

TECHNOLOGICAL ADVANCES IN COTTON MARKETING: E-COMMERCE AND PRICE DISCOVERY

**Kelly Burkholder
eCotton, Inc.
Fresno, CA**

Abstract

Business has shown a willingness to adopt new methods that make it quicker and more efficient. Electronic commerce certainly offers that possibility. Only a few short years ago we would have all been ready to believe that electronic commerce would be the only way business would be transacted in the future. We now know that doing business on the Web is just another way of doing business. In agriculture, and cotton marketing more specifically, things are not any different. Electronic marketing is not the only way business gets done, but increasingly it will be one of the ways it gets done. However, if electronic commerce is really here to stay, what benefits does it provide? Is better price discovery and transparency its primary benefit or is there more to it?

Introduction

The year 2001 marked the beginning of electronic cotton marketing on a broad national and international scale. Firms like eCotton, Inc., The Seam and DealCot, to name a few, began offering buyers and sellers of cotton across the country and around the world the opportunity to conduct business electronically via the Internet. Of course the cotton business is not a stranger to electronic marketing thanks to PCCA (Plains Cooperative Marketing Association) and TELCOT which started in 1976. And technically The Seam began trading bales in December of 2000, but the year 2001 saw a wider adoption of the technology and an expansion of the choices available so that almost anyone with a PC and modem has the opportunity to sell or buy cotton on The Web.

Business is Business

The Dot.Com boom and bust has shown us that in the end all businesses must not only innovate but also produce value for their customers and shareholders or they will die. As new uses for, and applications of, Internet technology were created and discovered, as new IPO's were offered and stock prices soared, there was a growing sense that normal business cycles were being suspended. We were beginning to believe that businesses in the "New Economy" were not governed by the old rules. Trees really do grow to the sky! Then we were all brought jarringly back to earth. We learned that the laws of gravity still exist and that there are no signs that the business cycle has disappeared.

So what this means to those of us trying to make it in the world of electronic cotton marketing? It means that to simply take the act of buying or selling a bale of cotton and move it to the Internet is not enough. We must add value to that transaction for both the buyer and the seller, above what they are already getting, or the business will have no merit and fail.

Working Principals of E-Commerce

While businesses that deal with electronic commerce and the Internet are not free from the rules that govern other businesses, they do challenge us to think differently about our own business. There are several key working principals for e-commerce.

1. The Internet changes the perception of business time and distance.
2. Business learning on the Internet must be fast, continuous and evolutionary.
3. E-Commerce requires creative destruction and construction.
4. E-Commerce expands the reach and the richness of information available to buyers and sellers.
5. Networks increase interactivity exponentially among people, companies and industries
6. Turning data into information and usable knowledge for people and companies will redefine the role of intermediaries in e-commerce.
7. The Internet reduces the Cost of Interaction.

Let's take these one at a time:

The Internet changes the perception of business time and distance.

This is nothing new, of course. Just like the introduction of the railroad and the telephone, the Internet has shortened the perceived time and distance between a business and its customers. To some degree it has made location irrelevant.

Everything is experienced in the present, in real time. Time and action are compressed into shorter intervals and businesses are expected to quickly respond to all complaints, important or otherwise.

Business learning on the Internet must be fast, continuous and evolutionary.

In electronic commerce learning and doing are practically simultaneous acts. Businesses must respond to customer complaints and suggestions and the actions of their competitors. We are certainly used to adapting to change in the cotton business. We are used to changing crop conditions, quality, and government regulations. But this kind of change is very different. Here we are talking about a fundamental change in business relationships and to a great degree this is still an industry based on relationships, some of them going back generations. That is why I see this as one of the most difficult challenges for the future of electronic commerce in the cotton business.

E-Commerce requires creative destruction and construction.

In a traditional business setting, what a business does (content), where it does it (context) and the resources it uses to accomplish it (people, plant and equipment, information and technology) are all intertwined and it is hard to separate one from the other. In the world of e-commerce it is possible to reconfigure the content, context and infrastructure so that the accepted business model for the industry can be fundamentally redefined. At the most basic level this can mean that a company like eCotton does not have to have an office in a region to serve our clients, and serve them well. In our case we do have offices across the cotton belt but a gin that calls us with a problem does not care if they are talking to someone in Fresno, Lubbock, Memphis or Raleigh as long as he gets good and prompt service.

