

BANKING INDUSTRY TECHNOLOGY SECRETARIAT

THE BANKERS ROUNDTABLE

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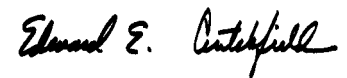
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COMMENTS FROM THE CHAIRMAN OF THE BOARD

I am pleased to report that BITS has delivered on three key initiatives—the Fraud Reduction Program, the Electronic Check Presentment/Electronification Program, and the development of the IFX/InteroperaBILL Specifications—for a total annual industry cost savings of \$3.5 billion beginning this year. You will hear more about these projects at the Annual Meeting.

BITS' new initiatives—the Security Lab and Information-Sharing Database, the Shared Utilities Project, the Privacy Decision Tool, and the Electronification Alternatives Program—promise an additional potential savings of \$7-\$9 billion +, some beginning at the end of this year. We will be discussing these at the joint Board Meeting.

I am a believer in BITS. BITS is effective and shows the influence we bring to our industry through our focused attention. Other industry groups, the Federal Reserve Board, Treasury, the OCC, and most importantly, the technology vendors, are responding to our efforts. We are leveraging our collective power. We need to continue supporting BITS, as it is right on-point with the issues facing our industry.



Edward E. Crutchfield
Chairman and CEO,
First Union Corporation
Chairman, BITS Board of Directors

STEERING COMMITTEE AND WORKING GROUP UPDATES

IFX/InteroperaBILL Initiative

InteroperaBILL Chair: Sharon Osberg, Wells Fargo & Company

IFX Project Chair: Kit Needham, BITS

BITS has achieved one of its first major goals to accelerate the establishment of new electronic payment and product delivery systems through the successful completion of the IFX/InteroperaBILL initiative. BITS announced in January 1999 that its promotion of the convergence of the OFX/GOLD standards into the interoperable IFX home banking standard had succeeded, under the leadership of both the Standards and the *de novo* Steering Committees. That accomplishment enabled the development and publication of both the IFX specification and bill presentment/payment specifications and operating rules.

This initiative has long-term strategic value because it has banks driving standards and sends a message to the industry that “banks are players” in the electronic commerce arena. In addition, the availability of one open, interoperable standard will cut banks' implementation and maintenance time and costs. A number of vendors and Roundtable banks participated in a comprehensive collaborative process and have committed to implementation of the IFX specification.

The IFX standard has been heralded as the truly open and interoperable solution that will provide online financial services independent of a particular network technology, platform or service provider. This BITS initiative represents a \$500 million industry-wide annual benefit starting immediately. That is the projected financial services-related revenue from more than 17 billion transactions as they are converted to electronic. The IFX specification ensures interoperability between proprietary systems and business models. All billers will be able to reach all customers, and all customers will be able to receive and pay bills electronically from all billers, regardless of the service providers chosen by biller or customer.

The final portion of BITS' work on IFX and Bill Presentment/Bill Payment has been preparing to hand over the management of the project to the new governance entity, the IFX Forum, to be managed by a standards organization. The IFX Forum is an open membership, non-profit corporation whose board of directors will be chaired by BITS. Four BITS banks (Bank of America, BankBoston, Citigroup, and Wells Fargo) will be represented on the IFX Forum Board. The Forum will act as an industry incubator for IFX enhancements and new efforts in financial services such as online investments, business to business, mortgages and loans and small business e-commerce.

BITS gratefully recognizes and appreciates the efforts and months of work on the IFX/InteroperaBILL project by the following: Sharon Osberg, Wells Fargo & Company, Chair, InteroperaBILL Steering Committee; Libby Ghekier, Bank of America, Standards Steering Committee; Janey Place, Digital Thinking, former co-chair of the BITS *de novo* Steering Committee; Frank Jaffe, BankBoston, and Allan Woods, Mellon Bank, current co-chairs of the BITS *de novo* Steering Committee; Dan Schutzer, Citigroup, liaison to BITS from the Financial Services Technology Consortium (FSTC), who is the architect of the initial interoperaBILL technical design; and Debbie O'Dell, FSTC, who served as InteroperaBILL's Technical Project Manager. Two members of the BITS staff deserve credit for successfully guiding this project: Kit Needham, BITS Senior Director for Payments Systems and Standards, who served as IFX Project Chair, and Penney Richardson, BITS Project Manager.

