The Connectivity Revolution

by David M. Rowe

In the aftermath of the dot-com implosion, it is tempting to relax and say, "Thank heavens, *that's* over." David Rowe argues that it is precisely in times like these that such complacency is most dangerous.

"…the competition (that counts is) from the new commodity, the new technology, the new source of supply, the new type of organization, competition that commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of existing firms but at their very foundations and their very lives." [1]

—Joseph R. Schumpeter

Creative Destruction

It's hard to believe that Schumpeter wrote those words 60 years ago. If anything, their incisive relevance has only increased with the passage of time. Unfortunately, it is in times like the present that such warnings can easily go unheeded.

In the late 1990s, the world was abuzz with new business models and the revolutionary implications of the Internet. Being characterized as an "old-line business" was a none-too-gentle putdown, and everyone seemed to be paranoid about whether theirs would be the next industry to be "Amazon dot-commed" to death. Needless to say, the tone has changed radically with the collapse of a breathtaking array of dot-com insurgents.

Many obvious lessons have been painfully driven home in the process. Operating discipline and cost control are essential prerequisites for profitability and long-term success. Twenty-somethings with tongue spikes are not so assured of inheriting the earth. In very many ways, the old verities appear to have been vindicated. True, we recently struggled with the hard realities of a business slowdown, but for those of us old enough to remember past recessions, these are familiar challenges and the long-term effects of this slowdown seem less punishing than many in the past. At a structural level, the world seems to be a much less forbidding place… and therein lies the real danger.

The Pattern of Revolutions

In 2000, Philip Evans and Thomas Wurster published the book *Blown to Bits: How the New Economics of Information Transforms Strategy*. It was an early articulation of how the massive multi-directional connectivity of the Internet would cause widespread upheaval in existing business models and organizational structures. One might think they would have tempered their dramatic predictions in light of recent events. Quite rightly in my view, they have stuck to their guns.

Evans makes a colorful, and to me compelling, case based on the historical pattern of past revolutions, both political and economic. Such events, he argues, rarely evolve in an uninterrupted trajectory. One of the consistent patterns is that a first manic phase

 Rowe is Group EVP for Risk Management, SunGard Trading and Risk Systems, Palo Alto, California.

ends in the revolution eating its own children. Robespierre, the French Revolution's "Sea Green Incorruptible," was guillotined, face up, following the Coup de Thermidor (July 27, 1794) by the very movement he claimed to embody. Trotsky was exiled, deported, and eventually assassinated on orders of Joseph Stalin. John C. Fremont was impoverished by his attempts to capitalize and construct the first U.S. transcontinental railroad. In all these cases, however, the world did not revert to the status quo ante. The deeper forces that inspired these revolutions remained in effect and wrought dramatic changes long after the close of the first manic phase and the demise of many of the initial instigators.

The real danger to established institutions is complacency when the heat of the initial revolutionary phase seems to have subsided. All the seductive influences of comfort with the status quo, fear of undermining one's own profitable niche, and the ever present tyranny of the urgent over the important remain in play. In the current environment, these are combined with a compelling need to devote management time and attention to dealing with a slack period in the economy. This makes it all the harder to focus on the continuing existence of powerful forces that pose profound long-term threats.

The Power of Connectivity

The most unrealistic simplifying assumption of traditional economics is the existence of "perfect information." This means that everyone has access to all necessary information at no cost. In fact, of course, information is not free. It is costly to access and to organize into relevant, actionable form.[2] Companies often have an interest in conveying information to their prospective customers, but traditionally they faced a severe tradeoff between richness and reach. Broadly distributed information was necessarily quite simplistic, and making richer information available to an interested target audience was expensive. The Internet's massive parallel connectivity greatly improves this tradeoff by allowing rich and extensive information to be made available on demand to all interested parties. It also strengthens the consumer's position by allowing comparative product information to be compiled with dramatically less cost and effort.

To date, the impact of this connectivity has been restrained by the slower-than-expected adoption of broadband access to the Internet. With dial-up connections and comparatively slow transmission speeds, Internet access remains an as-needed activity for the majority of households. It is not integrated into people's day-to-day routines. Removal of this obstacle, however, is only a matter of time. Streaming video and other communication-intensive services will eventually gain public acceptance, making high-speed Internet connections at least as common as cable television is today. When that happens, many retail business will face a fundamentally new dynamic. Certainly retail banking, whose core product is information, will be profoundly affected. As just one example, technology available today allows fully encrypted transmission of funds to stored value cards via the Internet. Once such technology is widely available and widely accepted by retail merchants, what will be the fate of all those ATMs?

No, the connectivity revolution is not over; its impact has just been delayed. The prudent risk management organization will take advantage of this temporary breather to look beyond whether its company is doing business right and to focus some attention on whether it is doing the right business. ❒

Contact Rowe at
David.Rowe@risk.sungard.com

Notes

1 *Capitalism, Socialism and Democracy,* Harper Torchbook edition, p. 84.

2 The practical importance of relaxing this assumption of perfect information was recognized by the Nobel Prize Committee in awarding the 2001 prize in economics to George Akerlof, Michael Spence and Joseph Stiglitz "for their analysis of markets with asymmetric information."