

E-banking what next?

“What next?” That question that has ricocheted through our private lives and public institutions since Sept. 11. It may seem too momentous a question to ask about workaday issues in banking. Even with firm resolve to forge ahead, forecasting the future isn’t what it used to be.

Does that mean we throw out all the analyses and projections that seemed so persuasive in late summer? Most likely not; and we don’t in this article. But certainly the aftershocks of Sept. 11 have, in ways we don’t yet know, disturbed the most important element in banking: the mindsets and value sets of our customers.

Perhaps the deepest question is this: Will consumers want more isolation or more community in their daily lives? That is, will fear of sudden terror in the outside world make home feel like a more comfortable place for such activities as chatting, shopping . . . and remote self-service banking? Or will a heightened awareness of “what’s really important in life” tend to make people gravitate to the company of real people at neighborhood parties and weddings and worship—in preference to machines and virtual communities? Will the possibility of receiving an anthrax-powdered envelope give a big boost to e-mail? . . . e-checks? . . . bill presentment? Will the internet seem more secure? . . . more private? Will the vaunted payments infrastructure become another target of terror? Will the fears and hassles of flying make smart ID cards and biometrics feel like welcome protection and convenience, not intrusions?

A quarter of a year later, it’s still too soon to recalculate pro-

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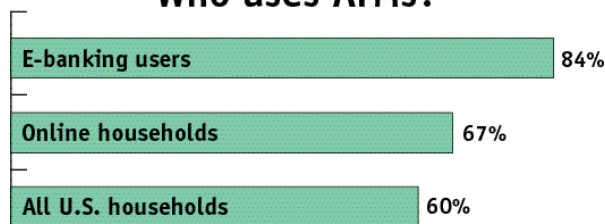
jections of market shares and consumer attitudes with any confidence. So bankers will have to watch trends closely to see which way the market actually goes, keeping in mind that the current volatile environment could easily cause sudden reversals in attitudes, values, and preferences.

A few players dominate

First, a definition. For purposes of this article, e-banking refers to electronic banking over the internet. The service is provided both by traditional banks with brick-and-mortar branches and e-banks (or virtual or direct banks) that deliver their services primarily over the internet. E-banks can have some brick-and-mortar facilities: telephone and web call centers and, increasingly, physical “touch points” for in-person demos and consultation. They must offer a general line of banking services—internet credit-card “banks” don’t qualify.

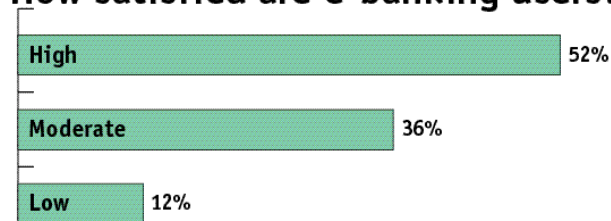
At yearend 2000, there were 1,850 FDIC-insured commercial banks and savings institutions—19% of the country’s 9,821 depository institutions—offering e-banking, as defined prior. That leaves nearly 8,000 e-banking have-nots. That number

Who uses ATMs?



Source: TowerGroup

How satisfied are e-banking users?



Source: Gomez, Inc.

shrank appreciably in 2001, but, as the Office of the Comptroller of the Currency recently projected for nationally chartered banks, it's likely that almost half of all financial institutions have no plans to offer e-banking, ever.

At the other end of the spectrum are eight big banks and two much smaller but very successful e-banks that together have about 35% of the estimated 16 million e-banking accounts in the U.S. Adding in three Canadian banks, these 13 North American leaders have 19.7 million e-banking accounts, according to TowerGroup research, led by Frank Caruana. Note that these are *accounts*, not individuals or households. A better criterion than simple enrollment is whether an account is "active"—has been used in the previous month. Some of the main features of e-banking demographics are summarized in the above table.

The top three banks in the

TowerGroup study—Bank of America, Wells Fargo and Wachovia (after acquisition by First Union)—each have more than three million accounts (not identified as active). A few banks are seeing growth rates of more than 100,000 new accounts per month. Taken together, between yearend 1998 and July 2001 the number of e-banking accounts at the 13 top North American banks grew at a compound annual rate of 101%.

