The new, new financial system? 
Towards a conceptualization of financial reintermediation

Shaun French and Andrew Leyshon
University of Nottingham

ABSTRACT

This paper attempts to develop a conceptual framework for analysing the impacts of the Internet and e-commerce upon industrial sectors. While a great deal has been written about the so-called ‘new economy’ much of it has been either speculative and hyperbolic, as in the ‘boom’ years of the late 1990s, or cynical and dismissive, as in the period since the collapse of ‘dot.com’ stocks in Spring 2000. We seek to move beyond and between these positions by providing a means to determine what difference the Internet and e-commerce might make to industrial organization through a consideration of the retail financial services industry. We do this through a critical evaluation of the concept of disintermediation that, as we argue in the paper, is better understood as reintermediation. We argue that the potential impacts of the Internet and e-commerce upon retail financial services are non-trivial, and they are consistent with the individualization of risk and reward that have characterized wider processes of financial inclusion and exclusion over the past decade or so.

KEYWORDS

Financial services; e-commerce; disintermediation; virtualism; individualisation; financial inclusion; exclusion.

I. INTRODUCTION

[Jim Clark had] accumulated a long list of grievances from his brief experience with real wealth. He disliked paying California’s capital gains tax – so much that he had moved his official residence to Palm Beach, Florida. He disliked the hassle of paying bills – so much that he’d hired a fellow named Harvey to take care of it. He disliked stock brokers – so much that he ignored their advice to diversify and kept...
all his wealth in Netscape and Healtheon. He disliked venture capitalists and investment bankers and, in general, the phalanx of financial intermediaries who sat between the creators of wealth and their just desserts.

At first he decided that what he really wanted was what rich people have always had: a family office . . . Pretty quickly, however, he realized he wanted more than a money butler. He wanted to be able to watch what his money butlers did. He wanted to be able to take in every aspect of his money at a glance, no matter where on earth he happened to be, and at what time. The Internet was perfectly suited to what he had in mind.

(Lewis, 1999: 386)

The final part of Michael Lewis’ perceptive and entertaining account of the rise of the ‘new economy’, The New New Thing, is given over to an idea for a new kind of financial institution that would cater for the special ‘problems’ faced by people who, during the boom years of the new economy, had become very rich, very quickly. Lewis’ story revolves around the figure of Jim Clark, founder of three successful Silicon Valley companies – Silicon Graphics, Netscape and Healtheon – and, as a result, a billionaire several times over. Clark’s name for this new kind of financial institution was myCFO.1 The plan was that myCFO would, like his two other Internet-based companies Netscape and Healtheon, deliver its services on-line. The rationale for the company was relatively straightforward. First, an on-line system would store and constantly up-date the financial positions of high-net-worth individuals, which could be viewed by them via the Internet from wherever in the world they happened to be, so they could know exactly how rich they were whenever they wanted to. Second, the company would provide specialist investment advice targeted at the very, very rich. Although their numbers were relatively limited, the promises of e-commerce was swelling their ranks, increasing the size of the potential market of people like Clark that would be attracted to a service that could be served quickly and efficiently through a handful of offices and Internet distribution systems. The potential efficiency savings that had in large part fuelled the dot.com boom were, however, less significant on this occasion than the ability that a firm like myCFO had to pool large sums of money from a relatively small number of people, that, in turn, would enable the company to exert significant power within financial markets. Lewis describes the logic behind the company as follows:

What [Clark] was groping toward wasn’t just a new company. It was a new kind of financial institution, and, as murky as it was in its conception, it posed a fantastic threat to old, established financial institutions. The Internet had made it possible for people to organize

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themselves in new ways. It made it possible for rich people to organize themselves. No one said that the new organization of rich people had to behave like other financial organizations. The people who joined forces in myCFO would have great bargaining power with traditional financial institutions... Jim Clark’s pile of money— which he figured could easily be the world’s biggest pile of money—would operate independently. Anarchically. Its customers, as a group, could play Silicon Valley venture capitalists and Wall Street investment bankers and Main Street stock brokers and Swiss private bankers off each other, much the way Clark already did in his own private business life. If myCFO did not seize control of the levers of capitalism, it could at least remove the lever from the capitalists’ hands. And the bigger the pile of money inside myCFO, the more market clout this cartel of the very rich would have. Once the number of dollars became sufficiently huge, they could sit on top of the financial world like an operating system sat on top of a personal computer.

(Lewis, 1999: 388–9)

Jim Clark’s new, new company did indeed come to pass. It was set up in 1999, and indicated its desire to go for only the very rich by insisting that the opening balances of new accounts be set at least $10 million, with a minimum annual fee of $25,000. By the end of that year, myCFO had recruited just 46 clients, although between them they had a net worth of $8 billion. By the end of 2000, the client list had increased to 310 and their collective net-worth topped $44 billion. While it was unlikely that all the wealth these individuals commanded would have been under the control of myCFO, the $10 million entrance fee meant that funds controlled by the company amounted to at least $3 billion. By the middle of 2001, the company had six offices across the US and was aiming for a public listing, volatility in the stockmarket not withstanding.

We have turned to this example because it is a useful introduction to a concept that we wish to interrogate in this paper. This concept, disintermediation, was initially mobilized in accounts of the restructuring of the financial services industry but has, more recently, featured in many accounts of the ‘new economy’, particularly in relation to e-commerce. In the 1980s, disintermediation was perceived to be the process that underpinned the revolution in global financial markets, leading to the growth both new kinds of financial instruments and the leading international financial centres in which they were traded. These changes also brought about a transformation in the nature of competition within such markets, leading to the decline and fall of many formerly dominant market incumbents. Following the rise of the Internet in the 1990s, advocates of its economic utility argued that the transformative power of e-commerce was
its power to disintermediate 'value' or 'production chains', making it possible to cut out distributors and other intermediaries, as electronic communications made it possible for producers and consumers to make direct contact on a hitherto unprecedented scale (Evans and Wurster, 1997; Evans and Wurster, 1999). As we shall see later, advocates of this explanation of e-commerce have often sought to illustrate their arguments with reference to the retail financial services sector; to illustrate the impact that will be made by the Internet and e-commerce upon markets and institutions.