E-Commerce expands the reach and the richness of information available to buyers and sellers.

Now businesses, especially sellers, have the ability to reach more customers with larger amounts of information about their products in a shorter period of time. This is contrary to the trade-offs experienced in the past where you had to choose between reaching a large number of customers with a limited amount of information or a small number of customers with a large amount of information. Now you can theoretically provide every buyer in the United States with all the information about a single bale or a large recap of cotton simultaneously with a few keystrokes.

Networks increase interactivity exponentially among people, companies and industries.

Metcalf's Law (named after Robert Metcalf, the founder of 3COM_Corporation) states that "For any communications network, the number of nodes (N) on a network yields that number squared in potential value (N²) to users." In other words, new technology is valuable only to the extent that a lot of people use it. "Use it or lose it"!

Turning data into information and usable knowledge for people and companies will redefine the role of intermediaries in e-commerce.

There are basically four characteristics of information on the Internet that are critical to the discovery of new business opportunities.

- a. All information must be in a digital form.
- b. Information is costly to produce but cheap to reproduce.
 - This means that information products must be priced according to what people will pay for them and not necessarily what they cost to produce.
- c. Information is an "experience good". You don't know if it's useful until you try it.
 - "Try before you buy"
- d. Intermediaries who help people and companies focus on the information they need at the time they need it can save customers time and money.
 - This is leading to the creation of a new level of intermediaries or "infomediaries" that help people focus on the right information at the right time.

The Internet Reduces the Cost of Interaction

This may be the true legacy of the Internet. Many of the article I have researched pointed out that there have only been a few times in the history when interaction costs, the cost of putting a deal together (finding, contracting and communicating with buyers or sellers), have radically changed. The railroads, telegraph and the telephone are again offered as examples.

I find it ironic that one of the articles I read that mentioned this featured Jeff Skilling, the CEO of Enron. I guess that points out that regardless of the cost of the interaction, if you make too many wrong ones you are still in trouble!

Size versus Importance and Importance versus Profitability

Peter Drucker, the business management guru, has said that when it comes to the Internet we must not confuse size with importance, and as a corollary, that we should not confuse importance with profitability. For me these comments are very insightful because they begin to de-mystify electronic commerce and the Internet and help to focus expectations of what the

Internet can and should do. His thought is that by itself the Internet is tremendously important but is only of marginal economic size. And he argues that just because it is important there is not law that says it must be profitable. In other words, size does not necessarily equal profitability or sustainability when it comes to e-commerce. Witness the rise and fall (promise or threat, depending on if you were a competitor or not) of Rooster.com or of Enron. Drucker believes that the main impact of the Internet is much more psychological than economic. There is not a “new” economy. The Internet has just greatly extended the old economy!

Price Discovery

I thought that the most obvious benefit of electronic marketing would be better price discovery. The more people you have looking at your cotton the greater the chance is that you will get the best price. That is the expected result of improved competition. I think that we can quickly and logically conclude that any system that brings together a broader range of sellers and buyers than has normally occurred in the past will lead to improved price discovery. And in the case of electronic marketing, do it in a much faster and more transparent manner. Of course improved price discovery can work both ways. In the case of cotton marketing, improved access to price information allows for faster comparison of available qualities by buyers, and pricing differentials that may now exist because of location are likely to diminish. For growers in some areas that may mean improved prices for their cotton and in other areas it could mean a reduction in premiums previously paid. This is not an argument against e-commerce, but a good example why electronic marketing will be only one of several ways growers will price and market cotton.

