The colour of money

In recent years, there has been a growing trend for brokers to develop third party branded products. Such white labelling has reached phenomenal heights, as Patrick Thornton-Smith* explains

Abacus, Opstracker, Insight, Greenscope, Swiskey, Exchange Links, MLX and MorComextra. Many people outside the futures and options industry would not recognise these names as the branded client-facing 'product' of such brokers as: ABN Amro, DrKW, Barclays Capital, RBS, UBS, Deutsche Bank, Merrill Lynch and JP Morgan. Over the last few years, there has been a huge expansion of brokers developing a branded product as the shop-front to their services. It is hard to find a broker these days that does not market its services through such a brand name.

This practice has now risen to such a level that the cost of developing, supporting and maintaining these branded products represent a significant annual spend to the broking community. For their customers, it represents the 'face' of their broker(s) to such an extent that many will use the brand name when asked who they use to execute and clear through. What has led to this surge in brand names?

The increase of the importance of technology is probably the most critical factor. Not too many years ago, the key document delivered to customers was the physical, paper daily (and monthly) statement. Today, this still represents the factual result of the previous day's activities, resultant calculations and is the regulatory and legal point of reference. What has changed has been the delivery medium. Legally, these statements still have to be sent in hard copy to the customer, however, the delay in this means that these documents are normally faxed to the customer in the early hours of the morning to allow for accurate and timely reconciliation and resultant cash movements on a T+1 basis. As the futures industry has moved to a more real-time, intra-day process and the increase in electronic trading has grown, customers are looking for a faster and more flexible level of service. The internet provides the most common form of broker to client communication and it is the ability to communicate and deliver information globally over the internet at a low cost that is the corner stone of the branded product.

As most of us know, the success of buying products and services over the internet is often down to the look, feel and convenience of the relevant site. In their early days, these sites were often (and some still are) confusing and in many cases too full of information to make navigation and ease of purchase easy. How many times have we got so frustrated that the purchase or retrieval of information has ended in anger and resorting to traditional methods of purchase such as the telephone or even, shock-horror, a trip to the local shop?

However, with the internet maturing and buyers and sellers becoming more discerning, many sites have changed their appeal and are now almost second nature to many of us for purchase and information retrieval. A major force behind the successful sites has been the recognition of the supplier to use their site as a strong and compelling engagement tool with their potential or actual customer. Site developers use the term 'sticky' to demonstrate how important it is for them to not only get the attention of the user but once gained to ensure that they remain on the site for additional purchases and thus effectively block competitors from intruding into their customers potential spending power. The often not so subtle inducement to add 'x' site as a 'favourite' to the user emphasises this point. Early sites were just one-way communication portals, to present information. The increase in e-mail,

instant messaging and improved security now allows a more dynamic two-way form of communication.

One of the overall results of this has been the branding of the relevant site(s). Only a few years ago, many retailers and providers immediately added a '.com' to their corporate brand to, almost overnight, appear technologically 'with it'. This then moved to a subtler branding where the adoption and addition of words such as 'direct' and 'on-line' to the existing company or product name tried to present an even more technologically advanced service. Today we have seen this move to a further level whereby the underlying corporate and/or product has disappeared completely to give rise to a 'new' image. The 'Egg' brand of internet banking is an example of this, where the underlying provider is the less glamorous sounding Prudential Insurance Company, there are many others, too numerous to mention. All too often the reading of the small print is required to find out the underlying vendor. The adoption of .com requires the running together of the product name or service before. With cross border trading, much care is required as the translation into another language can have disastrous and often funny results as happened recently with the Italian power generating entity whose initial web site was www.powergenitalia.com.

The web tightens

Cost, competition, differentiation, globalisation and the increase in cross border trades are other major factors in the increase of branded internet sites as important marketing vehicles to most vendors of products and services. Recent surveys show that internet based sales are overtaking more traditional methods of transaction in many sectors.

The financial services industry has been an early adopter of internet-based branded methods of delivery. The retail equities sector is a prime example of where significant volume has been added through this medium. The ease and cost effectiveness of purchase and sale and access to global markets has allowed many the opportunity for profit hitherto restricted to a very small percentage of the population.

Looking at the specific developments of the listed derivatives market over the past few years, there have been many factors that speeded up this process, some of these being: increased competition, electronic trading, dis-intermediation, proliferation of global markets, cost pressures, more discerning customers and a broader base of technological understanding.

Technological changes have been significant. The market place is awash with third party products, let alone in-house developed ones. Only ten years ago there were less than half a dozen core technology products available through even fewer vendors and a limited range of (expensive) hardware and operating system platforms. Today there is a huge range of products available from dozens of vendors with new ones appearing regularly. The revenues and investment in the futures industry every year now runs into tens of millions of pounds.

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With this increase of choice has risen the opportunity for intermediaries to offer third party products through a 'white-labelled' service. This typically means that the broker has a commercial relationship with a number of vendors to distribute these products under their own brand image. A prime example has been with the increase of electronic trading where the broker wants to offer a range of 'badged' products.

When Euronext Liffe first became fully electronic there was a rush of software vendors who developed and sold their products. Initially, most of the buyers chose a single product/vendor. However, more recently this model has changed and most brokers now offer a choice of trading platforms as the end user is now often demanding a range of products to satisfy their own customers. As with other services, the broker wishes to maintain an element of differentiation over its competitors and white labelling can often provide this. In its simplest format, white-labelling may mean the inclusion of the broker's own logo on the screen, at its most complex it may mean the purchase of a number of API connection 'pipes' presented through a single broker developed front end.

