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

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Information: Strategy, Systems, and Economics
Wharton School
February, 2001
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

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

And products 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 screening mechanisms:

• 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