Disintermediation and Digitisation in the B2B Marketplace

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Disintermediation and digitisation in the B2B marketplace

As high streets up and down the country all too visibly demonstrate, the way we buy things is changing. Digital transformation is revolutionising consumption patterns: how should B2B businesses react?

The momentum of digital is often underestimated. But an Intershop survey found that 40% of respondents claim digitisation has completely changed their organisation's business model, with a further 48% saying it has made at least some change (Intershop, 2016). Another 94% of respondents said their organisation will need to integrate at least one system into their B2B landscape in the next three years.

Digital consumerism has transformed the dynamics of business transactions. B2C businesses have been grappling with these challenges for over a decade already.

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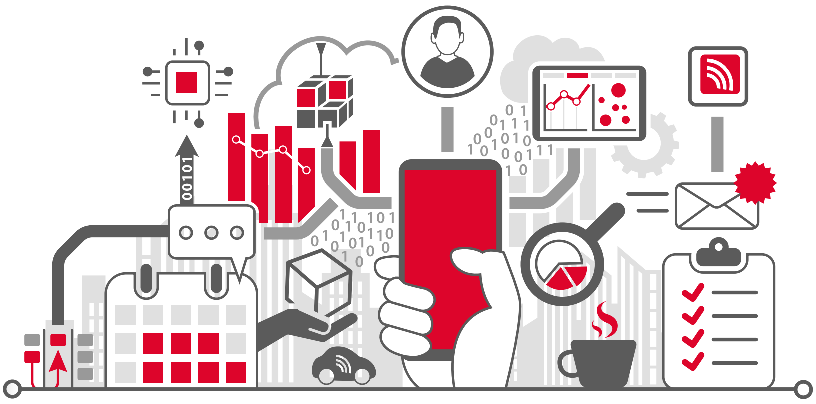

All change for intermediaries and wholesale

The potential of digital technology poses an interesting challenge for B2B companies, particularly those that work with intermediaries like distributors or wholesalers.

Intermediaries enable companies to reach and service end-customers more effectively. Some of the advantages of using an intermediary include economies of scale in production and distribution, focus and specialisation in supply, customer knowledge and locality for distribution.

Often these advantages, coupled with a perceived lack of knowledge and a fear of change, effectively hold businesses hostage. Digitisation, however, can significantly reduce the power once held by market intermediaries and put control back in the hands of the B2B organisation.

This so-called 'disintermediation' can be defined as an organisation's adoption of various mechanisms for handling intermediaries and strengthening links with end-customers (Nordin, Brozovic and Holmlund, 2013). The challenge of dealing with intermediaries is one that is poorly understood in academic research.

There is little information on gaining or holding a strategic position in market channels, or on addressing alternatives to undesired intermediaries. For this reason it is hard to provide a definitive route. Although the rise of e-commerce has accelerated the decline of intermediaries, they are still a powerful force in the market. Nevertheless, customers of intermediaries (such as wholesalers) have become much more demanding and cost conscious in recent years, and less willing to automatically pay for the distribution services built into intermediary margins.

B2B customers typically use strategic sourcing: concentrating their purchases with fewer distributors, maximising discounts by standardising products and brands; and obtaining the lowest prices for all locations (Rosenbloom, 2007).

Clearly, as more customers move to strategic sourcing, fewer wholesalers will be needed. The inevitable outcome for intermediaries that cannot deliver value is disintermediation from the channel. Even those that do adapt and continue to deliver value are likely to experience significant change.

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How does disintermediation work?

While there is little research on alternatives to intermediaries, some approaches for rebalancing the relationship with intermediaries have been proposed by Nordin et al (Nordin, Brozovic and Holmlund, 2013).

- Strategic partnering. By developing a collaborative relationship with an intermediary, a business may enable long-term strategic planning, thus improving competition.
- Mergers and acquisitions. Good for cutting costs, but often not feasible due to initial costs.
- Organic growth. By essentially developing an internal intermediary, businesses can promote direct contact with customers, hopefully building enough bargaining power to bypass intermediary companies. However, as Nordin et al note, this can be an uncertain, costly and time consuming option.
- Communication and training. This approach can help to bridge the gaps with customers that intermediaries create and strengthen relationships.
- Incentives. By encouraging intermediaries to prioritise your products, brand recognition and loyalty can be passed through to the customer. Incentives are particularly suitable for companies with strong brands that are able to develop suitable incentives to influence intermediary behaviour.

