

Banking without banks

Traditional methods fall to the Internet's irresistible force

With the advent of online banking, financial institutions have been downsizing their network of physical branches. Banks are recognising that a mere Internet presence is not enough. MARC PHILLIPS warns that they must actively pursue customers by offering innovative Web-based services — or be overtaken by more adventurous entrepreneurs.



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The use of online financial services is firmly embedded in the behaviour patterns of consumers. According to the quarterly MISC Internet Banking Data Pooling Facility Report of December 2000, the number of Internet banking accounts in Australia had grown 28% in three months. At the institutional level, business-to-business (B2B) financial services are also growing rapidly: FX Online, the Web-based electronic foreign-exchange arm of ANZ Bank, announced recently that its clientele had increased from 50 to more than 500 since its launch through a virtual private network (VPN) in April 2000.

A survey has concluded that corporate customers are looking to their traditional transaction banks to facilitate online transactions.

Internet-only-banking

When banks began to allow account details to be viewed online, the service was seen as merely another method to reduce teller and branch costs. However, advances on that technology have altered traditional business thinking and existing banks have found themselves competing with newcomers that operate in a new and different context. First-e (<http://www.first-e.com>), headquartered in Ireland, is the largest Internet-based bank in

Europe. Although the company began with a physical infrastructure, it is now an Internet-only service, able to offer its products around the world.

First-e provides three main services. Simple current and savings banking accounts with better-than-average interest rates make up the base-end of the business. Interestingly, the company has achieved a zero-risk operation by pooling customer liabilities and assets. To compensate for inadequate margins on Internet banking, First-e offers third-party financial products, servicing customers and earning margins by acting as an intermediary rather than an originator of these products. Finally, the bank intends to offer trading and investment products on reaching a critical mass of around 300,000 customers.

First-e's business model is built on a multi-tiered strategy using multi-channel distribution to improve customer service and expand business reach. Early in its operations, the company created a specialist banking arm, Factor-e, to provide technology services to other banks that have difficulty building efficient operations. This hedges against online competition by placing Factor-e in a position to benefit from other (potential competitor) online

bankers. First-e has also taken advantage of excess processing capacity that exists in Europe's traditional banks by outsourcing back-office processing.

Bank? Broker? Banking broker? Broking bank?

When US online broking service E*Trade (<http://www.etrade.com>) signed a merger agreement with the Arlington-based virtual banking institution Telebank in December 1999, a new inflection point was reached in the history of online financial services. No longer were the barriers between broking and banking services distinguishable. E*Trade created a subsidiary company, E*Trade Bank, which offers branchless banking through the low-cost direct-delivery channels of Internet, telephone, fax, automatic teller machines and mail.

E*Trade immediately introduced its first banking product resulting from the merger, a 12-month fixed-term deposit with an annual yield of 6.5%, which the broker boasted was more than 50 basis points higher than the US national average at the time. The offer, limited to E*Trade customers, illustrates how a banking service can be used to attract customers and then introduce them to other services.

The aim of the merger is the integration of bank and broking accounts, despite the fact that they are technically held in separate companies (E*Trade Bank and E*Trade Securities Inc.). E*Trade's website has successfully achieved a smooth transition from bank to broker with only a small disclaimer at the borders.

The impact on E*Trade is to create a highly scalable business model with cost and pricing advantages. The bank also features a bill-payment system which further bolsters E*Trade's integrated financial services approach.

Person-to-person payments

Person-to-person payment (P2P) services allow anyone to send money to other individuals online. The concept is simple yet extremely useful. The P2P service taps funds from the payer's credit card or cheque account, then e-mails the recipient, who logs on to the service's site to claim the funds. A number of operators offer P2P services, such as payme.com, [and \[eCount\]\(http://eCount\); however, the most popular service is called PayPal, operated by a privately held US company, X.com.](http://eMoneyMail</p>
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PayPal (<http://www.paypal.com>) is the most simple form of free P2P payment on the Web and is now the number one payment service on eBay, the leading global auction website. It claims to have more than 3.5 million users and, according to Media Metrix, is one of the fastest-growing websites. Anyone, anywhere can join PayPal online and instantly send money to any person with an e-mail address through the PayPal website using any standard internet browser. The service was listed as a recommended product by net authority CNET.com (<http://www.cnet.com>).

How it works:

1. Log on to PayPal.com. First-time users must register, supplying name, street address, e-mail address and passwords.
2. Fill in credit-card number, recipient's e-mail address and transaction amount, and send.
3. Recipient receives e-mail saying, "You've got cash."
4. Recipient clicks e-mail link to PayPal.com and registers.
5. Recipient asks PayPal.com to transfer payment into bank account, mail a cheque or leave the money at PayPal.com to use for future e-payments.

The major benefits of PayPal are its simplicity of use and support for all platforms and browsers. The online business model reduces the costs of acquiring customers — to \$US7 each, PayPal boasts — and, in the process, ensures a scalable global software application which has dramatic barriers to entry for traditional banking and finance competitors.

