



Whereoware.com, Inc.: Case Study of a B2B Exchange

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Introduction

Ben Johns, the Chairman and CEO of Whereoware.com, Inc. (“Whereoware”) had just gotten off the phone with Michael Franks, the COO of dmg world media (“DMG”). It was early August 2000, and Johns and Eric Dean, Whereoware’s President and COO, were scheduled to fly from Washington, D.C. to San Francisco the following day to meet with representatives from DMG and George Little Management, LLC (“GLM”). While both Johns and Dean had been led to believe that this meeting would result in an offer from these two major tradeshow operators to invest a substantial amount in Whereoware, a business-to-business (B2B) exchange focused on the gift and home accent industry, neither was exactly sure what to expect from this meeting. Both GLM and DMG had been very tight-lipped over the past month as these competitors performed a joint “tour” of the various B2B exchanges that had sprung up almost overnight in this industry.

As Johns and Dean sat in the office they shared in Whereoware’s McLean, Virginia headquarters, they could not help but wonder whether a partnership with these industry leaders was in their new start-up’s best interests and, if it was, how should such a partnership be structured to best take advantage of the strengths and core competencies of all the parties involved. Despite not knowing the agenda of the San Francisco meeting, Whereoware’s executive team had been busy preparing a proposal for a potential strategic partnership between the three companies, to be presented at the meeting if Johns and Dean felt it appropriate. Even with this proposal, Johns and Dean still had no solid answers regarding how a partnership would work between the companies, but both realized that this was the opportunity they had been hoping for to vault their young start-up to the forefront of this new industry.

Business-to-Business Exchanges¹

According to Goldman Sachs Investment Research, the value of online B2B transactions in the United States will reach \$1.5 trillion by 2004. Some experts predict that 40%, or \$600 billion, of these transactions will pass through on-line exchanges. For this reason, it is not surprising that B2B exchanges have begun developing in virtually every industry sector, from raw material markets such as steel and chemicals (e.g., e-Steel and Chemdex) to auto parts (e.g., Covisint).

B2B exchanges, while encompassing numerous industries, can be grouped into several basic business models: (1) aggregators; (2) trading hubs; (3) post and browse markets; (4) auction markets; and (5) fully-automated exchanges. Aggregators streamline the purchasing process by collecting and posting the product catalogs of many suppliers in one place and usually in one standardized format. Trading hubs aggregate sellers by providing them virtual storefronts and tend to cross various vertical markets (e.g., VerticalNet). Post and browse markets are sites where buyers and sellers can post their interest to buy or sell goods, much like a bulletin board. Auction markets, like eBay,

¹ Unless otherwise noted, the information in this section is taken from the note, Business-to-Business Exchanges, prepared by Richard R. Johnson under the supervision of Paul Farris, Landmark Communications Professor of Business Administration.

allow many buyers or sellers to competitively bid on goods or contracts. And, finally, fully-automated exchanges are centralized markets for standardized, commodity-like products that utilize the automated matching of orders (e.g., PaperExchange, e-Steel).

Along with these various business models, B2B exchanges typically utilize at least one of several price-setting mechanisms: (1) fixed pricing; (2) one-on-one negotiation; (3) auction markets; or (4) electronic auto-execution systems. Fixed pricing is just like it sounds – the seller fixes prices and little or no negotiation is involved in the transaction. This is the typical pricing mechanism for aggregator sites. Conversely, one-on-one negotiation is the typical pricing mechanism of post and browse sites, where buyers and sellers find each other through the exchange but then must negotiate over price and other terms. Auction markets, on the other hand, allow buyers and sellers to set prices dynamically, through bidding in either seller-driven or buyer-driven (“reverse”) auctions. Finally, auto-execution systems are basically two-way auctions that match the buy and sell orders of customers on a real-time basis, as you would find in a stock exchange.

