

E*Trade Financial Services

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ABSTRACT

*The electronic age continues to grow and to offer new and more efficient forms of electronic trade and electronic commerce. As this evolution continues, it is no surprise that the online financial services industry is seeing both significant changes and new revenue potential. One of the players in the online financial services industry is E*Trade Financial Services. Launched in 1992, the company was a pioneer in online brokerage services. At its inception, E*Trade's focus was on becoming America's dominant deep-discount brokerage firm by fully automating the front and back-office trade processing function and maintaining its position as the low-cost provider. Today, E*Trade offers a diverse and integrated portfolio of services including deep-discount brokerage services, traditional banking services like checking and savings, and mortgage and equity services. E*Trade strives to provide a range of services that are consolidated under one website, to provide convenience, and to be accessible 24/7. E*Trade also provides the tools necessary to guide clients through their financial needs. E*Trade faces growing competition as the industry is facing self-destructive price-war and, thus to reduce the costs, undergoing huge consolidations. While the competition is tough, E*Trade has a strong presence and percentage of marketshare in the industry. The company has proven that it can attract customers and provide the information and tools that they require to manage their own portfolio. The self-directed investors and the individuals who want control of and access to their finances are the core customers of E*Trade, and the company caters to them in terms of products and services. Where will E*Trade go from here? Should the company continue to slash the fee and commission charges like others do, or should it diversify its services and focus on core revenue generator of brokerage services? These questions are addressed in this paper as well as the current market position and the types of services that are offered. The paper provides a snapshot of what E*Trade is, what it does, and where it is going.*

INTRODUCTION

The electronic age continues to grow and to offer new and more efficient forms of electronic trade and electronic commerce. As this evolution continues, it is no surprise that the online financial services industry is seeing both significant changes and new revenue potential. E-commerce continues to increase as the world gains more access to the Internet and the world wide web. This new access opens the door to a larger potential customer base that will continue to see increases as the world becomes more globalized.

One of the players in the online financial services industry is E*Trade Financial Services. Launched in 1992, the company was a pioneer in online brokerage services. At its inception, E*Trade generated most of its revenues by providing back-office on-line processing services to discount brokers like Fidelity and Schwab.¹ E*Trade Financial went public in August 1996 and completed a follow-up offering one year later. The company's common stock is traded on the New York Stock Exchange under the symbol ET.² Today, the E*Trade Financial group of companies provides financial services including brokerage, banking and lending for retail, and corporate and institutional customers. Securities products and services are offered by E*Trade Securities LLC (Member

¹ Chuck Glew, Mark Lotke, Mario Palumbo, and Marc Schwartz, "E*Trade Securities, Inc." Graduate School of Business, Stanford University. (1996): 1.

² "Investor Relations," E*Trade, 2004, <<https://investor.etrade.com/investors.cfm>> (6 November 2004).

NASD/SIPC). Bank and lending products and services are offered by E*Trade Bank, a Federal savings bank, Member FDIC, or its subsidiaries.³

In a calculated move, the company changed from a “private label” strategy to a “direct-to-customer” business model, offering customers a savings of up to 75% as compared with traditional discount brokers.⁴ However, the company is now facing many new challenges as it moves forward, including the entry of new competitors like eBroker and industry giant Charles Schwab. In addition to the entry of these new competitors, there are banks that offer online services in addition to bricks-and-mortar facilities. The major challenges that are faced by E*Trade are how to maintain marketshare in a changing environment and to determine if online only financial services are all it should offer.

COMPANY BACKGROUND

Trade*Plus, the parent company of E*Trade, was founded by Bill Porter in 1982 as a PC financial management service bureau. In 1992, Porter decided to launch E*Trade Securities, Inc.⁵ The initial revenues were generated by the back-office processing services provided to companies like Fidelity and Schwab. Additional revenues were generated from the interest on customer cash balances and margin accounts.⁶

E*Trade’s focus was on becoming America’s dominant deep-discount brokerage firm by fully automating the front and back-office trade processing function and maintaining its position as the low-cost provider.⁷ In order to maintain this aggressive strategy, the company had to make significant investments in automating order entry, customer support, trade execution, and post-trade clearing and confirmation. The company had to look for sources to maintain these upgrades, and it found a partner in General Atlantic Partners, who made a significant equity investment in E*Trade in 1995.⁸ In addition, the company filed with the SEC in May 1996 for an initial public offering.

INDUSTRY BACKGROUND

Online Banking In The United States

The online banking industry in the United States began in 1995 when Presidential Savings Bank became the first American bank to offer online services to its customers.⁹ This service was a move that was quickly followed by the Internet-only bank, Security First Network Bank. These two companies looked to attract customers by providing the ultimate level of convenience. This convenience allowed patrons access to records anytime and anywhere that they had Internet access, and it allowed data access outside of traditional banking hours for those with complicated schedules.

The trend was then followed by the “bricks-and-click” banks that included Wells Fargo, Bank One, and Chase Manhattan Bank.¹⁰ These banks maintain physical facilities while offering electronic services like the ability to pay bills online, money transfers, and account balances. These are extensions of the services that the banks provide at their physical locations. The FDIC estimates that 15,845 banks offered online services via the web in 2003 while roughly 32 million households would bank online in 2003.¹¹

³ “Press Releases,” E*Trade, 2004, <https://us.etrade.com/e/t/home/PressStory?ID=STORYID%3Detrade_pr_2004_07_20_eng-etrade_16_57_31_pr&year=2004&month=1> (6 November 2004).

⁴ Glew, 1.

⁵ Glew, 1.

⁶ Glew, 1.

⁷ Glew, 1.

⁸ Glew, 1.

⁹ Nancy Feig, “Growing Online,” *Community Banker*, June 2004: 1, ProQuest (6 November 2004).

¹⁰ “Online Banking Marketspace and Trends,” *Presidential Bank*, 23 January 2002,

<http://www.presidential.com/pk_market-space.htm> (6 November 2004).

¹¹ “Online Banking Marketspace and Trends”.

