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Organizing for E-Commerce

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In theory, many established companies are well positioned to succeed at e-commerce. They possess critical assets—strong brands, established customer relationships, and existing logistics systems—that can give them an edge over start-up competitors. But in practice, companies will not be able to exploit these assets unless they can effectively organize for e-commerce. Indeed, for large incumbent companies, the most difficult challenges of e-commerce are not so much strategic as they are organizational.

This conclusion is the product of a recent four-month study of e-commerce initiatives conducted by The Boston Consulting Group. We interviewed senior executives and heads of e-commerce businesses at nearly 30 large corporations in a variety of industries that included retail, manufacturing, media, and financial services. The companies all had well-established e-commerce organizations and active e-commerce businesses in either business-to-consumer or business-to-business markets. Some had them in both. In addition, we talked with relevant external players such as venture capitalists and business partners. Among our findings:

- The success of a company’s e-commerce strategy rises or falls on the company’s ability to organize appropriately. In many situations, sound strategies have foundered on organizational problems.

- Although more and more big companies are focusing on the admittedly critical task of getting their new online organizations up and running, many neglect to make the changes and linkages in their off-line businesses that are necessary to make their online businesses work.

- Getting the structure right—the organizational design of the e-commerce unit and its linkages to the core business—is important. But getting the infrastructure right—people, mindset, culture, and processes—may be even more so. The best organizational design in the world cannot make up for the wrong infrastructure.

• Despite the perceived fuzziness of these soft organizational issues, there are many concrete actions senior executives can take. In this paper, we identify six emerging principles or best practices.

The Organizational Challenge of E-Commerce

Any established company organizing for e-commerce faces a double challenge. The first is by now familiar: to inject the company’s e-commerce initiative with the characteristics of a typical Internet start-up. Competition in e-commerce happens at a highly accelerated pace—orders of magnitude faster than the typical clock speed at most established companies. Winning business models are often profoundly disruptive of the company’s traditional business model. And given the early stage in the evolution of most online markets, outcomes are uncertain and risks high. A company’s e-commerce initiative needs to function on Internet time; challenge existing business models (including the company’s own); exhibit a great appetite for risk; and continually revisit its strategy and customer value proposition, shift direction when circumstances change, and recover quickly from mistakes.

The second challenge an established company faces is less familiar but equally important: to overcome the legacy mindset of the traditional business and put organizational mechanisms in place so that the new online business can leverage certain assets of the core in order to create advantage online.

A company’s legacy assets can be a valuable springboard into e-commerce. The ability to transfer customer relationships and trusted brands to an online environment, for example, can cut customer acquisition costs dramatically. Existing stores, sales forces, and distribution networks can provide the infrastructure that pure plays usually have to build from scratch.

But such potentially strategic advantages come with what might look like an insurmountable organizational dilemma: often, the very assets that the new online business can leverage in the short term are the ones that its success will destroy in the long term. It’s only natural that companies hesitate when faced
with this quandary. But hesitation can be fatal. The value of an incumbent’s legacy assets for e-commerce will never be greater than it is right now. Over time, as the online business matures and pure plays build their own brands and customer relationships, legacy assets will not so gradually lose their worth. Companies need to move quickly to exploit their assets while they still have maximum value. To do so, they must make sure that their online and off-line businesses are working in sync.

The price of failing to leverage core assets can be high. Consider the example of Barnes & Noble’s online business, barnesandnoble.com. Barnes & Noble was slow to grasp the opportunity—and potential threat to its core business—of online book selling. This hesitation left open a window of opportunity for Amazon.com to grow its customer base, develop its brand, and establish a strong first-mover advantage. By the time Barnes & Noble launched its online business, Amazon was enjoying a major cost advantage in the marketing spend required to acquire new customers. It cost Amazon $52 million to acquire its first 1.7 million customers; to acquire the same number of customers, barnesandnoble.com had to spend $98 million—nearly twice as much.²

Barnes & Noble encountered further problems in the way it organized its online venture. The company spun out its online business as a stand-alone entity with few linkages to the core. This organizational choice was driven in part by a desire to achieve the high stock valuations typical of pure Internet stocks and to avoid charging sales tax on online purchases. But it was also an attempt to avoid cannibalizing the existing business. The unfortunate result was that the new online company found it difficult to leverage Barnes & Noble’s substantial legacy assets, including its extensive store network and powerful off-line brand.