In this paper we critically evaluate the concept of disintermediation. We argue that the concept still retains significant currency not only within the cultural circuits of capitalism (Thrift, 1999) associated with the development of Internet-based financial services (or e-finance), but also within the wider communities of e-commerce and the new economy (see, for instance, Castells, 2001: 84). In its ubiquity, disintermediation has become an increasingly chaotic concept, taken for granted and rarely scrutinized or properly defined. What we seek to do is to prise open the 'black box' of disintermediation and trace the evolution of the term within the world of money and finance and its subsequent migration to the new economy, the world of dot.com start-ups and beyond. In so doing we seek to provide the 'conceptual precision' that Feng et al. rightly argue has been noticeable largely by its absence from accounts of the new economy and analyses of its likely impacts upon established industries and companies (Feng et al., 2001). In addition, we argue that the discourse of speed, efficiency and consumer empowerment that surrounds e-commerce and e-finance is politically freighted, as it seeks to normalize and justify longer-run processes of uneven development within the provision of retail financial services.

The paper has three main aims. The first is to offer a detailed etymology of the term disintermediation. Originating within accounts of transformation within the financial sphere, it has been generalized to predict the direction of change within the economy more broadly. The subsequent description of processes within the new economy as disintermediation, we argue, is problematic, serving to obfuscate some potentially regressive social and economic consequences of this process.

The second aim of the paper is to shed critical light upon those claims and assumptions that are made about society, economy, space and place in the mobilization of disintermediation and other closely aligned concepts and theories. To do so is particularly important in the case of e-commerce we argue, because canonical texts in this domain constitute examples of 'virtualism' (Carrier and Miller, 1998). Debates around the impact of e-commerce upon patterns of consumption, inclusion and exclusion, regulation, governance, issues of privacy, the power of corporations, and a whole range of similar issues, are framed by such texts and the concepts mobilized therein.
The third aim of the paper is to synthesise and translate theories of financial disintermediation and electronic disintermediation to offer an alternative conceptual framework for thinking about the significance of companies like myCFO. By recombining the theories of financial and electronic disintermediation, and translating the resulting insights into a model of financial reintermediation, the paper argues that we can begin to more properly explore the effects of the Internet on the social, economic and geographical landscape of the financial services industry. This is not an easy task, nor is the model we develop without its own problems. But we suggest that it offers a better conceptual and methodological starting point from which to analyse the impact of the Internet on this sector than do chaotic notions of disintermediation.

The remainder of the paper is divided into five parts. In part II, we analyse the rhetorical power and material effects of disintermediation within the financial system, with particular reference to the changing geography of the international financial system in the 1980s and 1990s. In part III, we turn our attention to e-commerce, with particular reference to the claims made for disintermediation in the creation of the new economy. In part IV, we suggest that what is commonly described as disintermediation is better understood as a process of reintermediation. In the case of both global financial markets and e-commerce the bypassing of existing intermediaries is only made possible through an engagement with new intermediaries, which are human and/or non-human agents. In part V we make a more general critical assessment of the processes at work by proposing an alternative model of financial reintermediation. Part VI concludes the paper.

II. MAKING SENSE OF FINANCIAL DISINTERMEDIATION

Although restructuring of the global financial system was already well underway in the 1970s, it was during the 1980s that structural and organisational changes began to radically remake the fabric of the prevailing financial order, introducing new kinds of dynamics and capacities to global financial markets. However, despite the ubiquity of disintermediation as an explanation of such changes, surprisingly little critical analysis of the concept is evident. At its most fundamental level disintermediation may be explained in relation to what it is a reaction to, namely financial intermediation. According to the standard economic account, financial intermediation is undertaken by firms such as banks and other deposit-taking institutions, which act as intermediaries between investors and borrowers to facilitate a 'going-between' surplus and deficit economic sectors and agents (Howells and Bain, 1990). There are two kinds of 'going-between', or modes of financial intermediation. Type 1
intermediation serves to reduce information and/or transaction costs. Type 2 intermediation serves to create liquidity (Howells and Bain, 1990; Lewis and Davis, 1987; Pawley et al., 1991). Financial institutions that specialize primarily in the provision of the first function are often referred to as brokers or ‘pure intermediaries’. Thus, firms such as insurance brokers, for example, undertake a ‘going-between’ to overcome the search, transaction, monitoring and enforcement costs that would otherwise inhibit the matching of potential borrowers and lenders (Lewis and Davis, 1987). However, Type 2 intermediation is a far greater accomplishment than this. As well as reducing information and transaction costs, Howells and Bain argue that the competitive advantage held by financial intermediaries resides with their ability ‘to create assets for savers and liabilities for borrowers which are more attractive to each than would be the case if the parties had to deal with each other directly’ (1990: 3). That is, by ‘going-between’ savers and borrowers, financial intermediaries are able to create better, more efficient outcomes than if savers and borrowers deal with one another directly.

One of the outcomes of this form of intermediation is the ability to aggregate many savers and match them with borrowers. By pooling or scaling funds in this way banks, building societies, insurance companies and other higher-order financial intermediaries are able to engage in what is termed liquidity creation or portfolio transformation, which means that the flow of funds are not reliant upon directly matching the individual maturity and risk requirements of savers and borrowers. Type 2 intermediaries create liquidity in the financial services market through the transformation of the maturity and risk profiles of savers and borrowers. Thus, for instance, long-term loans can be made to borrowers on the back of much shorter maturing deposits (Howells and Bain, 1990). Therefore, financial intermediation is justified within the economic and financial literature because, in the same way that monetary exchange holds advantages over barter, it facilitates exchange that is not reliant upon the mutual coincidence of want or need for it to proceed (Davies, 1994).