TowerGroup looked into the possible change in use of ATMs as e-banking catches on. They found that everybody still uses ATMs—and e-banking customers use them most of all (see chart, above left).

The study also revealed that of all the households that are on the internet, only one in five also do their banking there. This figure is ammunition for the analysts who fire criticism at bankers for their puny efforts at marketing e-banking ser-

vices to ready but not quite willing customers. The same poll showed that everybody uses direct deposit, which is a form of e-banking. Only a few years ago, huge segments of the public refused to submit their paychecks or Social Security checks to the hazards of electronic transfer. Then the U.S. Treasury mandated it. Now it's universally accepted. Attitudes do change.

The study asked for responses to this blunt assertion: "I prefer to go to the branch to conduct my routine banking transactions versus using self-servicing banking like ATMs, automated phone services, PC banking, etc." Half of all households agreed with the statement. And so did one-fourth of the e-banking households! Clearly, branches still have a broad appeal.

The incredible, shrinking e-banks
Beyond doubt, internet-only banks are an endangered species. Six years ago, they were toasted as a brave new breed that

Bank of America: a study in big numbers

Ascent five weeks after the terrorist attacks, Bank of America moved aggressively ahead with major e-banking programs. Its four million subscribers (2.5 million who qualify as "active") already led its two closest competitors in the multi-million-accounts circle. Late last year, the bank had launched an electronic bill presentation and payment (EBPP) service for its retail customers, which by this summer had signed up a million subscribers and every month is presenting 130,000 bills from 136 billers. The program now pays some 3.5 million bills totaling about \$1.1 billion a month. The service is free for the first three months and \$5.95 a month after that.

In April 2000, facing heavy new demands on its software platform as it planned to add bill presentment and take the program nationwide, the bank made the major decision to outsource the bill presentment and payment service to CheckFree under a ten-year contract. The bank was granted ten million restricted shares of CheckFree common stock, equal to roughly 12% ownership of the company. The bank

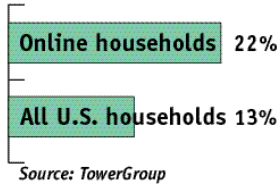
was given warrants to purchase an additional ten million shares which will vest when Bank of America delivers more than ten million electronic bills a month to CheckFree and more than ten million bank customers.

The bank seems to be satisfied with the program so far. Online billpay customers have a 75% lower attrition rate, make 34% fewer calls to service centers, have 28% higher balances, and 23% higher loan balances.

In mid-October the bank followed up by launching an account aggregation program in "select" U.S. markets, with a commitment to roll out the service nationwide by early 2002. With a single sign-on, a user enters her *My Bank of America* space, where for no fee she can access all of her BofA accounts plus the banking, investment, and loan accounts at other institutions. She can also access such personal information as frequent flyer reward programs.

Yodlee aggregates the data from other institutions. Broadview personalizes the presentations.

Who does e-banking?



could transcend geography, operate without the costly baggage of bricks, mortars, tellers, layers of vice-presidents, and obsolete legacy systems and lead us all into a new world of paperless anytime anywhere self-service banking. At the end of last year, only 40 out of an earlier 60 had survived. Today there are 20-25, and that number could eventually go down to 5-10, says Virginia Philipp, who headed a TowerGroup study of "Challenges for Virtual Banking."

What went wrong? Nearly everything, Philipp suggests.

First, she says, were the high startup costs—mainly the heavy marketing needed to acquire new accounts. New technology, though most of it outsourced, cost more millions. Operating on the leading edge required high-salaried managers and marketers.

E-banks had two other built-in disadvantages for their customers: how to withdraw cash and how to deposit paper checks. Typically, e-banks handled the cash problem by issuing debit cards and reimbursing customers for the cost of using them at foreign ATMs. This works unless a customer uses the ATM more times than the rebate policy allows. To this day, there seems to be no good way of making a deposit, other than via the postal system. Juniper Financial, a promising young e-bank that has since been acquired by Canadian Imperial Bank of Commerce, sought to solve the problem by a deal with Mail Boxes, Etc to accept deposits and mail them to the bank by overnight express, essentially a variation on "snail-mail."

In its recent report on internet banking, the OCC offers another theory of what happened. The business strategy seems to have been predicated on a belief that demand for e-banking would grow rapidly in the near term, allowing the new venture to cover its high capital costs. Like so many

What makes e-users purr?

