

Reality of virtual banks

On-line banking – e-banking – Internet banking (IB) – gives customers access to bank services through electronic media, including Internet.

Net-only bank is a type of bank providing its services exclusively through Internet; it does not have a physical office but only a legal address.

First banks' sites made their appearance in the Internet not so long ago – in mid-1990s. Before, banks had experimented with different on-line forms of access to bank accounts – mostly using closed systems; customers accessed banks through dial-up telephone channels. Such systems confined bank's potential clientele since involved extra expenses from customers and the bank. Internet spread brought the wide use of distant account management; credit organizations saw the prospect of this facility in bank business.

Originally, IB had two directions of application – passive and active. The first enabled users to get information on bank accounts without managing them. Active access implied the possibility to carry out on-line operations with clients' accounts. Some banks took the first path whereas others successfully developed both.

First IB systems were 'born' in the USA facilitated by a high rate of migration. Moving to a new place, a person had to switch to a new bank if his 'native' did not have a representative office at a new residence -- an obvious inconvenience for people and enormous losses for banks. Besides, several American states rule out opening branch offices of 'alien' banks. On-line accounts management systems that emerged in mid-1990s solved the problem and opened limitless market possibilities for banks.

IB's advantages are obvious. Even from the perspective of an individual, Internet banking makes a whole lot of sense. First and foremost, there is no need to take the time off and drive to your bank branch and wait in long, unending queues to be served. Beside saving a trip to the bank you can check your balance whenever you need to regardless of bank working hours. Not only that, but you can pay your bills online as well and make any financial transaction; stocks and currencies and other investments can be managed with online banking from your home or office depending on the current financial situation). Also, the convenience of the data capture online makes it much easier to budget and track where your money goes; any charge-off will immediately be reflected in statements of account, increasing customer's awareness of his expenses.

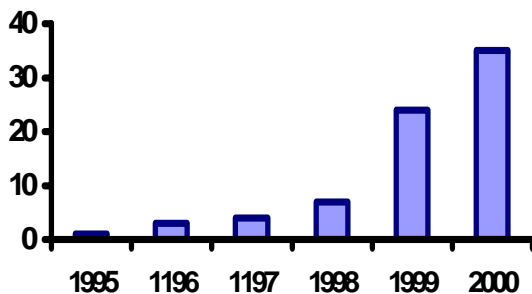
Because there are fewer buildings to maintain, and less involvement by salaried employees, there is a much lower overhead with online banks. These savings allow them to offer higher interest rates on savings accounts and lower lending rates and service charges. Business profits even servicing holders of small deposits at banks' accounts.

Cut costs is not the biggest argument to support on-line services. Research proves that competition has been and stays primary moving force pushing bank into IB-sector. This factor has shown to be stronger than decreased expenses.

The idea to employ IB's advantages to fight competition on the market of financial services 'gave birth' to fully virtual banks that do not have a single office – only a legal address. The first bank of the kind – *Security First Network Bank* -- appeared on the Internet on October 18, 1995. During a year and a half of its existence capital surplus reached 20 percent per month, assets grew up to 40 million USD; about 10 thousand accounts were open.

With such projects emerging, a lot of market participants plunged into euphoria about the wide prospects in winning new shares of market and removing traditional banks from the scene by lower organizational costs, close to boundless market and advantage of ultimate efficiency of service.

Picture 1. Dynamics of network banks growth in the USA



Advantage of internet banking is higher cost-effectiveness over traditional banks; therefore, on-line banks could offer a higher rate on clients' deposits. However, time revealed that it was not enough to fully push physical banks from the market.

Most of people are still not prepared to change personal contact at a real bank for efficient on-line financial operations. The fact was confirmed by *Deloitte Consulting* research *Myths and reality in financial services: what your customs actually need*. Despite billions of USD parked in the IB sector the latter has never grown to a boom.

