TD WATERHOUSE DISCOUNT BROKERAGE: A COMPETITIVE STRATEGY

by

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ABSTRACT

This paper provides a strategic analysis of TD Waterhouse (TDW), the discount brokerage provider within TD Bank Financial Group (TDBFG). Discount brokerage in Canada is an increasingly lucrative industry and contributes significantly to the bottom lines of every major financial institution in the country. It is also a rapidly changing and intensely price-competitive industry in which an explicit, educated business strategy is of the utmost importance. TDW currently employs a somewhat ambiguous, “mixed” strategy based on focus and low-cost. The company needs to clarify this approach if it hopes to remain competitive and profitable in the future. There are five clear strategic alternatives available to the firm. These fall into three categories: overall cost leadership, differentiation and focus. Industry and organizational analyses clearly demonstrate that the strategy best-suited to TDW with respect to its values and competitive strengths is one of differentiation through customer service.

DEDICATION

I would like to dedicate this paper to Paul, Amelia and Charlotte. Their unwavering support has taken many forms over the past two years and has inspired me to make them proud.

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CHAPTER 1: INTRODUCTION

Over the past twenty years there has been unprecedented growth in the number of people investing for themselves and doing so through the Internet. The intermediaries that facilitate this process are called discount brokerage firms. These are distinguished from full-service brokerage firms by the fact that they enable individuals to invest their own money without providing investment advice.

As individuals have become increasingly empowered by the widespread availability of financial information and easy-to-use technologies, discount brokerage has become an exciting and lucrative business niche. As innovation continues, the industry promises to become even more so. In Canada, all six major financial institutions (Toronto Dominion Bank Financial Group, Royal Bank, Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Bank of Montreal and National Bank) provide discount brokerage services. This segment, though small in comparison to the breadth of financial products and services they provide, represents an important source of revenue for these firms. These facts, coupled with the existence of a variety of online companies focused solely on discount brokerage (e.g., E*Trade, QTrade and Qestrade), mean that the discount brokerage market is highly competitive, heavily focused on price and is characterized by rapid change. It is therefore of paramount importance that firms wishing to remain competitive in this industry have a comprehensive grasp of market forces, a deep understanding of their rivals and, above all, a clearly defined business strategy.

This paper focuses on the discount brokerage industry in Canada from the perspective of TD Waterhouse (TDW). TDW is the subsidiary of Toronto Dominion Bank Financial Group (TDBFG) which houses this institution's discount brokerage operations. Specifically, this paper is an analysis of TDW's current business strategy and whether or not this strategy positions TDW well within the industry. It also provides recommendations as to how TDW might better position itself to remain competitive in the long run.

The paper begins with a brief history of TDBFG and TDW. It outlines the values, culture, organizational structure and current strategy of the firm. It then employs Porter's Five Forces framework (1985) to conduct a competitive analysis of the discount brokerage industry in Canada. Key Success Factors (KSFs) for the industry are identified, the strategies of TDW's major competitors are discussed, and the opportunities and threats facing TDW are described in detail.

From there, I employ concepts from the Diamond-E method to conduct an internal analysis of TDW Discount Brokerage and reveal the strengths and weaknesses of the organization. The central issue of pricing in discount brokerage is then examined in detail. Finally, this paper describes the specific strategic alternatives available to TDW and compares their relative merits to the realities of both the company and the industry. The paper concludes with a specific recommendation as to how TDW can best position itself within the discount brokerage market to ensure long-term profitability.

Corporate History

TD Bank Financial Group (TDBFG), in which TDW operates, is well-established today as a leader in Canadian banking. The firm has a rich history in Canada with origins that pre-date Confederation. Its corporate reputation exudes consistency, reliability and performance.

TDBFG has experienced dramatic changes since its founding in 1855, yet its focus on service, technology and expansion has endured. The firm's earliest predecessor, The Bank of Toronto, provided essential banking, insurance and commodity exchange services for flour millers and grain dealers in Ontario. Buoyed by the economic prosperity following Confederation in 1867, another predecessor of TDBFG, The Dominion Bank opened its first branch in 1871 in order to help the young country finance nation-building projects in central Canada. As the country grew westward, the Dominion Bank began offering loans to the resource, utilities and manufacturing sectors in Winnipeg while the Bank of Toronto opened a branch in Rossland, British Columbia.

Through the early part of the twentieth century, The Bank of Toronto expanded from 16 to 161 branches while the Dominion Bank made its first foreign venture by opening an office in London, England. During the challenges of the two World Wars and the Great Depression, both banks rapidly expanded their branch reach and achieved regional representation across the country. Recognizing the possible synergy between "a union of equals" (TDBFG, 2005a), The Bank of Toronto and The Dominion Bank amalgamated to form the Toronto-Dominion Bank on February 1, 1955. The newly minted organization had 449 branches, 5,550 employees and boasted that it was

"The Bank Where People Make the Difference"(TDBFG, 2005a) In the short span of thirteen years, The Toronto-Dominion Bank launched numerous new product lines, including mutual funds in 1964 and the VISA card (known then as Chargex) in 1968. The architecturally dramatic TD Tower at the corner of King and Bay Streets in Toronto symbolizes the company's global vision; it was the tallest building in the British Commonwealth when it opened for business in 1967.

In 1984, the Toronto-Dominion Bank moved into the discount brokerage business by launching Green Line Investor Services, the predecessor of TDW Discount Brokerage. The establishment of TD Securities Inc. in 1987 – a wholesale bank offering corporate, treasury and investment banking services to corporate clients – further enhanced TDBFG's product offering. Its purchase of New-York-based Waterhouse Investor Services in 1996 instantly doubled the size of its discount brokerage. In 2000, TDBFG purchased Canada Trust. Its aim was to bring together the strengths of a large, Canadian Schedule I bank (TD) and the superior service and technology of a younger trust company (Canada Trust). Most recently, TDBFG has taken a bold step into the highly competitive market of the American Northeast personal and commercial banking.

Corporate Values

From the early days of western expansion by the Dominion and Toronto Banks, to the advent of discount brokerage in Canada and TDBFG's current foray in the American Northwest with TD Banknorth, certain themes have remained consistent; customer service, technology and sustained growth.

Customer Service

In the beginning, TD Bank was established to meet the needs of grain farmers and merchants who required financing for the day-to-day business of an emerging nation. Over time, the company's focus on customer service has endured. The Bank of Toronto's 1945 annual report states, "By advice when new enterprises are contemplated, by information when new markets are sought, with assistance and guidance in facing problems, we desire our managers to be of the greatest possible help"(TDBFG, 2005d). Advertisements for the bank in 1955 profiled employees and announced that "helping you is part of his job" and "a big part of her job is to treat you nicely"(TDBFG, 2005d). In 1975, TD introduced a new 'rapid teller' system to accelerate branch service while Canada Trust rolled out extended branch hours, boasting "8 to 8, six days straight"(TDBFG, 2005d).

Over the past few years, TDBFG continues to be rewarded for its persisting focus on customer service. Synovate, the marketing arm of Aegis Group Plc, awarded the firm '#1 in Customer Service' among the Big Five Banks in both 2005 and 2006. The Canadian Investment Industry named TD Mutual Funds the Analysts' Choice "Fund Company of the Year' in 2004 and Forrester Research Inc. rated TDBFG the "highest ranking banking site" in two reports; the Canadian Bank Public Website Ranking in January, 2006, and the Canadian Bank Secure Website Ranking in March, 2006. Also in 2006, Global Finance ranked TDBFG "the best consumer internet bank in Canada" (TDBFG, 2007c). Most recently, the firm announced that it will expand its branch hours to a consistent 62 hours per week in its entire branch, effective November 1st, 2007. The company has done this in order to maintain its position as a market leader in customer convenience and to provide 'a comfortable banking experience' for its customers.

Technology

Similar to its focus on service, TDBFG has always stressed technological advancement as part of its competitive strategy. Typewriters were added in 1900, adding machines in 1903 and bookkeeping machines in 1920, all to allow employees to balance ledgers and customer passbooks each night, rather than monthly. In 1962, a new Data Processing department was established at TD Bank. It housed the company's first cornputer system to streamline cheque clearing. TD's Green Machine, launched in 1976, was one of the country's first full-function automated banking machines (TDBFG, 2007a). The launch of Bankline in 1990 offered telephone banking to TDBFG customers for the first time, 24 hours a day, and 7 days a week. Green Line Investor Services, introduced in 1996, was one of the first brokerage firms to offer securities trading on the Internet via WebBroker. TD's current EasyWeb Security Guarantee (TDBFG, 2007a) is an example of the company's effective use of technology in enhancing customer satisfaction.

Sustained Growth

By the early twentieth century, TDBFG began operating outside of Canada's borders. It entered Europe with its first international office in London, England in 1911. By its 125th anniversary in 1980, the firm controlled four international divisions; Asia and Australasia; Europe, Middle East and Africa; Latin America and Caribbean; and United States. In 1998, TDW became the second largest discount brokerage in the world. In

2002, TDW UK announced a joint venture with Royal Bank of Scotland to take a 50% stake in NatWest Stockbrokers. Over the past decade, the Canadian Competition Bureau has legislated against bank mergers, but financial institutions have continued to look for growth opportunities outside of their borders in order to remain competitive on a global scale. On April 20, 2007, TDBFG announced the full privatization of TD Banknorth, a leading financial services company headquartered in Portland, Maine. These milestones represent some of the highlights of the firm's expansionist policy.

The rise of the internet and e-commerce have triggered remarkably fast and, in some cases, profound changes to business environments. Banking is no exception. With this in mind, one might reasonably wonder if TDBFG's strong history and well-established corporate values position the company well for continued success in a marketplace characterized by continual and rapid change. With this in mind, we will now look at the company's vision.

Corporate Vision

Consistent with the firm's focus on customer service, technology and expansion over the past 152 years, the company's current vision, as stated on its website, "is to be the better bank" and, "where we compete, we will be the best run, integrated, customer-focused financial institution" (TDBFG, 2006a). The company's current Chief Executive Officer (CEO), W. Edmund Clark, believes that there are five key factors that will position TDBFG ahead of its competitors (TDBFG, 2006b).

1. A balanced and actively managed risk strategy that delivers the best possible return on risk taken;

2. Franchise businesses, within the TDBFG organization, that focus on organic growth;
3. Superior customer service at every level;
4. Operational Excellence;
5. Building for the future by focusing on short and long term targets.

