

Crossing the chasm: the next step forward

This year will be a crucial one in the development of e-FX. The bulk of the investment dollars in the multi-portal sites has been spent, two heavyweight companies, FXall and Atriax, are now live and competition is hotting up. Surely now is the time for us to migrate to the internet?

Back in 1991, a little-known management consultant wrote what was to become Silicon Valley's bible for marketing technology, *Crossing the Chasm*, which set out simple parameters for the development of markets for high-tech products. "I kept seeing this pattern of really exciting products, early successes, and then they tanked," said its author Geoff Moore, at the time. "That's what led me to step back and come up with this idea of the chasm – the gulf that separates early market success from mainstream market success."

Fast forward to 2001. Although written before the public internet was created, the same principles hold true. All the key factors that characterise the development of any technology adoption cycle are in place in the e-FX markets.

The product – or at least the underlying concept of it – is persuasive: to use the internet as a superior form of delivery for trading foreign exchange. The technology is now, more or less, robust. The advantages – such as cost savings to both buy and sell side, greater market efficiencies, such as price transparency and straight-through processing – are clear.

But, to paraphrase the book, the chasm hasn't been crossed. e-FX has yet to enter the mainstream of life in the foreign exchange markets – the leap in the number of users from the so-called 'early adopters' phase to the 'early majority' phase hasn't happened (see box, page six).

Or rather, it has happened – to a small degree in the single bank sites (see page 11) and in the institutional fund management market – but not in terms of the huge corporate audience that will eventually trade foreign exchange over the internet.

"Some of the early industry estimates about the uptake of e-FX now look wildly optimistic. The overall adoption rate has been much slower than anticipated – but it's still early," says Mark Galant, chief executive officer of Gain Capital, one of the earliest internet sites to



A leap of faith: Can e-FX participants cross the chasm to reach their ultimate aim – e-treasury?

offer foreign exchange trading online. "To date, some of the single-bank sites have been more successful, because there's been a lot of hand-holding to get their clients on line.

"So far, I don't think there's been the same degree of hand-holding to get people to make the leap to the multi-bank portals, nor is there as much incentive for the banks to do so," he says.

"The time is right to move to the early majority phase, which is where Atriax and FXall are targeting their efforts," says Galant. "Currenex did a great job of attracting the innovators and early adopters (who quite rightly didn't see any need to wait), but the challenge for them will be holding on to these clients as the competition heats up.

"For ourselves, we're not particularly concerned about competition from the multi-bank space because Gain Capital targets a different audience – the smaller corporates, hedge funds and money managers."

But what are the factors holding back this market? The first is clearly its infancy. Until this spring, there were only two multi-bank platforms operating: Currenex, an independent

portal financed by venture capital firms and latterly by Royal Dutch/Shell and Barclays, and State Street, the global custodian.

Currenex was at first a simple proposition, and initially offered a system that was more similar to a sophisticated e-mail reverse auction than anything else. But it swiftly grew more complex while growing its customer and bank base. It now has around 40 major clients and a similar number of banks, including such notables as Merrill Lynch, ABN Amro, ANZ, Barclays Capital, Lehman Brothers and Bear Stearns. The rest are mostly medium-sized banks active in foreign exchange.

"We started from a different proposition than other multi-bank portals," says Lori Mirek, the former AOL executive who heads up Currenex. "Our aim is to be the facilitator of the foreign exchange transaction, sitting between the bank and the buy side. That means we need to be independent to serve both parties.

"We don't think of ourselves as replacing the bank's role, but rather as a service party that allows the bank to concentrate on its core competencies – which are not, for example, the provision of internet technology."

State Street, by contrast, came to e-FX from the point of view of a global custody bank and saw that the provision of technology – particularly straight-through processing (STP) and automation – and liquidity would give it a deeper relationship with its clients. Its global connect platform, which it had been developing since 1996, went multi-bank last May and has attracted large volumes of institutional business.

But the whole of the e-FX multi-bank space could in no way be described as anything but a juvenile market – let alone one that is crossing any chasms.

Although Currenex and State Street have done extraordinarily well, the market-place has been waiting for the arrival of the two multi-bank platforms run by sell-side banks – FXall and Atrix, which both went live early this summer. Previously, leading corporates have publicly said that they had decided, if rather conveniently, not to advance their e-FX projects until they could evaluate all the available market systems.

