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A Few Supplier Networks Will Prevail, Thanks to the Need for Interoperability

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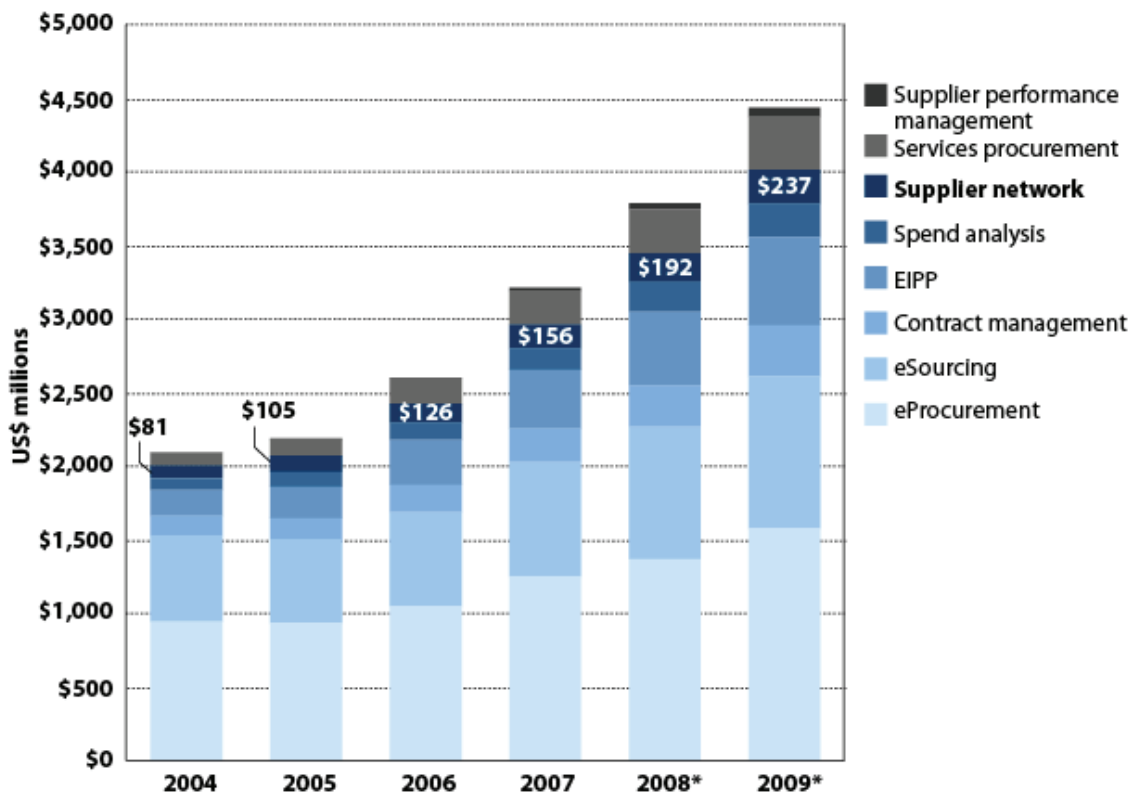
A Few Supplier Networks Will Prevail, Thanks To The Need For Interoperability

The supplier network market continues to grow, but will soon run into problems due to the lack of cooperation among many vendors in a fragmented market. There are currently too many players to solve the technical and commercial barriers to inter-network interoperability, also known as roaming. The solution is market consolidation. Customer demands and the advantages of large networks over small ones will drive four networks to the top, acquiring the others or relegating them to niche roles. This document describes the obstacles to interoperability and how the software industry – technology vendors and their customers – must work together to overcome them.

Lack Of Interoperability Is Delaying Adoption Of B2B eCommerce

Supplier networks facilitate business-to-business (B2B) eCommerce by acting as hubs that connect buyers and suppliers. Buyers can automatically send purchase orders (POs) to their chosen hub and receive shipping notifications, invoices, and other communications back from suppliers. They can also use the network's portal for other forms of collaboration like helping suppliers perform self-service payment status inquiries. The supplier network market continues to grow at 24% per year, but is highly fragmented (see Figure 1).¹ There are literally dozens of vendors, most focusing on specific regional, vertical, or document niches (see Figure 2).