The online banking industry continues to grow, offering a range of services from the “bricks-and-click” banking services to the Internet-only banks that are opening. The online banking industry is still in its initial growth stage. According to the FDIC, there are 10,623 banks in the United States and approximately 40% of them have websites; however, only 376 of those websites offer transactional Internet banking. There are about 30 Internet-only banks in the U.S. with a customer base of roughly 250,000 depositors while an estimated 6 million say they do their banking over the Internet.¹²

Online Brokering Services

The brokerage business was the revenue generating business that helped jump start E*Trade. The businesses that moved into the online brokering included electronic pure plays that were founded as deep-discount online brokering services only; E*Trade is one such firm as well as PC Financial Network (PCFN). Typically, these services originally formed partnerships with online service providers; E*Trade allied itself with CompuServe. The discount migrators were real world brokers who entered the online brokerage business after seeing if the services would become profitable. These businesses, such as Charles Schwab, were reluctant to enter the online world until they had seen that the business model could work. The final group to establish a virtual presence were the deep-discount migrators who entered the online world to reach customers directly as well as to use technology for purposes of cost reduction and communications.

E*TRADE BUSINESS PRINCIPLES

Mission Statement:

*To create long term shareholder value through superior financial performance driven by the delivery of a diversified range of innovative, customer-focused financial products and services and supported by an operating culture based on the highest levels of teamwork, efficiency, and integrity.*¹³

E*Trade lists its commitments on its website, including how it offers value to the customer. E*Trade promotions indicate that the company offers value through efforts designed to change the old ways of doing business by always asking, “Can this be done better?” The company is committed to meeting all of the financial needs of its customers through a diversified and integrated portfolio. This portfolio is designed to offer innovative and customer-focused brokerage and banking services.¹⁴ These services cover a wide range of activities and functions that are accessible to the customer round the clock from an Internet access point. E*Trade also offers corporate services to help companies and employees alike manage and understand their stock options and benefits.

COMPETITORS

Some of the most intense competition E*Trade faces is in its main revenue business of discount brokering. The following is a list of the types of brokerage accounts and some firms in each:

1. Electronic pure plays: These companies were incorporated as technology-focused, electronic-only brokerage firms. E*Trade is one such firm that helped pioneer the field using access through online service providers. Another such company is PC Financial Network (PCFN). In its early stages, PCFN established a presence on Prodigy while E*Trade established itself on CompuServe. Some of the current competitors include PCFN and TransTerra, who use both the Internet and a Windows direct modem link for it “power traders.”¹⁵
2. Discount Migrators: These discount brokers were slow to enter the market as they were unsure of how credible the electronic services would be. Charles Schwab is the market leader in non-electronic discount

¹² “Online Banking Marketplace and Trends”.

¹³ “Mission Statement,” E*Trade ,2004, <https://us.etrade.com/e/t/home/aboutus?traxui=F_GN> (8 October 2004).

¹⁴ “A Growth Company in a Growth Market,” E*Trade ,2004, <https://us.etrade.com/e/t/home/aboutus?traxui=F_GN> (8 October 2004).

¹⁵ Glew, 13.

- brokers, servicing a little more than 50% of the total market. It is a new competitor for E*Trade with its online service e.Schwab.¹⁶
3. Deep-Discount Migrators: When the world wide web matured, it became easier for deep-discount brokerage firms to enter the online world and reach customers directly. Using the technology to their advantage for cost reduction and communications purposes, these firms were able to establish their own homepages.¹⁷ Some of these competitors are National Discount Brokers and Lombard Institutional Brokerage.

These firms offer competition with E*Trade's brokerage business, but as the company continues to enter new markets, it also faces competition from traditional banks and from credit card companies, such as Discover and Capital One. The company will have to continually re-evaluate how it will combat these rivals. The firm is presented with several options, which include price leadership and the diversification of services. The competition will continue to grow and intensify as the market grows into the future.

SERVICES

Trading And Investing

The online trading accounts are the staple of E*Trade business. Having begun as a service to facilitate the trading functions of larger discount brokers, the company moved to a new direct-to-customer business model and offered very competitive pricing that appealed to a large customer base. The savings were a tool that attracted a customer base and allowed E*Trade to mature into a larger player in the online financial business. The trading options offered include stocks, options, mutual funds, bonds, and IPOs.

Trading and portfolio options include free investment research and real time information. E*Trade currently offers fifty percent rebates of 12b-1 fees. These fees, instituted in 1980, are paid by many mutual funds to brokerage firms to cover expenses incurred in the promotion, distribution, and marketing of those funds.¹⁸ The name is derived from the section in the Investment Company Act of 1940 that allows a mutual fund to pay distribution and marketing expenses out of the fund's assets.¹⁹ In addition, some mutual fund companies pay service fees to brokerage firms to cover costs associated with the servicing of their mutual fund accounts, and E*Trade currently offers to rebate 50% of those service fees that are received from the fund companies.

The remaining investment options include no-fee, no-minimum IRAs and a two second execution guarantee on all qualified orders that involve S&P 500 stocks and exchange-traded funds. This guarantee is backed up by a scorecard that tracks the time of all qualified trades and a commission free trade if the two second rule fails.²⁰

Retirement And Planning

A variety of options for retirement are offered, including traditional IRAs, Roth IRAs, rollover IRAs, and IRA accounts for the self-employed as well as accounts for education savings. These IRAs feature no minimum initial deposits or balance requirements. Some of the education savings plans require certain minimum balances depending upon the plan selected. All of these options are easily accessible 24 hours a day, 7 days a week.

¹⁶ Glew, 14.

¹⁷ Glew, 13.

¹⁸ "What Are 12b-1 Fees?," E*Trade ,2004,
<https://us.etrade.com/e/t/invest/mfstatic?gxml=mfrefunder_jump1.html&righttrail=disable> (8 October 2004).

¹⁹ Dustin Woodard, "12b-1 Fees Are Not Your Friend," *About*, 2004,
<http://mutualfunds.about.com/cs/beforeinvesting/a/12b_1_fees.htm> (8 October 2004).

