The A-B-Cs Of E-commerce
Sorting Out Internet Business Models by William Van Winkle
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In the spring of 1999, drkoop.com debuted before an adoring Wall Street and soared up within a month to nearly $40 per share. In January 2000, Yahoo! stock was plugging along at around $25 per share, and online auction house eBay’s stock didn’t peak until late March that same year.

But then the second quarter of 2000 rolled around, ushering in what really should have been known as the Y2K bug. Investors heard the bombs (and their portfolios) dropping, ran for cover, and a new dot-reality was upon us. Suddenly, proposing to be the newest IPO (initial public offering) on the Internet catwalk wasn’t enough to get a fat round of financing for Internet star-hips, and many with scheduled IPOs decided to delay or completely forgo stepping into an ice-cold market. By late 2000, Yahoo! shares had bottomed out at around $25. Today, drkoop.com is trading at $1/s, laying off its employees, and facing ejection from NASDAQ.

Why did the sky fall? What did investors want? If you boil the many reasons down to one word, it would likely be “profitability.” Investors were saying that if you’re going to do business on the Web, you need a business model that works and cash flow to keep you afloat.

The party may be over, but if you look down the hall past the confetti and party hats lying forgotten on the floor, you’ll find that there are still a few lights on. Business hasn’t abandoned the Internet. In fact, business is very much alive on the Web, and companies are using the Internet in ways they hadn’t just a few years ago. AssetTRADE is a prime example.

Businesses often have surplus equipment they’re trying to get rid of and that others are desperate for. Trying to match two such companies within a single city is challenging enough; imagine, then, how much more difficult it can be for multinational corporations, or corporations so large that some departments have surplus that others lack? This is where AssetTRADE steps into the picture. It first helps clients redeploy their assets internally by setting up private surplus marketplaces for them. If that doesn’t mop up the whole surplus, AssetTRADE helps qualify external buyers so that they can get the most value for the leftovers. It charges a fee for these and a host of other services, as well as charging listing fees and fees on auction transactions. Companies like AssetTRADE show that the Internet isn’t just a place to retail books anymore. There are complex business models afoot that fill real needs within the business and consumer sectors, but following where the money flows in these models can be a challenge.

The relationship between business model and cash flow is far from simple. Even the differences between business models can be hazy; some consumer-to-consumer models look more like business-to-business models. And what about peer-to-peer commerce? What is it, and where is the money being made? Are these companies making any money?

To answer these questions, we need to get the business model jargon out in the open and look at these models’ different sources of cash flow.

B2C (Business-To-Consumer)

Many people instinctively associate e-commerce with the B2C model. Goods flow straight from businesses, typically retailers, to end-users without the help of a middleman. Popular Web sites like Amazon.com and Dell.com receive millions of hits per week from consumers enthusiastic to buy books and all manner of consumer goods, often at prices lower than in physical stores. The assumption is that without the overhead costs of storefronts, retail sales staffs, and other conventional expenses, online B2C companies should be able to operate on lower profit margins and thus offer more aggressive pricing. (Many B2C e-businesses would argue that the expenses of running commerce servers, securing data, handling returns, advertising, and all their other costs of daily activity leave them in the same financial boat as their physical retail counterparts.)

The success of B2C enterprises hinges on the experience they can provide to consumers. In part, this relates to old-fashioned customer service. Companies like Amazon.com and REI have built online juggernauts largely on their reputations for impeccable customer satisfaction.

Another facet of an online customer’s experience is the interface, or the text and graphics the customer must interact with in place of a human salesperson (although new technologies like VoIP (voice over Internet Protocol) may soon have online consumers talking with live sales reps as they shop). Some of the earliest forays by businesses onto the Web were static, HTML (Hypertext Markup Language)-only pages that provided basic information about a company, like what it did, its contact information, and perhaps a product list. These were, in essence, glorified business cards.