B2B exchanges typically derive revenue from a number of different sources, including: (1) transaction fees; (2) posting fees; (3) subscription or membership fees; (4) listing fees; (5) advertising; (6) information selling fees; (7) information licensing fees; (8) % of cost savings; and (9) revenue sharing fees. For most exchanges, the primary revenue source is transaction fees – either as a fixed percentage of the purchases made on the site, or a fixed fee based on the dollar value of the purchases. In most cases, only the seller pays these fees.

The Gift and Home Accessories Industry²

The domestic gift, collectibles and home accessories industry represented more than \$70 billion in retail sales in 1999. In addition, according to a 1999 study by Unity Marketing, the “non Wal-Mart” gift industry generates \$22 billion in wholesale sales annually. Although difficult to measure because of its high level of fragmentation, the gift and home accessories industry has been estimated to include around 30,000 suppliers and nearly 300,000 specialty retailers, mostly independents and small chains of up to 25 stores.

Typically, the strategy of independent specialty retailers is to stay ahead of mass merchants by being first to market with the newest products and trends. In fact, the top manufacturers typically turn over 20 to 40 percent of their inventory every year with new product lines. Despite the pressure to remain at the forefront of customer tastes and trends, the gift industry utilizes an aged business model that relies on personal contacts, paper invoices, fax machines and very few efficient, automated systems. As Johns noted, “Ninety-five percent of the orders [in this industry] are done with a No. 2 pencil.”³

² Unless otherwise noted, the information in this section is taken from the business plan of Whereoware.com, Inc. and is based in part on the 1999 Unity Marketing study of the gift and home accessories industry.

³ Johnston, Nicholas, Deal of the Week, Washington Post, p. E05 (December 4, 2000).

Although mired in out-dated business practices, these specialty retailers recognize the importance of the Internet in allowing them to “level the playing field” with the large mass merchants such as Wal*Mart. According to the Unity Marketing study, gift retailers ranked the Internet and e-commerce as the top trend that would have a positive impact on their businesses in the next two years. Regardless, in 1999, only one-third of retailers reported that they actually used the Internet in their businesses, suggesting a significant opportunity to expand Internet use as a business tool in this industry.

The traditional method of business in the industry is quite simple – retailers typically travel to one or two major trade shows held throughout the year in such locations as Atlanta, New York, Dallas, San Francisco and Boston. At these shows, thousands of manufacturers display their new products, while retailers attempt to peruse as many booths as possible and place orders for their stores. Due to the cost and time involved in attending shows, retailers are typically not able to visit more than one or two shows a year. Throughout the rest of the year, purchasing needs are typically handled by sales representatives (either those that work directly for one manufacturer or independent representatives who carry multiple suppliers’ lines) who contact the stores on a regular (or sometimes infrequent) basis, either by phone or in person, to take orders.

Whereoware.com⁴

From 1981 to 1999, Ben Johns helped build the Bacova Guild, Ltd., a manufacturer of decorative home products located in Hot Springs, Virginia, from a \$500,000 a year in revenues gift company to a \$50 million a year international business. After selling the company to Burlington Industries in 1995, Johns remained with Bacova but soon began envisioning ways of utilizing the Internet to bring greater efficiencies to the gift industry. In 1999, Johns and Eric Dean, the former business manager of Bacova’s floor mat business unit (and a 1992 Darden graduate), set about designing a company that could help the independent retailers and manufacturers in the industry take advantage of the Internet in order to “level the playing field” with the mass merchants.

Two of the problems that Johns and Dean saw were the lack of a strong trade association and the out-dated and inefficient business practices still used in the industry. With respect to the former, Johns commented that, “There is no trade association, there are no standards. We want to define the nomenclature and define the product categories. In a sense, provide a virtual association.”⁵ Whereoware, founded and run by industry insiders, was designed to change the way the industry operated.

The first step in this process was finding a technology partner who could help Johns and Dean build the website and technology platform to implement their vision. Through a college classmate, Johns found Ventera Corporation, a young information technology company in McLean, Virginia. In October 1999, Ventera agreed to become a founding partner of Whereoware, helping to build the complicated technological platform and

⁴ Unless otherwise noted, this section is based upon information from the Whereoware.com website, conversations with employees and my experience working at Whereoware.com this summer.