What, then, is disintermediation, and why does it occur in the face of all the apparent advantages of intermediation? Just as there are two forms of intermediation, so there are two kinds of financial disintermediation. Type 1 disintermediation occurs when investors, or the purchasers of financial instruments, deal directly with the producers of those products, side-stepping the need to go via established intermediaries such as insurance brokers or agents. Type 1 disintermediation may occur, for instance, through the development of direct marketing and sales processes that reach out to customers over the heads of intermediaries. For it to be significant, it is usually accompanied by an increase in the availability of financial information and of levels of financial literacy (Cutler, 1997;
Harmes, 2001; Knights et al., 1994; Leyshon et al., 1998; Tennyson and Nguyen, 2001), so that consumers have the confidence to be able to understand what this information means without recourse to the interpretations provided by intermediaries. Therefore, Type 1 disintermediation, ‘always ... requires a degree of sophistication on the part of customers that was not present before’ (Martin, 1998: 24).

Type 2 disintermediation may be defined as ‘direct investment or market borrowing by companies without going through a bank or other financial intermediary’ (Hamilton, 1986: 244). The amount of funds circulating between economic institutions and agents free of the intermediation of a financial institution has increased markedly since the 1970s (see Leyshon and Thrift, 1997). There have been at least two reasons for the growth of Type 2 disintermediation. The first reason has been a response to financial regulation. Because the assets and liabilities produced by intermediation appear on the balance sheets of financial institutions, it is relatively easy for governments and regulatory authorities to devise controls on lending – either, for the purposes of prudential regulation or as part of wider macroeconomic strategies (Dow and Saville, 1988) – recorded in this way. Such controls have the potential to restrict the amount of income that banks and the like can earn, and their imposition has encouraged such firms to explore the possibilities of making money through activities that are not recorded on the balance sheet.

A second reason has been a growth in the volume of information available to assess the relative creditworthiness of borrowers (Evans and Wurster, 1997; Leyshon et al., 1998; Leyshon and Thrift, 1999; Sinclair, 2000). Traditionally within financial institutions, the task of determining creditworthiness has been undertaken through an intensive and expensive process of face-to-face assessment, based on relationships developed over time (Eccles and Crane, 1988; Auletta, 1986). However, over the past 20 years or so, there has been a marked increase in the growth of at-a-distance means of credit assessment, which developed first within professional markets with the rise to prominence of leading credit rating agencies such as Moody’s and Standard and Poor’s (Sinclair, 1994).2 As a consequence the process of credit creation has become more transparent and increasingly triggered by ‘objective’ measures of credit worthiness determined by third parties, rather than based upon ‘back stage’ negotiations between financial intermediaries and borrowers.

As has been documented many times previously, a significant outcome of this shift in the knowledge base has been the circumnavigation of financial intermediaries. Armed with more freely available creditworthiness data firms have been increasingly able to bypass banks and go directly to the financial markets to raise money. And, of course, to escape the regulatory restrictions on financial intermediation that we referred to above, intermediaries themselves have also pushed disintermediation
along in the search for non-balance sheet fee income that could be earned from borrowers for placing their securitized debt with investors.

All of this is fairly well known and has been well documented. The outcomes of 'disintermediation' in the wholesale financial markets have also been fairly well rehearsed, which include the production of more uneven and more intensely polarized landscapes of investment and borrowing. The interest rates that borrowers in disintermediated, securitized markets have to pay are directly determined by their credit rating. In other words, there is now a closer relationship between perceived risk and the price of credit. Overall, large 'blue-chip' borrowers have increasingly enjoyed more favourable borrowing terms, while smaller, less-established entities have had to pay more. Thus, as the process of credit creation became more transparent, strong borrowers and investors recognized their strengths in relation to financial intermediaries, and it has become increasingly difficult to cross-subsidise weaker performing assets on the balance sheet as was previously commonplace. In other words, as 'good' business has gone 'off the books', the performance of that which remains has been examined more critically.

Moreover, the advent of disintermediation has had significant geographical outcomes, of which three are of particular note. First, disintermediation has reinforced the power of leading centres of financial calculation. Disintermediation brought about a process of vertical disintegration within the process of credit creation, creating significant knowledge spillovers within the leading global financial centres, which strengthened their position as centres of interpretation, calculation and power (Clark, 2000; Leyshon, 1997; Thrift, 1994; Tickell, 2000; Leyshon and Thrift, 1997). Second, disintermediation has deepened geographies of financial inclusion and exclusion. The inability of intermediaries to cross-subsidize weaker borrowers and the emergence of a more direct relationship between credit risk and pricing have produced uneven financial outcomes at a range of geographical scales (see Leyshon and Thrift, 1997). Third, and finally, the advance of disintermediation has been geographically uneven. It is more pervasive within those regulatory jurisdictions that cleave most strongly to the efficacy and effectiveness of markets (such as the US and the UK, for example) but has proceeded more fitfully and less completely within those regulatory spaces where intermediated finance has traditionally exerted more economic and political power (such as Germany and France, for example).  

The story of disintermediation is now so firmly entrenched within accounts of the financial system, that it has become something of a 'black box', a standard and largely unchallenged account that circulates within the industry and among its many commentators. Indeed, the account has stabilized to such an extent that disintermediation, which was originally coined to describe a process particular to the financial system, has taken
on the status of a metaphor, which has been redescribed to explain a much broader set of processes within the contemporary economy. It is to the use of this metaphor to explain and justify the emergence of the new economy that we now turn.

III. THE RISE OF ELECTRONIC DISINTERMEDIATION IN THE NEW ECONOMY

In the excitement that surrounded the growth of the so-called new economy from the mid-1990s onwards, a great deal of attention has been paid to the relationship between dotcoms and the financial system. Much of this attention speculated upon the relationship between e-commerce and the financial system. That is, these accounts have focused upon the large amounts of speculative capital injected into companies prior to their Initial Public Offerings (IPOs), on the so-called 'burn rate' of companies, and upon the spectacular fortunes that can be made – and lost – by venture capitalists, entrepreneurs and investors alike (Lewis, 1999; Wolff, 1998). This was particularly significant because so much of what was represented as new economy practice was effectively improvised. The little research that has been done on the dynamics of the new economy suggests that this is a highly unstable mixture of actors, organizations, products and services that are struggling to impose meaning about what they do, and to legitimize their existence within a contemporary business environment (Pratt, 2000). Fortunately, such representational struggles took place at a time when the business world seemed particularly receptive to organisational models that challenged predominant conventions (see Feng et al., 2001). Indeed, in the 1990s many financial analysts attached very high premiums to companies that seem to be operating according to a discontinuous theory of economic change (Christensen, 1997), and which promised to undermine and supplant the existing bases of competition across a range of industries.

