

<http://www.meatingplace.com/meatingplace/DailyNews/News.asp?ID=8581>

Change is inevitable. Growth is optional.

Inventor Charles Kettering (1876-1958) noted that Man's imagination is the only limit to what he can have in the future. What Mr. Kettering failed to mention is that in the absence of good things to imagine, most men imagine bad things: People fear what they don't understand and avoid what they fear. And that, in a nutshell, is the story of Internet technology adoption in the food industry. So far.

In 2000 the value of all worldwide business-to-business (B2B) Internet commerce transactions surpassed \$433 billion, a 189% increase over 1999 transactions, according to AMR Research. AMR projects total worldwide B2B Internet commerce to reach \$919 billion in 2001 and \$1.9 trillion in 2002. Yet B2B Internet adoption has been slow in the food space. Why?

Though complicated in practice, the basic theory of an online marketplace makes sense for the meat industry. Just ask ProvisionX, one of the food industry's most promising sellside Consortia of Brick and Mortar (CoBAM) initiatives.

Early on, the USA's largest meat packers realized that someone was going to be successful with an online meat exchange, and that someone might as well be the people who control the market's liquidity (them). That ProvisionX was in some ways a reaction to dot-coms doesn't make e-commerce a bad idea. On the contrary, there's much about our industry that the Internet can and will improve. However, *improvement* can be a subjective term – especially for the small- to mid-sized meat purveyor, the people for whom this article is written.

All software sales people spend their lives trying to paint for the client a picture of the future. For the meat industry, imagine an industry wide increase in returns on invested capital (ROIC) wrought by the following:

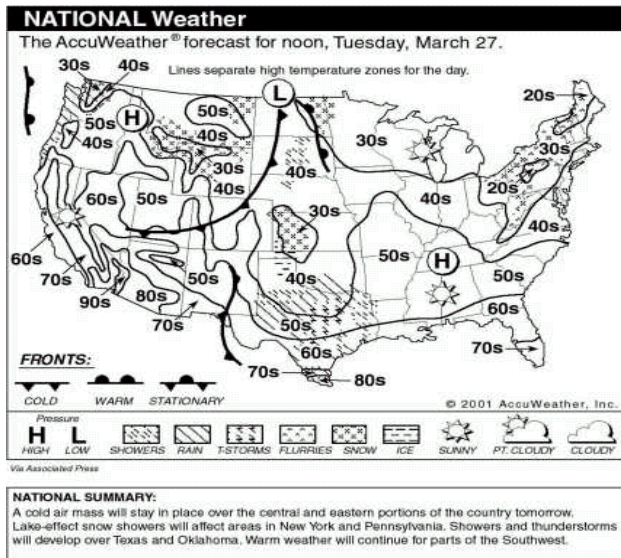
- Wireless buying & selling in a safe, secure, neutral, liquid, worldwide food market
- Meat packers profitably producing to demand rather than supply conditions
- Packers developing an interactive “dialogue” with every customer in the marketplace, building a learning relationship with each one across every customer touch point – purchasing, traffic, accounting, sales, and so on.
- Product cut on spec being positioned and stored where it's most needed
- Distributors being able to optimize backhauls from any cold storage by being able to see and buy any quantity of any type of inventory available for sale at that location.
- Global food industry competition becoming pie-enlarging instead of pie-rearranging

Sound crazy? Maybe, but keep in mind that computing power is 8000 times less expensive now than it was thirty years ago. If this were automotive technology, today you could buy a Lexus for about two dollars and it would travel 600 miles at the speed of sound on a thimble of gas.

Thirty years ago you couldn't confirm a Saturday tee-time on a Tuesday without making contingency plans for rain. In fact, at one time people thought the weather was random. Today's satellite technology allows us to plan for the weather. In reality, randomness is a matter of perspective. True,

weather satellites won't keep you from getting wet, but you'll be better prepared should you decide to play.

How does this apply to the global protein markets? Quantum physics provides that the basic law of the universe is economy. Randomness is in the eye of the beholder. Peace exists in the absence of anything that prevents it. All events strike a balance, and everything is knowable.



Like a weather satellite, a liquid global food exchange could provide its members with an eye-in-the-sky perspective on the market, *if it wanted to*. For example, imagine a real-time market map depicting bone-in pork butts selling in the 70s in south Florida and in the 20s in northern Maine.

The implications of such a perspective on production planning, capital budgeting, procurement, and industry-wide inventory levels are awesome. With modern software, that kind of market intelligence is possible – given the proper conditions.

The first question is **“Who will define those conditions?”** The second question is **“What will the playing field look like for small- to mid-sized meat purveyors after those conditions have been defined?”** Both questions are critically important to the future of the meat industry and will be examined closely in future articles.

Heads I win. Tails you lose.