The combination of Amazon’s first-mover advantage and Barnes & Noble’s difficulty in exploiting its core assets has reinforced Amazon’s strong lead. Nevertheless, there are established companies that are meeting the organizational challenge of e-commerce. Our research shows that they are embracing six best practices that address a broad cross section of issues: vision, organizational design, governance, culture, management process, and external relationships.

² This calculation is based on analysts’ reports and SEC filings. The costs of customer acquisition for the two companies have since converged. Still, this early advantage was instrumental in helping Amazon establish its lead in the online book-selling business.
Vision: Creating a Sense of Urgency

Given the rapid dynamics of e-commerce competition, incumbents can find themselves at a disadvantage. A company’s first step is to establish, in both the online and off-line organizations, a sense of urgency—indeed, emergency—about its e-commerce strategy. The organization needs to understand—viscerally, not just intellectually—the imperative to move quickly and play to win, even when that means challenging the fundamentals of its core business.

The signals that senior management sends are crucial. For instance, Jack Welch’s simple act of creating a destroy-your-business-dot-com initiative in every General Electric business unit has gone a long way toward focusing the organization on the need to move fast to develop and execute e-commerce strategies. At one media company we studied, the slogan is “We’re dreaming our worst nightmare—and then inventing it.”

Another practical move is to have the head of the e-commerce initiative report to a powerful senior executive. Indeed, in more than 60 percent of the companies we studied, the e-commerce head reported directly to the corporate president or CEO (see Exhibit 1). In our experience, a good guideline is the rule of “level plus two.” In other words, companies should establish a

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**Exhibit 1**

The Heads of E-Commerce Businesses Reported Directly to Senior Executives

<table>
<thead>
<tr>
<th>Number of companies surveyed</th>
<th>Reported to corporate president or CEO</th>
<th>Reported to division president</th>
<th>Reported to EVP or SVP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>17</td>
<td>6</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: BCG analysis.
reporting relationship at least two levels above what would ordinarily be expected.

Elevating the reporting relationship has several positive effects. It makes the importance of a company’s e-commerce strategy highly visible and signals senior management’s strong commitment. It also speeds the resolution of internal conflict. The e-commerce leader is on an equal footing with other business-unit or functional heads and has somewhere to turn when he or she encounters obstacles in the mainstream organization.

Organizational Design: Managing the Tradeoff Between Leverage and Disruption

Once companies are committed to competing in e-commerce, the first questions many senior executives ask concern the structure of the new online organization. Should it be on or off the balance sheet? Inside or outside the core organization?

There is no one-size-fits-all answer. We found a wide variety of organizational designs for e-commerce units, ranging from independent companies entirely separate from the core, to new business units reporting to a common CEO or COO, to organizations fully integrated within existing business units. And many companies that pursue several e-business opportunities use a combination of reporting structures (see Exhibit 2).

Which structure makes sense in any specific situation depends on the individual company’s e-commerce strategy and on precisely which business model it is pursuing. It’s useful to think in terms of four generic online strategies defined along two dimensions.

The first dimension is leverage, or the degree to which the e-commerce initiative stands to profit from existing assets in the core business. Will integrating the online and off-line businesses benefit customers? Will the new online business gain significantly from the use of core brands, assets, capabilities, resources, information systems, and infrastructure? How valuable to the new
business is access to the existing customer base? What are the economics of moving that customer base online?

The second dimension is disruption, or the degree to which the new business will undermine the old. What is the potential of the online business to devalue the core business and its assets? How much organizational inertia is the new e-commerce initiative likely to face from the traditional organization? What will be the impact of the new initiative’s funding and resource requirements on the company’s balance sheet?

