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A Shift in the Landscape:

A Comparison of Third-party Intermediary Portals to Industry-backed Portals in the Global Forest and Paper Industry

Summary | Challenges and Benefits for portals | Critical mass and Neutrality | Uncertainty | Disintermediation | Establishing Industry Standards | Control of Customer Relationship and Market Information

Summary

Although intermediary-backed portals create a market and channel to connect buyers and sellers, procure supplies and bypass traditional wholesalers, forest product companies remain subject to a third party. The present industry structure, competitive forces and rivalry within the global forest and paper industry suggest that intermediaries are unlikely to provide a *sustainable* strategic advantage to forest and paper companies. Intermediaries will seek to capture the majority of the added value they provide, distributing the remaining benefits of e-business to buyers. Countering this trend is the recent joint announcement by International Paper, Georgia-Pacific Corp and Weyerhaeuser Co. of their intent to develop a global, industry-backed business-to-business vertical portal (vortal) to provide procurement and sales functions to the forest and paper industry.

A co-operative industry-backed, vortal initiated by three of the world's largest forest and paper companies will

- establish a critical mass of suppliers and buyers as \$45.6 Billion (USF) in product and established buying relationships are enabled and leveraged by e-business,
- provide forest and paper companies with the opportunity to leapfrog intermediary first movers, exceeding the network benefits of these established portals and becoming an ever-growing attraction to their customers,
- encourage late adopters of e-business to forego short-term benefits of an existing intermediary-backed portal in favour of waiting for greater certainty and the long-term benefits associated with an all-inclusive, standardized industry-backed model,
- consolidate market power of forest and paper companies via strategic partnerships, threatening intermediaries with redundancy as forest and paper companies assume the function of existing internet-based intermediaries,
- increase the likelihood of establishing industry standards for the co-ordination of strategic information,
- reduce the threat to forest product companies of being further distanced from customers, providing industry producers with the ability to control and retain ownership of customer relationship and market transaction data, and
- enable forest and paper companies to share in the benefits of e-business via equity-based ownership of an industry-wide vortal.

Until recently, the development of vertical industry portals (vortals) has resided in the domain of internet-based, third party intermediaries such as PaperExchange.com. Forest and paper companies had limited their involvement in e-business to extending their existing distribution and communications functions to the Internet via their own web sites, participating in third-party vortals and, in some cases, developing strategic, equity-based partnerships with the third party intermediaries. However, on March 23, 2000, International Paper, Georgia-Pacific Corp and Weyerhaeuser Co. jointly announced their intention to develop a global business-to-business vortal to provide procurement and sales functions to the forest and paper industry.

The motivation for the venture was stated as the "creation of a foundation for common industry standards to simplify and accelerate the adoption of e-commerce (e-business) across the industry." The joint industry initiative seeks to expand by acquiring additional industry partners. The co-operative nature and stated motivations are providing some new challenges to intermediary-backed portals.

One of the strategic imperatives of a vortal is to establish positive network effects as a barrier to entry. For example, the strategic imperative of PaperExchange.com and other internet-based market exchanges is to develop a critical mass of suppliers and buyers, thereby creating a situation in which all participants benefit from the presence of other participants. Vortals employing consortium-based procurement (buying groups) provide a good example. In such instances, there are switching costs associated with transferring from an established vortal to a new entrant with fewer participants since the value of participation (aggregated buying power) is a direct function of volume purchased and thus number of participants. Another important imperative for vortals is to increase customer retention by increasing switching costs. This is normally

Challenges and Benefits for vortals

Some of the challenges and benefits associated with intermediary and industry-backed vortals are highlighted below

Critical mass and Neutrality

Depending on the characteristics of the structure, competitive forces and rivalry within the industry, the inability to develop, or the loss of, critical mass of producers (suppliers), buyers or both pose a substantial risk. Unlike intermediary-backed vortals that must acquire buyers and sellers individually over time, a co-operative industry-backed joint venture such as the one announced for the Forest and Paper Industry by the three of the world's largest producers instantly establishes a critical mass of buyer and supplier relationships that can be leveraged. This provides industry-backed vortals a distinct advantage over their first mover intermediary counterparts, however intermediary-backed vortals have established presence and more importantly have real-life experience of forming e-marketplaces.

Probably the biggest advantage that intermediary-backed vortals have is their neutrality to buyers, sellers and other complimentary service providers. In the industry-backed model, it is more than likely that the dominant member will want to control the e-marketplace moving forward. The industry-backed model certainly brings challenges for competitors in the same industry to work together and be mutually successful.

Uncertainty

The current B2B marketplace is emerging and evolving rapidly but with no clear indication of winners and losers as yet. In view of this, there is a great deal of uncertainty as to which models will be successful. During this uncertain period, the industry-backed vortals have the distinct advantage of possessing bricks and mortar operations, that is, they have an existing revenue and asset base that they can fall back to, unlike the intermediary-backed vortals. In view of this, intermediary-backed vortals have greater uncertainty and are thus more susceptible to news and events, as is evident by the volatility of their share price.

Disintermediation

The industry-backed vortal establishes the credible threat of intermediaries becoming marginalized. The presence of a large direct buyer or supplier-centric consortium which has existing relationships presents a real threat to third-party intermediaries of being disintermediated. This would have the additional benefit of better margins on goods and services for the direct buyers and suppliers as the intermediary margins do not exist. While this sounds plausible, the strategic sourcing for goods and services for a consortium or an e-marketplace requires considerable negotiation and on-going management which requires time and effort.

Establishing Industry Standards

One of the more substantial potential benefits of any vortal is the potential to deploy "value chain" strategies and mechanisms, producing highly integrated and seamless interactivity via standardized and managed processes. An all-inclusive, industry-backed vortal has an economic interest in establishing a common standard, an increased ability to develop a standard in co-operation, and the opportunity to share in the benefits of its adoption via equity-based ownership. A co-ordinated industry-backed venture could have the benefit of instituting industry standards with greater ease than intermediaries while retaining control of strategic customer relationship and market information with forest and paper companies.

Control of Customer Relationship and Market Information:

Perhaps the greatest threat to forest product companies is the potential for producers to be further distanced from customers. In response to pressures to acquire market share and in the absence of an industry-backed vortal, companies risk sharing or even foregoing customer relationship information to intermediaries in exchange for access to substantial new markets and distribution channels.

The sustainable competitive advantage offered by e-business is not increased operational efficiency; it is the acquisition of a tightly coupled customer base and opportunities available from the strategic management of customer information. Consequently, the forest and paper industry has tremendous incentive to control and retain ownership of customer information and market transaction data. Direct contact with customers and ownership of customer data is likely to emerge as one of the increasingly important benefits of an industry-backed vortal and e-business in general.

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