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conomics

Internet revolution and new economy

Finance portals: opportunities for customers and banks

The moneyshelf report on selling financial services online

conomics is a special edition of "Frankfurt Voice"

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The moneyshef report on selling financial services online

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Summary

The Internet is changing the nature of banking transactions, bank structures, and thus also of retail banking. Germany too is increasingly embracing online banking. More and more, the classic branch business is being complemented or replaced by electronic distribution channels. The German online banking market is off to a running start. It is credited with strong potential, being expected to grow at double-digit rates over the coming years.

The driving forces behind this phenomenon are the growing popularity of investment in equities and low transaction costs. Online retail customers like the high transparency of the market for financial services on the Internet, the wealth of choices and the ability to access the market at any time. Consumers have become more cost-conscious and have higher expectations. They show a growing readiness to switch financial providers or to maintain several account relationships.

Independently of the Internet, the investment behaviour of households has been changing. The key trend is that retail investment in securities – most recently especially in equities and equity mutual funds – has gained market share at the expense of the various forms of savings deposits. Retail customers have become more return-conscious and risk-tolerant. In 1999 the share of securities in financial wealth (about 35%) for the first time surpassed that of bank deposits (33%) in Germany. In the USA, this trend was even more pronounced, which underlines that, when it comes to investment in equities and equity funds, Germany is still far from having reached its potential.

Banks are meeting the challenge of online banking by offering a growing range of products and services. The chief motivation behind banks' adjustment and modernisation of their range is to win customer loyalty and enhance their image. The established large banks and direct banks occupy good starting positions in the intensifying competition, as they already have a wide range and the requisite technical infrastructure.

By international standards, Germany still lags behind in terms of Internet equipment penetration, but it is quickly gaining. In growing measure, the technical prerequisites of online banking are falling into place as the number of Internet connections (and thus of potential online customers) soars. An important driver of this growth is the reduction in access charges. By 2005 one person in three could have a residential Internet connection, as is already the case in the USA. So far, in Germany it is one citizen in eight. The degree of openness to using the Internet for monetary transactions is growing throughout the population. However, there is still a considerable gap between the rapidly widening interest in online banking and the slower actual adoption of the practice.

In banking transactions in particular, security is a critical decision factor for prospective adopters. An important step forward in assuring the legal validity of Internet transactions has been the EU's legalisation of digital signatures. With the growing acceptance of the Internet – both by the young and by older age groups – the potential customer base for the distribution of network-based financial services is expanding strongly.

Yet the Internet is far more than an additional distribution medium for the multi-channel bank. It also paves the way for new business models. New markets with high growth potential are being born. A current example is the development of the market for finance portals.

Finance portals are conceived to serve users as a kind of compass for their financial transactions, lest the Internet with its wealth of information and financial services become an impenetrable maze for customers. Providing an overview of the products on the market at any given time, including prices and terms, the portal offers the customer well-organised information as the best possible basis for financial decisions. The novel insight is that, in order to ensure this, the operator of a finance portal must offer not only its own products but those of third parties.

The portal operator can meet the attendant risk of cannibalisation of its own products only by going on the offensive, not by attempting to seal out competing products. In the transparent world of the Internet, customers expect a high-quality product range. If their own bank does not offer it, they turn to other providers, which after all are only a mouse click away.

The combination of proprietary and third-party products lets operators of finance portals offer customers innovative, return-optimising solutions for liquidity and monetary wealth management. Customers receive not only investment recommendations tailored to their individual investment and risk profile: the finance portal also gives users the necessary tools to integrate bank and security accounts at other institutions in their Internet-based asset management and check the status of their financial assets at any time. This business model requires that the finance portal be a largely separate entity organisationally and legally from the institution owning the portal.

Finance portals as a marketplace should become firmly established over the next one to two years thanks to the forecast strong demand. The provision of this new infrastructure for financial services will give rise to new value chains and bank structures. As the production and distribution of financial services via finance portals typically involves a large number of partners and specialists, good cooperation management is required. The rise of finance portals promises a process of "creative destruction" à la Schumpeter that will be gripping to watch. As well, finance portals should reinforce the trend towards shifting bank deposits into securities investment with higher returns, and thus contribute to more efficient allocation of capital in the economy.

1. Introduction

The Internet is changing the nature of banking transactions and bank structures. This is increasingly true of German retail banking as well. But the profound change in retail customers' investment behaviour and expectations regarding service is not driven only by the Internet. There have also been a number of structural shifts in saving and investing patterns since the beginning of the 1990s, such as the unbroken decline in households' savings ratio and their growing holdings of equities and mutual fund units. The Internet gives bank customers a new world of virtually unlimited information and access to financial services whenever they wish. This brings much more transparency to the market. Transaction costs fall thanks to the network advantages of wide use. That makes the network more attractive to retail customers, who are increasingly exploiting the possibilities of Internet banking. Among financial services companies, the competition for Internet-friendly retail customers is heating up. The close ties which bound customers to their bank in past are loosening dramatically, and nowhere more so than in the securities business. At the same time the rapidly growing retail market for financial services on the Internet holds out considerable business potential. In order to exploit this scope, financial services companies need to invest heavily in technology and marketing. A critical success factor is achieving strategic positioning early enough to gain first-mover advantages.

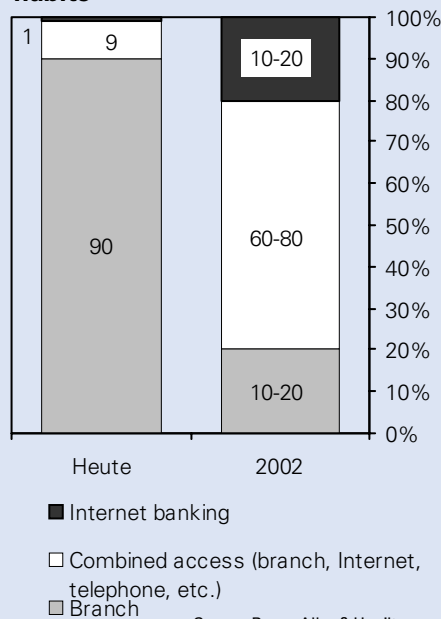
The purpose of this study is to analyse and portray the market potential, technical requirements and market environment for Internet-based financial services, especially finance portals. In order to identify the business potential of Internet-based retail banking, we pinpoint the structural changes in private investors' saving and investment behaviour since the early 1990s and assess their probable duration. Different customer profile descriptors, such as age and income structure, will be considered in the process. A comparison with trends in investment behaviour and Internet banking in the USA provides clues to future developments in the German banking market.

Of central importance is the examination of the opportunities and risks associated with the establishment and use of finance portals, especially from the perspectives of customers and banks. A key task when establishing a finance portal is to persuade many different providers to place their financial products on the site. We therefore need to assess the extent to which finance portals can correct inefficiencies in financial investment and thus contribute to improving portfolio structures in investors' favour. Finally, we analyse the new opportunities that grow out of mobile access to Internet banking.

2. Internet banking: setting and potential

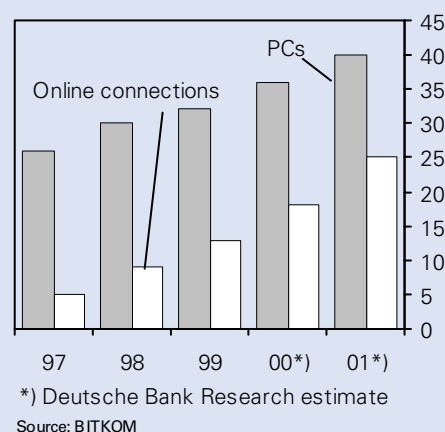
The banking sector, which in Europe is in the vanguard of business-to-consumer Internet use, has been propelled forward into fundamental change as a result of the new information technologies. One consequence of the use of new technologies is potential for cost-cutting in internal business processes. Another result of using the Internet as a distribution channel for financial services and as an interactive information medium is a complete transformation of traditional customer relationships: the branch business is increasingly complemented or supplanted by the use of electronic distribution channels. But far from being just another sales channel for the multi-channel bank, the Internet smoothes the way for new business models and new markets with high growth potential. A topical example is the development of the market for finance portals.

Bank customers change their habits

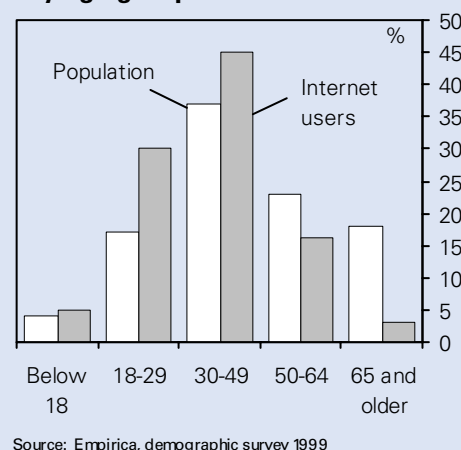


Personal computers/online in Germany

per 100 population



Population and Internet users by age group



The intentions of bank customers with respect to how they will transact their banking business in future signal substantial scope for growth. Thus, according to a study by Booz, Allen & Hamilton, at present only 1% of customers do all their banking via the Internet. In 2002 this number is expected to climb to up to 20%. Pure branch business should accordingly contract significantly. Importantly, however, the study predicts that in two years, 60-80% of customers will still want access to traditional branches in addition to Internet banking. A survey by Deutsche Bank 24 bears out these results: 60% of bank customers surveyed want to be able to choose in future from a distribution mix of branch, PC/Internet and telephone. According to the Deutsche Bank 24 survey as well, pure branch users and pure direct banking customers will only amount to about 20% of the clientele, respectively. Financial institutions that do not want to lose large customer segments in the medium term will therefore be forced to provide both distribution channels.