What is increasingly clear, then, is that there are a number of important connections between the financial system and the growth of the new economy, links which have influenced the evolution of each in significant ways (see Castells, 2001: 78–90). The exact nature of these links is still being worked out, but we can nevertheless identify three connections that are of particular significance.

The first is the way in which the financial system acted as a growth machine for the new economy, giving shape and energy to the entity that it became. Some commentators have argued that the new economy was produced through a process of 'financialization', as the power of money and the search for returns on investment effectively fuelled a speculative bubble founded on the promises of 'digital alchemy which could (ultimately) generate huge riches' (Feng et al., 2001: 481; see, in addition,
Aglietta, 2001; Williams, 2001). As Thrift (2001) argues, the phenomenon of the new economy served as an effective ‘ramp for the financial markets, providing the narrative raw material to fuel a speculative asset price bubble founded on an extension of the financial audience’ (p. 422).

The second connection is the way in which the new economy was accompanied by its own version of the ‘end of geography’ debate. Originally developed through the work of financial industry commentators such as Richard O’Brien (O’Brien, 1991), who argued that information and communication technologies would reduce the significance of geographical location within the international financial system, the idea was dusted down and repackaged for the e-commerce market through the concept of the weightless world (Coyle, 1997), the weightless economy (Quah, 1999, 2000) and the death of distance (Cairncross, 1997). In this new version of the same story, electronic markets promised to efface space and place, and to bring about an ‘anytime, anyplace, anywhere, 24/7’ economy for retail consumers, just as O’Brien predicted would be the case in professional financial markets.

The third, and as far as this paper is concerned, the most significant connection between the financial system and the new economy concerns the central role attributed to processes of disintermediation. The justification for the rise of the new economy in general, and of e-commerce in particular, has been explained by many leading commentators through the capacity of new information and communication technologies to bring about disintermediation. Advocates of e-commerce have argued that it will rewrite the rules of organization, providing significant first-mover advantages to those firms in the vanguard of its development. It predicts that the growth of electronic-mediated market information will bring about a reduction in the costs of economic co-ordination, and the decline in the importance of hierarchical means of co-ordination. The rise of the Internet, and the growth of software devices such as search engines and intelligent agents, which purposively scan internet databases for specific types of information (Hagel and Singer, 1999), make it possible for buyers to search electronic markets at speed and at low cost for supplier and product information that is both rich in content and geographically extensive (Evans and Wurster, 1999).

But, is the use of the term disintermediation actually justifiable in the case of the processes at work in the rise of e-commerce? How has this term been translated from the financial system to the new economy, at what cost and with what effects? It is to these questions we now turn.

IV. REINTERPRETING DISINTERMEDIATION

In order to address these sorts of questions it is useful to focus upon some canonical texts from the late 1990s, texts that provided both an economic
and a strategic case for the transformation of the economy through the incorporation of Internet distribution systems and the power of network effects. These texts have been influential, precisely because the claims made for the new economy and e-commerce were so high, and because of the high levels of uncertainty surrounding the likely outcomes of these new ways of doing business. As we stated at the beginning of the paper and as has been argued previously (Leyshon, 2001), we therefore view the literature on e-commerce as being formative to a very considerable degree in the way it defines important problems, important questions, and in general, what is significant (cf. Callon, 1998).

This literature, which is strongly heterodox and ranges from academic books and journal articles, through consultancy reports and business journalism to more popular accounts, including biographical and autobiographical accounts (see Feng et al., 2001), has been produced by a newly emergent knowledge community that has sought to give theoretical, practical and rhetorical shape to e-commerce. We see this literature on e-commerce as an example of ‘virtualism’, whereby ‘the economy is increasingly forced to change itself in order to match the descriptions of abstracted models that are produced by academic economists’ (Miller, 2000: 201) and, it should be added, by the more practical models developed by consultants, journalists and other commentators of various kinds (Carrier, 1998; Thrift, 1999; Thrift, 2000). One reason for the growing significance of virtualism is the growing power of the discipline of economics in the world, and the colonization of influential spaces within the economic and political sphere by its disciplines (Carrier, 1998). There is growing evidence of the power of such formal representations within contemporary organizations (Star, 1995), and of the impact of abstract and practical models have been noted in institutions as diverse as the International Monetary Fund and World Bank (Stiglitz, 2002), management consultancy (Micklethwait and Wooldridge, 1997), as well as workplaces (Thrift, 2000). Here we focus on the work of Phillip Evans and Thomas Wurster, two particularly influential writers who have put disintermediation at the heart of their analysis of the new economy and the rise of e-commerce.

Evans and Wurster are in many ways emblematic of the knowledge community that has grown up around the new economy since the mid-1980s. They are both management consultants, and work for the Boston Consulting Group in its Media & Convergence Practice in Boston and Los Angeles. As such, they are active members of what Thrift describes as the ‘cultural circuit of capitalism’ (Thrift, 1999). Like much consultancy-based writing, Evans and Wurster’s work is partly analytical and partly prescriptive (Micklethwait and Wooldridge, 1997). The analytical dimension of their work derives from their experiences and observations of business strategies and practices, and which seeks to identify an
underlying order within the turbulent seas of economic change. The prescriptive quality of their work is connected directly to their role as consultants, as knowledge intermediaries that proffer advice to management on the routes that businesses should take to navigate safely through these dangerous economic waters.

Evans and Wurster have made two significant contributions to both understanding and constructing the edifice of the New Economy. The first was an article entitled, ‘Strategy and the new economics of information’, published in the Harvard Business Review in 1997 (Evans and Wurster, 1997). The success of this initial contribution encouraged them to extend their ideas into a book length treatise – a process that is increasingly common in the world of management consultancy (Huczynski, 1996; Micklethwait and Wooldridge, 1997) – which was entitled Blown to Bits and published in 1999 (Evans and Wurster, 1999).

