DISINTERMEDIATION AND THE CHANGING DISTRIBUTION LANDSCAPE

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Technology-driven change is having a major impact on the shape of the marketing landscape, particularly the organization, processes, and structures of distribution channels. This article examines a facet of changing distribution known as "disintermediation." Evolution of the phenomenon is outlined, and current and emerging perspectives and business models are identified. The article also overviews how technology-driven disintermediation decisions made by suppliers, without careful attention to traditional and still relevant marketing perspectives and considerations, can be risky. The article concludes with a set of Critical Concept Drivers for Disintermediation Decisions in both B2C and B2B markets.

INTRODUCTION

Firms that have traditionally facilitated information, goods, and other flows between businesses and their customers are being by-passed and/or their roles severely altered. Called "disintermediation," this phenomenon of eliminating intermediary layers has been sweeping across a variety of business-to-consumer and business-to-business sectors. It has been listed as one of the top five driving forces affecting distributors (McClelland 1998), and viewed by one expert (Prahalad 1998) as one of eight significant discontinuities in the competitive landscape of the new millennium. Because almost every function in the distribution chain can be relegated, in whole or in part, to software and hardware solutions, traditional intermediaries must find new or redefined roles to play or face severe profitability challenges, and perhaps even extinction. Threat to their existence is not a new problem for marketing intermediaries. In fact, the marketing concept of *functional shiftability*, and the notion that one can eliminate functionaries but not functions, are important ideas precisely because they provide insight into the need for constant role assessment and redefinition for distribution channel members.

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In addition to the threat to intermediaries is the very real danger that disintermediation poses to the suppliers who eliminate them. Although disintermediation offers the promise of streamlining marketing transactions, lucrative (but myopic) opportunities for disintermediation can blind business managers to significant marketing risks. If customers don't want to buy a product online, "...even the best technology and the most streamlined, cost-efficient, Web-based, point-to-point transaction architecture won't help" (Frieswick 2001). Traditional marketing perspectives still apply. In fact, one author has argued that "Success on the Internet hinges as much on applying traditional management discipline as on staying knowledgeable on the latest (and usually ephemeral) Internet trends and technologies" (Tjan 2001).

The risks to suppliers, therefore, do not always come from activities that typify application of modern information technology. They also come from the failure of potential disintermediators to honor traditional marketing perspectives, and make such issues as the buyer's decision process, a top priority. Hewlett-Packard's chairman and CEO, Carly Fiorina, in an unusual management *mea culpa,* admitted that HP (the favorite vendor of solution providers), was misguided in its technology-driven direct selling strategy (Zarley 2001). The resulting major sales losses that HP suffered underscore the challenge faced by organizations attempting to develop and implement technology-intense channel strategies, and also suggest that basic marketing principles are still very relevant.

The pet care industry further illustrates the risks. By mid-1998, the industry had seen at least five different major dot.com rollouts. Don Laden, President of Pet Warehouse, a direct marketer of pet supplies, was told by a Silicon Valley consultant that "*Your catalogs are going to be toast in five years.*" However, Pet Warehouse survived the onslaught of such cyber upstarts as Pets.com and Petopia.com, and is now celebrating a jump in Internet sales ("Pet Smart" 2001). The key to the firm's success was sticking to the basics of marketing – and focusing on its catalog – using the Internet as a tool. According to Laden, "Our catalogs are a shopping experience that won't ever go away. We stuck to our knitting and did what we do well."

This article overviews the evolution of disintermediation; outlines major, current disintermediation perspectives; and argues that new economy, disintermediation-related decisions can be substantially informed, and improved, through the use of traditional and fundamental marketing perspectives.

THE CONCEPT AND EVOLUTION OF DISINTERMEDIATION

Financial Service Industry Disintermediation

The term "disintermediation" was used initially to describe evolving structures in the financial industry. In 1970, federal regulations placed severe limitations on banks' lending, resulting in "massive disintermediation" as other institutions stepped in to do the lending (Heller 1973). Banks were also among the first to be challenged by information technology when confronted with a strategic choice of facilitating electronic media cash management and disbursement or clinging to the status quo at the risk of losing out to non-bank technology companies (Meschell 1997). ATM technology provided both a more efficient and more error-free transaction vehicle for banks and improved convenience for customers by shifting traditional transaction process elements away from tellers to machines *and to consumers,* but this disintermediation caused the banks to risk being viewed by customers as increasingly impersonal and unhelpful.

