

# The Present State of Online Brokers



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## **Introduction**

An ever-emerging dimension of “eFinance”, online security trading, has now been on the scene for over ten years. “Online brokers” provide an online trading interface to investors, allowing them to buy and sell securities via the Internet. Studies suggest that there are approximately 140 online brokers currently operating web sites<sup>1</sup>. These brokers offer investors a wide variety of trading services including: equity trading, bond trading, mutual funds, options, futures, foreign exchange, retirement accounts, mortgages, insurance, investment advice, real time quotes, as well as an array of financial planning tools. The benefits of trading online have substantially revolutionized the world of investing, as more and more investors turn to online brokers.

## **The Advantages**

Trading securities through online brokers has proven to be very advantageous to investors. These benefits have been looked at in comparison to “bricks and mortar” brokers. By using the Internet for investment purposes, users become exposed to a vast amount of financial information. This information includes real-time stock prices, price history, extensive financial information of companies, and free market analysis. Another benefit of trading online is that investors have direct command of their own account.

There is no need to call up a traditional broker to place orders. This gives the investor an added sense of control. It also eliminates any inconveniences when dealing with a traditional broker, such as him/her not being in the office, or the chance of an order not taking place in a timely fashion. One of the most significant advantages of online brokers is the low commission fees they charge. Because of these fees, in comparison with traditional brokers, online brokers are frequently referred to as “discount” brokers.

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<sup>1</sup> <http://finance.lycos.com/qc/perfin/broker.aspx?options=choose>

Traditional brokers charge higher fees, which are often referred to as a premium for their “expertise” in assisting investors with decisions. Online brokers have eliminated this “middle man”, allowing the investor to make purchases or sales on their own, at a lower cost. This price savings has had a vital role in the growth of online investing. Online brokers also offer investors a much wider variety of investment products than in the past. By offering such a great selection of products, they provide users with the opportunity to build a diverse portfolio, ranging from income generating bonds, to tax-sheltered retirement accounts, all with ultimate convenience and low commission fees.

### **What are the disadvantages?**

Along with all the benefits, those who invest online will experience some disadvantages. Investors who use online brokers miss out on the financial assistance of the traditional broker. By opting for lower fees and more control over their accounts, they must accept the responsibility of making their own investment decisions without the “expertise” of an investment professional. This could scare inexperienced investors, who may feel more comfortable dealing with a traditional human broker one on one. In many cases, online investors will still have access to a live investment advisor, but this is no substitute for an ongoing relationship with a professional who knows their history, resources and goals.<sup>2</sup> Another factor which comes into play with any electronic commerce operation is security and network reliability. While this is becoming less and less of an issue, there are still those who do not yet feel entirely safe managing their financials online. If this is the case, investors may again be inclined to pay higher fees and use a traditional broker in order to maintain financial security. Top online brokers take many measures in order to maintain a high level of network reliability and security. These factors have been

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<sup>2</sup> <http://finance.lycos.com/qc/perfin/broker.aspx?options=why>

explored in-depth as part of the research of “e-quality” standards for our research.

Although these disadvantages come hand and hand with the benefits, generally speaking, the advantages of online investing overwhelm the dangers.<sup>3</sup>

## **The Research**

During the growth of online investing, of all the online brokers that exist, a select few have stood head and shoulders above the rest in terms of customer satisfaction and services offered. In our description of the current state of online brokers, we saw it fit to analyze some of the top players in the game. Two of the most well known online brokers have been the subject of an in-depth research.

## **Analyzed Brokers**

Fidelity Investments and Ameritrade have been chosen for evaluation. These brokers were selected because they have been ranked in the top five online brokers according to ConsumerSearch.com in September, 2004.<sup>4</sup> For the purpose of our research, we chose one broker which charges higher commissions, requires higher deposits, and is more geared towards high asset, experienced investors (Fidelity). We then selected another broker (Ameritrade) which charges lower commissions, has a low minimum deposit requirement, and caters to the lower-asset trader. The companies have been analyzed and compared using a variety of criteria ranging from investment products offered to some “e-quality” factors of web site design and management.