²⁰ "Introducing Two Second Execution Guarantee," E*Trade ,2004,
<https://us.etrade.com/e/t/invest/apptemplate?gxml=exec_guarantee.html&righttrail=disable> (8 October 2004).

These services are augmented by the information available to customers, including tax tools and tips, IRA tips and strategies, a rollover IRA checklist, and information on automatic investing in mutual funds. Many customers are attracted to not only the competitive pricing but the multitude of information that is provided by E*Trade as part of the service. In the past, this information was only available to large investing companies that would not freely share it with just anyone. Providing this information is a strength for E*Trade as it provides a sense of caring for the customer; the customer feels that E*Trade cares about its clients. This feeling is a result of the fact that E*Trade offers the information free of charge so that investors can make the best possible choice on what to do with their money.

Banking And Credit Cards

E*Trade offers a number of traditional banking functions, including checking, savings, money market, certificates of deposit, credit cards, and loans for purchasing recreational vehicles and boats. These services are typically offered by traditional brick-and-mortar banks. The challenge is to convince customers to use the online system rather than choosing a traditional hometown bank.

Checking Accounts

Three distinct checking accounts exist depending on what the customer wants to use: the Complete checking account, the Value checking account, and the Regular checking account. These accounts offer varying interest rates, free online bill payment, and certain deposit and balance requirements based on the account chosen. These are some of the more traditional banking services offered by the company to compete with bricks-and-mortar banking institutions.

Savings Accounts

The SmartSaver© savings account is an FDIC-insured savings account offering premium rates like a CD but without the term requirements and the ability to add to the principal at any time. Requirements include a \$100 initial minimum deposit and a \$1,000 minimum balance to avoid a fee. Account features include the ability to make six withdrawals or transfers from the account in any calendar month (ATM withdrawals excluded), unlimited deposits, direct deposit, and FDIC insurance up to \$100,000.²¹

Money Market Accounts

There are two distinct money market accounts. The standard money market offers CD-like rates with easy access to funds. E*Trade offers rates that it promotes as consistently higher than the national average along with unlimited free withdrawals at E*Trade Financial and Plus® ATMs. The *E*Trade Money Market Plus* account is an FDIC insured account that offers super-premium yields for customers who maintain high balances, along with unlimited ATM access and the flexibility to write up to three free checks per month.²²

Certificates of Deposit

CDs include the *Fixed Rate CD* with a guaranteed high rate of return with terms from three months to five years. The *Variable Rate Prime Link CDs* offer a high rate of return that fluctuates with the Prime Rate, and the IRA CDs are high yielding, fixed rate CDs that are good for investors who need a tax deduction or who want to defer taxes on earnings until they withdraw the earnings at retirement when they may be at a lower rate.²³

²¹ "Account Details," E*Trade ,2004, <https://us.etrade.com/e/t/home/savings?_skinnertab=bank> (6 November 2004)

²² "Types of Bank Accounts," E*Trade ,2004, <https://us.etrade.com/e/t/home/oaabankingall?_skinnertab=bank> (6 November 2004).

²³ "Types of Bank Accounts"

Credit Cards

The Platinum Visa® card offers a variable rate with no annual fees and the functions of standard cards for balance transfers and cash advances. The card also offers limited liability in the event of card loss or theft. Credit limits are offered up to \$20,000.

RV and Boat Loans and Refinancing

E*Trade also offers low-rate loans for the purchase of new or used RVs and boats or refinancing for existing loans on these vehicles. The loans are promoted as having competitive interest rates along with the ability for fast, convenient online applications with no application fees. For those who want a fast answer, the loan decisions are made within one business day for purchase transactions.²⁴

Mortgages And Home Equity

A diversified number of mortgage loans are offered for customers ranging from first time homeowners to those looking for refinancing options. There are a number of options, including no or low money down mortgages and options for current homeowners to use and manage the equity in their current estates.

All of the E*Trade services offer convenient and easy to understand tools on the website. These tools include loan calculators, IRA help and tips, and comparative information for the different types of loans. The investment tools include information on past stock history and real time quote information that can help investors make decisions. This investment information offers helpful hints that many websites charge for. These services enable E*Trade to attract a larger number of customers. As the use of online financial services increases, this tool will continue to help bring in new customers and to make them loyal users.

Corporate Services

Over 2,500 companies use E*Trade for the management of stock plans for 1.3 million employees in more than 100 countries. The company offers services that help employers understand and manage stock plan administration that ensures compliance to the law. These services are also designed to help employees understand and gain access to their stock benefits.²⁵ E*Trade promotes cost-effective solutions for services like record-keeping, regulatory issues, and the required reporting activities.

CUSTOMERS

What are E*Trade's customers like? Typically, the customer is an active, independent, and empowered investor who is comfortable in the world of online services.²⁶ These investors make their own decisions and want low commission fees; in fact, they despise these high fees and will do whatever they can to avoid them. E*Trade offers commission prices that are competitive with other online brokers. The opinions vary as to the rates – they are higher than some brokers and lower than others.

ORGANIZATION AND IT STRUCTURE

E*Trade has about 3,500 employees, and according to Connie Dotson, the chief communications officer, it uses a "very flat" management structure. According to Dotson, the company has four different levels of titles, including professionals, business managers, business leaders, and officers.²⁷ The business leaders include the vice presidents and directors of different groups within the company. For a complete listing of company officers and

²⁴ "Types of Bank Accounts"

²⁵ "Corporate Services," E*Trade, 2004, <https://us.etrade.com/e/t/home/businesssolutions?traxui=F_GN> (6 November 2004).

²⁶ Glew, 10.

²⁷ Troy Wolverton, "At E*Trade, it's not lonely at the top," 3 May 2002, *cnet*, <http://marketwatch-cnet.com.com/2100-1017_3-899046.html> (8 November 2004).

selected salaries, see Exhibit A in the appendix. The company is based in Menlo Park, California where the majority of its employees maintain a call-center and a support center.