When both dimensions are taken into account, four distinctive online strategies emerge (see Exhibit 3):

**E-enabled growth of the core.** Some online strategies do not disrupt traditional business models. Rather, they enable growth of the core business. A dramatic case in point is Cisco Connection Online, the Internet-based system for online sales and procurement that Cisco Systems developed and deployed...
in July 1994. The initiative was the vision of company CIO Peter Solvik and a strategic priority of CEO John T. Chambers. The company’s IT department drove the implementation, and the system is today fully integrated into the company’s standard business processes and organizational units.

Most commentary on Cisco’s shift to online sales and procurement has emphasized the massive cost savings the company has realized—in the neighborhood of $500 million annually. But these savings also represent an equally important strategic benefit. Cisco’s business strategy depends on its continuing dominance of the fast-growing market for routers and other Internet networking equipment. This strategy requires sales growth of 40 to 50 percent every year just to maintain Cisco’s current 85 percent market share. If Cisco had to continually expand a traditional physical infrastructure—its sales force and network of distributors—to support this growth, the long-term costs would be enormous. Even more serious, the time it would take to expand its physical infrastructure might well become a drag on growth. Cisco Connection Online

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**Exhibit 3**

*Distinctive Online Strategies Lead to Different Organizational Structures*

- **E-Enabled Growth of the Core**
  - **Integrated**

- **New Business Concepts Outside the Core**
  - **Independent**

- **New Business Concepts That Transform the Core**
  - **Coordinated**

- **New Business Concepts That Compete with the Core**
  - **Independent or new business unit**

**Potential for disruption of traditional business**

**Potential value of leveraging traditional business**

*Source: BCG analysis.*
allows the company to sustain its growth rate far more cheaply and effectively, thus supporting its current business model.

Of course, Cisco’s e-enabling strategy was disruptive for some organizational groups. The sales force had to be trained to play a new role that focused more on providing value-added services than on merely processing orders. Customers and suppliers had to make changes in their own systems to take advantage of Cisco’s new electronic infrastructure. Nevertheless, these disruptions were relatively minor compared with the clear benefits for Cisco’s business model.

**New business concepts outside the core.** Many established companies are pursuing e-commerce opportunities that lie outside their core business. Although not disruptive to the core, such businesses have no particular need to leverage core assets. In such situations, the principal challenge is financial—how to fund the new business concepts in which the traditional business units have little interest.

Business models of this kind are frequently spun off in order to take advantage of equity funding. This was the approach, for example, of Dixons Stores Group, a leading U.K. consumer-electronics retailer. In September 1998, Dixons created Freeserve, one of the first free Internet service providers and today the largest Internet portal in the United Kingdom. Dixons organized Freeserve as a stand-alone corporation for two reasons: Freeserve had little to do directly with Dixons’s core business, and the investment necessary to establish the portal and create a technological infrastructure equal to expected demand was high. The new company was the first major U.K. Internet company to go public, and its current market capitalization is more than £1 billion (roughly $1.6 billion).

**New business concepts that compete with the core.** Many e-commerce business models compete with the core business. In those cases where the new business has little to gain from leveraging core assets, the main imperative is to free the new unit from the constraints of the traditional business and protect it from being undermined. For this reason, many companies in this situa-
tion create an independent business unit or a separate company. Bank One, for example, has chosen to enter online banking by creating an online financial-services business that is fully competitive with its traditional off-line products and services.

Bank One created an independent unit, WingspanBank.com, to bring the online offering to the marketplace. Wingspan’s business model, which is minimally integrated with Bank One’s traditional products and services, is based on the economics of a pure play. Although the online bank does offer some Bank One products, it also offers many competitive third-party products and services. Wingspan’s intent is to navigate consumers through a broad selection of competitive offerings. Like pure-play online banks, Wingspan attracts accounts by offering higher interest rates than are available at the off-line bank. Wingspan’s combination of high interest rates and competitive offerings is potentially damaging to Bank One’s traditional business. And because it would have been extremely difficult to execute this strategy from inside the traditional bank, Bank One chose to create the entirely separate organization.

**New business concepts that transform the core.** The greatest organizational challenge—and the most common one—comes from new business models that compete with and undermine the core business while leveraging its assets in order to succeed. For example, some online initiatives need access to a traditional customer base in order to penetrate it; others require the use of a retail distribution network in order to steal sales from it.