It makes sense that any strategy adopted by the organization would need to conform to these positions. As an organization, TDBFG also employs what it calls 'Guiding Principles' that govern the actions of its staff and inform its strategies. These are:

1. **Be customer driven**; know your customers and understand their perspective; work as an integrated company to meet customers' financial needs; and protect customers' information.
2. **Respect each other;** treat fellow employees as intelligent and valued individuals, communicate clearly, celebrate successes, reflect the diversity of the communities in which TDBFG operates and encourage healthy debate.
3. **Execute with excellence;** use resources well to fulfil corporate and business unit strategies, continually improve processes, remove barriers to excellence, embrace teamwork and acknowledge mistakes early and address them.
4. **Know our business;** understand what makes the business profitable, know how other TDBFG businesses can help customers, stay current in

your field, develop focused strategies in alignment with the firm's goals and be an expert at what you do.

5. **Enhance our brand;** act with integrity, understand reputational risk and treat TDBFG's reputation as your own, be a leader in corporate governance and make a positive contribution to the communities in which the organization does business.
6. **Increase shareholder value;** deliver consistent and growing financial results, adhere to TDBFG's strategies and principles and be performance driven.

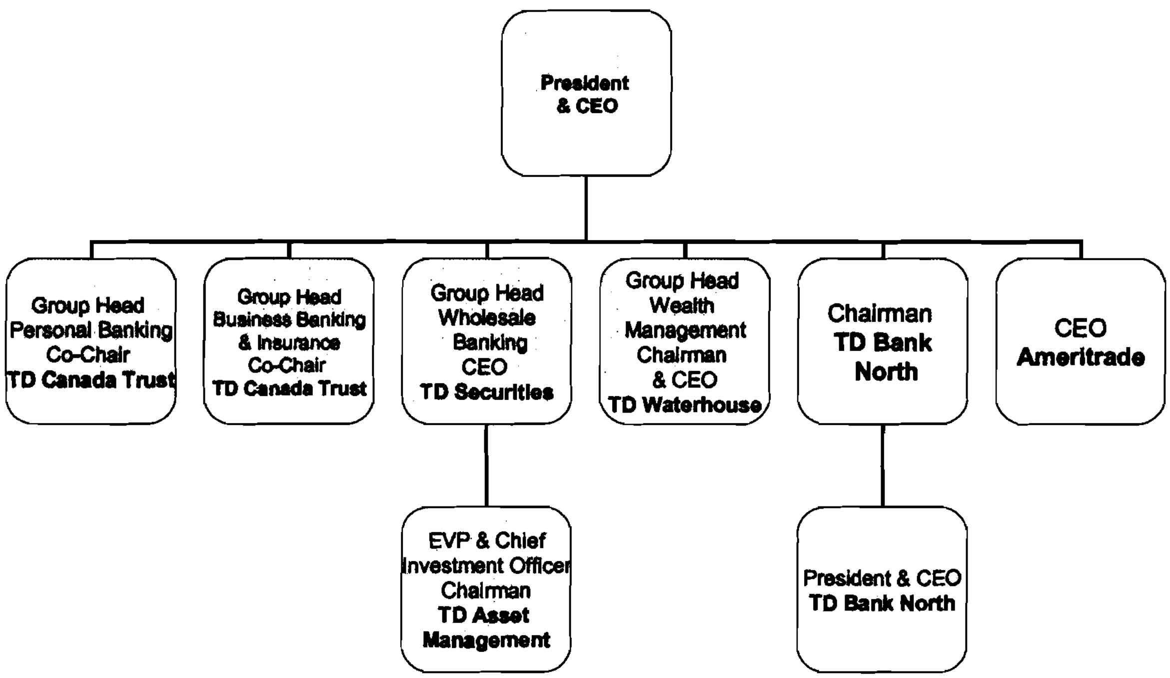
Guiding Principles are meant to inform the actions of employees across all business groups within TDBFG. These groups are diverse in their geography, the nature of their businesses and their structures. The challenge for an organization the size of TDBFG is to allow for growth in the different areas of the bank while ensuring that the culture and brand of the bank are retained. All this must be accomplished while the firm competes in a constantly evolving industry.

Since its inception in 1855, TDBFG has grown from a small financing company focused on the needs of grain farmers and merchants to a multi-national banking enterprise with a rich corporate reputation based on customer service, technological innovation and perpetual growth. We will now outline the structure of this enterprise to highlight the position of discount brokerage within the firm's broad range of financial services.

Organizational Structure

The operations of TDBFG are organized into four specific groups, each with their own internal management hierarchies. These groups are: 1) Canadian Personal and Commercial Banking, 2) US Personal and Commercial Banking, 3) Wholesale Banking and 4) Wealth Management (see Figure 1). This structure, with its significant focus on US operations, resulted from the acquisition of a majority stake in TD Banknorth in 2005. TDW operates within the Wealth Management segment, which includes both Discount Brokerage and Financial Planning.

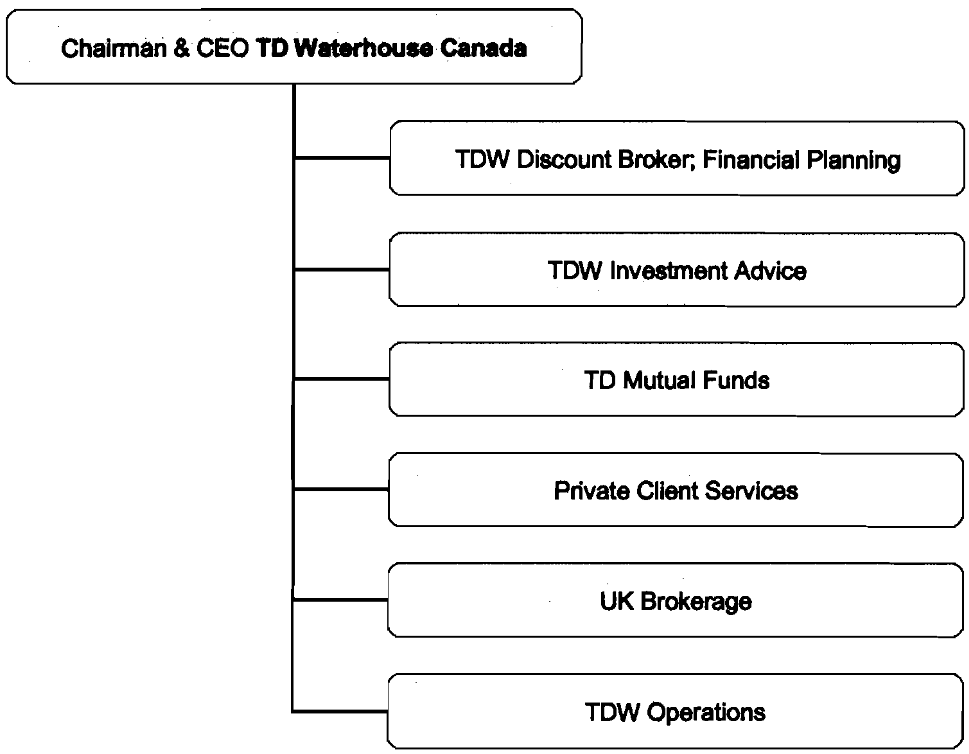
Figure 1: TDBFG Organizational Structure



Wealth Management

TDW Wealth Management is currently organized into six divisions: Discount Brokerage, TD Mutual Funds, Private Client Group, Investment Management, Private Investment Advice and Financial Planning (see Figure 2).

Figure 2: TDBFG Wealth Management Organizational Structure



The Wealth Management division at TDBFG provides investment products through a wide range of products and services. It is comprised of advisory, distribution and asset management businesses. Based on market share, TDBFG's Wealth Management division is one of the largest in Canada, with total revenue in 2006 of $2,260 million and an adjusted net income for the same period of $590 million. This segment comprised just over 15 percent of the firm's total revenue in 2006. Through its discount brokerage channels, TD Wealth Management serves customers in Canada, the United States and the United Kingdom. At the end of 2006, Wealth Management had assets under administration of $160 billion and assets under management of $151 billion.

In Canada, the Wealth Management divisions of discount brokerage, financial planning and private client services cater to different customer segments through different stages of the investment life cycle. TD Mutual Funds now ranks fourth in industry ranking and has been number two in net sales in long-term mutual funds for fours years in a row. In January of 2006, TDBFG closed the sale of its US brokerage business, TD Waterhouse USA, to Ameritrade, thereby forming TD Ameritrade. As part of the transaction, TDW Canada acquired 100 percent of Ameritrade's Canadian operations.

Clearly, Wealth Management comprises a significant share of TDBFG's overall operations. In order to better understand how Discount Brokerage fits into the above structure, we will now take a closer look at the firm's current Wealth Management strategy.

Strategy for Wealth Management

The strategy for Wealth Management at TDBFG has remained consistent over the past three years. It can be summarized as follows:

- develop an integrated asset-gathering, client-focused organization;
- continue to grow under-penetrated businesses at above average growth rates;

- leverage the TD Waterhouse and TD Mutual fund brands as a premier, trusted advisor;
- develop a top tier selection of products and services designed to meet the needs of each client segment;
- leverage technology to enhance the systems architecture supporting the customer experience and to increase operational efficiency;
- leverage the strong client referral relationship with Canadian Personal and Commercial Banking (TDBFG, 2006a);

TDBFG's Wealth Management division clearly supports the firm's corporate goals of superior customer service, leveraging technology and continued growth. It is therefore equally important that the Discount Brokerage segment, although it competes in the altogether different forum of e-commerce, support those goals, too.

Discount Brokerage at TD Waterhouse

Discount Brokerage (DB) is the segment of the bank that supports customers' self-directed, on-line trading. In Canada, TDW DB is an industry leader with more than 50 percent market share of assets under management. At the end of 2006, the revenue of $954M generated by this segment of the business constituted 42.2 percent of the revenues of TDW and 6.5 percent of the overall revenues of TDBFG. Services offered to customers include web- and telephone-trading, eServices, a Tax Resource Centre, custodial support, regular client appreciation events, Investor Insight Magazine, market and research data (some of which is proprietary), cash management services and TD Waterhouse Investor Centres.

Corporate Summary

Based on the way TDBFG has operated its businesses over the past 152 years, and guided by its current values and vision, it is apparent that the firm is a traditional, 'blue-chip' business that seeks to deliver improved business results quarter after quarter to its shareholders. As it competes in new and increasingly competitive marketplaces, the company must continually seek new advantages in order to deliver the reliable returns that investors have come to expect. Strategic direction is therefore of crucial importance for TDBFG. Careful study must be made of both the external and internal business environments in which TDBFG operates in order to develop and test possible paths for the future. This is the ultimate goal of this paper.

