



On-line Brokerage in Europe: Actors & Strategies

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Abstract

The tough game among e-brokers is still going on and is becoming more and more ruthless. The challenges they are facing will determine who will survive and who will be squeezed out of the market. Money they receive from shareholders will not always flow in if they do not prove that they are capable of achieving their break-even point and that will have an impact on stock prices. Thus in the race to attract as many clients as possible they should stop to rethink their strategy. The purpose of this article is to give a few references on the subject of on-line brokerage in order to understand the financial players' strategies on the Internet. We explain the challenges and the brokerage value chain and analyses the problem of the break-even point.

Introduction

The on-line stock exchange has exploded in Europe as a result of financial markets' and its services' predisposition to become virtual. In the beginning of 1998 only ten brokers offered the purchase and the sale of shares on the Internet in France. Since the end of 1998 operators have multiplied - several dozens in a few months. Most of them were new entrants who quickly began to conquer the market. But huge market perspectives attracted others, already established players. Thus "traditional" brokers and banks, such as BNP-Paribas, BRED, CCF and Cortal have joined the movement, as well as the TDS store group, which, in addition to its on-line auction site iBazar, opened iBourse in partnership with Swiss Harwanne Bank. Currently, there are about fifty brokers. The banks whose core business is oriented "wealth management" then completed their strategies through their presence on the Internet.

The purpose of this article is to give a few references on the subject of on-line brokerage in order to understand the financial players' strategies on the Internet. This article is broken down into three parts. First, it presents a European panorama of on-line brokerage. Secondly, it explains the challenges and the brokerage value chain and, in particular, it compares French and American brokers. Finally, it analyses the problem of the break-even point.

We can define On-line brokerage as the selling of securities (stocks, bonds, mutual funds, warrants etc) on the Internet.

1. European panorama of On-line Brokerage

1.1 The players

Secondly, I will explain the challenges.

In the third part, I will comment on the brokerage value chain.

In the next section, I will compare French and American brokers.

And lastly, I will analyse the problem of the break-even point.

I'd ask you to save your questions for the end.

Now let us turn to point one.

We can define "on-line brokerage" as the selling of securities (stocks, bonds, mutual funds, warrants etc.) on the Internet. 4/We can distinguish There are two main sorts types of brokers on the network. ():First, there are traditional banks and brokers - "bricks and mortar", examples of which are:

- "Bricks and mortar" : traditional banks and brokers
- Traditional brokers: CPR, Ferri, Dubus, Financière Warny, etc.
- Traditional banks: BNP-Paribas, Bred, CCF, etc.

But there are also new entrants, which have created a real "e-commerce business model": : direct banks and new brokers

- Boursorama (ex Fimatex): Société Générale (principal shareholders) and general public;
- i-Bourse: BIPOP Carire Italie & Fineco Group (principal shareholder) and Harwanne bank;
- Self Trade: DAB bank Germany (principal shareholder);
- eCortal: Cortal is 100% subsidiary of the Group BNP-Parisbas;
- Fortuneo: Norwich Union and founders;
- Bourse Direct: private investors and public,
- Consors: Consors Germany (principal shareholder);
- Comdirect: Commerzbank (principal shareholder);



By directing their offer first at the most active private investors, Internet brokers had carried out a targeted strategy,. Given their advantageous cost structure (absence of physical branches and low overhead costs compared with banks), they invested massively in marketing in order to conquer and to develop the loyalty of new customers. Their objective was to develop their client base quickly in order to reach the break-even point. This boom was to the advantage of private individuals because the commission rates charged by virtual brokers were considerably more advantageous than those of traditional channels. This decline in prices and the continuous growth in terms of offers, caused by pressure from the new entrants, led the clients to move towards this distribution channel, thereby undermining the position of banks and traditional players in the brokerage business.

The year 2000 was the peak period of moving brokerage clients online and meanwhile the traditional brokers and banks joined successfully the online market via either creating own e-business models or acquiring some of the existing once while the traditional institutions still had several stakes to offer & potential customer base and knowledge to enhance the online trading.