In these situations, companies must design organizational structures to maintain a constructive tension between disruption and leverage. Decisions must be made about the allocation of capital (how deeply to subsidize the new and at what expense to the old); the assignment of human resources (whether to pull talent, especially managerial talent, from the off-line business); and marketing and sales support (whether to shift customers to the online business). Moreover, those executives who manage an incumbent’s legacy assets must participate in the long-term transfer, transformation, or devaluation of those assets, including, perhaps, their own jobs.
Some companies combine a structurally independent online business with a series of coordinating mechanisms to ensure that the online and off-line organizations operate in sync. A good example of this approach is the experience of Chapters, Canada’s leading book retailer and distributor. Having already shifted much of its business from mall-based stores to superstores, the company was familiar with the dynamics of cannibalization. On the basis of that experience, management was convinced that in order to succeed, its online business needed to be free to steal sales from the off-line business. But company managers also saw enormous value in linking the two businesses with a common brand and a common customer loyalty program, and sharing such services as purchasing.

So the company created Chapters Online, an independently traded online business. The online business has complete control over its pricing and stock selection. And it has a clear mission to cannibalize in-store sales.

But at the same time (and in marked contrast to Barnes & Noble), Chapters, the parent company, put in place a set of mechanisms that link its online and off-line businesses. For example, both businesses report to one CEO so that if the online business has any problems gaining access to key core assets, it has a court of last resort. Because the two businesses share a common brand and the online offering is aggressively marketed in the off-line stores, an ad hoc marketing committee made up of managers from both businesses makes decisions about which online promotions should run in the stores and when.

Furthermore, the company takes an integrated approach to the economics of the two businesses. Chapters routinely tracks and communicates such synergies as the number of sales the stores generate for the online business. Chapters has designed its business processes to take advantage of the combined economics of the two companies. For instance, store customers sometimes want books that are out of stock. It is cheaper for the company to have those customers order the books from the online business and have them shipped directly to their homes than for the local store to order the books through the company’s traditional logistics system. So each Chapters store has a number of online kiosks, the retail staff is trained to help customers search
for out-of-stock books online, and transfer-pricing mechanisms reward the local store for every online sale.

**Governance: Adopting a Small but Powerful E-Commerce Center**

Of course, most big corporations are pursuing not one e-commerce initiative but many. For example, at the same time that Bank One is creating Wingspan, it is also developing its own branded online offering to pursue an alternative strategy that leverages the bank’s core assets. This effort is being executed from inside the traditional organization. Automobile manufacturers are simultaneously pursuing direct business-to-consumer opportunities and business-to-business opportunities that involve both dealers and suppliers. And multibusiness conglomerates typically have many different e-commerce initiatives under way. In addition to figuring out how to organize each individual venture, these companies must also create mechanisms that coordinate multiple e-commerce initiatives and manage the company’s portfolio of e-commerce activities.

In the early phases of e-commerce, many companies were content to let any number of business units and functions pursue their own e-commerce strategies with relatively little coordination. The approach was to “let a thousand flowers bloom” on the theory that this was the best way to encourage experimentation, learning, and fast responses to new competitive threats.

Whatever value that approach may have had in the early days of e-commerce, it is no longer appropriate. Many companies have discovered that such decentralization, in addition to leading to waste and duplication, can also seriously compromise the effectiveness of a company’s e-commerce effort. Just letting a thousand flowers bloom can lead to initiatives that are insufficiently radical, have inadequate resources, and are unnecessarily at cross-purposes.

Without some central coordination, business units may hesitate to make big e-commerce bets—either because of the negative impact the investment would have on their P&Ls or out of fear that their core business would be cannibalized. But when they do get initiatives up and running, their lack of coordina-
tion and common standards can be confusing to customers and damaging to the brand. Most such initiatives underinvest in key specialist skills, don’t provide adequate training, and neglect to share best practices across initiatives. Overall, there is a failure to leverage the heft of the entire corporation.