Many fortunes have been made in the food business due to the existence of asymmetric information – a seller knowing more about something than the buyer, or vice versa. Admit it: Sometimes asking a meat packer which way the market is headed is like asking a barber if you need a haircut. They have a vested interest in your perception. Shades of gray are a fact of life in any business, and the meat business is no exception.

Citicorp's legendary CEO Walter Wriston used to say that information about money is more valuable than money. Likewise, the control of product usage information is not a minor issue to a meat packer. In fact, the bigger the packer, the more critical this issue is of who is using what, when, where, how, and why.

Everyone knows that manufacturing profitability is based on maximizing economies of scale. Selling a million widgets is more profitable than selling a thousand. The concept of mass production dates back to the industrial revolution. Mass production bred mass markets, which in turn bred mass advertising campaigns like “Winston tastes good.” Mass production also bred the Henry Ford school of customer responsiveness: “The customer can have any color car as long as it's black.”

Traces of Ford's philosophy can still be seen in the meat industry today. Unfortunately, buying meat from some packers is no different than using a Coke machine. You can have anything you want as long as you have enough quarters. Just don't ask for ice.

The Internet is changing that. For the first time, consumers can talk back to a manufacturer, and – more importantly – they can talk amongst themselves. Consider David Felton, a Duncan Donuts customer who became upset when his local shop refused to put skim milk in his coffee. Felton registered the Internet domain “www.duncandonuts.org” and turned it into a public comment board. When the negative comments poured in from franchisees, employees and customers, Duncan Donuts sued Felton. Rather than face the legal bills, Felton sold the site to Duncan Donuts for an undisclosed sum – but not before someone else had registered the Internet domain www.duncandonutssucks.com. Like it or not, markets are conversations.

How might the Internet improve meat procurement?

Check out Amazon.com, a fine example of how the Internet can empower buyers. Amazon's site allows buyers to review the books they've read and then rate them on a scale of one- to five-stars. Since Amazon buyers typically have more money than time, objective **product feedback ratings** reduce the risk that a buyer will waste valuable time reading a bad book. The rating feature also allows Amazon's site to build a “**learning relationship**” with each buyer as they click through the site. For example, if I click on the biography of Babe Ruth, the site will surmise that I like books about biographies and baseball and make relevant suggestions. As I use the system, it gets “smarter” about me. All I have to do is browse.

It's worth noting that last year Amazon charged me more for certain titles than it did my friends. When Amazon's system noticed that I had purchased 22 copies of Digital Capital for clients, it raised my price. I was oblivious to this until well after the fact. Now Amazon's system sends me weekly e-mails to offer “specials” on the latest books on business strategy and e-commerce – two subjects it knows I read about often. Many times I buy them.

Contrary to popular belief, the Internet does not always facilitate price erosion. In fact, last year researchers at MIT's Media Lab found that price *dispersion* – the spread between the highest and lowest prices on the same item – is greater on the Internet than it is in the shopping mall. MIT verified out what Amazon already knew: Once buyers teach a seller about their preferences, they are not inclined to switch vendors on the basis of price. Accordingly, Amazon changed its tagline from “The World's Largest Bookstore” to “Earth's Biggest Selection” ... of games, software, music, cars, cameras, toys, tools, consumer electronics, kitchenware, and patio furniture. Customer wallet-share and market-share are now of equal importance.

In addition to simplifying the purchasing process with **one-click ordering**, Amazon allows buyers to maintain a **wish list** of their most wanted items for their friends to see. (No more holiday returns!) And now Amazon's buyers can purchase **pre-owned** books on the same web page as a brand new copy. If Babe Ruth's biography is \$24.95 new and \$8.95 pre-owned, I can buy the pre-owned copy through Amazon and the seller will ship the book to me via regular US mail. Amazon handles the settlement and collects a listing fee from the seller. The risk I take is that the pre-owned book is not

in the same condition described by the seller. Thanks to the seller feedback ratings, they always are. Violations of the Amazon by-laws result in sellers being expelled permanently.

Amazon's successfully undercutting its primary suppliers with used books says a lot about who owns the customer. With enough reliable customer information, it's not hard to imagine how Amazon might grow its business. What if Amazon polled 200,000 of its most die-hard Tom Clancy fans to offer an Amazon-only collector's edition Tom Clancy novel for \$27.95 paid in advance? Variable cost in the book business is about \$4.00 per copy, and shipping is usually \$3.95. In this case, there's no marketing or promotion budget, and there will be no inventory overruns or storage costs. All books would be direct shipped from the plant. Assuming a 50% response rate from these die-hard fans, Amazon and Tom Clancy could split two million dollars in gross profit by cutting out the publisher. And that's just on one title! Amazon has several million books in "inventory".