2.1. Internet banking growing at a breath-taking pace

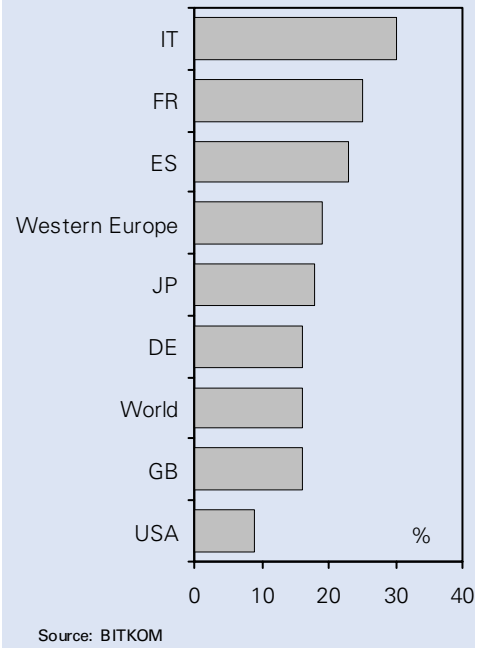
The technical requirements for a stronger shift away from, or replacement of, traditional distribution channels in favour of Internet banking are not yet met in Germany. Although slightly more than 30% of the population owns a PC, the figure already exceeds 60% in the USA, the trend-setter in Internet matters. What is more, Internet penetration in Germany is low by international standards. In 1999 about 11 m Germans (some 13%) had their own Internet access. The actual number of users, i.e. including individuals who lack direct access but who go online in the workplace, at friends' residences or in Internet cafés, amounts to 18 m (14- to 69-year-olds) according to the latest GfK survey. Until 2005 Germany is predicted to witness growth in Internet connections of 16% p.a. This means that by 2005, one-third of all Germans could have their own Internet access – the degree of penetration already reached in the USA. By then, in fact, a total of more than 40% of the German population should have Internet access of some kind. Within the next five years, then, the number of potential Internet banking customers could double (1999: about 11 m; 2005: slightly more than 22 m). This forecast is underpinned especially by the ever-declining telephone rates and the dwindling prices for PCs and other Internet terminals.

In terms of PC and Internet penetration, there are conspicuous differences between the typical customers of German major banks, cooperative banks, savings banks and the Postbank. More than 50% of large banks' customers use a PC and almost a quarter have online access. The customers of the other categories of banks lag far behind by these criteria. At present the major banks thus have much greater customer potential for Internet-based financial services.

2.2. The typical Internet user

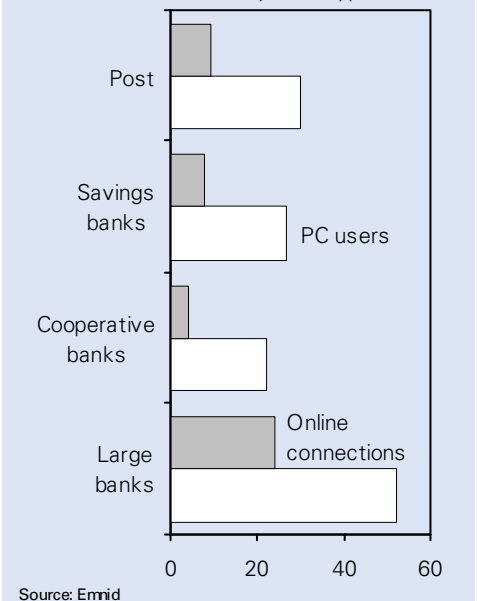
In the Internet society, the younger age groups still make up the largest fraction. Three-quarters of Internet users are between 18 and 49 years old. However, the age group from 50 to 64 now already accounts for 15%. Acceptance of the World Wide Web is thus rising in the higher, relatively more affluent age classes. In fact, the age structure of Internet users increasingly conforms to that of the general population – a sign that in future, the Internet will not be the domain only of young, technology-savvy people but should become entrenched as an everyday medium for all age classes.

Expected average annual growth in online connections, 1999-2005



PC users/online connections

Number of customers by bank type in %



Utilisation of the Internet increases with level of education: nearly 60% of German Internet users hold a high-school diploma (i.e. qualification in principle to enter universities). By contrast, very few individuals without any school certificate or who have completed only junior high school surf the Net. As well, the interest in financial subjects on the Internet rises with income.

For banks this constitutes an attractive target group: predominantly young people with some education and higher incomes, spelling the prospect of relatively high transaction volumes. Moreover, this group is more receptive to the existing direct banks, and thus to Internet banking, than are other population strata.

2.3. Seeking information above all else

Most German users (about 80%) say they use the Internet mainly to gather information. The websites most heavily used for these purposes are those of online magazines (31%) and pages with information on financial markets (28%). Demand is strongest for price information and stock recommendations. Customers' favourite services are customised e-mail newsletters and answers to their individual questions by e-mail. Significant for banks' retail business is the fact that more than 50% of respondents look up information for personal use.

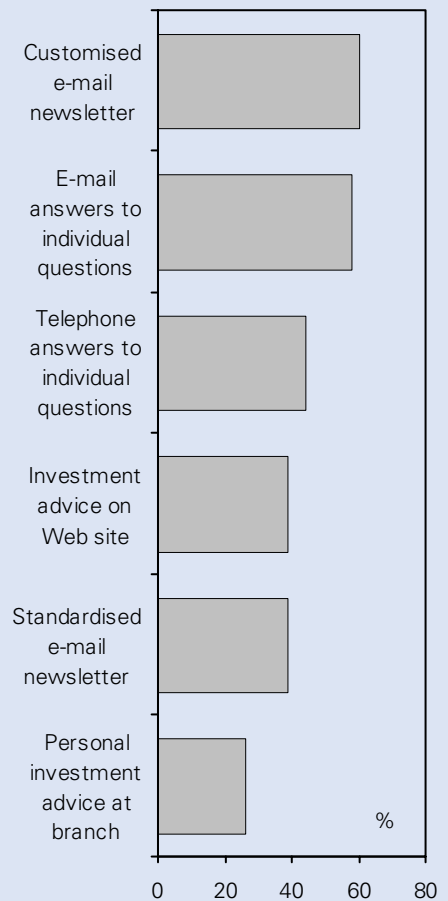
On the other hand, the high popularity of gathering information from finance pages does not equate to a similar readiness to bank via the Internet. Although interest in banking online is swiftly growing, the percentage of Internet users actually practising it is lagging well behind. Whereas today about 75% of Internet users express an interest in managing their private accounts electronically, only about 45% were interested half a year ago. But in the past six months only about 53% in fact used these online financial services. In other categories of financial services as well, such as buying and selling securities over the Internet, thought is often not followed by action. More consulting-intensive products such as consumer loans, mortgages and home loan and savings contracts are clearly not customers' favourite subjects of online transactions and are only rarely delivered over the World Wide Web.

2.4. Banks adjust product offerings

In response to the ever stronger demand for online services, credit institutions are overhauling their ranges. Forrester Research reports that about 65% of banks already offer online transactions. In 1999 the number of bank accounts kept online rose by more than 50% to over 10 m. Better than 40% of electronic banking of this type is done by private banks. The rear is brought up by Postbank, which maintains only about half a million online bank accounts. The chief motive for adjusting the product range is the provider's wish to retain customers and enhance its image. According to Forrester, about 70% of traditional banks name these reasons for their online activities. Thus, although online banking has a wider meaning than Internet banking, online bank customers are very likely to be potential Internet banking customers.

At the same time there is a growing number of direct banks that distribute their products exclusively via Internet and telephone and do not operate a branch network. Some of these Internet banks are recording vigorous gains in customer numbers. A driving force in this recruitment has been the provision of brokerage services, notably for equity transactions.

Online brokerage advisory services



Source: Forit

Online banking encompasses the various forms and methods of banking transactions performed online (i.e. via computer and modem; telephone banking is not considered online banking). The different methods are, among others: Btx/T-Online, Multicash and the Internet (using, for example, the HBCI security standard). Internet banking is thus one form of online banking. Two uses of online banking are in maintaining and managing checking accounts and securities accounts online.

2.5. The customer is king

The Internet introduces greater transparency into the market for banking products and financial services. Customers gain much easier access to the offerings of a variety of credit institutions and can comparison-shop very conveniently. That raises the competitive pressure. As individual providers on the Internet are separated only by a click of the customer's mouse, the propensity to change banks should increase. Traditional customer loyalty is thus likely to become less prevalent. In future, banks will therefore strive to retain customers by tailor-made offerings. To date this is not yet reflected in the actual behaviour of bank customers. Most still tend to do their banking at savings banks, credit unions and agricultural credit cooperatives. But a growing number of customers, while keeping their traditional principal bank, are adding a checking account and securities account at a direct bank and conducting their securities transactions there.

