

# *receiver* # 02

## DisinteREmediation: Longer, Not Shorter, Value Chains Are Coming

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Beware of conventional wisdom, for it is nearly always wrong.

Barely five years ago, the notion of commerce over the Internet was anathema. Later, Internet commerce became the hottest thing in cyberspace. Once Net-commerce became real, conventional wisdom held that the Internet would spell the death of advertising. In fact, the Internet has turned out to be a huge new advertising frontier.

Now a much more dangerous bit of conventional wisdom is on the loose. It is the notion that information technologies will bring about disintermediation that is, networks and information systems will allow buyer and seller to interact directly, thereby eliminating intermediaries and radically shortening value chains.

There's only one problem with this theory. It's directly at odds with what is actually happening. Rather than eliminate intermediaries, information systems do quite the opposite. Information systems are powerful commercial tools because they lower transaction costs. Lower transaction costs enable new kinds of transactions, which lead to new market niches and, overall, make the market environment more complex. In short, information systems create openings for new intermediaries to discover and occupy.

Meanwhile, old intermediaries are disappearing, but that is only part of the picture. What seems to be disintermediation is really a mirage, one static piece of a larger process in which the introduction of new information systems perturbs market environments, creating slots for new intermediaries whose presence threatens older established intermediaries who either disappear or adapt to new market realities. What looks like disintermediation is but one frame of a larger dynamic of „disinterremediation.“

What Is DisinteREmediation?

Disinterremediation is not new. It isn't even always a consequence of digital technologies. Even before the advent of computers, information innovations triggered disinterremediation processes. For example, the advent of movable type and subsequent invention of the printing press set loose disinterremediation forces in the hill towns of Northern Italy, where the advent of the printing press led to a quickening and complexification of commercial life. By the early 1500s, this transformation

led to the birth of modern mercantile capitalism complete with a host of utterly novel financial instruments, and novel terms to describe them, terms that form the basis of commercial language today.

And now the innovative center of gravity has shifted from simple computer systems to the Internet in general, and the World Wide Web in particular. Amidst all the changes are a few constants. One is what happens when you lower transaction costs – you have more intermediaries than ever, not fewer. We are seeing new intermediaries springing up all over the Net. A particularly good example is the bookseller Amazon.com, which emerged out of nowhere to exploit a new electronic niche which has allowed it to directly threaten traditional booksellers like B. Dalton, which is now struggling to launch a Net offering of its own. A key to Amazon's strategy is leveraging the new efficiencies of the Net-based environment to keep its costs far below that of a traditional bookseller.

A second example of lowered costs leading to new complexification is that of „microcash,“ a hot new concept on the Net whose essence is that in cyberspace, one is able to conduct transactions involving a fraction of the amounts required to conduct transactions in the physical world. This new capability to conduct micro-transactions will be exploited by a host of new players offering countless new products.

Disintermediation's bottom line is quite simple, namely that computers and information systems make the commercial environment more complex, creating new niches for new kinds of intermediaries who recognize opportunities that did not previously exist. In other words, following each information innovation, we will have more intermediaries, not fewer, BUT these may not be the same old intermediaries, for new players will first occupy niches overlooked by old. And if the old aren't careful and adaptive, they will be first displaced and eventually replaced by new innovators.

### Implications

Disintermediation generates a host of implications. Here are a few from a longer list to consider: *From value chain to value web.* The notion of a value chain is as much an optical illusion as the notion of disintermediation. One doesn't have a single-transaction relationship with a seller, but rather, the relationship arises out of multiple interactions. And these quickly evolve into a web of interactions, not a chain. Some interactions are immediate and direct, while others are highly indirect, transmitted through intermediaries serving the interests of both buyer and seller. *Get closer to the customer at your peril.* If one views transactions as a static process, value chains are, in single transactions, getting shorter. But if viewed as part of an overall relationship between buyer and seller, they are getting longer than ever. Indeed, they are becoming value webs, as

explained in the previous bullet. The trick in a world of disintermediation is not to blindly get closer to the customer, but to get farther from the customer in the right way by interposing intermediaries who can effectively deliver your message in ways you can't accomplish directly. The world in which disintermediation operates is a world not unlike the old board game of Chutes and Ladders, in which you are willing to head in the opposite direction of your goal in order to get to the top of a chute that will drop you off exactly where you want to be. The essence is not blind efficiency, but effectiveness in accomplishing the ultimate goal.

*Net pricing is weird.* A world of disintermediation is a world full of surprises. For example, net pricing is truly weird. Classical economics suggests that a single item bought on a per-item basis will be more expensive than the single item bought in a batch. But next time you're on an airline flight, look around and consider who paid what for their ticket. Chances are that the grandmother who flies once a year paid less than the business traveler who flies over 100,000 miles per year. The lesson is that there is a premium on occasional but utterly reliable users who must use the product in some form or other. And the more you use something – the more you must use it – the greater the premium may become. Net pricing isn't weird; it is utterly logical, but only in cyberspace.

*Advantage goes to small players.* The lesson of the last several decades is that systems scale up badly. That is, they deliver useful benefits to small players first, and larger players later. Consider the PC: It delivered clear benefits to individual players almost the moment it was introduced. But benefits to teams didn't emerge until the desktop revolution of the mid-80s. And the benefit of PCs to enterprises was elusive until the early 1990s. This has profound implications, for it means that when new information technologies are introduced, the playing field is not level. Advantage adheres not to large players, but to small. All things being equal, you are at an advantage if you are small, novel, and flexible. All other factors being equal, larger players will have a much harder time using new information tools in innovative ways.

Sharing: A Competitive Strategy?

Disintermediation creates an interesting market situation that on the face of it seems counterintuitive – in the longer run, companies can do better by sharing their competitive advantage. Compare the fortunes of Apple and Microsoft. Both had a unique crown jewel – their operating systems. But Apple kept its crown jewel locked up in its hardware, while Microsoft happily rented its crown jewel to third-party manufacturers to bundle in their operating systems. At first, Microsoft's crown jewel was vastly inferior to Apple's, but by virtue of its cooperative strategy, Microsoft ended up the long-term winner. The lesson? Don't lock up your assets in a castle.