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E-Banking in Italy: An Analysis of the Evolution of Prices, Services and Competition Strategies

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Abstract

There are been many claims that the Internet could represent a "frictionless" and almost perfect market [1]. This belief was particularly evident in that banking industry, where Internet was considered as a source of sustainable competitive advantage for a new generation of banks focused on this sale channel.

E-banking in Italy, ever if it was started later then U.S.A. and other european countries as now reached a fast expersion stage. Most of the banks though whit different timing and structures have developped web-sites to growt customers banking and trading access through Internet. At the same time new competitors not in the banking business have recently entered in the market.

Our research empirically analysed the e-banking services offered by a sample of 54 Italian banks.

We considered as e-banking services all banking services that can be accessed through the Internet.

Data on offered services and their prices were collected on a quarterly base. We analysed the following aspects:

- Trend in services offered on-line to customers;
- Trend in market segmentation and in banks strategies;
- The economics emerging from the competition in on-line banking.

We used these data for testing the hypothesis of "frictionless market". The obtained results seem to show that the market of e-banking services is very different from early expectations, and that economies of scale and brand remain as important sources of competitive advantage.

1 Introduction

One of the most important and innovative aspects of the new set-up of the banking distribution system is the use of virtual channels for distributing financial services, which will certainly represent key factor in the future structing of banking. The new distribution channel have a strong potential impact all aspects the relationship between the customer and the financial broker, which cover from the choice of the broker up to the identification of a specific financial service to the delivery. In spite of the fact that at present stage of the cultural environment, the human contact is not easily replaceable as the foundation of the financial brockerage, the virtual channel is likely appearing as radically innovative instruments for most of the current transactions, in terms of efficiency and convenience [3].

The present paper purpose is to analyse the delivery of financial services and retail banking through Internet.

E-banking in Italy, ever if it was started later then U.S.A. and other european countries as now reached a fast expersion stage. Most of the banks though whit different timing and structures have developped web-sites to growt customers banking and trading access through Internet. At the same time new competitors not in the banking business have recently entered in the market, these new commerce taking advantage of the substantial reduction of the obstacles to the entry in the sector, have developped offers of on-line banking services with the objectives of gaining market shares taking advantage of the synergies they have with their own core business (i.g. the network of promoters working for on line banks originated from insurance business).

Our analysis has covered a simple of banks and SIM wich offer on-line financial services taking into a count types, completeness and pricing of the services. We have tried to draw a model of this new virtual market including the strategies used and being used by the brokers in order to obtain an entry and describing the new types of banks which are succesfull. The research is focused on the analysis of the offer of retail services for private customers (BtoC) and was aimed at verifying the consinstency of the theoretical viewpoint that claimed that the Internet could represent a "frictionless" and almost perfect market. This belief was particularly evident in the banking industry, where Internet was considered as a source of sustainable competitive advantage for a new generation of banks focused on this sale channel, due to the fact that "location" was irrelevant and customers were fully informed of prices and product offerings. Such hypothesis was based on the following (and often untested) facts:

- on-line banks would have had lower operating costs and a wide product portfolio; fully informed customers will recognize these advantages and will switch to these banks;
- it would have been very difficult for incumbent banks to imitate newcomers strategy, loosing profitable customers attracted by newcomers' services;
- Internet would have divided banking services into

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new segments, with different customers and profit margins;

Competition among newcomers will lead to lower and more homogeneous prices. Our research empirically analysed for a period of 18 months (from December 2000 to June 2002) the e-banking services offered by a sample of 54 Italian banks (they account for about the 80% of Italian banking industry).

The research was limited to the main italian banking groups as well as to all virtual banks thus covering 60% approx of the total all italian banking system, using as a ranking criteria the total business value. The term virtual bank describes both thae new virtual banks and the spin-off of traditional banks who have chosen a new brand name for the Internet services distribution.