Nonetheless, the propensity to transact at direct banks still is far lower. But in all likelihood, more and more consumers will in future use financial services delivered by Internet because of the very current information provided, the greater convenience, higher transaction speed and lower prices.

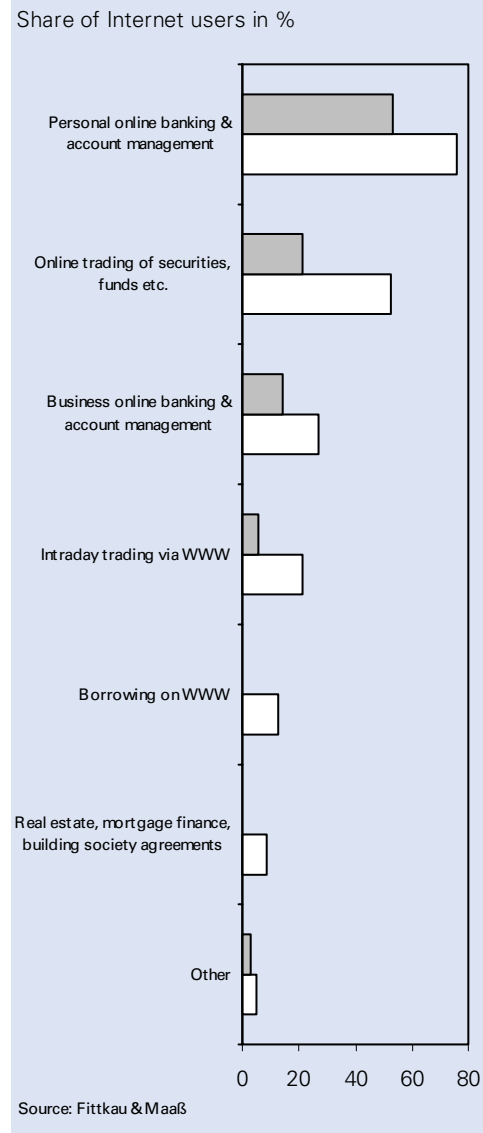
The Internet strengthens customers' hand significantly. On the Web, customers can bank 24 hours a day, seven days a week, regardless of branch hours. This is a boon for target groups that are at work during traditional banking hours, and possibly also for customers who are elderly or ill.

2.6. Internet banking: a business of promise

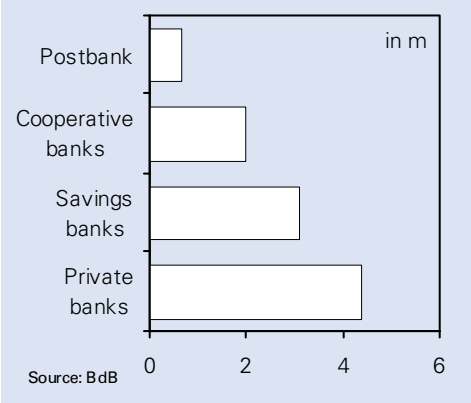
Insufficient technical infrastructure in terms of Internet terminals, high access costs, security concerns and – a widespread phenomenon in parts of the population – an aversion to technology have so far limited the demand for Internet banking in Europe. But the outlook which we presented above for the diffusion of personal computers and Internet connections signals that Europe – and especially Germany – should quickly catch up with the leading online nations (USA, Sweden and Finland) in the next several years. And the still frequently encountered misgivings about the Internet as a medium are gradually softening. The EU took the political initiative at its special summit in Lisbon in March 2000. Its presentation of the eEurope action plan brought home to the general public the importance and inevitability of e-commerce. One main thrust is the "Schools Go Online" campaign now being implemented.

When it comes to banking transactions, security is a key decision factor for prospective direct banking customers. The legalisation of digital signatures by EU law represents a big stride towards secure, simpler web-based delivery of financial services. Only if the legal validity and authenticity of transactions are assured will electronic business transactions take off on a large scale. The digital signature is thus an important prerequisite of expanding the offering of electronic financial services. As well, the added measure of security will stimulate more demand. One exception to the acceptance of electronic signatures to date are those legal transactions governed by specific statutory requirements of form, such as guarantees and acknowledgements of debt.

Interest expressed in and actual use of financial services



Number of online accounts in 1999



eEurope action plan

1. Bringing education systems into line with the digital age
2. Low-priced Internet access
3. Promotion of electronic business
4. Fast Internet for scientists and students
5. Secure electronic access by means of smart cards
6. Risk capital for high-technology SMEs
7. eParticipation for the handicapped
8. Health care via the Net
9. Higher traffic safety and better quality of public transport through digital technology
10. Easier access for the public to information from public agencies via the Internet.

Internet banking is thus becoming ever more attractive both for consumers and providers. The battle for customers' business is inevitable. The established major and direct banks are starting from a strong position. Even now some already offer a broad range and have the requisite technical infrastructure. The relatively high penetration of PCs and Internet access in their present customer base also indicate a high potential for acquiring an enthusiastic online clientele. The fact that in 1999 about 40% of electronic banking traffic involved online bank accounts at private credit institutions supports this thesis. A positive factor for private banks is also that the willingness to effect financial transactions is closely tied to customers' trust in the bank. Brand names with a long banking tradition thus enjoy a clear advantage, at least at the outset. Particularly the financial services that are not advice-intensive, such as operating private and business accounts as well as securities trading, should find a mass market. Integrating complementary products like building finance or insurance into the range could enhance demand.

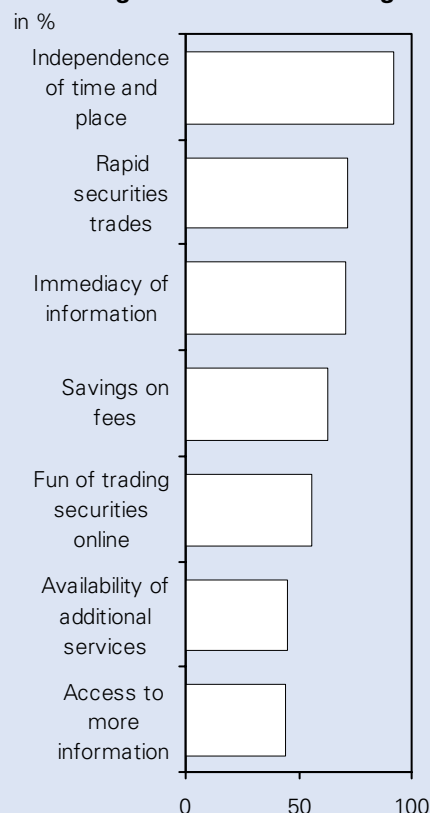
Yet, given the high transparency and anonymity of the Net and the attendant ease of comparison at least of standard products, customer loyalty will weaken in the medium term. The growing use of financial services in the Internet should entail a trend towards opening accounts with a second or third financial institution. This should be true of younger Internet users in particular, most of whom have not yet banked with the same institution for years and are therefore already more flexible in their choice of e-finance services. This target group holds special promise for pure Internet banks or banks participating in finance portals.

3. Trends in the savings patterns of households

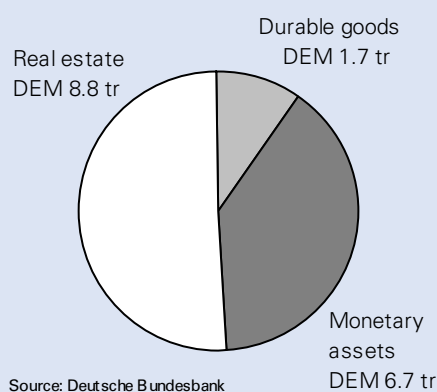
3.1. Households' financial situation

The Bundesbank puts the gross fixed and financial assets of households at DEM 17.3 trillion as of the end of 1999. It states households' net worth (i.e. total assets less mortgages and consumer loans) at DEM 14.6 trillion. Of this, financial wealth has a share of about DEM 6.8 trillion, or almost 40%, while real estate constitutes about 50% and durable goods around 10%. Since 1992 financial assets, growing by 64%, have increased more than twice as quickly as real property. The surge in financial assets, apart from the annual growth in current savings, is attributable primarily to higher share prices and the relatively

Advantages of online brokerage



Total wealth of household at the end of 1999

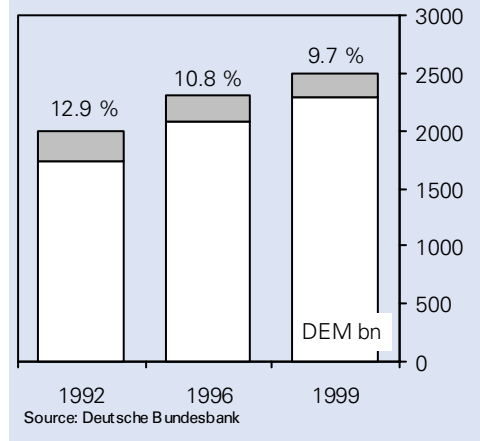


high interest rates in the first half of the 1990s. German citizens at the end of 1999 owned average financial assets of DEM 82,000. For the approximately 37.5 m households, this corresponded to average financial assets of about DEM 181,000. There are conspicuous differences in these statistics between east and west Germany.

