The Net and the Future of Financial Services Transparency, Bypass, and Differential Pricing

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Context

Principal Issues in Retail Financial Services

- **Transparency**
  - "Buy Low, Sell High"
  - "God I love this job"
  - "Not that kind of Sabbatical"

- **Differential Pricing**
  - Love 'ems and kill yous
  - Pricing the stock vs. pricing the trade

- **Bypass**
  - "I can do that trade for you for $200"
  - "I can do that trade for you for $8.00"
  - "But we provide the research"
  - "Would you swing by McDonalds and get some catsup?"

Transparency and Terror

Harry Potter and the Prisoner of Askaban

- **Amazon.com**
  - List: $19.99
  - Our price: $9.98

- **Barnes and Noble**
  - Bn.com: $9.97
  - Retail: $19.99

Green Sea of Heaven

- **Amazon.com**
  - Our price: $14.95

- **Barnes and Noble**
  - Bn.com: $11.20
  - Retail: $14.00

Transparency

Price for a Retail Stock Trade

- **Merrill Online: $29.99**

- **Schwab: $29.99**

Price for an options trade is 20% lower at Merrill

Like *Harry Potter* and *Green Sea of Heaven*

Transparency

Net changes information endowment:

- Customer finds what he wants
- Customer finds the price he wants
- Hard to confuse the customer
- Even harder to deceive the customer

But…

- We own the product
- We know more than the customer
- We determine the rules of engagement
- We've always needed a marketing strategy

The game is not over yet…

Pricing Strategies

Strategies for one-to-many/B2C

<u>Customers</u> are different:

- Cost to Serve and Revenue Differences
- Willingness to Pay/Honest Revelation/History and Path-dependent pricing

And <u>products</u> are different:

- Different attributes, different appeal
- Different quality, different appeal
- Differences can be augmented, through *mass customization* strategies

Combine the two

All that delightful complexity!

Cost and Revenue

- ***Love 'ems*** **and *kill yous* in credit card**

- ***Love 'ems*** **pay finance charges**

- ***Kill yous*** **do not**

- **The *customer profitability gradient* and the *Money Pump***

- **Enormous profitability differences**

- **Exploited through product design**

- **The *Balance Transfer* product**

- **Death Spiral**

Product Design

Product design for profitability, through <u>screening mechanisms</u>:

- **Love 'ems and kill yous in credit card**
  - Love 'ems pay finance charges
  - Kill yous do not
  - Balance Transfer Product

- **Love 'ems and kill yous in insurance**
  - Love 'ems drive safely
  - Kill yous do not
  - Vary the size of the deductible or the nature of policy exclusions

Honest Revelation

Willingness to Pay

Versioning

At Priceline

At Merrill Lynch

For the London Stock Exchange

Path-Dependent Pricing

Air Tickets at Expedia

Cell phone service from Sprint

"*Everybody is doing it…*"

Cameras at Yahoo…

Implications

"When one of your competitors starts down this slippery slope..."

- **Availability of early morning hotel check-in?**

- **Availability of credit cards?**

- **Availability of low cost telephone service half-way up Mount Shasta**

- **Availability of universal, affordable health insurance?**

- **And role in encouraging bypass and opportunistic pick-off**

Bypass – Is it safe?

"Is it safe?" –

> **Marathon Man**

"Is it safe?" –

> **Unilever**

"Is it safe?" –

> **British Airways**

"Is it safe?" –

> **Brokerage, Insurance**

How do we know?

Newly Vulnerable Markets:

- Easy to enter – change in consumer preferences, complexity and subjectivity of interface design

- Attractive to attack – "*love 'ems*," "*kill yous*," and a "*customer profitability gradient*"

- Difficult to defend – obstacles that interfere with defender's immediate replication of attacker's strategy

How do we know?

Newly eVulnerable Markets:

- Easy to enter – change in consumer preferences, complexity and subjectivity of interface design

- Attractive to attack – "*love 'ems*," "*kill yous*," and a **visible** "*customer profitability gradient*"

- Difficult to defend – rapid and plausible punishment from retailer if threatened with bypass

Future of Bypass

For grocery stores?

For music stores and record labels?

For Wal*Mart?

For full service brokers?

For insurance agents?

Conclusions

- **Transparency**

- **Channel Power and Bypass**

- **Love 'ems, Kill yous, and Pricing Strategies**

- **Clear Strategic Choice**

- **Complex Social Choices**