Do you use the Internet to bank online? If you do, you live in one of the 33% of U.S. households that report that they have used online banking in 2005. Today, about ten years after banks first began to offer online banking, most American consumers still prefer their branch bank to their computer. That spells trouble, particularly for firms that are attempting to break the mold by offering Internet-only banking.

Pure online banks can offer customers a compelling value proposition: 24/7 access, better interest rates (because they operate more efficiently, they can pass along the savings to customers), direct control of accounts, banking anywhere there is an Internet connection, and no waiting in customer lines or even driving to a bank. A traditional bank spends on average $1.07 to process a transaction, whereas an online bank can perform the transaction for 1 cent. Moreover, while human-based support calls cost banks $10–$33, a Web-based self-service session typically costs about $1. However, despite the advantage of having up to a 50% lower general and administrative cost structure, many financial service sector executives believe that the Internet-only banking business model does not work. Why not?

While the online banking market is growing, most customers have moved online primarily through the online offerings of their traditional offline bank that can provide both a physical branch structure, with human advisors, tellers, and account managers, as well as an online presence where transactions can be consummated more efficiently. According to the Online Banking Report, less than 3% of U.S. households currently have an account at an online-only bank, and online-only banks hold less than 1% of U.S. deposits. One of the primary challenges facing pure online banks is overcoming the reluctance of the American public to give up their local branch bank relationships. In addition, pure online banks also face expensive customer acquisition costs, stiff competition from existing full-service banks and other financial institutions that offer a wide range of services, and a weak base of mortgages or other debt assets from which they can derive fees.

NetBank FSB, the first federally insured Internet-only bank in the United States, is one of the few pure online banks successfully facing those challenges.
Formed in 1996, and now a wholly-owned subsidiary of financial services company NetBank, Inc., NetBank currently has over 270,000 accounts throughout the United States and 80 foreign countries (and $4.7 billion in total assets), making it the largest branchless bank in the United States. It offers its customers a full line of banking services, from checking and savings accounts, to mortgages and auto loans, credit cards, online brokerage, insurance, IRAs, and online bill payment. NetBank does not maintain physical bank branches. Its lower cost structure enables it to offer customers benefits that most traditional banks, with their higher costs, cannot match, such as higher interest on savings accounts and free checking. According to NetBank, passing along cost savings to its customers in the form of higher deposit rates and better technology is a cornerstone of its value proposition. NetBank has also developed or acquired a diverse group of complementary financial services businesses that leverage technology for more efficient and cost-effective delivery of services, including a retail mortgage company, a provider of ATM and merchant processing services for retail and other non-bank businesses, and a wholesale non-conforming mortgage provider. NetBank earned a record $50.5 million in net income in 2003. In 2004, NetBank’s retail banking segment continued to perform well, but overall results declined steeply to $4.2 million due to problems with its mortgage brokerage business.

As noted previously, a pure online bank such as NetBank faces significant competition. Most, if not all, traditional banks now offer online banking. It has been much easier for established full-service banks to develop an online presence than it has been for pure online banks to develop the physical infrastructure that many customers demand from banks. In addition, online financial services firms such as E*Trade and Juniper have also successfully moved into online banking, and in many cases are developing their own networks of kiosks and investment centers around the country.

To counter the growth of its traditional land-based but online competitors such as Citigroup and Bank of New York, NetBank has expanded into mortgages, insurance, and other banking services while continuing to add online services and benefits. NetBank’s continued growth—like that of most other pure Internet financial services firms—also increasingly depends on developing a physical presence in neighborhoods across the United States, in addition to an aggressive expansion program in online ventures. For instance, NetBank has developed a relationship with the major ATM networks so that its customers can withdraw cash from over 8,000 ATMs around the country. However, prior to 2005, NetBank customers could only deposit funds via electronic funds transfer (such as payroll checks) or by mail. In 2005, however, NetBank struck a deal with UPS that allows UPS staff to take deposits, enabling them to be posted to customers’ accounts within no more than a day or two. The service now accounts for over 30% of NetBank’s deposits, and in effect has turned UPS’s 3,900 stores into NetBank branch banks at less than the cost of opening a single branch of its own. Depositing funds into online banks should also become even easier within the next several years as ATMs that take in checks, convert them into digital images, and send those images wherever they need to be processed and posted, become more common.