When E*Trade experienced enormous growth after its initial public offering in 1996, it realized that the firm would need an information technology system that could expand as needed to match its growth, including the financial and accounting reporting policies. The company needed to carefully examine its goals and strategies and to find a suitable system to support those initiatives. The surge in online investing and financial markets forced the company to increase the amount of employees and required a system that could effectively handle both the accounting and the reporting of financial results as well as help to plan for continued growth. To help meet these goals, E*Trade chose to employ Oracle enterprise resource planning (ERP) applications to manage its financial and human resources functions.²⁸ A web-enabled ERP application was the tool that E*Trade needed to deliver accurate and real-time data necessary to the success of the company's founding principles. "The self service aspects of both the financial and human resources applications were consistent with E*Trade Financial's philosophy of the self-directed investor and consistent with the Company's overall goal to create an infrastructure that leveraged technology."²⁹ Using Oracle financials, the company designed an infrastructure that suited its current needs and allowed for future growth that included the potential for new countries and lines of business. Success meant rapid growth in the workforce, and the Oracle software was used to manage HR data centrally, giving it a better grasp of which employees were associated with which sites, lines of business, and supervisors.³⁰ According to Brian Corcoran, Vice President of Corporate Systems, the system allows E*Trade to use a lean staff to run all of the modules, which keeps productivity high and production costs low.

E*Trade guarantees that it will execute trades in two seconds; the industry average is 5 seconds.³¹ Thus when E*Trade decided to upgrade its North American web services, it was a very important decision, and the contract went to IBM with **@server**™ xSeries™ 330 servers running Linux®.³² While upgrading its servers, the company changed its operating system to Linux for a more open-source and standards-based platform, allowing for flexibility in the applications that the company chose to employ. Given the nature of online trading and financial services, E*Trade needed a system that could handle the highs and lows of website usage and that could help to provide the level of customer service that the firm wanted to maintain. According to Josh Levine, Chief Administrative Officer (CAO) of the E*Trade Group, Inc., the company wanted to upgrade its servers while also reducing the total cost of ownership: "We have less expensive, high-performance, standards based, open-source technology with Linux. Linux has momentum the marketplace."³³ A website that is up and running when customers want to use it is the vital component for a firm like E*Trade, and it used IBM to develop a horizontally scaled system that can adapt to workload changes and failures.³⁴ By using Linux, E*Trade has reduced software licensing fees and service costs, resulting in savings that can be used to provide further upgrades and to generate better earnings.

To ensure that everything is running smoothly, E*Trade uses ProactiveNet software to provide real-time application, SLA, and infrastructure performance analysis. Proactive explains itself as an essential and cost-effective alternative to traditional systems management and performance monitoring tools.³⁵ Prior to ProactiveNet, E*Trade used several performance monitoring tools to check on current performance. The problem was that it would take a staff member 4-5 hours every morning to pull together data from the different monitoring tools and to

²⁸ "Flexibility Propels Exponential Growth at E*Trade Financial," *Oracle*, 2004, <http://www.oracle.com/pls/cis/Profiles.print_html?p_profile_id=2605> (8 November 2004).

²⁹ "Flexibility Propels Exponential Growth at E*Trade Financial"

³⁰ "Flexibility Propels Exponential Growth at E*Trade Financial"

³¹ "E*Trade is On," *IBM*, 25 June 2004, <http://www-306.ibm.com/e-business/ondemand/us/ondemand/on/turniton_etrade.html> (11 November 2004).

³² "Total solution leads to high-profile win for IBM: E*Trade Financial," *IBM*, 2004, <<http://www-306.ibm.com/software/success/cssdb.nsf/cs/kmoe-5eamke?OpenDocument&Site=default>> (9 November 2004).

³³ "Total solution leads to high-profile win for IBM: E*Trade Financial"

³⁴ "Total solution leads to high-profile win for IBM: E*Trade Financial"

³⁵ "what we do," *ProactiveNet*, <<http://www.proactivenet.com/index.asp>><<http://www.proactivenet.com/index.asp>> (12 November 2004).

prepare a daily performance report. This delay meant that E*Trade was not capable of reacting to performance issues in real-time. E*Trade Financial is now using ProactiveNet to monitor all of the servers in its production environment for the company's North American trading and banking website in order to assure continued and successful operations.

With 15,000 machines, E*Trade owns the largest number of ATMs in the United States.³⁶ The closet rival is Bank of America. E*Trade reached 15,000 with the acquisition of 4,000 machines from a subsidiary of Canadian Imperial Bank of Commerce in February of 2003. These ATMs are the primary physical connection to its customers since it has limited traditional offices.³⁷ Customers are allowed to use both their E*Trade Bank ATM cards to make no-fee cash withdrawals for up to \$500 a day or \$1,000 for purchases. The E*Trade website lists the ability to use more than 600,000 ATMs worldwide. An advantage to the ATM cards is that customers are not charged a fee when using an out-of-network or non-E*Trade machines. The network is continually being strengthened through the addition and acquisition of more ATMs around the country and the globe. E*Trade has compensated for a lack of physical branches by building its ATM network.

E*TRADE IN 2005

With the tech-bubble-burst of late 1990s, the brokerage industry started undergoing de-growth phase. All the firms in the industry, along with top players like Fidelity Investments and Charles Schwab Corp., have been continuously slashing the fee and commission charges in their one or other portfolio. This was the only feasible alternative left for all the companies to retain and widen their customer base and sustain their profits. And to reduce the costs and losses incurred through curtailing fees and charges, companies started actively looking for acquisitions and mergers. Analysts say that the primary motive behind the industry consolidations trend is to stabilize the commission prices.

