

# **Mortgage Banking in the Internet Economy: Myths, Half-Truths, and a Crystal Ball**

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## Mortgage Banking and the Net:

- Big picture: The Transformation of Mortgage Banking
  - Good news and bad news: MB *is* in the forefront...
  - But we can learn from other sectors- and gravity still works
- Institutional Framework: The Value Chain project
  - MBA - RETF Funded Thesis; Work with the MBA
- Current projects- Extensions and New Projects
  - Technology, IT-based players and the Value Chain
  - Study of the MBFRF data: Analyzing hard evidence
- And for today- a little de-bunking, and a crystal ball

## Myth # 1: The Web is killing intermediaries (are we in the endangered species list?)

- The reality is that almost *everywhere* the web is *adding* new players...
  - Amazon.com and the bookselling value chain
  - Chemdex.com and specialty chemicals
  - So should we be afraid?
- Dis-intermediation: Changing roles or links
  - Re-definition of who does what- and how they're linked
  - Focus on what is the value realistically provided at each step

## **Myth # 2: The Web is Bringing Customers closer to the end producer...** (hence mortgage banking is to be history)

- Now, Is this so?
  - The IKEA syndrome
  - What do customers really need?
  - Customer stratification- and picking the wrong messages
- Consider the functions of intermediaries:  
Who will do them? At what cost? And why?
  - And how will they be linked to the rest of the Value Chain?

## **Myth # 3: Simplification of mortgages will lead to a simpler, neater Value Chain structure (and people doing “odd things” have it wrong)**

- Couldn't be more wrong... (sorry, Andy King!)
  - Plug & play leads to a complex web of alliances
- Standardization of information => further breakdown
  - Who does what- institutional division of labor
  - What arrangements exist between parties
- Positioning in this new complex web will be a key issue
  - Strategic issues with losing core parts of the business?
  - ... Think 1980's IBM “and that Gates kid”

**Myth # 4: In the New Economy,  
it is scale and critical mass *uber alles*  
And we'll pay to get it!**

- In that case, you may be in for a hefty price...
  - Most often, critical mass itself is not dramatically important
- Economies of Scale: Truth or Mirage?
  - The tale of servicing
- Network Externalities: Popular Fiction or reality?
  - The lack of representativeness of Microsoft and AT&T
- And the notable exception of B2B and other markets
  - Which are not your run-of-the-mill stuff anyway!

## Myth # 5: In the e-economy, the *Best* are Rewarded Wherever they are in the Value chain

- Well, sort of ...
  - But the reality is much more subtle!
- Eco-systems: Why a Winner (alone) is not enough
  - Why B2B's are both necessary and not sufficient
  - Key question: Will the vertical specialized set of players *as a whole* out-compete existing guys?
- Multi-level dynamics: Competitive Webs
  - Learn to compete in configurations of firms
  - The wider picture: S&L's vs the MB-GSE nexus

## Myth # 6: The Web is the Great Equalizer

And gives a neat playing field

- Think Again!
  - DoJ and the new “B2B antitrust initiative”
- Information as a Competitive Tool:
  - And the GSE’s growing appetite to control it
  - Automated Underwriting and Consumer data...
- Brand power dying in the Web?
  - **No!** Despite the hype, brand is even stronger on the web