3.2. Declining savings ratio

The 1990s in Germany were characterised by significant structural changes in savings patterns and investment behaviour. The traditionally high savings activity of households eased consistently over the past years. Last year households created additional monetary wealth of DEM 277 bn, compared to DEM 296 bn in 1992. The savings ratio reached its high in the old Federal Republic of Germany in 1970, at 14.5%. From 1992 to 1999 it fell from 12.9% to 9.7%, i.e. households are no longer saving even one D-mark in ten. The reasons lie partly in the economic cycle and partly in structural aspects. From 1992 to 1999 disposable incomes gained relatively little in nominal terms – and at times lost ground in real terms – as a result of weak economic growth and rising tax and social insurance burdens. Consumers’ wish to maintain their level of spending took its toll on the rate at which they saved. A parallel contributing factor was the protracted decline in employment, which hurt many households’ ability to put money by. That was especially true in the east German states. The resulting negative impact on the savings rate was progressively less offset by the higher savings derived from expanding incomes from entrepreneurial activity. As well, the role of interest income from financial assets became less significant amid the sharp fall in interest rates in the late 1990s and investors’ growing fascination with equities.

Household disposable incomes and savings rate



Average monetary wealth per capita in DEM

	1992	1999	Increase in %
With banks	22,000	27,700	25.8
With insurance companies	10,500	19,100	81.8
With building societies	1,770	2,200	24.3
In fixed income securities	6,900	8,800	27.8
In equities	2,250	7,700	342.9
In other equity	1,760	3,000	70.3
In mutual funds	2,870	9,200	321
In pension provisions	3,230	4,300	33.3
Total	51,000	82,000	60.6

Source: Deutsche Bundesbank

The level of savings activity tends to be brought down by the strong increase in single-person households, which display a lower average savings rate. Slightly more than 36% of west German households (and about 30% of east German ones) are now one-person households, and the rising trend continues. Finally, the Bundesbank speculates the savings rate may have been inhibited by the high expectation of inheritances, which are estimated at DEM 200-250 bn per year.

Regardless of the declining savings ratio, however, Germans’ willingness to save is intact. Surveys show that over 80% of the population put money aside more or less regularly. The most common motive for saving is by now private provision for retirement, in view of the foreseeable underfunding of the statutory pension systems. This motivation ranks ahead of maintaining an emergency nest egg and saving for specific expenses. For young families, saving to buy their own home also continues to play an important role.

Willingness to save is alive and well

Deutsche Bank Research expects the trend in the savings ratio to stop declining at the beginning of the new decade (2000 and 2001). The ratio should rise again somewhat as a growing percentage of Germans grasps the need to accumulate personal retirement savings in light of the dismal long-term outlook for the public pension systems. This is particularly likely to come about if the pension reform is passed this year, since the reform is to introduce tax incentives for private defined-contribution retirement plans. Granted, it cannot be ruled out that incentive-promoted private saving will simply take the place of unsubsidised saving. But Deutsche Bank Research believes that most of the saving associated with tax incentives will represent new savings. This view is also supported by the good economic situation and bright outlook for growth in 2000 and 2001, the first years of significant growth in employment after a prolonged decline.

3.3. Structural changes in investment behaviour

The structure of financial wealth creation by households has changed profoundly in the past two decades. Households' financial assets are now more diversified. With increasing affluence they have become much more return-oriented. The most important trend is that investment in bonds and risk-carrying securities (equities and equity-based mutual funds) has consistently gained ground at the expense of the various forms of bank deposits. Whereas in the 1980s bonds and bond-based investment funds became very popular, the 1990s were shaped by a growing preference for equities and equity mutual funds.

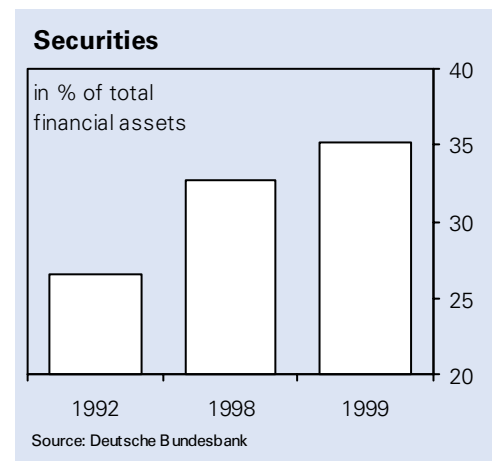
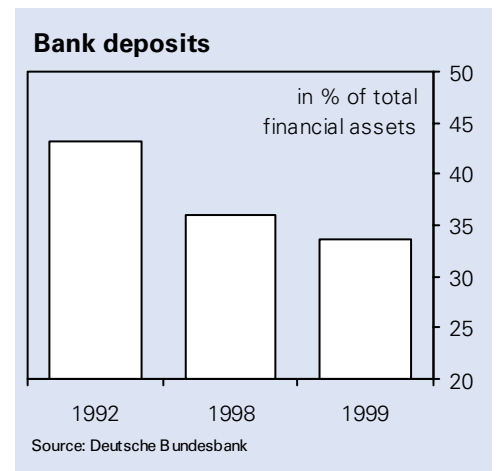
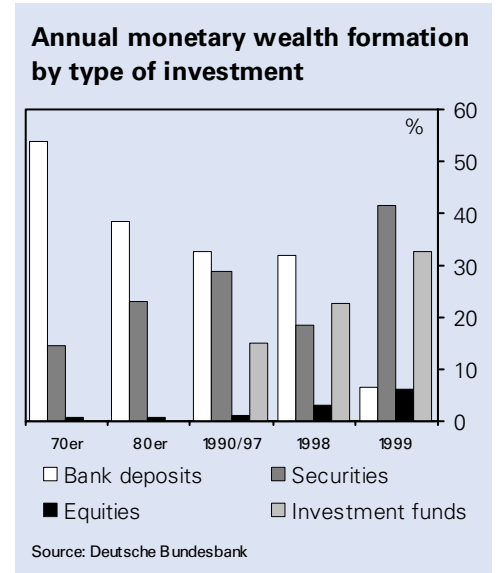
A distinctive trait of wealth formation in Germany is the growing role of saving through insurance products. The share of "insurance saving" in Germans' financial assets was a good 20% in the 1990s and is rising (1999: just over 23%). Half of all Germans carry endowment insurance. The self-employed in particular use their endowment policy as an element of their retirement savings strategy. Life insurance is tax-privileged over other forms of investment, which leads to distortions of competition. Last year sales of life insurance profited especially from a rush to buy policies ahead of proposed legislation that would have reduced the tax advantages of life insurance. The planned law was eventually shelved. In 1999 saving through insurance accounted for fully 45% of the DEM 277 bn in new financial assets. That share should now normalise to a much lower level.

3.3.1. Less bank deposits – more saving through securities investment

The structural shift in financial wealth creation is illustrated by the fact that the share of bank deposits in monetary wealth formation has fallen from an average of 54% in the 1970s to a good 30% in the 1990s. In 1999, owing to the strong preference for life insurance, it amounted to only 6.5%. Over the same decades the contribution of securities increased from 14% to nearly 29% in the 1990s, climbing to 42% in 1999. By a strikingly wide margin, retail investors favoured indirect investment in equities through mutual funds over direct investment in equities. Thus, last year direct investment in equities accounted for only DEM 17 bn of monetary wealth formation, while more than DEM 90 bn of new money flowed into – largely equity-based – mutual funds.

The share of financial assets held in equities rose in 1999 to 9.4%; that held in investment fund units increased to 11.3%. This meant that, for the first time, securities (35%) made up a larger component of monetary wealth than did bank deposits, which constituted about one-

Savings ratio not expected to decline further



Composition of financial assets (totals at year-end)

	1992		1998		1999	
	Mrd. DEM	%	Mrd. DEM	%	Mrd. DEM	%
Bank deposits	1775	43.1	2253	35.9	2272	33.7
Financial assets	847	20.6	1441	23.0	1570	23.3
- with insurance companies	143	3.5	184	2.9	184	2.7
- with savings and loan associations	1109	26.6	2053	32.7	2367	35.1
- securities of which						
· equities	181	4.4	492	7.8	635	9.4
· other equity	142	3.5	230	3.7	250	3.7
· mutual fund units	231	5.2	566	9.0	760	11.3
· fixed interest securities	555	13.5	765	12.2	722	10.7
- arising from company pension provisions	260	6.3	345	5.5	356	5.3
Total	4115	100	6275	100	6799	100

Source: Deutsche Bundesbank

third of the total. Households are thus increasingly willing to take greater risks for higher prospective returns. Savers have become investors. Germany has seen the creation of an equity and mutual fund culture.

Retail demand for equities in Germany jumped in 1999 and 2000 thanks to the boom in new issues, sustained price gains and upside speculation. According to the German Institute for Share Promotion, the number of shareholders (direct investors and fund unitholders) rose from 8 m to 11.3 m in the first half of 2000 alone. The proportion of shareholders in the population over 14 years of age increased from 12.9% to 17.7%. Still, Germany has catch-up potential in the breadth of its equity culture compared to other countries. In the USA, for instance, almost 50% of the population owns shares, a percentage nearly four times as high as in Germany.