Having established the history, vision and values of TDBFG and the position of Discount Brokerage within the larger Wealth Management niche, we will now conduct a competitive analysis of the discount brokerage industry in Canada to determine the major forces affecting success and the Key Success Factors for the industry.

CHAPTER 2: INDUSTRY ANALYSIS

We will now use the concepts from Porter's Five Forces (1997) to conduct a competitive analysis of the discount brokerage industry. We will then discuss the Key Success Factors of discount brokerage and their impacts at both the industry and firm level. This chapter will conclude with a discussion of the reality of competition between Canadian financial institutions.

Financial Services Industry

In Canada, banking is an oligopoly dominated by five main competitors that hold over 90 per cent of banking assets. The banks compete mainly on price, differentiated products, customer service and productivity. Canadian banks provide consumers many different products such as core accounts, mortgages, credit cards, financial planning and discount brokerage through a variety of distribution channels (ATMs, Internet, branches, etc.). Competition is very strong in the financial services industry. It impacts the efficiency and quality of financial products and the degree of innovation demonstrated by financial institutions. Specific to financial services is the connection between competition and stability. This has long been recognized by investors.

TDBFG is one of the 'Big Five' banks in Canada, with over 14 million customers worldwide. It is one of the top 10 banks in North America by market capitalization and the leading web bank with more than 4.5 million online customers. TDW Discount

Brokerage is wholly-owned by TDBFG. It provides investors and financial advisors with a broad range of brokerage, mutual fund, banking and other consumer financial products on an integrated basis.

The On-line Discount Brokerage Industry

Discount brokerage is the segment of the industry in which investors select and purchase financial instruments independently (i.e., without advisors) in order to manage and grow their assets. These investors use on-line brokerage to facilitate trades (i.e., buying and selling) and they usually pay a commission for doing so. The industry caters to a broad range of clients including personal and institutional clients with investable assets beginning at $1000. Regardless of wealth or experience, investors can open a discount brokerage account. Regardless of the size of the account, almost every investor has equal access to the products and services offered.

With the increased focus on retirement savings and the growth of the internet and "e-commerce" in the past 20 years, the on-line discount brokerage industry has blossomed. The roots of the industry can be traced to trading software developed by Fidelity Investments, a mutual fund dealer and discount broker, in the late 1980's (Ramchandran & Gurbaxani, 1999). Discount brokers, with their existing focus on lean and no-frill operations, were the first to embrace online trading as a means to further reduce costs and improve efficiency of delivery to the customer.

Industry Attractiveness

Retail brokerage represents one of recent history's most successful applications of e-commerce; the number of online accounts grew from 7 million in 1998 to over 31 million in 2003, with online brokers responsible for 28% of U.S. retail trades in 2002 (Backos, Lucas, Oh, Simon, Viswanathan & Weber, 2005). Most analysts are extremely positive about the continued growth potential of the on-line brokerage industry. Canada's 'baby boom', born between 1947 to 1966, was the most impactful among the industrialized world. Baby boomers in Canada, including those born elsewhere, totaled 9.8 million people in 1996, almost 33 per cent of the Canadian population (Foot & Stoffman, 1996). This generation is now poised to inherit an unprecedented amount of wealth, expected to grow to $4.3 trillion by 2010 (CBA, 2007).

Porter's (1997) Five Forces Analysis

Porter's Five Forces Analysis (1997) is a convenient, insightful method of examining the competitive forces that shape an industry and thereby establishing its profit potential. The Five Forces are defined as 1) Supplier Power, 2) Buyer Power, 3) Competitive Rivalry, 4) Threat of New Entrants, and 5) Threat of Substitutes.

Supplier Power

There are three major categories of suppliers to on-line brokerage firms: 1) providers of IT infrastructure, 2) providers of the software required to operate these sites and to provide functionality to its customers, and 3) the information services that provide content to the brokerage firm's websites.

IT infrastructure requires significant commitment on the part of the discount brokerage firm. Once a system is selected and put in place switching costs can be quite high. Although there are many such providers of IT infrastructure, it is important in the beginning for a discount brokerage firm to select systems that will allow for future growth, maintenance and support service. Contracts with suppliers sometimes last for many years, such as the 5-year contract TDW has with Digital to provide high-availability server, production server and 24/7 technical support. Once committed to lengthy contracts, discount brokerages effectively transfer power to those suppliers for the length of the contract and beyond.

Software is a different matter because software programs can be sourced from more diverse suppliers. Software provides different tools to enable transaction processing, order routing, execution and clearance, position keeping, tracking and research. Most such programs update market information in 15 second intervals. TDW uses KANA software provided by IBM Business Consulting Services for Customer Relationship Management (CRM) and Service Resolution Management (SRM). Although easier to change than IT infrastructure, customers become accustomed to software and changing suppliers can impact customer service. As with infrastructure, software decisions, once made, transfer power to the supplier.

Information services required by discount brokerages are provided by various news agencies and securities commissions, such as Reuters, Associated Press and numerous securities commissions across the world. Because of the highly regulated environment of the securities industry in Canada, information is distributed equitably to all users. It is unlikely, therefore, that any information provider can exert significant power over a brokerage firm.

Buyer Power

Increased access to information technology, the hallmark of on-line investing, allows customers the ability to search and switch more easily and at the present time the market for online discount brokerages is very fragmented. The typical customer is educated, middle to upper middle class with respect to income level, and generally makes informed decisions. As such, customers tend not to wield power in this industry as individuals, but can be quite powerful as a group. It is worth emphasizing that the switching costs for an individual customer to move from one brokerage house to another are quite low. This gives the individual customer a large set of options. Moreover, the existence of chat rooms and other discussion forums on the Internet make it relatively simple for individual customers to share their opinions with each other, and to organize groups that can collectively express their opinions to the brokerage firm. A recent phenomenon in the wealth management industry is guerrilla investors, vocal groups of shareholders who target Annual General Meetings to voice their concerns over company operations. These groups, whether they are online investors or not, can wield tremendous power over corporations who in turn exert pressure on brokerage firms.

Rivalry in the Industry

This year's Globe and Mail survey of online brokers for investing in Canada included 15 firms that focus strictly on services delivered over the Internet (Carrick, 2006). The most significant of these competitors include the 'Big Six' banks, E*Trade Canada, Merrill Lynch HSBC and three newer 'boutique' competitors; Disnat, QTrade and Qestrade. This amount of competition, and the rate at which it has increased over the past decade, means that firms must compete more feverishly for market share. Currently, TDW is the largest player in the market with CAD$151 million in Assets under Management (AUM). It is widely accepted that the next closest competitor is Royal Bank, although RBC aggregates its retail and wealth businesses into one Canadian retail segment for reporting purposes. In its 2006 Annual Report, RBC claims itself to be "the 2nd largest Canadian self-directed brokerage as measured by AUM". RBC is followed closely by BMO, which reports CAD$96 million AUM. E*Trade Canada, a Canadian subsidiary of US-based E*Trade Financial Corp, competes most directly with TD for the 'active trader' segment. That firm claims $US 176 billion in assets under management (E*Trade, 2007). The boutique brokers mainly target aggressive stock traders but are increasingly reaching out to more mainstream investors.

New Entrants

The online market is constantly evolving and new entrants to this market are continually emerging. Despite fairly high sunk costs, the lure of the visibility of Internet-based businesses attracts more entrants all the time. Over the past 10 years, with changes to the Bank Act, insurance companies in Canada have begun to delve more fully into the sphere of wealth management and discount brokerage. Another source of competition is those companies that have established their core competency in other on-line businesses, have large customer bases, and are attempting to expand their businesses into new industries. Examples might include portals such as Yahoo Inc, AOL, and Microsoft. Such companies bring large customer bases and a comprehensive understanding of those customers' on-line preferences and behaviors. It is conceivable that these or other companies could enter the discount brokerage industry.

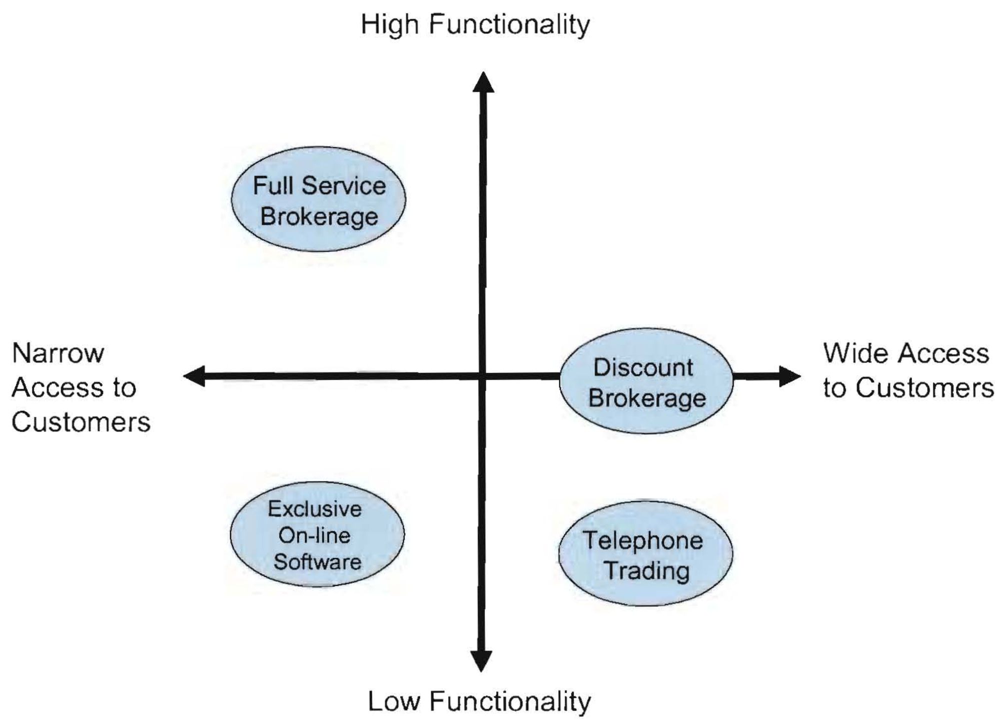
New technologies continue to be introduced making it possible for new entrants to leapfrog existing competitors who may have invested in less flexible architectures. Observe the recent efforts of the brokerage industry to reach customers through a variety of information appliances such as Blackberry RIM and cell phone providers such as Rogers.

