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Forget Disruption, This is Revolution!

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Disruption has been one of the most popular buzzwords of the 21st century but it doesn't go far enough to describe the fundamental changes we've witnessed over the last 20 years. The largest, fastest-growing and most successful new companies have shattered outdated business models and are using technology and big data to win customers in exciting new ways. Rather than a disruption of the status quo, what we're really seeing is a New Industrial Revolution.

The most obvious example is undoubtedly Amazon, which in less than 25 years has gone from being an online bookstore to the main marketplace for buying virtually any product imaginable, making itself the world's most valuable company in the process. It took Amazon many long years to show consistent profit, but by avoiding the fixed costs that hamper so many brick and mortar retailers, it was able to heavily invest in technology, logistics, algorithmic marketing and overall innovation. Amazon therefore managed to displace countless traditional retailers by seamlessly integrating into American consumers' lifestyles. It used technological advances to create a more customer-centric experience. By being able to analyze a customer's browsing habits, it's able to predict what else that shopper may be interested in buying. Using technology and proprietary algorithms, it became more and more customer-friendly in terms of predicting customer preferences, much like Google does with our web searches.

On Amazon, the popularity of products is ranked and if people buy one thing, pop ups and other web tools make it easy to find or buy something else, based on their and other similar people's browsing history. Using technology and algorithms like this represents an entirely new way of competing and it's disrupted just about every industry.

As such, the story is much bigger than just Amazon. The retailing disruption causing distress among mall-anchored retailers and big box stores (Sears, ToysRUs, General Growth Properties, Circuit City, RadioShack, etc.) is really only the most obvious example of this revolution, because technology has transformed almost every business. The nature of competition has dramatically changed and will continue to do so.

It used to be, if you wanted to fly somewhere, you simply called up your travel agent who'd then look at airline schedules, fare charts, and your desired travel dates and then tell you the best options. Today, consumers go directly to an airline's website or use a platform like Expedia, Orbitz or Yahoo! Travel,

thereby, adding travel agents to the list of professions that may no longer need to exist (like typesetters and blacksmiths). As a result, online purchasing transparency drove down ticket prices for travelers so much that technology helped seal the fate of most major legacy airline operators (United Airlines, Delta, Northwest, American, USAir, etc.) who eventually restructured in bankruptcy court. The travel industry has also been heavily impacted by other wildly successful technology startups, like Uber, VRBO, and Airbnb.

Separately, Voice-Over-Internet-Protocol (VoIP) and online streaming of movies and TV shows has certainly disrupted the telecommunications, cable and movie theatre industries. Thus, we've seen bankruptcies among all sorts of debt-saddled telecommunications firms (WorldCom, Hawaiian Telcom, XO Communications, etc.), cable operators (Charter, Adelphia, etc.), and movie rental companies (Blockbuster, Movie Gallery.)

In the financial world, we see it with the advent of "robo-advisors", low cost online trading platforms, and ubiquitously available financial data. I won't list examples of financial services firms that became troubled due to change since their 2008 distress was so overwhelming that it caused the Great Recession. For the restaurant and grocery industries, it's been meal kits and home delivery services delivered at the click of a mouse. Bankruptcy has been the inevitable result for those legacy grocery operators (A&P, Winn-Dixie, etc.) who couldn't compete due to excessive fixed costs. Meanwhile, realtors are finding their commissions diminished by the rise of options like Zillow and Trulia, which match consumer preferences for online shopping. Similar to other industries, realtors that couldn't adapt to the new world changes were forced into distress (Realogy).

As the previous examples make clear, virtually everything in our economy has been impacted by the internet and its massive disruptive change. Most people would agree that these changes are for the better, but from any perspective new technology, the internet and big data have launched changes that continue to sweep through our economy just like the industrial revolution displaced local craftsman with the proliferation of cheaper, mass-manufactured goods.

The revolution isn't over and the next few years will continue to be challenging for legacy operators burdened by fixed expenses since they can't flex to invest dollars and time necessary to adapt to these changes. What it all boils down to is economic Darwinism, where only those companies that are able to adapt and evolve will thrive, or even survive. Any business that's over-levered with debt, under-funded pension liabilities, long-dated leases, or other inflexible liabilities, will find it increasingly difficult to compete. The risk of technological change is so dramatic that it could drive any company into distress.

For old line operators, the best hope may be to stall for additional time as they adjust to changing circumstances. Fortunately, old line operators often do have competitive advantages – like substantially-positive operating cash flow or even large tax assets – which can enhance their position to compete with new entrants. However, if most or all of their cash flow goes to service debt, the competitive advantage may be lost.

The question investors need to ask is, how do businesses succeed in a market where there's massive disruptive change, on par with Industrial Revolution? It's still too early in the game to have a definitive answer but we do know that excessive debt and legacy liabilities impair any company's ability to be nimble in the face of massive disruptive change.