Number of shareholders in Germany (million)

	1997	1998	1999	H1 2000
Shareholders and fundholders	5.6	6.8	8.2	11.3
Shareholders	3.9	4.5	5.0	6.2

Source: German Institute for Share Promotion

Shareholders as a percentage of the population aged above 14

	1997	1998	1999	H1 2000
Shareholders and fundholders	8.9	10.7	12.9	17.7
Shareholders	6.2	7.1	7.8	9.8

Source: German Institute for Share Promotion

3.3.2. Equity investment remains on the advance

The trend towards investment in equities will probably endure in the years ahead. Shareholders will continue to become more numerous. Temporary setbacks in stock market performance should do little to change that. A poll by the Allensbach Institute from April 2000, conducted during the phase of disillusionment following the bull run of technology shares, reveals that the interest in equity investing has swelled continually since the initial public offering of Deutsche Telekom in 1996. Thirty-six percent of west Germans emphasised their interest in direct or indirect share ownership. In east Germany the retail following for equities grew from 11% in 1996 to 32% in 1999, a near-tripling.

Another reason to expect a continued deepening of the shareholder culture is the good growth outlook in Germany (about 3 1/4% in 2000 and 3.6% in 2001), Euroland (just under 4% in both years) and the USA (5 1/4% and 3 3/4%). This pace of economic activity will tend to lift corporate earnings.

The German tax reform too should be beneficial for share prices. It gives corporations not only lower tax rates but the opportunity to sell equity stakes tax-free, thus promoting structural transformation and growth of the economy. Further privatisations in Germany and Europe also create good entry opportunities in the stock market. The switch from the imputation system to the 50% dividends-received exemption will be good for the great majority of shareholders. The halving of the allowable deduction for capital gains similarly encourages investment in equities, as price gains can be realised tax-free after one year.

Along with continuing globalisation, the stepped-up use of the Internet in all areas of business and private life will lead to more extensive M&A activities and – in a departure from the past – will also inspire the forging of partnerships for cooperation on specific projects. This should regularly fuel speculation on stock markets.

Added to this is the need to strengthen corporate and private pension plans more in future. Above all, the necessary EU-level framework for Anglo-Saxon-style pension funds must be put in place as soon as possible. Equities, which have been shown to generate higher long-term returns than other financial assets (such as bonds), will feature prominently in building retirement provisions that complement the public pension system.

Weightings of 12-15% for direct investment in shares and 14-16% for mutual funds seem achievable in the next five years. These increases will continue to eat away at the practice of savings in the form of bank deposits. Investment in bonds as well should ease slightly. Saving via life insurance will increase only faintly.

3.4. The make-up of consumers' financial assets

The inroads being made by online banking and households' more return-conscious, risk-tolerant approach to investment are changing what customers need from banks. In banks' efforts to better position themselves in the new setting, information about the socio-demographic characteristics of households are a useful aid. Official statistics are lacking in this area, which leaves virtually only survey data as a source of information (such as the findings of Verbraucher Analyse VA 1999/1, on which the following information is based).

In west Germany, saving through equities is more widespread than in the eastern *Länder*, with 13 1/2% of the west German population holding equities directly or indirectly as fund units in 1998 vs. 8.5% in the east.

Sustained demand for shares

Tax reform strengthens stock market

Growing significance of retirement saving

Saving through equities more common in west Germany

By contrast, both regions of the country are about equal in terms of life insurance (share of just under 50%) and home loan and savings contracts (about 25%).

Almost 60% of equities and equity funds are held by men. The same split characterises the ownership of accounts at direct banks.

More than 45% of accounts at direct banks are held by the 30-49 age class. The group of 14- to 29-year-olds and the 50-64 age class each hold a good 20% of such accounts. In investment in equities and equity funds as well, the age group from 30 to 45 is dominant at around 45%. Close to 30% of such assets are owned by people aged 50-64.

Equities and equity funds are owned mainly by two- and three-person households. These vehicles are preferred especially by the self-employed and executives. With increasing household income, investment in equities grows more prominent. In households with a monthly net income of DEM 4,500 or more, shares are a significantly more important asset than bond holdings.

4. Internet lends wings to companies' capital market financing

The above-noted changes in the investment pattern of households go hand in hand with the altered financing behaviour of companies. In the past few years they have relied far more heavily on equity finance – best exemplified by the Neuer Markt – and on bond issues. The introduction of the euro and growing use of the Internet have heightened the transparency and competition in the financial markets, have lowered transaction costs and made securities-based financing attractive compared to credit financing. These developments have been facilitated by greater openness of the younger generation of entrepreneurs to publicity-grabbing capital market finance. Especially the young, innovative companies in communication technology and IT have spearheaded the further development of the German capital market. However, this process was also furthered by the elimination of currency barriers within EMU, which has widened the investor base for equity and bond finance by companies. Within Euroland, institutional as well as private investors have significantly diversified their activities across national borders and by sector.

The trend to disintermediation – the loosening of debtor-creditor relationships between companies and banks – and the attendant securitisation of corporate financing are intensified by the increasing use of the Internet for financial services. Not only is electronic trading of securities over the Internet already commonplace, but the notion of issuing equity and corporate bonds in virtual marketplaces is now well past the stage of a futuristic vision. The German financial market, expedited by the single currency and the ever-spreading use of the Internet for financial services, is thus evolving towards more-efficient capital market structures. This trend should prove long-lived.

While about 80% of corporate financing in the USA makes use of the capital market, the figure in Germany is below 40%. Germany thus has a long way to go before attaining similar efficiency as the US market. For the long term, this signifies much investment potential especially for retail customers investing in equities and possibly in bonds of German companies.

Biggest customer group for direct banks are 30-to 49-year-olds

Investor behaviour reflects change in financing mix

Internet reinforces trend to securitisation

5. Aside: structural changes in financial wealth formation in the USA

The very extended economic boom in the USA has had a profound influence on the growth in household income and wealth. Whereas incomes follow a fairly moderate uptrend, Americans' net worth grew strongly, particularly since the mid-nineties. But household indebtedness also rose, partly because of borrowing to buy shares or homes.

From 1992 to 1998 the average income of US households rose by an inflation-adjusted 16% to USD 53,100. In the years from 1995 to 1998 the share of American households earning USD 50,000 or more climbed by almost one-fifth to nearly 34% of all households. The self-employed and the relatively highly educated population groups were the biggest winners in this trend.

Income growth was far outstripped by the rate of wealth accumulation. This owes much to the performance of share prices. For example, the S&P 500 index has risen five-fold since 1991 to its present level of about 1500 points. From 1995 to 1998 alone the average net worth of households increased 26% to USD 282,500.

The decline in the savings rate in recent years to only 2% in 1999 is explained by the wealth effect. The wealth effect denotes the pattern of households considering the increase in their shareholdings as a substitute for savings and therefore stepping up their spending and borrowing. Accordingly the ratio of households' debt to their disposable incomes in 1999 for the first time reached the 100% mark, with per-capita debt mounting to a new high of USD 5,230. No comparable development was seen in Germany in the 1990s, partly because of the still far lower weighting of equities within financial assets.

Two trends in the USA over the past ten years are worth singling out. One is that the share of financial assets in households' total wealth rose from 30% in 1989 to slightly more than 40% in 1998, thanks above all to the powerful run-up of share prices.

The other important trend of the past decade is that within financial assets, the proportion of equities (whether held directly or indirectly in mutual funds, retirement accounts or other assets) has grown strongly, expanding much more quickly from 1989 to 1998 than in Germany. Over this period the weighting of these four forms of investment in the financial assets of all households combined increased from 53% to 73%.

Paralleling this trend, the share of US households owning any equities also went up steeply. Meanwhile investors clearly became less interested in bank deposits and bonds, much like in Germany.

The item "Total savings in equities" in the table comprises both direct equity holdings and indirect equity investments, especially in the form of mutual funds and retirement accounts. Directly or indirectly, nearly one-half of all US households already hold equities. The amounts managed in retirement accounts may be invested in almost any asset, ranging from equities and mutual funds, to bonds, to real estate.

Regarding the distribution of share ownership across the population, directly-held equities are highly concentrated in households at the upper end of the income scale. The top-earning 25% of families alone account for 96.9% of direct shareholdings. However, the absolute number of households owning equities (in direct or indirect form) also soared between 1989 and 1998, from 29.4 to 50.1 m.

In US boom, wealth has been growing more quickly than income

Share prices redouble increase in net worth

Fall in savings ratio is attributable to wealth effect

Equities make up a sharply increasing portion of financial assets

Almost 50% of US households already own equities

One-quarter of households own 97% of equities

Asset types as a percentage of total financial assets of US households (%)

Type of financial assets	1989	1992	1995	1998
Bank deposits and money market funds	29.3	25.6	19.7	15.7
Bonds	11.7	9.5	7.6	5.0
Equities	15.0	16.5	15.7	22.7
Mutual funds	5.3	7.7	12.7	12.5
Retirement accounts	21.5	25.5	27.9	27.5
Life insurance	6.0	6.0	7.2	6.4
Other	11.4	9.2	9.3	10.3
Memo: Financial assets as a percentage of total assets	30.4	31.5	36.6	40.6

Source: Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances, Federal Reserve Board Bulletin, January 2000.