Figure 2: Top e-brokers by On-line Accounts; Source: JP Morgan, November 2001



If taking the five biggest e-brokers in Europe by trade value at the end of 2001, four were German and

one was French (Fimatex), but all of them were present at the German market, due to its size. The leading company, by the number of on-line accounts, was Comdirect Bank, which entered the French market in March 2000 with the purchase of Paresco Bourse, a French brokerage. There was a distinctive difference between the number of accounts and the trade ratio. For example, Fineco (i-Bourse) was placed at the sixth position when taking the account number into consideration but it went up to the third position according to the trade criterion. This situation is simply related to the active and passive traders. It is one thing to acquire customers and the other is to make them dealing on-line. It could have been observed that most of the e-brokerage leaders (9 out of 10) started their international campaigns operating on at least one foreign market in order to keep growing the number of accounts and consequently the trading activity too.

In Europe the five leaders gained 57% of the market against 81% of it in the USA, which is a more mature market (other actors have adopted niche strategies). In France, until now, more than 50 brokers operate and recently big banks such as Cr dit Lyonnais or Banques populaires have entered this market. So far only big American brokers are not present but is there still any place for new entrants?

1.2 The evolution of on-line brokerage in Europe

The best way to show the development of on-line brokerage in Europe is to present the evolution of the number of accounts. The leading role in this area is still taken by the German market. Germany is by far the largest market for online brokerage in Europe, so its size and maturity alone gave the crisis a European dimension and the European competitors were not in any better shape, either. By mid-2001 there were 2,141,000 online brokerage accounts in Germany, roughly 50% of the European total. The next closest competitor at the time was Sweden, with 11% of the market. Germany's major online brokers were therefore also the European leaders: combined comdirect, Consors, DAB, maxblue and Advance Bank held 47% share of the European market in mid-2001. Only Italy's BIPOP with a market share 9% was at the same competition level (acquired by Entrium Bank formerly owned by German shareholders).



The second half of 2001 slowed the European market in crisis, the number of transactions conducted through online brokers fell and the growth in the number of online custody accounts diminished rapidly. Some brokers pulled out of the market, others filed for bankruptcy and many small investors claimed they were not given sufficient warning about the crisis facing the equity market. The dramatic fall in markets continued across Europe. The number of online brokerage accounts grew by a comparatively low 16.5% to 4.4 million in the first half of 2001, which is far from the heady days of 2000, the growth in the number of new accounts declined by more than 30% in comparison with Q1 2001. In most of the large European countries there was only single-digit growth: Germany 7.5% to 2.1 million accounts, France grew 2.9% to 478 000 and Sweden added 4.0% to reach 452 000 accounts, UK 4.9% to 320 000, losing its fourth place to Italy, which grew by a relatively strong 17.0% to 328 000. We observed a slight shift in market shares in Europe: Germany no longer accounts for half of the European online brokerage market, while the relatively fast-growing countries, Spain and Italy, increased their market share in Europe by total of 2.1 percentage points.

For example the number of orders executed with Germany's four biggest online brokers (comdirect, Consors, DAB bank and maxblue) decreased from 16.3 m in H2 2000 to 12.6 m in H1 2001 and reached 10 m in H2 2001. The quarter-on-quarter growth of the number of online brokerage accounts declined from 54% in Q1 2000 to 7% in Q2 2001. The trend of slow growth continued in the second half of 2001 all over Europe. The decline in trading resulted in a fall in commission income for the online brokers set against substantial fixed costs, which were defined at a time of higher-volume turnovers. As a consequence, the providers were operating at a loss, several German online brokers introduced short time work or staff cuts (e.g. Charles Schwab by 15%), in November 2001 a consortium of several German banks temporarily took over the former leader of the online brokerage sector, Consors, from which foreign providers had been withdrawing.

Figure 3: Quarter-on-Quarter Growth in Customer Accounts; Source: JP Morgan, November 2001



As revenues in the online brokerage industry went cold, consolidation deals heated up reflecting, not necessarily, an increased interest by major banks in online brokerage but rather the period of

consolidation of online brokers. While June and July 2001 produced scores of deals in the online financial-services market, further revenue and trading declines lead to more consolidation across the industry and the continuation of the trend of big online brokerages acquiring smaller entities.

The following graphics shows the evolution of the total number of online executed orders between January 1999 and February 2003 and also the online brokerage market share. We can observe a significant increase in the number of the orders executed online since November 1999. There are two reasons to explain this phenomena: the first fact is that there were many brokers that moved online just at that period and the second that there occurred Internet speculations, which were stopped by the reversal of the market in March 2000.

Further more the 11th of September caused a depression within the markets consequently resulting in small oscillations of the number of orders carried out since this fateful date. Finally in February 2003, the online brokerage market share was 12.51% corresponding to the 446 427 orders executed online.



