Chapter IV

Reduction of Transaction Costs by Using Electronic Commerce in Financial Services: An Institutional and Empirical Approach

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Abstract

This chapter introduces the Transaction Cost Approach as a means of analyzing specific transactions in financial services by using the theoretical framework of New Institutional Economics. It argues that transaction costs can be assessed and used to compare different business processes. Furthermore, these costs allow a detailed explanation why certain underlying technologies which form the basis for transactions become widely accepted whereas others do not prevail. The authors emphasize the
relevance of this approach and its application to the field of electronic commerce both on a theoretical and practical level to document and to interpret current trends in this sector on the one hand, and to predict future developments on the other hand.

Introduction

The authors analyse the impact of the increasing utilization of information and communication technology (ICT) and electronic commerce on the coordination of specific transactions in financial services. In particular, two business processes commonly occurring in the contractual relationship between a financial institution and its customers will be considered: bank transfers and stock purchases. The chapter focuses explicitly on the relationship between a bank and its customers which, in contrast to internal and inter-bank processes that have already been subject of intensive research, has been neglected so far.

The basic principles of New Institutional Economics and the instruments developed in the context of the Transaction Cost Approach serve as theoretical background for the study and further discussion. The chapter develops and implements a proposal how to exemplify and to compare these processes under the varying influence of certain technologies. Therefore, a cost model is developed that will be used in the following to assess two basic transactions in this specific area. The intention is to reveal the basic phenomenon and to document the reasons for the current utilization of ICT in this sector by emphasizing relative reductions of transaction costs by means of electronic commerce. The basic statements and conclusions are underlined and illustrated for Germany in an empirical section. At the end of the chapter, future perspectives and impacts on the chosen topic will be given and derived.

Electronic Commerce

The need to explain the most important terms and definitions in this context arises directly from the topic chosen. Choi/Stahl/Winston (1997) define electronic commerce as “a new market offering a new type of commodity, such as digital products through digital processes.” This specification already indicates the potential scope and the enormous consequences which result from the use of electronic commerce.

More fundamentally, electronic commerce can be seen as any economic activity on the basis of electronic connections (Picot/Reichwald/Wigand, 2001). Hence, it follows that the underlying technology is crucial to promote the acceptance and the use of electronic commerce. The use of digital lines and early devices to generate and to exchange information between participants in the economic cycle was a first step. The introduction of telephone and telefax services can be seen as the advent of a massive development which turns out to be the “digital revolution.” Phone lines can be used to connect
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