The scenario of the banks considered relevant in the business includes the first 29 italian banks plus other six banks which are located between the thirtyesth and the fiftyesth rank in the ranking by business value and which offer Internet banking services of remarkable innovative type. On the other all virtual banks and SIM operating on-line have been taken into consideration since their number is relatively small.

We considered as e-banking services all banking services that can be accessed through the Internet.

Data on offered services and their prices were collected on a quarterly base. We analysed the following aspects:

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2 Characterizing Competition in Electronic Markets

A basement computer room at Buy.com [2] headquarters in Aliso Viejo, California holds what some believe is the heart of the new digital economy. Banks of modems dial out over separate ISP accounts, gathering millions of prices for consumers products: books, CDs, videos, computer hardware and software. Specially programmed computers then sift trough these prices, identifying the best prices online and helping Buy.com deliver on its promise of having “the lowest price on earth”. Buy.com’s model seems to represent the economic ideal for frictionless markets: low search costs, strong price competition, low margins, low deadweigh loss.

This paper approches this expectation by exploring aspects of business to consumemer electronic commerce markets.Expectations in terms of “frictionless markets” that we tried to test in banking on-line were the following:

- By using the Internet, buyers have perfect information of sellers offering and of higher price elasticity. Price elasticity measures how sensitive consumer demand is to change in price. For commodities, price elasticity may be an important signal of market efficiency. In efficient markets, consumers are more sensitive to small changes in prices, at least as longue substitute vendors or products exist. Highter price elasticity may result from lower search costs or lower swichting costs for Internet consumers Low buyers switching and search costs will promote price competition among sellers and reduce price dispersion;
- Operating and menu costs are lower for banks that offers only on-line services. Menu costs are the costs retailers incur when making price changes. In a conventional setting, menu costs result primarly from the costs to physically re-label products on shelves. In a electronic market we hypotezise that menu costs should be lower, comprised primarly of the cost to make a single price in a central database
- There will be a new segmentation of the retail banking industry, with the newcomers serving the most profitable part of the market.

Data colletion was therefore focused on the evolution of services characteristics, prices level and dispersion, menu costs, market segmentation.

3 The Results of the Analysis

We have found that the offer of e-banking is far from what theory expected. More in detail our findings were the following.

3.1 Market Segmentation

After a very short period, banks clearly divided their on-line services into three segments, each oriented to a different type of customer:

- *on-line upgrade of existing accounts*, that allowed customers to access both via the Internet or existing branches the “traditional” accounts. In this case banks’ strategy was to allow existing customers to on-line access “traditional” banking services, including trading. In 2001-2002 this segment was the one with the highest growth rate in Italy, and is also gaining market shares in stock trading. The offer of this type of product is in line with the “multi-channel stategy” presently followed by most of the traditional banking institutions. The promotion campaign for this product is generally carried on the branches and marginaly on media specifically at the time of the introduction on the market;
- *pure on-line accounts*, offered mainly by newcomer “virtual” banks, are cash deposits with high interests rates and low prices. These once “virtual” products are now becoming more “physical” by offering the possibility to operate through bank branches. This type of

product is offer by the on-line banks, which are new financial instiution, generally spin-off of traditional banks or insurance company which have elected Internet as their main distribution channel and as a core business. This financial institution considered e-banking channel as an opportunity for obteining a substantial competitive advantage on the traditional institutions, thanks to the reduction of the huge costs of structure and personal due to the operation of the branches

- *pure trading accounts* are cash deposits with advanced trading services. This product is obviously the only one offered by all SIM and is addressed to a type of customers whose only interest is to operate on stocks market through Internet. Such product is also offered by some traditional banks that have the objective of specializing their offer for the on-line traders, thus aiming to get reach new customers.