Amazon continues to seek partnerships with brick-and-mortar retailers modeled after a deal it did with Toys 'R' Us last year. In that alliance, Amazon agreed to run the Web site, fulfillment, and customer service operations for Toys 'R' Us in exchange for fees. As part of the deal Amazon handed over to Toys 'R' Us the operations it had struggled with, such as buying, merchandising, and inventory management. During the past few months, Amazon has held talks with a number of retailers, including Wal-Mart.

Clearly, you're only limited in your use of the Internet by the size of your imagination. Those with the wildest imaginations will be the winners.

Art meats Science

Today meat procurement is more art than science, but you can imagine how a meat procurement portal such as ProvisionX (or one governed by NAMP, Urner-Barry, or Topco, for example) might feature Amazon's functionality. Based on first-hand experience, buyers could rate meat quality, consistency, yields, etc. Similar cuts with different yields would fetch different prices. Community feedback would reduce the risk of a buyer making a poor purchasing decision for a least-cost formula sausage recipe.

The Internet communities leverage the fact that none of us is as smart as all of us. Imagine having instant access to the entire knowledge base of NAMP, AAMP, or AMI. There is online community development software that would facilitate the capture and use of such an enormous body of knowledge, which the famed Swiss psychologist Carl Jung termed "collective intelligence".

Trust is the most precious commodity in cyberspace. The more candid the product feedback mechanisms, the "stickier" the procurement portal would be. If buyers routinely slammed a certain plant for poor quality, prices from that plant would drop (to reflect the risk of product ownership) until the plant improved its quality.

If the site built a **learning relationship** with the buyer based on click stream data, it might suggest substitutes for product that's in short supply. Suppose the buyer uses a fat-cattle no-roll flank steak and the market gets tight. The site might suggest a fat-cattle no-roll tri-tip or a utility grade flank steak based on whatever attributes that the buyer dictates are most important to him.



The site might offer dynamic discounts as the buyer increases his purchases of a particular type of item or basket of items. This would allow packers to cross-sell each other's products on the basis of marketing alliances, and it would improve any customer loyalty programs packers already have. Think of it like a frequent-flyer program for your center-of-the-plate purchases.

Since re-distributors ensure that nationally branded products are non-differentiating for the wholesale distributor, frequency-marketing programs hold great promise for the improvement of packer margins.

Instead of a **wish list**, the buyer could place a quotation request on the open market. For a fee, the buyer might be able to mask his identity while the site's rating system identifies him to sellers as credit-worthy. If the buyer decides to buy "**pre-owned**" product from a trader, the trader could ship the product to the buyer via common carrier. Pre-owned product could be anything offered on the secondary market today – overruns, aged product, out of spec product, or anything bought on speculation.

Whatever the circumstances of the sale, the exchange might handle the insurance, settlement, and claims arbitration while earning subscription revenues from buyers and sellers and transaction fees from sellers. The exchange might also require participants to post a performance bond to ensure ethical trading practices.

This scenario describes a win for everyone. But what if the interests of the buy-side are often diametrically opposed to those who control the platform? What if the ones who control the platform were star students at the Henry Ford school of customer relations?

To appreciate packer psychology, it's necessary to understand that the meat industry is radically different from other industries. In most manufacturing environments, raw materials go in through the factory's back door and are assembled into a finished product. Product costing is easy to determine, and if demand slows at the bottom of the supply-chain, the manufacturer simply stops ordering raw materials.

Even under "normal" circumstances, production planning up and down the value chain is one of the most difficult tasks companies face. What types and how much product must be produced? How much capacity exists and where? What materials are needed, where do we get them, and where do they need to go? How do we optimize all of these resource and capacity constraints? These are the basic questions that manufacturers must address to create accurate forecasts to meet customer demand and make a profit.

With a slaughterhouse, an animal walks through the back door and is knocked down into dozens of parts – all dynamically cut and priced to stimulate their timely consumption. Aside from being an extremely dangerous way to make a living, the cost accounting can be a nightmare. A packer with an Applebee's pork backrib contract can't simply stop boning loins if the demand for all other pork cuts craters. He must find buyers for the other cuts at whatever price the market will bear. Until hogs are genetically bred to yield more than two backribs, such limitations will remain at the root of many of the meat industry's inefficiencies.

CoBAM Business Models

Given the difficulties of their everyday business, it will be a challenge for any food industry CoBAM to manage a software venture. Software ventures can be expensive to start (\$30-40 million) and operate (\$15-20 million per year). Relative to the food business, the software venture learning curve is especially steep in sales, marketing, product development, and implementation.

Complicating matters is the fact that some packers belong to more than one initiative. For example, Tyson and Cargill belong to ProvisionX, which interfaces with retailers. They also belong to EFS, which is foodservice oriented. Reconciling strategies, investments, technology functionality, and political agendas across multiple online initiatives will not be easy.

