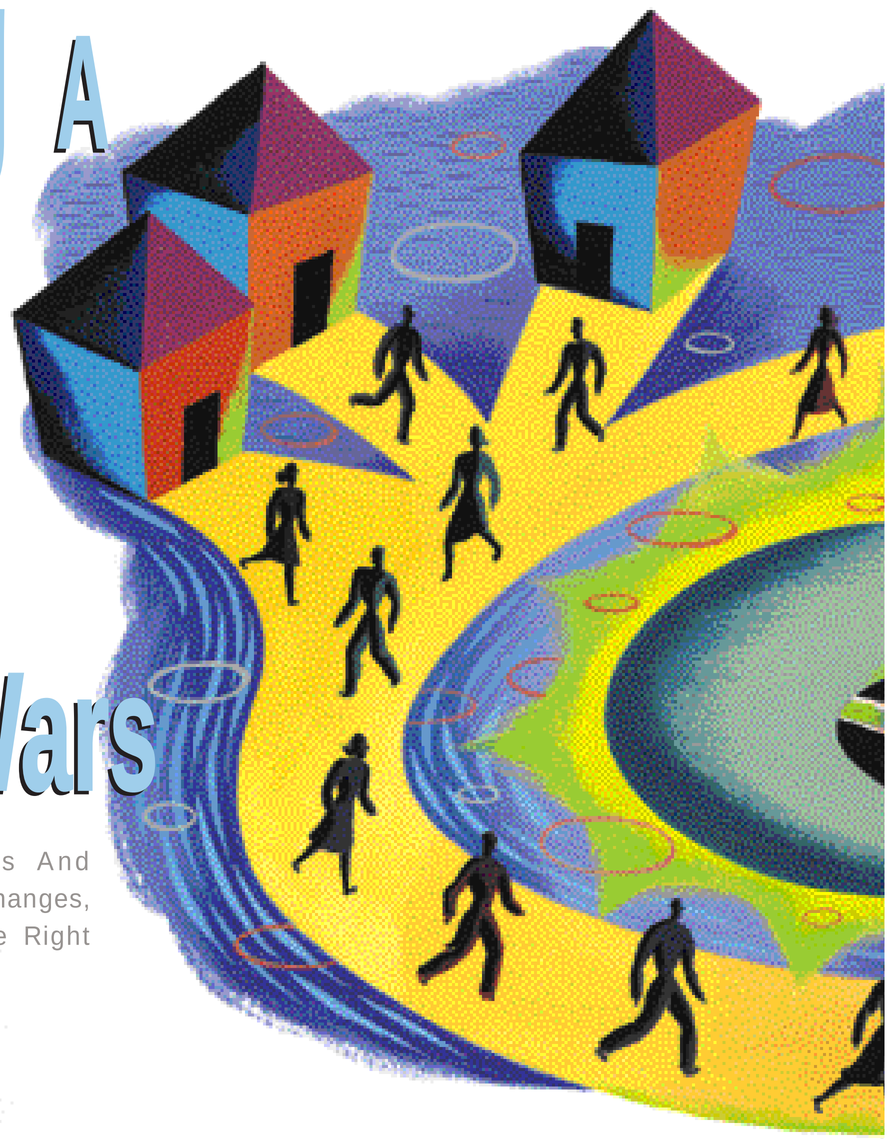
COVER STORY

Backing A Winner In The Electronics Exchange Wars



Many Electronics Manufacturers And Distributors Today Are Wary of Exchanges, With Good Reason. Choosing The Right One To Work With Can Be Difficult.