This development has seen the split between 'utility' and 'value added' products. Utilities are often where there is no discernible differentiator and where the product is simply doing a task based on information in the public domain: price feeds and independent exchange margin engines are examples. The value added area is typically where the broker is engaged directly with their end customer and where differentiation can be created. An example of this is unique margin-offset algorithms and VAR models where the information is based on the (prime) brokers unique view and thus not in the public domain. It is here where the brokers typically spend a large amount of money developing their own products and for the utility-based services will buy off the shelf. This utility versus value added dilemma is often decided on the basis of buy vs build criteria such as total cost, support, time to market and the question of differentiation. Thus very few firms have built their own electronic trading platform and even fewer have built their own back office system, the bulk tending to buy rather than build.

In some cases, the broker's branded portal offering is a collection of white labelled products merely 'bundled' together under a unique brand name. Others have gone further and enhanced these products to create a unique, more integrated solution. The fact that most electronic exchanges have open API connections allow the brokers to quickly add or remove third party products seamlessly, with limited integration costs and disruption.

As with many high street technology products such as DVD players, televisions and mobile phones, the broker branded portal bristles with gadgets, bells and whistles. Typically only a limited amount of this functionality is used on a regular basis, some research indicates this can be as low as 20%. Think of how many functions available on our own mobile phones or DVD players we fully utilise?

The above suggestion, within the context of the futures industry, often means that

when an end user is selecting a new broker for clearing, the 'beauty parade' is focused on the technology portal (notwithstanding other important factors such as credit rating, access to markets, customer support, etc). The futures and options business is a much-commoditised one where the historical differentiator has often been down to commission rates. Now the participants in the beauty parades have the opportunity to differentiate themselves with an array of technology products. It is often the case that the end user who selects a new clearer is won over by a particular piece of technology but in practice rarely uses it to its fullest extent. Again, think of the times that we buy a DVD player with a dazzling array of features but in practice only use the basic ones. Human nature plays a large part in any buying process and often the presentation of what a product can do may win the sale.

ASPs on the increase

As noted previously, the internet has created significant change in the world we live in. As a cost effective, secure and truly global method of communication it has given rise to the current increase in ASP (application service providers) products. Many people have suggested that this new phase of ASPs is a cyclical return to the days of the service bureau and even further back (for those old enough to remember, mainframe time sharing.) This suggestion fails to recognise the impact of the internet on the rise of the ASP. The service bureau hey-days of the 1970s and 1980s relied on expensive fixed communication lines typically (for the UK at least) restricted to the then monopoly of British Telecom. These fixed lines typically cost between £5,000-10,000 per annum just within the EC post codes of the City of London and would often mean a lead-time of many months for installation. Although the end user would have a transaction based charging mechanism and no need for expensive hardware (typical benefits of the ASP), the telecom costs made the overall service relatively expensive and limited, geographically.

Today, with the internet being relatively cheap and the power to cost ratio of hardware reducing, the ASP offers a fast to install and cost effective route for many end users. Added to this the increase in mobile devises connected to the internet means that cost effective global distribution is readily available for many technology providers. The end user benefits from the ability to switch and change suppliers quickly and with minimal intrusion and pain of change that were features of the legacy technologies of the 1980s and 1990s.

In contrast to the rise of the ASP is the component-based approach. In short, this offers the brokers the ability to build a new system, in-house, through a suite of 'building blocks' rather than a 'shrink wrapped' solution. Again, the utility vs value added decision is critical in component-based decision making. One of the supporting defences of the component-based approach is the 'best of breed' argument. This proposes that the buyer has a greater choice of discrete functional components that can be integrated together to provide the 'best of the bunch' overall solution.

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For some, the component-based approach can appear ideal as it allows for greater freedom of vendor reliance and a level of control over final destiny. However, there are very few industries that have succeeded (from both vendor and buyer perspectives) in this approach. Firstly, the rise of the ASP, especially where the product relates to a utility, accessed over the internet means that the consumer does not really care about the hardware platform, all he/she wants is a discrete piece of functionality cheaply and without the requirement for a long term commercial commitment. Most technologies now allow for relatively easy integration even via an ASP over the internet. If this means that there is no need for hardware then so much the better. Secondly, the costs associated with integrating a series of components on an in-house basis can be substantial. A recent Tower Group survey indicated that 70% of total system costs are spent on integration. This percentage is huge and therefore only allows buyers with large budgets and a sizeable internal IT staff access. In addition, the annual hardware and data centre environment running costs and effort in ensuring multi-component upgrades can defeat the aims of overall IT cost reduction and speed to market.

In-house systems built with components can provide a level of internal control and on the surface show a unique proposition, however, they are typically limited to those institutions with very deep pockets for the reasons outlined above. Nevertheless, the time commitment needs to be significant with a typical payback period in line with the vendor's normal three to five year term contracts. Conversely, the ASP approach may allow the buyer a more immediate solution at a greatly reduced cost, with a far lesser time commitment and shorter pay back period.

The time and commitment elements are crucial. In today's economic climate very few individuals or firms can confidently predict what they will be doing in a year's time, let alone five. In addition, the cost and time to market elements mean that immediacy and results are most important to many superiors who oversee and fund such initiatives.

This article has focused on a range of technological changes: branded portals, white labelling, ASPs and component based approaches. As with many things in life, fads and fashions come and go and in certain areas the adoption of a '.com' can appear to be the latest thing but perhaps based more on a herd instinct rather than a well thought out plan, taking into account tactics, strategy, profitability and what the customer really wants. The 'Rolls Royce' solution may be what the broker or vendor wants but in practice the customer may want a more immediate and cost effective offering.

The cynic might say that even in the sophisticated world of listed derivatives these shifts in technology are based less on what the customer wants or can afford to pay now, but more on 'keeping up with the Jones' or indeed the Schmidts, given that BMW now owns Rolls Royce! ❑

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