



## The Internet and SMB<sup>1</sup>

The Internet bubble burst in March 2000. Like the great tulip mania in the Netherlands of the early 17<sup>th</sup> Century<sup>2</sup>, the Internet mania could not be sustained because the underlying economics did not support the valuations placed on organizations built around and for Internet communications.

Since that time, many people and organizations have been asking themselves: “Why should I care about the Internet?” This is especially true for small and mid-size organizations, which see the Internet and e-business as an added expense, and not an instrument that increases revenue or decreases costs. Today, we’ll explore a few issues raised by this question.

### The Computer Utility

Any business activity conducted over the Internet seems to have acquired the moniker of “e-something.” We have “e-tail” for retail activity, “e-procurement” for purchasing, “e-marketplace” for trading activities, and “e-commerce” for many undifferentiated business activities. There is today a movement toward identifying any business activity conducted over the Internet as “e-business.”

E-business is an apt term for describing business activity in this electronic era. For many years, the pundits have talked about computers becoming as ubiquitous as the telephone, and the computer industry functioning more like a utility. Ken Olsen<sup>3</sup> often talked about this concept in the early days of distributed computing. The PC revolution, and the associated technology enhanced by the Internet and broadband communications links, all support this concept. Today, more than ever, we can begin to envision computers and e-business as a utility.

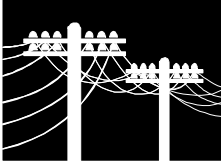
When we need electricity, do we build generating capacity? When we need water, do we dig a well? When we need a telephone, do we build a local voice network? Obviously, these essential business tools are available from companies that provide this capability on a usage basis. We plug into their established network, and pay for the service based on our usage.

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<sup>1</sup> An Acronym for Small and Mid-Size Businesses. Sometimes referred to as SME, or Small and Mid-Size Enterprises.

<sup>2</sup> MacKay, Charles, *Extraordinary Popular Delusions and the Madness of Crowds*, 1841, ([www.litrix.com/madraven/madne001.htm](http://www.litrix.com/madraven/madne001.htm)).

<sup>3</sup> Founder and CEO of Digital Equipment Corporation, inventor of the mini-computer in the mid 1960s.



This same evolution has taken place with computing resources. Two decades ago, e-mail was an internal affair, with large companies creating e-mail within their organizations. Digital Equipment Corporation had, arguably, the largest e-mail network in the 1970s, but with limited connectivity within the general business community. E-mail is useless unless the target audience also has e-mail technology, and connectivity. Fax also had a similar barrier, but the connection over phone lines simplified the adoption of fax technology. The popularity of the PC and the evolution of the Internet made e-mail accessible to all, and perhaps more commonplace today than the fax!

### **The Application Service Provider**

The Application Service Provider (ASP) is the implementation of the computer utility for business. This segment of e-business provides specific capability for businesses on a subscription or usage basis. It is expanding rapidly, especially with daunting applications that change rapidly. Examples that are widely used today include payroll and electronic data interchange (EDI). A business today no longer needs to have in house capability to provide automated payroll services to employees, or EDI services for connectivity with trading partners. Access to these applications can be accomplished with a PC, a browser, and access to the Internet.

Several national, and many local companies provide payroll services today. The company purchasing these services provides the basic information required about each employee to the service provider. This information is inserted into the service provider's database. Prior to each payroll period, the company accesses the application over the Internet and provides the appropriate payroll information for each employee, such as hours worked, pay rate changes, vacation time taken, and changes in voluntary deductions. The payroll service then calculates the payroll, makes deposits directly to employees, and debits the company's checking account for the calculated amounts. They also submit deductions to the appropriate government organizations and insurance/investment companies, while providing reports to these organizations, the employee, and the company. Companies pay the service provider a fee based on the number of employees and the frequency of the payroll, as well as special charges for unique and periodic reports.

EDI is an even more complex, and continuously changing computer application. The cost and complexity of implementing EDI has limited the growth within the US to perhaps 250,000 – 300,000 firms, usually the largest business enterprises. More recently, the ASP is providing EDI capability to SMB on a subscription and usage basis.

### **Why?**

Why should a company choose to use the ASP approach to a business application, and especially one that is part of the company's supply chain? The reasons are both simple and

complex. As is often the case, this is a specific “make or buy” decision. The economics of using the Internet for e-business are not as obvious as buying electricity!



***The most compelling reason for using EDI today is revenue growth.***

Large trading partners often require a firm to accept purchase orders, and provide invoices using EDI - or another form of electronic communication directly to their computer system. Especially in the retail industry, one of the most computer automated industries for routine business transactions, the vendor often must use EDI to become a supplier. Retailers often require even more complex electronic transactions than purchase orders, change orders and invoices, such as Advance Ship Notices (ASN) to their stores and distribution centers. If a supplier wants to sell products through WalMart, or other large retailers, they must use EDI.

The first use of EDI is usually due to the desire to acquire a large trading partner as a customer, and increase revenue. Once this is achieved, however, the efficiencies of EDI and electronic receipt and transmission of business documents become apparent. The reluctance of firms to adopt this technology is the realization that this change requires a change in business process, without any hope of eliminating the former process. Using EDI to conduct business with a large trading partner does not mean the elimination of receipt of purchase orders via phone, fax, or mail. These manual systems must still be continued for many purchase orders and invoices. So, the initial implementation of EDI increases the cost of business for the supplier, and must be justified by the increase in revenue, and profit, from the large trading partner.

Until recently, the cost of implementation has been significant. Buying computers and software, hiring and training personnel resources, and establishing a relationship with an EDI Value Added Network (VAN) has cost a minimum of \$20,000, and usually more than \$100,000. There are also continuing costs for software upgrades, updates, training, and VAN charges. These costs deter all but the most committed suppliers to the largest trading partners. We estimate that fewer than 20% of the 7.4 million small businesses in the US with between 10 and 100 employees use EDI or e-commerce today, largely because of this cost and complexity!

With the evolution of e-business, and the ASP model, smaller companies can now use the advantages of EDI and e-commerce without the large initial investment and continuing expense of times past. With a modest initial charge, a monthly subscription fee, and a small per transaction cost, a company can conduct EDI transactions over the Internet. One supplier in the marketplace today, Electronic Commerce Systems, provides Internet EDI for an initial fee of \$1700 and \$100 monthly subscription fee. This entry-level plan provides up to 100 monthly transactions with one trading partner, and additional transactions are only \$.50 each!

*Once a company has established the electronic capability to exchange business documents, then it can begin to achieve cost reductions. Additional trading partners can be added to the electronic capability quickly, and with only a small incremental cost. Over time, the cost savings from reductions of administrative personnel, reduced telephone line charges (fax) and reduced mailing costs will improve the profitability of the company. Capturing the economic efficiencies requires a study of the business processes, and it can be daunting to capture them, but they are real and can be directly calculated.*

## **Summary**

The growth of the Internet is providing the first evidence of computing power as a utility, a long promised evolution of technology. Using an ASP, a small or mid-size company today can have the kind of e-business capability once reserved for the largest firms. The economics of the Internet permit the smallest firms to compete effectively with much larger firms, profitably.

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*The Innovative Strategies Group is a collection of talented and experienced professionals who focus on helping companies develop and implement growth plans, including expansion through the use of computers and the Internet. We welcome the opportunity to review these issues and observations with you.*