⁵ Johnston, Nicholas, Deal of the Week, Washington Post, p. E05, December 4, 2000.

website of the company. By January 2000, Whereoware had taken up residence in the offices of Ventera.

Whereoware's mission was and is to be the leading business-to-business “e-hub” for the home accents, gift and collectibles industry – adding value by lowering transaction costs, increasing selection, buying convenience and information flow, and broadening the customer base of manufacturers. The company’s website, www.whereoware.com, went live on June 5, 2000.⁶

The Whereoware business model has several important features. First, the site is designed to be a community-based portal for the entire independent gift industry -- providing proprietary news and industry information, along with editorial content in an on-line magazine format. Renee Bennett, the former editor-in-chief of the home fashions business magazine LDB Interior Textiles serves as Whereoware’s Editorial Director. An example of the site’s “WOW-zine” is found at **Exhibit 1**. Retail members must provide proof that they are indeed legitimate retailers, such as a tax identification number, in order to register on the site. Once registered, though, each retailer is welcomed with its own customized home page upon logging in – displaying current and past orders, re-order reminders, and featured items. Retailers and manufacturers can participate in chat rooms and message boards where best practices, common problems, concerns and anything else of interest can be shared among industry peers across the country. In addition, the site features a customizable community calendar, providing information regarding various industry events. Examples of the Whereoware retailer home page, the company splash page and various community pages are found at **Exhibit 2**.

Whereoware utilizes a classic aggregator business model – the company integrates manufacturers’ catalogs of products onto its website, allowing retailers to search for, and purchase, products directly from the suppliers. Retailers are able to search for products in numerous ways – by supplier name, by price, by product, by SKU number or even by keywords. Retailers can discover new suppliers and products for their stores, keep track of their previous purchases and create re-order lists with reminders for simple ordering throughout the year. An example of a search page from the Whereoware site is found at **Exhibit 3**. Products are advertised with fixed prices and there is no negotiation involved– each supplier’s catalog page lists its own special terms of sale. In addition, Whereoware does not hold inventory or take ownership of the products sold through its site. Rather, the company serves simply as a middleman – orders placed on the site are sent directly to the supplier, who is responsible for fulfillment and billing. While Whereoware foresees the opportunity to utilize auction-based selling mechanisms in certain situations, such as the liquidation of excess inventory for manufacturers, this functionality is not yet available on the site.

Whereoware’s revenue model is based primarily on the transaction fees it receives from its partner suppliers. Unlike its competitors, who use a percentage-based fee structure,

⁶ Whereoware was not alone in recognizing the potential that the Internet brings to the gift industry: a number of competitors have targeted the same area, including ICG-backed Usgift.com and Hallmark-backed eBizMix.com.

Whereoware's transaction fees are fixed on a sliding scale, relative to the total amount purchased by the retailer. These fees can be low as \$5 and are capped at \$20, depending on the size of the order placed with the supplier. Eric Dean explained the use of the fixed fee as follows: "We wanted to minimize channel conflict with the sales representatives and we also wanted to position the fee, in the minds of the supplier, as more of a marketing or administrative fee rather than a commission." A copy of the Whereoware Fee Schedule is found at **Exhibit 4**.

While Whereoware's current business model relies exclusively on transaction fees as its source of revenue, the company envisions diversifying into several different revenue streams in the near future. The primary sources of additional revenue for the company in the future will be: (1) advertising and sponsorships; (2) value-added services and affinity programs; and (3) the sale of industry information.