Share of households holding the following financial assets (%)

Financial asset	1989	1992	1995	1998
Deposit accounts	19.9	16.7	14.3	15.3
Bonds	29.6	26.6	25.9	22.3
Equities	16.8	17.0	15.2	19.2
Mutual funds	7.2	10.4	12.3	16.5
Retirement accounts	35.6	38.1	43.0	48.0
Memo: Total savings in equities	31.6	36.8	40.4	48.9

Source: Household Portfolios in the United States, Federal Reserve Board of Governors (Finance and Economics Discussion Series), April 2000.

6. Target group of retail customers – structural changes in the Internet age

The growing importance of Internet and online banking – and the strengthened position of customers on the Internet – is also making banks pay closer attention to the changing composition of the target group of retail customers. Of special importance for banks is the business with high-net-worth individuals. These clients will be very valuable to retail banks even in the age of the Internet. Given its above-average earnings potential, this target group will thus continue to be courted intensively. In view of the rapidity with which the business world and society are changing in the Internet era, however, an exclusive focus on the affluent would be overly narrow. We will therefore begin by examining the structural changes in the group of wealthy private banking clients in Germany, then look at target group concepts that may do justice to the issues of Internet banking. Specifically, the discussion is based on target group analysis using the modern concept of “Sinus milieus”.

6.1. Target group of affluent individuals

The German market of high net worth clients has changed materially, as is shown by a Datamonitor study from March 2000. The number of affluent individuals (whom Datamonitor’s report defines as customers with financial assets of more than DEM 300,000) more than tripled during the period from 1992 to 1999, growing from 0.8 m to 2.6 m. The size of this group thus increased by almost 18% a year. Over the same period, its financial investments also multiplied more than threefold, from DEM 0.83 trillion to DEM 2.74 trillion. According to this study, affluent individuals own nearly 53% of the nation’s private monetary assets, although they represent only 4% of the population. Three important groups are distinguished: the “Elders,” the “Earners” and the “Heirs”.

The group of Elders accounts for the largest share, at 40%, followed by Earners (36%) and Heirs (24%). The strongest growth in financial assets was registered by Earners, at 23% p.a. This reflects the fact that the number of persons earning high incomes at a relatively young age has shot up by 20% per year since 1992. The same applies to the Heirs, who increased in number by 18% p.a. and whose financial wealth gained 19% annually.

Both groups demand good returns on their financial investments and to this end are willing to accept a certain level of calculable risk. They have high expectations, are cost-conscious and open to online banking. They frequently go online for information to help them manage their financial affairs, and they keep an eye on transaction costs.

In Datamonitor’s forecasts, the number and wealth of well-to-do private customers will continue to grow apace in the next few years. In an optimistic scenario that assumes continuing positive economic and stock market trends in the USA and Germany, the number of affluent private clients in Germany is forecast to pass 4 m in 2003; the affluent segment’s financial assets are predicted to rise to DEM 4.3 trillion. Even in a pessimistic scenario with level growth on both sides of the Atlantic and a sharp correction of stock markets, the number of affluent private customers is expected to grow to 3.3 m, while their financial assets are predicted to expand to DEM 3.4 trillion.

Number and wealth of affluent are increasing steeply

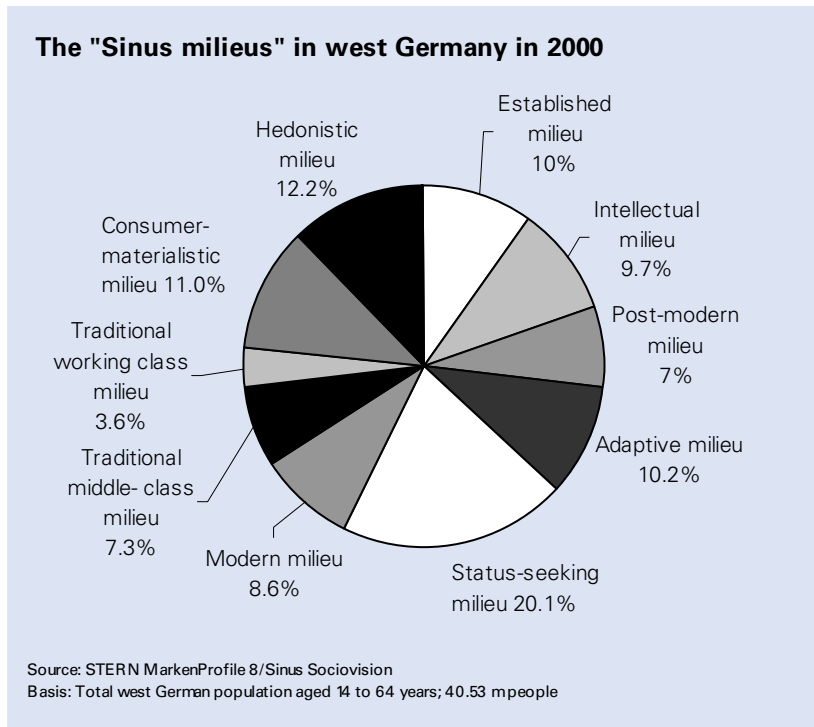
Three kinds of affluent customer

Return-oriented and receptive to online banking

Number of affluent continues to rise

6.2. "Sinus milieu" as a basis for defining target groups

In these times of runaway societal and technological change, traditional defining criteria of target groups, such as income, education and occupation, are no longer precise enough. Contributing to this imprecision in the case of online banking are rising expectations of customers and the growing intensity of competition. For the purpose of marketing online products, that makes it all the more important to develop a more discriminating target group strategy.



In Germany the concept of "Sinus milieu" has gained currency in marketing as a proven tool for the identification of optimal target groups. The delineation of target groups by this method is based on the analysis of "life environments"; or milieus. The term "Sinus" refers to the winding shape of the lines delineating such milieus on a cluster chart. "Sinus milieus" classify consumers by their outlook on life and their lifestyle. Milieu research captures all major spheres of everyday life – among them work, family, leisure and shopping – that shape the development of and changes in attitudes and behavioural patterns. The approach takes account of the basic orientation of people's values as well as desires, fears and expectations about the future. The chart above presents the "Sinus milieu" delineated for west Germany in 2000. The boundaries are updated annually by means of a broad-based sample of more than 10,000 respondents.

These milieus are crossed with the criterion of social position, which is determined by income and occupation and has the values "lower", "middle", and "upper" class with the middle class further divided into lower, middle and upper tier. This permits the description of a milieu landscape, in which milieus touch and overlap in places.

The management of a financial services company intending to launch a finance portal must decide according to its strategy which milieus are to form part of its target group. The results of the sample referred to

"Sinus milieu": a new marketing instrument

Strategy determines which milieus are targeted

above, published in the volume "MarkenProfile 8" of the Stern library, provide little support for these decisions, even if they supply some interesting (but not target-group-specific) data on, for example, affinity for and awareness of 25 named banks, direct banks and banking groups.

7. Online banking remains a growth market

Online and Internet banking for retail customers is a growth market in Germany and Europe. In no segment of the market is this more true than in direct brokerage, i.e. online- and Internet-based securities transactions. Not only is the German online banking market the largest in Europe, but it is also expected to expand at double-digit rates in the years ahead. About one-third of Europe's direct bank accounts and more than half of its securities accounts are held with German institutions.

The success of direct banks in Germany will continue to be driven by the securities business with retail customers. It should be boosted by the popularity of investment in equities and by the need for private retirement provision. In the fast-growing market of Internet banking, transparency is increased and customers become more exacting about top-quality service. The German retail customer is highly cost-oriented, which is expressed in the rising demand for online products. Customers are still relatively loyal to their principal banking address. Thus, according to a survey by GfK published in August 2000, only 1% of households changed banks last year and only 4% intend to switch in the next six months.

Considering this growth potential, it is unsurprising that a growing band of new providers want to tap this market. However, a handful of large established providers in Germany has more than three-quarters of the online banking market. Not only established financial services companies are vying for a share in the online and Internet market, but near-banks (such as credit card companies) and non-banks (software houses, for example) could attempt to set up shop, encouraged by low barriers to entry. Foreign providers from other European countries and the USA will also try to profit from this growth market. Competition is thus bound to escalate.

Against this backdrop, the German direct banks are striving to place their business on a wider footing. Increasingly this entails the strategy of also expanding into other European countries. As well, they want to fulfil customers' mounting expectations of more and inexpensive financial services in the investment and credit segments. Their product ranges thus include insurance products. One remarkable development is that the one or other branchless bank is feeling the need to "transcend" the Internet and seek personal contact with customers. As a case in point, Direkt Anlage Bank recently opened its first – small and low-cost – branches in department stores.

The trends described indicate that online and Internet banking via direct banks will remain a market in motion. In light of the strong demand we think the growth phase will persist for several more years before the market enters a stage of consolidation.