The IFX specification was developed as a cooperative industry effort by major financial institutions, service providers and information technology vendors. BITS would also like to acknowledge additional member bank representatives who worked on this project: Ian Amdor, Chase Manhattan Bank; Julie Elberfeld, Fifth Third

Bank; Richard Foote, Wells Fargo & Company; Louis Fuertes, Chase Manhattan Bank; Michelle Furey, Bank of America; Jackson Johnson, Bank of America; Elizabeth Lee, Bank of America; Ray McMunn, Mellon Bank; Jane Morse, BankBoston; Bev Schwalbach, Wells Fargo & Company; Cindy Solt, First Union; Carolyn Spicer, ICBA; Frank Tiller, Bank of America; and Jane Wallace, Bank of America.

BITS expresses its gratitude to the following non-bank members of the Interactive Financial Exchange (IFX) effort: AT&T, BellSouth, CheckFree Corporation, IBM, Integrion, Intuit, Just in Time, Microsoft Corporation/TransPoint, NetDelivery, and the Bill Payment Council of the National Automated Clearing House Association (NACHA).

Industry Infrastructure Steering Committee

*Co-Chairs: Austin Adams, First Union Corporation
C. Webb Edwards, Wells Fargo & Company
Joseph Sponholz, The Chase Manhattan Bank*

Fraud Reduction Initiative

Chair: Nancy Cloyd, Bank of America

A second major BITS goal was fraud reduction, especially through rationalizing existing infrastructures to remove redundancies and reduce costs. Under the leadership of the Industry Infrastructure Steering Committee, BITS has delivered on this objective.

Through the Fraud Reduction initiative, BITS established a fraud-reporting structure, common reporting definitions, and a regional and national focus on statistics that will enable banks to combat fraud through exposure to other banks' successful strategies. In addition, earlier awareness of check fraud trends will enable the development of effective fraud reduction tools. Educational forums have been implemented and the potential for a virtual database is becoming a reality. Individual banks are beginning to report seeing immediate benefits from BITS' Fraud Reduction Program.

One hundred percent of BITS banks have agreed to the Fraud Reduction Program, with some difference in implementation. Thirty-six Roundtable banks, representing 60% of assets and 44% of US deposits, have committed to collection and sharing of check-loss data as part of this initiative. Twenty-five percent of Roundtable member banks, representing 51% of assets, are participating in a shared database.

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Meeting Dates

BITS Board Meeting

April 8-10, 1999
TBR Annual Meeting,
Naples, FL

BITS Advisory Group Meetings

May 13, 1999
Chicago, IL

June 10, 1999
New York, NY

July 15, 1999
Santa Fe, NM

August 5, 1999
San Francisco, CA

October 14, 1999
Boston, MA

TBD
Phoenix, AZ

December 9, 1999
Washington, DC

BITS Council Meetings

May 14, 1999
Chicago, IL

BITS Industry Forums

May 12, 1999
Chicago, IL

July 14, 1999
Santa Fe, NM

October 13, 1999
Boston, MA

December 8, 1999
Washington, DC

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WORKING GROUP UPDATES

Industry surveys show that check fraud losses are increasing significantly each year. Current estimates from banks represented on the BITS Board indicate between a 25%-35% growth rate in check fraud, totaling \$260 million per year. Checks are used in 24% of retail sales. Use of the Internet and electronics will place greater demands upon banks, calling for more formalized, organized and rigorous programs to continually deter fraud.

When banks fully participate in the BITS Fraud Reduction Program, this initiative will represent a \$1 billion cost savings from \$2.5 billion annual industry losses, beginning in 2000—including \$350 million for Roundtable banks. The greater the industry's participation, the greater the benefits to any individual bank.

BITS wishes to gratefully acknowledge the efforts of Nancy Cloyd, Bank of America, who chaired the Fraud Reduction Working Group; Kit Needham, BITS Senior Director for Payments Systems and Standards, and Jessica Hymowitz, BITS Project Manager. In addition, the following chairs of the five Fraud Task Forces deserve credit for their efforts: Dick Clausen, Bank of America, Statistics Chair; Gayle Helm, Wells Fargo & Company, Legal Chair; Shirley Inscoe, First Union, Database Chair; Bob Jones, KeyCorp, Electronification Chair; and Ed Potter, Chase Manhattan Bank, Successful Strategies Chair. Janice Bunting, Bank of America, also earlier chaired a Task Force.

