Briefs

Wireless Finance: On the Money

For decades, pundits predicted the demise of banks as we know them. Killer competitors were going to be everything from brokerage houses to national retail chains to automobile and computer companies. Yet, somehow, sheltered by their monopoly access to the payment system, their branch systems, deposit insurance, and consumer inertia, banks have held their own despite of declines in their share of financial assets.

Today, however, the next threat to banks is at hand in the form of the mobile phone.

It has already started in Europe, because Europeans have embraced mobile technology with greater enthusiasm than Americans. But wireless-driven change in financial services is sure to follow in the rest of the world.

The potential for this revolution is real because there's a natural fit between wireless phones and financial services. To start, telecom customers are just as accustomed to doing business with their phone companies as they are with their banks. Furthermore, coupling the telecoms' large, expensively acquired customer base with a communications technology that can be leveraged easily in new, lucrative ways is irresistible. It also may be necessary.

Telecoms have sunk billions of dollars into licenses and infrastructure, and they're now in a race to provide content that will generate a return on their investments. Although they're looking for content from media, entertainment, gaming, and other industries, financial services increasingly are seen as the most appealing because that's where the money is.

The core attraction: Most financial services are inherently "bittable." Twenty years ago, former Citicorp chairman Walter Wriston said the beam of electrons that carried a bank's foreign exchange positions via a satellite in orbit was indistinguishable from the signal carrying the morning news. Today, paying for lunch with a credit card is comparable to making a quick call on a cell phone while in a restaurant.

Using a mobile phone for banking is logical for consumers. Retail finance innovations often fail because they require wholesale changes in consumer behavior. But using a mobile phone instead of a credit card to pay for a meal hardly seems a stretch. Successful innovations in retail finance — think of credit cards and 24-hour ATMs — always complement rather than complicate consumers' lives.

The relationship between telecoms and their customers also mimics banking relationships. For example, when telecom customers settle their long-distance charges at the end of the month, that's credit management. Prepaid phone services are like savings accounts.

A host of firms in Europe are betting on this convergence of telecoms and financial services companies. Take Movilpago, a joint venture subsidiary of Telefonica Moviles, the cellular unit of Spanish telecom Telefonica SA, and BBVA, Spain's largest bank. Telefonica brings to the union the front-end capabilities for processing transactions at a low cost. BBVA supports the credit and payment functions that Telefonica did not possess.

The power of the business concept was made clear by Movilpago's recent legal challenges over competition issues before Spain's highest court. The power is also demonstrated by its ambition: Movilpago expects to acquire 100 million customers and 5 million merchants in

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30 countries in three years, a penetration that took the credit card associations and American Express decades to achieve. And that's just one telecom with a brand presence, primarily in Spanish-speaking countries. Other multinational brands have even greater potential for leveraging their names. Vodafone has built a global brand that customers carry everywhere. Think what it could do with Vodafone-branded financial services.

For the telecoms, the question is how deeply to get involved in financial services. Some will settle for distributing products and services made elsewhere, but the most aggressive may become "manufacturers" themselves. Already, Vodafone's German subsidiary, Mannesmann, has a joint venture with Deutsche Bank.

Today, the preferred structure is just such a joint venture. However, one or more telecoms might try to acquire a bank. Even with recent market corrections, telecoms enjoy higher absolute capitalization and P/E ratios than banks, which gives them the means to do so. Regulations and an unwillingness to take a bold step could hold them back. But, over time, a megaplayer union such as an AT&T/Citigroup merger will make more sense, not less.

Meanwhile, banks have strong cards to play: brands that evoke security and reliability, credit skills, and physical distribution channels.

The sooner banks ally with telecoms for their share of the wireless marketplace the better. Otherwise, their franchises face additional sources of competition.

By teaming up with a telecom provider, prescient banks have the chance to monetize their investments in online capabilities, and amortize their services across a broader, telecom-enhanced customer base.

The convergence of telecoms and banks is an opportunity for those banks that act soon. For those that wait, it will become a threat. Ask not for whom the phone rings.

Wouter Rosingh, Adam Seale, and David Osborn

Complementors: Alliances Built for Speed

As traditional companies move toward the dot-com space and the dot-coms build toward the physical space, the sweet spot lies where they meet — the combination of dot-com capabilities in a traditional organization. But the speed with which companies get to that point is critical and demands a new kind of business partner we call a complementor.