Increasing numbers of companies are trying to define a coherent strategic and operational framework for all their e-commerce initiatives. We found that a new model is emerging: that of a small but powerful central e-commerce unit led by a senior executive who reports directly to the CEO. (For an example of a typical organizational structure for the e-commerce center, see Exhibit 4.)

The e-commerce center sets the strategic context and manages the company’s portfolio of e-commerce initiatives. It develops a framework for making decisions about which initiatives to push and whether to handle them as new business units, new independent businesses, or e-enabling efforts. The center identifies untapped business opportunities or gaps, sets priorities among multiple

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**Exhibit 4**

The Structure of the E-Commerce Center at a Global Manufacturer

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Source: BCG analysis.
initiatives, and manages brands, partnerships, and joint ventures. Typically, the e-commerce center consists of three organizational components:

An **e-commerce enabling group** provides shared services to the company’s Internet businesses. This unit houses such specialist expertise as Web site design and development and partnership management, oversees the interface with the IT organization, and identifies and transfers learning and best practices across initiatives. It is generally responsible for establishing companywide processes and standards, and coordinating technology platforms and the look and feel of company Web sites.

An **e-ventures incubator unit** identifies, develops, and launches new-business opportunities. This organization functions as an internal venture capitalist and business mentor. In the early phases of promising ventures with no clear owner in the traditional organization, the incubator drives the effort. It can also provide centralized funding to support valuable opportunities that a business unit might hesitate to support on its own.

At Delta Air Lines, for instance, a central e-ventures group evaluates potential deals and new business concepts. For promising or high-priority opportunities, the group assembles a SWAT team of relevant business and functional experts who drive the project forward and ensure that the ventures and initiatives the company supports are tied back to the core business.

As part of its central e-commerce organization known as CustomerConnect, Ford has created a business-development-accelerator unit. The unit’s mission is to generate breakthrough opportunities in e-commerce and to help Ford focus on the most critical ones. The unit accelerates the development of the highest priority initiatives. It also supports and coordinates Ford’s relationships and partnerships with leading external e-commerce organizations.

Finally, a new senior executive role—think of it as the **e-czar**—manages the e-commerce center and runs the incubator units and the e-enabling group. Typically, the e-czar oversees a company’s entire e-commerce portfolio and sets companywide priorities. He or she manages the interfaces and, when necessary, resolves conflicts among the traditional business units and between the
e-ventures unit and the traditional businesses. In addition, the e-czar is usually responsible for managing partnerships with external parties.

Culture: Internalizing an External Perspective and Making It Stick

Getting the structure of the online organization right is necessary but not sufficient. The best structure in the world is useless unless it is animated by the right kind of people with the right mindset and the right culture. And yet, because culture and mindset are fuzzy concepts that seem hard to influence, many companies neglect them. They do so at their peril.

Consider the example of a consortium of traditional newspaper companies that tried to create an online business for classified advertisements. The companies knew that to be successful, the business would need the freedom to attack the newspapers’ traditional classified business. So they spun the venture out as a fully independent company, recruiting and hiring the majority of the leaders for the new business from the traditional business. Although these new employees were excited about joining a start-up, they just didn’t have the profile to make it a success. They lacked the bias to action and willingness to take risks that are essential in the e-commerce environment. What’s more, the culture and processes of the new business mirrored those of the traditional organizations—minimal stock options, traditional management processes, and, in the words of one participating manager, “a culture that is too similar to that of the mother ship.” As a result, the business has not gained traction.

So no matter which organizational structure a company chooses for its e-commerce effort, it must also make sure to incorporate fresh perspectives on the business. One essential mechanism for doing so, especially for companies pursuing disruptive strategies, is extensive external hiring. We found that more and more companies—roughly half of those we surveyed—are bringing in outsiders to lead their e-commerce efforts. And in many, as much as 90 percent of the entire e-commerce staff is hired from outside. One company, for instance, first staffed its new online business with roughly 80 percent internal hires and 20 percent external hires. But only when the company decisively
reversed the ratio, hiring 80 percent from outside, did the online business really get off the ground.