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<sup>3</sup> <http://finance.lycos.com/qc/perfin/broker.aspx?options=why>

<sup>4</sup> [http://www.consumersearch.com/www/personal\\_finance/online\\_brokers/fullstory.html](http://www.consumersearch.com/www/personal_finance/online_brokers/fullstory.html)

## The Criteria

A list of criteria was developed in order to measure and compare the most important components of an operating online broker. The criteria have been divided into four general segments:

- (1) Customer Satisfaction: Investment Products and Services
- (2) Expenses
- (3) Additional Features
- (4) Web Site Quality

**(1) Customer Satisfaction: Investment Products and Services:** Here we look at two components which have imminent effects on customer satisfaction:

**A. *Range of Investment Products Offered:*** Measures the sheer quantity and types of investment opportunities which are available to customers.

**B. *Customer Service:*** Measures the extent of personal customer assistance offered. This includes a look at the methods by which customers may speak to broker Web site representatives.

**(2) Expenses:** Two measures of costs associated with opening an online broker account have been identified:

**A. *Fees:*** Analyzes the amount of fees which customers are required to pay. This is inclusive of all fees ranging from commissions on stock trades to the load fees charged by online mutual funds.

**B. *Minimum Deposit:*** Find out the minimum initial deposit required to open an account.

**(3) Additional Features:** Many online brokers offer additional features for customers.

We have identified three here:

**A. *Research Tools*:** Looks at what kind of financial analysis tools are offered to customers. This includes a measure of how much financial/economic information is readily available for investors.

**B. *Investment Advisory Services*:** Reviews the amount of investment advice which the online broker offers, as well as the costs of this service.

**C. *Banking Features*:** Analyzes to what extent the online broker integrates online banking features with their brokerage services. Also measures the scope of liquidity of customer accounts. This includes the ability to write checks.

**(4) Web Site Quality:** The online brokers' web site operations have been critically analyzed using several dimensions which have been previously identified in measuring the quality of a service-oriented web site<sup>5</sup>. Four of these have been chosen which are most pertinent to online brokers. The dimensions we used in measuring the e-quality of online brokerage services are as follows:

**(i) *Performance and Structure*:** Performance is based on two features: Use and content. Use deals with the ease of using the web site, as well as ease of navigation. Content deals with the accuracy and timeliness of information presented. Structure takes into account the organization of the information presented (i.e. hyperlinks)

**(ii): *Aesthetics*:** Deals with the visual attractiveness of the web site.

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<sup>5</sup> Madu, C.N. and Madu, A.A. (2002), "Dimensions of e-quality", *International Journal of Quality and Reliability Management*, Vol. 19 No. 3, pp. 246-58

(iii) *Storage Capability*: Deals with how well the web site stores information and makes it easily available to the customers

(iv). *Security and System Integrity*: Deals with the sites ability to safeguard and protect customer information

## Method

In order to measure the quality of each of the selected online brokers, we have conducted extensive navigation of their web site, investigating all aspects of their brokerage services, as well as important web-related components. We did not open any real online accounts with the chosen companies. However, we have gone as far as possible in account creation processes, without actually creating one, in order to mimic the experience of a real online investor and become exposed to all relevant information.

## Results

As a means of representing results of the research, and comparing the service quality of the chosen brokers, we have summarized our findings according to the above mentioned research criteria in the following tables:



### I. Customer Satisfaction: Investment Products and Services

<i>Range of Investment Products Offered</i>	<i>Customer Service</i>
Mutual Fund Investing (4500 funds available) • Stock Trading • Options Trading • Exchange-Traded Funds • IPO participation • Unit Investment Trusts • Precious Metals • “Basket Trading” • Margin Trading • Extended Hours Trading • CD’s • Fixed Income Trading • Bond and Money Market Funds • Annuities • Life Insurance • IRAs • College Savings 529 Plans	Numerous 1-800 phone numbers each representing a different service • Email communication • Instant Messaging with Representatives • Physical “Investor Centers” in various locations around the country • “Ask a question” web search tool