When CGI (Common Gateway Interface) scripts and other interactive technologies came along, businesses realized they could actually sell products over the Web. If shoppers placed items in a virtual shopping cart and supplied a credit card, companies could process orders with virtually zero human handling and still meet most of the consumer’s needs throughout the process. In time, systems like context-sensitive help screens and personalized advertising came into play. After some initial public concerns about the security of credit card transactions, B2C e-commerce began to skyrocket. According to the U.S. Department of Commerce, online sales for 2000 totaled roughly $28 billion.

A small slice of that business belongs to Powells.com (http://www.powells.com). Long before Powells.com was making Best of The Web lists in Forbes magazine, it was the world’s third-
largest physical bookstore. A few years back, Powell’s became a bricks-and-clicks operation, meaning the store has both physical and online presences. Under pressure from Amazon.com and Barnes & Noble.com, Powell’s realized that becoming an online force was likely the difference between long-term growth and a slow downward spiral.

Most experts feel that the bricks-and-clicks B2C model will prove to be the most successful. Established physical retailers like Wal-Mart and Sears have the financial resources and brand recognition to build successful online endeavors; online-only startups generally have neither. Moreover, old-school retailers have been content to only dabble in e-commerce, waiting for the technology to improve, market awareness to build, and “pioneers” to showcase how not to do business on the Web.

E-tailers like Powells.com, FTD.COM, 800.com, Overstock.com, and a legion of others count on making money through direct sales. Customers buy merchandise, money goes in the till. But there’s more cash flow going on in e-tailing than just direct sales.

Powell’s offers a partnership program to affiliates who link from their sites to Powells.com. Affiliates can be anyone from another big Internet site to a mom-and-popized site. For example, if you run a small Lobbyist’s site called Joe’s Lovecraftian Crypt, you might also want to offer your visitors books for sale by H. P. Lovecraft. Powell’s would give you permission and the tools to market the Lovecraft titles they have in stock through your site, paying you a “referral” or “affiliate” fee every time you direct a sale to it.

There are other ways B2C vendors can make money aside from direct sales. A site can sell advertising space on its site for a fee, or sell access to premium content on either a pay-per-use or pay-per-view basis. In the latter scenario, companies break their content into small chunks and sell it to consumers for a single use, or use over a prespecified amount of time. An example of this is the Wall Street Journal’s (http://www.wsj.com) daily edition that gives buyers limited one-day access to an online version of the paper for less than 50 cents. Such businesses can sell content on a subscription basis as well (and there are other kinds of Web-based subscriptions we will examine later).

**B2B (Business-To-Business)**

As exciting as the retail environment might seem, the lion’s share of trade actually goes on between companies. Many companies buy equipment and commodities they need from other companies. Louisiana-Pacific sells planks to lumber yards, banks buy computer systems from IBM, and mobile sales forces use online scheduling software from HotOffice.com. But B2B models function in a world largely removed from that of retail, and the needs and processes of B2B are often different from those in B2C. Services are often more valuable to businesses than office equipment, for example, and the Web is equipped to handle transactions involving everything from consulting services to secretarial staffing.

Before the dot-coin bust of 2000, B2B ventures were the hyped-up darlings of Wall Street. Forrester Research, a firm that analyzes movement in the technology sector, predicted in 1999 that B2B e-commerce in the United States would reach $1 trillion by 2004 and early the next year revised that figure to $2.7 trillion. Others have given even more spectacular estimates, but in either case just a sliver of these sums would shower a B2B company with profound riches.

Safetylogic, a company that sells a subscription-based safety service to corporate clients, is an apt example of an online B2B operation. Most companies have to contend with safety issues, but implementing guidelines and procedures can be problematic. Companies need to conduct audits, coordinate safety meetings, file reports, and so on. Traditionally, people conducted these activities by putting pen to paper and sending materials through the mail, or at best through data entry and fax. Safetylogic offers a service designed to automate and centralize how companies move safety materials and communicate safety issues between corporate headquarters, regional offices, and facilities such as factories and warehouses.