Finally, companies are also including outsiders on the governing boards of their e-commerce businesses. Nordstrom, for example, has named a venture capitalist to the board of its e-commerce business. And Wingspan has even gone to the extreme of including representatives from target consumer groups—a stay-at-home mother, a software programmer, and a college student—on its advisory board.

New perspectives on the business are of little value, however, if their only effect is to cause the core business to reject the transplant. When leveraging core assets is central to a company’s e-commerce strategy, it is essential that certain positions in the online business be filled by veterans who know how the traditional business works and have networks they can activate in order to get things done. These “guerrilla networkers” build an all-important bridge between the new business and the old.

At Chapters, for example, a critical component of the leveraging strategy is getting salespeople to direct customers to in-store electronic kiosks where they can search for out-of-stock books online. The company made a veteran salesperson head of sales in the online venture. Her knowledge of the traditional business and her personal relationships with key players allowed her to communicate the potential value of the new online offering to the in-store staff and build active support for the online strategy.

New kinds of measures and incentives can also go a long way toward creating the right mindset and culture. For instance, given the importance of demand-side economies of scale in e-commerce, many companies have been developing customer-based performance measures to supplement traditional profit measures. Revenue per customer and contribution margin per customer are useful and straightforward metrics of this kind, as are growth in the customer base and customer defection rates. On a more sophisticated level, some companies combine customer acquisition costs, retention rates, average spending, and spending growth to develop a global measure of lifetime customer value.
As for incentives, many companies make extensive use of options-based compensation, whether through participation in an IPO or through tracking stock. But in addition to granting equity options, there is also a great deal more companies can offer to encourage the new kind of mindset and behavior necessary to succeed in e-commerce. For instance, they can reward success with increased responsibility—and greater visibility to senior management. One executive explained that “compensation is important, but working on a high-profile project critical to the company is a bigger incentive.” And in some cases, the very culture of the online venture itself—freewheeling, action-oriented, nonbureaucratic—functions as a significant incentive.

When refashioning measures and incentives, it’s important not to forget the managers who remain in the core business. Companies can do a variety of things to give them a stake in the success of the online initiative. Transfer pricing can reward the off-line organization for the online unit’s utilization of core assets and capabilities. Sales force performance can be evaluated in part on the degree to which salespeople push traditional customers toward the online offering. Retailers can credit stores for the online purchases coming from their region. Some companies even reward core-business managers and traditional distributors with equity in the online venture.

Process: Designing E-Commerce-Ready Management Processes

As the measurement and incentives examples suggest, one of the most effective ways to influence the culture of an organization is through the design of its management processes.3 This is especially true in e-commerce, where the fast pace of competition, the rapidly changing environment, and the uncertainty of long-term outcomes make traditional management processes not only cumbersome but nearly irrelevant. Therefore, the e-commerce focus on speed and willingness to act with imperfect information must be hard-wired into the management processes that oversee online businesses.

Consider, for example, how e-commerce initiatives are selected and funded. The vast majority of online business opportunities require massive up-front
investments in marketing and advertising. In the short term, the outcome of these investments is highly uncertain. And they often have an immediate negative impact on a business unit’s P&L. As long as business units use traditional metrics based on near-term return on investment, they will systematically underinvest and neglect important strategic bets.

Many of the companies we studied are experimenting with new approaches designed to free business units from the constraints that traditional processes impose on online initiatives. They are establishing special approval processes and funding committees to screen online investments from a long-term strategic perspective. They are setting up blended funding pools through which the corporate center supplements business-unit investments in e-commerce in order to soften their negative effect on the business unit’s bottom line. Some companies are even moving to options-based funding that segments the life of an online business into a series of short periods and justifies investments in any one period on the basis of the option value of that investment at the period’s end.

So, too, with budgeting and planning. The typical annual cycle most companies follow is far too long to effectively address the high levels of uncertainty and rapid change in e-commerce. As an alternative, some companies are adopting 90-day planning cycles with a scenario-based planning process. They postulate a number of possible scenarios for how the business could develop, pick the most likely, and base their plans on that assumption. In some cases, companies pursue several options against a single opportunity, monitoring progress at 90-day intervals. As the business environment changes, they revise their scenarios, probabilities, and plans accordingly (see Exhibit 5).