Substitutes

Within the client-directed segment of wealth management there are several channels, or substitutes. In addition to discount brokerage, participants in this channel include retail branches and direct-sale mutual fund companies. There are also several advisor-directed channels such as full-service brokers, on-line marketplaces and direct-to-customer sales.

Clearly, these are substitutes for discount brokers. In theory, existing customers can take their business to full service brokerages, though this is unlikely because of the higher cost of dealing with full service brokers. Customers could also begin trading between themselves in new on-line marketplaces, thus disenfranchising the brokerages, but this is also unlikely given the high costs associated with authenticating and verifying trades, maintaining the required ownership and registry databases, providing custodial services and complying with intensive securities regulations. Companies could stop selling shares (at least for new issues) via brokerage firms and go directly to the customer (company-to-customer transactions). This is also somewhat unlikely, given the economies of scale, scope and volume that brokerages have achieved.

Figure 3: Wealth Management Channels: Spectrum of Brokerage Services



Summary of Competitive Forces

To summarize, the most significant competitive forces affecting the discount brokerage industry are supplier power (i.e., IT and software providers), buyer power (especially when customers act in groups), feverish rivalry between competing firms and a continual stream of new entrants armed with new technologies. With these characteristics in mind, we will now discuss the key success factors for the industry.

Key Success Factors

Key success factors (KSF) are defined as the major determinants of financial and competitive success in industry. A KSF can be a specific skill or talent, a competitive capability or something a firm must do to satisfy customers. Winning competitive advantage often hinges on being distinctively better than rivals at one or more of the KSFs. Here we will examine the key success factors that govern the discount brokerage industry and how they apply to TDW.

Discount brokerage is characterized by five key success factors;

1. Price
2. Information technology
3. Brand Recognition
4. Customer Service
5. Networks

Price

Price is arguably the most significant success factor in discount brokerage. In an industry with low switching costs and strong buyer power, pricing can be a critical factor of success. In the eighth edition of the Globe and Mail's broker ranking, costs were the most important factor for discount brokerage customers. In a survey conducted recently on the Globeinvestor.com website, a little more than one in three of the 1,641 participants ranked cheap commissions and fees as the top attribute of an on-line broker. No other attribute was even close (Globeinvestor, 2006). Fees and commissions are the focal point of most advertising in the industry, particularly in the US. Even TDBFG's 2005 Annual Report states, "In Canada and the U.S., discount brokerage revenues were hampered by intense price competition" (TDBF, 2005c). Economic theory would suggest that such intense price competition is not sustainable over the long term.

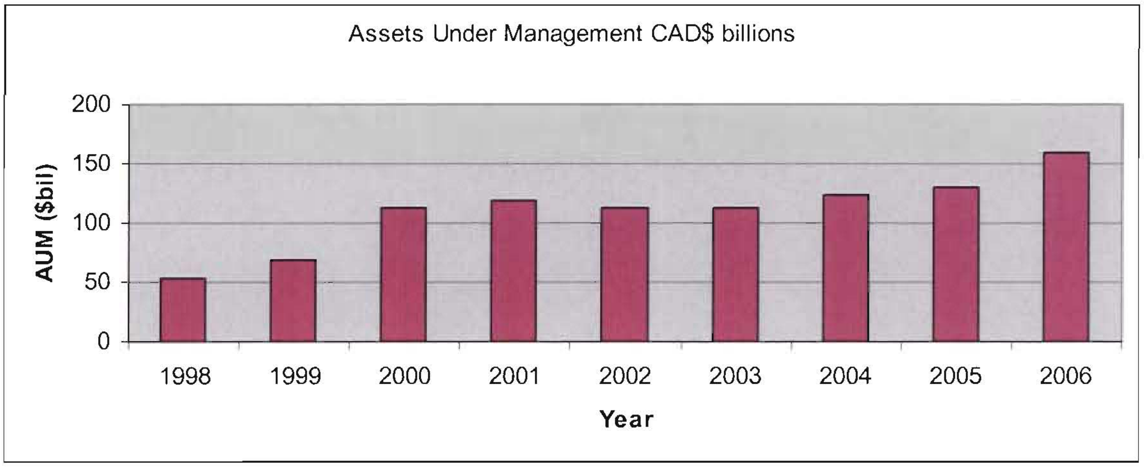
As Porter (2001) argues, the internet bolsters buyers' bargaining power, reduces barriers to entry, creates new substitutes, intensifies rivalry among competitors and tilts cost structures toward fixed costs, creating significant pressure for companies to engage in destructive price competition (Porter, 2001). These are the main features of the discount brokerage industry in Canada. The industry is defined by its high fixed costs and low variable costs. With trading volumes increasing annually, this highly competitive environment leads to slim margins on trade fees. Instead, profits are made in other areas such as interest income and margin loan balances. Cost reduction continues to be a focus.

Information Technology

Clearly, online businesses require extremely reliable and secure IT systems. Scalability of technology systems is critical as the assets under management (AUM) and trade volumes continually increase (see Figure 4). The threat of new entrants who may have superior technology means that existing firms cannot become complacent about their IT infrastructure, software, training or service. In a rapidly changing environment, customers' preferences change continually and their switching costs are low.

Another area of concern to investors is security, not just for online trading but in the entire field of finance. Increasingly, financial institutions must focus their attention on improved security enhancements and enforcement. Many online brokerages allow customers to apply for accounts on the Internet and in so doing, request highly personal information such as social insurance number, bank accounts and credit card numbers.

Figure 4: Assets Under Management Growth; 1998-2006



Source: TDBFG Annual Reports, 1998-2006

While many firms have improved their security by way of complicated encryption technology and various anti-virus and anti-phishing applications, there are still some firms that do not have these capabilities. Computer crashes are possible and, increasingly, heavy internet traffic can delay or stop Internet connections. Lack of adequate Internet security can be a serious problem, destroying customer confidence and eroding a firm's credibility. This lapse would logically result in reduced assets under management and trade fees, the two key drivers of revenue in the business. On the positive side of maintaining adequate technologies, mature online businesses can harvest large amounts of information that they have collected about their customers. They can mine this date to understand customer preferences, to identify the most profitable customers and they can target those customers directly.

Due to unprecedented growth in electronic trading, system boundaries are constantly being redefined and there is always a pressing need for improved data transmission speeds. This “latency challenge” impacts the quality of trade execution. One of the most pressing issues impacting financial industry firms is how to increase speed and reduce latency when accessing market data and trade execution venues. Growth in the size and quantity of orders is requiring that both the buy and sell sides develop solutions that will increase data speeds and capacity. This is mandatory to achieve success in the highly competitive securities business.

Brand Recognition

A brand is a name, term symbol or design intended to identify the services of one supplier from others. Brand recognition consists of all of the thoughts, feelings, images, experiences and beliefs that are associated with that brand. Brands that signal a certain level of quality or trust will be selected repeatedly by buyers. As consumers' lives become more complicated and rushed, the ability of a brand to simplify decision making and reduce risk is invaluable. Because of the wide scope of the Internet, when customers are searching for discount brokerage services they are likely to do so through familiar channels. TDBFG has a clear advantage here over some of the less familiar online brokerage brands because its business is multi-dimensional and not solely online. There are therefore more opportunities for Canadian consumers to have contact with the TD brand than most others. At TDW, 69 percent of its accounts are opened through the branch network, signalling that customers' are more likely to initiate a discount brokerage relationship with a supplier they know. TD Bank has the second most valuable brand in Canada, according to the Globe and Mail's Report on Business, just behind Royal Bank (Perkins, 2007).

Customer Service

Part of what enhances a product's brand position is based on a customer's past experiences with a particular supplier. Customer service contributes to those experiences in a significant way. Because of the online forum of discount brokerage and the self-service nature of this industry, there are fewer 'touch points' with customers than in more traditional industries. For suppliers such as TDW, this means fewer opportunities to influence the purchasing decisions of its customers and the magnified importance of those interactions. In discount brokerage there are times that service is required; when opening an account, for problem resolution, for market research and for education. All new account documentation must be seen by an individual in its original form and signatures witnessed for compliance reasons. This means that all discount brokerage customers will have at least one face-to-face interaction with a customer service representative. These opportunities can also set the tone for the on-going relationship and can be considered very important in delivering a memorable and positive experience for the customer. Other opportunities for interaction with discount brokerage clients include branch and Investor Centre interactions, educational seminars, telephone support and access to market research.

As we have examined earlier, TDBFG has a superior market position based partly on superior customer service and this position is consistent with the long-term values of the organization.

Networks

Because the value of firms Assets under Management (AUM) is significant in the brokerage business, access to new customers is an important factor to success.

Building effective networks can be an excellent way to source new prospects, to increase AUM and, with more customers, increase trade volume. A customer may be introduced to discount brokerage through a number of different channels;

- Retail Branches; a recommendation from branch staff,
- Investor Centres; the location and operating hours of these centres can be critical in acquiring new customers,
- Online Searches; those search engines that recommend or promote certain services can enhance contact – online affiliations with organizations such as Google, AOL and Microsoft can be extremely important,
- Business Development Agents; these are individuals whose role is to develop business on behalf of the discount broker. They are usually mobile and operate throughout geographical territories.

Of the three main 'Big Bank' competitors in discount brokerage, RBC has the strongest network with 1443 branches across Canada. BMO is second with 1142 and TDBFG is third with 1050 (it is important to note here that the specifics of this data are continually changing and have likely done so, if only slightly, during the preparation of this paper – this is another example of how fast change can occur in the financial industry). TDBFG, however, has a much larger presence with Investor Centres (18 across Canada) than the other two banks. Royal Bank has only one 'Action Direct' investment centre in Toronto; it is a one-person operation. Likewise, BMO has only one 'InvestorLine' investment centre in Toronto. Each of the banks shares similar connections with online services, with no one company showing a distinct advantage over the others. In terms of Business Development Managers (BDM), TDBFG employs BDMs in each of its Investor Centres and has additional BDMs roving between retail branches to provide support and education. In comparison, RBC has none and BMO employs 20 on its National Business Development Team.

With respect to the above methods of gaining more customers, TDW is well positioned.

