

Understanding Abundance, Part 4: What will not change



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Feb 26, 2017 · 10 min read



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"I very frequently get the question: 'What's going to change in the next ten years?' And that is a very interesting question; it's a very common one. I almost never get the question, 'What's

not going to change in the next ten years?’ And I submit to you that that second question is actually the more important of the two — because you can build a business strategy around the things that are stable in time... In our retail business, we know that customers want low prices, and I know that’s going to be true ten years from now. They want fast delivery; they want vast selection. It’s impossible to imagine a future ten years from now where a customer comes up and says, ‘Jeff, I love Amazon; I just wish prices were a little higher,’ or ‘I love Amazon, I just wish you’d deliver a little more slowly.’ Impossible. And so the effort we put into those things, spinning those things up, we know the energy we put into it today will still be paying dividends for our customers ten years from now. When you have something that you know is true, even over the long run, you can afford to put a lot of energy into it.”

-Jeff Bezos

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To recap our series so far: In part 1 we talked about abundance, what happens when friction goes away, and how we get compounding, bifurcated outcomes. In part 2 we talked about how the modern tech industry evolved into the perfect supply-side innovation to accommodate and fuel this abundance, through the explicit modularity of differentiation and utility. In part 3, which was a lot of fun, we made some guesses and predictions about where the future is going, and how it will look different from the present. We talked about our shift from consuming objects to consuming functions, the importance of the Function + Infrastructure paradigm, its relationship to AI, and the future of business creation.

This section, part 4, is actually more important than part 3. Because instead of guessing at what might change, we’re stating what we think will stay the same. That’s something you can actually make plans around.

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Let’s begin with four statements that we can be confident will continue to be true in the future:

Friction (scarcity) is what allows for return on invested capital.

As friction goes away (abundance), the Red Queen runs faster.

Technology increases access to what is scarce.

When friction goes away, it tends to reappear elsewhere.

All happy companies are alike in one basic way: they have harnessed some sort of scarcity. The more scarce the resource, and the better you are at uniquely providing access to it, the more business you will get and the more influence you will have over your circumstances. This is not a zero sum game, and technology is the reason why: as we develop, invent and deploy new technology, we collectively increase access to those scarce resources. Technology is what lifts us out of zero-sum competition, and allows 10x the people to enjoy something for 1/10th the cost. This is a good thing; when more of us have access to more of what we need, we all prosper.

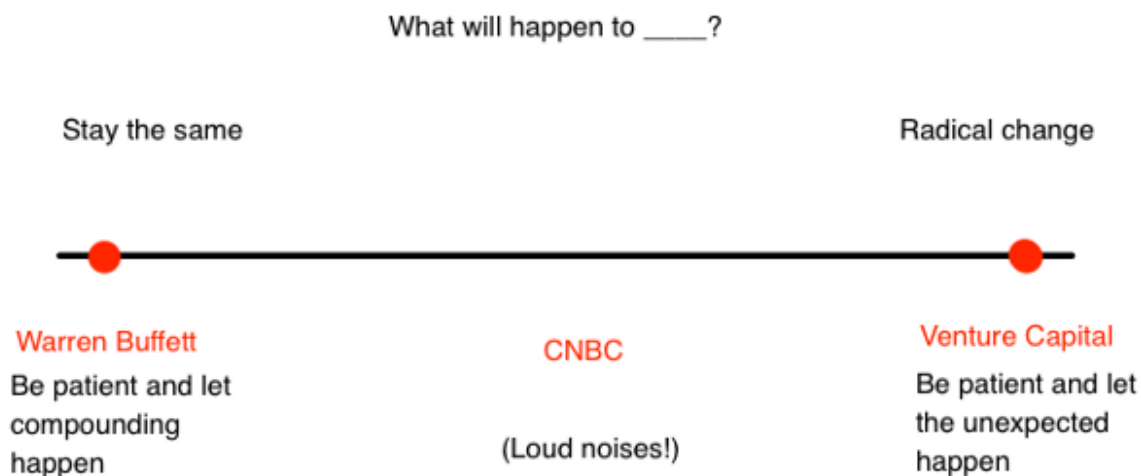
Scarcity used to be something we could take for granted, because it was obvious and easy to see. But in the future, it may be harder to find. That does not mean it is not there; the difference is that those who can find scarcity and understand it have a fundamental advantage over those who don't. Furthermore, if we take off our Silicon Valley glasses and look around the rest of the world, we quickly recognize that there's still a whole lot of old-fashioned scarcity remaining, and a lot of hard problems left to solve. Large fractions of the earth's population still don't have clean drinking water, or quality health care, or the ability to participate in our economy of abundance the way we do. Scarcity still defines most of the world.