8. Finance portals – pursuing the rich potential of the Internet

More than a platform for the provision of financial services, the Internet also offers a near-infinite wealth of economic and stock market information and investment opportunities. For bank customers this abundance of information and service offerings can turn into information

Double-digit growth rates

Internet raises customers' expectations

New providers push into market

Direct banks enlarge their offerings

Finance portals serve as a compass

overload, a maze in which they may lose their bearings. This is where the concept of the finance portal, or open finance, comes into its own. The finance portal offers the customer convenient, organised overviews of the products, terms and prices available in the market at any one time. Finance portals – and herein lies their true novelty – offer not only the products of their parent financial services firm but also those of outside providers. This creates transparency. The retail customer can comparison-shop and make decisions on a very well-informed basis.

8.1. High demand is forecast

Small wonder, then, that an analysis recently presented by Forrester Research (“Open finance storms Europe”) shows the financial portal concept to be highly popular with retail customers in Europe. To date the market for finance portals is still at the orientation stage as banks, brokerages and insurance companies test different business models on their customers. A survey of 40 financial services companies conducted for the Forrester study concludes that the concept of open finance will require until 2003 to become firmly entrenched in the markets as a sales and service channel. The report predicts that the established financial institutions will dominate this market.

What are the opportunities and risks of open finance, and what are the obstacles to its swift implementation? Surprisingly, the Forrester report forecasts a three-year establishment period for this market, which in the Internet is a long time indeed. In our view, the market should be firmly rooted within the next one to two years. Many finance portals have already set up on the Web since last year, most of them small, little-known or new firms (e.g. the comparison portal E-LOAN). These providers concentrate on bringing together customers and providers of third-party financial services, not on offering their own products.

Creating a finance portals thus involves, as so often in e-commerce, the redefinition of value chains. Finance portals can be positioned as intermediaries for the providers of financial products, or focus on production and distribution of their own products, or sell both proprietary and third-party products. While the first option poses no great difficulty according to the experience to date, the incumbents among Europe’s financial services companies are far behind in their readiness to sell financial products of third parties.

8.2. Objections to inclusion of outside products don’t stand up to scrutiny

The Forrester report on open finance relates incumbent providers’ stated concern that by helping distribute third-party financial products, their (lower-quality or higher-priced) proprietary products would be cannibalised. Incumbents also argued that the quality of outside products cannot be judged with confidence and that these products therefore cannot be marketed aggressively. Here the temptation for the finance portal’s owner is to offer only those third-party products which are inferior to the proprietary offering and which therefore would not threaten proprietary sales. A not insignificant hurdle is also seen in the required adaptation of legacy IT systems that are geared only to proprietary products.

However, in the competitive environment of the Internet, these objections are near-sighted. The transparency created by the World Wide Web strengthens the position of customers. Based on the results of the Forrester study, demand from customers is likely to be very strong. Consumers want only high-quality products. If a financial services

Open finance is still getting oriented

Market will be established before long

Misgivings about selling third-party products

Proactive distribution creates customer loyalty

company does not offer the best proprietary and third-party products, it risks losing the customer altogether. The risk of cannibalisation of the firm's own products cannot be met by attempting to shut out competing products. Instead, it must be handled proactively. The two basic choices are to offer customers a high-quality range or to risk losing them. The hurdles mentioned above must therefore be overcome quickly – and they certainly are surmountable. For most incumbent financial services companies, however, adding third-party products to their range would mean venturing into uncharted territory.

In all likelihood, several providers of finance portals will pursue a Europe-wide strategy in order to reap the scale economies of distribution in the single-currency market. Naturally, the design of finance portals must take into account national differences in the wants of retail customers and in the terms of back-office settlement.

8.3. Customers drive product range

An all-important question to answer is what products should be offered in finance portals. This is for the market to decide – in other words, the customer, who in Germany is particularly cost-conscious and looks for quality products at bargain prices. From a finance portal the customer expects a comprehensive product range, taking for granted the inclusion of third-party products. For established financial services companies, the Forrester report considers the adoption of outside products especially likely where a product is not manufactured in-house (insurance, for example); where a third party offers an investment product with above-average performance (such as specific mutual funds); or where the outside product offers more favourable terms (e.g. in the case of mortgages).

The portal provider's task is to ascertain the customer's requirements in the way of information and advice, and determine the extent to which these needs can be satisfied via the Internet. Customised financing and investment solutions can be initiated on the finance portal by directing the visitor to in-house advisory resources. In this case, the finance portal thus does not make personal advice for customers superfluous. When it comes to seeking financial advice, clients' trust in their bank, i.e. in its brand, is indispensable. This also explains the conclusion of the Forrester report that established financial services companies will dominate the market for open finance in future.

8.4. Finance portals create opportunities to innovate

Finally, we need to ask to what degree finance portals can be used to devise and mobilise new, innovative distribution channels. Without a doubt, the inclusion of outside products in finance portals can do much to expedite such new developments. This inclusiveness enables financial services companies on the Internet to offer customers tailored, comprehensive solutions for liquidity and asset management that optimise returns. In view of the trend to monetary wealth formation in Germany described above, there is still considerable potential for assets to be shifted into higher-earning investments. This is also demonstrated by developments in the USA, where the equity component is significantly larger still. Comprehensiveness of solutions would also mean giving customers tools that let them integrate bank and securities accounts held at other institutions into their liquidity and asset management and thus remain abreast of their financial situation at any time.

Customers expect first-rate products

In finance portals too, advice is very important

More efficient management of customers' finances

The critical question here is what technical and organisational structures are needed to be able to offer customers such a service. What is certain is that customers' trust in the security of online banking is an important factor. Equally important is their confidence in the integrity and independence of the providers of such services. The brand of an established financial services company vouches for its trustworthiness. By independence we also mean that the management of such a finance portal should be legally, organisationally and technically autonomous. In effect, the finance portal needs to be spun off by the incumbent financial services provider and market itself under a new brand name.

What will customers expect from their online banking partner in future and what conclusions can be drawn from it about the opportunities awaiting finance portals? In wake of the generational change the trend persists towards the self-sufficient investor conscious of costs and returns who is open to Internet banking and places high demands on his bank both online and – in the case of advice-intensive investing or financing needs – at the branch in face-to-face advisory meetings. If we extrapolate from the surveys about the penetration of online banking, this tendency should exist in virtually all categories of retail customer. The Datamonitor report quoted above has shown that this also applies to private banking clients in Germany.

8.5. USA: customers seek combination of online banking and advice

This is also concluded in a publication by Forrester Research about the market of private banking customers in the USA. The report distinguishes three types of private customers: the *delegator*, who delegates all his asset management to a professional; the *validator*, who places his assets in charge of a professional manager but contributes his own ideas and takes an active part in asset management; and the *soloist*, who, drawing on research found on the Internet and elsewhere, manages his assets himself. The forecast of Forrester Research: the share of delegators in the US market will decline from 50% in 1999 to 30% in 2004. Over the same period, validators are to increase from 40% to 55% and soloists from 10% to 15%. A core message of Forrester's findings is that those financial services companies which focus on the growing segment of validators have the best marketing opportunities.

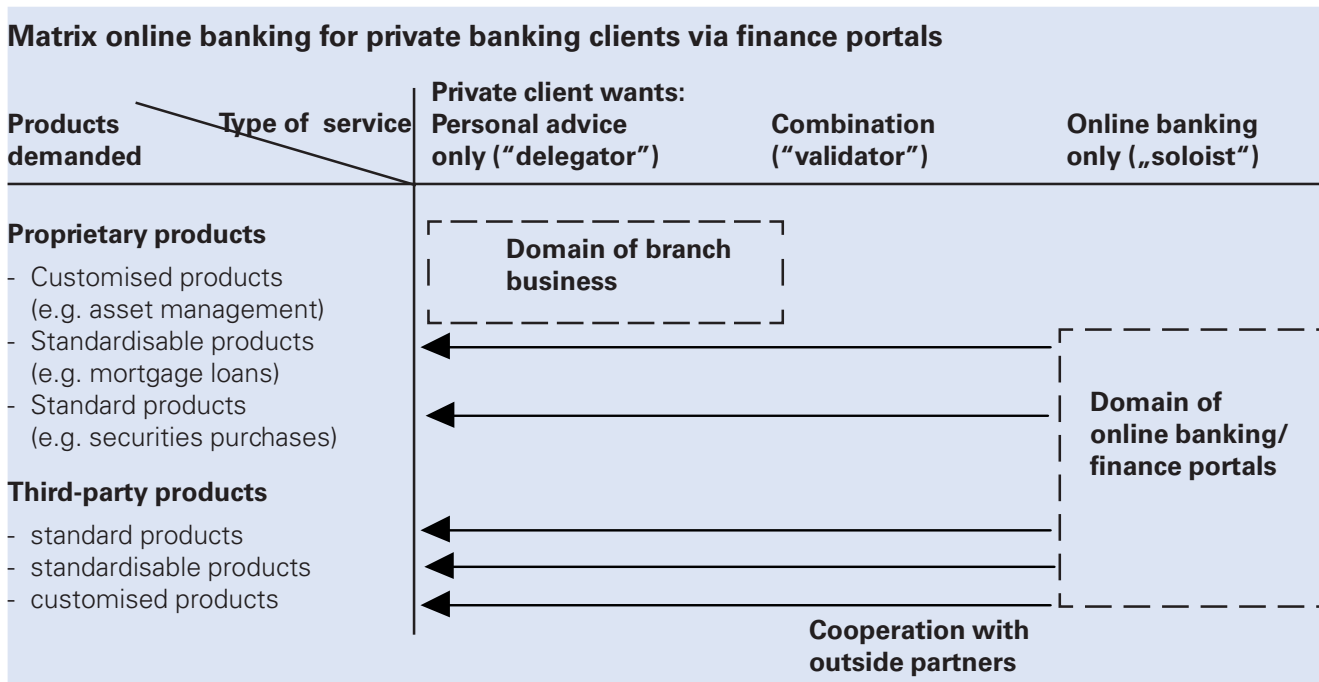
8.6. Market segments for finance portals