Their argument is that the growth of the Internet and a proliferation of commercial websites is making available new kinds of information that empower the consumer, which in so doing erodes the advantages formerly held by established intermediaries within the ‘value chains’ of all kinds of businesses. In other words, the proliferation of electronic information is ‘blowing apart’ value chains, with the potential to fundamentally reconfigure the grounds of economic competition. Information is central to their argument, which they see as:

the glue that holds together the structure of all businesses. A company’s value chain consists of all the activities it performs to design, produce, market, deliver, and support its product . . . When we think of a value chain, we tend to visualize a linear flow of physical activities. But the value chain also includes all the information that flows within a company and between a company and its suppliers, it distributors, and its existing or potential customers. Supplier relationships, brand identity, process co-ordination, customer loyalty, employee loyalty, and switching costs all depend on various kinds of information.

(Evans and Wurster, 1997: 72)

But, the ability of these value chains to cohere, and the ability of numerous businesses within them to maintain their positions as intermediaries between producers and consumers, is threatened by the capacity of electronic networks to ‘disintermediate’ them. Evans and Wurster argue that there are two modes of disintermediation that may effect value chains in this way. The first mode ‘refers to those instances when the ultimate supplier circumvents intermediaries and sells directly to the ultimate consumer’, whereas the second mode ‘refers to the emergence of a new intermediary that employs a lower-cost way of distributing the good or service to try and displace existing intermediaries’ (Evans and
Wurster, 1999: 237). The capacity for disintermediation has grown in direct proportion to the intensity of electronic communication networks because, they argue, such networks enable information to be decoupled from the physical manifestations of extant value chains:

When information is carried by things – by a salesperson or by a piece of direct mail, for example – it goes where the things go and no further. It is constructed to follow the linear flow of the physical value chain. But once everyone is connected electronically, information can travel by itself. The traditional link between the flow of the product related information and the flow of the product itself, between the economics of information and the economics of things, can be broken. What is truly revolutionary about the explosion in connectivity is the possibility it offers to unbundle information from its physical carrier.

(Evans and Wurster, 1997: 73)

Such processes of disintermediation, they argue, have the capacity to shake-up and remake value chains across a wide range of industries. It is the unique capacity that e-commerce applications have to reach large numbers of consumers and to provide relatively rich information exchanges that distinguishes electronic- from non-electronic-based disintermediation, such as mail order catalogues. It is at this point, then, that we can see the echoes of the ‘end of geography’ debate that circulated around corporate financial services, for through such at-a-distance but information-rich networks businesses have the potential to extend their markets on a global scale.

Evans and Wurster’s thesis has undoubtedly been influential in shaping ideas about what e-commerce might bring about. However, their argument that the new economy and e-commerce is founded upon disintermediation needs to be qualified, in at least two respects. First, while they draw upon the example of financial disintermediation to justify the power of its effects in relation to the economy as a whole (1997: 79), their translation of disintermediation from the world of money and finance is only partial. Their description of disintermediation refers only to Type 1 disintermediation that we described earlier; that is, the form that displaces pure intermediaries such as brokers and agents. The more significant mode of financial disintermediation, Type 2, which substitutes assets and liabilities on balance sheets with money market instruments, is clearly far more difficult to translate into a general model that might be applied to businesses as a whole.

The failure of Evans and Wurster to consider both processes is well illustrated in their analysis of the impacts of electronic disintermediation on the retail financial system. While they argue that the growth of electronic information has the power to destabilise value chains within the
review of the retail financial system, they focus exclusively upon the role of pure intermediaries, such as brokers. They do not consider the other process of financial disintermediation within the retail financial sector, which would enable individuals and households to occupy either end of the flow of funds from investors to borrowers without the intermediation of a bank or some other deposit-taking institution. If one does so then it is discovered that individuals are increasingly able to supply funds directly to borrowers, due to the proliferation of money market instruments and general increases in financial literacy. However, it is far more difficult for individuals and households to occupy the other end of the flow of disintermediated funds where they would borrow from capital markets. Thus, whereas corporations and other large organisations are able to take advantage of financial disintermediation as borrowers, individuals and individual households are far too small to be able to exert any leverage in such markets. 

Unless, that is, they ‘scale’. One of the leading mantras of the advocates of e-commerce (Kelty, 2000), the ability of e-commerce businesses ‘to scale’ holds out the promise of something being ‘both big and small at the same time’ (page 3), or at least, start out small but end up big very soon afterwards. Therefore, only if retail customers can join together, as a ‘virtual community’ (Hagel and Armstrong, 1997), are they able to exert any leverage over the financial system as borrowers within disintermediated financial markets. This is theoretically possible, but to imagine the ways in which this might happen serves to draw attention to the second qualification that needs to be applied to the prevailing accounts of financial and electronic disintermediation.

The second qualification is that the processes that are normatively described as disintermediation are in fact more accurately described as reintermediation (Kenney and Curry, 2000; Zysman and Weber, 2001). This much is recognized by a number of advocates of e-commerce who have put disintermediation at the heart of their claims to have been able to foretell the dawning of a new economic epoch. For example, Kevin Kelly, perhaps the most famous member of the e-commerce’ knowledge community, has gone so far as to argue that:

the expectation that the network economy favors disintermediation is exactly wrong. It is quite the opposite. Network technologies do not eliminate intermediaries. They spawn them. Networks are a cradle for intermediaries.

(Kelly, 1998: 100)

Indeed, if one looks more closely at Evans and Wurster’s argument then they too are arguing for reintermediation, although they never actually use the term. Disintermediation is used throughout, no doubt for dramatic effect given the likely audience for their work, to draw attention to the
perceived vulnerability of market incumbents to new entrants using Internet distribution systems. But these new entrants would become intermediaries within value chains, albeit more efficient and/or competitive intermediaries than the businesses they displaced. It is at this point, then, that we can begin to understand the possibilities for fundamental financial reintermediation within the retail financial services at both ends of the value chain, and explain the rise of institutions such as myCFO as an example of a new kind of financial intermediary that exploits the power of network effects through leveraging scale.