But uptake still appears to be slow. Market impressions – which both Atrix and FXall naturally will not confirm – are that both portals have been unable to attract as much business as they had hoped.

A second reason for the lack of development in the multi-bank e-FX market-place continues to be the buy-side's concerns about security.

“Part of the slow adoption of online exchanges has been related to two key elements: perceptions of security and STP,” says Mark Tirschwell, chief technology officer at technology vendor Wall Street Systems. “One hurdle in dealing with security is overcoming people's security objections – and that's more of an education process than anything else.”

“Typically, a large proportion of end users have never had to look at the issue in this way before – so it's a question not of educating the technologists on the buy side, but the corporate treasurers,” he says. “In the past, when they've picked up the phone to make a trade, security has not been an issue. It was a trusted form of communication. They have to feel the same way about the technology.”

“One thing I'm certain about is that security is a topic that is very rapidly going to be a non-issue in five years' time,” says Tirschwell. “Our systems are already secure and, in any event, every year the encryption systems get deeper and deeper. In the end, security measures will operate in the background and no-one will think anything more about them than about, say, electrical wiring or plumbing.”

Concerns about security are frequently masking an inherent conservatism among large corporate treasurers. It is interesting to

note that in a recent study by Greenwich Associates, almost a third of the interviewees said they had no intention of trading online.

Effectively, technology – however good it is – will not necessarily always be the recipe for quick market uptake. A third factor behind the slow uptake of e-FX has been the long and slow marketing needed to get customers happy with not just the technology, but the whole product. This is especially important when the front office starts linking up with the back.

“As soon as you automate, you are setting in stone – admittedly not permanently, but typically for some time – a whole set of procedures and routines,” says an industry observer. “STP can be both very positive and very negative.”

But some banks feel they have overcome customer resistance to change. “We took the approach that we would get the customers on

concern for the buy side: connectivity. Atrix is generally seen by industry observers as having problems with its connectivity, and FXall appears further advanced in this respect.

Atrix denies this is the case, and a spokesperson says: “Since the rollout of Atrix Dealing services, we have seen a significant acceleration in the efforts of treasury management systems (TMS) suppliers to achieve connectivity to Atrix. The catalyst for this is end-user demand.

“Atrix is now working with around 30 leading suppliers,” says the spokesperson. “A number of these connectivity and integration projects are at an advanced stage and will be completed shortly.”

A last and relatively recent factor is the arrival of yet more portals (see box, page 10) – with the launch of STN Treasury, Centradia, and an unnamed platform apparently run by Singapore Technologies – over the next two

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Mark Tirschwell, Wall Street Systems

board first – that's the hardest bit – and then they would bring their banks on board later,” says Simon Wilson-Taylor, managing director at State Street. “Typically, we take the view that the technology is the easy bit – at the end of day it's mostly a question of spending the money. The hard bit, for any asset class, is having the ability to ‘prime the pump’ and getting volumes up to critical mass levels.

“You have to get your customers over the confidence hurdle until they feel comfortable with the product and the new way of doing business,” he says. “Inherently, most people are conservative about the way they do business and therefore have to see major benefits in order to change. So if you have always bought your foreign exchange by phone from a friendly dealer at your relationship bank, then typically you won't move until you see something a lot better.

“And don't just think that something like STP is an automatic selling point. It often is, but typically it's the most senior people at buy-side firms that get enthused about it,” says Wilson-Taylor. “But at the FX Connect user level, we can simplify your batch trades and paperwork, and deal with tickets so that you don't have to fill them in. This will save time and remove human error, allowing you to focus on improving the price, rather than just getting through the process.”

A fourth factor causing the delay remains a

months. “It's yet another reason for the continued wait-and-see approach of many on the buy side,” says one banker.

While the buy side dithers, the present multi-bank platforms already trading can point to clear customer and service benefits from using them. One driving factor behind the creation of these platforms has been tight prices and price transparency.

“Clients can ask for both sides of the market and because we offer streaming prices, spreads have been very tight,” says FXall's chief executive officer Phil Weisberg. “As a result, many of our clients have indicated that they receive better prices on FXall than they receive over the phone. Banks have the ability to quote in – effectively – all currency pairs, and we have seen a number of large trades go through in exotic currencies.

