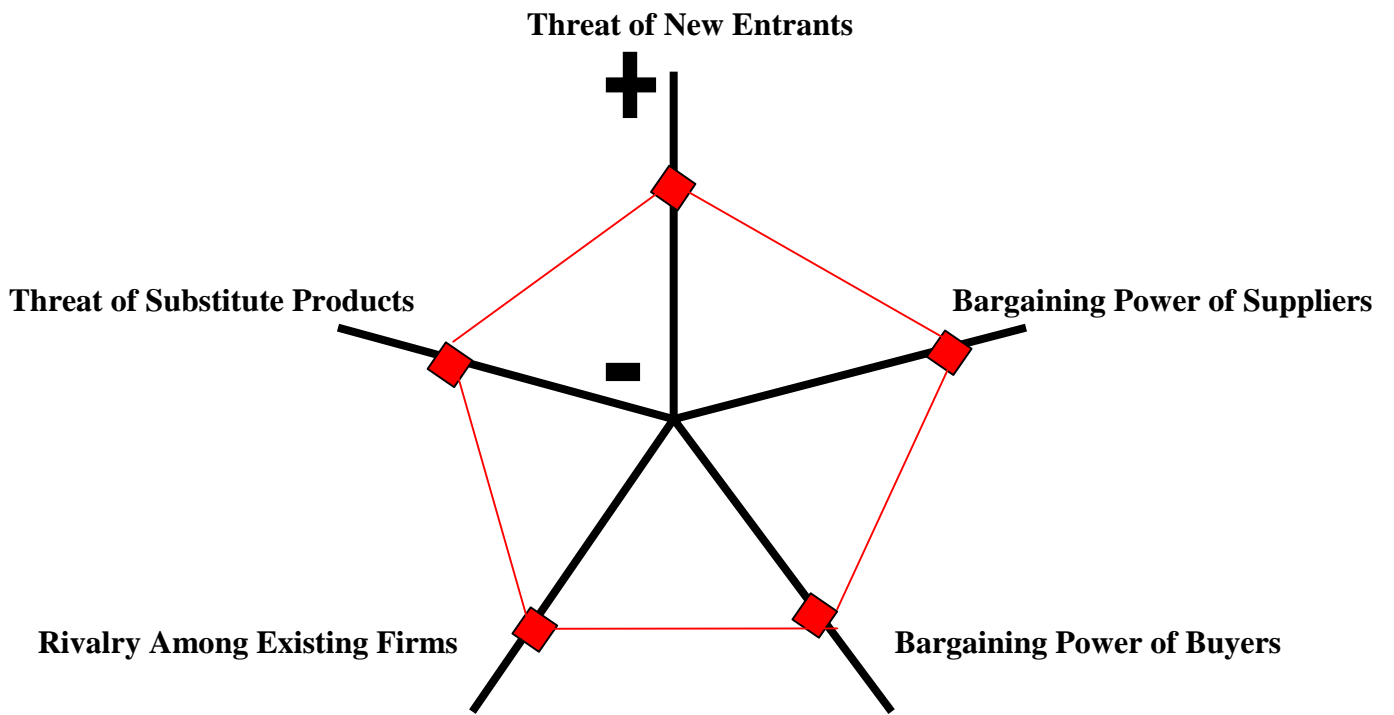
While deploying the Internet can expand the market, doing so may come at the expense of profitability. Fundamentally, the Internet is a great paradox. Its benefits of making information widely available, reducing the difficulty of purchasing, marketing, distribution, and allowing buyers and sellers to transact business more easily- also shifts leverage, lowers barriers and makes it more difficult for companies to capture those liberated costs and benefits as profits. Therefore, the key is in *integrating* as many activities as possible to *weave unique solutions* that build barriers. Simply selecting one or two activities does not provide *sustainable competitive advantage*. Your competition is smart enough to do the same and quickly.

To assess the attractiveness and sustainable profit potential of your e-Commerce strategy, think of the fundamental forces underlying each of your value chains. Michael Porter, distinguished professor at Harvard University defined five competing forces to determine the structural integrity of a business: the intensity of rivalry among competing firms, the bargaining power of buyers, the bargaining power of suppliers, the threat of substitute products or services and the barriers for new competitors.