Competition at Canadian Financial Institutions

Banking is a competitive business in Canada and is growing more competitive as the net-worth of Canadians increases. In 2005, Canadians' total net-worth reached $4.9 trillion, a 41.7 percentage growth from 1999. This increase is mostly due to favourable economic conditions, a strong real estate market and a rebound in the Canadian stock market. The varieties of financial institutions offer customers choice and convenient access to a full range of financial products and services from a variety of suppliers. In the past decade, many facets of the industry have changed, including a significant increase in competitiveness. This has precipitated a number of developments:

1. **Breaking down regulatory barriers:** Over the past two decades, regulations that prohibited financial institutions from competing in others' businesses have largely disappeared. The traditional four pillars of financial services – banks, trust companies, securities dealers and insurance companies – now have an increased ability to operate in what were formerly distinct business lines.

2. **More flexible ownership and access opportunities:** Recent changes to the Federal law governing financial institutions – the Bank Act – have expanded opportunities for foreign banks to operate in Canada. As a result, new entrants and certain non-bank financial institutions now offer their clients chequing and account privileges and access to the Interac debit system.
3. **Innovation in technology and product offerings:** Each year, more diverse products are offered and technological advances trigger the emergence of new types of competitors and products.

According to the Canadian Bankers Association, in addition to the six largest banks in Canada there are also 16 smaller domestic banks, 49 foreign-owned subsidiaries, 35 trust companies, over 1000 credit unions and caisse populaires, over 100 life and health insurance companies, 37 mutual fund companies, 168 investment dealers, over 170 property and casualty insurance companies, over 150 pension fund managers and over 190 financing and leasing companies (CBA, 2007a). Therefore, competition in the financial services sector continues to grow, with pricing becoming progressively more important as players strive to improve their market share position within an increasingly crowded market.

Wealth Management at Canadian Financial Institutions

The Wealth business is already a significant contributor to the overall earnings of Canadian financial institutions and that trend appears to be growing. According to Bank of Montreal Analysts, the North American wealth management industry continues to be an attractive business and growth is expected to remain strong, with high net-worth and aging baby boomer segments becoming increasingly significant. The high net-worth market is expected to expand significantly faster in North America than the mainstream banking market (BMO, 2006). On average, the wealth segment of the 'Big Six' banks grew 15.36 percent between 2005 and 2006, representing an average increase of CAD$155 Million (see Table 1).

Table 1: Overall Revenue Derived from Wealth Segment

Percentage of Revenue from Wealth Segment (in CAD millions)

	2006			2005			
Bank	**Total Revenue**	**Wealth Revenue**	**Percentage from Wealth**	**Total Revenue**	**Wealth Revenue**	**Percentage from Wealth**	**YOY Change in Wealth**
TD	$13,466	$2,009	14.92%	$12,361	$1,757	14.21%	0.70%
RBC	$18,328	$2,692	14.69%	$16,631	$2,294	13.79%	0.89%
CIBC	$11,559	$2,481	21.46%	$11,897	$2,450	20.59%	0.87%
BNS	$11,694	$992	8.48%	$10,643	$911	8.56%	-0.08%
BMO	$10,074	$1,617	16.05%	$9,800	$1,467	14.97%	1.08%
NA	$3,970	$819	20.63%	$3,816	$803	21.04%	-0.41%
							0.00%
Six Bank Average	$11,515	$1,768	15.36%	$10,858	$1,614	14.86%	0.50%

It is clear that wealth is a significant business for the banks. The wealth segment has grown at four of the six financial institutions over the past year and seems poised to grow even further. As we analyse these findings, it becomes clear which of these institutions' strategies are truly focused on growth within the wealth segment.

The Banks' Stated Strategies for the Wealth Segment and the Reality

In the Management Discussion and Analysis section of every annual report, the leaders of financial institutions provide their stated vision and direction for their business. This provides some clues regarding the importance of the wealth segment to the overall organization. If we examine how each of the aforementioned banks has publicly projected its vision for the wealth segment of its business and compare that to percentage of revenue that the parent organization derives from the wealth segment, we should develop a clear idea of whether these institutions are executing on their stated goals.

TD Bank

TD's wealth business publicly states that its strategy focuses on an integrated customer-focused approach to asset gathering. It plans to "leverage the brands of TD Waterhouse and TD Mutual Funds as a premier, trusted advisor and "to deliver a top tier continuum of products, services and solutions designed to meet the needs of each client segment" (TDBFG, 2006b). The language of "premier" and "top tier" seems to indicate an interest in specific niche markets and alludes to a differentiation strategy. When we analyse the revenue from TDBFG's wealth business, it contributes almost 15 percent to the firm's bottom line and that contribution grew by 0.70 percent between 2005 and 2006. In terms of growth, TDBFG Wealth is middle of the pack for the 'Big Six'.

Royal Bank

The Royal Bank states very little publicly about its wealth management strategy. The company seems to value secrecy in this regard and one must assume that it has something to hide; either a strong competitive advantage or a weakness that it does not want exposed to the market. (Efforts to obtain data for the purposes of this project from both public and private sources proved futile). In general, RBC states that it plans to "continue to streamline our processes and structures to make it easier for our clients to do business with us and to improve the ability of our employees to deliver cost-effective and efficient solutions" (RBC, 2006). In the same Annual Report, in discussions regarding its discount brokerage operations, RBC claims it introduced "market-leading pricing" for active investors and that the bank has significantly enhanced its online capabilities. This seems to indicate RBC also plans to segment the wealth market with a 'niche' approach. Wealth revenues in 2006 comprised just under 15 percent of RBC's overall revenues, putting RBC fifth of the leading six banks for the importance of its wealth operations.

CIBC

The stated strategy for CIBC Retail Markets is to develop strong relationships with clients by extending the affluent client experience to more clients, to continue to enhance product competitiveness and to leverage its strong retail and wealth distribution channels (CIBC, 2006). It seems that CIBC plans to use its existing distribution channels to gain more market share, which would mean it plans to grow its number of customers broadly while simultaneously expanding the affluent segment of its client base. This strategy of selective differentiation appears to be a 'cover all your bases' strategy, which makes sense given the importance of this business to the bank. CIBC's wealth revenues in 2006 made up almost 22 percent of its revenues overall and was the highest of the 'Big Six'. This channel is extremely important to CIBC.

Bank of Nova Scotia

The Bank of Nova Scotia has indicated that it has an interest in pursuing growth from a niche approach toward higher value clients. In its 2006 Annual Report the company states, "Domestic Banking's strategy for growth is to expand our client base, particularly with customer segments that have high growth potential". Again, this appears to be a differentiation strategy but in this case, BNS seems to be moving away from its reliance on the wealth segment. In 2006, the revenue from these operations decreased to only 8.5 percent of its overall revenues. This is the lowest of all the banks analysed and shows clearly that the wealth business is not a strong strategic focus for BNS.

Bank of Montreal

BMO shows no apparent favour for a niche approach to the Wealth market. Instead, the company's stated strategy for the wealth segment focuses on "exceptional client service", improved profitability, operational effectiveness and accelerated growth (BMO, 2006). And like RBC, BMO is reluctant to give away trade secrets in terms of its competitive direction. What we do know is that BMO values its wealth business, which contributes just over 16 percent to overall operations, and that the company is growing this segment more quickly than the other banks.

National Bank

In its Management Discussion and Analysis section of its 2006 Annual Report, National Bank states, "Our wealth management strategy is anchored by our branch network, specialized distribution channels and the Financial Advisors at National Bank Financial". Branch staff sell mutual funds and discount brokerage. Once a client has accumulated certain investable assets, he/she is referred to a Financial Planner or Private Banker within the organization. Here again, we see interest in leveraging existing channels in order to build a broad customer base, but NB's approach seems to be more one of organic, rather than acquired, growth. The percentage of revenue gained from the wealth segment has decreased in the last year, moving down 0.4 percent to just over 20 percent of overall revenue. We can logically assume that NB has decided to continue its course of organic growth while reducing reliance on wealth.

Summary of Bank Wealth Analysis

Without any less than 8 percent of revenue generated from wealth business and as much as 21 percent, it is fair to say that this segment is significant to all of the banks, albeit some more than others. In order to better understand how discount brokerage contributes to the value of wealth overall, we move into a similar examination between TDW and NB Direct Brokerage. Although examination of a broader selection of firms would make sense, only TDW and NB report distinct data from these operations. Analysis of other financial institutions would be purely speculative. From the findings of our comparison between TDW and NB, we will make some assumptions in regard to the other financial institutions. From there we will move into the issue of pricing and examine how the various institutions are using pricing to attract customers.

Discount Brokerage Value: TD Waterhouse vs. National Bank

It is difficult to compare the value of discount brokerage operations to the variety of firms who participate in this market. For those whose sole business is discount brokerage, such as E*Trade, QTrade and Qestrade, it is obvious that the segment is crucial. Selecting appropriate strategies is of paramount importance to these firms; their survival depends on it. More difficult to determine is the value of discount brokerage operations to the overall operations of the various organizations who participate in several different lines of business simultaneously, such as the big banks and HSBC. What makes this determination even more difficult is the fact that, of the six largest banks in Canada, only TDW and NB report discount brokerage operations separately from Wealth. By comparing these two businesses, however, we can generate some general assumptions about the others that will again demonstrate the importance of pricing in the segment.

TD Waterhouse Discount Brokerage

The revenue from discount brokerage operations at TDW makes up a significant part of TDBFG's business, 7 percent in 2006 but down from 13 percent the year before. In terms of dollars, this segment generated CAD$ 954 million for TDBFG in 2006, down from CAD$ 1.6 billion in 2005. This revenue reduction of $ 667 can mainly be attributed to the sale of TD Waterhouse USA to Ameritrade and the coinciding purchase of Ameritrade Canada.

In the 2006 TDBFG Annual Report we find that the company's revenue from its wealth business decreased by CAD $486 million which, the company claims, was "mainly due the Ameritrade sale". This presumes that not all of that revenue decrease was due to the Ameritrade transaction. Upon further examination, we see that all of the businesses that make up the Wealth Management group except discount brokerage saw their revenues increase (see Table 2).

Table 2: Revenues from Wealth Management: 2004-2006

Wealth Management Revenues (in CAD millions)	**2006**	**2005**	**2004**
Discount brokerage	$ 954	$ 1,621	$ 1,611
Mutual funds	$ 512	$ 427	$ 381
Private client group	$ 208	$ 187	$ 167
Investment management	$ 143	$ 117	$ 103
Private investment advice	$ 348	$ 333	$ 291
Financial planning	$ 95	$ 61	$ 37
Total	$ 2,260	$ 2,746	$ 2,590

There are two logical conclusions to this: 1) the Ameritrade transaction impacted discount brokerage and not the other wealth businesses, and 2) discount brokerage lost revenue of at least CAD $181 million in 2006.