This three-way segmentation has been applied to the matrix "Online banking for retail customers via finance portals" in order to illustrate the future market potential of finance portals. The domain of branch business relinquishes the category of standard products to online banking, and branches' mandate for standardisable products is under threat. Bank branches are not involved in the sale of third-party products. The finance portal addresses all customer needs except for tailor-made solutions. Many banks offer only two mutually exclusive alternatives without a middle way: online banking or full-service branch banking. Yet such an either-or approach is more and more out of place as customers become increasingly empowered by the Internet. The gap between discount service and full service outlet can be filled by finance portals. In the matrix the direction in which finance portals' role is expanding is indicated by arrows. Through finance portals, customers can have a broad range of proprietary and third-party products at their fingertips.

Established brand name strengthens starting position

High net worth customers in the USA increasingly bank via Internet

Finance portals fill gaps between full-service and discount providers



Better yet, finance portals offer consumers different tiers of service intensity: a given customer can retrieve the precise products online which he needs to manage his financial affairs on his own. However, finance portals must also give the Internet-wise customer the option of choosing combinations of online banking products and advice. In other words, finance portals will also have to provide advisory services if they are to succeed in the market. Ensuring efficient delivery of advice as a finance portal will mean making available online a range of well-organised information resources and recommendations for courses of action. This includes the following:

- proprietary and outside research, which may involve a link to a research portal offering a good overview of recommendations in the market. To formulate investment recommendations it is important to know the customer’s investment profile. The investment advice offered by the portal operator is based on criteria – agreed with the customer – relating to returns, risk, and liquidity. Recommendations to portal users also take into account external ratings of products, such as of the performance of mutual funds.
- provision of software that assists in comparison-shopping for financial services (comparison tools) in order to give customers good decision support. This software must be made available for all product groups and services relevant to the specific needs of the individual customer.
- direction to a qualified call centre that is ready to provide technical support for using the online functions of the portal or that refers the customer to a comprehensive solution in the form of expert personal advice.

The launches of finance portals and the inclusion of proprietary and third-party products in companies’ ranges of financial services and information will give rise to new value chains and bank structures. As the production and sale of financial services via finance portals will typically involve a host of partners and specialists, high demands will

Tiered service

Research and investment advice

Comparison tools

Call centres

Growing demands on cooperation management

be placed on cooperation management. Finance portals promise a suspenseful process of “creative destruction” in the sense contemplated by Schumpeter.

9. Finance portals: Reducing inefficiencies in customers’ portfolio structure

The operators of finance portals offer consumers a selection of the products on the market at any given time. As portals compete with one another, they will focus on those products offering customers the most value for money. For customers, the transparency of the market rises and choosing the best alternative is simplified. Portals may also offer model portfolios representing the specific mix of investments optimal for a customer’s particular set of preferences (such as growth- or income-orientation). The combination of high transparency and lower transaction costs on the Internet represents ideal conditions for finding inefficiencies in customers’ portfolio structures and switching into more attractive investment instruments as appropriate. This has both a microeconomic and a macroeconomic dimension.

On the customer side, the portfolio structure can be improved, for instance, when low-yielding financial investments can be reallocated to vehicles that pay higher returns without involving higher risk. A simple example would be the liquidation of demand or savings deposits in favour of government bonds or comparable instruments, such as mortgage bonds. Higher returns can also be achieved by accepting higher risk, notably by increasing a portfolio’s equity component.

Since, as we have mentioned, about one-third of monetary wealth in Germany is held in bank deposits, higher returns and – macroeconomically speaking – a more efficient allocation of assets can be achieved by switching some of these deposits into securities holdings. Finance portals could be used for the gradual conversion of the portion of bank deposits not required in the form of cash.

In other product and service segments as well, such as account management or mortgage loans, finance portals can uncover inefficiencies in a customer’s financial arrangements. Thus, for a customer with accounts at several banks, a finance portal could be used to set up cash management, i.e. for instance to juggle credit balances and overdrafts in a way that best takes advantage of interest rates. Another possible example is that of a customer taking out a new mortgage or renewing a mortgage. Using the finance portal, he can identify the lowest mortgage rates in the market and thus obtain the best terms available.

10. Online banking changes banks’ structure

The wider use of e-banking will have far-reaching consequences for the banking landscape in Germany. Standardised bank services and those capable of standardisation are increasingly being shifted from branches to online banking divisions. The advances in information technology are thus an engine of structural change in the German banking sector. As it is, Germany is still overbanked by international standards, with one bank branch for every 1,725 Germans, compared, for example, to 2,740 per bank in the USA and 2,110 in France. The process of consolidation which since the early 1990s has reduced the number of banks by a quarter to just over 3,100 will accelerate. The number of branches, which at the end of 1999 stood at 47,600 (excluding Postbank), should decline sharply, by an estimated 20-30% by mid-decade. The familiar neighbourhood branches will soon be thinner on the ground.

Finance portals expose inefficiencies

Higher yield through portfolio shifts

More efficient allocation

Customers benefit

Online banking hastens industry consolidation

But this will not compromise the supply of banking services. To the contrary: customers will have a multi-channel bank at their disposal. Online, they can contact their bank at absolutely any time and choose the services they wish. As this consolidation process unfolds and online banking is rolled out further, the core business of bank branches will increasingly migrate towards delivering advice-intensive products and customised solutions for investment and financing.

During the growth phase of the online banking market, new competitors from other European countries and the USA are apt to be drawn to Germany, initially swelling the number of providers in the German market. New entrants will probably have to make do with a small market share. Providers with established brands will fare better, if they harness the potential of the new technologies and distribution channels. In spite of the growing number of customers and transactions, the more intense price competition hangs over the earnings situation of many competitors like Damocles' sword. In a few years we should therefore witness a consolidation stage of mergers and acquisitions.

11. Mobile banking: distribution channel with a bright future

Mobile phone users as well could become attractive Internet banking customers. The ability to retrieve financial market data no matter where the user is located, and thus to react instantly by buying or selling securities on the move, represents high additional customer benefit. Optimists expect that by 2005, there will already be more WAP-capable cell phones than personal computers connected to the Internet, thus upstaging the PC as the Internet terminal of choice.

At present mobile access to the Net still suffers from slow data transfer and low transmission capacity. The introduction of GPRS standards (General Packet Radio Service) makes improvements to these bottlenecks and thus creates the basis for more complete customer service. And the UMTS (Universal Mobile Telecommunications System) wireless standard available from 2002 will enhance the attractiveness of mobile banking still more. In addition to largely text-based offerings, providers can then also make more-complex services with charts and pictures available to mobile customers. An advantage for customers is that, starting with the launch of GPRS, they will be billed for mobile phone Internet usage not on the basis of transmission time but of the amount of data transmitted. Call length in itself will thus be a threat to budgets no longer.

The forecasts for the spread of mobile telephony and of mobile Internet access in Germany are grounds for optimism: mobile penetration in Germany should pass the 50% mark in 2003. By then some 25 m Germans could own an Internet-ready WAP mobile phone and thus be potential users of Internet banking products. According to a report published by Durlacher Research Ltd., mobile commerce (m-commerce) revenues in Europe will mount from DEM 630 m in 1998 to more than DEM 45 bn in 2003. With a share of 20%, Germany, like Britain (15%) and Italy (19%), is likely to become one of the largest m-commerce markets in Europe. By 2003 financial services could make up a good 20% of mobile commerce revenues and thus become one of the most attractive product groups sold through the wireless channel. The coming-on-stream of faster connections between cell phones and the Internet will add buoyancy for network-based financial services.

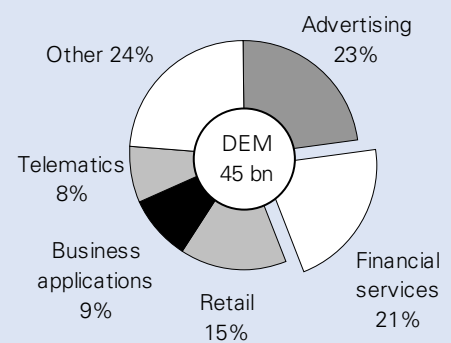
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Supply of banking services improved

New entrants face an uphill battle

WAP stands for Wireless Application Protocol. This technical standard forms the interface of Internet and mobile communication. It permits mobile surfing on the Internet by cell phone. For this, the user needs a special WAP-ready wireless device. The code language used is WML (Wireless Markup Language). Graphics are produced using the WBMP (Wireless Bitmap) format.

M-commerce in Europe in 2003



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