**Myth # 7: With Reduced Search Costs,  
Commoditization is upon us  
hence we'll all (but a couple) bleed to death**

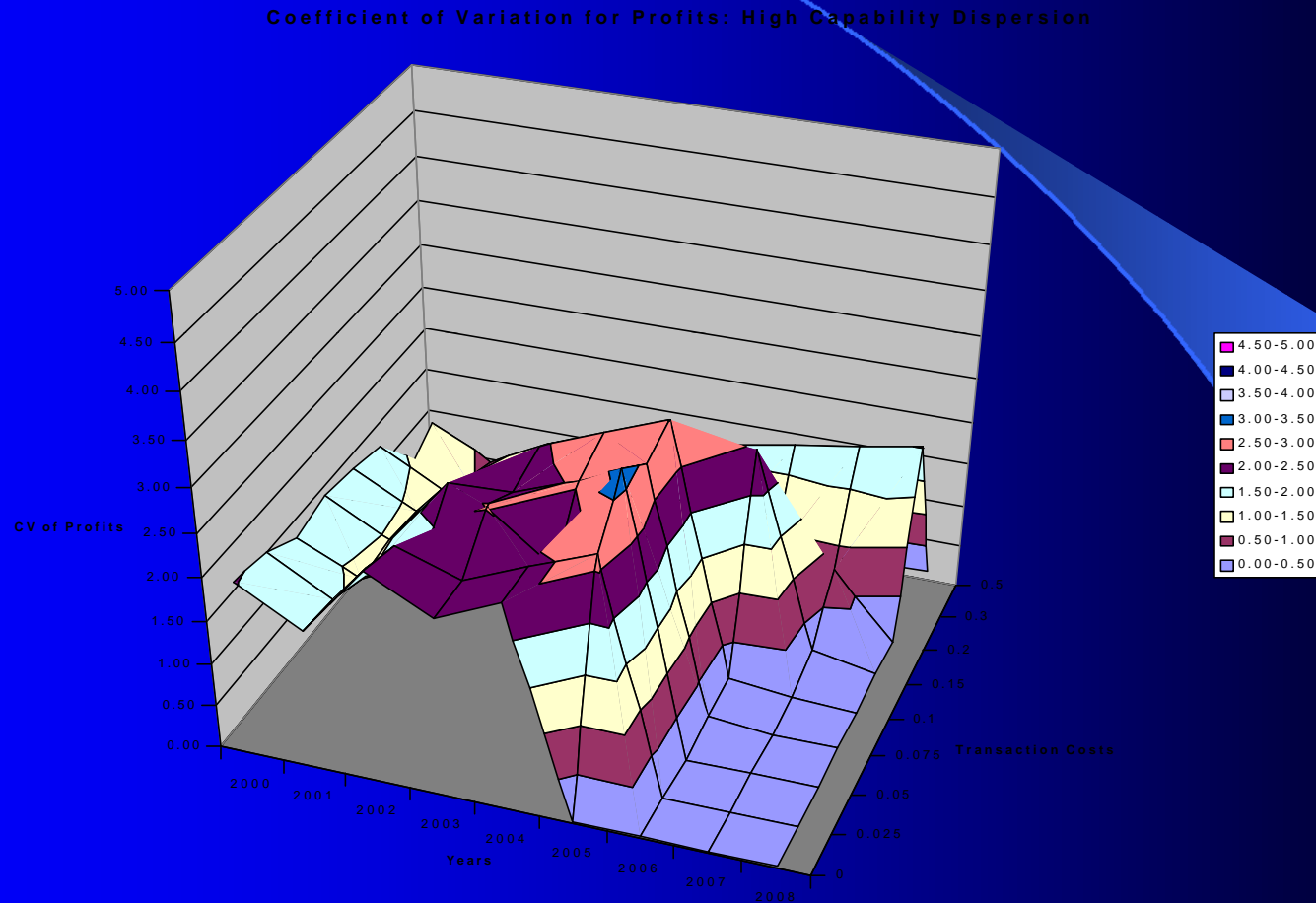
- Web does not always induce huge price competition
  - Evidence from existing studies: mixed
  - And brand power still exists!
- Which part of the business are we referring to?
  - Commoditization possible in B2B relations more than B2C
- The problem is “Tipping Markets”, really
  - *How* competitive dynamics are different in the e-world
  - But this does not mean we'll all perish

## **Myth # 8: In the e-economy, the winner takes it all...**

**So few players will dominate and make tons of money**

- Sort of. Initially.
  - But what are the dynamics?
- Competition in concentrated markets
  - Collusion vs. competition – and the DoJ's role
- Some curious micro-economics:
  - Inefficient guys in the market create profits!
- Factors that Matter: Scalability; Capability differences; Transaction Costs
  - And the possibility of success paving the way to poordom

# An Academic "Plug": A Model of Profitability Evolution



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## Myth # 9: Owning the Customer Information is the key to success in the e-world

- That's exactly what travel agents told airlines
  - And did survive for a little, before being beaten to death
- Assumptions on the value of information: ... “F”
  - As if the customer was a captive, with no alternatives...
  - Plus, 100% of information value times 14 > 100%...
- The elusive promise of cross-sells...
  - And the near complete lack of any evidence (but: *re-sale*?)
- And why would you *not* trade “customer custody”?
  - Development of such markets would change expected benefits

## on to the Crystal Ball: How will parts of the Value Chain evolve?

- The money isn't in 'net originations!!
  - The MB Channel (un-intermediated) will be modest at best...
  - ... but the real impact is in the relations along the Value Chain!
- Is the web substituting for the broker's function?
  - For free, too?... And how does that matter?
- Origination: Differentiation emerging
  - High-Net Worth savvy customer hand-holding
  - Low Fico, high-margin, locally "sticky" customers
- Servicing: Being better vs. being bigger

## Crystal Ball, cont'd

### Value Chain structure evolving

- The end of cross-subsidies
  - Newspapers as a bundle of news, ads and classifieds
  - ... business models, re-discovered
- Pricing and revenue changes
  - How do we make money? Discovering Business Models
  - The B-L-T example & Competitive Dynamics
- What the customer would do and what they do do
  - Industrial and end customers alike & price / performance ratio
- Killer App: Re-selling Mortgages?
  - What would shoot profitability in the industry?

## Crystal Ball, Cont'd

### Other People's Problems are My Problems

- Realtors dis-intermediated: Why should I care?
  - Some of the best dinosaurs around; but what's their next niche?
  - Co-opetition again: Learning to live with foe-friends
- The bigger picture: Who needs GSE-type aggregators?
  - The big challenge: Information Standardization obsolescing GSE
- GSE's and the duopsony problem: HUD or DoJ?
  - Their Business Model and implications for MB
  - Increasing repayments and margin pressures
  - The problem of information use & the problem of market power

## Crystal Ball, Cont'd

### What I'd be on the lookout for

- Further Standardization: XML's and other templates
  - Operational impacts are only part of the story!
  - What does Plug & Play mean for an industry?
- The disaggregation in mortgage origination:
  - Déjà vu: Changing relationships with Loan Officers
  - Will MB firms become networks of linked brokers?
  - What *is* the value each firm adds?
- Standardizing Technology: Is there hope for small fish?
  - Prospects of the “MS Office” Production suite?

For further details, and a more comprehensive analysis,  
contact...

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