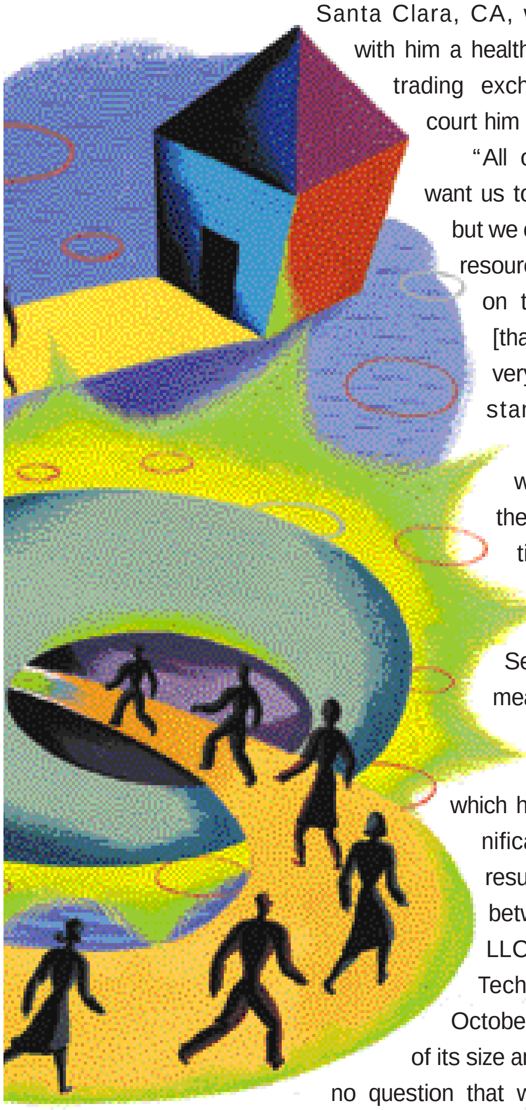
By Karen D. Schwartz

In the heyday of the Internet frenzy, when venture capitalists were freely handing out money to promising online electronics exchanges, the future looked bright. Entrepreneurs were setting up shop on the Web, offering to broker electronics components for manufacturers. These exchanges—as many as several dozen at one point—promised electronics manufacturers a way to offload inventory quickly and efficiently, while offering buyers the ability to find the materials they needed less expensively than ever before.

As investors began to sour on Internet-based ventures, the money began to dry up. Massive consolidation began to occur with the weakest exchanges quickly disappearing and others being bought by larger, more well-funded organizations.

That situation has given pause to electronics manufacturers and distributors, many of whom had been eagerly testing the waters with various exchanges. Today, semiconductor and chip manufacturers are taking a much more critical approach to evaluating electronics marketplaces, judging them in terms of health, longevity, and creativity in an effort to avoid striking up business relationships with exchanges that may be on their last legs.

That's certainly true for Phil Gibson, vice president of Web business for National Semiconductor Corp. of Santa Clara, CA, who now carries with him a healthy suspicion of all trading exchanges trying to court him as a customer.



"All of the exchanges want us to work with them, but we only have so many resources, so we focus on the major players [that] we know are very stable and substantial," he said. "We'll only work with the rest of them if they fit a particular need at a particular time."

For National Semiconductor, that means an inevitable partnership with eChips Inc., which has become a significant player as a result of the merger between ChipCenter LLC and QuestLink Technology Inc. in October 2000. "Because of its size and impact, there is no question that we will now work with eChips," Gibson said. "They're big enough and have enough of an audience and eyeballs on their Web site that it now makes a lot of sense to do business with them."

Analysts say Gibson is on the right track by focusing on exchanges with crackerjack management teams, plenty of funding, impressive client rosters, and major industry alliances. If you want to test whether a relationship with an electronics exchange could truly be a long-term relationship, look at whether some of your primary partners have also made investments in that exchange, advised Jim Forquer, director of the electronics industry group in the Costa Mesa, CA, office of management consulting firm PRTM. "When some of your primary suppliers or other major OEMs—even competitors—have made investments, that's a good sign," he said.

Measures Of Strength

One measure of strength is the amount of funding an exchange has been able to gather. Any marketplace that begins with less than $50,000 to $75,000 in capital and has no commitment from large buyers and sellers is probably a bad risk, said Charles Phillips, managing director and analyst for B2B stocks at Morgan Stanley Dean Witter of New York.

Evaluating the funding level of an exchange is actually fairly easy because venture capital funding—as well as announcements of mergers and acquisitions—is public knowledge. "If you know how much money they have raised and you know how long they have been in business, you can figure out what they are spending and how much is left," Phillips noted.

Determining the number of transactions actually flowing through an exchange is a dicier proposition, but exchanges that are doing particularly well often broadcast that fact whenever possible. Scalability is particularly important in assessing the viability of these exchanges because in this environment, "bigger is better," said Tom Lantzsch, vice president of e-business for Motorola Inc.'s semiconductor products sector in Austin, TX.

"From an efficiency standpoint, the more [transactions] these exchanges do, the better off they are because the economics are pretty scalable. Their infrastructure costs are pretty fixed, so they should be able to scale by greater and greater numbers of transactions," he said.

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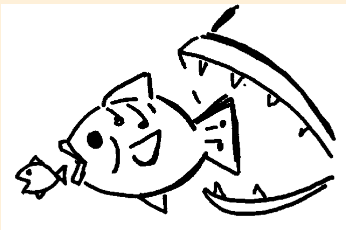
Exchanging INFORMATION

Key Questions To Ask Electronics Exchanges:

- What is the exchange's business model?
- What alliances or partnerships does the exchange have in place?
- What type of funding has it been able to acquire?
- How many transactions per month does the exchange actually handle?
- How many suppliers are actually doing business with the exchange?
- What type of unique capabilities does the exchange provide?
- What exchanges do your customers favor? Is this one of them?
- Are you confident in the exchange's management team?
- Does the exchange truly add value for the manufacturer or its customers?
- Does the exchange operate under a set of standards?