National Bank Discount Brokerage

Discount brokerage is not as significant to National Bank's business as it is to TDBFG's. In 2006, discount brokerage operations contributed one percent of National Bank's revenues, or CAD$ 50 million. As a percentage of overall bank revenue, this is almost identical to the contribution made in 2005 (see Table 3). Year over year however, the importance of discount brokerage revenue to wealth operations increased from 9 percent to 10 percent. Though notable, this increase is not significant enough to suggest National Bank has plans to change its strategy as it relates to discount brokerage.

Assumptions

From the data that we have examined – and keeping in mind the dearth of publicly available information – we may assume that although discount brokerage operations are not a heavy focus for the banks when it comes to their bottom line, the segment contributes between 1 and 13 percent of overall bank revenues. Within the realm of wealth business, however, the importance of discount brokerage increases significantly, generating from between 9 and 59 percent of overall wealth revenues. Given this importance, it makes sense for the banks to remain competitive in this market.

Table 3: Percentage of Revenue Derived from Discount Brokerage

DB Revenue (in CAD millions)

	Total Bank Revenue	**Wealth Revenue**	**DB Revenue**	**DB as % of total bank**	**DB as % of Wealth**
			2006		
TD Waterhouse	$ 13,466	$ 2,260	$ 954	7%	42%
National Bank	$ 3,970	$ 504	$ 50	1%	10%
			2005		
TD Waterhouse	$ 12,361	$ 2,746	$ 1,621	13%	59%
National Bank	$ 3,816	$ 509	$ 44	1%	9%

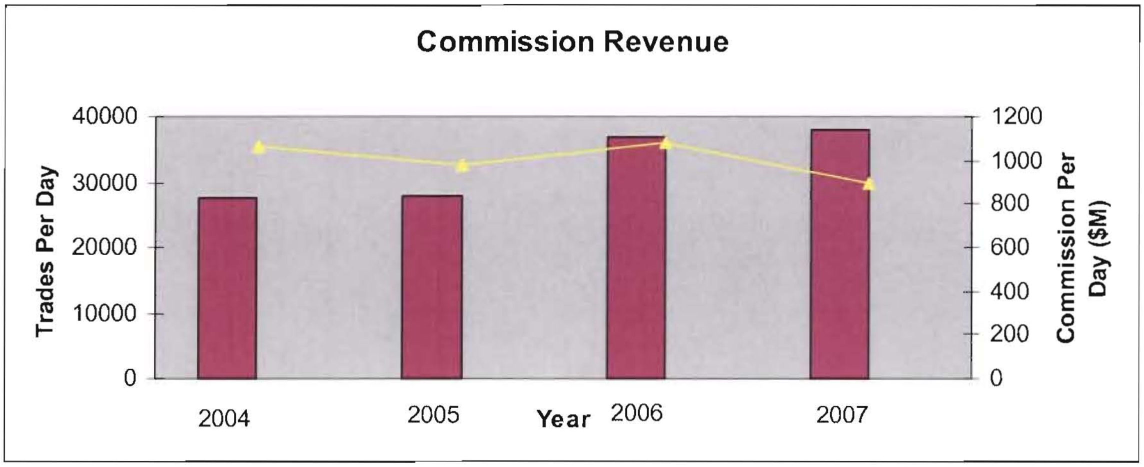
Commission Revenue

In the past two years, there has been intense pricing competition of commissions, or trade fees, among the providers of discount brokerage as they vie for market share. This competitive pressure has resulted in several institutions dramatically lowering fees and, not surprisingly, this has cut into the banks' revenues. So far, the key strategy for overcoming this revenue shortfall is to increase the number of transactions. For virtual companies, such as E*Trade Canada, the reductions in commission revenue, while impactful, can more easily be made up from high transactional numbers because of their low overhead costs. At the big banks, the challenges are more complex as the banks try to determine effective strategies for segmenting the market and catering different offerings to each. The bigger question for the banks is, as revenues continue to decline due to pricing competition, is this a worthwhile business to be in? And if so, what is the most effective way to remain profitable?

To use TDW as an example, in the past two years the commission per trade has decreased by 25 percent or $9.33 per transaction. This is mainly due to pricing competition. The number of transactions, meanwhile, has increased by 35 percent. The overall impact of these moves has been a decrease to the revenues of TDW Discount Brokerage and, as examined earlier, to the bank as a whole. With current pricing in place, approximately 49,000 trades per day are required in 2007 to maintain daily commission revenue at 2006 levels (see Figure 5).

At TDW Discount Brokerage there is a growing interest in moving away from commission revenue and toward other sources of revenue because of the pricing competition. Commissions are expected to contribute approximately 43 percent of the revenue in 2007, down from 54 percent in 2005. Other sources of revenue include interest, mutual fund trailers, foreign exchange and other customer-related fees and all of these are expected to increase. At the moment, however, it is impossible to ignore the fact that commission still contribute almost half of the revenue generated by Discount Brokerage and, as examined earlier, this is significant to TDBFG.

Figure 5: Commission Revenue: 2004-2007



Industry Analysis Summary

To summarize, discount brokerage is a continually evolving industry characterized by high supplier power, significant group buyer power, low switching costs, intense rivalry and a constant stream of new, tech-savvy entrants. Pricing, or cost reduction, is the most important success factor for firms in this business. Other key success factors include reliable and secure IT systems capable of executing trades and delivering information at every-increasing rates of speed, brand recognition, a commitment to superior customer service and the ability to access to new customers through a variety of different channels.

Environmental risks to TDW are particularly strong around pricing. Most online businesses end up competing purely on price, as differentiation can be challenging in an on-line environment with strong buyer power. TDW has already seen evidence of lost revenue in trade commissions. With lows switching and search costs, TD Waterhouse must create value specifically from the customers' perspective.

Online security breaches such as viruses, hackers, and phishing also pose a significant threat in terms of financial loss and reputational damage. Tech-savvy new entrants could bring superior technology that removes the need for costly maintenance of existing infrastructures. Wealth Management divisions at major banks, in which discount brokerage operations reside, make up significant percentages of their overall earnings, and this contribution to revenues continues to grow. Banks are therefore likely to make great efforts to remain competitive in the discount brokerage segment of their businesses.

Clearly, discount brokerage in Canada provides exciting business opportunities. The country's aging demographic and growing population is becoming significantly richer every year. The scale and scope of TD Waterhouse's operations vis-à-vis its competitors and its large base of existing customers, together with its strategic alliances and branch networks, positions it well to capitalize on some of these opportunities. But this begs the question: which strategy – a cost, differentiation or focus strategy – would be the best guarantor of success? And which of these three strategies is TDW best suited to pursue?

With these questions in mind, we will now turn inward and focus on the strategic alternatives facing TDW and how well they correspond to TDW's internal business environment. We will identify the strengths and weaknesses of the firm going forward and then take a closer look at the issue of pricing in discount brokerage. Finally, a series of strategic recommendations will be made.

CHAPTER 3: INTERNAL ANALYSIS

The discount brokerage industry in Canada is intensely competitive. As Porter (2001) suggests, the internet creates significant pressure for companies to engage in destructive price competition (Porter, 2001). TDW's main competitor in the 'Active Trader' segment, E*Trade Canada, is executing a cost strategy while its competitors in the 'Long Term Investor' segment, Royal Bank and Bank of Montreal are focused on a more broad approach to asset gathering. Meanwhile, TDW seems to be using a focus strategy on its 'Active Trader' segment concurrent with a cost strategy aimed at that market. Within the broader 'long term investor' market, however, TDW seems not to have clearly defined its approach. In an industry as competitive as discount brokerage, this lack of a clear route forward is cause for worry and demands close attention.

This chapter will employ the Diamond-E Framework (Crossman, Fry & Killing, 2005) of internal analysis to determine the best route forward for TDW Discount Brokerage. The Diamond-E is a useful method of analyzing a firm's current resource, organizational and management capabilities in light of the major strategic alternatives available to the company. We will begin by describing these strategic alternatives.

Strategic Alternatives

Consider the situation facing TDW Discount Brokerage. Although TDW is one of the largest managers of wealth in Canada based on market share of assets, price competition within the discount brokerage industry has resulted in "lost revenue" from trade commissions. The organization has only retained its superior market position by growing its assets under management (AUM) and increasing revenue in other areas. These include interest income from margin accounts and client deposit balances. Between 2005 and 2006, the contribution of the Discount Brokerage segment dropped dramatically from 13.6 percent of overall TDBFG earnings to 6.5 percent. Although part of this decrease can be attributed to the sale of TD Waterhouse USA to Ameritrade, there was also a sharp decline in trade commissions. Needless to say, this is an important stream of revenue that cannot simply be turned off without consideration of the ramifications. TDW operates in a highly competitive industry and customer retention can easily be influenced by factors such as pricing, changes in service levels and changes in products or services offered. There is increasing pressure on financial services companies to provide products and services at lower prices. This directly reduces revenues.

In order to improve its position in the market, TD Waterhouse can clarify its strategy by either pursuing a cost strategy or a differentiation strategy. The current strategy can be described as "differentiation with a mix of pricing strategy thrown in" (Alghabi, 2007). The organization differentiates based on its offering of '24/7' call centres, 23 Investor Centres across Canada and the TD Canada Trust retail branch network. The organization's position on pricing is "we will never be the cheapest player out there but we will never be the most expensive either" (Alghabi, 2007). The linkages between resources, organization, management preferences and TD Waterhouse's strategy must be robust enough to endure rapidly changing circumstances of the discount brokerage industry.

Short and Long Term Risks

In the short-term, there is a risk that TDW may not respond quickly enough to pricing competition and lose market share. As we've already examined, assets under management and trade volumes are two key drivers of success in the discount brokerage industry. The other short-term risk is that the company may not have the resources, organizational structure or management preferences to allow it to compete effectively.

In the long-term, there are very real risks that the discount brokerage industry may evolve well beyond recognition. It is still an immature market and the pace of change is rapid. There is a risk that new technologies or legislation may be introduced that will make TDW uncompetitive in the long-term. A clearly defined business strategy will help to ensure that there is compatibility between organizational goals and capabilities.

The Strategy-Resources Linkage

Resources that are required to successfully implement a cost strategy in the discount brokerage industry are different than the resources required for a focused differentiation strategy.