ECP/Electronification Initiative

Chair: Michael Pasielki,

The Chase Manhattan Bank

A third major BITS initiative for Electronic Check Presentment (ECP) has brought significant results, again under the leadership of the Industry Infrastructure Steering Committee. Industry-owned organizations have committed to distinct responsibilities. ECCHO has been endorsed as the private-sector, rules-making body for ECP. Small Value Payments Company (SVPCo) has been endorsed as the coordination point for multi-lateral ECP for the banking industry. A framework for an open, multi-lateral system in which banks of all sizes can participate has been established, and a common set of rules adopted by the private sector. The Federal Reserve has been actively involved with BITS throughout this process, and education of bankers is being conducted through regional ECP Forums to escalate the rate at which ECP is implemented. This initiative represents a \$16

million annual benefit to each large Roundtable bank and \$580 million overall annual benefit in one-to-three years.

Although the movement is toward electronification, more than 66 billion paper checks are written each year, increasing at 2%-3% per year. The challenge is to reduce handling paper as early in the process as possible. ECP is a first step. The principal obstacle is industry fragmentation that prevents coordination and timely transition to check electronification. In an increasingly electronic commerce setting, banks need to be competitive with those who have no paper infrastructure to burden them.

Ninety-two percent of BITS banks are fully committed to the ECP initiative. Twenty-eight Roundtable banks, representing 61% in assets, have committed to implementing ECP by the end of 2000. In addition, some 2,500 community banks are processing checks using ECP through the Federal Reserve. The largest banks in the country are responsible for 26% of check transaction volume. All are fully committed to the BITS ECP initiative, representing a "critical mass" to escalate the rate at which ECP is adopted. The Federal Reserve processes 25% of all checks; of these, 15%-20% will be cleared through ECP by the end of 1999. With the Federal Reserve's corresponding efforts, significant impact can be achieved on electronification of checks.

BITS' goal is for large banks to process 50% of checks electronically by 2001. One hundred percent of the nation's largest banks have committed to sending and receiving ECP. A process to track the growth of ECP has been implemented. Ongoing work relates to other types of electronification (see article following) and removal of legal and regulatory impediments.

BITS gratefully acknowledges the tireless work of Mike Pasielki, Chase Manhattan, who chaired the ECP/Electronification Working Group, and the following members of the Working Group: Jennie Cook, Comerica; Ann Dronzek, Key Services; Hank Farrar, SVPCo; Tony Gerevics, Wells Fargo & Company; Fred Herr, Federal Reserve Bank of Atlanta; James Maxwell, First Union; Paul McGuire, ICBA; Gerard Milano, California Bankers Clearing House; Richard Re, Chase Manhattan; James Sarras, Chase Manhattan; David Walker, ECCHO; and Viveca Ware, ICBA.

Cheryl Charles, BITS Senior Director for Research and Communications, and Jessica Hymowitz, BITS Project Manager, also deserve credit for their efforts to guide this initiative.

WORKING GROUP UPDATES

Electronification Alternatives Task Force

*Co-Chairs: John Beran, Comerica
Janet Smith, Wachovia*

The Electronification Alternatives Working Group has been established. An initial meeting was held March 4th in Dallas. The Task Force co-chairs approved the following mission statement, subject to adoption by the Task Force. *The mission of the Electronification Alternatives Task Force is to encourage the elimination of paper checks from the payments process at the earliest possible point through electronification; to encourage alternatives to replace paper from the payments process; and to seek, whenever possible, to consolidate back-end payments systems in order to eliminate redundancies and leverage banking-industry entities.*

Preliminary deliverables include an analysis of current electronification alternatives projects, and an educational summit similar to the ECP Forums now underway. BITS has endorsed ECP as a first step in the electronification process. The Electronification Alternatives initiative depends on the critical mass of banks committed to ECP in order to achieve the additional benefits associated with alternatives, such as: POS MICR conversion to ACH, check truncation at bank of first deposit with image on demand, and check truncation at bank of first deposit with image to follow.

