

ELECTRONIC MONEY: RISKS, THREATS, PROMISES TO BANKING

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Money is the foundation of modern capitalist society. Throughout history, it has been both the vehicle and catalyst for commerce. It is the lifeblood of trade – facilitating the movement of goods and services. It is the initiator of production. In totality, money sustains and grows economic activity.

Money has three important roles in both society and the economy. First, it is a medium of exchange. It is used to buy and sell goods and services. Secondly, it is a unit of economic measure. It is a standard by which the value of goods and services is measured or bench-marked. Lastly, it provides a store of value by itself. In effect, it is a means by which wealth is stored and accumulated.

The critical roles money plays have spawned and evolved the institution which has provided the engine to sustain the flow, measurement, storage, growth, and creation of money – the bank. By a long tradition, banks are the custodians of financial flows and growth. Banks fulfill this function through the services they provide. Banks provide deposit services. They encourage the storage of wealth and the growth of wealth through interest and other forms of income. Secondly, banks facilitate the exchange of goods and services, trade, through payment services. Thirdly, banks provide credit and therefore drive production, distribution, and consumption. Finally, banks, in conjunction with the law of supply and demand, market forces, and producers, sellers, and consumers determine the value of money both within national borders and across international boundaries.

Apart from these services, banks traditionally have unique functions not exercised by other economic players. Banks create money and increase the money supply. Banks also provide the critical role of intermediation between sources and uses, depositors/investors and borrowers, and consumers and producers.

Electronic money has changed all this!! Money in computerized account balances, flowing in transient electronic fund transfers, stored in magstripe and smart cards, and accessed via credit and debit cards has transformed the very concept of money itself. Electronic money is more than traditional money – in both content and character.

Information technology has created the new information economy through the birth of a second lifeblood in commerce, trade, and production – information at electronic and even light speed. The interbreeding of financial and electronic transactions and the transformation of manual into computerized accounts has produced a hybrid offspring – money with information. While traditional money had exchange medium, unit of measure, and storage value characteristics, electronic money has all of these plus information. Why is this possible? Simple: electronic money emerged out of the electronic information medium as a representation for traditional money – in the process possessing the characteristics of traditional money while surpassing the limitations of traditional money due to inheritance of the characteristics of the transport medium, electronic information. The medium became the message.

Electronic money surpasses traditional money in many ways. It is non-physical and therefore more convenient. It is more mobile and portable. It moves in real-time. Simultaneously, it retains the critical characteristics of traditional money. It can be and is already being used as a medium of exchange. It can be and is emerging as a unit of measure (tied to traditional money such as the dollar initially). It can be and is becoming a store of value. In fact, it is a more natural store of value in an information-based economy. This is because there are natural barriers to traditional money in an information-based economy: conversion inconvenience; high cost of security; and lack of mobility which can make traditional money a bottleneck in the fast-paced electronic transactional environment.

There are two major factors propelling electronic money. The first is the rise of Internet commerce and its impact on the distribution of goods and services. Internet commerce has made cross-geographical and

global commerce easy and real-time. The Internet has leveled the playing field between big and small businesses. This has forced a new paradigm of quality and customer focus to replace the old advantages of mass-muscle-marketed junk. The Internet is the closest there will ever be to democracy for the consumer. All these qualities of Internet commerce require a form of money that is real-time, mobile, convenient, innocently unbiased to historically-accumulated traditional financial muscle, consistent with the new exciting landscape of millions of high-quality, customer-focused small entrepreneurs, and highly consumer-driven in value. This is exactly what electronic money is all about.

The second propelling factor is the integration of distribution and payments in the soft goods and services industries. Soft industries are those where goods and services can be fully digitized and electronically distributed and include financial services, entertainment, telecommunication, and education. Since payments can be executed electronically as well, the logical cost-effective consequence is a single electronic infrastructure for both distribution and payment. This is only possible through electronic money. In fact, even in hard industries where physical goods and services are involved and cannot be digitized, only manufacturing and distribution are non-digitizable which does not matter since these business processes can still be triggered financially through electronic money. The non-electronic logistical triggers will still rely though on electronic information for sourcing, routing, and delivering (still paid for by electronic money).