Full-featured and interactive subscription-based services such as Safetylogic’s are one way B2B companies on the Internet are able to generate cash flow. Naturally, direct sales are a major source of revenue, such as when a business sells its products directly to another business, as in B2C transactions. Still, the Web can change the dynamics of direct sales. StaplesLink.com (franchise office supplier Staples’ online presence) enhances its direct sales of office supplies to business users by helping automate the procurement approval process. StaplesLink only allows authorized users through its virtual door, and even then certain rules apply to specific visitors. For example, the site adheres to preset spending limits based on a per-order or per-line item basis, subject to the company’s final authorization.

In addition to subscriptions and occasional pay-per-view sources of cash flow, B2B sites often advertise with one another. This creates both expenditures and a source of revenue, depending on which side of the transaction the business is on.

**C2B (Consumer-T-Business)**

While online consumer spending continues to mushroom, many would-be buyers find that product choices are vast, perhaps even overwhelming. Furthermore, the chaotic structure of the Web often makes it difficult to comparison shop for specific items. Simply running product names through search engines is likely to yield sites that mention the product but don’t sell it.

When consumers do find sites that sell their target product, it’s often a chore to navigate the site, find the product, and determine its cost. Shoppers often have to jot down price lists the old-fashioned way and compare them, perhaps requiring several hours of tiresome
The need for a better purchasing process has helped spawn a new kind of Internet business, that of online agents. Agents act as middlemen, go-betweens for consumers and businesses in an attempt to help buyers get the best deal. While agents can appear in any business model, they’re fundamental to C2B commerce. To make the agent business model profitable, however, some agents such as priceline.com have had to adopt a business strategy that is a little more restrictive and demanding upon the consumer than just consolidating the best prices into one place for comparison.

Having tapped Star Trek actor William Shatner as a spokesperson for television and radio advertisements, priceline.com has one of the more visible non-Web advertising campaigns among e-biz players, and is still plugging along despite losing favor with investors on Wall Street Consumers interested in getting aggressive (although not necessarily the best) rates on airfare, hotel rooms, mortgages, and more can enlist priceline.com to connect them with businesses that will supply these items at prices they’re willing to pay.

When shopping for airfare, a shopper enters the travel dates and cities involved, along with the price he wants to pay for the tickets and a credit card number. Within an hour or less, priceline provides notification as to whether any participating vendors accepted the terms the shopper is looking for. If so, priceline immediately charges the credit card, locking the consumer into the purchase. With this business model, consumers agree to give up a little freedom in order to get the prices they want. In addition to surrendering the freedom to back out, there are other conditions users must agree to up front. All tickets, for example, must be round-trip, and customers must be willing to accept any of several flight times within a given range.

Priceline.com makes its money primarily by collecting various transaction fees that it charges during the process of brokering other companies’ products to consumers. It also has an affiliate program that pays referral fees when traffic directed to its site from others results in certain bound offers or confirmed transactions.

As we mentioned earlier, the online agent concept works in other online commerce models (such as B2B) as we Demandline.com brokers business-to-business deals on services like payroll processing and software support. Demand for such items in business is high, but even this B2B segment has been hard-pressed for results. Last August, business supply products agent OfficeCoop closed its doors after barely six months in business.

C2C Consumer-To-Consumer

C2C Internet commerce is somewhat analogous to classified ads in a newspaper or to booths at a flea market. The idea is that consumers contact one another in a forum where personal goods are bought and sold.

Online auction giant eBay (http://www.ebay.com) stands out as an archetypal C2C example. eBay doesn’t sell anything of its own, but like priceline.com and AssetTRADE it serves as an intermediary between buyers and sellers by supplying the forum (and the rules) for online auctions. Someone wanting to sell a teapot online can list her product through eBay by paying a nominal listing fee. Interested parties place bids for the item, and when the auction is over the seller pays a small success fee (also called a Final Value fee) based on the selling price if a successful transaction takes place.

eBay makes the buying and selling environment attractive through several means. For instance, eBay lets sellers set a reserve price that bidders must meet before the sale can become final. The auctioneer also hosts a safety service called SafeHarbor, meant to prevent unhappy trading experiences and offer investigations when auction transactions go amiss. It’s worth pointing out that businesses also use eBay to reach consumers with select goods such as office supplies or airline tickets.

