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THE NEW RULES OF THE GAME – STRATEGY AND THE NEW ECONOMY

In recent years, we have seen the disappearance of an increasing number of companies that had become household names, either through bankruptcy, through acquisition or the company actually being "broken up" into its component parts and/or "sold off". Examples of this are: Singer, the world's largest sewing machine company, is now in Chapter 11 in the United States; Renault has acquired a key stake in Nissan, the very epitome of Japanese manufacturing excellence; the Royal Bank of Scotland has acquired NatWest in a fiercely contested takeover battle; United Biscuits is about to be acquired and "broken up" by US predators; and now both Rover and BNFL have serious question marks hanging over their future.

What is going wrong? In one sense, there is nothing new about corporate failure. We know, from looking at research on corporate longevity that 20 to 30 years is about the average lifespan of a company in the West. Nor is a high incidence of corporate failure always a negative sign. There is some evidence, notably from the United States, which suggests that there is a direct relationship between the incidence of corporate failure on the one hand and the rate of innovation in an economy.

Changing the game plan

What is new is that the rules of the game in business strategy are starting to change. The first indications of change came in the mid 1990s. For the first time in many years, the pendulum of advantage appeared to swing away from incumbent companies, which had previously been able to exploit economies of scale and first mover advantages to dominate their industries, towards newer entrants coming into the marketplace. Thus, Direct Line in insurance and, to a lesser extent, Daewoo in the motor industry, challenged the rules of the game for competing in their respective industries. They were able to do so because, as new entrants, they did not suffer from the inhibitions or preconceptions of the existing players. Such moves were the harbinger of things to come, but it has been the growth in the last couple of years of electronic business, which has posed the most serious challenge to existing business strategy.

So what's new about the 'new economy'?

Well, there are number of distinct characteristics which are driving the changes we are now witnessing in the competitive landscape. Firstly, we are now seeing a shift from wealth based on physical assets like plant and equipment towards wealth founded on intangible assets. Knowledge or intellectual capital increasingly makes up the larger part of the wealth, which is generated by our companies. Secondly, we have seen a substantial, ongoing decline in the costs of computer processing power. We have become used to the tenets of 'Moores Law', which dictates that the cost of processing power will roughly halve every eighteen months. This has meant that many computer processing activities can be decentralised to networks of ever-smaller devices. At the same time, investments in these intangible assets will not suffer from the diminishing returns that beset traditional old economy companies. They generate increasing returns to scale once the initial investments have been made in building up a system, the marginal cost of transacting then declines to zero or near to zero.

In some industries such as telecommunications and banking, network benefits dictate that the value of each unit sold will rise in proportion to the number of units sold. Thus, the value of membership in a service like AOL, for example, is dependent on the number of other subscribers who use the system.

One consequence of these new drivers on the face of it, would seem to be remarkably familiar to practitioners of the old economy - size, ultimately matters. Those players that make substantial investments now, in order to build up the systems and to establish the brands in e space will, if they are successful, establish a dominant position in the new medium which will generate significant future profit potential. Of course, nobody can predict who the winners ultimately will be. There will be many casualties and setbacks along the way. We can already discern some of the contours of this new economy. We know, for example, that some of the traditional ways of doing business will be radically transformed. In recent years there have been many changes to companies' value chains not least caused by a trend towards outsourcing. The revolution in e business however, will accelerate this process. The cost of sharing information digitally will be so cheap that it will encourage companies to remove/sell off interests along their value chains and keep only those operations, within which they have some comparative advantage.

Where the future lies

The new virtual value chain of business is likely to be both global and decentralised. Activities will take place either where they are cheapest to perform, where there is some natural or developed advantage, or even where there is some locational time advantage e.g.: the data processing activities carried out on behalf of US companies in Ireland and India. As a result, companies will be able to make major savings on their operational costs and reduce the amount of work in progress and inventory stored, whilst at the same time becoming more responsive to customers.

However, e business, if nothing else, is transparent. Just as it enables companies to seek out the most cost effective solutions to their supply needs, it also provides customers with much clearer information about their performance. Prices and sources of differentiation will be subject to relentless comparison and the costs of failing to fulfil customer needs are likely to be substantial and immediate. Bad news spreads fast across the Internet!

One early view of the impact of the new economy on business has been that intermediaries (middlemen to you and me) increasingly disappear as producers and consumers are able to get together directly, without the intervention and cost of an intermediary channel. There will be products, such as computers, which lend themselves easily to direct selling.

. In fact, it is likely that disintermediation, whilst important, will not be universal. By providing consumers with a form of navigation or pre selection, as well as additional services (think of the book reviews provided by Amazon.com for instance) they will provide a superior service to customers.

However, these structural changes may be just the beginning. Some observers believe that we are heading towards a radical restructuring of industry, which will dwarf the reorganisations we have witnessed in recent years. Traditional businesses will separate into specific functions, which will be grouped together according to their fundamental economic logic.

Take a pharmaceutical company as an example. It has traditionally, integrated within the same firm through distinct activities. First, in order to ensure maximum coverage and rapid penetration of the market for its new products, there is the sales and marketing function, including a large direct sales force,. It also promotes the brand to key decision makers like physicians. In addition to this customer-facing role, which is aimed at attracting and retaining customers, there are also key manufacturing processes, which the company performs in order to produce the pharmaceutical products.

Equally, the company will also employ research scientists in laboratories in order to develop new products. But these three functions operate on different economic logics. Sales and marketing needs economies of scope, offering the broadest range of products to the largest number of key clients, in order to retain their loyalty, the logic of the internet portal. By contrast, manufacturing needs economy of scale and research needs a focus on individual talent and creativity. It is not difficult to see that if these functions separate out, only a few major brands would survive, served by large producers or providers of back office functions fed by large numbers of small research boutiques.

Whatever happens, all our existing businesses, not least business schools, will face tremendous challenges unleashed by the power of the "New Economy."

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