With a cost leadership strategy the key resources for TDW would be financial resources and Information Technology. Aggressive cost competition requires efficiency in scale and scope, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of poor quality accounts and cost minimization in areas like staffing, advertising, research and development (Porter, 1980). And while cost control is essential, it is perhaps more important for the organization to have strong financial resources on which to draw in times of intense price competition. Likewise with information technology, one of the key risks with a cost strategy is that technological change can quickly nullify past investments or learning (Porter, 1980). A differentiation strategy would require both of these things; financial resources and IT, but it would also require more commitment to human resources in order to execute on better service, brand enhancement, superior technology or other dimensions.

Financial Resources

As the Canadian leader in discount brokerage by market share, TDW possesses significant financial resources. In 2006, the organization's net income grew to a record $590 million, 37 percent ahead of 2005. Over the same period, retained earnings of the parent company, TDBFG, grew by CAD$3,075,000 (TDBFG, 2006b). Clearly, TDBFG is an organization that could weather price competition if necessary.

Information Technology Resources

TDW possesses significant IT resources and is considered a leader in the industry in this regard. While this may appear as a strength, the organization does not actually have a great deal of experience in this field. This considerable lack of corporate knowledge in terms of IT can certainly be considered a weakness.

Human Resources

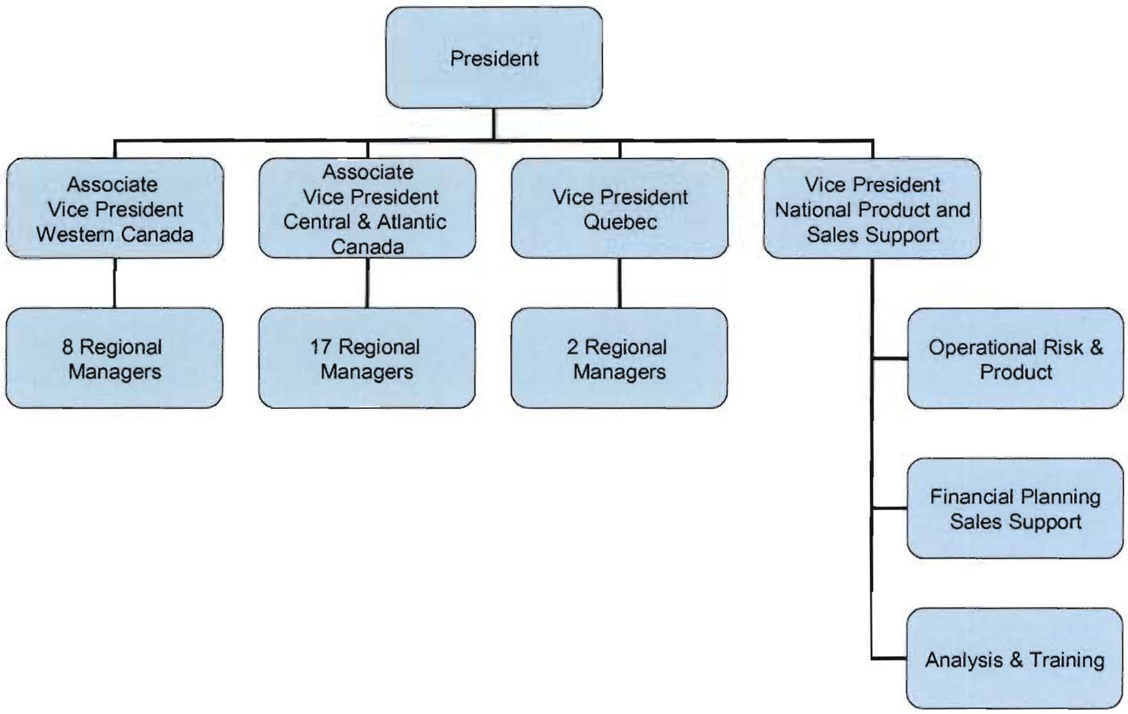
Human resources support at TDW is provided by a wealth-specific HR department in Toronto. This group is responsible for attracting and retaining staff for TDW operations in accordance with TDBFG standards. A TDBFG Employment

Standards department provides support to this group to ensure consistency in the application of policy. Overall, the company spends $1051 per employee on training and development per year (TDBFG, 2006b) . Evidence from recent national surveys of workplace training (Betcherman, Leckie, and McMullen 1997, Ekos Research Associates 1993, and Canadian Labour Market and Productivity Centre 1993) indicates that the incidence of workplace training tends to be lowest in small firms and rises with firm size. One explanation for higher levels of training found in large firms is the existence of internal labour markets. As a large financial institution with a large internal labour market, TDBFG is well positioned in terms of human resources.

Organizational Resources

For the most part, TDW is a centralized organization based in Toronto with a fairly standard, hierarchical structure (see Figure 6). The components that make up its structure are; 23 Investor Centres, three call centres, and a support office. Call centres are located in Markham, Ontario (360 employees), Edmonton, Alberta (120 employees) and Montreal (60 employees). Each operates 24 hours per day, 7 days a week and supports in-bound customer calls. The 23 Investor Centres (IC) are located across Canada in all major centres including Vancouver, Calgary, Edmonton, Toronto, Ottawa, Montreal and Halifax. These ICs are designed to attract new clients, to retain and grow existing customers, to refer customers to other TDBFG partners and to deliver personalized service to clients for an otherwise virtual company. In addition, TDW accounts can be opened at any retail branch of TD Canada Trust in over 1000 locations across the country. TDW operates one support centre, employing approximately 2000 full-time equivalents (FTE) in Toronto, to support its business in addition to other segments of TDW.

Figure 6: Organizational Structure of TD Waterhouse Discount Brokerage



All TDW employees are compensated on a base salary and commission structure. Those who work in sales participate in the company's *Sales Incentive Plan,* with compensation based on sales results. Those in service and support functions participate in *Service Gain Sharing,* based on the Customer Service Index.

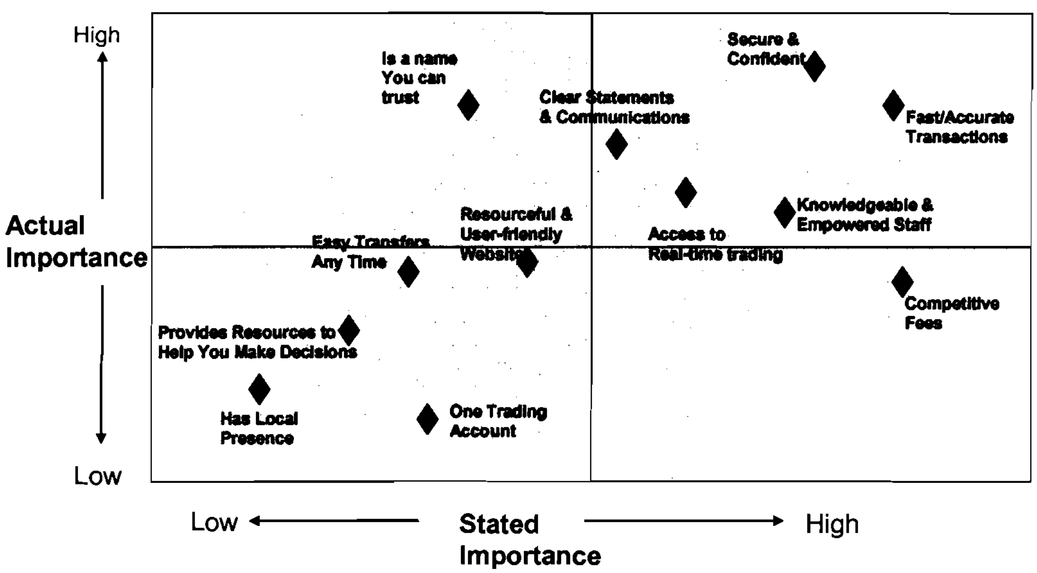
Tight cost control, close supervision of staff, and frequent, detailed reports are easier to enforce in a centralized environment. Likewise, it is easier to set clear performance objectives and offer incentives consistently based on strict quantitative targets in such a situation. These would be significant advantages for a company competing on cost. If the organization is competing on a focused differentiation strategy instead, collaboration between different areas of the organization such as research and sales becomes more important and a centralized approach can also be useful. TDW's centralized organization structure can be considered a strength, regardless of which of these two strategies the organization chooses to pursue.

Management Preferences

TDBFG has a strong culture of customer service, technology and sustained growth, described within the organization as a "caring performance culture." The firm emphasizes coaching as a tool to enhance performance – in fact, performance and coaching are considered the "bookends" of the firm's approach. The organization believes in and practices organic growth and focuses strongly on the customer. TDBFG's focus on customer service has earned the organization the #1 spot in overall customer service and satisfaction by JD Power & Associates for the past two years (TDBFG, 2006b). The Globe and Mail named TD "one of Canada's best brands" in 2006, In terms of governance, the firm has made several enhancements in recent years and in 2006 was recognized by Investor Relations Magazine with its Best Governance Award (TDBFG, 2006b). This strong brand and clear culture permeates all businesses within the organization, including TDW.

When competing on a cost platform, brand recognition and customer service are very important. On-line customers can be swayed by the strength of a brand and may make online investment choices based on perceived trust. TDW Voice of the Customer research on discount brokerage clients indicates that the highest rated factor in actual importance 'Is a Name You Can Trust' (see Figure 7) (Sheikh, 2005). In a focused differentiation strategy, however, these factors are critical. Differentiation provides insulation against competitive rivalry because of brand loyalty, which results in lower sensitivity to price. To build brand loyalty a company must firmly establish its brand in the marketplace and to reinforce that brand through superior customer service. TDBFG has built a strong corporate culture, it excels in customer service and it has one of the most powerful brands in Canada. These factors position the firm well for a differentiation strategy.

Figure 7: Voice of the Discount Brokerage Customer



Summary of Internal Analysis

The resources most necessary to compete on price in the discount brokerage industry are financial and IT and a centralized organizational structure are ideal. Scope and scale are important to achieve these goals and TDW has these strengths. In a focused differentiation strategy, strong brand awareness, customer service and a clearly defined market segment are required to be successful. TDW also has these strengths. The company's biggest weakness is not clearly defining how it plans to address the market. As examined, it has the capacity to approach strategy either in a cost or a focused differentiation way, although it is somewhat better position for a focused strategy. The risk to TDW of not clearly defining its direction may be what Porter (1980) categorizes as "stuck in the middle". He argues that firms stuck in the middle are almost guaranteed low profitability because they lose high-volume customers who demand low prices or they bid away their profits to earn this business. They also lose high-margin business – the cream – to firms that effectively target it and have achieved differentiation. TDW is at a crossroads and must decide upon a strategy in order to maintain its strong market position and grow its market.

