Chapter 2.16

Business Model of Internet Banks

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ABSTRACT

Internet is not simply one more distribution channel among the multi-channel strategies used by the financial industry; it is fostering new "e-Business Models" such as Internet-primary banks. However, in spite of its strong development potential, this type of bank has often achieved a weak breakthrough onto this market and shows modest financial results. The goal of this chapter is to study the "e-Business Model" of Internet-primary banks and to determine if it can perform better than the "Business Model" of a traditional bank.

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INTRODUCTION

The development of Information and Communication Technologies, and more specifically Internet, has increased competition in the banking sector and brought about the separation of production from the distribution of financial services and products. The arrival of Internet has given a new dimension to the convergence and the deconstruction of the value chain by making it possible to lower information costs, and by reducing barriers to entry into the financial sector.

Convergence has taken place on three levels:

- convergence of offers; by widening their product range, banks and insurance companies have entered into direct competition,
- convergence of the sub-sectors of the financial industry; banking, insurance and asset management activities increasingly overlap,
- financial institutions and non-finance actors have become more closely linked

Previously, deconstruction came mainly from the offer side, i.e. from the emergence of new entrants (e.g. consumer credit). With Internet, it comes from the demand side: customers can choose the best supplier depending on their preferences (e.g. real estate loans, online brokering). With the appearance of banks which mainly sell their services by Internet (Internet-primary banks), the major competitive advantage of traditional banks - a network of local branches - has been diminished for certain types of customer. These customers have been attracted by the prospect of accessing their accounts and carrying out bank transactions 24 hours a day, seven days a week without having to go anywhere, and sometimes with a better quality of service than was offered by a bank branch. Online brokers were the first to offer private individuals the opportunity to invest on the stock exchange via Internet. Moreover, the vast majority of Internet-primary banks charge lower account administration fees than those charged by traditional banks. This has often been used as an argument to attract customers in a nearly saturated market.

The goal of this chapter is to study the "Electronic Business Model" of Internet-primary banks and to determine if it can out perform the "Business Model" of a traditional bank. After having defined the Business Model and e-Business Model (e-BM) concepts, we will analyze the e-BM of online banks as an economic model through the study of its revenue sources, costs incurred, and how it creates value for customers. Then, we will question its strategic development prospects. Lastly, we look at Internet's impact on performance in the case of both traditional institutions as well as Internet-primary banks.

BUSINESS MODELS IN THE FINANCIAL SECTOR

Business Models and Electronic Business Models

The objective of this section is to better understand the "Business model" (BM) concept. Many papers have already been written which attempt to clarify this concept due to its dynamic dimension. We will look at how this concept has been applied to electronic services: the "Electronic Business Model" (e-BM).

One of the first workable definitions of this concept was provided by Timmers (1998). He defines a BM as being:

- the architecture for product, services and information flows including a description of the model's various business actors and their roles;
- a description of the potential benefits for each business actor involved;
- a description of the sources of revenue.

Other writers have since expanded this idea. Linder and Cantrell (2000) state: "It's a rich, tacit understanding about how all the pieces work together to make money". These authors confirm this vision of BMs by the fact that 62% of the company directors they interviewed found it difficult to describe their BM over and above its success[1]. While for Loilier and Tellier (2001), a BM can be likened to a firm's value creation method.

In fact, defining what a BM is can be a difficult exercise because this concept is associated with dynamic dimensions such as value creation,

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