In each segment medium banks developed versioning strategies, by offering a basic (and usually low cost) and an advanced (with more services and high annual fees) version of their accounts. Initially, accounts belonging to the basic version were devoted to customers oriented, firstly, towards banking services. Those belonging to the advanced version were devoted to customers with trading needs.. Nevertheless after 18 months we observed how the distinction between basic and advanced versions is rapidly reducing. On the contrary, large incumbents immediately gave up to versioning by offering standard, low cost and all-included accounts [Fig.1 and 2]

3.2 Price Level

We founds that prices of banking services are always lower on-line than in branches. Such saving is mainly due to the lower commissions on share trading, which is three times cheaper on Internet. Transfer cost is also lower, since in most cases money transfer by the Internet are free of charge. Sometimes few trading transactions can generate enough savings on commissions to offset tha yearly cost of internet banking services. Sometimes no charge are applied for a given number of yearly transactions.

Bank size seems to be an important driver in determining prices and number of offered services, since large banks are offering more services and have the lowest prices. This fact contradicts the claim of cost advantages for newcomers and shift focus on the importance of economies of scale and existing customer relationships [Fig.3].

On line banking services show a different perspective. The most renown players are those who offer the overall best terms.

However success depends strictly on a well-know and high reputation brand name. This is evidenced by the market scenarious:

- The higther shares of market belong to the new players (on line banks and financial services); “the first mover” advantage depends onbeing perceived by the customer as a market leader in the supply of innovative services since the very onset.
- In the case of traditional players, being backed by a well know and established brand name enhances credibility and customer confidence; this is evidence by the substantial market shares obtained in a few months by the quantity of customers acquired over a short period of time by traditional large bank Sanpaolo, as compared with other players already established on the market.

3.3 Economics and Strategy

Menu costs are the costs retailers incur when making price change. In a conventional setting menu costs result primarly from the costs to phisically re-label products on shelves.Menu costs are close to zero from a theoretical viewpoint; nevertheless banks found very difficult and costly to include in advertising information about price change different from fees for stock trading and interest rate on deposits;

Although customers have a perfect information from a theoretical viewpoint, they have to deal with information overload caused by banks strategies. On line accounts cost is not generated by early charges only.

- As opposed to other possible instances, the cost of these type of products consists of two elements: the cost of the account or the upgrade package; the fee whose total yearly amount depends on the number of client’s transactions. Such strategies have made the cost structure of accounts (in terms of mix of fixed and variable costs) very complex and difficult to be compared. This aspect strongly affects the ability of customers to find the best account and to move to a new bank, explaining the problems that both newcomers and incumbents are experiencing in attracting new customers.
- Branding and trust remain sources of heterogeneity and competitive advantage;
- Competition is not on prices. Prices did not significantly change in18 months and, more significant, their dispersion slightly increased [Fig.4]

In the same period each type of offered accounts increased the number of additional services [Fig.5].

In terms of competition, what we have observed is that Internet is transforming the retail banking industry in way that is very different from the one expected.

On-line account is becoming a commodity, causing e-banking services to evolve “down-market” to a low margin – high volume business. Initially, competition was based on “price” and “differentiation”. The service was particularly standardised, banks tried to acquire new customers by reducing more and more the trading commissions for negotiation approaching to zero the costs for the use of the basic banking services. Then, banks reacted, trying to differentiate their products, enriching them with new functions and new services: all players chose an improvement of the trading services and of all the services which supported the trading. These went from the platforms of technical analysis to the tools which operated on derivates. But, they soon realized that any innovation could be easily imitated by competitors, making products more and more homogeneous. Now, banks are looking for the wholeness of the offer, for an improvement and a development of services also through the enlargement of channels from the call centres integrated with web to wireless systems. The offer of the service is not enough . The future will probably see a further change aimed at the elimination of the "dematerialization" of the relationship whit the consumer.

As an effect of product increased homogeneity, after their initial success newcomers lost their momentum and now are serving some sorts of up-market niches (on-line and trading accounts for a small number of sophisticated customers). Incumbents rapidly imitated the behaviour of newcomers and focused on low cost – all included upgrade of existing accounts, including in some cases services that are close to the ones of the trading accounts. According to this strategy, at the moment the largest incumbents are the more competitive in terms of breadth of offered serviced and have the lowest prices [FIG.6].

