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How Business-to-Business Sales Dominate e-Commerce

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Mark Uhrbach,
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Summary

The Internet has revolutionized the way consumers interact with businesses. Thanks to the World Wide Web, they have more information and options for shopping than ever before. It is now possible to buy anything from hockey tickets to computers to gardening supplies at the click of a mouse.

However, the Internet has also dramatically altered the way companies do business with one another. Experts in the field say the ABCs of “B2B”, as business-to-business is known, are simple. Companies that buy and sell on the Internet may potentially be able to manage their inventory more efficiently; get goods to markets faster; reduce the cost of paperwork; and get lower prices on some supplies.

Media attention on e-commerce has focused on retail sales. However, the vast majority of gains in e-commerce during the past few years have been the result of increased sales from one business to another, not sales from businesses to households.

In 2004, total online sales were estimated at $26.5 billion. Sales from business to business represented 75% of this total, or about $19.8 billion. This was roughly the same proportion as in 2000.

The three industries covered in this study—wholesale trade, manufacturing and retail trade—accounted for just over one half of online sales made by private companies in 2004.

Firms in manufacturing and wholesale trade were most likely to engage in B2B sales. In 2004 94% of online sales made by the manufacturing sector were between businesses, as were 84% of online sales made by firms in wholesale trade. Firms in these two sectors have adopted e-commerce strategies that enhance their natural position as B2B sellers.

The retail sales sector sold close to $3 billion of goods and services over the Internet last year. This represented just 0.8% of total retail sales in Canada.

Most people gauge the impact of e-commerce on the basis of retail sales to consumers because this has become part of everyday life. However, in reality, the most important aspect of e-commerce is the way firms interact with one another. There are promising signs, however, that online sales will continue to become a more important facet of retail trade as e-commerce extends its reach. In 2004, online sales by retail firms grew by 51%.

This study examines the online sales of three major industrial sectors in Canada, and sheds light on the importance of business-to-business online sales. In particular, it contrasts the performance of e-commerce sales in the retail sector with that of the two large B2B sellers, manufacturing and wholesale trade.

Description of discussed industrial sectors

North American Industrial Classification System (NAICS)

Manufacturing (NAICS codes 31-33) - This sector comprises establishments primarily engaged in the physical or chemical transformation of materials or substances into new products. These products may be finished, in the sense that they are ready to be used or consumed, or semi-finished, in the sense of becoming a raw material for an establishment to use in further manufacturing.

Wholesale Trade (NAICS code 41) - This sector comprises establishments primarily engaged in wholesaling merchandise and providing related logistics, marketing and support services. The wholesaling process is generally an intermediate step in the distribution of merchandise; many wholesalers are therefore organized to sell merchandise in large quantities to retailers, and business and institutional clients.

Retail Trade (NAICS codes 44-45) - The retail trade sector comprises establishments primarily engaged in retailing merchandise, generally without transformation, and rendering services incidental to the sale of merchandise. The retailing process is the final step in the distribution of merchandise; retailers are therefore organized to sell merchandise in small quantities to the general public.

Retail sales have grown, but not as originally expected

Many people predicted in the late 1990s that a time was coming when a majority of retail purchases would be made over the Internet. This time has not yet arrived.

In 2004, online retail sales of just below $3 billion represented 0.8% of all retail sales in Canada. This proportion has more than doubled over the past three years from 0.3% of total retail sales and represents growth of hundreds of millions of dollars.

Retail e-commerce accounted for 11% of all online sales last year, a slight increase from 2002 when it represented only 9%. In terms of value of Internet sales, retail was the fourth largest sector in 2004. The vast majority of these retail e-commerce sales, 85%, was to households and individuals, a proportion that was virtually unchanged from 2003.

Retail e-commerce does not account for a higher proportion of online sales in part because retailers are dealing primarily with a client base of households instead of firms. While firms often have long-standing relationships with one another that involve a level of trust and responsibility, these relationships are often not in place between a consumer and a retailer. In addition, a large percentage of overall retail sales consists of services, many of which do not lend themselves to online sales.

In many cases, there is a definitive economic advantage for companies to purchase online from other firms in the form of reduced transaction costs or increased availability from global suppliers. The advantages of purchasing online may be more obscure, or less appealing to an individual consumer.

Why online retail trade is still in adolescence

In many ways, online shopping at the beginning of this century was undergoing a similar growth process as shopping through mail-order catalogues experienced in the early 1900s. Consumers were reluctant to send cash through the mail system at that time. Nowadays, many Canadians have security concerns about the Internet and are reluctant to provide their credit card number to pay for a purchase.

In addition to the issue of security, Canadians appear also to be disinclined to make major purchases over the Internet. According to the 2003 Household Internet Use Survey[1], books and magazines were the most common item households bought over the Internet.

This reluctance has led to a great deal of ‘window-shopping’ by consumers on the Internet. So, instead of buying merchandise on the Internet, they browse online, then drive to a store. The challenge for retailers then appears to be to convince consumers that it’s safe to make major purchases, as well as minor ones, over the Internet.

To address this challenge, some retailers have taken a different tack. They have attempted to confront this obstacle by offering in-store returns, if they have a “bricks and mortar operation”, or by offering special incentives and discounts to only their online customers. Retailers are trying to make the advantages of shopping online more tangible to their customers.

Others are embracing the opportunity to offer a multi-channel retailing approach. Retailers may advertise their products on an Internet web site, even if consumers must actually go into a store to purchase an item. For example, in 2004, 38% of retail trade firms had a website, while only 13% offered an online purchasing facility.

