



Empowering the user – markets and the web

Chris Cook looks at how the web revolution is likely to shape the way in which we do business.

The web revolution is gathering momentum, linking more and more businesses, businesses to people and, most of all, people to people. Corporates can connect to individuals, service providers to their customers, and let us not forget that government, whether local or national, is ultimately a service provider to the people.

Like the Web, markets are everywhere: in goods and services, capital and employment, logistics, and even communications. E-commerce is where those markets meet the Web.

E-commerce is the force driving the Web Revolution. Why? First, the Web removes the need for paper, greatly reducing the costs of providing goods and services. Second, it provides access to masses of data.

Fortunes will be made by those service providers who can stake out claims in 'e-space' on some or all of this reduction in costs and on the provision of data. E-commerce can be described simply as a combination of the three following functions, linked by the internet, as shown below:

- market mechanisms;
- payment (involving a transfer of title, usually in money, but possibly barter);
- delivery (involving a transfer of title in the asset delivered); and
- operating instantaneously or 'real-time'.

Markets, of course, come in all shapes and sizes; but they distil down to basic forms. For instance:

- you either know and care who you are dealing with (a 'bilateral' market), or you don't (a 'multilateral'

market);

- you either request a price, or you provide one; or
- you deal in wholesale or retail size.

No matter what the market, however, there are two generic functions:

- the contract must be recorded and given legal effect – contract formation or 'trade capture'; and
- payment.

Any market is defined by those market participants who use the 'trade capture' function.

The creation and empowerment of such market user groups will effectively lead to a reconfiguration of markets outside current exchange and off-exchange proprietary business models.

Wholesale markets – International trade associations

Global international trade associations (ITAs) will be created around a trade capture engine or 'market operating system' with three components:

- a matching mechanism, whereby one counterparty records his acceptance of the trade details as put forward by the other;
- a database of the resulting trades held ('registered'); and
- a 'user agreement', which binds the counterparties legally in respect of the registered trades.

These ITAs will be served by a market-specific application service provider (market service provider – MSP) which will provide, among other things:

- market access, through market-specific voice/IP networks;

- market data (in other words, disseminating, without the intermediation of a quote provider such as Reuters, the 'captured' market data to market participants);
- market-specific payments, outside the proprietary banking networks, but linked to them;
- market-specific trade and title registry databases; and
- other internet-delivered services such as risk management and accounting Web ledgers.

ITAs will also:

- acquire the potential to be wholesale market regulators with a global reach provided by the ultimate sanction of removal of the right to capture trades
- handle dispute resolution/arbitration; and
- have considerable status as a representative body.

The cost of the services received by the members would be defrayed by a combination of annual subscription and transaction charges that would reflect the number and type of market participants and the scale and speed of market transactions and turnover.

Retail markets – Retail individual trade associations

Joining a retail individual trade association (RITA) is easy. Users would simply log on to their national ritanet site and complete the user agreement. Using the system they would be able to anonymously request prices for any goods and services on the site.

In settling their purchases they would use their e-account/RITA wallet charged

with e-cash accepted multilaterally by all firms on the site. They would also receive e-incentives from the retailers which would have bilateral agreements among themselves in respect of the redemption of such e-incentives, whether for e-cash or otherwise.

All the advantages of ITAs would apply, particularly consumer dispute resolution, access to consumer data, and free or subsidised internet access with free calls subsidised by the firms.

Capital markets and 'self-listing'

It is the application of the above wholesale and retail models to the capital markets that perhaps would be most revolutionary in its effects.

While stock and derivative exchanges attempt to protect their territory through automation and global alliances, new proprietary electronic dealing systems – the electronic communications networks (ECNs), such as Instinet and Archipelago – aim to replace them. In the meantime, brokers of all sizes are expending considerable resource in essentially replicating the functionality of their competitors' on-line brokerage systems.