Disintermediation: Migration, Threat and Opportunity

The migration and exponential expansion of electronic technology users beyond the finance industry led to what was termed a "disintermediation squeeze" (Quint 1998), and to a host of distribution role changes, as diverse companies envisioned selling direct to consumers, bypassing, in one way or another, traditional intra-firm or extra-firm middlemen (Joachim 1998). Among the more important changes was consumer performance of activities that consumers previously would not have been permitted or asked to do, especially activities having to do with information gathering. As a result, intermediary providers of information such as real estate agents, stockbrokers, and travel agents have been threatened by Internet-empowered consumers doing their own medical, legal, and travel information searches.

Southwest Airlines' early decision to opt out of the travel agent network and deal directly with travelers signaled things to come in that industry. Switching ticket sales to Internet technology, the company angered the travel agency business and generated predictions that Southwest would ultimately be forced to use travel agents. But it didn't happen. In fact, lower costs have apparently resulted in better prices for Southwest's customers, as well as leading the company to a better understanding of, and to better relationships with, its target market. This channel change eventually permeated the travel industry, resulting in substantial travel agency business decline and one of the earliest and most notable and visible examples of disintermediation.

Disintermediation has also become a major issue in the business-to-business sector. Many business-to-business transaction channels are migrating into a "complex mix of vertically and horizontally related, information-focused" (Cort 1999), and information technology-based intermediaries and logistical channels. By 1999, fears of disintermediation were leading many distributors to begin seeking protective measures to stem the loss of commissions and sales credits due to direct selling from their principals' Web sites (Keenan 1999). Even supplier sales force functions have felt the disintermediation impact as Internet technology has enabled movement and integration of front and back office functions to a mobile environment dominated by laptop computers, removing intra- and extra-company intermediaries from between the customers and the companies (Mishina 1998).

The negatives of disintermediation for affected intermediaries notwithstanding, technology can also produce positive results such as, bringing producers and consumers closer together more efficiently (Duncan 1998). This has led some observers to argue that the Internet should be seen less as a threat and more as an opportunity for new and more effective distribution partnerships (*Health Industry Today* 1999). However, even when disintermediation is the right decision, companies must be careful and proactive about avoiding problems related to its implementation (Schulman 1998). The implication is that the decision must be made in the context of larger concerns, and that continued success in the so-called "new economy" requires that both intermediaries and their principals carefully consider such issues as brand equity and customer loyalty if they want to intermediate effectively (*Internetweek* 1999). The mandate is to recognize that no matter how sophisticated the technology, it is still the customer that drives distribution changes. This mandate can be observed in the new, evolving perspective on the role of distribution channels in the value creating process, e.g.:

> *The model of the distribution channel as a series of companies, buying from and selling to one another, is indeed a casualty of the Internet. The job of an intermediary is not to buy, sell, and hold inventory between those two events, but rather to add just that customer-required value that the intermediary is best equipped to provide (Hammer 2000).*

The job of collectively creating value for the customer requires repositioning of channel activities to intermediaries best equipped to provide them. It also requires new intermediary concepts, tasks, forms, and structures. A variety of these have emerged.

New Intermediary Concepts, Tasks, Forms, and Structures

Intermediation and Reintermediation

Recognizing new requirements, several experts suggest that disintermediation fears and concerns should be replaced with a focus on the opportunities to be found in proactive intermediation and reintermediation. For example, the introduction of electronic journals to library organizations does not replace the library's functions as much as it eliminates some clerical tasks, thus improving *intermediation* (*Online* 1998). This concept was early illustrated by *Wired* columnist Nicholas Negroponte (1997), who introduced the notion of *a new intermediary* who focuses on personalized, individualized customer service and aftermarketing. Further, he argues that intermediaries who are about to be disintermediated can survive by changing their offer and becoming *reintermediated.*

Metamarkets and Metamediaries

Mohanbir Sawhney (2000), another leading electronic marketing author, describes these new intermediaries as *metamediaries,* emerging intermediary forms that operate in new kinds of markets called *metamarkets.* In Sawhney's view, the Internet is revolutionary because it connects firms with customers without regard to time space and hardware or software platforms, and does so at far lower cost and time of purchase transactions, while at the same time improving the transportation quality. He points out that for every intermediary that is eliminated, several are created; e.g., Amazon.com sells books directly to customers, but uses Ingram Book as an intermediate supplier, United Parcel Service and DHL Worldwide Express for delivery, and America Online for customer acquisition. What is happening is the unbundling (and rebundling) of value-added activities that traditional intermediaries have provided.