During the next several years, NetBank hopes to double the number of its banking customers from 270,000 to 500,000. Initiatives such as its joint venture with UPS should go a long way to helping it reach that goal.
SHOULD YOU AGGREGATE AND HAVE YOUR SCREENS SCRAPED?

Account aggregation allows you to see all of the financial relationships you have—all your current balances and all account transaction details—in one place. The service is so popular that as of May 2005, over 5 million online consumers had signed up for Yodlee's free account aggregation service—either at the Yodlee site or at one of the many financial services firms that license the software from Yodlee. Account aggregation is now offered by Schwab, Fidelity, Morgan Stanley, and JP Morgan Chase, along with many other online banks and financial portal sites. In fact, more than one-third of people who use account aggregation in the United States obtain their account aggregation services from Internet portals such as Yahoo Finance, AOL, and MSN Money. This has significant implications for traditional financial institutions who are competing for the same customers.

Account aggregation relies on a variety of techniques to help customers aggregate their account information. Web site extraction, or "screen scraping," uses a software program that intercepts messages sent to a display terminal, converts the messages to a Windows-readable format, and displays the information on a PC. This type of screen scraper uses HTML to pull information from one Web site and display it on another. Direct XML transfers (direct feeds) are a newer alternative to screen scraping. Yodlee reportedly uses this method to gather over 40% of the data it aggregates. With a direct XML feed, the aggregation vendor can use industry-wide standards established by Open Financial Exchange (OFX) to obtain the data directly from financial institutions.

Here's how account aggregating typically works. First, you must register at a site offering account aggregation services (call it the "account aggregator"). Then you must give the account aggregator the login name and password of a Web site you want to aggregate. The account aggregator passes that information along to an aggregation service such as Yodlee's. These services actually do the data mining for your information, and then pass the information back to your account aggregator for display.

Done right, account aggregation can deliver a new level of time saving and convenience. Account aggregation allows you to store information from all of your online accounts on one Web site. This could include savings, checking, mortgage, credit cards, personal loans, airline hotel award programs, and even supermarket award programs.

But account aggregation has its pitfalls as well. Screen scraping is a low-tech, high-maintenance method of gathering information that is prone to errors and difficult to update, and it often requires special programming for each site. Direct XML transfers are the technology of the future, but experience is still thin and contributing institutions lose control over how their information is used by the aggregator.

Moreover, using an account aggregator gives your financial information to the aggregator. What if the aggregator goes bankrupt and sells the data as an asset? Although account aggregators provide a banking-like function, the aggregation is totally unregulated. There are no laws protecting your information. One of the biggest issues appears to be trusting aggregators with your account information. What if someone—such as a disgruntled employee—breaks into the aggregator's site and drains your account? Traditionally, banks and brokerages perform these information (continue)
account of all account to an account or your on back deliver mingle. Informa- tion Web ecking, rine or market falls as mainte- that is and it each site. r of the n and er how ir. or gives agator. id sells account nction, are no of the gators’ account as a aggregation. on, ration. continued.

Custodial roles, and can be held legally accountable through federal and state statutes should they make mistakes. However, account aggregator services are not subject to the same scrutiny or legal standards as banks or brokerage firms.

The introduction of more stringent authentication solutions for online financial information has created additional issues that account aggregation services must deal with. Forrester Research predicted in June 2005 that the introduction of two-factor authentication solutions (ones which include an additional authentication factor, such as a hardware token with a numeric access code that changes every minute, or a one-time-use passkey, in addition to the typical user name and password requirements) would be the “death knell” for account aggregation services as they are currently implemented, due to incompatibility issues. However, Yodlee has moved quickly to address this issue by entering into strategic alliances with firms such as PassMark and RSA that will enable Yodlee to help ensure compatibility of its aggregation applications with two-factor authentication solutions.

Lukewarm consumer response is perhaps a more difficult hurdle for account aggregation services to overcome. In the period between 2000–2003, there were a number of extremely optimistic predictions about the increase in the use of account aggregation services in the coming years. For example, U.S. Bancorp Piper Jaffrey believed that account aggregation users would rise to 50 million by 2005; Morgan Stanley predicted about 22 million users by the end of 2003, and Celent Communications projected 19 million. It is now clear that these growth projections were off the mark. Yodlee, by far the biggest aggregator, currently claims somewhere between 5–6 million users. Forrester notes that account aggregation has not been widely adopted, and in November 2005, Wells Fargo announced that it was discontinuing its free account aggregation service in February 2006 due to poor customer usage.