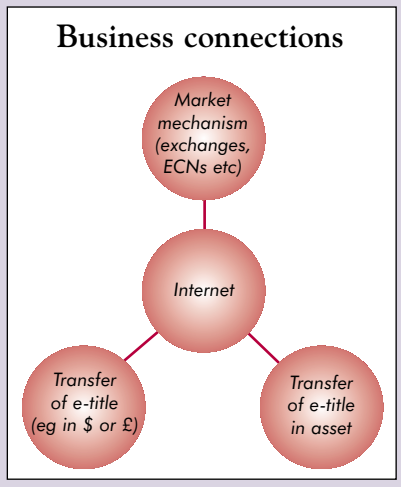
The proliferation of market mechanisms fragments liquidity, and the proliferation of dealing systems is a staggering waste of resources. Everyone is engaged in a 'race to the bottom'. There is a simple solution – 'self-listing' – which relies upon the creation of a new market model reconfigured about the wholly new 'mutual interest groups' of market users described above.

For example, where is the most obvious place to trade a Dell share? Not the Chicago Stock Exchange, not the New York trading floor, or even the Nasdaq network. Neither Instinet nor Archipelago. The answer has to be the Dell website. It seems obvious that anyone buying or selling Dell shares should do so at a single focal point of global liquidity. But there are two distinct types of trader out there. Wholesale and retail, institutional and individual. So we need two different mechanisms on the Dell site to account for this:

- a secure real-time wholesale market mechanism available to corporates and institutions on a dedicated 'intranet'; and
- a retail mechanism available to any individual on the internet.

But how can this be done outside the

FIGURE 1



existing market models? How can share purchases and sales be concluded at the Dell site, and then the resulting contract performed by payment against delivery of the shares?

The answer lies in the application of the new wholesale and retail market mechanisms described above. For example, an individual or corporate would offer his shares for sale on the Web site of the firm whose shares he is trading. In other words, a firm becomes its own market.

All that is then required are links to the Dell share registrar and to the relevant payment mechanism.

Consider first the mutual interest group of wholesale market participants who will typically be:

- corporates and/or institutions;
- accustomed to trade in large size;
- require continuous real-time; and secure market access

These would be members of, for example, the International Equities Trade Association (IETA). The association would have a global wholesale market regulatory role, it would have adequate entry requirements, and if a member breaches the IETA rules he would be suspended or disqualified permanently from using the system.

Consider next a mutual interest group of retail investors who will typically be:

- individuals;
- trading in relatively small size; and
- requiring occasional market access, not necessarily real-time.

This group would belong to a RITA

and, as described before, brokers would be available via the ritanet site to provide services to individual investors alongside service providers such as ft.com and hemscott.com. Any UK investor owning shares would join the UK RITA by establishing their identity, and provided they are not disqualified from trading would be able to buy and sell shares at practically zero cost on the relevant company website. German investors would be members of the German equivalent of RITA, and so on.

But shares are only the beginning. Bonds should also be available on a firm's website. Why give your money to banks and building societies when you can get a better interest rate by lending it, say, directly to Tesco in the form of a bond or otherwise?

Clearly the role of intermediaries will change dramatically, but this is a process that has been going on for many years as automation has gathered pace. Brokers will continue to execute business for those who are unable or unwilling to do so.

They will become more akin to individual financial advisers and/or private bankers. Banks, having lost control of the payment mechanism, would focus more on relationship banking, leading to a return to merchant banking and the growth of a form of universal private banking.

What of regulation?

The role of the regulator will among other things be to monitor the information provided by the self-listing firms and to decide under what circumstances RITA members may deal in particular classes of shares, bonds or collective investments. For instance, regulators would decide when and to what extent individuals would require professional advice before investing.

In addition, the regulator would have a regulatory and enforcement role in respect of market abuse, including – but not limited to – 'insider' dealing and market manipulation.

Complaints from investors would likely be e-mailed to the regulator in a parallel mechanism to the Feedback Forum and Star Ratings underlying the on-line self-regulatory model developed by eBay.com.

Self-listing merely brings the trend towards on-line Initial Public Offering (IPOs) to its logical conclusion. Investors are Web-empowered by the use of sim-