Figure 1: ePurchasing Market Forecast



Source: Forrester Research, based on revenues from more than 100 vendors
 *Forrester forecast

Source: Forrester Research, Inc.

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Figure 2: Six Types Of Supplier Network Compete In A Fragmented Market

Type	Examples	Core expertise	Characteristics
Vertical consortium	Agentrics	Retail	The main customers were original co-owners, and often still are, so might migrate to a better network once they sell out (as happened to Hubwoo after it bought Traderanger). They are dominant in their vertical, so suppliers have to participate, but have struggled to expand into other areas.
	Covisint	Automotive	
	Elemica	Chemicals	
	Exostar	Aerospace	
Category expert	DO2	Oil field services	Special functionality and extensive supplier membership gives them an edge in one or two categories gives them an edge in verticals for which that category is key. They also support general requirements for those customers, but without as extensive a supplier stable.
	Powertrack	Freight	
	SciQuest	Lab equipment	
	Tradecard	Global trade	
Regional focus	Hubwoo	France	Local concentrations of customers and suppliers, gradually expanding into other regions, they provide buyer support and supplier enablement services, based on someone else's platform (e.g., IBM's, Oracle's, SAP's).
	IBX	Scandinavia	
	Quadrem	Africa/S. America	
	Tejari	Middle East	
Invoice specialist	JP Morgan Xign	Supply chain finance	Providing invoice-specific functionality like fiscal validation, they support all suppliers, not just direct and large indirect, so many are smaller companies that want self-service entry rather than direct integration.
	OB10	Enablement	
	Transcepta		
	Many small, local players	Local fiscal rules	
Global network	Ariba	Largest network	These offer a wide range of document types and global support, with no particular vertical or category specialization; enterprise buyers might use both global and category-specific networks.
	Oracle	Free add-on portal product	
	Perfect Commerce	SaaS SRM	
	Tradecard	Global trade	
Payment gateways	Bottomline Technologies	Existing bank customers	These build on existing payment solutions to provide a complete one-stop shop for all payments to suppliers, whether from AP or other sources.
	MasterCard	Leveraging card-accepting merchant network	
	Peoplesoft	AP add-on	

Source: Forrester Research, Inc.

Currently, most supplier networks' business models are based on signing up a few enterprise customers that then persuading, or sometimes forcing, their suppliers to use the same service. The problem for suppliers is that not all of their customers have chosen the same vendor, and the networks cannot talk to each other. With interoperability, also known as roaming, one network could forward its clients' transactions to other networks used by their trading partners and forward transactions coming back the other way to the right destinations. Unfortunately, general interoperability does not yet exist, which means that suppliers either:

- **Have to incur extra cost to support customers' multiple networks . . .** Even if it doesn't have to pay to join the network, it will have to spend time and money building and supporting the integration. This is inefficient for all companies, but small and medium-sized businesses (SMBs) might find the cost prohibitive and be effectively blocked off from the eCommerce world.

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- **... or refuse to support networks that don't interoperate with their own.** Companies getting sufficient business from the major customers on their preferred network might decline to trade with minor prospects that want to use a different service. For example, iPayables is one of many small, specialist invoice networks that secured American Airlines as an early client. This, in turn, attracted several other major airlines including Delta and NorthWest, which signed up with iPayables rather than try to persuade their shared supplier base to support a duplicate vendor.

Four Barriers To Interoperability Delay Progress

Everyone agrees that inter-network interoperability would be a good thing, but direct action is patchy and progress slow. So what is the holdup? Sure, there are technical issues to resolve, but they aren't overly complex. Integration is a core competence of all the B2B network vendors, so each could develop a link with any one of its peers should both want to do so. Why aren't they doing this as quickly as they should? Because they cannot overcome the:

- **Fragmented market that makes vendors reluctant to collaborate.** Network companies see their supplier stable as part of their value proposition and do not see why they should give perceived weaker competitors access to it. They prefer to try to persuade the other network's customers to defect rather than risk bolstering the rival's offering.
- **Lack of a commercial model that would reward networks for supplier enrollment.** Most vendors provide their service free to suppliers on the assumption that the buyer will be paying. Because they will earn no revenue from forwarding suppliers' invoices to other networks, there is no financial incentive for acceding to any request to pursue specific inter-network integration.
- **Egocentric enterprises choosing closed, proprietary solutions.** Buyers aren't demanding interoperability from their networks because they think they can force their solution on their suppliers. They are mistaken. At best they will cause their suppliers some process inefficiency, at worst be unable to deliver adequate adoption of their chosen service.
- **Variety of technical specifications for documents and status messages.** Global document so-called standards exist aplenty. Unfortunately, industry initiatives like OAG have failed to deliver consensus on any one set of standards, and there are too many players for separate bipartite agreements on formats and protocols to solve the problem.² Nor is not just document equivalents like POs and invoices that are needed; networks must also be able to send each other processing acknowledgements, reject notifications, status updates, and unstructured messages.

A Handful Of Supplier Networks Will Become Dominant

These barriers are insuperable as long as multiple vendors compete against each other, so convergence is inevitable. A small core of successful supplier networks will rise to the top and the others struggle to survive. It is too early to predict exactly how many, and which specific, networks will be the winners, although some clearly have a better chance than others. A handful, three to five, will eliminate the obstacles to progress while continuing to give buyers and suppliers sufficient choice because:

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- **A community of equally successful companies will worry less about competition.** They will be more amenable to cooperating with each other because in the long run they will all benefit from the larger market that interoperability will help to create. This group will strike commercial agreements and develop point-to-point integration with each other, ignoring smaller vendors.
- **Stable networks can focus on delivering value to suppliers.** An inter-network recharge system would be a nightmare to create and administer. Much better would be a model that sees both buyers and suppliers paying a fair and proportionate fee for the value they get from the service. Ariba and OB10, for example, have demonstrated that a supplier will pay for a network service that delivers the needed services and information.
- **Enterprises will flock to the networks with the widest reach.** Supplier resistance is the main barrier to eCommerce adoption, so buyers will prefer hubs that can already link them with their trading partners, directly or indirectly, over those that need to enroll them from scratch. Networks outside the top tier will remain sub-scale, being unable to deliver sufficient supplier participation to attract new customers, and see existing members defect to larger communities.
- **The leaders' message formats will be de-facto standards.** For example, an aspiring standard such as OAG will immediately achieve respectability and attract enterprises to it if two large network players agree to use it with each other.

Three Forces Will Drive This Convergence

This necessary rationalization won't appear on its own. The stakeholders – vendors, buyers and providers of related services – must make it happen because it is in their interests. The forces that will shape the supplier network market over the next three to four years are:

- Visionary players driving market consolidation.
- Enterprise buyers insisting on open solutions that support supplier choice.
- Value-added service providers completing open networks' procure-to-pay solution.

Visionary Players Will Drive Market Consolidation

The economics of a supplier network, like all software, depends on scale. It has to leverage the network effects of having many buyers and many suppliers to create a profitable business on thin margins. Long-term, the sub-scale companies won't be able to fund the necessary level of R&D or achieve adequate profitability to satisfy investors. Nor will they be able to deliver the extensive access to suppliers that buyers need. But defragging this market won't be easy. Many supplier network owners still harbor unrealistic ambitions and won't be willing to sell out cheaply. So who will have the vision, desire, and access to funds to effect mergers and acquisitions? The candidates are:

Favorites

- **The existing global networks that want to stay ahead of the pack.** Ariba's supplier network is the largest, followed by IBX's, Hubwoo's, and Quadrem's, among others. So far, they have been content to grow organically, with occasional small acquisitions, but might decide to accelerate the process if they see someone else threatening to overtake them.

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There will also be mergers of equals that can pool customers, gradually combine technologies, and generally leverage economies of scale to boost profitability.

- **New entrants with technology-related B2B service as a core expertise.** B2B service is a vital element of a successful supplier network. Perhaps it would be more accurate to describe it as B2b, the small b indicating the SMBs that will form the bulk of its membership. Supplier networks would be a logical direction for a large corporation with a background in, say, customer support call-centers.