A complementor is a company outside your industry that has a significant influence at a certain moment over your customers. Complementors can lead you to crucial customer information before the customers actually have to make a buying decision, giving you a great opportunity to influence their decision.

The Century 21 Real Estate Corporation is a great example of a complementor to the telecommunications industry. Why is Century 21 important to telecoms? Century 21 knows when people are moving, knowledge that, when shared with a telecom, gives it the first opportunity to retain an existing customer or attract a new customer in its service area.

Other complementor relationships might include real-estate developers and electrical equipment suppliers; service-station owners and direct satellite vendors who can beam content to the video screens on new gas pumps; baby gift registries and college investment plans; home gym manufacturers and vitamin supplement suppliers. But companies shouldn't look too far afield for com-

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The convergence of telecoms and banks is an opportunity — for those that act soon.

plementors, or they will miss those right in front of their face. A complementor is basically any firm that has information that will lead to a deal.

Why are these partnerships so important? The answer is speed. Putting a world-class dot-com capability online takes traditional companies, on average, 5,000 hours of planning and an additional 28,000 hours for the first release, according to Netscape research.

Dot-com entrepreneurs can operate far more quickly. One I met on a plane cemented a deal with our company and began operations in 100 days; 65 days later he was offered $4.2 million for his company. All this after an investment of only $217,000. Alliances are the only way to operate at that speed. (However, with dot-com valuations significantly reduced since early 2000, many potential complementors may make more tempting acquisition targets.)

America Online Inc. does three to four major deals — and another dozen or so of a smaller size — every quarter. It's all a part of rounding out the experience for and providing a scope of services and capabilities to our customers that we couldn't do by ourselves.

The whole idea of looking inside your own industry for partners is pretty much passé. You need to look outside your industry, determine who complements your offering by influencing your customers' decisions on an ongoing basis, and develop relationships with those companies that can help you deliver more innovative products and services faster.

Kevin G. Coleman

The Priceline Problem

Dynamic pricing has been with us since the first farmer haggled with a customer over the price of grain in a village market. Although haggling went out with industrialization in most of the world, many believe the real-time interactive capabilities of the Web can revive it.

Still, not all Web-based dynamic pricing schemes have worked. Take Priceline.com's now-defunct affiliate WebHouse Club. It seemed like a good idea when it was launched. Priceline.com Inc. had successfully developed its name-your-own-price technology to lure bargain-conscious travelers searching for cheap airline tickets and hotel rooms. Why not go after the rest of the consumer marketplace, starting with necessities like groceries and gasoline? On that theory, Priceline's first progeny, WebHouse Club Inc., was born in November 1999. Less than one year later, in October 2000, WebHouse ran out of gas, groceries, and money. With as much media fanfare as when it began, WebHouse folded.

Why did Priceline's pricing scheme work for one set of products but not the other? Because the success or failure of pricing depends on the product and who benefits:

First, there's the nature of the product's sales cycle. Airlines or hotels have an incentive to sell off unfilled seats or rooms at the last minute, because they're "perishable." That is, if a seat

on a particular flight isn't filled, or a hotel room on a given night isn't used, the opportunity to sell them at any price is lost forever. And you can't put them in inventory to wait until you find a customer. Consumer packaged goods and gasoline — the products offered by WebHouse — have no such limitation.

Second, selling inventory at a discount makes little sense if it must be replaced, possibly at a higher cost. Because airline and hotel operating costs are fixed, filling a seat or a bed uses capacity that is already paid for. Therefore, the cost of adding a customer is negligible, so almost any sale price would be profitable. Groceries, in contrast, have unit costs — related to manufacturing, processing, shipping, and maintaining inventory — that must be covered.

Third, there's a difference between commodity products and branded goods — at least from the producer's point of view. For airline tickets and hotel rooms, Priceline targets bargain hunters, in effect making the product a commodity. Customers for such services don't care about carrier names or the inconvenience of changing planes. They want a flight to where they want to go at a price they can afford. And the airlines and hospitality companies, for all their lip service to the importance of branding, also treat their products and services as commodities, varying prices according to supply and demand.