Budgeting also is tied to this 90-day cycle in a continuous rolling-budget process. After establishing an initial budget with a range of potential funding, the actual spend is adjusted up or down on the basis of changes in the environment and in reference to a set of goal-oriented metrics—growth, time to market, customer acquisition costs, traffic, revenue per customer, customer loyalty, and success in meeting model-building milestones. Because success is often relative, it is essential also to keep close track of competitor activity.
Such e-commerce-ready management processes tend to make planning more strategic and less tactical. By the same token, budgeting, no longer an accounting-based control mechanism, becomes a means of accelerating the growth of the online business within certain well-defined economic parameters. This approach emphasizes the long-term value of the customer base and the option value of the online investments over a short-term focus on profit and loss.

External Relationships: Using Partnerships to Leverage the Core and Accelerate the Online Business

Organizing for e-commerce does not stop at a company’s boundaries. One of the most important—and most difficult—organizational challenges is to manage the myriad partnerships that are central components of competitive success and critical sources of value. E-commerce partnerships are fundamentally

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**Exhibit 5**

E-Commerce-Ready Planning and Budgeting Maximize Flexibility

<table>
<thead>
<tr>
<th>Traditional Annual Process</th>
<th>Accelerated 90-Day Process</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Q1</strong> Develop budget and plans, submit for approval</td>
<td><strong>Q1</strong> Define strategic scenarios</td>
</tr>
<tr>
<td><strong>Q2</strong> Review variances</td>
<td><strong>Q2</strong> Review scenarios and measures</td>
</tr>
<tr>
<td><strong>Q3</strong> Review variances</td>
<td><strong>Q3</strong> Review scenarios and measures</td>
</tr>
<tr>
<td><strong>Q4</strong> Review variances</td>
<td><strong>Q4</strong> Review scenarios and measures</td>
</tr>
</tbody>
</table>

Source: BCG analysis.
different from traditional partnerships: Companies form many more of them; they change quickly; and they are more complex. Few incumbent companies have the experience or skills to manage them effectively.

Part of the difficulty is that e-commerce partnerships take many different forms. Some of them are relatively simple outsourcing arrangements for acquiring badly needed capabilities such as Web site design and development. Other partnerships take the form of affiliate programs in which an e-commerce site shares revenue with other sites that are sources of online traffic. Some partnerships are nonexclusive licensing arrangements with providers of content. Still others are major strategic alliances involving shared equity investments.

Whatever the form, multiple partnerships are often critical to success in e-commerce. Many of the most successful online offerings aggregate the products and services of an array of companies to provide a rich customer experience that is hard to duplicate off-line. Bringing customers to that offering is often a matter of linking to the Web sites of hundreds—sometimes, thousands—of affiliates. Thus, defining the offering is itself an exercise in partnership management. (For a map that shows the full range of partnerships in one e-commerce business, see Exhibit 6.)

Even more important, rapid and extensive partnering is often the most effective way to achieve the first-mover advantage that can prove essential to winning at e-commerce. Over the past four years, for example, the start-up Healtheon/WebMD has put more than $800 million into strategic investments and forged more than 70 strategic partnerships with organizations across the health care marketplace, including physician groups, practice management companies, laboratories, pharmaceutical companies, insurance companies and other payers, and providers of health care content. By creating a network of partners in every segment of the health care industry, Healtheon hopes to establish industrywide standards for the communication of such medical information as patient records, lab results, doctors’ bills, and insurance reimbursements. If the company succeeds, the cost savings for the industry will be enormous, and the company will reap huge rewards.
Finally, strategic partnerships of this kind are especially important for incumbents. For one thing, they can be a source of enormous near-term value. For example, early in 1999, Delta Air Lines agreed to be the first major airline to sell excess seat inventory on Priceline.com, the reverse auction site, in exchange for an 18 percent stake in the new start-up. At the time of Priceline’s IPO in March 1999, Delta’s stake was valued at more than $1 billion. Late last
year, the company liquidated part of the stake, contributing to a reported
$596 million capital gain at the end of the year and helping to boost Delta’s
fourth-quarter net earnings to $352 million.¹