Special Advisory Group Project: Shared Utilities Initiative

Chair: Michael Zucchini, Fleet Financial Group

At the April Board meeting, the BITS report, "Cooperating to Compete: A Perspective on Shared Utilities in Banking," will be presented by Jack Stephenson of McKinsey & Company. This project, developed by members of the Advisory Group, addresses the Board's concerns about costs and redundancies in existing financial services infrastructures. The report contains recommended criteria for evaluating existing and/or creating new utilities and governance principles for their management, based on "best practices." It also identifies business or functional areas where utilities make sense in a rapidly changing environment and describes how the major shared utilities serving the U.S. banking industry (e.g., check clearinghouses, card associations, ATM networks, technology consortia, etc.) differ by function, type, and original intent.

The issue of the industry's ability to effectively structure and leverage shared utilities—and associations that have been established to perform industry functions—is a critically important one. In order to be competitive in the electronic commerce environment, financial institutions must be able to reduce costs, leverage what infrastructure

exists and have the flexibility to incorporate emerging technologies. Early analysis indicates that a potential industry cost saving of \$3 billion + could be realized from this effort. We will cover this project in more detail in future issues of the *BITS Bulletin*.

Research and Communications Steering Committee

Chair: Gary Roboff, The Chase Manhattan Bank

A major new deliverable of the Privacy Working Group, a Privacy Decision Tool, will be demonstrated at the Annual Meeting. It was created, with IBM, to identify cost implications of various privacy-related policies to individual banks as well as the industry. This tool will show, for example, how changes in bank processes and systems, combined with opportunity costs associated with privacy issues, could cost the 18 largest Roundtable banks, in the aggregate, from \$340 million (assuming relatively few changes) to \$1.6 billion (assuming the most substantial changes) in the next two-to-three years. The tool will help the industry make internal investment and policy decisions—and has important strategic value for developing public policy options. Two White Papers will be delivered as well: "Privacy and the Data Warehouse: The Benefits and Responsibilities of Using Detail Data for Consumer Marketing in the Financial Services Industry," and "The Impact to the Banking Industry Given Market Acceptance of the Platform for Privacy Preferences."

The BITS Industry Forum scheduled for May 12th in Chicago will focus on the privacy issue. All the Roundtable banks as well as community banks are encouraged to attend this one-day session featuring a demonstration of the Privacy Decision Tool. (See box on page 7.) For additional information on the Industry Forum, contact Cheryl Charles, BITS Senior Director for Research and Communications, 202/289-4322.

Security and Risk Assessment Steering Committee

*Co-Chairs: Peter Browne,
First Union Corporation
William M. Randle,
Huntington Bancshares*

Among BITS' new initiatives, one that has tremendous promise in addressing both individual bank and industry concerns is the Security/Technology Lab and Information-Sharing Facility. Losses related to security breaches, whether criminal or terrorist, are expected to reach billions of dollars in the next decade.

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WORKING GROUP UPDATES

In the financial services sector alone, the estimates range from \$300 million to \$1.5 billion. The BITS Lab/Facility will be established in the Washington, DC area and will be funded by vendors. The objectives of the facility are early product influence, risk reduction, implementation-cost reduction, and security interoperability, among others. SAIC/Global Integrity/Telcordia has been chosen to manage the facility. The Lab/Facility will also house incident and vulnerability databases that meet requirements of the Presidential Commission on Critical Infrastructure Protection (PCCIP). An official announcement will be made following the Annual Meeting of The Bankers Roundtable in April.

The BITS-American Banker Security Symposium held on March 9-10 in Washington, DC was well attended and yielded significant goodwill and press coverage for the financial services industry's efforts to ensure safety and soundness. This Symposium on security and privacy issues related to e-commerce was an opportunity to demonstrate that BITS and the industry are proactive in this area of critical importance.

de novo Steering Committee

Co-Chairs: Frank Jaffe, BankBoston
Allan Woods, Mellon Bank

A Framework for Electronic Commerce

Another strategic issue for the industry is being addressed by the BITS e-Commerce Framework

Retail Industry Issues with Banks Regarding Payments and E-Commerce

At the BITS Advisory Group Meeting on March 11th, members heard a presentation by a panel of executives from the retail industry. The retailer representatives discussed an industry RFP to achieve economies in payment systems and outlined concerns about payments, e-commerce and improving the ways that banks work with them. The panel included Larry Turner, VP and Treasurer at Kroger/Fred Meyer, and a representative of the Food Marketing Institute (FMI); Don Gilbert, SVP, National Retail Federation (NRF) and Mallory Duncan, General Counsel, NRF.