As a destination site for small retailers, Whereoware hopes to soon be able to actually sell advertising space on the site to its partner suppliers. On the right side of most pages on the website are three advertising slots for "What's New!", "Hot Buys!" and "Close Outs!", highlighting different product promotions available. Currently, the company rotates products through those slots on a random basis. However, as site traffic grows, the company envisions the opportunity to charge for this space. Because all retailers must register on the site and log-in at every return visit, Whereoware is able to collect important information about their customers and know who the customers are when they visit. Using this information, the company would be able to target relevant advertisements to each specific visiting retailer. For example, if a gift retailer that specialized in candles came to the site, Whereoware could serve up a specific list of featured products that directly related to that particular retailer's business, such as candles and candlesticks. The company hopes that once site traffic has reached a critical mass, suppliers will be willing to pay for these advertising spots, which are akin to slotting rights in a retail store. Because the advertisements would be specifically targeted to actual customers of those products, the company believes it could obtain CPM rates that exceed the declining industry averages. In addition, as traffic and membership grows, the company also plans to sell sponsorships to larger corporations on the site. For example, American Express could purchase the rights to be promoted as the small business credit card company of Whereoware.com.

The company also plans on implementing various value-added services and affinity programs for its customers, utilizing the purchasing power of thousands of retailers to obtain discounts typically reserved for the mass merchandisers, and earning fees for Whereoware at the same time. For example, Whereoware would partner with a credit card processing company to offer their services to Whereoware members. Retailers would receive a lower rate than most were currently receiving, and Whereoware would receive a small percentage of the transactions processed. Other services being considered include telecommunications, box, bags and ribbon suppliers and various small business service providers. For manufacturers, the company is partnering with a credit agency to provide suppliers with an ability to check new retailers' credit quickly and cost-efficiently. Another major initiative that Whereoware is considering involves taking

advantage of the product images on the site to offer custom catalogs and advertising mailers for retailers and, potentially, manufacturers. Whereoware also foresees offering tools to assist retailers in building their own websites (most independent gift stores had no web presence at all) and e-commerce capabilities, primarily through partnerships with companies that specialize in these services.

Finally, the company envisions a time when it is THE industry source for information and statistics. Once a large community of retailers and suppliers develops, Whereoware will have access, through the tracking of purchases on the site, to information on what is selling, what is not, the newest industry trends and other vital industry information. Through data-mining techniques, the company hopes to one day generate revenue from the sale of such information – much like Webvan earns fees for the sale of customer purchasing information to mass marketers such as Proctor & Gamble.

Obstacles to Growth

From its inception, there have been certain key obstacles to growth that Whereoware must overcome in order to succeed as a viable and, most importantly, profitable company. The main obstacles involve building a community of retailers and suppliers; changing the way the independent retailers do business; and raising capital.

Like any online exchange, Whereoware's business model depends on its ability to scale quickly to a large community of both retailers and suppliers. The problem, of course, is the classic chicken and egg story -- Do you direct your efforts at signing up manufacturers to join the site before there is a significant retailer presence? If so, there is less incentive for manufacturers to participate unless it is at little or no cost to them. If you target retailers first, however, you run the risk of them having a bad experience on their initial visits due to the limited number of products from which to choose. A bad initial experience may result in a lost customer forever. Whereoware chose to target manufacturers with their initial efforts, hiring a team of four sales associates dedicated solely to convincing manufacturers to join the site. Because of the intense competition in the industry, Whereoware has not been able to charge manufacturers for the catalog integration process. In addition, the company has had to agree to waive all transaction fees for the first few months of the manufacturer's catalog coming online.

Another major hurdle, and maybe the largest, for Whereoware has been convincing retailers to change the way they do business. Johns is fond of describing Whereoware's target market of retail owners as "Aunt Betty" – the typical owner of an independent retail gift store is a female from 45 – 55 years old. Many of these storeowners have been doing business the same way for years. Many storeowners do not even own a computer and those that do only use it for e-mail. Convincing these retailers to move the sourcing of their goods to the Internet is not easy. And it has been much more difficult than even Johns or Dean expected. **Exhibit 5** provides statistical information on site traffic and transactions from June through the writing of this case. While Johns and Dean believed that virtually all retailers would one day use the Internet to conduct a significant portion

of their business, they both worried about how long that process could take and whether Whereoware would have the financial resources to await the slow industry adoption.