But the next question is, does the market want improved price discovery? As we went live with the eCotton WebMarketing System and began demonstrating it to brokers and merchants, one of the first requested changes was to not publicly display bids to other buyers. The reasoning offered was that this actually discouraged bidding and could prevent the seller from getting the best price. Published bids become the floor price, establishing the minimum level a buyer needed to offer to beat the competition. A buyer who might have been willing to pay a much higher level because of his position or current need to fill a contract may lose the incentive to do so if he can see that the highest public bid is significantly lower than the top price he is willing to pay. On the selling side, growers and ginners told us that they did not want a marketing system that limited them to offering only at a fixed price, afraid they would miss out on any sudden market movement (Up, of course!).

Sellers also told us that they did not want a marketing system that was anonymous. They wanted to know with whom they were doing business. In other words, price discovery was not necessarily the most important thing to either the buyer or the seller! In fact I think we are beginning to understand that the idea that the reach and openness of the Internet must result in electronic markets that are more open and provide better price discovery than the traditional marketplace is not true. The Internet can be used to personalize information and in some cases it is desirable to keep it private.

B2B versus G2B

The two electronic marketing sites for cotton that are available to buyers and sellers on a truly national level have approached the market from two entirely different starting points but with several common goals.

The Seam was conceived primarily as a B2B site and its development and launch were textbook. The largest merchants and Co-ops spent a long time developing consensus, obtaining financial commitments and created a site that met their needs: Fixed Price, Guaranteed and Anonymous. Interestingly I believe that the primary driving force was not price discovery but the reduction of transaction or interaction cost. It lowers the cost of putting a deal together and reduces the back office costs to administer it.

The eCotton WebMarketing System was conceived and developed as a G2B site since our core customer is the grower or the ginner who is representing the grower. Our customer wants an open system, full control, and multiple pricing options. They do not want to release their collateral (EWR's) to a third party sub-holder account. And they want to know who they are doing business with. We listened to our customers and you can see it in the features of our site. I believe that eCotton has developed a site that gives the seller the control they want but also provides the buyer with all the tools necessary to efficiently and easily find and purchase the cotton he needs.

The two similarities between the development of these two systems are the goals of reducing the cost to sell and/or buy the cotton and increase the liquidity – the opportunity to show the cotton to as many buyers/sellers as possible in search of the best price.

What Electronic Commerce Cannot Do

Electronic marketing of cotton may improve price discovery and help the seller and buyer reduce the cost of the transaction. It may indeed help the seller determine if he is receiving the best possible price on any given day. However, if the websites are truly “neutral”, the one thing they cannot, and should not, do is tell the seller if today is the right day to sell his cotton.

We cannot and should not be offering marketing advice. That is why I believe there is still a role for the middleman or consolidator. E-commerce may change the way they do business and interact with sellers and other buyers. And perhaps in the end the market will determine that they do not add value but I do not believe that will happen any time soon.

The other limitation of electronic commerce as it applies to the cotton business is the fact that we are dealing with a physical commodity and the operation of delivering the bale to the end user remains. E-commerce can only directly impact the transaction costs of the information that can be digitized. However, it can influence improvements in logistics and transportation that will help to further decrease the cost of moving a bale from the field to the factory.

Conclusions

I am a believer that the Internet has many great uses and benefits for agribusiness in general and cotton marketing specifically. The promise of the Internet to reduce the costs of transacting business, increase efficiencies, and perhaps improve price discovery, is enough to insure that the industry will continue to seek ways to use and improve electronic commerce. However, how it will evolve, what business models will prevail, and who will survive is difficult to predict. Competition and the rapid evolution of technology practically guarantees that any predictions made today will look foolish tomorrow. In fact, in all the reading and research I have done I have not found anyone that I think is smart enough to say with clarity, certainty and consistency what will happen in the future. However, I think we can all agree that electronic commerce is here to stay and that over time a larger percentage of individuals and businesses will use it and find it useful. How things will shake out in the short run is much harder to tell. Paul Saffo of the Institute for the Future said it best when he described the most important rule of forecasting: “Never confuse a clear view (of the future) for a short distance!” To this Rolf Mueller, a professor of Agricultural Economics at the University of Kiel in Germany adds the Sailor’s Corollary, or the “Misty View” rule: “Never mistake a misty view for a long distance!”

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