Prior to the panel's presentation, Richard Foote, Wells Fargo, presented valuable background

Project. It provides the context for understanding some of the emerging business opportunities involving the Internet and other electronic business options. A panel presentation on this project at the Annual Meeting will provide a view of the e-commerce players, relevant technologies, and the threats and opportunities for the financial services industry. A BITS White Paper related to this project is also being delivered. Among the findings of this project to date are: the implications of e-commerce growth for banks are significant; success depends on speed-to-market and agility; people who build e-commerce technologies are non-traditional; no safe strategies exist; and, in the end, the industry's culture may be its own worst enemy.

Legal and Public Policy Working Group

Co-Chairs: John L. Burke, Jr.,
Foley Hoag & Eliot, LLP
Richard M. Whiting,
The Bankers Roundtable

The Legal and Public Policy Working Group is supporting the ECP Task Force and working with ECCCHO to achieve a common set of rules to allow electronic check exchange between clearinghouse banks and the Federal Reserve. This Group is working with other organizations to ensure that the Uniform Electronic Transactions Act (UETA) will provide check imaging with the same evidentiary status as a paper check, and that an electronic record would satisfy any current rule of law requiring that a record be "in writing."

information on the retail industry. Among the data he introduced:

- Retailers were responsible for \$2.5 trillion in U.S. sales in 1998. Some 1.5 million retail establishments in this country have an aggregate of \$222 billion in payroll.
• 87% of retailers today have some kind of retail POS payment system.
• Retailers offer more than 20 POS payments, including private label credit and debit cards, prepaid store cards, fuel cards, EBT, and check truncation products.
• Retail POS creates significant business for banks, including 14 billion in personal checks deposited annually.
• Retailers handle most POS transactions.

(continued on Page 7)

RETAIL INDUSTRY ISSUES

(continued from Page 6)

Salient points from the retail industry panel's perspective:

The food industry through FMI has issued an RFP seeking advice from financial services companies and others about controlling front-end costs related to payments. They are dissatisfied with much of the current bank-merchant payment interactions and are considering options like pooling resources to create their own check-processing and credit card-processing capabilities. "We did an RFP because we are serious about controlling our costs. We are willing to invest in technology to drive our costs down. We need to find the alliances to work through that," Larry Turner said.

Also relevant to the RFP, retailers are installing MICR readers for check guarantees to address check truncation, a major interest. The food retail industry deposited 183 million checks last year; therefore FMI supports consumer- as-keeper, not merchant-as-keeper. They believe that customers need to be educated on check truncation and that banks should lead the effort, although they would agree to assist.

Retailers would like to work with the banking industry on fraud reduction, especially check fraud, which is the highest incidence of fraud among food retailers.

Electronic bill presentment is another area of common interest. The average grocery store gets 8-10 utility bills a month. With 2,200 stores, a food chain like Kroger/Fred Meyer could see real savings and efficiency by getting bills consolidated.

Retailers would like banks to differentiate between fees on use of online/offline debit cards and credit cards. They would also like bank credit card associations to contain costs and eliminate costly redundancies. Many retailers are already looking for ways to circumvent this system.

The retail industry expects to be involved in developing new technologies. NRF, FMI, and the National Association of Chain Drug Stores have formed a coalition on technology.

BITS and the retail industry executives are exploring specific areas of common interest, like ECP, bill presentment/payment, security/privacy issues and electronic commerce standards. The retailers will become part of BITS Working Groups.

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BITS Industry Forum on Privacy Issues

Bankers will have a unique opportunity to learn more about the impact of privacy and data-sharing issues at the BITS Industry Forum on May 12th in Chicago. The issue of confidentiality of consumer information remains in the forefront for regulators, the Congress, the White House, and the news media. BITS has designed a one-day forum for bankers to focus on this critical consumer and industry issue.