Partnerships can also provide a way for incumbents to get into the game
quickly and leverage existing assets to repel threats from start-up attackers. For
instance, Delta is a founding member of an as-yet-unnamed multi-airline e-
commerce site on which 27 airlines around the world will offer tickets (includ-
ing special discounted fares available only over the Internet) and travel-related
services.⁵ Although individually the companies compete for customers on
their own Web sites, they are joining together to provide consumers with
levels of choice and convenience significantly better than what is currently
available at such new navigator sites as Microsoft’s Expedia.com or Sabre’s
Travelocity.com. By pooling their unique assets—for instance, proprietary data
on more than 100 million frequent fliers and comarketing deals with hotels,
car rental agencies, and tour companies—the airlines are aiming to compete
against the new navigators more effectively than any one airline could com-
pete on its own.

As these examples suggest, e-commerce partnerships are different from tradi-
tional partnerships. Whereas most traditional partnerships are vertical, linking
companies with suppliers and customers up and down a predefined value
chain, most e-commerce partnerships are horizontal, linking competitors (like
the airlines in the above example) or players from entirely different industries
or business sectors.

What’s more, equity participation is becoming increasingly common in e-
commerce partnerships as established companies trade rights for exclusive use
of their assets in exchange for stakes in new start-up businesses. Nike, for
example, gave the online retailer Fogdog Sports an exclusive right to sell Nike
shoes in exchange for a 15 percent equity stake in the start-up.

There is little doubt that the increased popularity of equity is driven, at least in
part, by a desire on the part of many established companies to profit from the
current sky-high valuations of Internet companies. And yet, there is a deeper,
more strategic reason as well. Equity stakes are the institutional equivalent of stock options for individual employees. And they are the most effective incentive for ensuring the full commitment of all partners and their alignment to the strategic goals of the partnership. Given the fast pace and ruthless competition of the e-commerce marketplace, traditional contractual relationships rarely give participants enough “skin in the game” to make the partnership successful.

And yet, even as partnerships grow stronger through shared ownership, most are also short-term and opportunistic. Nike’s agreement with Fogdog gives the start-up an exclusive right to market and sell Nike shoes online—for only six months. The short window of opportunity is acceptable to the start-up because six months is a relatively long period in Internet time. If Fogdog executes well, it will gain an important lead over its competition, and that advantage will likely induce Nike to renew the deal. By the same token, because the time limit allows Nike to keep its options open and align itself with new, more attractive partners should they emerge, the company can manage the uncertainty of the fast-evolving online marketplace.

Given the sheer number of e-commerce partnerships, as well as their strategic importance and potential to create value, leading companies are embracing four best practices:

First, they are managing their e-commerce partnerships centrally in order to avoid conflicting deals, build expertise, and leverage the full market power of their core business. At GE, for example, a small central unit vets all e-commerce partnership agreements before they are signed.

Second, companies are being aggressive about the value their traditional assets bring to the relationship, making sure they don’t throw that value away. One major U.S. corporation, for instance, was on the verge of signing a contract to pay $8 million to a small e-commerce start-up for adapting its software to meet the company’s needs. Fortunately, a manager involved in the negotiation recognized the potential benefit to the start-up of having his company as a lead customer. The manager reopened the negotiation, and the company ended
up with a 20 percent equity stake that was valued at hundreds of millions of dollars.

Third, companies are alert to situations where they can use partnerships to act as kingmakers in the early stages of e-commerce markets. By moving into strategic partnerships early, when their own assets are still at peak value, companies can have a dramatic effect on the success of their start-up partners and reap enormous value.

Finally, even as many incumbents are aggressively leveraging their legacy assets to strike advantageous partnership deals, the best companies are recognizing that they need to be flexible in their approach to e-commerce. It’s highly unlikely—and probably not even desirable—that any company will be able to maintain total control over its rapidly evolving complex of partnerships. In their partnerships, as in their internal organizational arrangements, incumbents need to be prepared to move the e-commerce business in unanticipated directions, including directions that will undermine the core business. Those incumbents that do so will greatly increase the value of the shared equity in the partnership.