But despite account aggregation’s slower than expected start, reports of its demise may be somewhat premature. Many still believe that account aggregation, while still in its early stages, is nevertheless a great “enabler,” providing a platform from which to launch new services. And that’s exactly the approach being taken by Yodlee, which characterizes aggregation as a platform to “turbo-charge” bill payment, presentment, funds transfer, and other applications that are at the heart of consumers’ online financial activities.


applied for a mortgage during the previous 12 months, compared to only 1% in 2000 (eMarketer, Inc., 2005d). Although online mortgage originations currently represent a small percentage of all mortgages, their number is expected to continue to grow slowly but surely over the next several years (see Figure 11.4).
INSIGHT

TURF WARS—ANTITRUST AND THE ONLINE REAL ESTATE MARKET

The promise of e-commerce is that it would create a fair, level playing field where thousands of suppliers and millions of consumers could negotiate prices and terms in a very efficient marketplace. These electronic markets would be more efficient in part because intermediaries—the distributors, wholesalers, and agents—would be eliminated by direct commerce between sellers and buyers.

Although these outcomes may have occurred in some e-commerce sectors, in many other sectors we see the emergence of oligopolies—near monopolies—characterized by three or four giant firms, or an even smaller number. Instead of disintermediation, e-commerce sometimes can cause a strengthening of existing intermediaries through exclusive market relationships. At times, the level of concentrated power and collusion online can become so strong that government agencies such as the U.S. Department of Justice and the Federal Trade Commission get involved.

Consider Homestore, Inc. Homestore operates Realtor.com, the official site of the National Association of Realtors (NAR), which lists more than 2 million homes based on exclusive agreements with over 900 local trade associations called Multiple Listing Services (MLSs) that represent over 1.1 million real estate agents. In addition, Homestore’s Rentnet.com includes more than 40,000 properties, representing approximately 5.5 million apartment units in more than 5,500 cities nationwide, and its Homebuilder.com offers information on more than 66,000 new and model homes for sale in over 6,500 new home communities and planned developments in the United States. Collectively, the various Homestore Web sites attract about 9 million unique visitors a month. Homestore is the exclusive provider of national property listings for AOL, MSN, Netscape, CompuServe, and Digital City and the exclusive provider of new homes and apartments listings for Yahoo. Other significant portal relationships for the Homestore network include The Excite Network, iWon.com, Internet Broadcast Systems, and its Web sites for 61 local network affiliated TV stations, and United Online through its NetZero and Juno brands.

In April 2000, the Department of Justice opened an investigation into Homestore, Realtor.com, and the NAR. At issue were the exclusive agreements that Homestore had with the NAR and the potential it had to monopolize online MLS listings. In February 2001, Homestore eliminated its largest competitor by purchasing Cendant’s Move.com. The Move.com acquisition gave Homestore access to more than 25% of the industry’s brokers and transactions, and enabled Homestore to tap into more than 200,000 local real estate agents. Perhaps the biggest jewel in the Move.com purchase was a 40-year exclusive listing agreement with Century 21, Coldwell Banker, and ERA, three of Cendant’s prized national franchises, as well as 7-year exclusive listing pacts with the nation’s largest rental market brokers (NRT and Rent.net). This meant that Homestore.com now had exclusive access to three of the largest bricks-and-mortar real estate firm listings in the United States. The Move.com deal also raised antitrust issues because it allegedly had the potential to give Homestore control of up to 90% of all online real estate listings. Homestore executives argued they had not violated antitrust laws or “restrained trade” in any way, but they had simply been successful in growing quite large. Industry experts argued that competitor sites could obtain local listings from sources other than local MLS agencies. For instance, competitors could obtain listings from local newspapers, although this

(continued)
clearly would not be as efficient as having access to local MLS listings. The Department of Justice apparently was swayed by these arguments because in July 2001, it ended its inquiry into Homestore without comment.