Evaluate the business strategy while integrating the strategic influence of the Internet on each of the five forces for each of your value chains. The example below refers to a generic adhesives value chain as seen from the perspective of an adhesives company:

How The Internet Influences Industry Structure



<p>How The Internet Influences Industry Structure</p> <p>(Industry Attractiveness)</p>	<p><u>Threat of New Entrants</u></p> <p>(-)</p> <ul style="list-style-type: none"> • Reduces barrier to entry such as channels, sales force, physical assets • Internet applications can be copied unless woven into integrated solution • Cost of Internet competitors low relative to traditional brick and mortar <p>(+)</p> <ul style="list-style-type: none"> • Integrating solutions within value chains may create unique value not easily matched by competitors • Can reach a wider geographic scope
<p><u>Bargaining Power of Suppliers</u></p> <p>(-)</p> <ul style="list-style-type: none"> • Suppliers gain power when proliferation of adhesives companies exists due to Internet • May give suppliers access to your customers information particularly in ERP-ERP integration <p>(+)</p> <ul style="list-style-type: none"> • Reduces leverage of suppliers due to loss of differentiation • Buy products that meet customized specifications 	<p><u>Rivalry Among Existing Firms</u></p> <p>(-)</p> <ul style="list-style-type: none"> • Reduces differences among competitors • Public exchanges migrate competition to price • Lowers variable costs relative to fixed costs, increasing pressures for price discounting • Geographic scope widens to competition • New entrants destroying value by offering free services in favor of click through revenues, etc. <p>(+)</p> <ul style="list-style-type: none"> • Provides ability to bundle offerings with co-suppliers to co-produce value • Enhance responsiveness and customer relations management • Direct connect with major customers and suppliers to drive out transactional inefficiencies
<p><u>Threat of Substitutes</u></p> <p>(-)</p> <ul style="list-style-type: none"> • Rapid changes in the Internet creates a proliferation of substitutes at a relatively low cost • Substitutes may spawn from non-traditional competitors <p>(+)</p> <ul style="list-style-type: none"> • Expands the size of the market • Provides new marketing channels, particularly within specification selling • Access to information from downstream customers beyond your direct customer 	<p><u>Bargaining Power of Buyers</u></p> <p>(-)</p> <ul style="list-style-type: none"> • Reduces switching costs • Sell side public exchanges shifts leverage to customers <p>(+)</p> <ul style="list-style-type: none"> • Provides efficient specification information to buy side purchasing decisions • Manufacture to plan rather than to inventory • More efficient management of working capital

So you see, gaining a competitive advantage using the Internet does not require a radically new approach to business, rather it requires incorporating new thinking and building the proven principles of effective strategy. Now that we know how the Internet can help us strategically, let's incorporate it into our business plan.

The Internet in the Business Plan

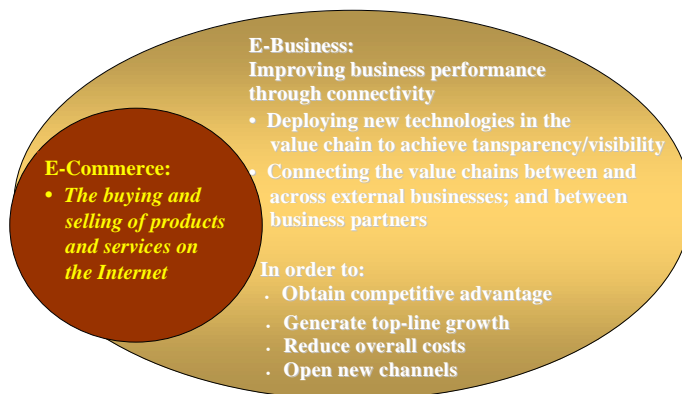
Electronic Commerce is becoming an important and critical element of the business plan. However, the chemical industry, and especially the specialty chemical industry has struggled to successfully develop and integrate E-Commerce into their overall business plans. E-Commerce is not, and must not be, an isolated venture, but rather must be approached as an integral component of the overall business plan. Only then can E-Commerce fulfill the potential to accelerate growth and provide significant savings in operational and transactional costs. Data shows that chemical



organizations are significantly less likely than their counterparts in other industries to have an effective E-Business strategy. Difficulty in aligning the organization on a course of action is a primary barrier to conducting e-business. In some cases a lack of interest among their companies or management is another reason for their lack of an e-business strategy.

