Chapter 3

The Neo-Intermediation

Ravi Kalakota and Benn Konsynski

Abstract: Developments in information technology and increased competition both within and outside the industry have led to the unbundling and desegregation of brokerage functions. Nimble on-line institutions like E*Trade and Microsoft Investor are usurping the roles traditionally played by full-service and discount brokerages, forcing some powerful firms to narrow their focus and others to broaden their product offerings.

These changes raise the question: will full-service and discount brokerages continue to exist as we know them in the twenty-first century? To answer this question, the authors provide a new market transformation framework called Neo-Intermediation that helps explain how leading on-line firms are desegregating and reaggregating functionality in order to create value in innovative ways.

The pattern of change for brokerages is:

- Unbundling of traditional services - market players examine the elements of the buyer and seller relationship;
- Reallocation of authorities as the "customer" determines what they will do and what they will pay for in the market;
- Creation of strategic alliances with complementors - sites/products whose products complement yours. This means that if a customer has their product, they would also want yours; and
- Repackaging and emergence of both commodity and differentiated service providers that serve the needs of the "new" customer.

The authors believe that these patterns are evident in all forms of financial services and form the basis of market interventions in most service industries. This paper addresses the transformation of the brokerage services marketplace. With new patterns of intermediation emerging, the winners of the future will be those who most successfully create new context bundles that meet customers' needs.
1. BROKERAGE AT THE CROSSROADS

The technological and regulatory barriers that gave brokerage and securities companies breathing space are rapidly becoming extinct. Companies have to scramble to create viable strategies that balance many priorities: Should they defend their existing customer base or enter into new customer segments? Grow their existing business or expand into new products? Acquire, partner or go alone? Basically, companies are competing not only to offer different and better products and services, but to design robust, lucrative business models that take advantage of emerging forms of electronic commerce.

Electronic commerce - the facilitation of exchange of value over computer networks - is fundamentally changing the brokerage business in part by increasing the velocity of financial services (Kalakota and Whinston, 1997). On-line investing faced great skepticism from full-service brokerages just a short while ago (1996), but it is estimated that by the end of 1997, there were nearly three million on-line investors. To serve this growing customer base the number of on-line firms has mushroomed from a handful in 1994 to more than 50 in 1997. More rivals, including banks and insurers, are beginning to emerge (Barboza, 1998).

At a strategic inflection point in terms of providing services for time-starved, high net-worth do-it-yourself investor, the brokerage industry is transforming itself in unpredictable ways. Today fast-moving firms like E*Trade are usurping roles such as research analysis traditionally offered by full-service brokerages, forcing current market leaders to narrow their focus, and others to broaden their product offerings. Confronted with growing competition, old-guard brokers are being forced to restructure and re-focus their market offerings. Existing off-line market leaders seek to maintain their lead in value-added services through a focus on knowledge/advise - more financial planning and investment advice - rather than transactions - processing trades. Other firms are attempting to comprehend how to offer on-line services without alienating their brokers, to minimize channel conflict.

To compete, full-service brokerages are increasing the scope of their service by taking the acquisition route. Morgan Stanley, for instance, has