According to Sawhney, traditional channel member bundles involve significant compromises that need not be made in the new economy. He concludes that to achieve the promise of frictionless commerce, deconstructed channel flows and offerings must be reassembled in ways that reduce the search and evaluation costs for customers. In his view, customers think in terms of activities, while firms think in terms of products; in the new economy, we are witnessing the emergence of "metamarkets," clusters of cognitively-related activities that customers engage in to satisfy a distinct set of needs. Accordingly, metamediaries are neutral third parties that operate in the marketplace to realign the marketplace with cognitive space, assembling products and services into seamless, integrated bundles. Unlike traditional channel intermediaries, metamediaries do not participate in actual exchange. Their value, and the fees they collect, come from the connections they facilitate between customers and product providers.

Hypermediation and Microintermediation

In a similar vein, Nicholas G. Carr (2000), claims that rather than experiencing disintermediation because of the Internet, business is undergoing precisely the opposite phenomenon, what he calls *hypermediation.* Transactions over the Web routinely involve all sorts of intermediaries besides the familiar wholesalers and retailers, including content providers, affiliate sites, search engines, portals, Internet service providers, software makers, etc. In Carr's view, all of these intermediaries may be involved in very small transactions, but they are positioned to capture profits by virtue of volume and efficiency. He describes each transaction as a microcosm of the emerging economic structure of e-commerce: the profits lie in intermediate transactions, not in the final sale of a good. Companies with technical innovations are well aware that every click is a potential source of profit and will figure out new ways to turn clicks into transfers of cash. Robert Hettinga (1999) suggests that the successor to disintermediation is *microintermediation,* the surfacing of information (particularly financial) into "smaller and smaller bits on an increasingly ubiquitous Internetwork."

Emerging Distribution Business Models

The changes that have actually occurred during this time of incredibly fast technological innovations are reflected in multiple new business models representing, according to one author: "the first major channel shift in quite some time" (Segal 2000). Unarguably, sophisticated technology has created the capability of transactions with minimal friction; reduced operating expenditures; improved communications processes and value; and ultimately, increased revenues, profit and customer service. This view is supported in an article discussing the development of new rules for new markets. Roberts (2000) contends that the trends do not mean that intermediaries are automatically a dying species; rather, the value they add must change. He states that the Internet causes much of the logistics value of intermediaries to disappear but that new value is added in terms of saving search costs, communicating trust, etc.

The issue is no longer whether to change the supply chain, but how to do it so that greater efficiency and effectiveness will result. Although the initial inclination of suppliers was to eliminate intermediaries through an online transaction presence, total elimination has not been the prevailing model of distribution change. In his discussion of the Internet's effect on a company's ability to compete, Porter (2001) disputes the threat of disintermediation and argues that Internet technology can actually expand opportunities for many traditional intermediaries. Changes have been evolving and the results are varied for different industries and different companies as they are learning what is needed in order for their supply chain to be both efficient and effective (indeed, one author contends that the future role of e-enabled supply chains is to solve the priority business issues for their industries (Cross 2000)). A variety of emergent, innovative business models is a result of this struggle.

Perhaps the fastest growing business model is one that reflects the need for reintermediation through the use of networks of multiple intermediaries and suppliers. One form of this is Web-based intermediaries, such as portals and online marketplaces (e.g., Priceline.com, PaperExchange.com, E-Steel.com, and Farmbid.com) and other vertical and horizontal destination sites that are now offering one-stop shopping for focused and niche markets in both B2C and B2B markets. Described as electronic hubs, these Internet-based intermediaries host electronic marketplaces and mediate transactions among businesses (Kaplan and Sawhney 2000). Besides providing quick and easy access to multi-functionaries in the supply chain, these super-unaffiliated sites provide the buyers with trust and credibility through their neutrality.