Today's Changing Online Electronics Marketplace

Weaker electronics exchanges today are getting swallowed up by larger, better-positioned players. One of the first to undergo this transition was NEXC Global Electronics Exchange, a marketplace for semiconductors, computer systems, and subassemblies, which was acquired by VerticalNet Inc. of Horsham, PA, in November 1999.



Since then, more consolidation has taken place. The most recent is eChips Inc., a company formed in October 2000 from ChipCenter LLC and QuestLink Technology Inc. that aims to provide a fuller range of collaboration services than did its predecessors.

Competing with these stronger exchanges are a handful of independent electronics exchanges with specific market niches, such as FastParts.com of San Jose, CA, PartMiner Inc. of New York, and eeParts.com Inc. of Dallas.

But perhaps the biggest threat to both consolidated exchanges and niche marketplaces are the new consortium-based electronics exchanges, which are backed by industry giants with plenty of clout and cash. One of the most prominent is eHitex Inc., a full-service exchange for the electronics and telecommunications industries that opened for business in May 2000.

The rapid consolidation in the online electronics marketplace shows no signs of slowing down. Today, there are about a dozen exchanges servicing the electronics marketplace—down from at least twice that number a year ago. Eventually, there will only be a half-dozen left, said Charles Phillips, managing director and analyst for B2B stocks at Morgan Stanley Dean Witter of NY.

"It won't get down to a single market," he predicted, "but you might eventually see a few independents in each of the major relevant segments like chips or parts and one or two consortium-type exchanges."

—Karen D. Schwartz

Ensuring that the exchange offers a good value proposition, in general, for your business and customers is paramount to choosing the right partners, Lantzsch said. "Understand the value proposition they offer. Understand the motivation of the creators of the exchanges," he advised. "And based on that value proposition, figure out how you are going to use it to better service your customers and reduce your costs."

Offering a unique service is another good measure of an exchange's long-term viability. "When one of these new exchanges crops up, you have to ask if this is just one more in the big mob trying to be a cross-vendor comparison site or if there is some significant value point they are adding to the equation," said Jane Schoen, Internet channel director with the semiconductor group at Texas Instruments Inc. in Dallas. "Maybe they have a rich repository of simulation tools or a tremendous library of technical training that would be very valuable to our target audience. It has to be an extraordinary step in value."

"If these exchanges survive, great. If they don't, it's probably because they weren't satisfying a customer base."

— Phil Gibson, vice president of Web business for National Semiconductor Corp.

Making sure the exchanges you choose use standard interfaces, such as RosettaNet, BizTalk, or Commerce XML (cXML), is also important. Adhering to standards can help minimize a manufacturer's resource commitment and make it easier to communicate with all of the supply-chain members.

"The more standards-driven the exchanges are, the more likely we are to embrace them," Gibson said. "If they line up with the RosettaNet process and I only have to write the RosettaNet interface once, we'll sign up because it will be convenient for our customers."

Warning Signs

Even when everything about the exchange looks healthy, there still may be reasons to be wary. After all, exchanges are in the business of doing or saying anything they can to get business—your business.

Beware of any exchange that tries too hard to recruit you as a member—or even worse, as an investor, said Bruce Goldberg, president of All American Semiconductor Inc. of Miami, an electronics distributor with clients like ON Semiconductor in Phoenix, and Samsung Electronics of Seoul, Korea.

"Some of these exchanges that were on their high horse a few months ago have started singing a different tune. All of a sudden, they became very persistent in asking us if we wanted to sign up," he said. "But when they started saying, 'By the way, you can have an equity investment at a very good discount,' that was a clear signal that their model wasn't working the way it was expected to work, and perhaps they were struggling to keep it going."

However, even exchanges with adequate funding can be a bad risk.

Texas Instruments' Schoen: "When one of these new exchanges crops up, you have to ask if this is just one more in the big mob trying to be a cross-vendor comparison site."

"In the dot-com craze, a lot of companies were able to get one or two rounds of financing that they used to prove they were doing well," Goldberg said. "But we're finding out that that financing was probably a lot easier to get than it should have been, and just because they have money doesn't mean their model is substantiated."

In fact, no type of exchange—even well-backed consortia—should be immune from intense scrutiny, said David Cahn, research director for telecommunications and high-tech at AMR Research Inc. of Boston. Even though consortia like e2open and eHitex Inc. have the best funding and most mature technologies, political infighting from partners who have been traditional rivals can get in the way of progress, he said.

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“There are questions about whether these [consortia] can set aside their infighting and put down their political and marketing bandwidth to develop this technology,” Cahn said. “There are even questions about how well these companies will be able to integrate their technologies. For years they have been trying to integrate their own operations. Now they are telling the world that they can integrate their external supply-chain and everyone else’s disparate systems when they can’t even do it themselves. There is definitely a level of skepticism.”