But what this example also reveals is the possible regressive social and political outcomes of financial reintermediation, which are glossed over in the boosterist accounts churned out by management consultancies and the like, where the justification for the new economy and e-commerce is founded in large part upon a neo-liberal faith in the sanctity and power of consumer sovereignty and serial acts of economically-rational consumption. What the rise of organizations such as myCFO reveal are the possibilities of empowerment for the financially super-included (Leyshon and Thrift, 1996) who, with the aid of new kinds of intermediaries, are able to carve out better deals for themselves at the expense of cross-subsidizing the less affluent through the balance sheets of financial intermediaries. Thus, the rise of new intermediaries is not a neutral practice, brought about by the logic of efficiency gains. Rather, it is a highly charged political process that favours some (richer) actors over others.

V. DISSECTING THE NEW, NEW FINANCIAL SYSTEM

We introduced this paper with the case of myCFO because this new, new way of organizing financial affairs exemplifies, in a dramatic fashion, the transformative potential not only of e-finance, but also of e-commerce more generally. In seeking to explain and justify the significance of the Internet as an emerging economic space the concept of disintermediation has frequently been mobilized within debates surrounding the future of a whole series of industries and sectors. Because of the provenance of the term, disintermediation has particular appeal for an analysis of the development of Internet retail financial services. However, as we have illustrated the concept is much more problematic than is often assumed. Drawing on the preceding analysis, we now want to attempt to make a more general critical assessment of the concept of disintermediation by proposing an alternative model of financial reintermediation. We want to argue that, whilst ultimately rejecting the notion of disintermediation, by rescuing some key insights we are able to develop a useful framework for thinking about the significance of the growth of Internet-based financial services. In addition, this model helps to reveal the ideological suppositions that underlie normative justifications for disintermediation, which
Figure 1  Towards a model of financial reintermediation
expose it to be not merely a technical exercise but as a process that has non-trivial political implications.

As is illustrated in Figure 1, the progression from disintermediation to our model of financial reintermediation involves three stages.

The first stage is to develop an etymology of disintermediation. It should be clear from the proceeding analysis that disintermediation is neither an easy concept to define or mobilize. Following on from the foregoing analysis it is possible to identify at least two different conceptions of disintermediation. These are (i) financial disintermediation and (ii) electronic disintermediation. Financial disintermediation describes a general process within financial services, which in the past has been driven by regulatory changes and a growth in information regarding credit-worthiness. Electronic disintermediation refers specifically to the formation of electronic markets, markets that will have an impact upon a large number of industries, not just financial services. These markets are less implicated within specific financial metrics and regimes of credit scoring, but instead are more dependent upon the production of trust around issues such as brands, on-line security and technology more broadly.4

A closer examination of the concepts of financial and electronic disintermediation also reveals different modes of disintermediation within each. Following on from the detailed discussion of financial disintermediation in Part II, the first stage of Figure 1 distinguishes between brokerage disintermediation (Type 1) and the disintermediation of higher-order liquidity creating institutions such as banks, building societies and insurance companies (Type 2 disintermediation). Similarly, the diagram also differentiates between the two modes of electronic disintermediation identified in part IV. The first mode refers to a process of organization whereby ‘ultimate suppliers sell directly to ultimate consumers’. As previously noted, such a broad definition could be argued to encompass both modes of financial disintermediation. In practice, as indicated in Figure 1, advocates of disintermediation via e-commerce use this term in a much more restricted sense to simply describe the circumnavigation of financial brokerages. In contrast, a second mode identified in the work of Evans and Wurster – whereby, new, more efficient intermediaries emerge to displace market incumbents – provides a very different interpretation of disintermediation to that associated with the concept of financial intermediation.

Having unpacked the concept of disintermediation and identified its constitutive parts, the second stage of the development of our model represents an attempt to synthesize financial and electronic disintermediation theories; or, in other words, to repack disintermediation to be able to more properly critically assess the usefulness of the concept. One benefit of insisting upon the separation of these two kinds of disintermediation is
that they provide us with a potential classification system for analysing Internet-based restructuring and reorganisation, and for differentiating between types of new relations. As illustrated in the second part of Figure 1, synthesizing these two accounts produces a three-fold typology.

First, there is portfolio or higher order liquidity-creation disintermediation. These are new ways of organizing money that enable consumers to circumnavigate the traditional architecture of liquidity creation associated with higher order financial intermediaries. It includes processes such as securitization, which has become an increasingly important tool for managing risk and debt over the past 20 years or so. Second, there is brokerage disintermediation, associated with the emergence of software packages like Quicken and Microsoft Money, and with web agents like Motley Fool, for example. These intermediaries provide information to enable customers to buy financial products without the aid of traditional brokerages. Third, and finally, there is efficiency disintermediation, which is achieved through new intermediaries and ways of organizing, which broadly replicate traditional architectures of brokerage or liquidity creation but new intermediaries that, via the Internet, enjoy efficiency gains over market incumbents.

By distinguishing between different types of e-finance operation this three-fold typology provides us with a potentially powerful tool with which to begin to map out and assess the significance of the emerging landscape of electronic retail financial services (and of other industries). However, despite bringing much needed conceptual clarity the unpacking and repacking of the theory of disintermediation still leaves us with a fundamental difficulty for, as previously stressed, those processes frequently described in terms of disintermediation are in fact processes of reintermediation. Rather than disintermediating the value chains of retail financial services, institutions such as myCFO owe their significance to the fact that they are reintermediating existing chains. In other words, they are displacing and replacing existing intermediaries within value chains. Nevertheless, disintermediation remains, particularly in the field of financial services, a term that has a great deal of currency amongst business commentators, consultants and academics, intrinsically linked as it is to the power of the financial intermediation thesis. As we suggested at the end of part IV, talk of disintermediation, whether that be of the financial or electronic kind, is not only misleading but is also highly politically charged.