The core function of every product is to satisfy the people who use it. Gomez, Inc. recently queried more than 3,500 online users to find out what gave them high, moderate, or low satisfaction with their e-banking experiences. They divided users into three life-stage groups: youth (18-24), mid-life (35-54), and mature (55+).

Here is a potpourri of their findings:

- Low satisfaction correlates with low functionality.
- Basic satisfaction goes with basic banking.
- In the user experience, success breeds satisfaction. Be sure every new user starts off with a successful experience. Users who complete 90% of their monthly tasks online are almost three times as likely to be "highly" satisfied as "moderately."

- Don't bother with non-financial services (news, weather, shopping): such "obstructive" content "may in fact cause distraction from completing primary banking tasks."

Overall, users are only moderately satisfied with e-banking. Mature users are more satisfied than younger cohorts.

- Mid-lifers register the highest satisfaction with e-banks. Beset by unrelenting time pressures, they are most likely to have made a full commitment to e-banking and to using the internet as their primary banking channel.

- Never get complacent: the average score of users who cancelled their service was slightly *above* the threshold for "moderate" satisfaction. One of every four users who cancelled

the service said they did so because they were enticed into it but never used it. A slightly higher proportion of "disusers" cited concerns about security. [It must mean something that these users became concerned *after* they started using it.] Close to one in three disusers said they quit because e-banking didn't save time or offer enough benefits.

- The big problem for big banks is their relatively poor website performance.

- Almost all users (84%) have contacted customer service. Overall satisfaction correlates with wait time for a CSR response. Among all users, 58% waited less than two minutes. More than twice as many users from big banks as from e-banks hung up on customer service because they had been kept waiting too long.

other dot.com startups, e-banks simply couldn't hold their breath long enough.

Now the good news

But the news isn't all bad. E-banks *can* operate at lower costs, and *do* pass savings on as a lure for new customers. In general, Virginia Philipp says, e-banks offer three times the national average interest rate on depository accounts. In general, they build or buy next-generation technology and avoid legacy problems.

Philipp says that to succeed, e-banks must stay away from mass marketing with its massive costs. Don't build the bank around depository accounts, but around a mix of standard financial services plus wealth management, financial planning, and online lending. Go for owning a big share of a targeted niche market, she advises. VirtualBank does this by pitching to new-technology millionaires. Everbank pitches mid-level wealth management and forms partnerships like the one with

American Skandia and its 35,000 independent financial representatives. NetBank has 160,000 accounts and \$2.5 billion in assets. The profitable bank offers a broad range of functions and earlier this year acquired Market Street Mortgage, which allows the bank to originate and refinance mortgage loans through 44 branches across the U.S. The bank also has cross-marketing partnerships with Federated Department Stores, Thomas Cook Currency Services, and PeopleFirst.com.

The biggest e-bank success story is E*Trade Bank, formed when the high-flying discount trader acquired Telebank, which was leveraging its branchless telephone banking into a substantial position in e-banking. E*Trade Bank is now the unchallenged champion e-bank, with 435,000 online accounts, \$7.7 billion in deposits, and \$13 billion in assets. About 45% of those online accounts came from existing E*Trade clients, thanks to an aggressive nationwide cross-sell cam-

RETAIL BANKING

paign. Early on, the bank acquired online mortgage originator LoansDirect. Last spring the bank acquired the e-banking accounts of Advanta, one of the largest issuers of MasterCard credit cards for small businesses. This move brought in 15,000 new high-balance accounts and approximately \$400 million in deposits. E*Trade Bank has another asset that is as valuable as it is unique for an e-bank: the third-largest ATM network in the U.S. (10,000 stations), which it got with the acquisition of Card Capture Services.

Through a partnership with Target stores, the bank can have a physical presence in strategic locations nationwide. In August the bank opened the first E*Trade Zone in Roswell, Ga. It's small, but big enough for an ATM, computer terminals for online banking, and a desk for giving information and taking applications. It plans to open another 20 Zones, plus some larger centers that look and feel like branches. The first of these centers opened in Manhattan.

E*Trade Bank is making it the hard way: by mass marketing. So the beat goes on. **BJ**