Many major suppliers such as GM and Ford are creating their own online marketplaces, often in partnership with other intermediaries and suppliers; for example, Boeing, Lockheed Martin, and Raytheon formed their own online exchange that includes several major airlines (Gumpert 2000). Other examples of similar channel cooperation include cobranding and cobranded showrooms such as Office Depot's deal with Hewlett-Packard Co. in selling HP printers, 3M's cobranded showrooms with its resellers, and the mutually beneficial arrangement of an online retailer, HomePoint Corporation, with more than 200 furniture makers and dealers (King 1999). In the industrial arena, companies such as Rockwell and Dupont illustrate the struggle to achieve successful supply chain strategies, having implemented various programs ranging from EDI with a few major suppliers to systems integrator solutions to web-based integrated supply houses (Pinto 2000). Most of the new models include solution provider networks comprised of multiple intermediaries such as application service providers, value-added resellers, and management service providers.

The future is coming fast. Even current noteworthy business models are themselves in danger of being rendered obsolete. Kenny and Marshall (2000) claim that for B2C business, destination sites may soon be replaced by "mobilemediaries" such as smart cards, e-wallets, and bar code scanners that will enable "contextual marketers" to deliver highly relevant information in the most timely manner possible, eliminating the need for repeat visits to many destination sites.

Underpinnings of New Distribution Perspectives

Participants in the marketing process now face a choice: be rendered irrelevant by emerging technology or embrace the Internet to create unique solutions that will lead to deep, long-lasting and profitable relationships (Vargas 1999). This choice must be made at a time when it is increasingly difficult to make sense of the distribution landscape as new entrants with new business models pour into the business-to-business space (Kaplan and Sawhney 2000). It is also becoming increasingly clear that the job of the modern intermediary is still to add the customer-required value that the intermediary is best equipped to provide. But old verities still apply. Thus, even while marketing and channel objectives remain the same, future channel strategy and management will require a return to, and an informed understanding of, some well-established, and fundamental, concepts of marketing. Examples of these are discussed below.

STILL RELEVANT – AND CRITICAL – MARKETING PERSPECTIVES

In the new and changing high-technology distribution landscape, firms must make use of new and effective business models, but decision makers cannot ignore traditional and fundamental marketing concepts and perspectives. Their channel system designs must reflect and respond to the bottom-line marketing considerations described below and summarized in Exhibit 1.

Functional Shiftability: Marketing functionaries can be eliminated, but not functions. Although the players may be different, somewhere in the system all the channel functions must be performed. It is now more imperative than ever that channel designers look beyond activities and functions to the basic problem these are designed to solve.

Customer Orientation: Technology cannot ignore the basic marketing need for a customer orientation. Thus, for example, when product or service satisfaction and customer retention are dependent upon factors beyond those related to price and performance, it is critically important for potential disintermediators to design systems that meet customer requirements for such needs as recognition, respect, and responsiveness, as well as needs for experiences or atmospherics that customers desire as part of the purchase process. The supplier who does not understand, for example, why Barnes & Noble and other bookstores continue to draw large patrons to their stores, does not understand the importance of consumer experiences in purchasing certain products.

Buyer Problem Solving: Buyers are decision makers who recognize problems, search for alternatives, evaluate alternatives, make purchases, and engage in post-purchase evaluation and behavior. Thus, potential disintermediators must be sure that a variety of major customer decision-making issues have been addressed. These include: 1) the level of buyer involvement and buyer-perceived risk; 2) the level of buyer-seller negotiation, purchase and application support and aftersale services, or problem resolution (e.g., is it a rebuy or a new or modified buy?); 3) the amount of search information required by the customer (e.g., routine, limited, extended searches); 4) the level of seller involvement in skill-dependent activities, such as diagnosing customer problems, customizing solutions, selling, etc.; 5) the level of urgency felt by the buyer for problem resolution; 6) whether or not the product is a sought or unsought good or service, and 7) the time frame from initial problem awareness to purchase, and how customer problem recognition evolves over time, from imperceptible (soft leads) to very urgent (hard leads). The potential disintermediator must ascertain: 1) what value is added for the consumer's problem solving by currently-used players/intermediaries, and 2) if the value that the customer requires is still being delivered, or better yet, enhanced.