Scarcity is what empowers us with the conviction to act for the long run. Not long ago, it was hard to develop new technology. You needed teams of researchers and scientists to make fundamental discoveries; engineers to design and build new products, retooled plants and equipment to produce these goods, and then you'd finally have a shot of achieving return on investment for your efforts.

What is changing now with software and the Internet is that this process has become easier and faster. You no longer necessarily need a giant team of experts and a huge budget; a kid with a laptop can write software whose value derives from its novel application of the hugely capable tech stack underneath. No multi-year R&D allocation

required; no giant costs to recoup; no limits to what a planning committee can imagine. Software, in effect, is technology that makes it easier to develop new technology — or, if you want to get recursive about it, technology that *increases access to what is scarce about technology*. This is a puzzling and powerful dynamic. But it does not change the crucial role of scarcity in letting us set our sights far in the future, and not for just next week. In fact, if anything, this role of scarcity has intensified.

Any time you make a decision to allocate resources — whether money, time, knowledge, or anything else — you’re making a bet about the future, when given information about the past. And if you really get down to it, all bets about the future fall somewhere along the axis of: “Things will stay the same” to “Things will be different”.



What the two extremes have in common and the middle lacks is the ability to be calm, clear-eyed, and patient. That’s because the extremes have the ability to do something the middle can’t: **articulate hypotheses in terms of what is abundant and what is scarce**.

Compounding:

If you’re counting on something staying more or less the way it is, then you’re betting on *compounding*. Compounding as a phenomenon is not much different in worlds of scarcity or worlds of abundance. There’s only one major difference: when there’s less friction, compounding can proceed with fewer obstacles.

In parts 2 and 3, we talked about the emergence of two new types of companies that thrive in conditions of abundant supply-side consumption: highly differentiated pointy

businesses and giant underlying utility businesses. We can understand their strength from the perspective of compounding and return on invested capital: those generating attractive returns on tiny amounts of capital only invested once (differentiated pointy businesses), or heavy, compounding returns on giant amounts of continually invested capital (the huge utility businesses).

Consider the huge utility businesses like AWS, which are increasingly asset heavy and have low gross margins, quite unlike the usual expectations for a software company. However, they have high incremental margins, and can accommodate a huge amount of incremental invested capital while delivering a high rate of return on each incremental dollar. They are effectively like the traditional water and electric utilities, but with higher intrinsic returns. With proper execution, they can create a snowball effect as they compete for and devour more and more of the work previously done by others, just like AWS is doing now, and in return acquire more capital seeking ever-more attractive returns.

Second, consider the emergent tiny point businesses that are pure differentiation and sit on top of abstracted utilities. They are asset-light and have high gross margins, although they likely can't accept very much invested capital. But they don't *need* very much capital in the first place, because all of the underlying work (which used to be what consumed all of that capital investment) is now being done by the giant utilities. In the long run, this may turn out to look a lot like the explosion of small family businesses we saw in the early American 20th century. When water and electricity and roads all became available through utilities, small companies (now no longer at a disadvantage against their larger foes) could thrive. We may be seeing the beginning of something similar today, but at global scale, with all kinds of digital goods and services now available "on tap". To better get to know the 21st century economy, we might do well by studying the rise of family businesses in the early 20th.

Frictionless consumption and supply-side abundance will increasingly be commonplace. But the fundamentals of scarcity, ROIC, and the successful practice of capitalism will stay the same. And, as Jeff Bezos tells us, things that stay the same are the things you can plan around.