Possible Contenders

- **Large enterprise software companies like Oracle and SAP.** These corporations have been the most active buyers of technology companies, but this isn't a good space for them. Their traditional strength is within an enterprise's four walls; they are less good at providing B2b services. They will continue to focus on providing platform software to their partner networks, and to enterprises that want to run their own supplier portals.³ Oracle could propel its Oracle supplier network (OSN) into the top four, but doesn't currently regard it as a strategic product; it is merely a free adjunct to its eProcurement modules.
- **Large banks that have already made acquisitions.** Notable in this category is American Express buying Electronic Invoice Presentment and Payment (EIPP) vendor Harbor Payments, and there are many others that own or part-own ePurchasing technology companies.⁴ The bank's main goal is to attract buyers to the network, and persuade them to drive their suppliers to its supply chain finance (SCF) business. This closed, proprietary approach doesn't support interoperability and thus isn't in suppliers' best interests. Many companies would not want to be limited to one bank's SCF product just because of their customers' choice of EIPP product. They want instead the flexibility to find finance at competitive rates independent of their, and their customers', technology decisions.

Risky Bets

- **A consortium of small, specialist networks could not achieve critical mass in time.** Several niche vendors might be able to club together to create a global solution without falling out over common prospects. The Hub Alliance is an example of just such a multi-company initiative.⁵ Currently, it is an informal alliance of four or five vendors that lacks sufficient size to be taken seriously by the larger players. A consortium like this will struggle to fund the central co-ordination of product development and rapid recruitment of additional members it needs to make the leap to the big league.

Enterprise Buyers Will Insist On Open Solutions That Support Supplier Choice

Companies choosing eProcurement, EIPP, and payment products tied to proprietary networks will experience the supplier resistance described above. Most buyers will accept the supplier's need for options and favor collaborative vendors. Moreover, they will respect their suppliers' decisions to sign up with other networks, and won't try to persuade them to defect. Instead they will tell their chosen vendor to strike individual interoperability agreements with any networks with significant presence in their supplier base. The vendors that follow this path will give their customers' access to a wider supplier population and thereby gain a significant competitive advantage over more insular rivals.

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The same principle of choice applies to the related services that complement supplier networks' value propositions. These include payment gateways that help buyers initiate all outbound payments from a single system, and reverse factoring that affords suppliers immediate access to funds.

Value-Added Service Providers Will Complete Open Networks' P2P Solution

The trend to fewer, larger interoperable supplier networks creates opportunities for related services including:

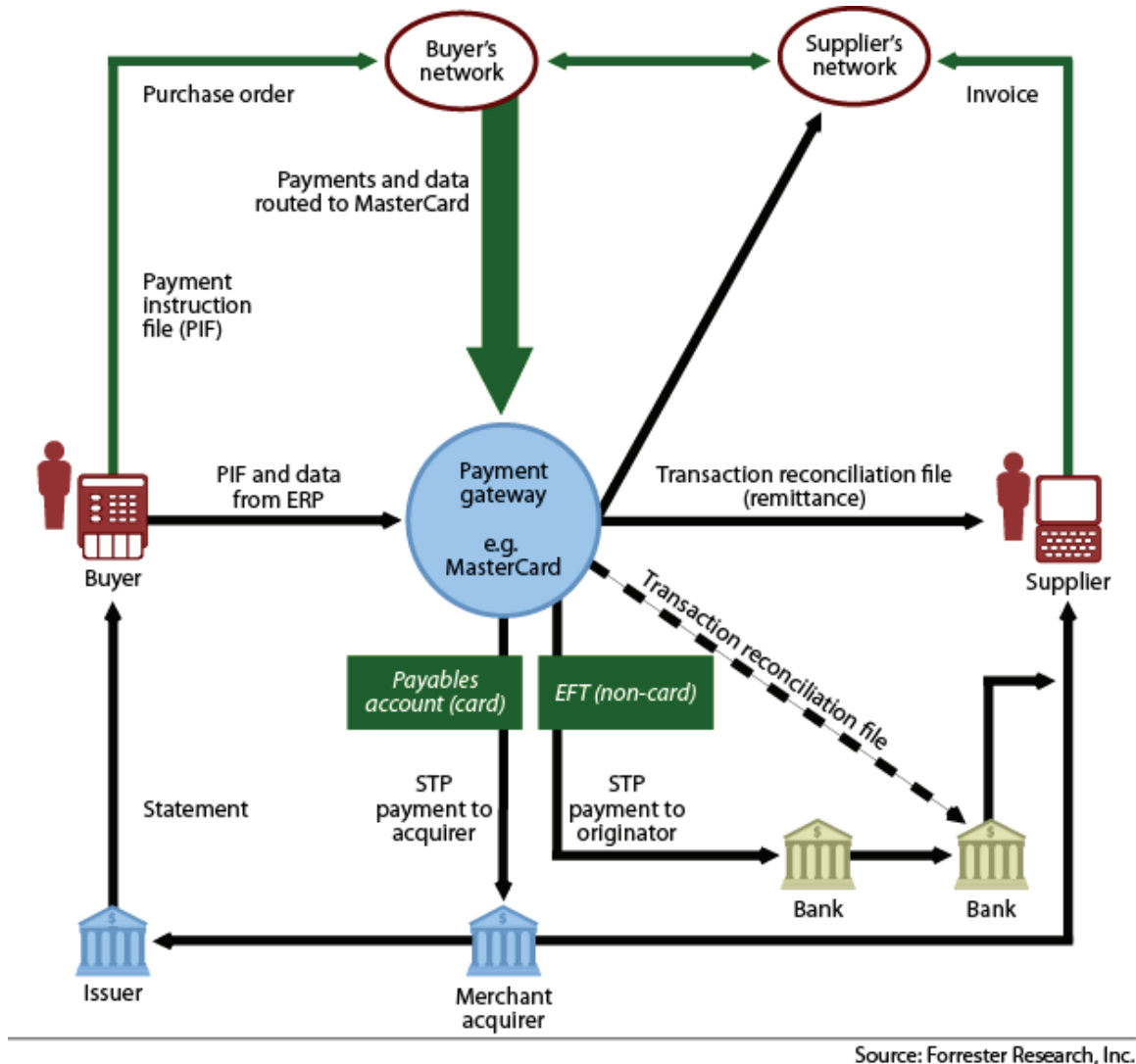
- Payment gateways that provide a complete, automated way to pay all of an enterprise's suppliers.
- SCF providers that let suppliers secure early payment of their invoices.

Enterprises that have automated almost all of the B2B process will no longer accept such inefficient solutions for the last step as printed checks or manually processed letters of credit (LOC). The payment gateway is single product that a treasurer can use to pay all suppliers – from those using a supplier network to those responsible for manual, non-PO invoices – automatically, efficiently, and accurately. It completes the procure-to-pay (P2P) process by:

- **Enabling treasurers to trigger the payment process in their own systems.** A treasurer can use either a financials application or specialist EIPP product to send payment instructions to the gateway, directly or via its supplier network (see Figure 3).
- **Knowing how to transfer funds safely to the right place.** The transfer might be done by a card-based settlement such as the MasterCard Payables Account™ or electronic funds transfer (EFT) like ACH or Chaps.⁶ It is vital that the gateway know to which financial institution to send the outbound payment file. The supplier network could collect this information and forward it with the payment instruction, but that presents some security concerns, so it is better that the payment network be responsible for the task.⁷
- **Sending rich remittance data to the supplier.** The payment gateway must give the supplier, directly or via its supplier network, the comprehensive information it needs to match the payment with open invoices in its accounts receivable (AR) system. This reduces queries from suppliers that can waste a large proportion of an AP department's time.
- **Delivering a single supplier registration process.** Suppliers should be able to register in one place to receive POs, submit invoices, and get paid. The supplier networks must ensure that the payment gateways have accurate "remit-to" information for all their members. Many are forming partnerships to achieve this, such as iPayables with MasterCard. But because the payment companies cannot strike single deals with every hub, the supplier networks must interoperate to make this model work. An open ecosystem will undermine the proprietary model.

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Figure 3: Interoperating Payment And Supplier Networks



Source: Forrester Research, Inc.