The crisis that has hit the online brokers was preceded by a breathtaking upswing, which was mainly attributable to two factors. First, the use of Internet technology helped new providers to gain access to the market. Non- and near banks were able to process retail clients' orders without expensive branch networks and labour-intensive advisory services therefore the new players had to keep the prices low. Second, the bull markets attracted a large number of new customers. The broad spectrum of Internet advantages – information free of charge, in real time, heightened market transparency as well as the opportunity of selecting more specialized financial-service providers, considerably greater comfort – in combination with rising share prices, appealed especially to heavy traders placing their orders online without advisory services.

Figure 5: Trading Activity at European Market; *Source: JP Morgan, November 2001*



Trading activity remained depressed in the first six months of 2001. Companies with significant exposure to heavy industry, such as Bipop, Consors and Fimatex, were hit hardest. On average, annualized trades per account declined 16% quarter on quarter in Q2 2001, similar to the development in United States. The crash in the technology markets and the declines in the blue-chip segment have resulted in a decrease in the number of transactions and slower growth in the size of the customer base. Retail brokerage activity remained depressed across Europe, trading per account at online brokers fell 29% in Germany, 35% in Italy, 29% in France and 24% in UK in Q2 2001 and 15-20% on average in Q3 2001. The large German online brokers had excess capacity and the only way out was to offer a wide range of products, advice and investment centers, cut costs and/or consolidate.

The German players dominated the European market. More than two-thirds of all online brokerage accounts were held at the 10 largest companies in Europe. JP Morgan expected a change in the months ahead on the back of cost-cutting, continual weak markets and induced cash flow problems – mainly in the case of marginal players. These factors were expected to drive consolidation and close the concentration gap with the United States, where the top 10 companies were sharing 93% of the market. According JP Morgan estimates, only 1.9% of the population in Europe sample (France, Germany, Italy, Netherlands, Spain, Sweden and UK) had online accounts, compared with 7.6% in the United States.

The increasing interest in possessing securities among the European population shows an important change in savings habits. According to the data from JP Morgan and Jupiter we can estimate the shareholder population in 2003 at 16% compared to 11% in 1999. But for e-brokers much more important is the percentage of on-line clients (maturity ratio) and fortunately it has to be said that the migration to on-line accounts will rise rapidly.

Figure 7: Prediction of on-line brokerage development in Europe ; *Source: JPM -Jupiter*



Clients place more and more trust in new technological solutions, its comfort, security, time- and money-savings, etc. But companies trying to attract on-line investors by giving them some extra bonuses have to take into consideration that a lot of them can quickly retire or turn into passive customers because of the lack of knowledge and experience. Brokerage services are not fast moving consumer goods and to make clients loyal and profitable at the same time, it is important to educate them and to create an investment culture. Certainly this requires time to enable them to manage with, for example, a slump in the market. Only then, will they be aware of benefits they can profit from on-line trading and not only from being in vogue.

Furthermore, e-brokers' source of revenue based on commission is risky for companies because the demand for brokerage services also depends on stock market attractiveness. Taking the French market as an example one can notice how the demand for on-line trading is variable.



Figure 8: Variation in executed orders on French market; *Source: Association Brokers On Line*

As Figure 5 shows the variation in the number of on-line executed orders is much higher and that is why it is "more dangerous" for those who want to base their income on commissions. Adding huge marketing expenses that "kill" net benefits, e-brokers can soon find that they are no longer solvent. In short, the rising number of on-line brokerage accounts does not directly mean that they turn into profitable accounts.

Therefore e-brokers should look for some alternative sources of revenue. This trend is already present on the market and the case of Self Trade is an example. This year it will obtain a bank status and decrease the percentage of strict e-broker revenue (from 67.3% to 50%). Generally the different and alternative ways of e-brokers' development can be presented as Figure 6 shows.

Figure 8: Future e-brokers evolution



E-brokers have three choices: they can evolve in the direction of bank activity, they can enrich their offer (training products and services, life insurance contracts, etc.) or they can do both thus become, step-by-step, a financial supermarket with well diversified portfolio of revenues.

Another issue is that increasing on-line accounts is not simply correlated with funds being under management. The Banque de France indicates that only 29% of French shareholders hold more than 20,000 euros in securities. One asks two other questions: how to encourage clients to keep bigger portfolios and whether they are financially able to do so.

