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

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

**Internet-only-banking**

When banks began to allow account details to be viewed online, the service was seen as merely another method to reduce teller and branch costs. However, advances on that technology have altered traditional business thinking and existing banks have found themselves competing with newcomers that operate in a new and different context. First-e (http://www.first-e.com), headquartered in Ireland, is the largest Internet-based bank in Europe. Although the company began with a physical infrastructure, it is now an Internet-only service, able to offer its products around the world.

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

First-e’s business model is built on a multi-tiered strategy using multi-channel distribution to improve customer service and expand business reach. Early in its operations, the company created a specialist banking arm, Factor-e, to provide technology services to other banks that have difficulty building efficient operations. This hedges against online competition by placing Factor-e in a position to benefit from other (potential competitor) online
services, such as Payme.com, eMoneyMail
logs on to the service’s site to claim the
account, then e-mails the recipient, who
from the payer’s credit card or cheque
allow anyone to send money to other
Person-to-person payment (P2P) services
Person-to-person payments

E*Trade’s integrated financial services
The impact on E*Trade is to create a highly
disclaimer at the borders.
from bank to broker with only a small
successfully achieved a smooth transition
Securities Inc.). E*Trade’s website has
companies (E*Trade Bank and E*Trade
that they are technically held in separate
bank and broking accounts, despite the fact
The aim of the merger is the integration of
banking institution Telebank in December
agreement with the Arlington-based virtual
banking institution in December 1999, a new inflection point was reached in
the history of online financial services. No
longer were the barriers between broking
and banking services distinguishable.
E*Trade created a subsidiary company,
E*Trade Bank, which offers branchless
banking through the low-cost direct-delivery
channels of Internet, telephone, fax,
automatic teller machines and mail.

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

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

Person-to-person payments
Person-to-person payment (P2P) services
allow anyone to send money to other
individuals online. The concept is simple yet
extremely useful. The P2P service taps funds
from the payer’s credit card or cheque
account, then e-mails the recipient, who
logs on to the service’s site to claim the
funds. A number of operators offer P2P
services, such as payme.com, eMoneyMail
and eCount; however, the most popular
service is called PayPal, operated by a
privately held US company, X.com.

PayPal (http://www.paypal.com) is the most
simple form of free P2P payment on the
Web and is now the number one payment
service on eBay, the leading global auction
website. It claims to have more than 3.5
million users and, according to Media
Metrix, is one of the fastest-growing
websites. Anyone, anywhere can join PayPal
online and instantly send money to any
person with an e-mail address through the
PayPal website using any standard internet
browser. The service was listed as a
recommended product by net authority
CNET.com (http://www.cnet.com).

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

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

When PayPal forged an alliance with
Providian Financial Corporation, the fifth-
largest bankcard issuer in the United States
in February 2001, profitability was assured.
As part of a series-D fund raising of $US90
million, Providian invested in PayPal and
will offer a co-branded credit card to PayPal’s
six million members, and has the
opportunity to license PayPal’s technology
for private label person-to-person payments
for Providian’s 16 million customers. In
2000, Providian Financial was named one of
America’s most admired companies by
Fortune magazine. It has more than $31
billion in assets under management and
over 16 million customers.

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

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

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

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

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

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

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

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

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

A method for reliably and simply automating the payment process for the domestic market has proven particularly lucrative for some innovative operators.

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

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

Goodbye to cash: Can banks handle it?

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

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

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

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

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

This is bad news for banks, which are seen as a cumbersome payments system stubbornly locked into plodding methods where some transfers take days to clear.

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

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