- A major part of the program will be devoted to demonstration of the Privacy Decision Tool developed under the auspices of the BITS Research and Communications Steering Committee. Bankers will be able to experience first-hand the uses of the Tool, the first-of-its-kind device for cost/impact analysis.
- Panel presentations will include a report on current legislative and regulatory activities related to customer privacy, as well as an overview of the latest relevant technology and related security issues.
- An educational kit will be provided to help banks individually make informed choices about the cost implications of various privacy scenarios.

For additional information about the Forum, contact Cheryl Charles, BITS Senior Director for Research and Communications, 202/289-4322.



W. Brian Arthur is Citibank Professor at the Santa Fe Institute (SFI), a multi-disciplinary research and education center devoted to pursuing emerging science, including complexity theory. He pioneered the study of positive feedbacks or increasing returns in the economy—in particular their role in magnifying small, random events in the economy.

Arthur is widely sought out as a speaker. In addition, his work has earned the respect of many national leaders, including Treasury Secretary Rubin, Federal Reserve Chairman Greenspan, and top Justice Department officials—especially regarding the government’s antitrust case against Microsoft—who frequently consult with him. Roundtable members will have the opportunity to hear Arthur discuss “Financial Services and the New Economy” at a BITS Special Briefing on April 9th, at the Annual Meeting in Florida.

This is a continuing series of interviews with members of the BITS Board of Directors, BITS Advisory Group and other key leaders in electronic commerce and financial services.

BITS: We hear references today to the “new economic paradigm,” and “the new economy.” In your view, what is new in today’s economy, and what is its significance for the financial services industry?

WBA: If we take a historical perspective on the world of business we see that there are actually two worlds, and that today, we are moving more rapidly into one as the other economic model shrinks. This is what I mean when I refer to a New Economy. Our understanding of how markets and businesses operate was passed down to us more than a century ago and is based squarely upon the assumption of *diminishing returns*. Diminishing returns assumes that products or companies that get ahead in a market eventually run into limitations, so that a predictable equilibrium of prices and market shares is reached. The theory was, in rough measure, valid for the bulk-processing, smokestack economy of a former day. But, Western economies in this century have steadily undergone a transformation from bulk-material manufacturing to design and use of technology, from processing of resources to processing of information. Concomitantly, the underlying mechanisms determining economic behavior have increasingly shifted from ones of diminishing returns to ones of *increasing returns*.

Increasing returns are the tendency for that which is ahead to get farther ahead, for that which loses advantage to lose further advantage. For example, one bank’s decision to implement electronic of checks becomes worth more when it’s amplified by significant numbers of other banks taking the same step. Likewise, connecting a number of regional credit card networks will increase exponentially their value as a network—and to each member of the network. Increasing returns are mechanisms of positive feedback that operate to reinforce that which gains success—or aggravate that which suffers loss.

In fact, the increasing-returns character of service industries is steadily strengthening, with everything that is information-based today being handled by software. As this re-engineering of services plays out, centralized software facilities come to the fore, with two consequences. First, where the local character of service remains important, it can preserve a large number of service companies, but clustered round a dominant software provider—like physicians tied in to an HMO. Second, where locality is unimportant, *network effects* can transform competition toward the winner-take-most character we see in high-tech industries. For example, when Internet-based retail banking arrives on a large scale, regional demand limitations will vanish. Each virtual bank will gain in advantage as its network increases. Barring regulation, consumer banking will then become a contest among a few large banking networks. It will truly become an increasing-returns business.

BITS: Would you elaborate on the implications of this new economy for banks and their market strategies, management strategies?

WBA: Many managers have some intuitive grasp of this new increasing-returns world. Here are a few questions managers need to ask themselves when they operate in knowledge-based markets.

Do I understand the feedbacks in my market? In the processing world, understanding markets means understanding consumers’ needs, distribution channels, and rivals’ products. In the knowledge-based world, success requires a thorough understanding of the self-negating and self-reinforcing feedbacks in the market: the diminishing and increasing returns mechanisms. These feedbacks are interwoven and operate at different levels in the market and over different time frames.

Do I have the resources to become a major player? Playing in the “Casino of Technology” requires several things: excellent technology, the ability to hit the market at the right time, deep pockets, strategic pricing, and a willingness to sacrifice current profits for future advantage. All of this is a matter not just of resources, but also of courage, resolution, will. And, it involves the decisiveness to leave the market when increasing returns are moving against you.