The biggest difficulty in building the community is getting in front of the retailers. There were no public databases of independent gift stores and purchasing e-mail and address lists from magazines and other trade groups was expensive and often resulted in worthless information. The company has tried several marketing campaigns to encourage retailer registration and purchases, such as advertising in trade magazines; co-branded, direct mail advertising to the customers lists of select supplier partners; and even on-line contests giving away free vacations. While the co-branded direct mail marketing showed the most promise, many manufacturers were hesitant to hand over the names of their customers – they sought new customers from Whereoware and did not necessarily want their current customers moving to online purchasing since such a move would cost them extra transaction fees.

In addition, the company was wrestling with the role of the independent sales representatives in their business model. Unlike some of its competitors, who believe that the sales representatives should be completely disintermediated, Whereoware recognizes the important relationships that the sales representatives have with the retailers – and their ability to speed customer adoption given the proper incentives. While no specific strategy has been chosen, Whereoware has been in talks with several sales representative organizations regarding possible partnerships or acquisitions. The sales representative strategy is a key success factor that the company is still trying to understand.

Finally, Whereoware needed financing. The company had been started with approximately \$ 1.2 million from its founders and a first round of financing from “friends and family.” In late June 2000, the company closed on another \$ 3.5 million of financing, the bulk of which came from Peregrine Systems, Inc., formerly Harbinger Corporation – a strategic investor that, among other things, would begin the process of tying the Whereoware site into the back-end order processing systems of suppliers. Once fully implemented, orders placed on the Whereoware system would be immediately channeled directly into the fulfillment systems of participating suppliers. Without such integration, Whereoware simply sends orders via e-mail to the suppliers who then must manually key in the sales information into their internal systems. The company believes that its relationship with Peregrine will help differentiate its services to suppliers and provide significant cost savings for them as well.

Even with the June financing, though, the company needed another large equity infusion soon. The private equity market had turned sour on B2B exchanges in the spring of 2000 and, thus far, the company had attracted little interest from venture investors. While Johns believed he could still find interested individuals to invest in the company, such financing would only go so far. As Dean described it, “We were putting Band-Aids on our financing, but we needed a long-term savior. Our experience with the venture capitalists had led us to believe that they did not share the same long-term interests in this industry as we did. That’s why the tradeshow groups had so much appeal for us. This industry was their business.” Whether from angel investors, venture capitalists or

strategic industry investors, Whereoware needed a significant financial backer if it was going to last long enough to generate significant retailer adoption and traction in the marketplace.

The Strategic Partnership Opportunity

In mid-July, Johns was contacted by Phil Burke, a Vice-President at GLM. Johns was informed that representatives of GLM and DMG, two competitors in the tradeshow industry, were currently conducting a joint tour of various B2B exchanges in the gift industry and would like to visit Whereoware to get a first-hand look at their operations and technology. Johns readily agreed and a date was set. A short description of GLM, DMG and a third player in this industry, the Dallas Market Center, is attached as **Exhibit 6**.

Whereoware had been aggressively pursuing several of the major United States tradeshow operators over the past months in the hopes of forging some type of online-offline strategic partnership. The rationale for such a partnership was clear to Whereoware – the tradeshow offered the four critical things it needed:

- Money;
- Relationships with retailers and manufacturers;
- Marketing power (the three tradeshow groups described in Exhibit 6 send over 5 million direct mail pieces to their customers every year); and
- Industry credibility.

For example, GLM operates the New York International Gift Fair, considered by many to be the premier gift and decorative accessories market in the United States. Twice a year, nearly 600,000 square feet of the Jacob K. Javits Convention Center and surrounding buildings are occupied for five days by over 45,000 attendees and over 2,500 exhibiting firms. To date, however, the tradeshow had refused to grant booth space at these shows to the B2B exchanges, possibly fearing that these dot-coms posed direct threats to their own business. A partnership with a tradeshow operator, however, would give Whereoware exclusive access to shows, the retailer attendees, a database of thousands of retailers and manufacturers, millions of pieces of direct mail for marketing and, maybe most importantly, credibility with retailers and manufacturers alike.