1.3 Activity of e-brokers in France

In France, direct share ownership failed to increase between 1988 and 1997 as a result of the 1990s recession and the fall from grace of high-profile stocks such as Eurotunnel. Moreover, ownership of equity mutual funds fell significantly. While the economists are not suggesting that France is set to relive the tough early to mid-1990s, French investors are clearly more steered by this experience and they are not likely to flee funds in the same way that Italians have done over the years.

We could have observed a strong increase in the number of executed orders from November 99. The origin of this phenomenon was two-fold. First, many brokers began their activity at this date. Second, it is due to speculation on Internet stocks, which stopped with the downturn in March 2000. Finally, the market share of e-brokers grew from 8 to 19.3% in nineteen months.

In France, the online market shared by four major players (Cortal, Fimatex, Self trade and Consors

france) dropped from 69% to 63% in terms of number of accounts. This can be explained in particular by the opening of bank subsidiaries, which, following the example Line Bourse, profit from the network of agencies of their head office to recruit customers.

The account growth in the French brokerage market was more subdued than in any other European markets in Q2 2001. Only 3% (14,202 accounts) were added to the existing base of 480,442 online customers. The data on the development of account growth in Q3 showed a strong improvement in the total number of customers, which grew by 2.1 % (15,470 accounts) q-on-q mainly owing to inclusion of Zebank, adding 10,000 customers.

After the first trimester 2002, the results published by the association of Brokers Online again reflected another bad period for the French market. The executed orders dropped by 17% compared with the last trimester 2001. However, the financial equilibrium had been achieved in France.

Figure 10: Market Shares in France; Q4 2001; Source: BNP Paribas



Meanwhile, trading activity has halved compared with the previous year's second quarter. While the annualized number of trades per account dropped to 12.2 in August the lowest figure since the Association of Brokers On Line began reporting aggregated data September figures showed a strong rebound in trading activity, with the figure increasing by 30% month to month to 15.8.

2. Challenges and Value Chain

2.1 The Three Challenges

In 2000, e-brokers invested large sums to increase their capacity and absorb a permanently growing demand. Their basic goal was to acquire the largest possible group of customers. Advantageous offers and promotions exposing them to very high costs, combined with enormous marketing expenses, were considered as the only way to increase market share. It highly streamlined the development of the online brokerage market. However, e-brokers did not take into account the fact that stock markets were very volatile, and that one-day they would certainly have to face a significant decrease in capital investments. Such a situation took place in year 2001, when the previous euphoria transformed into serious regression. As the economic situation became weaker, investors suffered quite high losses before escaping from the market. In their efforts to save what was left, day-traders decided to switch to stand-by positions. Large investors, unable to react, had to watch their melting portfolios while small, often inexperienced players terrified by the vision of losing their savings, immediately quit the market. E-brokers realised that their capacity markedly surpassed market needs. As it came as a great surprise, almost all of them reported heavy losses. This costly experience made them rethink their challenges and goals.

Generally we can mention three issues that electronic brokers have to challenge. They are as follows: strategy, marketing and technology.

Strategic challenge because "e-brokerage" changes the market situation and opens the door for new competitors to enter the industry. But competitive advantage can be achieved by possessing technology, access to the clientele or knowledge of the clientele. The conceivable new competitors that meet these requirements are, for example, portals or especially financial portals that can attract cybernauts with additional services and thus generate clients. The others are financial institutions like insurance companies or banks, the large customer bases of which can be a very dangerous weapon in competition with entering or existing e-brokers.

Having discovered how harmful the effects of market volatility can be, e-brokers decided to protect themselves from its negative impact. They have learned that their business models have to be flexible enough to be able to face a huge demand during a bull market as well as to let them keep afloat when the market turns bearish. Presently, we can distinguish the following business models:

- International asset gatherer,

Country player,

- Bank subsidiary,
- Complete service provider.

The objective of asset gatherers is to acquire the largest possible group of individual customers via an active marketing strategy. Successful asset gatherers expect to increase and stabilise revenues by taking control over customers' savings. CortalConsors and DAB BANK adopted such a strategy.

Country players decide to concentrate on their home market. In their efforts to dominate the markets, they target customers with different portfolio sizes. Although this strategy allows quite a considerable costs reduction, it does not seem to be very efficient. For instance, a German market leader, comdirect, managed to obtain merely 24% of its home market while the French player, Fimatex, was even less successful attracting 14% of French e-traders.