That said, there are two types of business models from which any CoBAM can choose: The NewCo and the Co-op. Business model selection is the most difficult decision a CoBAM will make. Each has profoundly different implications for the CoBAM as well as the small- to mid-sized meat purveyor.

NewCo: This entity behaves like a classic startup, creating value for founders and investors through profits and capital appreciation. Like any startup, it must offer a broad set of revenue-generating services that go well beyond the founders' normal operations. Moreover, it needs to attract customers supplemental to the founding members to generate a profit for its owners.

The size of the US meat and poultry market is estimated at \$70 billion, and many thousands of USDA establishment numbers are listed for in the USDA Meat and Poultry Inspection Directory. Averaging half a percent per transaction, an online exchange that captures just 15-20% of the primary meat and poultry market could easily ramp up to \$40-50 million in annual subscription fees. The addition of secondary market and non-meat and poultry product offerings could eventually double or triple figure. Not bad.

Yet everyone knows that food can't be traded safely like stock, especially in the secondary market. The devil is in the details. If you don't specify to the seller exactly what you want, you'll end up with what he wants you to have. Traditionally, personal relationships have reduced this risk while adding friction to the market.

$$\text{Value} = \frac{\begin{array}{l} \text{Consumer acceptance} \\ \text{Quality \& Consistency} \\ \text{Supplier Dependability} \\ \text{Reliability of Transport \& Logistics} \\ \text{Terms of Trade} \\ \text{Purchasing Efficiency} \\ \text{Competitive Advantage} \\ \text{Advertising \& Promotional Support} \\ \text{In-store Merchandising Support} \\ \text{Strategic Alliances / Partnerships} \\ \text{Continuity \& Tradition of Relationships} \end{array}}{\text{Price}}$$

Online exchanges have so far been unable to lessen the risk-reducing role of personal relationships in an industry where “price is what you pay and value is what you get”. Dr. John Allen of Michigan State University has defined the Wholesaler / Retailer Meat Value Relationship at left. Any online meat exchange must provide greater total value than the industry’s status quo.

Invitation-only exchanges and “private trading rooms” with individualized graphics are two solutions to this problem, though they will have less liquidity due to the small number of approved participants. Their primary role is to allow for the supply-chain coordination of a small constellation of regular, interdependent trading partners.

While some companies prefer to deal with specialized niche exchanges, the huge returns will come when someone figures out how to web-enable the best elements of both the primary and secondary open markets across all channels and product categories. Imagine an Amazon (or eBay) for food, with cold storages, banks, insurers, and logistics companies being added to the investor mix to round out fulfillment.

Co-op: This model is essentially a service company that provides shared infrastructure to improve the efficiency of the supply-chain while cutting procurement and transaction costs for the member firms. The co-op creates value for its founders by improving their bottom line through cost-savings on the back end of the business.

Despite the possibility of reducing commodity meat prices ($\pm 1\%$), a CoBAM meat exchange might attain cost recovery gains through disintermediation ($\pm 1\%$), reduced spoilage ($\pm 2\%$), claims reductions ($\pm 1-2\%$), inventory reductions ($\pm 1\%$), and decreased customer stock outs. These gains would supplement any user subscription fees.

The most significant benefit of e-commerce is the effectiveness with which information can be shared. Many companies’ purchases are done through contractual or relational arrangements. Similar to electronic data interchange (EDI), supply-chain software has been developed to manage the daily work dataflows between these entities, creating collaborative webs in the process. Collaborative and value-creating activities include:

- Sales forecasting
- Logistics management
- Purchase profiles
- Contract management
- Planning & scheduling
- Electronic payment
- Complex pricing
- Community functions
- Scrap management
- Factoring services
- Vendor benchmarking
- Channel management

Formerly, EDI was available only to those whose volume could justify the expense. Today the Internet allows meat purveyors to streamline the procurement process by eliminating the countless phone calls, faxes and e-mails associated with today's meat buying process. This appears to be the road down which ProvisionX is headed.

But here's the catch: Small- to mid-sized meat purveyors who don't have their own solution will be encouraged to use the solution of their counterparty. For example, if you want to web-enable your business with GoldKist, Tyson, IBP, National, Farmland or Excel, they will ask you to consider ProvisionX. If you sell to Safeway, you'll need to consider Agribuys. In fact, by now most major food companies have a vested interest in which system you use to deal with them.

Initially, you may be limited as to the variety of products you can buy on a CoBAM's system. But once outside sellers begin to transact with you on a CoBAM's system, that system will begin to capture data such as product usage and pricing information. In fact, every time you use any system you teach it something about your business.

Depending on the CoBAM's charter, extended use of their system could give them indirect influence over your own in-house technology initiatives while creating product switching barriers. It's hard work to teach any system about your business, and the more you use a system, the easier it is for you to continue to use it.