The WebHouse model broke down because the match between price-conscious buyers and brand-promoting sellers was untenable. WebHouse needed the brand-name manufacturers. But they stayed away because Priceline's permanent discounting was seen as a dangerous liability for their brand strategy, which is supposed to promote repeat purchases and loyalty.

Fourth, giving one buyer a lower price does not easily translate into providing discounts to the majority of buyers. Airlines can offer a lower fare to one customer who is willing to make last-minute travel plans, without cutting prices to others who want to book seats well in advance of their travel dates.

There is little flexibility to charge different customers different prices for manufactured items. You can sell day-old bread at a discount, but there's no such thing as day-old gasoline. Differentiating products on short notice in other ways, such as design or function, is cumbersome and prohibitively expensive.

To assess a given dynamic pricing model, we recommend a few criteria as a starting point.

• Information has to be an important component of the product or service. The Web can't compress physical labor and other fixed costs; it can only make marketing and other information-intensive processes more efficient so there's room to haggle.

• To change the way buyers and sellers do business, there must be benefits for both. Self-interest has to be part of the system.

• At a minimum, the broker must match the right buyer with the right seller (like eBay Inc.), and make a profit. If, as with WebHouse, the intermediary can only add value by burning investor cash to deliver a benefit to one participant in the transaction, the enterprise can't succeed.

Raman Muralidharan and Rhonda Germany

How to Profit from Ignorance

The idea that ignorance could be of any value runs against the grain of today's conventional wisdom that knowledge, ideas, and intelligence are the keys to wealth creation.

While knowledge is on a par with green open spaces, dolphins, and organic food as unquestionably good, ignorance is considered a thoroughly bad thing, ranked alongside body odor and bad breath. Yet ignorance has far more going for it than most people think. Knowledge and ignorance are two sides of the same coin in the modern economy. The growing significance of ignorance means we need to invest as much in ignorance management as we have invested in knowledge management in the past. Let me explain why.

Under the right conditions, ignorance can make us more efficient. As consumers, we rely on the knowledge of other people, often embedded in the increasingly complex products we need, rather than learning it all ourselves. Imagine if you had to gather all the knowledge you needed to build a computer.

Or take the mobile telephone. Millions of people have cell phones packed with power and software. Yet which of us could explain crisply how a digital mobile phone works? Only a tiny minority. Every time most of us turn on the phone we depend upon the intelligence of the engineers, designers, and software programmers who made it. The growing sophistication of the technology allows us, the consumers, to remain in blissful ignorance of how it works: We just use it.

This kind of ignorance has become more pervasive because of the explosion of new knowledge. Compared to any previous point in history, today modern societies engage in more science more productively, and translate the results into more commercial products that are developed more quickly and spread faster and farther around the world.

And whereas we invest in knowledge creation and innovation in a systematic and highly collaborative fashion today, in the 19th century innovation was largely due to inventors and mavericks working on their own. In 1900 there were about 20,000 scientists and technologists in U.S. industry. By the end of the 20th century there were 1.2 million.

Yet knowledge tends to expand only by becoming more specialized. At the start of the 20th century there were a handful of scientific disciplines: physics, biology, chemistry. Now every science is broken down into dozens of specialist components. Postgraduates don't do biology anymore; they study distinct branches of the science.

As our society's knowledge becomes more specialized, individuals know relatively less. That is why we need to manage our growing relative ignorance more effectively.

Ignorance can lead to a slavish and unquestioning dependence on experts that exposes us to potential abuse and exploitation. For example, most of us trust doctors because of the way they were trained and their ethical codes of conduct. And yet that trust can be easily abused.

The less we know about a product, the more difficult it is to assess its risks. Which of us really understands the risks associated with genetically modified food or cellular telephones?

Innovative companies need to recognize that tough and transparent consumer regulation is vital, so consumers can see that the risks associated with new products are being properly addressed. Companies generally must be more adept at managing the public risks their inventions generate, or they will find it harder to win consumer trust in their new products.

Innovations prosper only when consumers are willing to suspend their skepticism and trust a product. That is one reason brands have become so important. Through brands, consumers are encouraged to trust not just products but entire companies.

In the knowledge economy, we all become richer by becoming relatively more ignorant. We trade our know-how with one another but reveal our ignorance in the process. Ignorance is not quite bliss, perhaps, but it can be far more productive, creative, and efficient than people give it credit for.

Charles Leadbeater