Bank subsidiaries attempt to retain control over present bank customers. Line Bourse belonging to the French group of Banques Populaires adopted this business model.

The merger of Fimatex and Boursorama pioneered the market of complete on-line financial services. This business model is considered quite original and is expected to increase customer base in the longer term.

Based on Michael E. Porter idea of 5 leading market forces one can carry out a strategic analysis of the e-brokerage market. This approach is presented as follows:

Rivalry among existing e-brokers:

- + Strong market concentration
- + Same offer
- + Weak e-broker differentiation

-/+ Access to larger market increases prospective customers' base but it gives rise to new competitors.

- + Destructive price competition

Bargaining power of suppliers:

- + Possibility of catching final clients by suppliers
- + Standardisation of final offer raises suppliers' power
- + Ease of entry makes supplier stronger

Bargaining power of buyer:

- + Better access to information
- + Low switching costs
 - + Better customers organisation and better information flow among them (for example, virtual communities)

Barriers to entry for new competitors:

- Open character of the Internet makes it easy to join
 - Easy access to indispensable a technological solution
 - Systems cannot be kept proprietary
 - No need to possess physical branches
- + High marketing expenses

Threat of substitute products and services

- Enriching the e-brokers' offer

Knowing the huge concentration of the e-brokerage market in Europe and especially in the USA (see 1. "European panorama of on-line brokerage") and taking into consideration the number of e-broker companies, it has to be stated that the level of competition is very high. Added to the problem of difficulty of differentiation, resulting from technological restraints and the nature of financial products and services, it is obvious that rivalry was moved to very unfortunate price competition. Therefore, e-brokers are trying to choose a different set of services and financial products but, in fact, the offer is very similar. Their efforts are thus not very productive. Adding new financial components (insurance, real estate, and other alternative ways of multiplying one's property) to trading portals they limit the threat of substitute products and services. But the competition is progressing with an expansion of market and with an increase in the number of potential competitors.

Because the Internet is an open system it is simple to join and profit from network effects (the more participants are involved in the functioning of the network the bigger prospective profits are for all involved parties). Furthermore, its common standards make all indispensable software and system solutions for future e-brokers cheaper. On the other hand, makes it difficult to differentiate oneself and to keep Internet proprietary applications from new entrants. New competitors do not have to build their brick and mortar branches so one can find here another source of lowering entry barriers. However, if a new e-broker cannot boast about a remarkable brand borrowed from one of its shareholders, he will have to deal with serious marketing expenditures. And this is a unique factor, which raises the ticket price to invite oneself to an e-brokerage party.

E-brokers who do not offer every link in the brokerage chain are open to the rising bargaining power of their suppliers who complete their activity by, for example, placing their clients' orders on the stock exchange (see 2.2 The Brokerage Value Chain). Furthermore, suppliers who are closer to the stock exchange via their complete activity can attract clients of those who are focused only on, for example, the first and the second function of the brokerage chain, because the Internet makes it easier than ever before. A low entry barrier means that the rising group of financial intermediaries who do not offer end-to-end service builds a stronger supplier position, which results from simple law of demand and supply.

Their clients are gaining more and more power, which stems from relatively good access to information and their ability to build virtual and informal organisations like virtual communities that constitute a strong business partner, which must be taken into account. Whenever the individuals who belong to that kind of organisation are not content with the quality of the service they can easily and very quickly make the information available to rest of the group and thus can provoke a real "storm" among customers. With low switching costs the consequences for e-brokers are too evident.

Marketing challenge because e-brokerage leads to a new positioning based on new products/services for customers. Moreover, focusing on service complexity seems to be the most successful approach. Such solutions enable e-brokers to eliminate intermediaries and take control over the whole value chain. As an example, we can mention Boursorama (ex Fimatex) which offers a lot of services such as economic information, specific information and financial analyses of firms, charts, history of stock prices, on-line analyses of stock prices, commentaries on the stock-exchange session, educational and training tools, etc.

In the future, as more and more institutions enter the Internet banking industry, it will become difficult to differentiate the services offered by each company. Thus, appearance of e-brokerage spawns the next problem, which is differentiation among players. New technologies can, of course, support the differentiation taking advantage of different solutions and instruments (mobile services, 3D technology, virtual agents and/or advisors, etc.).

On-line brokerage corresponds to a special "servuction" method that changes the traditional positions of banks. The segmentation analysis must take into account supply and demand specifications. It is necessary to define a specific marketing mix, in particular, for the offer of non-financial products or services.