While challenges clearly exist for the online retail sector, there is evidence that positive trends exist for its future in e-commerce. In 2004, 13% of retail firms were selling online, almost double the Canadian average of just over 7%. Also, 38% of Canadian retailers also had a website, a first step toward selling online.

In addition, while retail sales increased about 6% overall last year, online sales in retail surged 51%. Since 2000, the value of retail online sales has more than tripled from $976 million to $2.95 billion.

Wholesale trade at the forefront of B2B

One of the leaders of the e-commerce movement, the wholesale sector, often tends to be overlooked. This sector is at the forefront of the adoption of information and communication technologies (ICTs) and online sales.

In 2004, wholesale trade had the highest value of online sales of any industrial sector for the fourth year in a row. Wholesalers sold an estimated $6.1 billion in goods over the Internet, which represented roughly 23% of total online sales.

B2B sales accounted for some 84%, of wholesalers’ online total, or around $5.1 billion.

1. Statistics Canada, 2003, Household Internet Use Survey, CANSIM Table 358-0022. This survey was not conducted in 2004 due to a survey redesign. The survey will re-emerge for the 2005 reference year in the form of the Canadian Internet Use Survey, collecting information on the use pattern of the Internet by individuals as opposed to households.

The contrast with the online retail sales model that deals primarily with households is pronounced.

Wholesale trade not only has the highest level of online sales among industrial sectors, it is also one of the leaders in the use of other advanced ICTs such as extranets and intranets. In 2004, 11% of wholesale trade firms had an extranet, while 25% had an intranet. These are often good indicators as to whether a firm will sell online.

Wholesalers have used technology to become more efficient, reduce transaction costs and reach new markets. Technology that enables just-in-time delivery has enabled wholesalers to reduce their overall inventory-to-sales ratio from 1.36 in 1997 to 1.23 now.[2]

Online sales have become a much bigger component of the wholesale trade industry. In 2004, they accounted for 1.7% of operating revenue for firms in this sector.

While still a small part of the sector's total sales, online sales increased 60% for the industry from 2003 to 2004, while operating revenue increased just under 2%.

Manufacturers focus on B2B online sales

In 2004, the manufacturing sector had the third largest value of online sales in Canada. Of the $4.2 billion in goods they sold over the Internet, 94% or $3.9 billion was to other firms.

The nature of B2B sales can be quite varied. A sale may consist of a one-time purchase that is paid via credit card. However, many B2B transactions are much more complex, involving standing or variable orders that can be manipulated by either the buyer or seller as a result of real-time inventory counts or market conditions.

Manufacturers are part of a well-developed supply chain. So it is natural that their ICT systems have also become highly integrated between customers and suppliers. According to the Survey of Electronic Commerce and Technology, manufacturing firms showed above-average use of the Internet, intranets, extranets and electronic data interchange on the Internet.

Much like wholesale trade, the manufacturing sector does not receive a great deal of attention as a user of e-commerce, since it primarily does business with other firms. Even so, the sector's online sales accounted for about 16% of the Canadian total.

Many manufacturing firms have taken the additional step of incorporating extranets and intranets into their businesses to facilitate B2B sales. In 2004, 11% of firms had an extranet and 24% had an intranet. In contrast, only 6% of all firms nationwide had an extranet and only 18% had an intranet.

In 2004, online sales in the manufacturing industry increased by 58%, with B2B sales fuelling this growth. On the other hand, the operating revenue for the manufacturing sector grew about 5%.

2. This is a measure of the number of months it would take to exhaust current inventories at current levels of shipments. See Alex Hays, "Wholesalers: A Key Link in Canada's Economy," *Analysis in Brief*, Statistics Canada Catalogue no. 11-621-MIE-2005026, 2005.

Integration of ICTs leads to the dominance of B2B sales

The high degree of technological competence that exists within some firms makes B2B sales easier to initiate. Once consumers, or in this case companies, understand the technology, they are more likely to use it.

In 2004, more than half the firms in wholesale trade and manufacturing made purchases online, compared with the national average of 42%. It appears that there is a willingness to use technology to conduct business and that the infrastructure is in place.

Online B2B sales tend to be made by large firms that are the leaders of e-commerce and often have a trickle-down effect to their smaller counterparts. In some cases, a large wholesaler or manufacturer will set the bar for their smaller customers or suppliers who are integrated in their supply chain.

Firms that wish to buy or sell to the larger wholesalers or manufacturers on a regular basis are encouraged to employ similar e-business processes to ensure compatibility and enhance efficiencies for both firms. This can have the end result of raising the level of readiness throughout the entire industry and across sectors.

This is a conclusion that is unlikely to occur when sales are being made from a business to an individual consumer. The existence of extranets and online sales can be an important step in the supply chain for Canadian firms where efficiencies can be gained. These advantages may apply both to firms that concentrate on B2B sales and those that sell primarily to households. However, these efficiencies may not be as evident for a single consumer who is deciding whether to purchase online.

Firms often order the same product from suppliers time after time and the existence of an e-commerce portal may simplify ordering and billing procedures. Clearly, this is the thinking of firms that have adopted such technologies.

The application of B2B sales and the technologies that enable them will determine how the online market in Canada will continue to develop. Technology and shifts in business practices are steadily moving e-commerce practices from only early adopters toward mass adoption.

The importance of these shifts is not always immediately apparent. However, these innovative leaders remain instrumental players in Canada's transformation towards an electronic economy.