While these mechanisms are quite broad, some will inevitably suit certain situations and industries better than others. In the built-product environment for example, firms tend to focus on research and production, rather than on distribution, which may lead to a weak understanding of customer needs.

Interestingly, even across these industries, B2B revenue is increasingly digital. Online sales account for 37% of total sales in the construction industry and 45% of sales in warehousing, according to Intershop's survey (Intershop, 2016).

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Potential of digital

By far the most important mechanism for disintermediation, however, is digitisation and IT. The use of digital technology, particularly in marketing, is fairly low cost and has high penetration levels, making it both efficient and effective. Digital can provide many of the interactive benefits of personal communication, in addition to added benefits such as rehearsability and control over timing.

Rather than finding ways to sustain their traditional approach to the market, digital technology enables businesses to capitalise on the fundamental shift in the market itself.

A 2016 Divante report, for example, found that 74% of B2B buyers made at least half of their work purchases online, and nearly 75% said that purchasing from an e-commerce website is more convenient than buying from a sales rep (Karwatka, 2016).

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Impact of disintermediation across industries

Disintermediation occurs across industries. For example, in the B2C travel industry, hotels use their own websites and direct marketing to try and reduce their reliance on third-party online booking intermediaries. This strengthens the customer relationship and reduces third-party commissions. Intermediaries try and prevent this by focusing on niche markets and strengthening their value proposition.

While current literature recognises the need for omnichannel strategies as a tool for integration across multiple channels – like the websites and direct marketing used by hotels – there is limited knowledge on how to achieve it, especially in a B2B environment. 60% of B2B companies report that their B2B buyers spend more overall when those customers interact with multiple channels (Karwatka, 2016), and omnichannel B2B customers are also more likely to become repeat and long-term customers.

An example that is an exception to this rule is Hummel, a clothing company with an annual turnover of $240 million (2015). Hummel's revenue consists almost entirely of wholesale B2B sales through a series of distributors and licensed partners. Selling through numerous distributors, it found its brand was weakened due to inconsistent portrayal of its products. To address this, Hummel sought to align global branding and increase revenue by enhancing e-commerce support for B2B partners and building an omnichannel customer community. Utilising its own website, Hummel began selling its product direct to customers, while simultaneously sign-posting consumers to physical stores using a 'store finder' feature.

Additionally, it used a combination of blogs, newsletters, social media and in-store advertisements to both increase sales and regain control of the brand. The strategy proved extremely successful, resulting in a ten-fold increase in ROI (Hansen and Sia, 2015). It should be noted, however, that these achievements took significant effort and careful management.

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What does the market say?

A useful reference point is a 2016 Intershop survey to around 400 B2B decision-makers with responsibility for e-commerce, marketing, products, or strategy across the UK, Europe and the United States (Intershop, 2016).

56% of surveyed firms cited the benefits of greater efficiencies of digital, with 44% saying they are generating more total sales thanks to digital marketing and e-commerce.

Some 40% of respondents reported their organisation was using digital channels to capture additional business from existing customers, while 43% said they now target and sell to new B2B audiences who previously wouldn't have purchased from them. 53% of firms confirmed that IT plays a key role in their sales strategy, and that digitalisation is having further impacts on sales, with 50% saying sales are more cost effective.

The Intershop survey also suggests that 71% of B2B sales will be targeted through their own e-commerce sites in future, with a further 46% citing social media as another mechanism.

A further study of more than 1400 B2B buyers found customers rely heavily on a variety of online information sources, and complete nearly 60% of a typical purchasing process before contacting the seller.

This indicates not only that buyers are increasingly researching products online before purchase, but also highlights a significant gap between this trend and the response of the B2B sector. One study has shown that due to a lack of trust between sales and marketing, sales representatives ignore approximately 70% of all leads generated via marketing (Järvinen and Taiminen, 2016).

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Those who fail are left behind

The competitive B2B landscape is changing rapidly. The digitalisation agenda is moving beyond simply responding to B2B customer expectations.

Businesses have to make it easier to transact and do business online.

They need to build deeper relationships by attracting, building and maintaining trust with current and prospective customers, and by providing personalised, useful content that meets their needs.

It took more than 70 years for telephones to reach 50% household penetration, compared with 28 years for radio, and 10 years for the internet. Following this trend, the rate of technology adoption should continue to accelerate so that each new technology outpaces the adoption of its predecessor, and the future will see adoption rates measured in weeks and days rather than years.