E-brokers use many different channels to contact their customers and to enable them to deal. The frequency of their use depends on development of technology, clients' acceptance and e-brokers' strategy (targeting different groups they have to choose appropriate communication tools). Thus, it is very important to find the right combination of contact channels. In the matrix presented below, there is an attempt at a presentation of the different channels' influence on e-brokers' competitive advantage.



Figure 8 Different channels and their impact on competitive advantage

Currently, the best-known technology is, of course, the traditional telephone but, at the same time, its impact on competitive advantage is the smallest of all. At the other end of the diagonal is 3rd Generation telephony. Until now general knowledge of this technology has been very "poor" because of its physical absence. We can only imagine its power to combine almost all of the existing technologies. In all likelihood in the future the leading role will be taken over by "mobile Internet" which will offer full mobility combined with interactivity. And thus it will create a strong impact on competitive advantage by giving a larger field of manoeuvre for differentiation. The 3rd Generation of telephony can be a carrier of this change.

The most frequently used channel is the Internet, which seems obvious because of its quite strong advance in development. 2nd Generation mobile phones and particularly WAP usage is not as high as usage of the Internet because of the former technological restraints. Interactive TV will probably create some kind of hybrid with pure Internet. That will lead them up the scale of competitive advantage. It can result from its conceivable and relatively easy use in comparison to computer usage, and there is no need to have PC equipment.

Technological challenge. Investment in new Internet technologies is needed, as well as the assurance that these new technologies will be integrated efficiently and effectively into the existing company information systems. Contradictions between the technological objectives of the past and those of the future need to be overcome. Legacy systems cannot always work in accordance with new technologies. Thus there is the dilemma of whether we should discard the old system completely and use the new system or just keep the old system and improve it step by step. Forgetting this integration presents a double risk: not offering the customers the full potential of Internet capabilities and disconnecting the existing information systems in the brokerage from the new system.

Moreover, the back office is a strategic point, because active investors are also very demanding: intraday transactions, high ratio of deals per portfolio etc. Here is one of the main limits of the expansionist strategy of some e-brokers, who will then have to make large technological investments, which will increase their fixed costs and will decrease their profitability. And finally, there is, a very crucial problem with transaction security which unsolved can provoke either stagnation of the customer base or even its decline. Without customers' confidence there is no chance to build a large market.

The company can generally choose one of three system solutions to deliver services to their clients.

- Installing a parallel information system, which is the choice of most traditional banks.
- Building a new information system based on new technologies, a risky and difficult challenge but one, which can gain many advantages for existing players. This was CitiBank's choice.
- Setting up an e-broker subsidiary that, in fact, creates the idea of a new system, which ensures plenty of Internet functionalities and preserves existing systems that can be then slowly upgraded. This solution is preferred by, for example, Soci t  G n rale, which created its subsidiary Boursorama (ex Fimatex).

These technological choices have important influences on strategic positioning. Companies that launch new purpose-built additional systems for e-brokerage or create new subsidiaries cannot fully profit from their existing competitive advantage. They simply offer similar e-brokerage services that cannot create a distinctive difference. Thus, in the long run they are forced to create new competitive advantages instead of developing the existing ones. Those who decide to add Internet as a component to their range of instruments that help to outnumber their rivals can more easily create truly distinctive value for consumers. By integrating the Internet into overall strategy they can capitalise on their traditional assets. Obviously the second solution is considerably more risky because there is no "way back". If the system fails there will be no simple return.

2.2 The Brokerage Value Chain

The brokerage value chain is composed of six main parts:

1. Making the stock exchange information available to customers
2. Collecting the orders
3. Trading operations
4. Accounting operations
5. Clearing operations
6. Safekeeping of security operations

Table 3 E-brokers value chain in different companies.

	ConSors	i-Bourse	Ferri
Function 1+2+3	ConSors	i-Bourse	Ferri
Function 4	Xeod Bourse	Harvanne Bank	Ferri
Function 5+6	Xeod Bourse	Euro-Titres	Ferri

The emergence of new competitors has entailed the destruction of the value chain of the brokerage and forced traditional players (brokers and banks) to rethink their strategy. They are losing ground to Internet start-ups, which are stronger in certain stages of the value chain. New rivals are attacking traditional brokerage players at the stage of client contact (function 1 and 2 of the brokerage value chain). Thus they are confronted with a strategic choice. They have to decide whether to adopt a niche strategy on one element of the value chain, or to choose a volume strategy on the whole of the value chain, where integration will be driven more by the offer so as to reduce production costs and increase value created for the customers in every stage of the value chain.