Whereoware had previously provided GLM with a specific written proposal for such a partnership, offering an equity stake in the company in exchange for becoming the online e-commerce partner of the GLM tradeshow. While not rejecting it, GLM had certainly not seemed to take it very seriously. In fact, at the time, GLM already had its own on-line presence at glmmarketplace.com. While the site did not engage in e-commerce, it was attempting to provide many of the same community features as Whereoware.

For these reasons, the news that GLM and DMG, two competitors in the tradeshow world, were engaged in a nationwide “tour” of the various B2B exchanges in the industry produced surprise and confusion among the management team of Whereoware. There

was no formal agenda for the meeting nor did these tradeshow operators make their intentions clear. Still, Johns and Dean saw this as the opportunity the company needed to make an important impression on two very important industry players and, hopefully, convince at least one of them that a partnership with Whereoware would serve both parties long-term interests.

On July 19, Whereoware rolled out the red carpet for its guests -- presenting them with a tour of the offices, a meeting with top Whereoware and Ventera executives, and a power point slideshow detailing the company's business plan, its technology platform and capabilities and even its vision of what a proposed partnership between the three companies might look like.⁷ A power point slide of Whereoware's envisioned "Global Gift Network" is found at **Exhibit 7**. While the meeting seemed to go well, the guests never divulged the intent of their visit and the partnership proposal was met with little discussion. When the representatives left, Johns and Dean were as unsure of the company's chance to strike a strategic alliance as before the meeting.

Opportunity Knocks

Several weeks later, Johns received a telephone call from Michael Franks, informing him that GLM and DMG wanted to meet with him and Dean at the San Francisco International Gift Fair, a GLM show. It became clear from this and subsequent telephone discussions that the tradeshow groups were interested in investing a large sum in exchange for a significant equity stake in Whereoware. In fact, Franks had pointedly asked Johns to determine how much money the company needed to continue operations over the next two years without regard to revenue or profits. At Whereoware's valuation from the financing round two months previously, such a capital infusion would require giving up a majority of the company to these established industry players. Still, without such funding Whereoware would not likely last long into next year and there were no other financing opportunities on the horizon. In addition, Johns and Dean were excited about the opportunities that such a relationship would hold for the company. GLM and DMG operated approximately 25 gift and home accessories tradeshow in the United States and Canada. The companies had a combined database of over 65,000 retailer e-mail addresses and relationships with thousands of suppliers. The chance to become the online partner of these offline industry powers would clearly give Whereoware a leg up on its competitors and a competitive advantage in the race to become the dominant portal in the industry.

Still, though, Johns and Dean had been given virtually know information on what these companies envisioned for their relationship. While Whereoware had been open about the possibilities it saw for a combined entity, they had not been given any hints as to what these tradeshow groups were actually thinking – would they view Whereoware as simply

⁷ The latter generated some controversy internally, as some members of the Whereoware management team felt it was premature and presumptuous to present an outline of a proposed partnership when no one knew the real purpose of the visit. Still, Johns was determined to provide the tradeshow operators with a potential vision of the future which included Whereoware and, thus, the Global Gift Network slide remained in the presentation.

an off-line e-commerce site or would Whereoware become the central portal for a new global gift network? Did these companies simply want to purchase the technology platform Whereoware had developed and nothing else? Would Whereoware simply become the engine for a new online exchange branded and run by GLM and DMG? As Johns and Dean scrambled to finalize their own ideas for a potential partnership, they continued to wrestle with how best to structure a “bricks and clicks” relationship that leveraged the core competencies of all the parties involved without losing control of the company they had founded.⁸

⁸ As a postscript, GLM, DMG and DMC eventually agreed to invest a total of \$21 million in Whereoware for an undisclosed equity stake in the company, thereby taking the first step towards Johns’ vision of a “global gift network.” The details of how these four groups will work together in practice are still being worked out. The press release announcing this transaction is found at **Exhibit 8**.