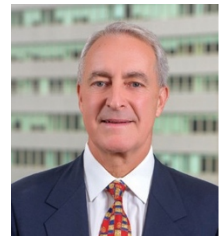
THE BORIS-KAPLAN GROUP

Thoughts for Investors



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SUMMER NEWSLETTER

SUMMER 2000

The stories are, unfortunately, all too common. In the greatest expansionary economic period the United States has ever seen, Fortune 500 companies are missing their quarterly earnings estimates. Legendary companies like Procter and Gamble, Coca-Cola, Honeywell, Xerox, Gillette, and Hershey Foods to name a few. The problems they are reporting are ones that should have been corrected long ago.

Those problems include:

- too much inventory of old components,
- shortage of inventory of new components,
- too much finished product of the wrong model in the distribution channel,
- not enough finished product of the correct kind in the distribution channel,
- logistics problems,
- accounting system problems,
- people problems,
- communication problems,
- problems with suppliers, and
- problems with websites.

How can these problems be happening to the greatest companies in the greatest country, during the greatest economic time? More importantly, what can be done to correct this? The answer is the e-process revolution.

<u>The E-Process Revolution</u>

The e-process revolution, as defined by DB Alex Brown analyst Jim Moore, is the movement of business to an Internet Protocol centric, “the web,” model that incorporates very efficient electronic commerce business practices such as virtually integrated value chains. For as long as business has existed there have been “value chains.” The raw material sat at one end and the customer sat at the other end. In the e-process revolution, each link is connected electronically rather than manually. This speeds communications between each link and generally makes the chain more productive. The e-process revolution is still happening although a lot of the work at the biggest corporations has been completed.

Simply put, the good news is that cost-cutting and efficiency gains of years ago are mostly completed. The bad news is that this turned out to be phase one.

Yet, the government’s published quarterly productivity numbers show productivity is still increasing dramatically. For the second quarter of 2000, the rate of productivity increase was 5.1%. This is the largest gain in 17 years! The continued increases can no longer be explained by saying that businesses are still “cutting the fat” -- linking together electronically. “Cutting the fat” as it was called, only served to keep a company in the game. Yet as the above companies have found out, it hasn’t guaranteed success. Now it’s time to gain and keep a competitive advantage; because the market seeks to punish those businesses that aren’t growing. One answer to growing a business lies in the morphing of regular value chains, or even e-chains, into e-loops. E-loops are significant because a loop provides for a continuously connected circle of communication between and amongst all parts of the chain. Of course any businessperson given the opportunity to pick where in the loop they would want their company to be situated would pick the center, the "hub". E-hub companies are the force driving the new economy and will be the force responsible for helping to correct the problems that are plaguing the Gillette, Coca Cola, Honeywell's, etc. from achieving great results. Now it's time to trade efficiency for effectiveness with the e-hub revolution.

In this newsletter, I will describe the characteristics of an e-hub company as defined by DB Alex Brown analyst Jim Moore. I will also discuss how e-hub companies are helping American business extend this economic expansion.

As stated previously, an e-hub company is one that is strategically situated at the center of the e-loop. There are many e-hub companies since business today involves the interconnecting of many loops. Each e-hub company acts as the communications nerve center. This allows for feedback between links and between separate loops. E-hub companies exhibit three basic tenets that Jim Moore describes as the "trident" model:

1. Strong core functions, i.e. the ability to help companies "deliver the goods" with "dial-tone" or "always on" reliability.
2. The ability to change the behavior of companies in the loop, i.e. convince them that there is a new way to do business.
3. The critical mass of customers necessary to "move the market."

E-hub companies don't make soap or pickles or cars themselves, rather they "enable" their clients to do those things.

<u>Strong Core Functions</u>

Perhaps the first "hub" was the spoken word. When humans first developed speech, its multiple benefits were quickly realized. For one thing a "watch out!" probably kept one from getting eaten. The invention of the telephone was a major advancement and probably the first electronic or e-hub enabling technology. Today the internet, with it's capacity to handle voice, video and data is the ultimate e-hub technology, enabling the creation of specific e-hubs to deliver core functions such as the optimization of employees or fleets of vehicles.

<u>Corporate Behavioral Changes</u>

E-hubs foster the formation of corporate alliances between entities that formerly thought of themselves as competitors. It will be "winner-take-all" for the hub companies that are the most successful at bringing their partners together.

It is also understandable that the biggest corporate behavioral changes are coming to some of the most challenged of industries – steel, paper and retail. Andy Grove, one of the founders of Intel has said that to really effect a change you must give a ten times improvement to sufficiently motivate people. To deliver this kind of improvement requires a very short gestation period between invention and widespread use. Enterprise Resource Planning (ERP) software is still being advertised for sale even though most tech experts are calling it the legacy systems (read-dinosaurs) of tomorrow. Today, the Internet is obsoleting ERP because ERP took too long to implement whereas the Internet is giving its users those ten times improvements quickly. Challenges still remain in harnessing that growth. In some ways it's like giving the keys to the Porsche to a sixteen-year-old. Harnessing the potential that the Internet brings to business requires significant corporate behavior changes even for companies with an already significant Internet presence. Both Dell and Lucent recently suffered stock price declines as a result of missing quarterly sales targets. The problem wasn't a lack of demand but rather a shortage of components for their products with the greatest demand. Both companies are now reworking their e-hub supply loops to be able to more quickly respond to changing customer demand, thereby gaining an even greater competitive advantage.

Critical Mass of Customers

Warren Buffett said "Price is what you pay, value is what you receive." B-to-B e-hub companies are already bringing tremendous value-added services to their growing customer base.

In summary, web-based e-hub technology's upside and downside is that it is speeding up the rate at which some companies succeed and some companies fail. Witness the tremendous volatility in stock prices. Jack Welch, the soon-to-retire CEO of General Electric, said that the Internet is priority 1,2,3 and 4, and that by the end of the year 2000 all 200 major business lines will have an Internet strategy. (I guess that means they do not have one yet). The last ten years were characterized by the "cut the fat" style of raising earnings. For companies to survive and flourish going forward they will have to learn to "optimize." They will have to ask themselves not how do "I" get productive, but rather how do "we" – my strategic partners and I – get productive. The answer lies, in part by harnessing the power of the Internet through the use of e-hubs.

AUDI PARTEM ALTERAM

Hear the Other Side

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If you would like to discuss the topic of this newsletter, or our team's approach to investing, please feel free to contact us by email at al.boris@alexbrown.com.

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