The first case means banks have to recognise the superiority of new competitors in the management of the customer relationship on the Internet. Since the latter do not suffer from any structure inherited from the past, they have adopted a dominant strategy based on cost. This repositioning of retail banks is translated by the separation of the activities of production and distribution, and a greater specialisation of banking institutions according to their comparative advantages in one of two activities.

These two strategies present numerous risks for retail banks. By specialising in the activity of production that is by supplying infrastructures or products to other banks, they agree to compete with their own distribution network. It is notably the case of the Banques Populaires group, which through its subsidiary, Xeod Bourse, processes the orders of the on-line broker Consors. This service has allowed this company to establish itself in France, and to compete with the brokers on the Parisian market place, and, in particular, with the stock exchange department of Banques Populaires (Line Bourse).

However, if this bank had not brought out this service, this broker would have found another supplier and it would have lost the volume of transactions, which it generates. Now, the customers of this type of on-line broker are much more active than those of large traditional banks.

2.3 American brokers versus French brokers

In the United States there are five times more on-line brokers than in France but this is due to the scale of the American market. However, comparing the ratio number of brokers/population, it can be stated that they are equal, even if there are 100 American brokers versus only 20 French entities. But not only should the number of e-brokers be considered but also, the quality and technological

advancement of their services.

American brokers enrich their value chain by aggregating new services. The traffic generated by their sites allows them to negotiate agreements of cross selling or to take participation with other financial suppliers in creating new services. One of the first agreements, which released mechanisms of this movement, was the partnership between E-trade and E-loan (the on-line loans activity) in March 1998. So, E-trade offered mortgages to their customers and conversely E-loan sent them back to E-trade's site for their stock-exchange deals. However, both of them finally got divorced and found other partners: E-loan operates with Charles Schwab and E-trade co-operates with LoansDirect. E-trade also has shares in the capital of Telebank (retail banking activity). The objective of these brokers was to become a kind of one-stop-shop where their customers would have made all their financial operations. In fact American brokers' offer is much more diverse and innovative when taking communication tools and services into consideration.

It is based on their way of evolving which can be described as follows: first they just offer a pure broker services; then they became a financial portal where one could find many additional information and supporting services. But the last stage of the evolution is an idea of a financial supermarket or financial one-stop-shop which can satisfy any financial need of the customers. It covers everything from simple stock exchange orders through the different insurance and real estate businesses to on-line payments.

We can quote the example of Bank of America and its "build your own bank" concept, which repositions the customer as the "consumer entrepreneur". In this case, the customer builds and personalises his relation with his banker. In return, the banker develops an autonomous and specific relation with his customer as well as an important database for commercial and marketing purposes. This step is innovative [MIC 98] and inverts the plan of the classic relation (banker/customer). Indeed, the customer takes the initiative to deliver the information to the bank; in return the latter offers him high added value services so as to make him a loyal client.

3. The Break-even Point

3.1 Incomes and expenses

On-line brokerage is a good way to reach new customers, income and to increase broker access (open 24 hours a day, 7 days a week, anywhere). Furthermore, the unit cost of operations is reduced. We can notice that a transaction carried out over the Internet is 25 times less expensive than a transaction at the counter of a branch. At a branch €1, by telephone 40p, and over the Internet only 4p. But, on the other hand, the establishment of the whole e-broker company requires huge marketing costs, employee training costs, adoption of new information system costs and security costs as well. This is the main reason why the break-even point of this distribution channel is far from being easy to achieve.

Internet brokers have, up to now, carried out a targeted strategy, by directing their offer first at the most active private investors. Given their advantageous cost structure (absence of physical agencies and low overheads compared with banks), they thought they could invest massively in marketing in order to conquer and to develop the loyalty of new customers. Their objective was to develop their client base quickly in order to reach the break-even point. But this was possible only with significant marketing expenses, which, at the same time, act against reaching the "level zero".