The resulting market competition does not seem to be close to what was figured out a couple of years ago. On-line *pure player* have been pushed to niche segments, and there will be probably no more room for them. Since technology can be easily imitated and requires large investments, it is the ability to effectively manage the relationship with the customer that makes the difference. Large incumbents developed a strategy based on offering on-line services at a very reduced cost in order to progressively convince customers to move to the Internet, in order to reduce cost of the network of branches.

4 Concluding Remarks

In conclusion Internet hasn't full filled the expectations. Ever though on one had the price level obtainable on the virtual market is lower than the true market's (however the different is small) also on the e-market the spread of prices is extremely wide.

In essence it can be said that the offer of the banks is in line only on the costs factors which are very "visible" such as commissions which have been the focus of the marketing campaign of all institutions. The prices spead is due to several factors such as:

- the variety of products. This is in fact main the factor of the spread. Many services can be combined to the accounts or to the "package", and each bank has its own policies and strategies, It's very hard to find two differents accounts that allow to perform exactly "the same functions in the same manner";
- the diversified information. It is sensible to assume that the players are not all equaly know and that most of the potential customers know only some out of them. The result of such situation is that banks are located in a scarcely competitive scenario, and this fact may justify the spread of prices;
- branding and trust;
- "lock-in effects". The lock-in effects represents the last exploration to the prices spread. Several banks are trying to developped the fidelity of their customers. It is too expensive for a customers in terms of the time required to change the bank.

In addiction it was a common thinking that Internet would have been a diminushing factor for the banking system but at the end we can say that even though the strategies adopted by the "incumbent" appear as conservative, they have any way succeded in obtaining competitives positions against the new commerce on the e-banking market. Furthermore the fact that all banks have set up a virtual counter and that the virtual banks have not multiplied as expected indicates that the incumbents have been successful in reacting by offering products capable of attracting new customers.

5 Appendix

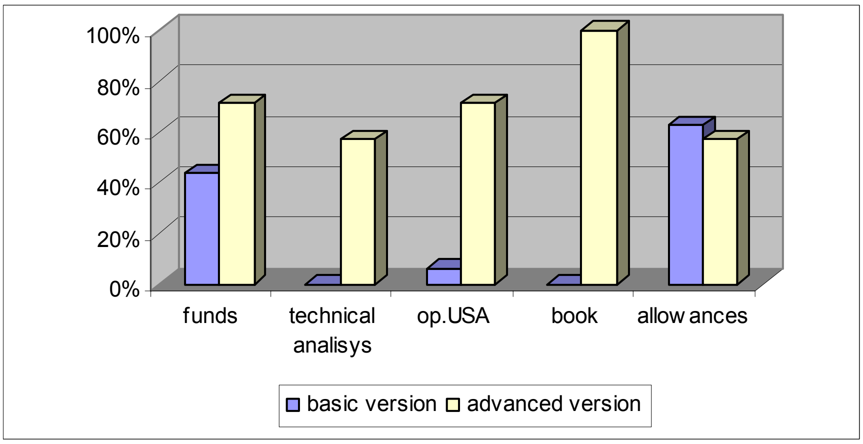

Figure 1. Scheme of the services included in the clusters of the pure on line accounts at December 2000

