e-Economy: The challenge facing companies today
Sandra Sieber, IESE Associate Professor and Francesc Riverola, Research Manager e-Business Center PwC&IESE

In spite of all the ups and downs of recent months, one thing seems to be clear: Internet is here to stay. However, it is still not too clear how it will affect most companies. So, the time has come to take a step back, recapitulate and try to understand the essence of the new environment and how it will affect the way companies do business.

First of all, Internet, and the new information and communication technologies in general, have a major impact on companies' transaction costs. Companies' search costs have been reduced in a whole range of industries as Internet has made it easier to identify suppliers, partners, customers or products. It has also made markets more transparent, as there are more possibilities for comparing prices. Coordination costs have also been reduced, a trend that started a few years ago with the introduction of EDI (Electronic Data Exchange) or the implementation of ERPs (Enterprise Resource Planning Systems) in companies, and which is now complemented with a series of systems, the most visible of which is perhaps the e-mail, and, in general, with a growing flow of communications through Internet. Finally, Internet also impacts on supervision costs, for instance by making it easier to track orders through the Internet, monitor production batches over a period of time, etc.

The reduced transaction costs lead companies to specialise increasingly in those activities in which they excel. Each company concentrates on its core business, coordinating via Internet with the companies that come before and after its link in the value chain. This in turn leads to the fragmentation of the present value chains, giving rise to new ways of organising business activities, the appearance of new markets and associated mechanisms, new ways of interacting with customers (personalisation) and even new ways of competing.

In many cases, Internet has also managed to increase customers' change costs due to the increased possibilities for personalisation and customer service. Thus, a customer/user will prefer to stay with a particular service than continually change its regular suppliers. Achieving high change costs is one of the main challenges facing companies operating in the Internet, as it is one of the few ways they have of putting a barrier on the Internet phenomenon of everything being "one click away", and avoid losing customers to other similar services or products. Consequently, it is important to capture, develop and retain a strong customer base, helping to develop on-line competitive advantages.

One good way of achieving high change costs is by promoting network externalities, which appear whenever the utility obtained by an user from an asset/service increases by the mere fact that other users can also use the same asset/service. Thus, any on-line business that manages to create network externalities has a chance of locking customers
in to its site with high change costs, placing it in the enviable situation of holding a
dominant position in its market.

Another factor to be taken into account is the information businesses' new cost
structure, with high fixed costs (particularly in technology and content development)
but day-to-day operating costs that tend towards zero. A good example of this is
Yahoo!, whose information development cost is very high, while the cost of serving a
page to a particular user is negligible. This cost structure implies the existence of
increasing returns to scale, where there is no limit to a company's natural growth.
Therefore, markets in which the companies operating in it manage to create high entry
barriers will have a natural tendency towards monopolies. In markets where there are no
entry barriers and no product differentiation ("commodity"), the natural tendency will
be towards price wars and a continual flow of companies entering and exiting the
market. These two trends are clearly visible in some of the main Internet sectors.
On the one hand, in the portals sector, Yahoo! has managed to benefit from the
increasing returns to scale, and it has succeeded in creating network externalities by
offering a broad range of personalised products, and a strong brand image, with the
resulting customer lock-in. On the other hand, Excite has not managed to achieve a
sufficient level of differentiation and, in recent weeks, has closed down its businesses in
various European and Asian markets, concentrating on a number of niche markets
which may be profitable for it.

Similarly, e-Bay has managed to position itself as absolute leader in Internet auctions,
creating collector communities and, in the process, the necessary critical mass to
organise all types of auctions. This, in turn, has enabled it to create a strong brand image
which attracts even more buyers and sellers. In short, it is a clear case of a company that
has managed to create and leverage the network effect on the Internet. At the other
extreme, many other auction houses never achieved the critical mass necessary to
compete on the on-line auctions market, as shown by the recent failure of the French
company iBazar, which has been taken over by e-Bay.

Amazon offers a similar story. It has been able to gain maximum leverage from the
possibilities of personalising offers and presenting information offered by Internet,
while companies such as Bol.com have never been able to attain sufficient sales levels
through the Internet, which has led it to curtail its activities in several countries.
The reduction in companies' transaction costs, the existence of change costs, network
externalities and growing returns to scale not only have led to the appearance of new
markets, as in the case of the on-line auctions and portals, but has also had a profound
impact on a number of traditional markets, such as bookstores, the financial sector or
food retailing. The changes brought about in these markets by the existence of new
infrastructures have given rise to a whole range of strategic responses. Thus, during the
previous year, all of the major financial institutions have started Internet operations in
order to gain adequate positioning in what is viewed as a "new way of competing".

As almost always, all these changes require an effort by companies to adapt to this new
framework, leading to drastic restructurings in some cases. Organisations will have to
shed old habits, changing their structures, systems and organisation culture. Above all
else, it will require an adaptation by people to new realities. It will be necessary to
identify the barriers that obstruct change and undertake actions, particularly in the fields
of learning and training, that help companies adapt to the new rules of the e-economy.