Strategy and the New Economics of Information

Most executives have witnessed the extraordinary impact of the Information Revolution on the operating processes of their companies. Now, it is beginning to have an equally significant impact on strategy. Changes are under way that will alter the structure of entire industries, forcing senior executives to rethink the strategic fundamentals of their businesses—and not just in high tech and information industries but across the economy.

The catalyst is the rapid growth of the Internet and the proliferation of similar electronic networks both inside and between companies (intranets and extranets). Open standards and the nearly universal connectivity they make possible are lowering the costs and changing the dynamics of how information is communicated, shared, and used.

No company will be immune to these changes. Key aspects of nearly any business—relationships with suppliers and distributors, brand identity, coordination of process flows, customer loyalty, switching costs—depend on various types of information. In many industries not widely thought of as information industries, information of this type represents a large portion of the cost or value structure. Even in businesses where the cost of information is small, information can be critical to competitive advantage.

Until recently, the way companies have used information has been governed by a fundamental tradeoff between richness and reach. To communicate rich information has required physical proximity and dedicated channels, but the costs or physical constraints of these arrangements have limited the size of the audience to which the information could be sent. Conversely, to communicate information to a large audience has required compromises in the richness of the message.

For example, a company can embed its marketing message in an advertisement that has mass-market reach but relatively narrow richness of content. Or the company can use direct mail, which offers greater customization (and, therefore, greater richness of content) but more limited reach. Or it can rely on a personal sales pitch that is extremely customized and interactive but only works one customer at a time.

As more and more information is available electronically and electronic networks take on the information-related tasks traditionally performed by physical entities such as a sales force, branch offices, and stores, this trade-off will be greatly diminished. Companies and individuals will be able to extend their reach by many orders of magnitude with a negligible sacrifice in richness. The competitive implications of this development are profound:

Existing value chains will fragment. Information and the mechanisms for delivering it have long served as the glue holding together the physical structure of a business. Once information is separated from its physical carrier, however, that structure starts to come apart. Each link in the traditional value chain becomes a potential business in its own right, with unique competitive rules and the capacity to evolve in a radically different direction from the rest. This creates new opportunities to break long-standing customer compromises and to achieve previously unattainable efficiencies.

In auto retailing, for example, dealers have traditionally provided a bundle of activities under one roof. However, as information about product options, prices, and availability becomes widely available electronically, it becomes progressively
easy to unbundle these activities. Already, auto manufacturers are providing product, price, and benefit information directly to consumers on the Internet. Potential customers can locate the cars they want at the price they are willing to pay through electronic brokers. Soon, car buyers will also obtain financing by putting their business out for bid via the Internet.

Once the informational reasons for the traditional auto dealership disappear, it is highly likely that the physical activities traditionally performed by dealerships also will become separate businesses, each following its own distinctive economic logic. Distributors of new cars could have fewer, larger sites in order to maximize economies of scale and minimize inventory and transportation costs. (Some automakers are experimenting with this approach.) Providers of after-sales service would be free to operate a larger number of smaller local facilities that would offer customers greater convenience. It’s not inconceivable that someday, specialty companies will even take cars directly to prospective customers for test drives.

Traditional barriers to entry enjoyed by incumbents may become liabilities. In many industries, proprietary infrastructures such as a sales force, a branch system, a chain of stores, or a delivery fleet have long served as formidable barriers to entry. The new economics of information will make many of these infrastructures expensive liabilities. Opportunities for bypassing middlemen will increase. For example, by offering greater choice and ease of search, electronic retailers of all kinds promise to undermine the economics of the bricks-and-mortar store. Given the high fixed costs of category killers such as Barnes & Noble, Toys “R” Us, and The Home Depot, even the loss of a small segment of customers to electronic rivals could pose a serious competitive threat.

Existing companies will have to rethink their value propositions and business models. Some companies will focus on mastering a single business activity or establishing an industry standard—and then pushing it into as many industry or customer segments as they can. Microsoft and Intel in computing are the classic examples. But this strategy isn’t limited to so-called information industries.

In manufacturing, for instance, some specialty components companies are creating modular designs, storing them in electronic databases, and then allowing customers to use the modules to design their own components. This approach saves costs by reducing the need for highly skilled salespeople. Even more important, it allows a maker of, say, valve systems for the auto industry to extend its reach to other industries requiring sophisticated valve systems, in the process achieving greater economies of scale. If such a company lacked the manufacturing capacity to meet the expanded demand, it could outsource manufacturing to others. Eventually, it might even decide to become a pure information company and outsource all manufacturing.

Others companies will choose to follow the path of a Nike or a Dell and focus on orchestrating the full range of relationships among independent players along the entire supply chain. As architects of the business system, they will gain the lion’s share of the rewards without having to bear the risk of owning all the assets.

Still others will exploit the vulnerability of traditional proprietary distribution channels and make new markets that offer participants wider choice, better information, lower transaction costs, ease of search, and electronic links to providers of other services such as financing and insurance. This is what General Electric has done by using its enormous buying power to jump-start a new electronic market in industrial supplies.
Finally, some companies will position themselves as trusted agents that help customers navigate the vast array of choices offered in the network economy. As they build their brand identity, more and more consumers will affiliate with them rather than with the ultimate providers of the product or service in question. And the navigators’ increased bargaining clout will allow them to negotiate even better deals.

None of these business models is new. What is new is the wide range of opportunities for applying them. The key will be to recognize and exploit those opportunities before competitors do. In a network economy, the winner often is the first to achieve critical mass.

The Changing Focus of Strategy

The new economics of information will change the focus of strategy. Strategy will be less about establishing and then defending a position within an industry. It will be more about investing in options that allow a company to change course or to pursue unanticipated opportunities as they emerge.

The challenges for incumbents are twofold. The first is to recognize which assets and customer segments are likely to become liabilities and to jettison them sooner rather than later. The second is to rethink how to make the most of one’s strengths—including the previously untapped informational elements of a business. It may mean repositioning a powerful brand to invade new industries. It may mean using the new economics of information to commoditize a competitor’s products or to customize one’s own. It may even mean splitting a corporation into independent businesses, freeing them to join the race to achieve ever-greater economies of scale or scope.

Defending the old order is not an option. Any business whose competitive advantage is built on the old tradeoff between richness and reach will be vulnerable. All it will take to undermine such a business is a competitor that recognizes the opportunity and attacks. As many incumbents striving to defend old business models already are discovering the hard way, attackers now have the advantage.

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