

Chapter 19

Intermediaries in E-Commerce: Value Creation Roles

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INTRODUCTION

Very early in the evolution of e-commerce, predictions were made that a significant degree of disintermediation would occur, i.e., that middlemen would be eliminated from the value chain through the use of the Internet. The reasoning was as follows. The economic benefit of middlemen, or intermediaries, is that they reduce transaction costs for functions that are outside the firm (Coase, 1937). Therefore, as digital technology reduced transaction costs in the open market, the role of these middlemen would be threatened (Tapscott, 1996; Downes & Mui, 1998). However, intermediaries have proven to be remarkably robust, even as they have transformed their roles and functions. The success of e-commerce firms like Amazon, eBay, and Yahoo is a testament to the continued value of intermediation. Even in an economy reshaped by digital technology, intermediaries still add value, and find new ways of doing so.

This article examines the evolution and robustness of intermediation in e-commerce, by examining the fundamental economics of intermediation in terms of economies of specialization, scale, and scope. It considers ownership, transformation, and agency as different dimensions of intermediaries. It examines various intermediary roles, and how they are combined, driven by economies of scope and strategic attempts to capture value. It discusses how the various intermediary roles are changing in e-commerce, through the impact of digital technology. The specific case of financial intermediaries, at the forefront of digital technology usage, provides several examples (Singh, 2000). The conclusion is that intermediaries are important and varied enough that they will survive and thrive in the era of e-commerce. Disintermediation will not be a general outcome. Traditional intermediaries that perform manual tasks, or are part of slow or inefficient value chains are in danger, but the economic roles that intermediation plays are unchanged by e-commerce, and will be carried out in new ways.

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BACKGROUND

The term ‘intermediary’ covers many different types of functions, so an ideal classification is difficult. If an intermediary is literally a ‘middleman’, coming between a buyer and a seller in a specific transaction, then the term has a relatively narrow scope. An example of such an intermediary is a specialist on the floor of the New York Stock Exchange (NYSE). However, within the entire value chain for a product or service, from raw inputs to final consumption, many types of organizations or individuals can be viewed as intermediaries. Distributors and wholesalers are an obvious example, but retailers, too, are intermediaries between producers and consumers. Even a computer manufacturer like Dell is an intermediary in this broadest sense, because it collects hardware and software components from a variety of suppliers, and assembles them into computers that are ready to use. Similarly, UPS is an intermediary when it delivers the Dell computer to the household or firm that ordered it.

There is one crucial difference between Dell and UPS, which provides a first basis for classifying intermediaries (Besanko et al, 2008). When Dell obtains components and assembles them into a working computer, it takes ownership of those components. It also oversees the locational transformation: the buyer does not make a separate transaction for the delivery. What Dell sells is the computer delivered to the doorstep, including the delivery charge. UPS is also an intermediary, but it does not take ownership of the computer. Therefore we can divide intermediaries into those which take ownership, creating two separate market transactions, and those who do not, leaving just one market transaction. The specialist on the NYSE floor mostly plays the latter role, matching brokers representing buyers and sellers. Sometimes the specialist also buys or sells out of his or her inventory, thus taking ownership as well.

If the intermediary does not take ownership, there is another important possible dimension of difference. To continue with the NYSE example, brokers who bring buy or sell orders to a specialist are acting on behalf of those who have placed the orders. In other words, the brokers act as agents, either for the buyer or the seller. An agent in this sense is anyone who is assigned a task on behalf of another (Casadesus-Masanell & Spulber, 2007). This assignment may be through a specific contract, or through a general rule. A stockbroker follows general rules laid down by the employer, and by the Securities and Exchange Commission (SEC) for every order, without requiring a contract each time. NYSE specialists, however, do not typically act as agents of either the buyer or the seller, but play a neutral role. (There are exceptions: specialists play an agency role for brokers when they execute prior trading instructions for floor brokers.) Other examples of agent-brokers are real estate brokers. There are invariably two brokers in a real estate transaction, representing the interests of the buyer and the seller respectively – though legally they are both the seller’s agent, since the seller pays both commissions (Wiley & Zambano, 2008). Real estate brokers do not take ownership, but only facilitate market transactions. Ownership and agency are mostly mutually exclusive characteristics of intermediaries, but they may not be totally so. Car dealers, for example, are agents (franchisees) of the manufacturers, but take ownership of the cars they sell. In reality, a great variety of arrangements are possible.

A third dimension of classification is that of transformation of the product or service. As illustrated by the UPS transportation example, transformation (of location) may take place without ownership. Outsourcing may also involve transformation without ownership. In a non-physical example, an advertising agency can change the image of a product with a successful advertising campaign, but does not buy or resell the product. Some intermediaries do not transform

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