Clearly, the chemical industry, and especially, the specialty chemicals portion of the industry, is behind in implementing successful strategies in E-Commerce. The specialty chemicals industry, which would include most of the adhesives industry as well as their suppliers, has unique needs that might not be best served by the models designed for commodity chemical producers.

E-Commerce vs. E-Business



Electronic Commerce is perhaps best defined as “business conducted via the Internet”. There are more complex definitions, but that simple statement includes pretty much all permutations of what has developed over the past few years. The successful implementation of E-Commerce can be thought of as *E-BUSINESS*, because that term better encompasses the many business elements that can be included in a successful implementation strategy.

In the most basic implementation, E-Commerce will consist of little more than a “home page” and some basic information



about the company, products, history, and so on, but today such an implementation would be considered elementary. Today, effective implementations include the ability to conduct many complex business transactions entirely within the Internet environment, including:

- Procurement of raw materials and services
- Exchange of information with suppliers, customers and others
- The ability to conduct actual sales and purchase transactions, either publicly or privately entirely within the electronic conduit
- Partial or complete integration with ERP (Enterprise Resource Planning) implementations

Further, these types of interactions can be conducted on a one to one basis, a one to many basis, or even in various forms of auctions or reverse auctions. Options exist for these transactions to exist in a public or private manner. Private exchanges can be created for business to be conducted between two or more parties on a very controlled basis.

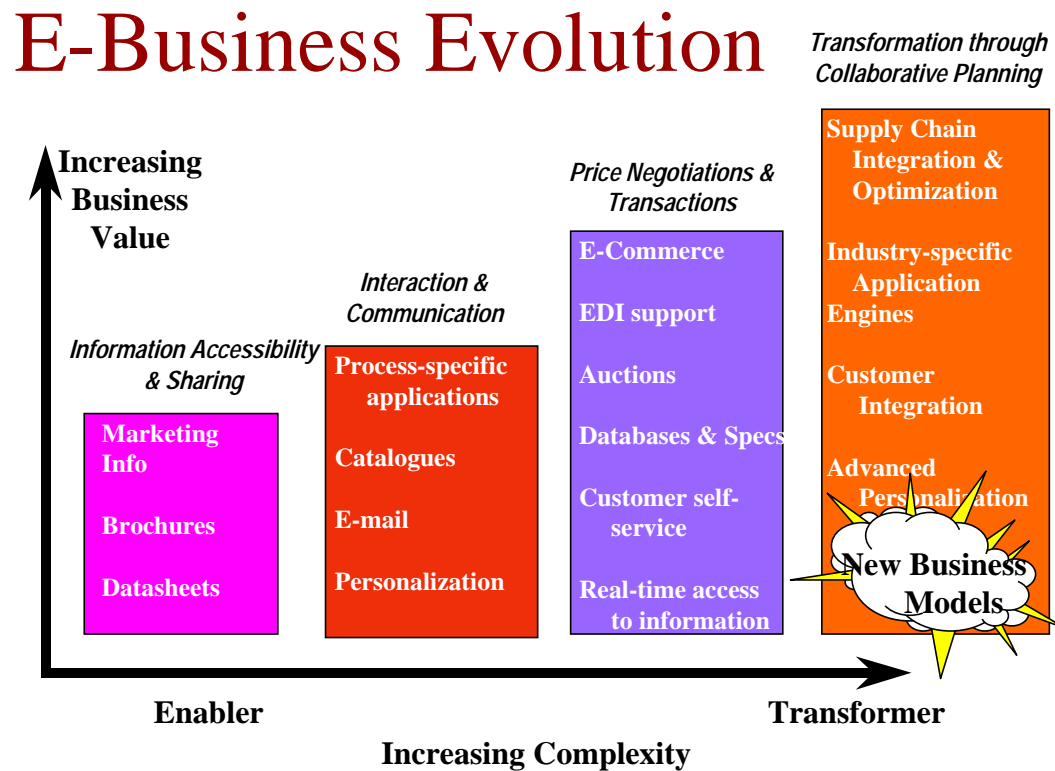
E-Business has clearly been demonstrated to offer some significant competitive advantages to those businesses that have developed and implemented a sound strategy to approach this new mode of business conduct.

