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# E*Trade Securities, Inc., Pioneer On-Line Trader, Struggles to Stay on Top

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*E*Trade revolutionized the securities brokerage industry by "creating" Internet trading. E*Trade's original strategy was to deliver cost savings to customers while amortizing fixed costs over a greater number of accounts. In 1997, several competitors established Internet sites and E*Trade was dethroned as the price leader. Its management team introduced a strategic initiative to transform the company into a financial, one-stop shop for investors. The initiative included expanding its information technology, improving its marketing and advertising program, and developing new strategic alliances.*

*By early 1999, E*Trade had established a popular Web site offering the convenience and control of automated stock, options, and mutual fund order placement at low commission rates. E*Trade's success pleased management but was challenged by fierce competition and emerging ethical and operational problems.*

## BACKGROUND

### The Securities Brokerage Industry

Before the securities industry deregulation on May 1, 1975, full-service brokerages charging fixed commissions were the only firms in the industry (Glasgall, 1999). A full-service broker is a stockbroker who gives personal attention and advice to clients and charges a flat fee or percentage of the transaction. Such a broker acts as an agent, providing advice and buying or selling securities for the client. The client interacts with the broker face to face or over the telephone. Full-service brokers provide a wide array of services, including investment strategizing, estate planning, and insurance advice, and they usually attempt to influence their clients' investment decisions.

After deregulation, most full-service brokers began to target households with assets ranging from $100,000 into the millions. In addition, given that commissions were no longer fixed, discount brokerage firms began to appear that targeted price-sensitive, self-directed investors who did not require the level of service and high-priced advice offered by full-service firms. Discount brokerage firms made profit from margin balances and per-trade commissions; technology also enabled them to employ less-skilled labor. Fidelity and Charles Schwab, two of the dominant discounted brokerage firms in the mid-1990s, led the charge by introducing lower-cost investment services without advice at significantly lower commissions. Discount brokerage customers typically had assets ranging from $5,000 to $250,000. To execute trades, they could visit a branch office or they could call an "800" number to speak with a "live order taker," who would place their trade orders but was prohibited from giving any investment advice. Over time, discount brokers added touch-tone trading, which offered further commission reductions to investors who would key-in their trade orders.

By 1995, with the continued expansion of the Internet, technology offered another alternative with more convenience, lower costs, and easy access to investment information: on-line trading. Most on-line trading firms were offering customers numerous ways to access their accounts and place trades, including individual company Web sites, direct dial-up connections, on-line services (America Online, CompuServe, and Microsoft Network), interactive television, touch-tone telephone service, a broker on the telephone (as a situational alternative to on-line trading, for an additional fee), and 3Com Palm Pilots (available through selected on-line trading firms). With on-line trading, investors paid lower commissions—ranging from $10 to $30. They had full control over their investment decisions, with no one to blame but themselves—investors could enter trade orders any time of the day or night (Piper Jaffray, 1998d). On-line brokerage accounts could be opened with as little as $1,000. While these firms first targeted frequent traders by offering low commissions, on-line trading evolved to support the needs of almost any individual investor.

## History of the Company

E*Trade was a pioneer in on-line trading, a phenomenon that was rapidly changing the face of investing for both individuals and the firms that served them. The firm's growth mirrored that of the on-line trading industry as a whole. Trade*Plus, the company that would later become E*Trade, was founded as a service bureau in 1982 by Bill Porter, a physicist and inventor with more than a dozen patents to his credit. The company provided on-line quote and trading services to Fidelity, Charles Schwab, and Quick & Reilly. Using primitive information technology, Porter placed the first on-line trade on July 11, 1983. He imagined that someday everyone would own computers and "invest through them with unprecedented efficiency and control."[1] He spent most of the 1980s refining and adding to his vision without introducing his plan to the world.

In 1992, Porter founded E*Trade Securities, Inc. and began providing back-office, on-line processing services to discount brokerage firms and offering all-electronic investing through America Online and CompuServe. The minimum balance required by E*Trade to open an account was $1,000 ($2,000 for a margin account), well below industry standards at that time, and only a short, user-friendly application was required to set up an account. E*Trade began offering on-line trading through its company Web site in February 1996, and the demand flourished. To transact securities, a customer had only to log on to E*Trade via the Internet, a dial-up connection, or an on-line service such as America Online. However,