In 2004 E*Trade, being no exception of this 'trade slump', made an unsuccessful attempt to acquire TD Waterhouse and failed over management sharing issues. In another vain attempt to buy its close rival, E*Trade offered more than \$5.5 billion to Ameritrade Holding Corp. The offer has surged the shares of Ameritrade and its stocks closing up \$2.09, or 18 per cent, at \$ 13.4 in NASDAQ stock market trading, valuing the company at \$5.4 billion. Though the merger would have been mutually beneficial for both the parties in terms of cost savings, Ameritrade with seven acquisitions and mergers under its belt since last four years, has rebuffed the offer stating that the 'company was not for sale'. To make its stand firmer and to show that the company itself is at the buyer's end, Ameritrade bought TD water house for \$3 billion. A close examination of the ongoing events shows that with the ongoing self-destructive price-war in the industry, Ameritrade, like Charles Schwab, started looking to gather more assets from longer-term investors rather than from commissions and analysts say that it was the main reason why Ameritrade chose TD over E*Trade, as the former has ten times more number of branches than the later with 2600 registered investment advisors in the U.S.

E*Trade, after failed 'negotiations to merge' with TD Waterhouse and Ameritrade, has approached Bank of Montreal Financial Group, in Toronto, and bought its discount brokerage division Harrisdirect LLC of Jersey City, NJ., for \$750 millions. In fact, Harrisdirect was a diseased organ of BMO, which was consistently underperforming and operating near and sometimes below break-even. Though this merger was very small when compared to the industry's largest marriage, TD-Ameritrade, E*Trade gained large number of affluent investors and also brought 15,000 daily trades which pushed company's total daily trades to 130,000. "The decision to sell followed an assessment of Harrisdirect's ability to compete in a changing landscape", Tony Comper, BMO's chief executive, said. "Given the additional amount of capital that would have been required to grow the business and remain competitive in the current environment of consolidation, we concluded that Harrisdirect would be more valuable to another participant in the online brokerage industry".

³⁶ Mark Anderson, "Deal Makes E*Trade top ATM owner," *Sacramento Business Journal*, 14 February 2003: 1, ProQuest.

³⁷ Anderson, 1.

In order to balance the pendulum and intensify the competition with the Ameritrade Holding Corp., E*Trade started negotiating with JPMorgan Chase & Co to buy its brokerage division, BrownCo by offering \$1.6 billion. “Adding BrownCo’s 200,000 clients – whose average account balance of more than \$145,000 is the second highest in the sector” said Jarrett Lilien, E*Trade’s president and COO, “and it will improve the overall quality of its customer accounts”. With the acquisition, E*Trade’s thirst for sophisticated clientele of active traders with high cash balances would be considerably quenched. Now the company offers trades for as little as US\$6.99.

Last January E*Trade bought Howard Capital Management, a money-management adviser in the Los Angeles area. And in August the company announced to appoint Mr. Kobern along with his two dozen analysts crew by acquiring his company- Kobren Insight management- for about US\$50 millions, adding a mutual fund manager that oversees about US\$1 billion.

E*Trade is not leaving any stone unturned to increase its trade-volume by acquiring or merging small and competitive companies in the industry. Its aggressive approach was apparent in the words of the company’s CEO Mitchell Caplan, who said that the company would continue to grow through acquisitions, to a question on whether the company still do a deal with Ameritrade or not.

The following are the top brokerage companies with their current average daily trades.

Fidelity Investments	244,000.
TD-Ameritrade	239,000.
Charles Schwab & Co	190,000.
E*Trade (After two latest acquisitions)	160,000.

E*TRADE POWER AND VALUE

Current Performance

E*Trade has established itself as one of the most visited banking and investing sites on the Internet and continues to see the addition of new accounts. It has a strong operating record that has shown improvement in financial and operating performance. The E*Trade online brokerage is ranked fourth (measured by daily trading volume) behind Fidelity, TD-Ameritrade and Schwab and ranks fifth in the number of accounts with more than three million. E*Trade bank is in the top 100 largest deposit-taking institutions in the United States with \$14.6 billion deposits in banking accounts.³⁸ Through the acquisition, expansion and retention of customer relationships, E*Trade has achieved a consolidated net income of 301.1 million, or \$0.79 per dilute share, for the nine months ended September 30, 2005, compared with net income of \$209.7 million, or \$0.75 per diluted share for the same period in 2004.

Third Quarter Highlights

Some highlights from the report of the third quarter, which ended September 30, 2005, are shown below. For a select listing of financial statements see Table of Contents: 2 in the appendix. The Q3 report of September 30, 2005 included the following data:

- Daily Average Revenue Trades ("DART"s), for the third quarter of 2005, increased 29% compared with the third quarter 2004.
- With the high interest-earning assets and increase in interest rate spread the net interest income for the third quarter of 2005 increased 32% when compared with the third quarter of 2004.
- The ratio of nonperforming loans to total loans, which was 0.17% at September 30, 2004, was decreased 0.13% at September 30, 2005.

³⁸ Yahoo Finance.

E*Trade currently holds a strong position in online financial services with a diverse portfolio of offerings. Its financials are growing stronger as new accounts are acquired through new acquisitions and new services are continually added and streamlined. The service charges and fee increased 38% to \$100.9 million for the nine months ended September 30, 2005 from the comparable periods in 2005.³⁹ The company holds its market position and continues to diversify services and to streamline operations in an attempt to better service customers. The financials show the company will continue acquisitions and improve services.

Demographics

The company is also benefiting from the aging group of baby boomers, roughly 83 million of them born between 1946 and 1964, who need to save for retirement.⁴⁰ These people's need for retirement funds is increasing the amount of money flowing into the investment industry. As they grow older, these customers realize that they will need additional income to supplement their social security monthly payments. These investors need to focus on conserving and improving their income streams, and E*Trade benefits from the additional money being invested in the industry.

