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Online brokers

Net gains

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Markets have welcomed talk of a bid by E*Trade for Ameritrade

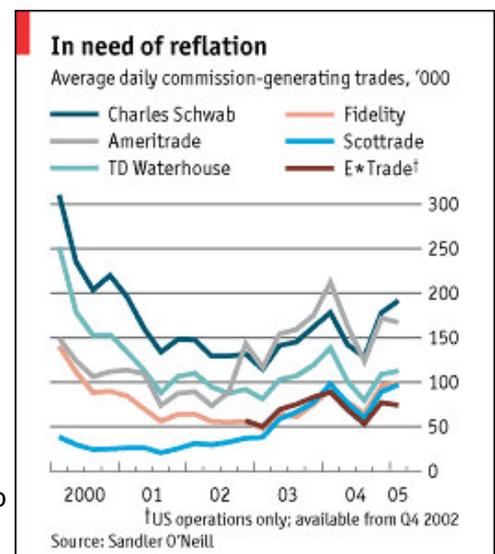
WELL, it's one way of drumming up trade. America's online stockbrokers, becalmed by slow trading volumes, have been agitating the markets with merger talks among themselves. This week, reports that E*Trade, a discount broker, had made an unsolicited bid for Ameritrade, a rival, set off a trading frenzy. Ameritrade's share price rose by 18.7% on the day after the news broke; more surprising, given markets' habitually dim view of acquirers, E*Trade's went up by 6%. Shares in Charles Schwab, the biggest such brokerage, also rose. Its eponymous founder and chief executive denied any intention to acquire either of its competitors.

The market likes the sound of a merger because retail customers' appetite for trading seems to have faded. Although margins are healthy—last year, Ameritrade's was 50% before tax—price wars threaten to eat them away. Fidelity, a giant fund manager that also runs a brokerage service, recently slashed its commission for frequent online traders by 25%, to \$10.95 a time. The most active pay only \$8. Schwab and E*Trade also made big cuts in February. According to Fox-Pitt, Kelton, an investment bank, there is still “plenty of room” for fees to fall further, given that processing each incremental trade costs only about \$1.

As for trading volumes, no relief is in sight. For some brokers, the dotcom glory days seem far off (see chart). Sandler O'Neill, an investment bank, predicts that the number of online trades, already down in the past year, will turn out to have been at least 10% lower in April than in March. The longer-term prognosis will depend on the markets, because trading volumes rise in good and markedly bad times.

Diversification is another reason to merge. Ameritrade gets about 60% of its revenue from stockbroking. It boosted its volumes by buying another broker, Datek, in 2002 for \$1.3 billion. By contrast, E*Trade emphasises banking, home-equity loans and mortgage services as well as its brokerage. Buying Ameritrade, which is roughly the same size, should mean more customers for its array of products, as well as savings from combining services and platforms. Still, this strategy carries risks. Schwab has been criticised for losing its focus after it revolutionised the discount-broking business. It bought firms specialising in private banking and institutional research. Broking commissions now account for less than 20% of its business.

If online brokers are struggling under flat volumes and pressure to diversify after shaking up their industry with new technology, they are in good company. A wave of consolidation among financial exchanges is being driven by similar forces. If the brokers link up too, traders will be hoping that savings at all stages of the chain are passed along to them.



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