“Clients can ask for prices from up to five banks at any one time using our graphical user interface, and an unlimited number on our application program interfaces,” he adds. “The members of the FXall customer advisory board believed that three or four dealers on the main currency pairs would be the maximum they would ever ask, so five seems sufficient.

“One particularly interesting point is the fact that we have an algorithm that converts the combined prices from the integrated rate engines of FXall banks, and we use this to provide an indicative market price,” says Weisberg.

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“This means our clients know where the real market is, more so than they would using a feed from Reuters, where indications can sometimes lag or do not reflect the true market.

“What we particularly have to stress is that FXall is up and running with a fully automated platform,” he adds. “The technology is in place and we have a significant client base. We have 17 banks that are fully integrated to quote automated prices and reap the benefits of STP. As a result, banks integrated to FXall are achieving significant efficiency gains not offered by any other platform. By the end of the year, 25–30 banks will be fully plugged in.”

But despite the buy-side benefits, the delay in the uptake of e-FX could be damaging in the near to medium term. Some industry observers are saying that in as little as six months we may see massive change in the names and number of multi-bank platforms.

“In many ways, rationalisation of the e-FX market is inevitable, though I don’t know how long the process will take, nor could I necessarily point to which ones will survive,” says State-Street’s Wilson-Taylor. “I think there are many misconceptions about the size of the market-place at stake, and as a result some business plans have been fudged.”

These plans also relied on either a big capital gain from an initial public offering spin-out, he says, which is no longer about to happen any time soon, or on massive projections of click-fee charges, which were over-optimistic. “These consortia now need to raise additional capital in a radically different market just to keep going,” he says. “That’s going to be really tough.”

“It must be very difficult for any bank to consider pouring more money into these consortia with no real possibility of a pay-back, especially in the prevailing climate,” Wilson-Taylor says. “Most banks are looking to substantially cut costs, so it is likely that

their forays into e-FX will be a casualty. We could be seeing rationalisations earlier than anyone thought.”

Part of the worry for the future of the e-market concerns the business of ‘crossing the chasm’. If it doesn’t happen soon, it may delay the process much longer than expected.

“We continue to see take-up of e-FX by our client base,” says Richard Estes, head of e-commerce at Bank of New York (BNY). “For the past year, we have experienced more than a doubling of transactions through our two proprietary BNY iFX products. But we’ve yet to see the mass migration of the subset of clients who for two years have told us they wanted a multi-bank version of e-FX. Ironically, the multiplicity of portals now available may have caused buyer confusion.”

“While some portals may have more advanced functionality than others, there is no



one portal at present with the right mix of full functionality and necessary complement of liquidity providers that is making the choice obvious,” Estes says. “As a result, this client subset is proceeding cautiously – despite the clear advantages of moving online – and thus causing hopes of a speedy adoption of e-FX by all to be deferred.”

“As a result of this cautious approach, the viability of multiple portals may be challenged, if there are not enough electronic transactions being generated early enough to

produce revenues to feed all of them. And this could stall the development of a large, liquid e-FX market.

“I think it is inevitable that we’ll get there in the end – the arguments for STP alone are compelling,” adds Estes. “But it’d be a shame if the buy side takes too long to take the market all the way, and thus compromises the significant financial investment made by many financial institutions and technology firms.”

The general opinion is that the current period is key to the development of the promised land – the drive to e-treasury. Gain Capital’s Mark Galant says: “In terms of crossing the chasm more generally – towards, say the drive to a multi-product e-treasury – that won’t be successful until the majority of FX volume is transacted online rather than over the phone.

“Once the buy side gets accustomed to dealing online and realises the benefits of STP, it will be easier to add new products. There’s a momentum that will push other treasury products over.”

Galant believes technology is the key to taking e-FX to the next level – moving beyond the early adopters and capturing the early majority. “The technology must be ‘plug and play’ and overall easier and more efficient than phone trading, or the majority will not adopt it,” he says. “And this is just as important, if not more so, than market share, liquidity and all the other promised benefits of the multi-dealer platforms.”

Currenex’s Lori Mirek says: “e-FX is simply a piece, admittedly an important one, in the much larger puzzle of the delivery of e-treasury. This is moving up the value chain, and means that the delivery of e-FX should be part of a larger strategy.

“The buy side is driving the whole process,” she adds, “and they are looking for one single window from which they can do all their treasury management business.” ■