## II. Expenses

<i><b>Fees</b></i>
Three Online Stock Commission Levels: Bronze (\$19.95/trade), Silver (\$10.95/trade), Gold (\$8.00/trade) • Bond Trade Concessions ranging from \$0.50 for US Treasury Securities to \$2.00 for Corporates • Mutual Fund Fees: Over 1100 funds have no transaction fees • Load funds are available • Commercial Paper is subject to \$50 service fee • \$35 charge on UITs • Proportional percentage charges on precious metals • Annual account maintenance fee of \$50 on most Fidelity accounts • Other fees ranging from \$15 to \$75 for bank wire redemptions, account close-outs, stop payments, late settlements, etc.

<i><b>Minimum Deposit</b></i>
• The minimum initial deposit to open a Fidelity account is \$2500

## III. Additional Features

<i><b>Research Tools</b></i>
• Simple security search based on specific criteria • Powerful screening tools with up to 100 criteria • 3 <sup>rd</sup> party research on stocks, bonds, mutual funds • Receive breaking news and set alerts on portfolio • Fund picks from Fidelity and Morningstar • Search Strategies created by industry experts to find new opportunities • “Watch List” • Real-time quotes

<i><b>Banking Features</b></i>
Credit and ATM cards offered • Online Bill Payment • Fidelity Accounts offer full features of checking accounts • Unlimited check writing, EFT's • Direct Deposit features • Loans • Money Market Funds • CD's • High amounts of liquidity with Fidelity Account.

<i><b>Investment Advisory Services</b></i>
• “Fidelity Portfolio Advisory Service” – for portfolios of \$50,000+ - Offers a carefully selected model portfolio of mutual funds and ongoing active management. • “Fidelity Private Portfolio Service” – for portfolios of \$300,000+ - Customized investment management of mutual funds and certain eligible individual securities you own - Managed for investors seeking to control the effects of certain income taxes • “Fidelity Private Portfolio Service” – for portfolios of \$300,000+ - Provides security and confidentiality through professional fiduciary expertise • All portfolio advisory services carry fees ranging from .3% to 1.1% • Market Commentary from Fidelity and Industry leaders.

## IV. Web Site Quality

### ***(i) Performance and Structure***

Fidelity.com offers relatively easy navigation, considering the large amounts of information which is accessible • This has been accomplished with a dynamic top bar menu, which is well organized • Information is organized in a fashion to distinguish between different types of investors • Good use of hyperlinks • For the most part, it was easy to find specific information • Although it was difficult to locate information about fees and minimum deposit amounts.

### ***(ii) Aesthetics***

Fidelity.com is rather plain, visually speaking • However, it is not hard on the eye, and appears almost simple-looking, which is most likely for the best, because it is very rich in content and should not visually overwhelm users.

### ***(iii) Storage Capability***

Account holders can customize the home page with “My Fidelity” • This personalizes the site for the user, making available to them all relevant account information • Online statements are all readily available.

### ***(iv) Security and System Integrity***

Account information is all encrypted via SSL • Users may use “Customer ID” for login, instead of social security numbers • Highly skilled professionals develop and maintain Fidelity's web sites, and data security experts audit them.



## I. Customer Satisfaction: Investment Products and Services

### ***Range of Investment Products Offered***

Mutual Fund Investing (11000 funds available) • Stock Trading • Options Trading • Exchange-Traded Funds • Margin Trading • CD's • Fixed Income Trading • Bond and Money Market Funds • IRAs.

