Transforming Financial Markets to Retail Investors  
- A Comparison of the U.S. and the German On-line Brokerage Market -

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Abstract
Fundamental changes in private investments are currently observable for the German stock market. The importance of equities as an alternative to traditional kinds of private investments has grown remarkably and technological progress provides new ways for private investors to participate actively in the capital markets in order to take advantage in securities trading. One of the latest developments in the area of investments in Germany seems to be the rise of ECNs. Since there is a rather large delay in development of the German brokerage market in comparison to the U.S., it is the aim of this contribution to determine (in a qualitative manner) possible future trends for the German retail brokerage market. Differences and parallels of the evolution of electronic brokerage systems in both countries will be analyzed by using the transaction phase model in order to systemize possible on-line brokers’ and ECNs’ strategies.

1. Introduction
In recent years, the importance of equities as an alternative to traditional kinds of private investments has grown remarkably\. American brokers adapted first to these changes by offering financial services and innovative trading systems based on new technologies like the Internet. Only since 1995, the so-called discount brokers have introduced innovative order routing systems in Germany which enable an easy, fast and cheap access to electronic exchange systems like Xetra and Sets. With the increasing impact of the Internet as a new convenient access channel for the market of financial products and services, the importance of those intermediaries offering brokerage services rose.

This paper focuses on the differences and parallels of the evolution of electronic brokerage systems in the U.S. and in the German stock market. Since there is a rather big delay in Germany, it is the aim of this contribution to derive (in a qualitative manner) future trends for the German brokerage retail market from the American experiences.

In the U.S., Alternative Trading Systems (ATS) have been used since 1969 (Instinet) and were able to acquire a significant market share by offering integrated electronic order routing and matching services for securities trading, by providing benefits to retail and institutional investors such as better prices and lower commissions as the traditional exchanges. Thereby, they attract not only professional but also retail investors to their systems. The traditional American exchanges (e.g. NASDAQ) continued relying on the market maker principle (quote driven markets) instead of adopting fully electronic trading systems with an automated matching procedure. This is why new intermediaries were able to successfully enter the market and compete with the traditional exchanges realizing their chances by taking advantage of the prevailing (operational) inefficiencies caused by relatively low computerized exchange systems.

In Germany, the automation of the financial service industry is fundamentally different, i.e., those retail banks and brokers that provide on-line services offer pure order routing systems – without any price discovery and settlement functionalities – and, hence base their business model on lower commissions and higher convenience to

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1 E.g.: the total stock exchange turn over at all German exchanges rose from 1995 (4.134.797) to 1999 (5.094.478) (German Exchange\[1999, p.10\]) for more than 20 %.