Autobytel.com is another hybrid C2C company that blurs all the lines. Autobytel and some of its other branded Internet sites (such as Carsmart.com) help consumers locate others who are selling their cars by providing searches of online classified ads. Sellers can place classified ads directly through Autobytel.com for a small listing fee. In other words, Autobytel.com helps consumers contact one another just like traditional classified ads do but adds the convenience of a hosted Internet search engine rather than requiring you to obtain and research various classified forums.

Autobytel.com is also very much a part of the C2B world. It enjoys a great deal of support from a nationwide dealer referral network called AutobytelDIRECT, consisting of roughly 5,000 dealerships nationwide. Users looking for new cars can visit the site for a quick check of dealerships within a prespecified area, and both parties can expect a haggle-free environment and a competitive price quote.

Fees paid by participating dealers form the bulk of Autobytel.com’s revenue, but the company also enjoys other sources of income. For instance, if a new car buyer chooses to buy from a participating dealer, they must agree to pay a deposit (currently $129). Autobytel.com refunds the full amount unless the buyer decides not to purchase the vehicle, in which case it keeps $29 as an administrative charge. Autobytel.com also sells advertising space on its Web site and runs a vigorous affiliate program (as discussed earlier in the B2C section).

P2P (Peer-To-Peer)

When bidders make online purchases at eBay.com, there are a couple of ways they can arrange payment with sellers, the most novel being a service called PayPal. PayPal exemplifies a new
business model known as P2P commerce.

PayPal is an attractive method of enabling online payments for several reasons. Prior to PayPal, many online merchants of various sizes regularly received payments via credit card-based merchant accounts. Such accounts can cost hundreds of dollars in setup and monthly maintenance fees, and in some cases (especially where smaller merchants are concerned), steep transaction charges can eliminate or greatly diminish any profit made on small ticket sales. Hence, conventional merchant accounts are often impractical for the occasional eBay seller. By contrast, PayPal’s expense to the merchant is modest (about 2% for receiving payments), there is no setup charge, and both the consumer and merchant can send money free of charge.

P2P commerce revolves around platforms that let individuals conduct direct exchanges with one another. While desktop-based transactions still make up the lion’s share of such exchanges, mobile technologies allow increasing numbers of people to do business wherever they are. PayPal recently gave users the ability to send money and check balances using their mobile phones. Mondex, a subsidiary of MasterCard International, has promised an even more direct implementation of P2P transactions using its technologies that enable users to exchange electronic cash. With Mondex hardware, consumers can use an electronic “wallet” about the size of a pocket calculator to transfer money from one credit card to another by plugging two cards into the wallet. The wallet doesn’t hold any money itself but enables such transactions and displays card balances. Another P2P agent, ProPay.com, lets you pay your buddy back for that lunch you owe him by wirelessly transferring money between your PDA (personal digital assistant) and his. Plainly, P2P has some exciting possibilities, and technology leaders are just beginning to bring them to life.

Some free P2P services like PayPal make their money on float, the interest that accrues on funds sitting in users’ accounts. ProPay.com is driving its revenue stream with transaction fees similar to those charged on merchant accounts, taking a small cut every time money moves around the Web and between devices.

**The E-prognosis**

Upon examining all these online business models, it’s clear that although e-commerce is wounded, it’s still very much alive. As industry pundits predicted, finding reliable online sources of revenue has been a matter of trial and error. The B2C and B2B models are getting most of the attention these days, but others are still refining their strategies and deployment methods. Online auctions, looked upon skeptically by analysts back in headier days, have shown real staying power. P2P systems may yet bring about the “cashless society” many have pondered for years. In any event, it’s probably wise to think of the first five years of e-commerce like the first five years of a child’s life: they’re only a turbulent prelude to the wonderful things to come.

In e-commerce articles that follow, we’ll look at specific examples of online businesses and see how leaders in each field are staking their claims to online profitability.