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The energy sector is just one sector in which Canada can lead the world in the age of the Internet

The power of e-business



In Part 8 of the Financial Post's 12-part series on competitiveness, Werner Antweiler explains that if Canadian business is to succeed in the 21st century, it must embrace the Internet and adopt business-to-business "hubs."

BY WERNER ANTWEILER

Although the dot-com euphoria of the late '90s has faded, e-business remains the wave of the future. To compete successfully in today's marketplace, companies need more than a Web site on the Internet.

According to research by IDC, a technology intelligence firm, Canadian businesses have eagerly embraced the Internet. Using Industry Canada statistics, IDC reports that Canada performed \$40.3-billion worth of e-business last year, a 69% increase over the previous year. This means that last year almost 4% of all of Canada's economic activity was due to e-business — a figure that is likely to grow substantially over the next few years.

Yet Canada still trails the United States. Last year, only half of Canada's small firms did business online compared with 77% in the United States. Furthermore, approximately one out of six Canadians purchased goods online last year, compared with one in four Americans. In another study, compiled by the Center for International Development at Harvard University and the World Economic Forum, Canada's "network readiness" ranked only 12th out of 75 nations.

Clearly, to succeed at home and abroad, Canadian businesses must understand e-business practices and exploit their potential.

The early days of e-business focused primarily on business-to-consumer (B2C) transactions — selling goods directly to the customer. Business-to-business (B2B) transactions, however, have since proved to be a bigger and more lucrative market. Traditional businesses are learning how B2B e-business improves the way they already source materials, manage transportation and logistics and fulfill customer orders. Silently, B2B is in the process of revolutionizing how businesses interact — and is generating big cost savings for businesses that adopt e-business strategies.

Auto manufacturers DaimlerChrysler, Ford and General Motors discovered the benefits of B2B two

years ago when they launched Covisint.com, an online B2B hub that streamlines the purchasing of auto parts. The site brings together buyers and sellers, where they can exchange information, form partnerships, exchange price quotes, trade goods by auction and manage other procurement activities. The auto-parts sellers save time and money by being able to sell their goods to three customers at once and by avoiding duplicate contracts. The car companies benefit because they have faster access to supplies.

Traditionally, after a supplier provides a price quote, the buyer conducts multiple rounds of negotiations, which can take several days. With online B2B auctions, a buyer invites participating suppliers to submit online bids and conducts an auction in a matter of hours rather than days.

Trust plays an important role for B2B hubs. Covisint is backed by an industry consortium, which gives it instant credibility and recognition. Also, B2B hubs that help both buyers and sellers will be more likely to succeed than those that benefit only one side.

B2B hubs come in different forms and shapes, depending on what a company buys and how it buys it. Standardized goods and frequently purchased goods are suitable for online exchanges, which act in a similar manner as a stock market. In contrast, when goods are industry specific or require specialized logistics — UPS and FedEx, for example, are unlikely to deliver hydrochloric acid — online markets can provide an environment for complex transactions and bargaining.

This is when B2B hubs are especially beneficial. First, they introduce buyers to sellers. The greater the number of participants, the greater the market transparency and liquidity: It becomes more likely that a buyer can find a seller, and vice versa. Second, B2B hubs streamline the contracting process. Auction markets require pro-

ducers and products to adhere to predefined quality standards. This standardization, plus the easier matching, saves participants substantial transaction costs.

Canadian businesses have a lot to gain by establishing online markets and B2B hubs, but successes in these ventures are far from guaranteed. Markets have a tendency to consolidate when transaction costs fall. Economists know this as a network effect: The more people participate in the same market, the greater the benefit to each individual participant. This leaves Canadian businesses at a disadvantage when trade roadblocks make it difficult for firms to participate in foreign hubs, and vice versa. On the other hand, some Canadian businesses are in a position to lead in sectors in which Canada has traditional competitive advantages over the United States, such as in the energy and natural resources sectors.

Notwithstanding last year's debacle in California, hubs in the form of energy exchanges have come of age. California's problems were unique: When it faced power shortages or brownouts, a deregulated wholesale market for electricity was unable to

pass on higher production costs to a still price-regulated retail market.