Technology adoption typically occurs in an S-curve, with exponential growth of technology adoption from early movers. The proliferation of digital channels gives consumers greater access to information, and the means for communication and collaboration. The physical world is being replicated in the digital world, fundamentally changing the way consumers engage with businesses and each other.

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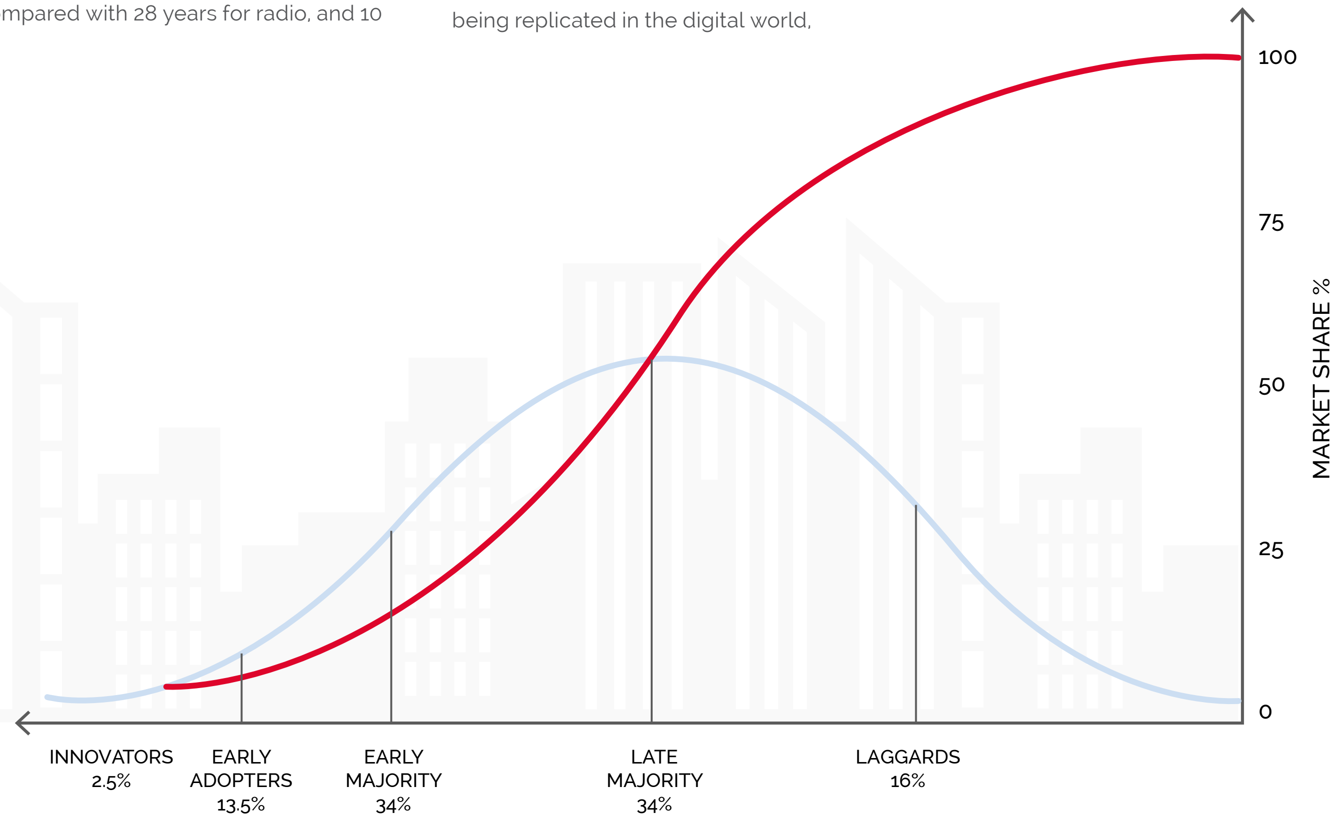

A similar pattern will no doubt occur with digitisation. Diffusion of digital technologies into the manufacturing industry has created new opportunities for innovation that firms must address to remain competitive. Early movers and fast followers tend to have much higher success rates in digitally transforming markets. McKinsey research suggests that three-year revenue growth for such companies was nearly twice that of companies playing it safe with average reactions to digital competition.

These early movers are able to utilise digital information across business models more effectively through channels such as marketing, sales and R&D. The research also found that the first movers in B2B markets were more likely to invest at much higher levels in technology, and more likely to make digitally related acquisitions.