Growth Options

As E*Trade continues to diversify its services, it is open to the potential of new markets. The company already has global operations but continues to look for new areas to capitalize on. One such market is China, and due to recent WTO regulations, the Chinese domestic market will be opened to non-Chinese banks in 2006.⁴¹ China, which accounted for one of the highest GDP growth rates in the world for the year 2004 and continuing the same in 2005, has a burgeoning middle class population that provides potential new investors and opportunities for both the mortgage and home equity services.⁴²

Honors

E*Trade received the top ranking on the Internet Broker scorecard during the summer of 1999 from industry leading analyst Gomez Advisors, and it was named the number one online investing site in an international survey of the top 20 Internet Brokerage firms by Lafferty Information and Research Group.⁴³

Traditional Banking

Online banking may never be as popular as traditional bricks-and-mortar banking. This is a fact that E*Trade must learn to compensate for. The younger generation is much more comfortable with online banking and continues to demand newer, better, and faster online services, but critics say that traditional banks will never be eliminated entirely. According to Yana Fishman and Irina Goffman, there are several reasons that online banking will never eradicate bricks-and-mortar banks including:

- The disclosure of personal information is a major customer security concern.
 - The concerns include the fear that hackers could gain access to account information.
- There are technologically disadvantaged customers who require personalized services.
 - Customers may lack a computer or Internet access.
 - Customers may lack the computer skills, Internet skills, or other technological knowledge
- Human interaction is required for addressing some customer problems and inquires.
 - Check cashing or depositing: If there are no teller windows to visit, then the check will have to be mailed in, and this will take time to process.

³⁹ "Yahoo Finance"

⁴⁰ "Company Overview"

⁴¹ "Company Overview"

⁴² "Company Overview"

⁴³ "E*Trade," *Archipelago*, 2000 - 2002, <<http://arcax.taltrade.com/default.asp?x=0&y=0&page=/inside/partners.asp>> (10 November 2004).

- When there are significant problems, customers prefer face-to-face communication to solve the problem, not e-mail or live chat communication.
- Human interaction is necessary to building long lasting relationships.
 - The development of these relationships can only be facilitated through face-to-face communication with banking customers.

Despite the ease of online banking and investing, there are still customers who are only comfortable with physical facilities. It will be necessary for E*Trade to provide some form of facilities if it is to attract these customers. Furthermore, even those with the access to online financial services may have a lack of understanding in the usage of the site or possess a fear that prevents them from trying to use the available services.

THE BATTLE FOR MARKETSHARE

Decline In Gain On Sales Of Loans And Securities And Principal Transactions:

The gain on sales of loans and securities, net decreased 21% to \$84.1 million for the nine months ended September 30, 2005 from the same nine months in 2004.⁴⁴ And also principal transactions decreased 17% to 75.5 million for the nine months ended September 30, 2005 when compared to the same period in 2004.⁴⁴ If same scenario continues, this declining trends threaten to weaken company's position and may lead to slow revenue growth.

Increased Competition

As the online financial services market continues to grow and become successful, there will be new entrants into the market that look to gain market share. E*Trade is fighting with full commission brokerage firms, discount brokerage firms, online brokerage firms, Internet banks, and mortgage companies. This market is incredibly competitive, and the rivals offer touchtone telephone, voice response and online banking services, bill payment, and other financial products.⁴⁴ With the industry price-war, mergers, acquisitions, its continued diversification of services and the new entrants, E*T is going to see increased rivalry form both old competitors and the new entrants.

THE FUTURE

What does the future hold for E*Trade? The opinions are as varied as the individual experiences of clients. Some analysts believe the company is doing the right things to get and keep customers. "Their stock trades are a flat \$19.95 which is competitive to Schwab at \$29.95, but not with Ameritrade and Datek whose trades average \$8-10. But if you want all your financial accounts under one roof, I can't think of a better place to go besides your local bank."⁴⁵ The author of this review feels that one of the main strengths of E*Trade is the number of services that are put together in a website that links all accounts and services together in a format that is easy to navigate. In addition, the author appreciates the fact that requirements to open accounts are minimal: \$1,000 for the bank or \$0 for the broker account. Schwab requires a minimum of \$5,000 for a broker account.⁴⁶ This article is one of the many online reviews that recommend E*Trade as a good place to conduct financial business.

Another online opinion considers E*Trade to be average in its services and transactions but would still recommend it based on several sets of criteria, including after-hours trading which costs \$14.95 for market orders and \$19.95 for limit orders. These rates are competitive with other brokerages. E*Trade also has a well laid out Account Services page and provides a variety of research tools, including a very extensive library of both general

⁴⁴ "Yahoo Finance"

⁴⁵ Ili_wright, "E*Trade is doing it right!", *Epinions.com*, 25 July 2004, <http://www.epinions.com/content_71196380804> (29 November 2004).

⁴⁶ "E*Trade is doing it right!"

news and “how to” documents.⁴⁷ So why does the author stay with E*Trade? “In conclusion, E*Trade is certainly passable as an on-line brokerage. Nothing about it, other than the news, stands out as the greatest in history, but then again, I haven’t seen anything that I like enough to make me switch.”⁴⁸

A number of online opinions support using E*Trade for financial service needs; a great deal of these authors use the services themselves. The majority of them point to E*Trade pros as execution, easy website navigation, and a large library of content. Of 287 Epinion website users, E*Trade received an average rating of three out of five stars for customer service, website experience, and website load time.⁴⁹

E*Trade has a strong record in the online financial services field and will continue to strengthen that position through expansion of services and growth opportunities. The company will continue to be a presence in the industry and holds the potential to become a global powerhouse. With the diversification of services and the careful management of the firm, it may become the online leader in several of its offered services. With acquisitions and strategic mergers simultaneously expanding into the bricks-and-mortar financial industry, E*Trade can continue to increase its marketshare and strengthen its position as a diverse financial services provider in both the virtual and real worlds.