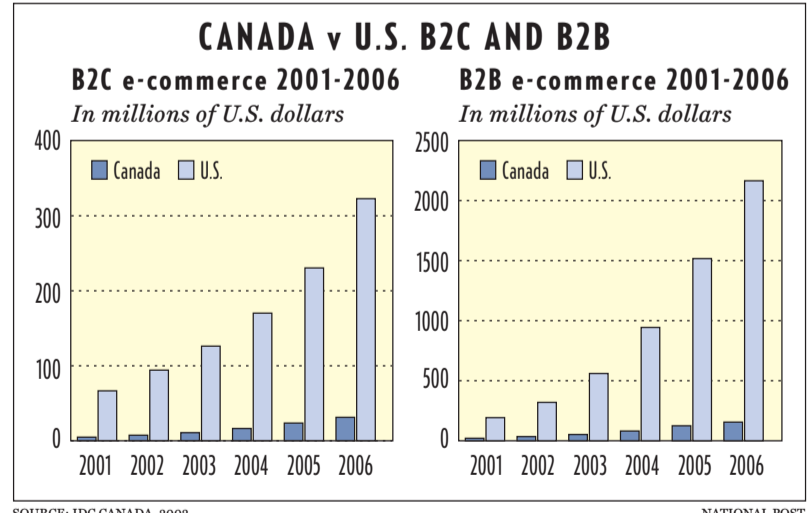
In comparison, European online exchanges, such as Britain's UK Power Exchange (www.ukpx.com) and Germany's European Energy Exchange (www.eex.de), have experienced very high growth rates in trading volume, and are widely regarded as running efficiently. In Canada, electricity can be spot-traded on the Alberta Power Pool (www.powerpool.ab.ca), while future trades can be carried out on the Alberta Watt Exchange (www.watt-ex.com). The Watt Exchange is expanding into Ontario, where the electricity market is being deregulated. With cross-border trade in electricity increasing, Canadian power exchanges have the potential to become pre-eminent continental players if they seize the opportunity.

The Achilles heel of B2B hubs is their tendency to concentrate. In a particular industry, only a few exchanges — or perhaps only one — will survive this consolidation process. This raises concerns about fair competition: Who controls the exchanges, who has access to them and who is excluded, and whether they facilitate collusion.

The new online exchanges look very much like a stock market. Securities trading in Canada is regulated provincially, while in the United States the Securities Exchange Commission (SEC) oversees trading activity nationally. This fragmentation of securities trading supervision in Canada is a hindrance to innovation and growth for online exchanges. Instead of dealing with just one national regulator, online exchanges may be required to deal with numerous provincial bodies.

There are yet more challenges. Many practical trade barriers remain between Canada and its trading partners — most notably the United States, the destination of 80% of our exports — which limit the market opportunities for Canadian e-businesses. The Internet has made the world a global village for businesses and consumers, but trade negotiators have yet to catch up to the business opportunities that lie there.

Werner Antweiler is an economics professor at UBC's business school. He teaches courses on e-business, competition in high-tech industries and international business. He is also an experienced software developer.



Why some shopping carts wobble

B2C — electronic commerce from business to consumer — has made companies such as Amazon and E-bay household names. Yet even after several years of expansion, Amazon is only marginally profitable. While the Internet was thought to level the playing field for online retailers, it quickly became evident that size and brand name still matter. When too many online businesses are pursuing the same small market, only a few survive.

The dot-com shakeout of 2001

taught some important lessons for e-businesses. Online-only operations, such as now-bankrupt grocer WebVan, did not succeed because warehousing and delivery costs were too high. Existing grocery chains, such as Safeway in the United States and Canada, and Tesco in the United Kingdom, studied WebVan's failure carefully. The supermarket chains learned that piggy-backing on their existing stores and supply chain systems made it profitable to offer online shopping services. Existing stores double as warehouses for the

online operation, enabling store clerks to fill orders and put them in a van for delivery. This keeps costs low.

What works well for grocery chains may not necessarily work for bookstore chains, however. When Chapters (now merged with Indigo) took its business online a few years ago, the company found its online business was competing with its bookstores. Promoting one came at the expense of the other, instead of expanding the overall size of the market. Werner Antweiler

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Rotman

Joseph L. Rotman School of Management
University of Toronto

Competitiveness series consultant
Daniel Treffer, Rotman School of Management