As seen in the graph (below), those who fail to adapt and respond to the changing landscape of their industry will fail, and be outmanoeuvred by digital business models. Early movers have the advantage of preparation, with information embedded across their business models, particularly in areas such as R&D, marketing and sales, and internal operations.

Large and steep power curves across other digitising industries suggest that those that win often win big.

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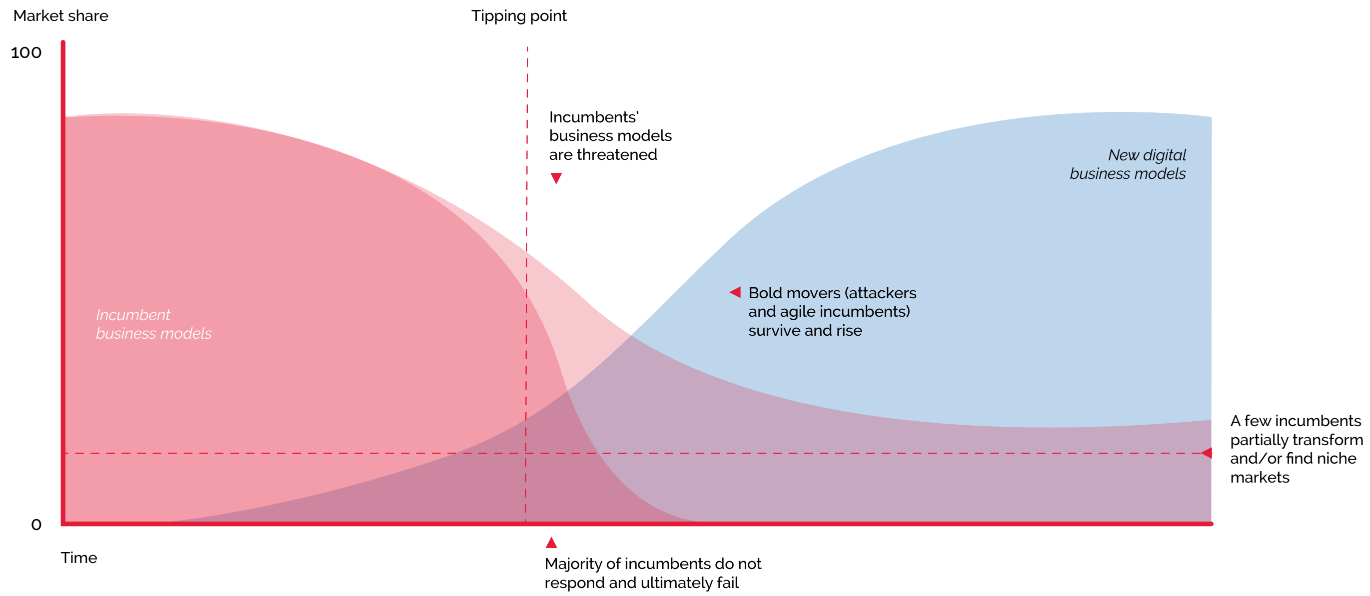

In order to succeed in digital transformation, leading companies tend to focus on two complementary activities: reshaping customer value propositions, and using digital technologies for greater interaction and collaboration.

Crucially, however, these firms must also be highly adaptive, with a nuanced sense of market direction, rapid reaction, and a more unified approach to implementation (Bughin et al, 2018). Interestingly, while most B2B companies are actually outpacing consumer companies in digitising back-office workflows and modernising their existing IT architectures, they tend to neglect innovation around sales and the customer experience - and that's where the real growth is.

Another interpretation of the 'digital tipping point' can be seen in this graph (below). It shows that early adopters need to be in line with new trends before mainstream adoption. Eventually, what was once radical is normal, and unprepared incumbents run the risk of becoming the next Blockbuster, the video rental business that was rapidly superseded by digital TV.

The tipping point is stressed by a number of forces. Firstly, digital technologies create near-perfect transparency, making it easy to compare prices, service levels, and product performance. This creates downward pressure on returns across consumer-facing industries, and the disruptive currents are now rippling out to B2B businesses, creating new pressure on prices and margins (Hirt and Willmott, 2014).

