Vlerick Sales Centre Article Summary Series


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Introduction

In this article, the authors introduce a classification scheme that gives order to the seeming chaos of the new B2B marketplaces, which they call electronic hubs, or e-hubs. By explaining how the different types of e-hubs work and how they create value, they provide useful guidance not only to entrepreneurs looking to launch e-hubs but also to the many buyers and sellers developing strategies for capitalizing on B2B e-commerce.

The What and How of business purchasing

At the broadest level, the purchases can be classified into manufacturing inputs and operating inputs. Manufacturing inputs are the raw materials and components that go directly into a product or a process. They are usually purchased from industry-specific, or vertical suppliers and distributors. They also tend to require specialized logistics and fulfillment mechanisms. Operating inputs, by contrast, are not parts of finished products. Often called maintenance, repair, and operating (MRO) goods. Operating inputs tend not to be industry specific; most every business needs computers, copier paper, and cleaning services. As a result, they are frequently purchased from horizontal suppliers, vendors.

The second distinction in business purchasing is how products and services are bought. Companies can either engage in systematic sourcing or in spot sourcing. Systematic sourcing involves negotiated contracts with qualified suppliers. Because the contracts tend to be long term, the buyers and sellers often develop close relationships. In spot sourcing, the buyer’s goal is to fulfill an immediate need at the lowest possible cost.

Classifying B2B Hubs

By applying this two-way classification scheme; manufacturing inputs versus systematic inputs and systematic sourcing versus spot sourcing; the B2B hubs can be classified into four categories:

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MRO hubs are horizontal markets that enable systematic sourcing of operating inputs. The operating inputs tend to be low-value goods with relatively high transaction costs, so these e-hubs provide value largely by increasing efficiencies in the procurement
process. These markets give buyers access to consolidated MRO catalogs from a wide array of suppliers. Because MRO hubs can use third-party logistics suppliers to deliver goods, they can disintermediate, or bypass, existing middlemen in the channel without having to replicate their fulfillment capabilities and assets.

Yield managers are horizontal markets that enable spot sourcing of operating inputs. They create spot markets for common operating resources like manufacturing capacity, labor and advertising, which allow companies to expand or contract their operations on short notice. This type of e-hub adds the most value in situations with a high degree of price and demand volatility, such as the electricity and utilities markets, or with huge fixed-cost assets that cannot be liquidated or acquired quickly, such as manpower and manufacturing capacity.

Exchanges are vertical markets that enable spot sourcing of manufacturing inputs. Online exchanges allow purchasing managers to smooth out the peaks and valleys in demand and supply by rapidly exchanging the commodities or near-commodities needed for production. The exchange maintains relationships with buyers and sellers, making it easy for them to conduct business without negotiating contracts or otherwise hashing out the terms of relationships. In fact, in many exchanges, the buyers and sellers never even know each other’s identity.

Catalog hubs are vertical markets that enable systematic sourcing of manufacturing inputs. They automate the sourcing of non-commodity manufacturing inputs, creating value by reducing transaction costs. Like MRO hubs, catalog hubs bring together many suppliers at one easy-to-use website. The only difference is that catalog hubs are industry-specific. They can also be buyer focused or seller focused.

Aggregation and matching

E-hubs create value by two fundamentally different mechanisms: aggregation and matching. E-hubs that use the aggregation mechanism bring together a large number of buyers and sellers under one virtual roof. They reduce transaction costs by providing one-stop shopping.

The aggregation mechanism is static in nature because prices are prenegotiated. An important characteristic of this mechanism is that adding another buyer to the e-hub benefits only the sellers. And adding another seller to the e-hub benefits only the buyers. The reason is simple: in an aggregation model, buyer and seller position are fixed.

Unlike the static aggregation mechanism, the matching mechanism brings buyers and sellers together to negotiate prices on a dynamic and real-time basis.

The matching mechanism is required for spot sourcing situations, where prices are determined at the moment of purchase. The matching mechanism can also take the form of an auction. The roles of the players are fluid: buyers can be sellers, and vice versa. Therefore, adding any new member to the e-hub increases the market’s liquidity and thus benefits both buyers and sellers.

Biased or neutral?

Another important characteristic of an e-hub is its bias. Most of the e-hubs are neutral; they’re operated by independent third parties and don’t favor buyers over seller or vice versa. But an e-hub can also be biased. When they favor sellers, biased e-hubs act as
forward aggregators that amass supply and operate downstream in a supply chain or as forward auctioneers that host auctions for buyers. Forward in this sense means that the process follows the traditional supply chain model, with the supplier at the start and the buyer at the end.

Neutral e-hubs, however, are the true market makers because they are equally attractive to buyers and sellers. That said, neutral e-hubs face some daunting challenges. At first, they confront a “chicken and egg” problem: buyers do not want to participate unless there are a sufficient number of sellers, and sellers do not want to participate unless there are a sufficient number of buyers. To succeed, these e-hubs must attract both buyers and sellers quickly, creating liquidity at both ends. Neutral e-hubs also have to overcome the sellers’ channel conflict. After all, sellers usually participate in these markets at the expense of their normal distribution channels. Finally, neutral e-hubs need to be careful when taking equity investments from large buyers as well as from large suppliers; such as investments can create a perception of bias.

Neutral and biased e-hubs differ in another important way. Neutral e-hubs are most likely to succeed in markets that are fragmented on both the buyer and seller sides. In such markets, neutral e-hubs add value by reducing transaction costs (aggregating) and improving matching (providing liquidity). If only one side of the market is fragmented, the benefits are greatly reduced for the non-fragmented side. Biased e-hubs, in contrast, can succeed as long as one side of the transaction is fragmented.

**A vast opportunity**

Because the B2B marketplace is changing so rapidly, many companies are stumbling to navigate through it. The classification framework should provide some clarity by explaining what the different e-hubs do and how the add the most value, giving buyers, sellers, and market makers a map to the new landscape.