Two thirds of respondents in nine countries of Europe and Northern America and in Japan do not consider on-line services are or can become the crucial factor determining their choice of a bank. At the same time, only 22 percent of those opposing the view make on-line transfers or payment; 30 percent of them do not know if their bank provides such services.

In Great Britain, for example, where net-only financial institutions actively compete with traditional credit organizations almost two third of the questioned are discerning to the level of service and attitude to them as towards valuable customers. The research people concluded that the above is what bankers should be wary of to offset risks related to competition from network banking.

As a result of the rivalry, the banking market emerged with two tendencies. On the one hand, old bank giants – having witnessed the results of network banks' 'attacks' on their customers' base – launched Internet-services. On the other hand, net-only banks turned to opening traditional offices after they realized drawbacks of virtual communication with customers.

Jupiter Media Metrix survey points out that traditional banks with net-only departments are more popular than banks with virtual only services. To confirm the fact, the number of those logging onto web sites of traditional banks in the USA has gone up by 110.5 percent last year whereas the number of visitors of virtual banks dropped by 8.1 percent. Experts are confident that net-only banks will have problems in preserving their positions. Choosing a bank, a customer judges it by traditional criteria. People would more willingly go to the bank with easier access to the clients' base, with an office near their home; recommendations from friends or relatives are also an asset.

Theoretical studies picture the future of net-only banking with certain criticism. Different authors in their works emphasize that a net-only bank loses to a traditional in terms of profitability and proves to be a less vital business model.

The opposition towards Internet bank services gave place to the understanding that on-line banking may become popular only in case of their joint promotion at universal financial Internet-portals. The compromise between distant access to bank accounts and 'live' service was the key to sustainable development of the new technology all over the world.

Today, Internet hosts more than 3 thousand of bank sites offering IB services. More than a half of European banks have introduced on-line systems. (See Table1).

Table 1

Bank	Share of Internet-customers, %
SE Banken (Sweden)	25
MeritaNorbanken (Finland-Sweden)	15
Deutsche Bank (Germany)	8
BSCH (Spain)	4
Barclays (Great Britain)	2

According to *Forrester Research* survey, like in traditional sector, Swiss banks lead on the European retailing on-line market; Finnish banks use Internet most actively (about 90 percent of their overall quantity).

Presently, IB is top popular in the USA where on-line services are offered by all large banks and 10 percent of small ones. Only the Bank of America (BoFA) serves 3 million customers via the Internet today (20 percent of general bank's client base); last year, 1 million of customers were added.

It is noteworthy that in the USA deposits safety guarantee covers clients of Internet-banks registered on the territory of the USA. A USA citizen can remotely establish an account practically at any bank but have to indicate his social security number – a unique number giving banks access to customer's data, t.i. his credit history, his real estate status, law violations, and so on.

Eastern countries, India, for example, witness growing popularity of e-banking -- including account status checking and electronic transfers. On the whole, 17 percent of total Indian banks' clients refer to e-services.

Marketing service *Qualisteam* presents the following distribution of Internet-banks by regions (see Table):

Table 2.

Region	Quantity of banks *
Africa	23
Northern America including	1415
Canada	32
USA	1383
Latin America	258
Asia	174
Europe including	1205
Germany	355
France	172
Italy	228
Other European countries	450
Asia	32

*Table covers 95 percent of Internet-banks in the world (3107 sites).

Despite moderate indices of IB promotion developers of Internet-systems do not give up; credit organizations introduce new technologies and the number of users is ever increasing. Are the trends are continue? Practically all analysts are optimistic about IB future.

New type of business emerging along with spread of Internet – Internet shops, wholesaling Internet trade platforms, electronic departments of insurance and brokerage houses – employing efficient on-line charging solutions to win the market is an asset for banks in this situation.

Datamonitor study group signals that 121 million people in Western Europe and the USA will perform bank operations via Internet in 2005. Only in Europe, IB market turnover it to amount 5 billion Euros. *Forrester Research* holds the view that Germany and Switzerland register the highest pace of IB development; by 2003, network services will be used by about 7 million people.