APPENDIX EXHIBIT A

Key Employees & Biographies

Name	Job Title	Board	Total Annual Comp.
Mitchell Caplan	Chairman and CEO (Since: 2003)	Executive Board	637,616
Lewis Randall	Director (Since: 1982)	Non Executive Board	-
Dr. Lester Thurow	Director (Since: 1996)	Non Executive Board	-
Michael Parks	Director (Since: 2003)	Non Executive Board	-
Vaughn Clarke	Director (Since: 2003)	Non Executive Board	-
Cathleen Raffaeli	Director (Since: 2003)	Non Executive Board	-
Donna Weaver	Director (Since: 2003)	Non Executive Board	-
Robert Lilien	President and COO (Since: 2003)	Senior Management	-
Arlen Gelbard	Chief Banking Officer and President, E*TRADE Bank (Since: 2002)	Senior Management	-
Louis Klobuchar, Jr	Chief Brokerage Officer and President-elect, E*TRADE Securities	Senior Management	-
Joshua Levine	Chief Technology and Administrative Officer	Senior Management	635,769
Robert Simmons	Chief Financial Officer	Senior Management	-
Russell Elmer	General Counsel and Corporate Secretary	Senior Management	-
Betsy Barclay	Chief Government Affairs Officer	Senior Management	-
Connie Dotson	Chief Communications Officer	Senior Management	-
Nicholas A. Utton	Chief Marketing Officer (Since: 2004)	Senior Management	-
Jim Bidwell	Chief Risk Officer (Since: 2004)	Senior Management	-

Source: DATAMONITOR.<http://academic-1.lynchburg.edu:2280/companies/company/?pid=DC301BD8-FB27-458D-9A95-C9B014823BCE#LocationsSubsidiaries>

⁴⁷ mrisch, “E*Trade, so average I couldn’t think of a good title,” [Epinions.com](http://www.epinions.com/finc-review-2BE6-3D20739-397136B8-prod1), 15 July 2000, <<http://www.epinions.com/finc-review-2BE6-3D20739-397136B8-prod1>> (4 December 2004).

⁴⁸ “E*Trade, so average I couldn’t think of a good title”

⁴⁹ “E*Trade overall rating,” [Epinions.com](http://www.epinions.com) <http://www.epinions.com/finc-Financial_Services-Online-Brokerages-A-E-E_Trade/display_reviews> (4 December 2004).

EXHIBIT B**Customer Benefits And Disadvantages Of Online Banking***Benefits*

1. Direct control over finances by the customer themselves
2. Convenience - the ability to instantly access information on all accounts easily and in one place
3. Ubiquity – the ability to access from anywhere that has an Internet or www connection
4. Transaction Speed - quick execution and transaction confirmation
5. Efficiency – to access and maintain accounts of all types from various locations
6. Effectiveness – for portfolio management and investment options
7. Real time information and quotes

Disadvantages

1. Learning curve – Learning to use and navigate a website may be difficult since companies have their own unique setups and tools.
2. Website changes – In the dynamic world of online banking, business transactions change quickly, and an update can require clients to learn to use a website and tools all over again.
3. Customer service – The online banking world offers very little interaction with real people, and this can frustrate some customers. If customers are uncomfortable talking to an automated phone service, imagine their aggravation dealing with a bank in only e-mail communication.
4. Security – Many are uncomfortable dealing with online banks since they have no physical presence and that frightens them.
5. Confirmation – If there is a major problem with an account, perhaps a large amount of money is missing, the only proof that a client has is the printed statement that he/she printed showing money having been in the account on a previous visit. A customer must be certain to always print a paper copy of any transactions and the remaining balances in each account; this is the only evidence that they will have in the event of a discrepancy.

This list was compiled using: “The Benefits to banking online” by Tom Silva and “What is Online Banking?” available at <http://www.bankrate.com/brm/olbstep2.asp>.

E*TRADE FINANCIAL STATEMENTS**Table of Contents: 1**

Revenues			
Nine Months Ended September 30,			
	2005	2004	Percentage Change
Revenues:			
Commissions	\$ 333,392	\$ 332,901	-
Principal transactions	75,547	91,417	(17)%
Gain on sales of loans and securities	84,121	107,078	(21)%
Service charges and fees	100,863	73,245	38 %
Other revenues	67,717	68,254	(1)%
Interest income	1,148,532	822,564	40 %
Interest expense	(535,532)	(369,616)	(45)%
	-----	-----	-----
Net interest income	613,000	452,948	35 %
Provision for loan losses	(37,946)	(25,701)	(48)%
	-----	-----	-----
Net interest income after provision for loan losses	575,054	427,247	35 %
	-----	-----	-----
Total net revenues	\$1,236,694	\$1,100,142	12 %

Source: Yahoo Finance.

Table of Contents: 2

	Three Months Ended September 30,		Percentage Change
	2005	2004	
	-----	-----	-----
Revenues:			
Commissions	\$117,165	\$84,869	38 %
Principal transactions	23,793	24,391	(2)%
Gain on sales of loans and securities, net	21,850	28,415	(23)%
Service charges and fees	32,960	21,653	52 %
Other revenues	22,920	20,798	10 %
Interest income	424,142	293,004	45 %
Interest expense	(207,101)	(128,852)	(61)%
	-----	-----	-----
Net interest income	217,041	164,152	32 %
Provision for loan losses	(12,909)	(9,145)	(41)%
	-----	-----	-----
Net interest income after provision for loan losses	204,132	155,007	32 %
	-----	-----	-----
Total net revenues	\$422,820	\$335,133	26 %
	-----	-----	-----

Source: Yahoo Finance.

Table of Contents: 3

	Nine Months Ended September 30,		%
	2005	2004	
	-----	-----	-----
Gain on sales of originated loans:			
Mortgage loans	\$32,513	\$54,429	(40)%
Consumer loans(1)	14,634	10,400	41 %
	-----	-----	-----
Gain on sales of originated loans	47,147	64,829	(27)%
	-----	-----	-----
Loss on sales of loans held-for-sale, net:			
Gain (loss) on sales of loans held-for-sale	(1,297)	5,159	*
Gain (loss) on hedges	95	(6,774)	*
Loss on loan prepayments	(240)	(1,226)	80 %
	-----	-----	-----
Loss on sales of loans held-for-sale, net	(1,442)	(2,841)	49 %
	-----	-----	-----
Gain on sales of securities, net:			
Gain on sales of securities	77,740	58,633	33 %
Impairment	(38,343)	(13,543)	*
Loss on hedges	(981)	-	*
	-----	-----	-----
Gain on sales of securities, net	38,416	45,090	(15)%
	-----	-----	-----
Total gain on sales of loans and securities, net	\$84,121	\$107,078	(21)%
	-----	-----	-----

Source: Yahoo Finance.