Antitrust and privacy debates aside, at a minimum you may need to learn to use multiple systems if you deal with more than one CoBAM. These systems can't pay for themselves if nobody uses them.

Choosing a solution

Different solutions do different things. Some are designed to improve the **front-end** of your business, which is everything that happens before a purchase order is created: Sales, marketing, catalog and contract management, vendor selection and certification, product selection, and negotiation.

Many of today's best solutions are designed to streamline the **back-end** of your business, increasing your operating efficiencies after a purchase order is created: order consolidation and load optimization, shipping, receiving, inventory tracking, capacity management, invoice reconciliation, settlement, data mining, and so on.

In addition to CoBAM offerings, there are software solutions that will web-enable almost any part of your business. Most software companies develop functionality that far surpasses the market's ability to meaningfully use. Some of these software providers specialize in back-end solutions. Some specialize in front-end solutions. Which one's right for you? Read on.

Back-end solutions

Many software application service providers ("ASPs") offer complete supply-chain solutions that web-enable the procurement process from PO to payment. Exactly what this means depends upon

your needs. The Amphire, Maverick/EFS, and Tibersoft solutions are oriented primarily towards foodservice. The Agribuys solution is targeted at retail. ProvisionX serves customers across multiple channels.

Expect the lines between retail and foodservice software functionality to blur as cross-channel acquisitions occur (such as Ahold and US Foodservice) and the demand for home meal assembly takes off.

For now, let's take a look at back-end solutions for these two channels.

Foodservice:

By 2010, foodservice will finally surpass retail in its share of the consumer food dollar. Such growth is expected to net \$76 billion in new foodservice spending. Yet despite the opportunities for growth, this channel remains inefficient. Efficient Foodservice Response (EFR) highlights the realities of the foodservice supply chain as follows:

- Mistrust & lack of cooperation between supply-chain trading partners.
- Pervasive lack of focus on providing value to the consumer.
- Archaic business practices that complicate trade between buyers & sellers.
- Poor penetration of modern supply chain practices & information technologies that can enable leaps in efficiency & effectiveness.

Frequently these characteristics result in manufacturer-to-distributor problems that include wrong items shipped, incorrect invoices, missed deliveries, quality claims, and miscommunications on promotions. In turn, these problems often manifest themselves down stream in poor service to the restaurant operator. To treat these symptoms, foodservice distributor e-commerce initiatives will pursue objectives that will help maximize efficiencies and improve margins, such as:

- Establishment of product standards
- Automation of the revenue cycle
- Catalog creation & maintenance
- Transaction processing & integration
- Links to value-added services
- Targeted interactive promotions
- Virtual Warehousing
- Activity based costing

If your company sells primarily to foodservice distributors, then it makes sense to use an ASP that speaks to distributors' needs. Changes in shifting consumer demographics, values and attitudes, the proliferation of technology, and industry consolidation will play an important part in transforming the foodservice environment in the coming years. By 2010, seventy percent of all foodservice operators will use online procurement.

Expect distributors to get serious about web-enabling their supply-chain as they gain a more fact-based understanding of each stakeholder's contribution to overall profitability. Standard product codes will become a pre-condition for all suppliers. Be prepared.

Retail:

Against a backdrop of rampant consolidation, private-label growth, and declining consumer shopping trips, the retailer's primary financial profitability metric remains Return on Net Assets (RONA).

Food supplier's interface with RONA in four areas:

1. Gross margin
2. Operating expenses
3. Inventory, and
4. Square footage productivity

Assuming its business is retail-driven, the small- to mid-sized meat purveyor's e-commerce strategy must seek to impact the retailer's business in these four areas. Specifically, retailers hope that meat and poultry suppliers will use the Internet to:

- Improve inventory management through supply-chain optimization, SKU rationalization, and smaller drop sizes that increase inventory turns on your product.
- Improve the economics of their private label programs
- Improve pricing "clarity" on product / service bundles. Know how your pricing supports your positioning within each retail environment and use the Internet to unbundle services that don't support your product's value in the eyes of the retailer.
- Establish interactive initiatives to educate consumers about your brand or category as the Internet becomes more important to retailers' in-store marketing strategies.

Wal-Mart's stated goal is 100% vendor financed inventory, which will increase the working capital requirements of all of Wal-Mart's suppliers. Debt-heavy food retailers such as Ahold may follow Wal-Mart's scan-and-pay strategy. In turn, banks are more likely to increase the credit lines of meat purveyors who use the Internet to drive cost reductions and optimize assets. This means that you must thoroughly examine how the Internet can improve inbound and outbound logistics, operations, sales and marketing, and after-sales service *in the eyes of your largest customers*.