With the shift to electronic money from traditional money, banking will experience its biggest threats and risks but can also look forward to big promises if a conscious transformation of the concept of banking is effected early enough. Why and how will all these be possible?

Let us start with deposit services. Deposits go where the consumer finds it convenient and “safe” (to keep or even enhance the value of his/her money). The crises that have hit banks, big and small, in recent years have eroded consumer confidence in banks to a certain extent. The threat to banks will come from electronic services. The issue of convenience is on the side of E-farms (electronic money farms) – repositories of electronic money structured into individual customer accounts. The second criterion of safety is actually an issue of trust – electronic money is safe as long as it is easily redeemable or convertible to the desired goods or services. Where either knowledge or entertainment goods and services are desired, electronic money will be easily redeemable/convertible. Thus, knowledge corporations (“knocorps” – corporations engaged in the provision of knowledge services electronically) and entertainment corporations (“encorps” – corporations engaged in the provision of entertainment services electronically) will threaten to take away a substantial slice of wealth in the form of electronic money from traditional banks through E-farms. These corporations are soft industry corporations and their investment-cost structure is compatible with the information-driven economy. Even organizations in the hard industries will migrate some of their wealth to knocorps. Knocorps will be the source of precious information on the most viable methods and reasonable costs of acquisition of raw materials and physical services. Thus, some of the wealth of hard industry players will be transferred to knocorps. The greatest risk will be to banks who do not transform. The big promise of being a significant player in the new economy will be for banks which can transform themselves into knowledge corporations (“knocorps”).

With payment services, both knocorps and encorps have a natural advantage in the soft industries. It is easier to pay for an Internet movie with E-cash issued by an encorp (like you use tokens in an amusement park). It is more convenient to pay for Internet books using electronic money paid and supplied to your E-farm account by your employer, specially if your employer happens to be in a soft industry. This is the big threat and risk to banks. Again, banks will have to remake themselves as knocorps. Remaking themselves as encorps may be far-out, acquiring an encorp would be more pragmatic.

While some may think otherwise, the credit function is not the exclusive domain of banks on a capability basis. An organization using an expert system for credit evaluation, packaged applications for loan processing and maintenance, and interactive Internet customer databases, portals, and transaction websites can do this very easily. These are natural component facilities within knocorps. Again, knocorps threaten banks unless banks transform into knocorps.

The intermediation knowledge, experience, and skills of banks will no longer be unique advantages. Knocorps will leverage and launch multitudes of intelligent software agents and mega-agents that will take care of searching for, finding, and designating (all automatically in the background), packaging, and optimally matching sources and uses, investors/depositors and borrowers, and consumers and producers of electronic money relevant to fast dynamic entrepreneurial ventures seamlessly and very quickly. Nevertheless, banks that turn into knocorps will enjoy big advantages over knocorps which were never banks since the knowledge in intermediation and financial engineering is richer with the former.

Finally, what about money creation? Technically, this can be done very easily by both knocorps and encorps as long as proper wealth controls are in place to provide economic stability in an economy dominated by electronic money. Financial regulation must also transform itself to cope with: the relatively high velocity of electronic money as compared to traditional money; the new security issues arising; and the entry of knocorps and encorps. The promise here for banks that transform into knocorps or acquire encorps is that their experience in financial engineering will be of high value versus competing knocorps that were not banks originally.

There is no doubt that traditional banks will be threatened by knowledge corporations and entertainment corporations in safeguarding, controlling, and managing the wealth of the accelerating information economy because of the shift from traditional money to electronic money. The risk is when banks refuse to recognize the inevitability of the new order and stick to the cherished dichotomy into electronic and traditional money. Such banks will die a natural death. The banks that transform themselves into knowledge corporations or buy entertainment corporations early enough will have a good share of the business in the emerging E-economy. However, these successful organizations will be more customer-focused and consumer-sensitive owing to the consumer-driven, real-time, and dynamic democracy of the E-economy.