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TEACHING NOTE:

Overview:

The case can be used for one class session. The main issues for the present case can be:

1. What alternatives company should consider to compensate the dearth of physical locations to attract Internet-illiterate customers and increase the trading volume?
2. With the increasing competition and customers' expectations, what alternatives company should consider to acquire new accounts and continue to grow?
3. What are the steps company should consider to deal with the increased competition experienced from its close rival and industry's biggest merger TD-Ameritrade?

I would begin the class by explaining, what actually the company is? How it evolved to the present shape? During the discussion I would highlight the following points.

- Pioneer in online brokerage services.
- Initially provided back-office online processing services to Schwab and Fidelity.
- Change from a "private-label" strategy to a direct-to-customer" business model.
- "Can this be done better?" approach.
- Alliance with General Atlantic Partners to upgrade Internet.
- Round the clock service.
- Most of the trades completed in less than one second.
- Most visited banking and investing site on Internet.
- Ranked fourth measured by daily trading volume with \$14.6 billion deposits.
- Largest number of ATMs in US (15,000 machines in US and 600,000 machines world wide.) and no-fee cash even when used an out-of-network ATM.
- Absolutely no physical branches.
- Convenient and easy to understand website tools (Ex: Loan calculators, IRA help and tips, and past stock history, etc.)
- Diversified and integrated portfolio of services.
- Offers trades for as little as US\$6.99.
- Over 2500 companies use ET for the management of stock plans for 1.3 M employees in more than 100 countries.
- Over 3500 employees with "very flat" management structure.
- Scalable Oracle EPR applications and ProactiveNet software to manage financial and HR functions enabled to use lean staff to run all of its modules and to provide real-time application and infrastructure performance analysis.
- Use of IBM to develop a horizontally scaled system that can adapt to workload changes and failures.
- Q3 2005 Vs Q3 2004: - DARTs increased 29%.
- Net interest income increased 32%.
- Acquisition of Howard Capital Management and Kobern Insight Management.
- Buying of Harrisdirect and BrownCo.
- With the acquisitions, average trading volume per day increased to 160,000.
- The deposits in banking accounts crossed above \$12.5 Billions.

As a logical sequence, I would analyze the current conditions of brokerage trading industry.

- Three higher ranked competitors Fidelity, Schwab and TD-Ameritrade.
- International growth: China doors opening for non-Chinese banks in 2006.
- Increased competition from 376 Internet banks, 30 Internet-only banks, and mortgage companies.
- Continuing popularity of traditional bricks-and mortar banks.
- Demise of day-trading boom in late 1990s.
- Intense price war, substantial slashing of fee and commission charges.
- Industry consolidations. Ameritrade being the major concern.

With the background in place I would allow the class to ponder on the above issues by stating the following key points.

Key Points:

- 16.5 percent cost reduction and a 6.3 per cent reduction in total interest income from 2002 to 2003.
- Firm completely virtual with no physical existence.
- Received an average rating of three out of five stars for customer service, website experience and website down load.
- Unsuccessful attempts to acquire TD-Waterhouse and Ameritrade.
- Decreased focus on Brokerage business, the core revenue generator.
- No prominent differentiating features.
- Consolidation of TD-Ameritrade.

I would then present the following as some of the possible solutions to address the questions posed at beginning of the class.

Develop Bricks-and-mortar Presence

The need for more physical locations is obvious. There are some customers who will not do business with a financial services firm that is completely virtual. The development of more bricks-and-mortar locations should be pursued as it can help to generate more customer accounts. The company has to start constructing the physical locations to develop a sense of “real world” that makes customers comfortable. These locations are the key to attracting new customers and to introducing them to the world of services that E*Trade has available online.

New Accounts

E*Trade will need to continue its focus on attracting new customers and getting them to set up accounts in the services offered. The diverse portfolio that E*Trade has is attractive to all types of customers, and the firm will promote this value to potential customers. E*Trade should make certain that customers know E*Trade is not just about investing and stock trading; it is also loans, checking accounts, credit cards, and other financial services. Targeting these new accounts may involve going to other forms of media advertising, similar to what *e-bay* has done with television commercials.

Increase Revenue in the Core Businesses

The brokerage business is the main revenue generator for E*Trade and efforts need to be focused on increasing the revenues in this area. Newer, faster, and better ways to offer online trades need to be continually researched and developed. The company should also focus on letting the customer base know that E*Trade offers faster trade executions and lower commissions. There may be customers who are looking for online services and just need a push in right direction. Once they become familiar with the company and its services, they may become loyal customers.

Focus on the Changing Demographics of Customers

The baby boomers are looking for somewhere to invest their retirement money and as a customer base make an excellent target. Efforts need to be concentrated on making them aware and ready to use the E*Trade services. If they can be attracted, they represent a significant number of new accounts. E*Trade should develop a website section targeted directly at these consumers that provides information and financial opportunities for them.

Pursue Growth Options

These growth options include the United States and international markets. The Chinese market offers significant opportunities to attract new customers and should be pursued as quickly as possible as the first companies to move will quickly develop a reputation in the country. E*Trade needs to be ready to move in and establish operations. The research into regulations should already be underway, and the design of a web interface to accommodate the Chinese customer should be developed immediately. This website should be ready to deploy as soon as legal regulations allow. E*Trade needs to be the first, or among the first companies, to enter the market.

Continue Acquisitions

In order to successively compete in the present industry conditions, ET has to continue strategic acquisitions and mergers with both the trading companies and prominent bricks-and-online banks. Bricks-and-online banks are more beneficial than pure online banks, because the company is in the process of compensating its dearth for physical locations. And moreover, the baby boomers who are less comfortable banking online, unlike younger generations, and who are considered to be one of the most potential prospective customer segments can easily be reached through these banks. Therefore, such an acquisition or merger brings more number of affluent customer accounts so that they can encouraged to use other services in the ET's portfolio.