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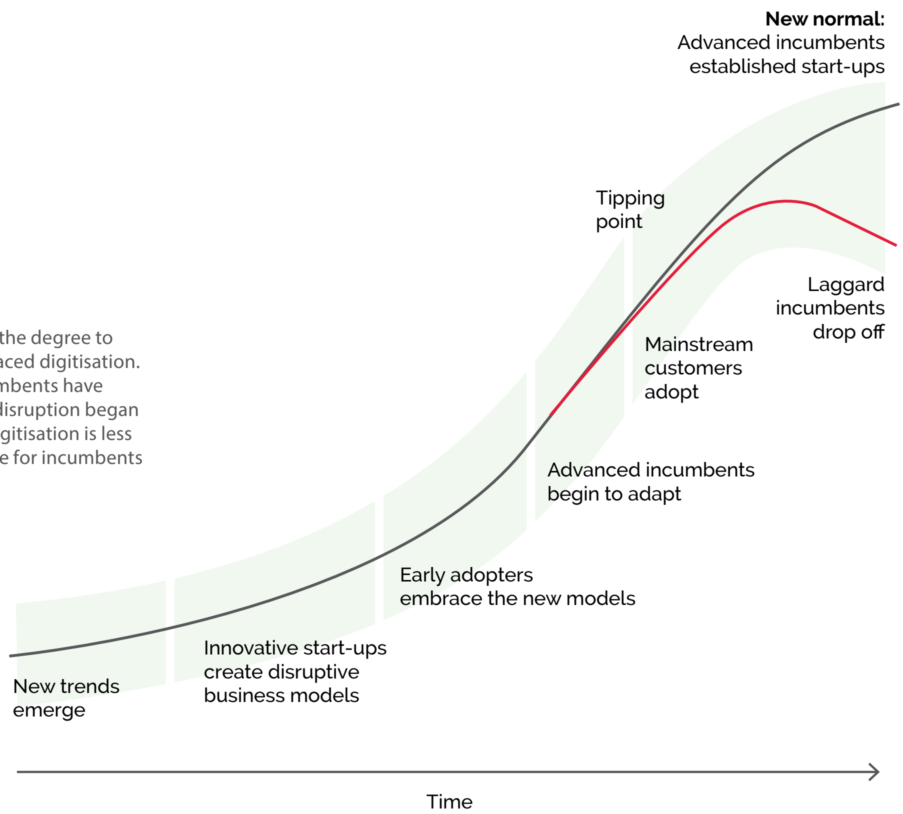
How digitisation transforms industries

The position of an industry on this curve depends on the degree to which companies and customers within it have embraced digitisation. While conceptual, the curve shows how laggard incumbents have already disappeared from industries in which digital disruption began early, such as traditional media. In industries where digitisation is less pervasive but more a gathering force, there is still time for incumbents to adapt and survive.



Secondly, competitors emerge from unexpected places. Digital dynamics often undermine barriers to entry and long-standing sources of product differentiation. New competitors can often be smaller companies that will never reach scale, but still do a lot of damage to incumbents. The winner-takes-all dynamic of digital businesses reduces both transaction and labour costs, and increases returns to scale from aggregated data. Importantly, as digital forces reduce transaction costs, value chains disaggregate.

Advancing the digital agenda takes lots of senior management time and attention. Customer behaviour and competitive situations are evolving quickly, and an effective digital strategy calls for extensive cross-functional orchestration.

The average B2B customer now uses six different channels over the course of their decision-making journey.

However, many B2B companies struggle with disjointed selling models, making online selling tough. Only 15% of B2B companies feel they have a complete view of their customers, but improving this rate may not be as hard as it seems. For example, using order histories of existing customers to analyse prospective markets can help increase win-rates by up to 5% (Catlin et al, 2016).