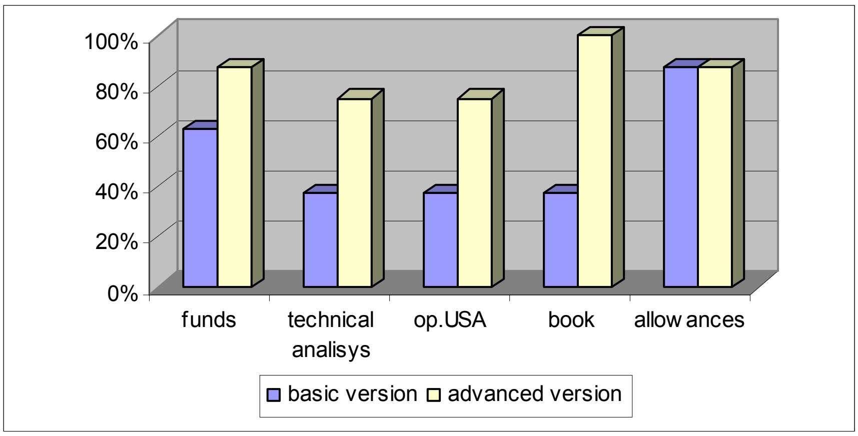

Figure 2. Scheme of the services included in the clusters of the pure on line accounts at June 2002

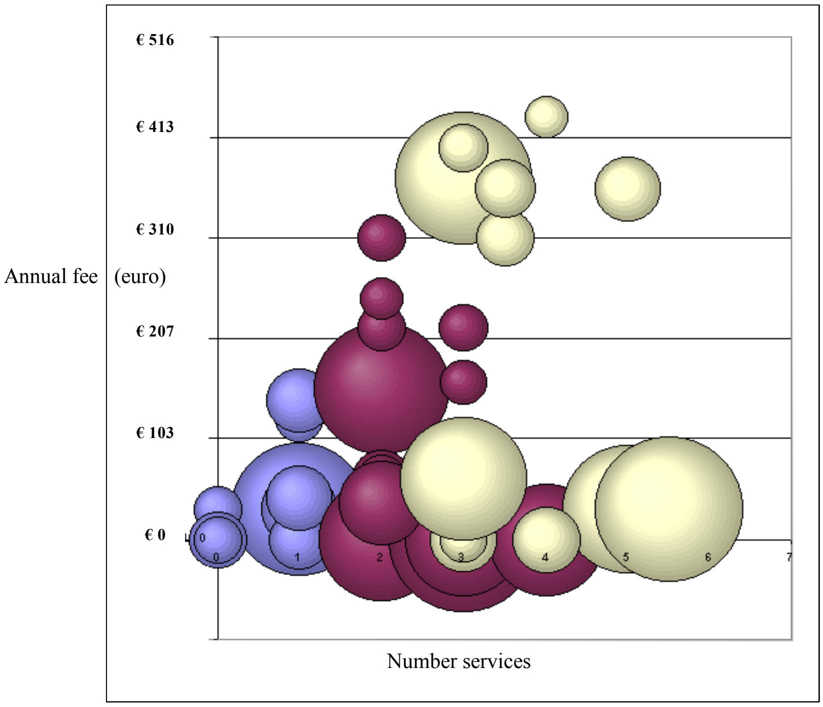

Figure 3. Relationship among the annual fees, services and dimensions of the Banking Institutes for on-line upgrade of existing accounts at June 2002

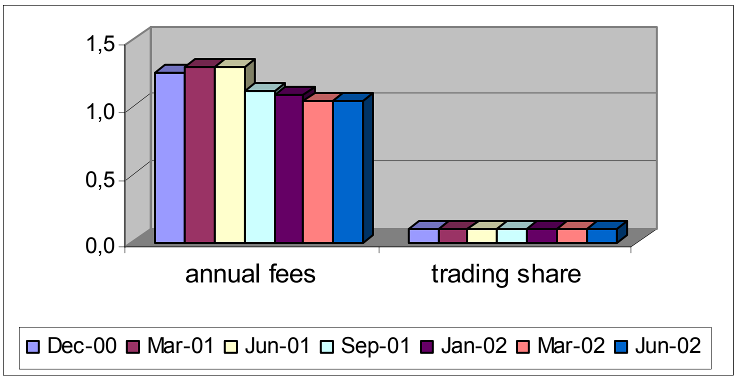

Figure 4. Trend of the variation coefficient of the trading accounts between December 2000 and June 2002