These twenty questions should be asked of any prospective solution provider:

1. **Can you get me up and running in 30-60 days?** The more complex the systems, the longer it takes to get it operational. It is critical that you have a solution that creates value quickly. Sellers must ask "How fast can you import my product catalogs?" If a solution provider can't get the system doing something useful in 60 days – steer clear.
2. **Do you have to write a lot of code?** The big surprise for many Dot-coms was the amount of coding and integration required. Be wary of the solution that requires "a small amount of code" to be written. This adds time and costs to implementation.
3. **How much hardware do I have to buy to get this solution running?** Hardware is an expensive component of a solution. You must have fail-over and backup redundancy. Hardware costs frequently soar to 2 to 4 times the original budget. That's is good to consider a hosted solution – so you can concentrate on your business and not on running yet another room full of computers.
4. **Can I enforce standardization?** Standardization is a critical component in reducing your costs. This is especially true with IT Spend. Millions are wasted every year troubleshooting incompatible IT products.
5. **Do you support EDI and XML transaction types?** Much of business today uses EDI, and over the next few years will transition to XML. If your vendor doesn't support both of these today – walk away. Be wary if your vendor talks about proprietary technologies.

6. **What "Spend" categories do you support and recommend?** The answer to this question will tell you where you are going to get the biggest return. IT Spend is a great place to start because it cuts to the heart of what typically is the biggest expense item on a per employee basis. B2B projects got in trouble because the Spend area for which they provided a solution didn't matter enough to recover costs!
7. **What happens when it breaks?** Your system will fail. Know what it takes to bring everything back up in terms of time, money, and effort. Some vendors offer a "quick return to service" but corrupt data or cause a painful data reconstruction process.
8. **Is my data secure?** In the world of "Supply Chain vs. Supply Chain" it is critical that you have all the security features required to keep the bad guys out.
9. **When it is time to upgrade the solution, do I lose all of my customizing?** Your solution provider is going to come up with an improved version of its offering. Some upgrades wipe out all (or some) of your customization. This could mean thousands of hours down the drain. Have your solution provider explain to you exactly what steps are necessary to upgrade and how much customization you will lose.
10. **Will the solution scale to meet your estimated needs for a period of 3 to 5 years?** Many solutions last 12-18 months before business conditions require purchasing a new solution. You can avoid this by making sure your candidate solution can meet your estimated transaction volume for 3 to 5 years. Have the vendor submit a 3-to-5 year cost-of-ownership analysis for your particular situation and estimated growth.
11. **How easily can the system be integrated into your ERP or legacy system?** It doesn't do much good to deploy a system quickly only to find out it is painful to pull that data into your own ERP or legacy system. Ask how long it takes, how much it costs, and how fresh the data will be in the ERP system. Also ask how your vendor would support ERP upgrades.
12. **Does the system reduce maverick spend?** One of the big advantages of these systems is reducing maverick spend, money spent by an employee who goes out and buys a laptop or software on his credit card. Your system may be complete, but if it doesn't get a Maverick what he wants quickly you will struggle with the problem.
13. **When it crashes, how quickly can I recover and what steps do I take?** All systems crash. Ask "How soon can I recover?" Some vendors took shortcuts to get to market, and that is reflected in their product stability. Is it practical to expect that your staff will have the skills and availability to get the system back up?
14. **Can the system improve our contract compliance?** Companies with multiple procurement offices often endure bill-back charges because they did not meet volume levels against a contract. Sadly, they often spend the committed volume but are unable to track vendor commitments. Insist on a system that can do this. Instill is an excellent solution for this problem. Visit them at <http://www.Instill.com>.
15. **Is the system easy to use?** Much of the savings that come from an eProcurement system are the result of employees being able to easily use the system. Your potential gains will be torpedoed if your solution is difficult to use.
16. **Does it present a common user interface across a variety of trading partners?** You have multiple trading partners to support. Insist on this capability to ensure you don't get single-sourced. Test-drive the system in real time with several of your top trading partners. Ask about training support among your trading partners.
17. **Do I have to give up my strategic supplier base to get rapid deployment?** Moving your supplier base with you is essential. Many solution providers will say that it is easy to move your

suppliers. The reality is that it doesn't happen very fast. Make sure rapid deployment doesn't cost you your suppliers.

18. **How fresh is my price and availability data?** The implications for food businesses are huge. Successful eProcurement depends on timely and accurate information.
19. **How stable is your offering?** Many offerings have a nice user interface but are torture to use after installation. Find out who else is using the offering and how many transactions it supports every day.
20. **Is it easy to make process changes as our environment changes?** B2B is about fast-paced change. If you often change your business processes but have an inflexible system, it will eliminate any savings that might have come from your solution. Speak to someone who is six months into the solution you are considering.