However, that did not end government interest in the issue of competition in the real estate market. In March 2005, the Department of Justice filed a complaint against the Kentucky Real Estate Commission, arguing that local rules prohibiting brokers from giving consumers rebates on real estate commissions (a key strategy for online real estate brokers such as Zillow.com and RealEstate.com) violated antitrust laws. The Department of Justice next focused on policies adopted by the NAR governing the Internet display of MLS listings. In September 2005, it filed an antitrust complaint alleging that the policies put Web-based brokerages at a competitive disadvantage vis-à-vis traditional brokers. The complaint claimed that provisions in the policy that enable brokers to unilaterally withhold their MLS listings from display on competitors’ Web sites (known as a “blanket opt-out”), yet at the same time allow those listings to appear on Realtor.com, violated antitrust laws. According to the Department of Justice, the policy allows traditional brokers to block their competitors’ customers from having full online access to all MLS listings, a critical component in the ability of a broker to effectively compete. In the government’s view, the policy enables brokers to discriminate against other brokers based on their usage of new technologies and business models, denying them the benefits of MLS membership available to traditional brokers; discourages competition on price and quality; and deprives consumers of benefits that would flow from new ways of competing. The move by the Department of Justice was, not surprisingly, applauded by discount and non-traditional real estate firms. In response to the suit, the NAR announced that it strongly backed its policies and had no intention of settling. It asserted that the suit mischaracterized the purpose and effect of the “blanket opt-out,” which it claimed was merely intended to protect brokers’ ownership rights in their property listings.

It’s unclear how long the NAR and its local members can maintain their stranglehold on MLSs, and thereby maintain the 6% commission. Undoubtedly, Craigslist.com (partially owned by eBay) and Google have their eyes on the $60 billion in annual commissions generated by traditional real estate agents. Alternatively, the future may be exemplified by firms such as FsboMadison.com, one of the largest for-sale-by-owner sites in the country, and which currently has a 20% share of the Dane County, Wisconsin market for real estate listings. The site charges just $150 to list a home, and provides a yard “For Sale” sign to boot. Lawyers are now offering advertisements to conduct a house closing for a fixed fee of $600. Consumers who in the past may have been frightened about the prospect of conducting a large transaction without a professional real estate agent holding their hand are now more confident they can do it themselves or with minimal help. Sellers, turned off by the huge 6% commissions of traditional agents, are also more confident they know how much to charge for their home. The technology for setting up a database with pictures and prices is now commonplace and inexpensive. Together, all of these factors may ultimately make it impossible for the NAR to continue to conduct business as it has in the past.

ZIPCARS

How would you like to have all the functionality of a car but not have to deal with any of the headaches typically associated with ownership of a car, such as maintenance and insurance, or even with the rental of a car from a traditional car rental agency that requires that you go to an office, stand in line, and fill out papers in order to rent, and that mandates a minimum rental period of at least one day?

This might sound like an impossible dream, but it's not. In the late 1990s, a new business model for renting cars was imported from Europe by a group of environmentally conscious entrepreneurs that leverages the power of the Web to make the dream a reality. Today, in the United States, two companies, Zipcar and Flexcar, are using this model in their way towards sustained growth.

Zipcar began in 1999 with a few hundred members and 25 cars in Cambridge, Massachusetts. Members could pick up cars at any one of several parking spots around the city, use them for as long as they wanted, and then return them to the same parking spot. By 2005, Zipcar had grown to 700 cars, and 50,000 members paying $35 a year, expanded to include Boston, New York, Washington D.C., and San Francisco, and achieved revenue of around $15 million. In the process, it now offers more than 20 different car makes and models, in addition to its trademark little green VW Beetle.

In order to make the business work, Zipcar uses a lot of technology and tries to reduce the human-customer contact as much as possible to keep expenses low. Here's how it works. Customers pay an annual subscription fee and are issued a Zipcar card. Customers go online or call an automated central number to reserve a car for $8.50 an hour. Once a car is rented, a central computer activates the car's key card entry system to permit a specific user to enter the car and start the engine. Customers return cars to the same locations and their credit cards are billed. Using wireless technology, the Internet, and automated voice recognition software at each city's central office, Zipcar is able to keep costs very low.

Zipcar and Flexcar, its competitor on the West Coast, are supported by city governments looking for ways to discourage car ownership, and encourage car sharing, to reduce pollution and congestion. However, whether or not hourly car rental services can expand beyond a few large cities remains to be seen. The idea might not work as well in the suburbs, because customers would have to drive a car to find a car rental. On the other hand, Zipcar and Flexcar are planning expansions to Chicago, Philadelphia, Seattle, Atlanta, Austin, and New York City. For concentrated urban areas, hourly car rentals may be a viable complement to urban mass transit systems for those situations where you need a car for a few hours, but not a week, month, or a year.