The boom in business-to-business exchanges

Almost every day there is some announcement about the establishment of a new business-to-business exchange. What is driving this trend?

First, consider what the ideal manufacturing industry would have. Goods would arrive exactly as needed, in the right lot sizes, and on time. No money would be tied up in inventory. Vendors would be paid as goods were consumed.

Further down the chain, items would always be in stock — no sales would be missed. Every item, in its preferred color and size, would be available to every customer at all times.

Of course, this is not our world. Companies today constantly seek ways to lower the cost and complexity of doing business, a task made all the more difficult by the simultaneous challenge to identify and develop new markets for goods and services. As the world becomes used to "Internet time," all industrial companies must increase the speed and certainty of their product delivery.

Despite the recent spike in oil prices, deflationary pressure keeps most prices in check and forces manufacturers to pursue cost reductions from their underlying suppliers. Yet industry consolidation also frequently translates to fewer vendor options.

The cost of goods sold usually does not represent a company's largest expense. But in many cases it may be one of a business's most inefficient processes. Here, we can often blame the underlying request-for-quotations process. Bid solicitations often omit key criteria, such as support, delivery and inventory.

It is tough to pick the "best" deal and sealed bids usually have only one round (at least with all bidders participating). As a result, there is great value to incumbency, and a company can easily be tempted to follow the path of least resistance.

E-commerce has fostered productivity improvement along several lines. First, we have seen the development of squeezing inventory, which supports buyers needing accurate and timely data on price, availability and guaranteed arrival date.

Next came value creators, prompting new sales. By eliminating geographical barriers preceding the link-up of buyers and sellers, these exchanges provide intermediation.

Most important, e-commerce can create new markets and products. For example, intangibles like intellectual property can now be easily bought and sold.

The development of online B2B markets seems to have followed a three-stage evolution.

First there was the migration to online; the focus was to buy and sell there. The benefits manifested themselves in faster inventory velocity and lower transaction costs. Initially, only large companies could take this plunge due to the large up-front investment in technology.

Over time, third-party exchanges were able to develop as there no longer existed the need to build from scratch. It was possible to purchase marketplace software and to outsource the technology piece.

Third-party exchanges were started by independent firms looking to create a genuine market, all the time seeking critical mass. The benefits here were more competition, and (usually) lower prices to the purchaser.

Such exchanges evolved in the same manner as their industry markets. Therefore, we have now become acquainted with the term "butterfly" market, one that is characterized by many buyers and sellers. B2B companies providing independent, third-party exchanges can dominate as intermediaries providing lower prices and improved liquidity.

Exchanges are now morphing into consortia. The wide availability of venture funding available — and the initial public offering model — has showed

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