### ***Customer Service***

Numerous 1-800 phone numbers • Email communication • Ability to conduct trades via Interactive Voice Response (IVR) • Telephone System

## II. Expenses

### ***Fees***

Stock Commissions: \$10.99/trade via Internet • \$14.99/trade via IVR • \$24.99/trade Broker Assisted.  
Mutual Funds: \$17.99/Buy, Sell, or Exchange (no fee for buy if fund has a load) • Options: \$0.75/contract • Bonds: \$5/bonds (1-50) • \$2.50/bond (50+ bonds) • \$25 Flat Fee for treasuries at auction • Margin interest rates vary from 4.75% to 7.25% according to debt balance • Account maintenance fee of \$15/quarter on accounts with less than \$2000 liquidation value that have not executed at least four trades in the last six months • Various other service fees include \$10 for Annual Trade Summary, \$25 for Next Day Settlement, and \$25 for a Stop payment • No service fees are applied to Ameritrade Apex Accounts (for active traders)

<b><i>Minimum Deposit</i></b>
\$1,000 equity is required to open an IRA and \$2,000 equity is required to open any non-IRA • \$2,000 minimum deposit is required to be considered for margin and options privileges

### III. Additional Features

<b><i>Research Tools</i></b>
Ameritrade Streamer (streaming quotes, charts, account information) • Advanced Analyzer (charting and research tool) • QuoteScope (patent-pending trading tool used to visualize market information at a glance) • Command Center Screen (used to bring together all critical trading information)

<b><i>Investment Advisory Services</i></b>
Education Center (Teaches users all about investing, also offers financial calculators) • Amerivest: an advisory Service which assists in portfolio construction • Fees are dependent on asset size: .35% annual fee for \$100,000+, .50% annual fee for \$20,000 to \$99,999, and variable rates for under \$20,000 (no more than \$25 per quarter)

<b><i>Banking Features</i></b>
Unlimited check writing • earn interest on eligible free credit balances • account transfers • electronic funding allows direct deposit from checking or savings account via an Automated Clearing House transaction • Ameritrade accounts provide adequate amounts of liquidity

### IV. Web Site Quality

<b><i>(i) Performance and Structure</i></b>
Ameritrade.com offers an extremely user-friendly navigation structure • Very little difficulty was experienced in finding relevant information • Excellent use of tabbed menus and hyperlinks • Also very easy to view all fees and commission levels • However, is no search capability within the site

<b><i>(ii)Aesthetics</i></b>
Ameritrade has a very pleasant look and feel • Short web page with efficient use of hyperlinks make for concise presentation of information • Easy on the eyes with good color scheme of white, orange, and blue

<b><i>(iii) Storage Capability</i></b>
Ameritrade offers the ability to request account information at any time • Account holders can also download account information into Microsoft Money or Quicken • Users can also receive account information electronically every month

<b><i>(iv)Security and System Integrity</i></b>
Unique account numbers and PIN's are issued to account holders • VeriSign certificates are used to authenticate the site • SSL and encryption is used • Only a limited number of employees have access to account information • Ameritrade boasts that they are constantly refining their security technology

## **Conclusions**

The research which has been conducted revealed some key characteristics of high-quality online brokers. The two chosen companies offer very wide ranges of investment products, while supplementing them with efficient customer service, advanced research tools, and various forms of investment advisory services. We consider these factors to be the “bread and butter” of online brokerage operations. Both companies also come with reasonable expenses and fees. Ameritrade is slightly more attractive in this area due to the elimination of service fees when you open an “Ameritrade Apex” account. As expected, both brokers employ significant integration of online banking services. This is becoming more and more common, with many companies now offering a combination of brokerage and banking services.

As for web site operations, both Ameritrade and Fidelity make excellent use of advanced technologies, while maintaining high levels of online security. For the most part, they demonstrate very high levels of “e-quality” according to the factors which were identified. However, both companies could benefit from some better organization of information. Fidelity should make it easier to locate information about fees and minimum deposits. Ameritrade should integrate internal search capabilities within their web site.

On the whole, the present state of online brokers is quite impressive and looks to be continuously improving. These conclusions have been made by taking in-depth looks at two of the top online brokers in the business today. Competitors should model their operations after companies like Fidelity and Ameritrade, who have risen to the top and have created a superior reputation for all online brokers.