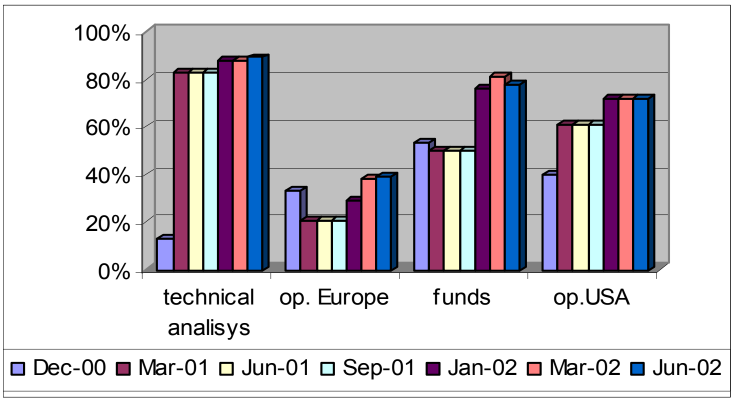

Figure 5. Trend of the services of the trading accounts between December 2000 and June 2002.

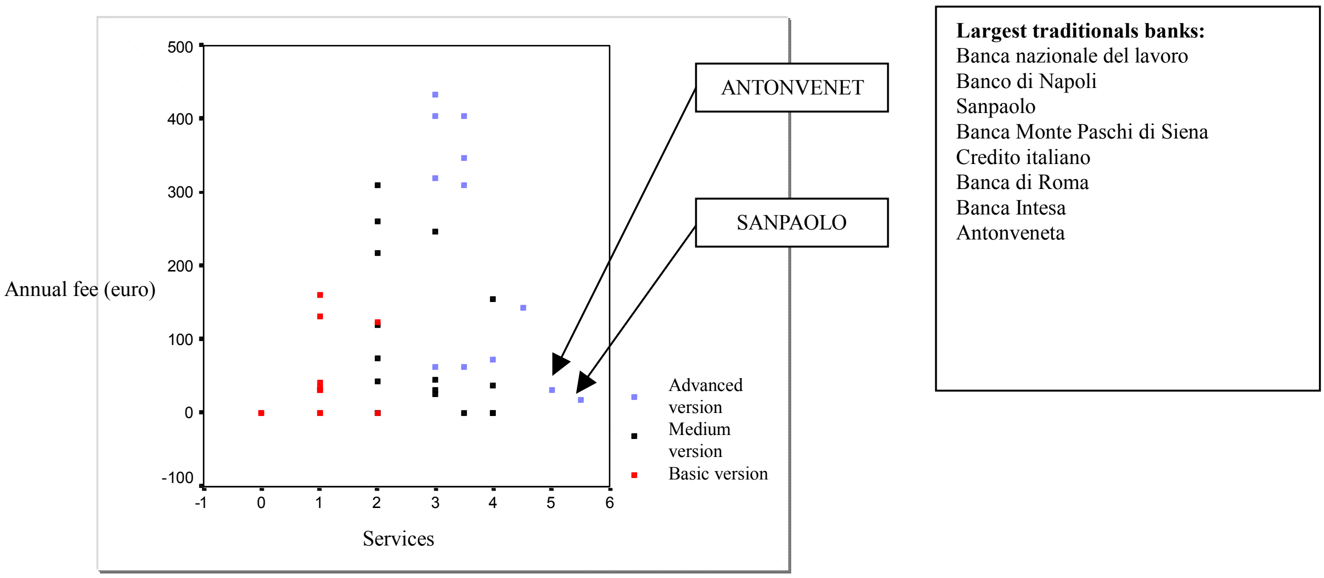

FIGURE 6: relationship among the annual fees, services and of the Banking Institutes for on-line upgrade of existing accounts at June 2002.

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