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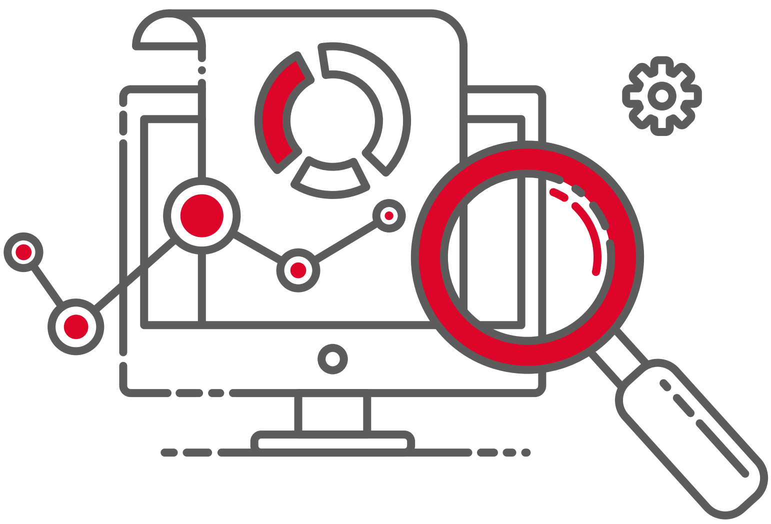
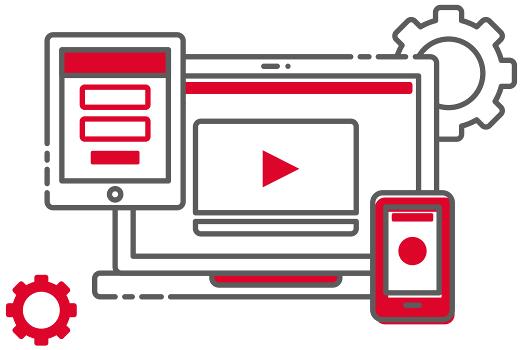


Digitisation Channels



Digitisation often lowers entry barriers, causing long-established boundaries between sectors to tumble. Additionally, the nature of digital assets causes value chains to disaggregate, creating openings for focused, fast-moving competitors. New market entrants often scale up rapidly at lower cost than legacy players can, and returns may grow rapidly as more customers join the network. Digital capabilities increasingly will determine which companies create or lose value.

Above all, communication is king. Customers need to be kept informed of things like new products and services or updates on existing ones. This kind of communication is a significant influence on purchasing decisions. Effective communication channels include websites, feedback pages, newsletters, promotional advertising and social media, as well as prototyping and sales meetings. And it should be a two-way process. Knowledge gained from customers can be used in product development and collaboration.

Interestingly, studies indicate that website users do not form their attitude towards B2B websites based on the number of users or level of credibility.

This may be because B2B users are more rational: they focus more on the utility they obtain, which is perceived value. This has direct and positive effect on user loyalty. The importance of improving online customer experience through successful and quality information searching, website credibility and customer support is therefore vital (McLean, 2017).

Price, product performance, and product reliability are key determinants for customers in B2B markets. However, some interviewees reported that customers are often unable to express their needs beyond short-term improvements and adjustments, and as they cannot specify their expectations for digital innovation, setting long-term goals is difficult (Abrell et al., 2016).

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The next step for your company

Digitisation and disintermediation are often more challenging in the B2B marketplace, simply because sales are often more time consuming, higher value and generally more complicated. In addition brand/ product loyalty in the B2B environment is often stronger.

Stability is also a deterrent, with customers generally being very conservative, valuing reliability and cost-effectiveness, and unwilling to take risks (Abrell et al., 2016). However, this does not mean digitisation and disintermediation are not important in the B2B sector. If anything, they are more important, precisely because of the reasons cited.

The importance of B2B digitisation, and its competitive implications, is easy to overlook because the digital shifts under way are less immediately obvious than those in B2C sectors and value chains. Industries studied by McKinsey, however, showed more B2B companies had digitised their core offerings and operations over the past three years than had B2C (Bughin et al, 2018).

Digital technologies provide challenges, but also the fundamentals for innovation. Proficiency with digital markets and clear market understanding is crucial to survival in the sector.

By digitising, businesses can reduce costs and improve the reach and quality of their offerings.

They should be talking to end-users – both customers and non-customers - in the search for new ideas. Product inventions in which users are involved are much more likely to succeed, and lead to innovations that the firm would not otherwise have developed.

The B2B manufacturing industry is often characterised by products that are complex with long life cycles. Innovation is expensive and time-consuming and major changes in development trajectories are rarely feasible. As a result, identifying the right long-term direction early is more important as frequent adaptive readjustments are much less feasible. Ultimately, today's B2B customers expect a frictionless experience, no matter what channel they use.

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Recognition of the challenge of digitisation is a first step for leaders. The next step is to develop a digital strategy that responds to these challenges.

Strategy ultimately depends upon business size and capability, as well as the market it operates within. By cherry picking digital initiatives, a business should be aiming to respond quickly to disruptive market shifts. This may entail many or few of the strategies mentioned; enabling lower cost and more transparent transactions, as well as enhancing customer and supplier interactions, boosting operational performance, and building capabilities to increase competitive advantage (Abrell et al., 2016).

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