Front-end solutions

Generally speaking, the more fragmented your base of trading partners, the more front-end solutions make sense. Foodservice is much more fragmented than retail, with the two top companies (Sysco and US Foodservice) holding less than 20 percent of the restaurant business – the industry's largest segment. Front-end solutions will help you grow your top line organically through:

- Identifying prospects or suppliers in untapped markets
- Using internal supplier or customer data to improve strategic planning
- Increasing profitability among marginal customers (like Amazon did with me)
- Improving stakeholder relationship management across every business touch point
- Understanding advertising effectiveness on the web
- Identifying the lifetime value of a customer
- Targeting customers for effective cross-selling and up-selling

Almost all food-specific ASPs have some front-end functionality, though some are better than others due to the nature of their business models. As a rule, private exchanges select members based on their relationship to the exchange's sponsors. Consortium exchanges may provide some access to new trading partners, though participation is limited to relevant supply-chain participation. Independent exchanges are the most open, though they have been shunned so far by large participants on the grounds that they might erode their competitive position in the marketplace.

When choosing an exchange, remember that the meat business is relationship-intensive because meat products are information-rich. Any e-commerce exchange platform must actually *improve* the relationship building process in order to be viable. Consider the exchanges primary competitor to be the speed dial.

Ultimately, just as the ocean must support thousands of types of marine life, so must a global food exchange be able to balance thousands of types of buyers and sellers. A successful online exchange must allow for community development while embracing the legitimate roles played by brokers, traders, and other market makers. These entities help to keep the marketplace swept of excess inventory, and they bear much of the risk of developing new markets.

Often there's no glamour for meat packers in selling direct. Traders and packers have different mentalities. Just because a packer's sales team wants to "go direct" does not mean that they have the

fulfillment expertise, capital to finance the trade, or risk tolerance to develop new markets. The economics of meatpacking and processing are different than that of trading, and the trader's role must be provided for by the exchange.

Finally, an online exchange's structure and charter must be highly conducive to its own viral, organic growth. It must promote the cross-pollination of information, experiences, ideas, and best practices throughout its membership. It must encourage a high standard of business ethics and practices within the meat industry. And ideally, it would encourage its members to adopt processing, marketing, and distribution practices for the benefit of the consumer and in the interests of total food safety from farm-to-fork.

Determining the Fit

Whether you opt for a front-end solution, a back-end solution, or a combination of both, it's instructive to liken choosing an e-commerce solution to buying a new suit of clothes. The features are a matter of how you'll use it. How it integrates with your business is a matter of fit. The difference between what you need and what the software will actually do is called the "gap". Determining the size of that gap is called "gap analysis", and you'll want to do this in order to make a strategically sound decision.

I have three litmus tests for clients who are facing this decision.

One: Take your customer list and break it up into fifths on a graph in terms of sales, with the highest grossing 20% first, followed by the next highest 20%, and so on. If the top twenty percent of your clients make up seventy percent of your business, then you have a steep customer valuation skew. In this case, a back-end solution makes sense. Getting these clients to use the system will be your next challenge, but the benefits of streamlining their business with you might make it a win/win.

If you have a flat customer valuation skew then chances are there's plenty of room to grow these customer relationships using the Internet's customer relationship management capability. Reliable Growth has a free questionnaire that can be used to determine whether or not your company should seek top line growth through an exchange. Drop me an e-mail at harry@reliablegrowth.com.

Two: Take last year's sales and subtract your direct product costs. What remains is gross profit, or the maximum amount of fixed overhead you can have in your business to breakeven. Multiply this number by one percent, which is the amount that many back-end ASPs claim they can improve your efficiencies. Assuming they can deliver on this claim, this one-percent represents the maximum amount you can pay to "breakeven" on the solution.

For example, some ASPs charge users \$1000 per month, or \$12 thousand per year. \$12 thousand is one percent of \$1.2 million, which is the maximum amount of non-product costs (or *overhead*) you could have in an \$8 million business with 15% gross margins. If your sales are less than \$8 million on 15% gross margins, then maintaining your own ASP solution won't be profitable. Go with something less expensive that allows you to pay incrementally for the benefits – like an exchange.

Efficiency gains may not show up on the bottom line. Often these gains are improvements to a firm's capacity, with employees being the beneficiaries through a lightened workload. Assuming

firms don't immediately increase sales to leverage the capacity increases, firms only realize cash savings when headcount is reduced. For example, assume you install a \$10 thousand software program that allows two \$30 thousand accountants to do their work in half the time. Unless you fire one of the accountants, it now costs you \$10 thousand more to get the same result, even though they are accomplished in half the time. You are still paying for 100% of both accountants' time. The only reason to keep both accountants would be an expected increase in their workload.

Three: Ask yourself "If I had to cut 30-40% of my overhead, where would I make the cuts?" If your answer is related to the back-end of your business, then consider a back-end solution that will allow you to mechanize the vulnerable functions: accounting, finance, inbound or outbound logistics, customer service, etc.