Thus, it is more accurate to talk of three possible modes of reintermediation: brokerage reintermediation (Type 1); higher order liquidity creation reintermediation (Type 2), and; efficiency reintermediation (Type 3). And to do so involves more than simply substituting the rubric of disintermediation for that of reintermediation; it requires a more fundamental translation. A simple substitution renders at least two modes, brokerage
and higher-order liquidity creation, problematic, even within the context of the financial system. In contrast to efficiency reintermediation, where there is an assumption that market incumbents will be replaced (reintermediated) by more efficient intermediaries, brokerage and liquidity-creation reintermediation are founded on assumptions that these services will no longer be required, that they will simply melt away into the unmediated space of markets. This mode of thinking is underpinned by a branch of financial theory known as the complete markets hypothesis. From this perspective, the existence of intermediaries signals that markets remain ‘inefficient’, and that they need to evolve further to reach a ‘purer’, more seamless state (Lewis and Davis, 1987). The belief that financial markets may indeed be moving in this direction is routinely rehearsed in leading business publications. For example, writing in the Financial Times, Martin (1998: 24) argues, for instance, that:

Banks have no future. Their economic purpose is redundant . . . Electronic technology and financial innovation are creating a world in which maturity transformation is unnecessary. Economic actors – individuals, households, companies – will no longer require this service . . . This is usually described as ‘disintermediation’ . . . during this process, maturity transformation drops out.

(Emphasis added)

Similarly, writing in The Economist, Long (2000: 5) states that:

Financial institutions . . . deal in a product – money – that for many of their customers has long been “virtual” . . . The Internet might have been designed for the distribution, monitoring and managing of this ubiquitous electronic commodity. More worryingly for the firms that make their living out of arranging financial transactions, the Internet might also have been designed to do away with them . . . For decades, banks in rich countries have been fretting about how to cope with “disintermediation”: lenders dealing direct with borrowers (as many already do in the capital markets) . . . The Internet is, potentially, the greatest force for disintermediation the banks have ever had to tackle.

(Emphasis added)

It seems to us that, in the rush to predict the imminent demise of banks and other credit granting institutions, the traditional roles of brokerage (reduction of information and transaction costs) and higher-order liquidity creation (risk and maturity transformation) – which represent specific methods for addressing the particular contradictions and tensions at the heart of current monetary networks – may be being prematurely written off. Further, such arguments also reflect a more fundamental assumption that the new, new financial system will not only make existing
solutions to these sorts of problems obsolete, but will actually eliminate these problems in the first place.

It may well be that the Internet facilitates the development of new ways of ordering that will allow the circumnavigation of the traditional architecture of brokerage, in the way in which Evans and Wurster (1999) describe. Or, as Martin (1998) and Long (2000) argue, it may bring about the circumnavigation of the traditional architecture of liquidity creation. But this does not necessarily mean that such processes will simply drop out or be done away with. Some of the traditional functions of banks and other traditional financial intermediaries may become less important. The Internet may provide an enhanced capacity to access equity markets, thereby reducing the need for maturity transformation. But, as a result, it may also be that other forms of intermediation, such as risk transformation, become more significant. Conversely, rather than disappearing altogether, it may be that maturity transformation and other such activities simply become less visible, as they are digitised and dispersed within electronic and financial space. More fundamentally, even if such activities can be eliminated, through an extension of securitization for example, this does not mean that there will no longer be a need to manage transactions, to produce and manipulate information, or to calculate and quantify risk through time and over space, for these activities lie at the very heart of monetary networks (Dodd, 1994; French, 2002; Leyshon and Thrift, 1997). The new, new financial system will still require intermediaries to carry out these tasks. It may suit the dominant market discourse not to acknowledge these intermediaries, and it is also possible that many of these new calculatory actors and agents will bear little resemblance to the traditional insurance company, bank or mortgage broker, but this does not mean that the risks and problems of financial co-ordination can simply be ignored or written off.

How, then, are we to take into account these possibilities? How are we to assess the significance of such intermediaries and to assess how much of a radical departure they represent? One solution is to translate the three modes of disintermediation summarized in stage two of Figure 1 into three possible modes of reintermediation. This is the third and final stage in the development of our model of financial reintermediation. This process of translation in turn involves three important movements. Following on from the previous discussion, the first movement is to draw a distinction not between a world with intermediaries and one without, but between new intermediaries which replicate the traditional architecture of brokerages and liquidity creating institutions on the one hand, and those that significantly depart from such architectures on the other. From this perspective brokerage and liquidity reintermediation (Types 1 and 2) involves a significant departure from existing architectures of risk and maturity transformation or information and transaction brokerage. As previously discussed, this may involve either new ways of solving the
conventional problems of risk and maturity mismatch, and of managing
information and transaction costs, or it may involve a much more radical
reworking of the tensions and contradictions which constitute the new,
new financial system. This would involve the rewriting of both the
problems and the solutions of retail financial services.

In contrast, efficiency reintermediation (Type 3) describes the replica-
tion, be it in a more efficient and competitive manner, of the traditional
architectures of financial advisers, stockbrokers or banks. In other words,
this is little more than a more efficient application of the traditional solu-
tions to the traditional problems of retail monetary networks. By differenti-
tiating between modes of financial reintermediation in this manner, we
may be better placed to judge whether the new monetary networks being
produced are of a similar or radically different topology to those we are
used too. Evidence of efficiency reintermediation would, for instance, be
clearly important, but evidence of brokerage or, most tellingly, liquidity
creation reintermediation would suggest that the Internet was facilitating
a radical reconfiguring of existing monetary networks.

This first movement leads onto a second. Rather than adopt the abso-
lutism of discriminating between intermediation and non-intermediation,
the translation we propose lends itself to a more relative interpretation.
Talk of disintermediation, whether this is the intention or not, is bound up
with assumptions of progress towards a natural, 'pure market' state;
towards, in other words, an unmediated space. By distinguishing between
different modes of reintermediation we are not forced to make a decision
between mediated and unmediated space. As such, we are not held
hostage to simply thinking of the growth of sole traders, retail securitiza-
tion, myCFO and the like as examples of disintermediation. Rather, we are
able to explore the ways in which new human and non-human inter-
mediaries allow processes of information and transactions brokerage, risk
and maturity transformation to be dispersed, displaced, collapsed and
reworked in space and time.