Instead of fixed, prompt-payment discount agreements with buyers, suppliers can use the network's "Pay Me Now" function to request early payment by a specialist SCF provider. Faster access to cash is particularly important in today's climate of limited credit. This model, sometimes called reverse factoring, is better than the traditional discount model because suppliers:

- Must invoice correctly against valid POs to ensure swift processing.** The quickest way to reduce AP administration cost is to improve invoice and PO accuracy so clerks waste less time resolving queries, processing corrections, and chasing sign-offs on variances. Giving suppliers access to SCF will motivate them to get their invoicing right. They will insist on official POs and ensure that they apply the right price if they know that mistakes will delay payment.

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- **Get a better discount rate than standard factoring.** The SCF provider can charge a lower fee than normal factoring because it can see, via the supplier network, that the invoices have been approved for payment by credit-worthy customers. Many supplier networks are already forming agreements with payment networks because they realize that suppliers will be enticed to join by access to streamlined payment and/or cheaper finance. Examples include Ariba's tie-ups with Orbian and Citibank, and OB10's links with Paypal and Santander.
- **Can choose when and from whom to get the SCF.** Suppliers can wait for the customers to pay to terms most of the time, but go for SCF when they suddenly need cash urgently. Moreover, they can, provided they choose an open supplier network, compare offers from different financial institutions and choose the best one. Companies involved in global eCommerce want these open, mutually non-exclusive arrangements, not artificial, restrictive links between finance and technology providers.

Innovative Banks Can Take Advantage Of This Trend

The market's convergence into a handful of dominant, interoperable networks will open up new business opportunities for banks that can create new product offerings to support their customers B2B transactions. They can convert the benefits to buyers and suppliers of an integrated, streamlined P2P process into higher margin revenue for themselves by offering:

- **B2B settlement as part of a complete payment solution.** Banks' customers want to pay all their suppliers through a single interface. Banks should seek to partner with payment networks that can provide a holistic, one-stop disbursement shop.
- **Products built on solid, open technology.** Enterprises do not ever want to have to migrate all their trading partners to a new network, so proprietary systems limit enterprises' flexibility to switch technology providers. Banks should partner with payment hubs that have the scale, brand, and vision to be part of the open ecosystem of supplier networks that will emerge.
- **Early payment, when the supplier wants it.** EIPP enables buyers to process invoices sufficiently quickly to be able to take the early-payment discount, if they have the cash available. SCF is even better because it lets suppliers choose when and from whom to pursue accelerated settlement. Because supplier choice will rule this new market, a bank must offer a compelling service in terms of streamlined, accurate payment at a competitive rate. Good services will help the network attract members, and the bigger it is, the better for all concerned.
- **Offer a purchasing card that is part of the P2P process, not a competitor.** With the right supporting services, the purchasing card has an important role to play in B2B commerce. Purchasing cards have historically been used for smaller transactions, whereby the supplier initiates the transaction from its point-of-sale device. Through integration with B2B supplier networks, the purchasing card has emerged as an additional, buyer-initiated payment option alongside other electronic forms of payment like ACH. This new approach to purchasing card processing provides enhanced control and security to the buyer, with straight through processing into the buyer's accounting, ERP, and EIPP systems.

Endnotes

¹ Forrester distinguishes the general Supplier Network market from the traditional vendors of EDI Value-added Networks (VANs) and services. EDI is used by enterprises to communicate with their larger, more strategic suppliers, but is too expensive for smaller and/or tactical trading partners. Supplier networks are cheaper, Internet-based alternatives to EDI.

² The Open Applications Group is a not-for-profit standards development organization focused on building enterprise ready, process-based, business language standards for both B2B and A2A integration. See www.openapplications.org.

³ For example, Tejari and iFaber are based on Oracle technology, whereas Hubwoo, Perfect Commerce and Quadrem are powered by SAP.

⁴ Other examples of banks owning or forming exclusive partnerships with supplier networks include BRED with b-process and Hubwoo, RBS with Accountis, and USBank with Powertrack.

⁵ The Hub Alliance includes Asite, Basware, Burns E-Commerce, Causeway, Certipost, and Liaison. See www.huballiance.org.

⁶ MasterCard is a registered trademark and MasterCard Payables Account is a trademark of MasterCard International, Inc.

⁷ The people who have authorization to access the supplier network to download POs or check on invoice status should not be allowed to amend payment destination information. It would be too easy to temporarily divert funds to their own accounts. Instead, this function should be limited to responsible officials, with tight security applied.