- **Transactional Savings.**
Significant transactional savings have resulted from a successful E-Business implementation. In some cases, total transactional costs have dropped to \$25 per order from \$125 per order in a “sell side” implementation.
- **“Store Front” Visibility**
The visibility of a world class implementation can be very effective in prospecting for new customers on a global basis. The effectiveness of the sales force or other marketing resources can be greatly improved.
- **Supply Chain Efficiencies**



These can be very significant, particularly when implemented with a full integration with a business's ERP system to streamline purchasing, improve just in time deliveries, strip out other inefficiencies in logistic functions, freeing staff for more important tasks.

- Value Chain Efficiencies
Combining efficiencies from selling and sourcing transactions, logistic details, and improving sales efficiencies will almost always alter the value chain and capture more value for the business with a truly strategic and successful E-Business implementation.



Case Study #1:

An adhesives company has inventory of a pressure sensitive adhesive for which their only customer has discontinued use.

The Problem: They have no other customer for this product and the material is now sitting as dead stock. It has been determined that it cannot be reworked into other product and needs to be disposed of at a significant cost.

The Solution: An Application Service Provider (ASP) offers the capability of selling this material over the internet. There is no software cost for the adhesives company. The dead stock PSA can be sold on a private or public exchange that includes the capability for potential buyers to view a detailed description of the product and actual lot specific data from a certificate of analysis. The product could actually find a new market in a region not currently served by the adhesives company. They control the selling price and terms of sale.

Case Study #2:

The strategy of a regional supplier of casein in Europe includes obtaining market share in the huge potential market for their product in China.

The Problem: The supplier does not have the resources or manpower to actively sell and distribute into the Chinese adhesives market and cannot move quickly enough to gain the significant market share that their strategy calls for.

The Solution: Set up an agreement with a distributor on the Chinese mainland that allows the distributor to include casein in their bundled product offering. Set up a private exchange for the products and market over the internet. The exchange requires only someone to enter product lot data and no sales force thus reducing transactional costs. Product is moved in containers to China and broken down by the distributor.

However, E-Business is not without potential downside risks. The business press is filled with stories of “dot-com” failures in both the business to business and business to consumer arenas. Many of these are the results of lack of cash flow, out of control expenditures, and in some cases, a fundamentally flawed business model. This latter issue is of particular importance because it suggests many casualties may have entered the E-Business arena without having first developed a sound strategy to integrate E-Commerce activities with the overall business strategy – a critical flaw. History and common sense have clearly demonstrated the importance of such strategic planning in developing a sound E-business



strategy. The challenge is to expand markets profitably and lead in the markets where differentiation is possible:

- ◆ Be first-to-market with E-Business tools in key businesses
- ◆ Tighten links with key customers
- ◆ Build alliances with new third parties
- ◆ Evaluate or create new channels for targeted market, product or customer segments
- ◆ Reduce costs and simultaneously improve service to customers and suppliers

These attributes as an integral part of your business strategy will create economic value through sustainable profitability and a sustainable competitive advantage and thus be your true measures of success.



About the Author



Michael L. Gregus

Director,
The ChemQuest Group, Inc.
an international strategic management
consulting firm specializing in the
Adhesives, Sealants and Coatings
industries, with headquarters in
Cincinnati, Ohio.

Mike joined The ChemQuest Group in June 2000 with 18 years experience in the chemical industry. Twelve of those years have been dedicated to resins and polymers for the Coatings and Adhesives Industries. Prior to joining ChemQuest, he served as Industrial Coatings Market Development Manager for McWhorter Technologies where he focused on market strategy development and formation of customer and supplier partnerships for the purpose of maximizing value. Prior to McWhorter he spent two years in sales with Ciba Specialty Chemicals, seven years in sales and marketing roles at Unocal Polymers and two years in sales with Sherwin-Williams Chemical Division. Mike holds a Bachelor of Chemical Engineering degree from the University of Dayton. Contact Mike at (815) 356-8907 or mgregus@chemquest.com

Questions or request for additional copies of this paper may be directed to the author at:

The ChemQuest Group, Inc.
8150 Corporate Park Drive
Suite 250
Cincinnati, OH 45242

(513) 469-7555
(513) 469-7779 – FAX

www.chemquest.com

