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Me-Too Route a Loser in On-Line Banking

In the last 15 years, changes in the banking industry's structure have seriously threatened the margins and growth potential of what has historically been one of the most profitable of all businesses.

In the face of these changes, many bankers have appropriately identified electronic ranking services as a way to defend their industry and preserve its earnings record. But ironically, the way they have approached electronic banking will only reinforce the factors that have led to the industry's overall decline.

Virtually all the institutions offering home banking services are doing so with the same brute-force, channel-driven response characteristic of the industry as a whole. Instead of using the new technologies to create better and more differentiated relationships with customers, these banks have commoditized the service--making it simply another channel for customers to get the same old services.

This has profound and dangerous ramifications for the individual institutions and the industry at large.

First, by relegating electronic banking to the status of yet another cost center banks actually increase, not reduce, the importance of scale for long-term survival. Far from creating virtual institutions, banks with substantial electronic offerings will need more, not less, scale.

Though the variable cost per electronic transaction is low, the fixed component is not. Analysts estimate that a regional bank can expect to spend $20 million to $60 million a year to support electronic banking capabilities.

Fee income will not realistically support the costs of these operations. This leaves cost reduction. And in institutions where costs have already been cut to the bone, an offsetting number of branches would have to be closed. Though Wall Street may applaud such a strategy, it may alienate a number of preferred customers. Glendale Federal Bank's aggressive attempt to chip away at the non-technology-oriented customer base of Wells Fargo Bank illustrates the point.

Another danger is that by predominantly adopting the Intuit-Microsoft model--providing remote banking services through shrink-wrapped personal finance software—banks are effectively relinquishing their ability differentiate themselves or offer customized products and services. For about $5 per month per user, a bank buys the right to display its postage-stamp-sized logo on a screen and send E-mail text to its customers. At best, this encourages customers to view banking services as commodities. At worst, it allows software manufacturers to disintermediate banks and their clientele.

A third hazard in current interactive strategies is that a financial institutions' promotions are laying the groundwork for consumer acceptance of branchless banking. Only a fraction of bank customers can be described as experienced cybernauts who feel comfortable banking by computer. The majority still want to visit branches. But banks may be gradually dispelling the notion that they must have a local, physical presence—the neighborhood branch offices that are critical strategic assets, reaching the traditional customer base and raising the barriers to entry to nonbanks into the core banking business.

It is too late to put this genie back into the bottle. Customer demand for home banking services exceeds the capabilities of most banks to provide it. If banks don't meet those needs, other players that possess the necessary capital and knowledge will. These organizations include familiar brokerage and monoline credit card competitors, and new entries like Security First Network Bank and D.E. Shaw & Co.'s FarSight Financial Services.

It is not too late, however, to critically reexamine the strategies behind electronic banking. This means identifying crucial strategic choices and making thoughtful decisions.

For instance, what is the bank's core business in a networked consumer economy? Which customers will you serve, and what new needs will you meet? How will your bank differentiate itself from competitors? How will the electronic banking operations generate a profit?

Shrink-wrapped solutions like those of Intuit and Microsoft are only short-term answers. Long-term success will require a sustainable business model for on-line banking that complements corporate objectives. Only by learning from mistakes and developing a broad vision of the future will banks fully capitalize on the opportunity.