When PayPal forged an alliance with Providian Financial Corporation, the fifth-largest bankcard issuer in the United States in February 2001, profitability was assured. As part of a series-D fund raising of \$US90 million, Providian invested in PayPal and will offer a co-branded credit card to PayPal's six million members, and has the opportunity to license PayPal's technology

for private label person-to-person payments for Providian's 16 million customers. In 2000, Providian Financial was named one of America's most admired companies by Fortune magazine. It has more than \$31 billion in assets under management and over 16 million customers.

Viral marketing

PayPal enjoys the benefits of being a viral product. That is, the business model intrinsically lends itself to self-promotion. If the payment is sent to a person who is not a registered PayPal user, the receiver simply completes the form attached to the e-payment to receive the money, which is already waiting in a PayPal.com account in the receiver's name. Completing the form also registers the receiver as a PayPal user, thus capturing further customers. In this way, the service can expand its user base in an exponential manner.

The PayPal P2P model is the biggest threat to traditional payment systems, as it leverages on some of the most powerful forces that the Internet unleashes — open architecture standards, viral marketing — has a scalable business model and achieves volume growth at near-zero costs.

Bill payment

Experts calculate that, for many people, paying bills can take from two to six hours a month. A method for reliably and simply automating the payment process for the domestic market has proven particularly lucrative for some innovative operators.

US-based and NASDAQ-listed CheckFree Corporation offers systems for electronic billing and payment of richly formatted bills over the Internet. Nearly 190 companies, including utilities, telecommunications companies, mortgage lenders and credit-card services are registered to distribute bills using CheckFree's online billing and payment services.

Consumers are able to access details and pay bills through the Web, including those from service-providers that do not present bills online, such a gardener or plumber. CheckFree's revenue stream is generated by charges for each bill paid. Customised website features are available for banks and brokerages which use the system to present a smooth and seamless online banking system.

The entry of portals

With so many different services available, it is not surprising that entrepreneurial Web operators have capitalised on these ideas by bundling them and integrating them into a portal.

As a major portal, US-based Yahoo! (<http://www.yahoo.com>) has aggressively manoeuvred to take advantage of the transition to online banking. It offers three banking services: Yahoo! PayDirect, Yahoo! BillPay and Yahoo! Banking.

PayDirect is a P2P system that works in a similar way to PayPal. Users can transfer money into a PayDirect account, and then send this money to anyone with an e-mail address, who then can open a PayDirect account or transfer the money into an existing PayDirect account. From there, the money can be moved into a credit card or cheque account. No charges are made for the service, although Yahoo! has reserved the right to introduce fees. As yet the service is available only to users with a US mailing address.

BillPay is a pay-per-use bill-paying service that allows electronic payment to more 60 major US companies (mostly utility providers). The site enables users to set up automated regular payments such as car instalments and rent.

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Yahoo! completed a deal in August 2000 with VerticalOne, a subsidiary of the NASDAQ-listed S1, which develops software to execute secure banking and credit-card transactions over the Internet. Yahoo! users can view account information through the customised site. They must already have online banking accounts with certain banks, all but four institutions being US-based.

Banks are facing increasing competition from non-traditional players and need to meet these challenges by exploring new avenues, leveraging on the Internet and the power of their online customer relationships. **J**

Goodbye to cash: Can banks handle it?

According to *The Economist*, PayPal has reached "critical mass" and is growing at the rate of 25,000 new users every day. It is the most popular method of payment for people bidding on the giant Internet auction site eBay and can be used for payments on 1.5 million other business websites.

The success of the system has renewed theorising about the advent of a cashless society, with the "virtual money" already represented by credit cards entering a new technological generation. This is bad news for banks, which are seen as a cumbersome payments system stubbornly locked into plodding methods where some transfers take days to clear.

Credit cards are closer to the dream of instant money, particularly for Internet transactions, although users remain suspicious about their security and susceptibility to fraud. And credit cards are expensive, for both merchants and purchasers. That fact scores a goal for systems such as PayPal, which charges merchants two percentage points less than credit card companies for transactions on the Internet. (Indeed, when first launched in 1999, PayPal deals were free for vendors and buyers.)

Major card companies such as Visa and MasterCard are nervous — at least, *The Economist* says, they are admitting to a "growing respect for PayPal's fleetness of foot". Worse, PayPal is luring more customers away from credit cards by paying interest on funds deposited in a PayPal account to be used for instant payments to other accounts. Another one

for banks, as well, to think about.

Electronic payment systems have a distance to go, though, if they wish to shake loose the banks' grip on financial transactions. Size does matter, as does the persistence of human behaviour. However, as Marc Phillips has explained in the preceding article, interest in e-payments continues to increase, no doubt helped by the growing versatility of mobile phones and their text-messaging capability.

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Stored-value cards and other forms of smart card are a part of the revolution. Although slow to win widespread acceptance in the financial system, these cards have an undoubted future in the handling of small-value transactions. It seems only a small step — and, who knows, it may already have been taken — to graft this capacity on to the SIM (subscriber identity module) card in a mobile phone.

The Economist jokes about the timing of the death of physical cash: When the busker in Piccadilly takes donations on his mobile, the banks had better be listening. **J**

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