Hedging Your Bets

One way to hedge your bets safely is to do business with more than one exchange. That way, if an exchange goes under, you’re protected.

“Take control of your content and get it cleaned up so you can publish to multiple marketplaces,” Phillips said. “If you have your content in only one marketplace and let that marketplace control your catalog, you’re taking a chance.”

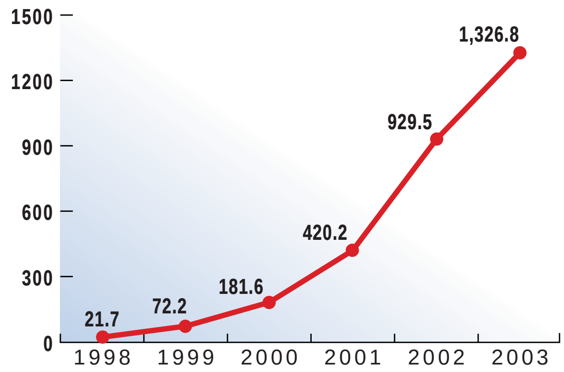
Grilling the exchanges on a variety of topics, including site visitors, transactions, financing, business plan, and future direction also is a great way to weed out weak exchanges.

“We’re in the driver’s seat because it’s very valuable for them to have us as a significant player. So we ask them what they expect to accomplish with the site, how they expect to achieve success, who their large partners are, and what features and functionality they offer,” Schoen said. “There is one company that for years would come and beg to have a richer relationship with us. I kept asking them to profile their users, and they couldn’t do it. That’s pretty telling.”

Starting slowly is another helpful tactic. That’s the method Elpida Memory Inc., a new DRAM company formed through a joint venture between Hitachi Ltd. and NEC Corp., may choose when it begins exploring the world of electronics exchanges. “It’s always the promise of success, but clearly, they aren’t all going to make it,” said Jim Sogas, vice president of sales and marketing for

Worldwide B2B E-Commerce: Computing And Electronics Sector

(billions of dollars)



Source: Gartner Group Inc. (2000)

The Online Electronics Marketplace Over Time

November 1999

NECX Global Electronics Exchange purchased by VerticalNet of Horsham, PA.

May 2000

eHitex Inc., a joint venture by Compaq Computer Corp. and Hewlett-Packard Co., is formed. The exchange, which services the telecommunications and electronics industries, eventually plans to offer a full range of services from e-procurement through supply-chain optimization and collaborative design services. The exchange is based on technology from Commerce One and SAP.

June 2000

e2open opens for business. This consortium-based exchange, headed by IBM Corp. with partners i2 Technologies Inc. and Ariba Inc., is based in Woodside, CA. Other partners include Matsushita Electric Industrial Co. and PartMiner Inc. Its goal is to provide collaboration services for design, supply-chain, manufacturing, procurement, and end-of-life management for high-tech products.

October 2000

ChipCenter LLC and QuestLink Technology Inc. merged operations to become eChips Inc. Major investors include electronics distribution giants Arrow Electronics Inc. and Avnet Inc., as well as i2 Technologies Inc., Pioneer-Standard, and CMP Media Inc. The exchange’s goal is to be a comprehensive online service for electronic component information and sourcing.

Elpida, in Santa Clara, CA. He said he would first evaluate the exchanges on their business models because "if the mechanics aren't right, the probability of success is pretty low."

If the mechanics are sound, Elpida might try dipping a toe in the water, trying one week's worth of parts to see what happens. "If it goes smoothly, we may try more, but if it doesn't go well, you just move on. There are plenty of others to choose from," Sogas said.

But even if you bet on a losing horse, it's an insignificant setback, National Semiconductor's Gibson said. "If these exchanges survive, great. If they don't, it's probably because they weren't satisfying a customer base," he said. "And our customers are the only ones we really care about. The channel is just a fulfillment engine."

Phillips of Morgan Stanley Dean Witter agrees. "The markets themselves may run into trouble, but that doesn't mean suppliers are in trouble," he said. "As long as you don't invest a lot of money or tie yourself in a proprietary way to a single exchange, you'll be fine."

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KEY SIGNS Of Trouble

- Exchanges that begin with less than $50 million to $75 million in capital
- Financing that seems to be running out
- Lack of confidence in the trading exchange's management team
- Signs of political infighting between trading exchange partners or consortium members
- Lack of standards, such as RosettaNet or cXML
- Invitations from the exchange to make an equity investment; such overtures are a red flag that financing is a problem
- Lower than expected number of transactions
- Little commitment from large buyers and sellers
- Inability to scale quickly
- Exchanges that provide only part of the puzzle instead of the full-service e-commerce engine