Venture Capital:

At the other end of the spectrum, if you think things are going to change, then you are implicitly making one of two bets: that this change will come incrementally, or that it will come in a sudden and unpredictable way (which is how it usually happens). If we've learned anything about tech, it's how it enables the latter: by transforming non-scalable entities into scalable ones, and eliminating friction by abstracting it away. Consumption environments become frictionless and abundant, which is a virtuous cycle that self-perpetuates. However, with abundance comes new scarcity that emerges somewhere else!

Our heuristics for abundance in modern tech, which reinforce each other in a virtuous cycle, have a hidden side consequence: *new scarcity*. When frictionless consumption leads to automatic if/else decisions, you see Zipf's Law in action as winner-take-all effects dominate — but you also see authentic brands that promise and deliver something special (the Apples, Nikes and Snapchats of the world) become highly sought after. With modularized differentiation and utility comes great economy of scale and abundant options — but also a longing for tight integration, for trust, and especially for security. As consumption decisions reach a state of zero friction, we get a world of consumerized abundance — but increasing scarcity of assets that are permanent and real, like land. At the heart of abundance is new scarcity — you just have to know where to look.

More importantly, lots of scarcity still remains in the world. Health care; education; clean water; energy; agriculture; biology; opportunity for all around the world. Anywhere there is scarcity, there is opportunity for those who want to bet on radical change. This is the opportunity for venture capital — as it should be! The Venture Capital industry, in many ways, needs to rediscover its roots around tackling muddy, messy technical problems that nobody wants to touch. But I'm quite confident that people will step up. It's a matter of who, not if.

Human behaviour:

One additional note to pay attention to before we wrap up our series. Just as we can be confident that the future will be full of many kinds of progress, so can we be confident that our future decision-making will be full of errors. To think otherwise is foolish; indeed, many of the errors we routinely make are not reflections of the current Zeitgeist, but on the contrary are embedded features of the way that humans think. Near the top of this list is the phenomenon of collective idiocy: when everyone believes in X, and X becomes a self-fulfilling prophecy, until X falls apart. As Friedrich von Schiller once put it, "Anyone taken as an individual is tolerably sensible and reasonable — as a member of a crowd, he at once becomes a blockhead." This has been true pretty much forever. I fully count on it continuing to be true in the future.

I mention this as a cautionary warning. Just as the past has contained moments of collective euphoria and panic, so will the future. Past speculative bubbles and financial crises, from The South Seas to mortgage-backed securities, have shown the dangers of excessive groupthink combined with excessive leverage. With a future full of function-driven, AI-powered abundance possibly around the corner, there's the dangerous possibility that for the average capital allocator, scarcity may become hard to see. And without the grounding and anchoring effect of understanding what is scarce, the crowd can make unwise decisions. It's just what we're like as people, so we should consider ourselves warned.

What, then, might be the collective idea that should concern us? Paradoxically, it might be widespread belief in *change* that should make us wary, or at least cautious. As Howard Marks has put it, the notion that “markets abhor uncertainty” is a misleading one. Markets function *well* when there is uncertainty, and when everyone is *certain* that everything will change and be different, then the marketplace of ideas, capital and purpose will not work as it should. When everyone believes in stasis, find what’s changing; *but when everyone believes in change, find what’s stable. Find the scarce resource. It will anchor you.*

And that’s all I’ve got to say about that.

In conclusion, for the time being:

There are great opportunities in front of us, for anyone whose eyes are open.

Friction (scarcity) allows for return on capital.

Lack of friction (abundance) allows for compounding growth.

The great businesses are the ones who harness both.

Technology changes where the friction is located.

Scarce resources become abstracted and turn abundant.

New scarce resources emerge elsewhere.

Scarcity is what gives us the conviction for act for the long term by solving hard problems.

When it’s not clear what is scarce, short-term thinking and noise prevail.


When short-term thinking and noise prevail, we are greedy when we should be fearful and fearful when we should be greedy.


And when we understand all of these things, we can all win.

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