Cisco's Internet Business Solutions Group has developed an excellent online test to assess your organization's ability to migrate to an Internet business model. This FREE tool provides a personal IQ Net Readiness profile that includes:

- An IQ Net Readiness Score.
- A visual representation of your Net Readiness relative to a Best-of-Breed index.
- A Net Ready Plan containing a prescriptive set of recommendations that you can adopt to improve your competitive position.

See <http://www.cisco.com/warp/public/779/ibs/netreadiness/scorecard.html>.

In short, the greater your fixed costs, the less volatile your product costs, and the more concentrated your base of trading partners, the more sense it makes to go with a back-end solution. A concentrated base of trading partners will speed your investment pay back as they come online.

On the other hand, if you choose an exchange to grow your top line, find out how its structure supports offline buyer / seller interaction while promoting its own organic growth. All exchanges rely on liquidity for their success, which means having broad and deep enough markets to leverage the circumstantial nature of spot market trades.

Some solutions will generate both cash flow improvements on the front-end and efficiency gains on the back-end. In this case it is critical for users to understand the true long-term objectives for that platform. What do its owners ultimately hope to accomplish with the system? What are their ulterior motives?

The world's most successful technologies are also the most user-efficient due to their *ubiquity* – which means that their use is widespread. This is what's known as network economics. If I have a cell phone and nobody else does, mine's worthless. But as the number of cell phone owners increases, so does the value of mine. Network economics is the opposite of traditional meat industry economics. As the supply of a technology increases, so does the value of that technology, as other companies build their businesses around supporting a standard platform. Furthermore, the value of the network that relies on it increases dramatically as each additional node is added to it.

Whether or not the CoBAMs realize it, the number of relationships on any network is mathematically defined as $(N \times (N-1)) + 2$. Imagine a global food exchange that facilitates the sale and re-sale of

product across all food categories. Just 1400 people doing business with each other equals *one million* relationships. And once these relationships become established on an exchange, it's very tough for them to migrate to another exchange with significantly better terms. The invisible hand of self-interest keeps them glued to where the action is. Either they all go or none go.

Whether you choose a front-end or a back-end solution, you don't want to support a solution that nobody else uses. In the case of an exchange, you need to consider its **liquidity** and the ease with which you can acquire new trading relationships. In the case of a back-end software solution, you must consider the solution's **ubiquity**. These are very different business missions for a CoBAM, which is why the choice between the NewCo and Co-op models is so critical. Essentially, CoBAM effectiveness is directly related to the extent that the members agree completely on this one issue.

Ask yourself if the solution you are considering has the staff to train everyone who wants to use it. In the case of ProvisionX it's easy to imagine every Tyson, Farmland, National, IBP, Excel, and GoldKist sales rep driving their customers onto the system. More imposing is the WorldWide Retail Exchange (WWRE), an international consortium of 53 leading retailers with combined sales of \$722 billion. How much pull will the WWRE have on its vast network of food suppliers? A bunch. And there are many other buyside CoBAMs vying for the support of the independent meat purveyor.

What then? Ask yourself how you will fare when the CoBAM you support determines the rules of electronic engagement? What will they do with the business information you ultimately pour into their system? To what extent will they attempt to control the offers that you see on the system or prevent you from selling to others on the network at whatever price makes sense for you? Do you trust them with the family jewels?

How they have treated you in the past may be an indication of what you can expect when they have even more leverage over your business.

Light cannot enter a closed box.

The Internet represents a classic "Blind Men and the Elephant" dilemma for all food businesses: It's a sales channel, a way to communicate, a tool for creating value-added services, and an information system – depending on your perspective. Successful food companies must think holistically about their entire business system, internally and externally, to best deploy an e-commerce solution.

For a list of this article's source material, please e-mail harry@reliablegrowth.com.

About the author:

Harry Joiner is the founder of Reliable Growth, a marketing consultancy dedicated to helping food businesses identify and cultivate new high-growth markets.

Harry has more than a decade of proven leadership in domestic and international business development, supply chain management, and e-commerce. Harry was Director of Trading

Operations for Global Food Exchange, where he built the B2B Internet trading department that helped the firm attract \$30 million in venture capital funding. In 2000, Harry's team led the food industry in both number of transactions and in pounds transacted, with more than 100 companies trading and an exchange membership of 2500 industry executives.

Previously Harry served as Director of National Sales for AJC-USA, where he created the firm's successful food import and redistribution business. For several years prior, Harry traded US and European red meat throughout Asia for AJC International. He has also held posts with AT&T Brazil and BellSouth International.

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**An excerpt of this article appeared in the August 2001 edition of
Meat Marketing & Technology.**