Fitch rating agency prompts that by late 2001 the share of IB-clients at European banks is to go averagely up to 15 percent. The quantity of banks offering services via Internet also constantly ascends. Analytical agencies provide data that by the end of the current year 10 percent of USA citizens (more than 22 million people) are to enjoy IB service.

In Russia, setting up banks' Internet sites was launched before August 1998. The financial crises led to ultimate distrust towards banking system – impeding the process of introducing interactive financial Internet programs. When economy hit by the crises showed tentative sign of stabilizing new electronic technologies again got into the spotlight of Internet users.

In contrast to foreign banks that surged deposits rates (average on-line deposit's rates reach 4 percent whereas that of traditional equals 1.5 percent), Russian banks turned to a principally different way to win customers -- they brought down tariffs on major bank operations. As a rule, Russian banks target first of all corporate clients when starting with serving on-line.

Today, more than 100 web-sites of Russian banks are registered. Still, Russia lags far behind in terms of e-services popularity. In most cases, banks' sites host information and only some of them offer on-line accounts access and managing.

Expectedly, most of IB users in Russia are located in Moscow. According to *Monitoring.ru* company, Moscow's and Saint-Petersburg's share of total number of network users reaches 33 percent. 46 percent of overall Internet-users reside in Russian cities with population over 100 thousand people; they are potential clients of network banks.

Statement of account, currency conversion, Internet-shopping, housing and utility payments, as well as cell phones charges are the most popular on-line banking services. In this sector, the year 2000 brought a sharp increase of users' number. Such result is quite predictable for the young market. However, it is important to understand that market participants swiftly invest into the new sector but the number of first active users is limited and it will be much harder to attract a wider public. So, this year, the number of newly joined in the network is on a decrease.

To our mind, the latter indicates the end of the first wave that brought the most active customers to e-banks. Russia has a relatively low level of population's income and people are destined to weak interest towards new banking services. Another factor posing an obstacle to IB movement in Russia is absence of appropriate legislative basis.

Why Russians are so reluctant about joining in to those who actively employ the high-tech advantages? Last estimates show that Russia has 6 million active web users but only about 10 thousand people conduct financial operations through Internet. *Internet Marketing* and *MFD-InforCenter* carried out research of Russian financial market of Internet-services. Below are the questions asked and the answers given to them:

Did and how changed the sum of average monthly at customers' accounts when shifting to on-line service?

58 percent – did not change; 30 percent – increased; 12 percent – decreased.

How did money turnover change after clients switched to on-lines services?

50 percent – increased; 28 percent – did not change; 22 percent – decreased.

Results vividly demonstrate that on-line services facilitate money movement but do not spur deposits growth. So, customers perceive IB (like other e-services – stocks, investment, insurance and so on) as an instrument but not an alternative way to invest money, which means that on-line services make life easier for the existing users of on-line bank services but do not attract new customers.

Experts concur in their opinion about the main reason driving Russians so indifferent towards high technology. Though 50-80 percent of IB users approve of this utility most of them are not confident about safety of Internet-operations.

Surely, concerns over security of financial transactions through Internet play one of the crucial roles in the popularity of on-line services, especially in Russia. Server of any bank is an open target for hackers as soon as it is logged on the network. Cases of direct fraud have also been registered. The survey among those who gave up transaction via Internet points out to inadequate security as the main reason.

The history of Internet banking has come a long way and it is only going to get better! Software and telecommunication producers fight for being able to introduce their technologies in IB – a prolific business nowadays. Evidently, rising safety of storing and communicating data will become the key to open new doors to the developing technology.

Still, it will take time until IB wins the trust of its potential users. Either we will habituate to virtual banking or the technology will offer us a new level of service will be sorted out by time. Experts admit that Internet-banking has strong potential in Russia. By 2005, a half of all Russian banks are to offer on-line services – winning 5 percent of population. Is not it inspiring!?