The third and final movement of translation requires us to think of
intermediaries not in the narrow sense that is often assumed, but to do so
more broadly, in the manner that Callon (1991) and other sociologists of
science consider intermediaries. As we argued at the end of part IV, new
intermediaries such as myCFO are not neutral entities, but are active
agents in the networks of money.

By translating the theory of disintermediation into one of three modes
of reintermediation as summarized in stage three of Figure 1, with the
qualifications outlined, we can begin to explore how the Internet might be
reshaping the social, economic and geographical landscape of retail
financial services. Looking at the social dimension, differentiating between
modes of reintermediation helps us to explore the uneven effects of e-
finance. As the example of the international financial system has
illustrated, there is no certainty that reintermediation will provide the uniform, positive social outcomes implicitly assumed by the concept of disintermediation and new economy mantras, such as that of ‘reverse markets’, concerning the enhanced ability to scale. Rather, this form of financial reintermediation has deepened and further polarized the uneven landscape of investment and borrowing. Transparency, in terms of the availability of information about credit worthiness, has undermined cross-subsidization and led to the individuation of risk (Beck and Beck-Gernsheim, 2002). By mapping the different modes of reintermediation associated with the development of Internet-based retail financial services, we can begin to identify those spaces and intermediary networks, such as myCFO, where the most significant changes are taking place. We can identify spaces of liquidity reintermediation, spaces of ‘scaling’, and map out their social outcomes.

VI. CONCLUSIONS

What we have sought to achieve in this paper is a disentanglement of the processes at work in the creation of e-commerce as a mode of economic organization. Through an analysis of the financial system, we have sought to draw attention to the normative values and assumptions that run through the claims made for e-commerce in general, and for e-finance in particular, and have advanced an alternative model for understanding the processes and impacts of reintermediation. Recombining the theories of financial and electronic disintermediation, and translating the resulting insights into a model of financial reintermediation provides us with a template for examining the effects of the Internet on the social, economic and geographical landscape of the financial services’ industry. Moreover, ‘unpacking’ the concept of disintermediation, and recasting it as reintermediation also reveals the neo-liberal assumptions upon which normative justifications for disintermediation are founded.

By focusing upon the social and economic implications of e-finance, our attention is drawn to a particularly important aspect of reintermediation, and that is the increasing role played by software. Despite making much of the part to be played by web navigators and info-mediaries, Evans and Wurster (1999: 48–9) and other new economy commentators have tended to treat software agents as functional ‘black boxes’. There is an increasing body of work, however, which seeks to trace out the ways in which software generally, and Internet software in particular, intervenes in the world (Leyshon, 2001; Thrift and French, 2002). Through the production of new standards and classifications of social situations and codes of conduct, as well as the production of new possibilities for creativity software helps to produce new modulations, new forms of governmentality which shape and direct the ways in which we act (Thrift and French,
2002). In the case of e-commerce, Lawrence Lessig (1999: 34–5) has identified a number of increasingly sophisticated architectures of identification (passwords, cookies, and digital certificates), which are employed to ‘render cyberspace regulable’. One consequence of the reintermediation of financial value chains by such info-mediaries is, therefore, the need to take the role of software seriously in helping to constitute and govern the social landscape of retail financial services.

As well as helping to determine the social landscape of money, the reintermediation of info-mediaries has implications for understanding the reconfiguration and governance of the economic landscape of retail financial services. If we are to take new financial software reintermediation seriously, an analysis of e-finance needs to include the producers of such software, as well as the producers of interconnected services like credit rating systems (Leyshon and Thrift, 1999). However, in order to be able to map out the ways and the extent to which credit rating agencies, financial software producers, consumers (and especially the financially super-included, such as those that make up the customer base for myCFO), supermarkets, and other new retail entrants to the financial services market are, with the help of the Internet, reshaping the sector at the expense of banks and other traditional financial institutions, we need again to be able to distinguish between the modes of reintermediation that are taking place. By utilizing the framework set out in this paper we are able to say something about how significant and how radical the emergence of these new actors and institutions really is. We can begin to address questions about whether such new intermediaries are ‘hollowing out’ financial institutions by absorbing their core competencies, or whether their activities are merely gloss, with the core, ‘calculatory’ functions still residing in banks and other traditional financial intermediaries.

Turning, finally, to the issue of geography, by tracing out the topography of the different modes of reintermediation we can also see how new intermediaries are changing the geography of retail financial services. As has been highlighted in the case of the international financial system, disintermediation does not necessitate the ‘end of geography’. In contrast, it has led to a deepening of uneven development within financial services, an intensification of the location of core activities within a few international financial (or calculation) centres. Identification of the organizational and institutional topography of reintermediation will allow an assessment of whether core activities are indeed, under the auspices of e-commerce, moving into new spaces and places such as the clusters of software and internet content production (Castells, 2001; Quah, 2000). Or, perhaps, that financial reintermediation is simply deepening existing geographies of uneven development within retail financial services as it has done in the international context.
ACKNOWLEDGEMENTS

We are grateful for the helpful comments of three anonymous referees on an earlier version of this paper. We would also like to thank the audience at the Rethinking Service Economies Seminar Series, Centre for Innovation and Competition and the International Centre for Labour Studies, University of Manchester and, in particular, Kevin Ward, Jamie Peck and Steve Musson. The authors acknowledge the support of ESRC Research Grant R000239472 (Putting e-commerce in its place: constructing electronic times and spaces).

NOTES

1 That is, a personal Chief Financial Officer.
2 These companies undertake regular review of the financial standing of large economic entities, such as corporations and governments, and produce ratings of their relative creditworthiness.
3 We are grateful to an anonymous referee for reminding us of the incomplete process of financial disintermediation.
4 However, e-commerce has, in less than a decade, produced its own regime of measurement and metrics (such as hit rates, page impressions, and so on) to attempt to illustrate the social and economic impacts that it is making (see Pratt, 2000).

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