Market Segmentation: Most markets are segmented, and thus a variety of schemes may be required to meet the differentiated customer needs and benefits sought in a particular product-market. Product selection, price points, and promotion activities will need to fit the market and the different characteristics of buyer behavior in the market. For example, some buyers will buy a car online, and others will shop online but demand substantial personal contact with store personnel before agreeing to consummate a deal. Promotion appeal, information-sharing methods, and customer satisfaction factors are other examples that need to be segment-driven.

Product Life Cycle: The Internet has accelerated the speed of product movement through the product life cycle. Furthermore, progression of a product through the life cycle gives rise to customer-driven, constantly changing price, promotion, and product strategies and tactics that must be integrated among all the partners of the supply chain. Both the service providers and the solution software itself must support the entire life cycle. Traditional intermediaries' activity bundles were designed to accommodate the inevitability of product life cycle change. Despite the acceleration, the same will be true for modern intermediaries.

Vertical Marketing Systems: The unit of competition and management in modern marketing is the channel. The channel is a vertical system that must be totally organized and managed if sub-optimization of its parts is to be avoided. The nature of disintermediation is to unbundle, rebundle, rearrange and reassign activities. This may or may not result in an optimized system. Multi-channel strategies necessitate a complex system of multiple functions and competencies that can provide unparalleled synergy but require optimal integrated systems governed by a go-to-market strategic goal. Not only must the system provide the appropriate channel strategy, but the channel strategy must be flexible and agile, prepared for constant change.

Supply and Value Chains: Value is not found in the players but in the network. Synergistic effects come from superior combinations of different channel elements. Intermediary functions deliver value. Regardless of whether the highest efficiency level will result from value functions being performed in-house or being outsourced, ultimately, customer-delivered value is the criterion; and it will depend not only on what value is delivered but also on who delivers and when, where, and how it is delivered. The new networks of distribution functions must not only provide the function values but also successfully balance and integrate these functions as well as the needs of the suppliers and customers.

Brand Equity/Positioning/Focus: The Internet is transforming customer-buying behavior, with major consequences and implications for how the consumer and business buyer develop and sustain brand familiarity and loyalty. The market offering, including product, product pricing, distribution, promotion, production, and service operations, must support the brand's image and position, thus building the value of the brand. Cost savings and disintermediation strategies are unlikely to succeed unless made compatible with a predetermined level of quality consistent with the brand's position strategy and aligned new data about how customers shop and buy online.

Customer Relationship Management (CRM): If customer loyalty and retention, and ultimately, increased customer lifetime value are to be realized, both CRM software and CRM provider services must strongly support the firm's chosen value proposition. CRM and e-commerce strategy choices, for example, must be integrated. The omission of online customer service elements such as live agent chats or Web call-backs can undermine an otherwise extraordinarily efficient network. Furthermore, cost savings that result in reduced customer satisfaction are illusory; potentially dangerous trade-offs between software and manual solutions to customer problems must be addressed.

EXHIBIT 1
Critical Concept Drivers for Disintermediation Decisions

1. **Functional Shiftability:** Marketing functionaries can be eliminated; functions cannot.
2. **Customer Orientation:** The marketing concept is still alive and well, demanding an orientation to first understand the customers' needs.
3. **Buyer Problem Solving**: Buyer problem-solving must be the cornerstone of intermediation design and decisions.
4. **Market Segmentation**: To achieve optimum customer-delivered value from the channel, it is critically important that the supplier incorporate objectives for target market coverage and depth/richness of coverage in its channel design and choice of channel intermediaries.
5. **Product Life Cycle**: Forecasting and preparation for accelerated life cycle changes have become even more important in the new economy and in the development of new business models.
6. **Vertical Marketing Systems:** A non-systems view of the distribution channel will encourage ineffective disintermediation strategies that can result in the presence of channel bottlenecks and a lack of integration and cooperation.
7. **Supply and Value Chains**: Channel intermediaries must become integrated partners in customer value creation.
8. **Brand Equity/Positioning/Focus**: To protect and enhance brand equity, any decisions made regarding the channel must be made in the context of the image and position of the brand, and the quality level as defined by the buyer and position.
9. **Customer Relationship Management:** Intermediation decisions must contribute to building relationships throughout the channel that result in successful execution of the desired value proposition, i.e., the benefit bundle promised to the customer.

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