It Takes a Village to Make a Mall

By Kevin Kelly

Expectations for online business have been set too high, says McKinsey & Company's John Hagel. He believes the road to Net profit is to let online commerce reinforce virtual community. It's a win-win for the whole economy.

A good rule of thumb for detecting real news is to track a fast-moving object that zooms below the radar of mainstream media. *Net Gain* will not appear on any best-seller list, but it has been handed out at numerous digerati summits and has traveled widely and well on the word of-mouth circuit. The book's coauthor, John Hagel, is head of McKinsey & Company's Worldwide Interactive Multimedia Practice, which includes about 200 consultants knee-deep in emerging online markets. *Wired* caught up with Hagel and asked him where wealth is coming *from* and going *to* in an increasingly Web-endowed world.

Wired: My interpretation of your book says that the feel-good idea of virtual communities as a wonderful thing for humanity is actually a wonderful thing for business.

Hagel

: Yes. Initially virtual communities were a spontaneous social event in a variety of network environments. What people fundamentally want is to connect with each other and create ongoing communities. But this represents an interesting commercial opportunity as well.

To reduce this concept further and more rudely, would you say your message is "It takes a village to make a mall"?

We put it even more concisely: "Community precedes commerce." In earlier network environments, there was a notion that commerce and community were somehow at odds with each other, that as soon as you introduced commerce, you undermined community. Certainly, that can be true if abused, but if it's thoughtfully done, commerce can actually reinforce community and extend value to members.

Can you point to an example of a community preceding commerce?

The Motley Fool on America Online. In the beginning, those guys created a very engaging, entertaining environment that appealed to people with a common interest - namely, stock investment. It became a very robust community, yet, until recently, there was very little commerce conducted there. Now it's evolving some of those commercial opportunities.

Is commerce where the Web is headed?

In the near term, we're setting ourselves up for a major backlash against the Web. Business plans have been put together by large companies and investors that say these early ventures have to be *big* businesses very quickly. But the unappreciated implication of increasing-returns models is that you go through an early period of very slow buildup before you hit accelerated growth. The expectations have been set too high.

What are the wild cards for life on the Net?

There are lots of wild cards. Two that I'm focused on are privacy and intermediaries. A key assumption of many of these business models is the ability to capture information about users. If that information starts to be systematically abused, we will see a huge backlash around privacy, and we will see policies implemented that will make it very difficult to unleash commercial opportunities.

The other wild card is a continuing competition between what I call "customer aggregation" and "provider aggregation" of network resources. One view says tools for individuals are going to be so powerful that you can access and aggregate information that is unique to you, with no need for intermediaries. The other camp argues that the first view may be true at some distant future, but for a while, at least, there's value in having someone between you and the resources to help organize all these choices.

You travel a lot. Do you have a sense that the fascination with Web technology is just an American fashion, or is it worldwide in import?

Because of network and related technologies, we're going to see wealth redistribution on a scale not seen since the Industrial Revolution.

What do you mean when you say wealth redistribution?

You can talk about wealth redistribution at a variety of levels. Here's one example: From 1985 to 1990, we saw a huge redistribution of shareholder value between companies that were owners of proprietary architectures and those that were championing open architectures. Something like US$40 billion worth of shareholder value was destroyed by companies that owned the old proprietary-style technology. But in just a five-year period, a new set of players advocating open systems created about $35 billion in value.

OK, I'll bite, what happened to the other $5 billion?

That's part of the magic of all this. The other five went to the customers! They also became champions of open architecture precisely because they benefited from this shift of value.

On first glance at econometric numbers, some critics argue that despite billions invested in computers, we haven't seen overall productivity gains.

The potential of this technology is heavily gated by the ability of people to change their work practices around technology; that practice always significantly lags behind the technology itself. Reforming old companies soaks up many gains, but if you fundamentally build a new type of business around the technology, the productivity gains will be dramatic.

There's also the extreme view of Peter Drucker, who has told *Wired* that the entire computer business hasn't made any money yet.

That may be true. Providers are having to work harder and harder to keep less and less in this increasingly competitive environment. In the end, a lot of this wealth is getting transferred to the customer - better goods for less money.

How long can this last? Twenty years out, could we see customers getting richer and richer, and most companies - save one or two giants - teetering on a fine margin, barely surviving?

In economic terms, these enriched customers have more and more money to spend, so this shifted wealth creates entirely new markets, products, and industries. Overall, the entire economy benefits, but it can be a painful process to go through.

From what you've seen on the Web, what are the winning characteristics of networked companies?

Companies attempting to survive, much less prosper, in these new environments are going to be ill served by traditional business-school notions - get a clear view of an endgame, focus on the migration path, then position yourself in that endgame. What happens if the endgame is unknowable, as it will be? Now what do you do? The chief objective of a company now is to maximize value for the Web. This is counterintuitive to most senior management, particularly those coming at this from outside the computer industry. Traditional management reaction to high uncertainty is "I want to maximize control," whereas the real operating principle here is "Don't try to control everything. Share the risk. Get others involved."

So give me an example of this strategy of throwing your weight with the Web.

We've invested heavily in trying to understand strategies for building standards. We think about architectural standards in an abstract way, as if they were for a specific technology platform, just like the Net. Either your company aspires to be a shaper, to own some of these standards, or an adapter who can play within this new architecture. You have to build a web of players who adopt these common rules. We call this "web-based strategy"; it's already well developed in high tech. But it will start to become dominant in telecom, banking, health care, and other industries just starting to see the change on the horizon.

The mantra for the new economy seems to be "Embrace the open, refuse the closed."

We've certainly seen open architectures take over the computer world. The next big wave is going to be the telecom world, which will become open, and in a much more significant way.

What, if anything, baffles you right now?

When I compare how much money is invested in the technology itself versus that spent on understanding social dynamics - how human behavior evolves in these environments - it's a hugely baffling imbalance. And yet so much hinges on understanding the latter.

What is your own group's method for divining what's ahead?

We invest a tremendous amount in being able to ask the next wave of questions.

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