A study by Morgan Stanley shows that in the purchase of financial products, consumers prefer the recognisable financial brands to the detriment of purely technological recognised companies [MAG, 2000]. The existence of powerful, known and differentiated brands is a major stake in the Internet to enjoy clients' confidence. In this respect the example of Egg in Great Britain is significant. This subsidiary of the Prudential group profiting from its brand image conquered 500 000 customers (that is a total deposit of 5 billion pounds) in six months of existence. The problem of the traditional bank is then to choose whether to create its e-brokerage under its own name or through a subsidiary. In the first case, it takes advantage of its brand image but it also risks destroying it, if its services on the Web do not live up to the customers' expectations. In the second case, it should build this image as the new entrants do. This means that it should raise marketing expenditure, which is going to alter the profitability of the structure for several years.

In France, the cost of a customer's acquisition is on average 500 euros but, according to firms, it is

very different: 293 euros for Fimatex, 325 euros for Consors, 818 euros for Self Trade, and 1448 euros for Bourse Direct. In fact, it is difficult to make comparison because:

- Some try to grow at all costs before launching an initial public offering - IPO
- Some of them have physical networks or benefit from an image (fame)
- Some of them have existed for a long time in the on-line activity as Cortal (it would be necessary to add up the losses realised in the past in order to calculate the real return on investment - ROI).

Nevertheless, the damaging experiences of year 2001 have made e-brokers realise that due to the significant volatility of stock markets they cannot afford expansion at any price. They have to grow but at the same time cannot neglect the strict control of costs and revenues. Consequently, they have fixed three basic financial goals:

- costs reduction,
- revenues stabilisation,
- long-term growth at a reasonable cost.

The reduction of marketing, personnel, IT and SG&A costs is indispensable to face growing competition. Different measures are being taken in order to achieve it. For instance, Boursorama (ex Fimatex) decided to close down foreign subsidiaries. comdirect signed an agreement allowing the reduction of working time depending on the market situation and needs, which is a great advantage in the face of significant market instability. Besides, all e-brokers try to negotiate the price of order processing.

Revenues can be stabilised in different ways. In general, the majority of e-brokers have increased their tariffs in order to have higher safety margins during a bear market but many other solutions are being elaborated to face the problem. DAB Bank, for example, introduced a system of a flat fee. This way, the cost of service consists of a stable part insuring a certain level of revenue regardless of market performance and a variable part increasing profitability when the market turns bullish. Another measure, adopted by Boursorama, is to offer services of boosted quality and complexity in order to induce customers to trade more actively. Moreover, some e-brokers decided to diversify their activity and, for example, build a part of revenue from advertising.

Lastly, e-brokers have concluded that new customers can be acquired only at a reasonable cost. Several solutions is being elaborated. All of them are based on partnerships and, frequently, on taking advantage of already existing customer bases. Consolidations and co-operations are considered as the relatively easy ways of expansion. For example, DAB Bank, decided to buy the accounts of First-e, e-commerce services developer, paying a fixed price for each transferred account. Fimatex found out that the acquisition of the financial and economic portal, Boursorama, will facilitate the increase in the number of customers.

3.2 Cost of security

The sales of on-line financial services raise the problem of transaction security because e-brokers and their clients deal through an open network. Consumers perceive the Internet as a less secure means of communication than other traditional communication channels, for example, the phone or other electronic channels such as the Minitel in France, while, in reality, it is the other way round. Consequently, the necessary investments in order to reach an acceptable level of security are higher. There are two main security levels that have to be accomplished. First ♦ encryption of the information being transmitted across the public network to ensure privacy, confidentiality, integrity of the message and non-repudiation (for example with a Public Key Infrastructure). Second ♦ installation of the trusted operating system (with firewalls, filtering routers etc.) to provide protection for information stored on the broker♦s side.

Conclusion

The Web is already driving changes in financial services and this is just the beginning. Players involved

will have to adjust to clients' expectations and these are changing too - whenever we speak about their "new technology" acceptance or saving habits. Thus e-broker agents are facing technological and marketing challenges but also strategic ones. They will have to choose the right place in the whole value chain and decide on their core market. Moreover, they have to do it quickly because new competitors such as "traditional banks" or even department stores are willing to partially take a place on this market. That is why some large repositioning and concentration are necessary. Increasing the scale of action by conquering other markets, e-brokers should be conscious of organisational problems with an increasing number of clients and number of orders. Furthermore, the price scale structure and the sources of revenues are very susceptible points in their strategy and, if wrongly designed and implemented can provoke crucial problems with the break-even point.

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Sales of on-line financial services have caused a lot of judicial problems. Even if the USA adopts the recent proposition of the EU to protect the consumer, a lot of uncertainties and problems still remain to be solved.