The next chapter will give a more detailed description of pricing and its importance to the discount brokerage industry. From there, we will discuss the specific strategic alternatives available to TDW in light of the findings of the above industry and internal analyses. This paper will conclude with our recommendations for TDW going forward.

CHAPTER 4: THE IMPORTANCE OF PRICING

In response to pricing reductions in the US discount brokerage industry, TDW introduced a lower priced 'Active Trader' strategy to its pricing in 2006 and made this segment of the market a strategic focus. Not surprisingly, E*Trade Canada, the firm's largest competitor in this segment, responded with similar pricing reductions. In that same year, trade commission revenue at TDW was down and commission per trade decreased by 25%. Overall, the impact of the new pricing strategy to TDW was an annualized revenue reduction of $100 million, partially offset by other revenue streams and increased trade volume. Beginning in 2005, the firm has been unclear in its strategy, pursuing a mix of focused differentiation with 'Active Traders' (who represent TDW's key target market) and cost. The company must now decide upon a more clearly defined strategy for future growth in this competitive online business.

Pricing Wars

Each of the institutions that compete in this market has an interest in profiting from online trading, some to a greater degree than others. We have examined the stated strategies of each of the 'Big Six' banks regarding discount brokerage; let us now look at their current pricing strategies to see if they correspond.

The market has become segmented between 'Active Traders,' defined as those who trade a minimum of 30 times per quarter, and 'Long Term Investors,' those who espouse a 'buy and hold' strategy and execute less than 30 trades per quarter. Active

Traders are, by far, more profitable to discount brokerage. At TDW, this segment represents one percent of all traders yet they generate 42 percent of all transactions. The banks are aware that if this segment is increased, profitability will follow. This is why much of the pricing competition over the last two years has targeted this segment of the market.

Active Traders

Pricing in the Active Trader segment has moved quickly to an almost market-standard level of $9.95 per trade. There are now seven companies offering this price to their customers who trade at least 30 times per quarter. These include: Merrill Lynch HSBC, E*Trade Canada, QTrade, and TDW. Two of the 'virtual' firms, Qestrade and Disnat, price even lower (see Table 4). Two of the other competitors, CIBC and National Bank, bundle their pricing and offer package rates, depending on the number of trades. Similarly, Bank of Nova Scotia offers tiered pricing, which depends on transaction frequency. It should be noted that this variety in pricing strategies makes comparisons somewhat difficult, as there are inevitably hidden costs to each that will not be taken into account.

Long Term Investors

Pricing for Long Term Investors can also be obscure and confusing. The various competitors are consistent in only one regard: trade fees change when an investor trades more than 1000 shares at a time. The market is divided on the correct market price for trades of less than 1000. Most institutions charge $25 - $29, while QTrade and E*Trade (two 'virtual' companies) challenge this model with pricing of only $19.50 and $19.99 respectively.

Table 4: Pricing Comparison between Canadian Discount Brokers: Active Trader Segment

Commission for Online Canadian Stock Trades	Number of Trades	Package Price	Commission per Trade
BMO InvestorLine	Any	n/a	$9.95
CIBC Investor's Edge	50	395/yr	as low as $7.90
	50 +		$6.95
Disnat	0 - 9	n/a	$19.95
	10 +	n/a	$5.00
E*Trade	30 +	n/a	$9.99
Merrill Lynch HSBC	Any	n/a	$9.99
National Bank Discount Brokerage	Various levels	0 - $148/mo	Included
Qtrade Canada	Any	n/a	$9.95
Qestrade	Any	n/a	$0.01/share, min $4.95/trade
	Any	n/a	$9.95
Royal Bank Action Direct	<1000	n/a	$9.95
	>1000	n/a	$0.01/share
ScotiaMcLeod Direct	Levels 1-5	n/a	Discount 20 - 50%
TD Waterhouse	30 +	n/a	$9.99

* Active Traders are defined slightly differently by each financial institution; for these purposes, >30 trades per Quarter

The value of the shares being traded can also be a factor. In these cases, pricing is deterrnined as a percentage of the trade value or as a set price per share.

The 'Virtual' Advantage

It seems discount brokerage fees are going the way of cell phone or cable TV packages – companies struggle for market share by creating "perceived value" and customers are left wondering what they are actually paying for. Through this analysis, though, the winners of the discount brokerage price wars are clear: 'virtual' firms win every time. For Active Traders, Disnat and Qestrade offer the lowest prices at $5 and $4.95 respectively. For Long Term Investors, QTrade and E*Trade offer the best price, regardless of the number of shares being traded (see Table 5).

Table 5: Pricing Comparisons between Canadian Discount Brokers: Long Term Investors

Commission for Online Canadian Stock Trades

	Number of Shares	**Price/Share**	**Commission**
BMO InvestorLine	<1000	any	$25
	>1000	0 - $2	1.5%
		$2.01 +	$0.03 / share
CIBC Investor's Edge	<1000	any	$25
	>1000	0.00 - $0.245	1.5%
		$0.25 - $1.00	$0.005 / share
		$1.01 - $2.00	$0.02 / share
		$2.01 +	$0.025 / share
Disnat	Any	0 - $2	1.5%
	<1001	$2 +	$29
	>1000	$2 +	$0.03 / share
E*Trade Canada	<1000	Any	$19.99
	>1000	Any	$0.02 / share
Merrill Lynch HSBC	Any	0 - $2	1.5%
	<1000	$2 +	$29
	Number of Shares	**Price/Share**	**Commission**
	>1000	$2 +	$0.03 / share
National Bank Discount Brokerage	<1000	Any	$29.95
	>1000	0 - $2	1.50%
	>1000	$2 +	$0.03 / share
Qtrade Canada	<1000	Any	$19.95
	>1001	0 - $0.5	1%
	>1001	$0.51 - $1.00	$0.005 / share
	>1001	$1.01 - $3.00	$0.02 / share

Qestrade	Any	Any	$ 0.01 / share
	Any	Any	$9.95 / month
Royal Bank Action Direct	<1000	Any	$29.95
	>1000	0 - $2	1.50%
	>1000	$2 +	$0.03 / share
ScotiaMcLeod Direct	<1000	Any	$25.95
	>1000	0 - $1	$0.01 / share
	>1000	$1 - $2	$ 0.02 / share
	>1000	$2	$ 0.025 / share
TD Waterhouse	Any	0 - $2	1.50%
	<1000	$2 +	$29
	>1000	$2 +	$ 0.03 / share

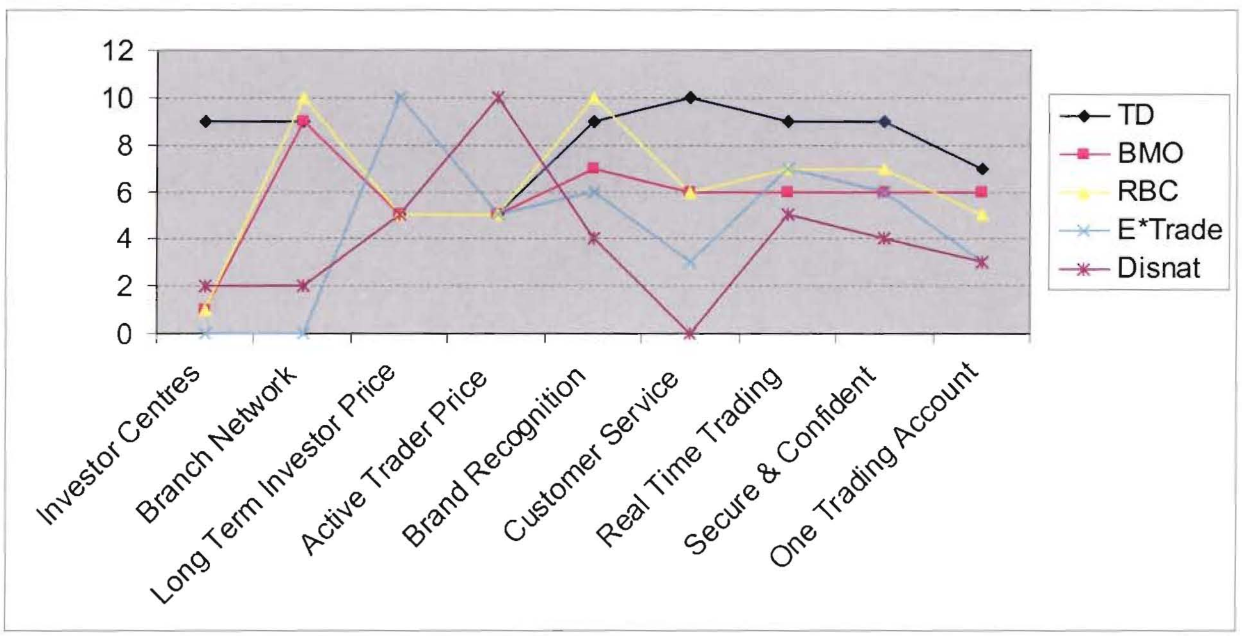
'Virtual' firms are able to compete so well on price because discount brokerage is usually their sole focus. They also do not face the same overhead pressures as traditional "brick and mortar" firms. Michael Porter's suggestion that the internet intensifies competition and creates significant pressure for companies to engage in destructive price competition (Porter, 2001) has never been more true than in the online brokerage business. For the discount brokers of the big banks this is proving to be a difficult dilemma as they struggle to generate meaningful profits and retain or grow market share.

A Value Proposition

As we have seen, TDW is "stuck in the middle" in terms of its strategy toward discount brokerage. It is trying to be all things to all customers, and in the process is losing valuable revenue potential. To understand where the organization needs to go in the future, we must examine its current value proposition. What is it that discount brokerage customers' value? And what is TD Waterhouse offering compared to the other on-line brokers out there?

To find out, we examined TDW's leading competitors in the discount brokerage market (RBC Direct Investing, BMO Investor Line, E*Trade Canada and Disnat) with respect to those factors deemed most important by customers (according to independent 'Voice of the Customer' research). These factors are: Security & Confidence, Competitive Fees (with Long Term Investors and Active Traders treated as distinct groups), Brand Recognition, Customer Service, Access to Real Time Trading, and One Trading Account (TDBFG, 2006c). We have plotted these items on a Value Matrix in order to illustrate their comparative merits, including the number of retail branches and Investor Centres available to each firm (see Figure 8).

Figure 8: Discount Brokerage Value Matrix



The results of this analysis clearly indicate that the only advantage offered by the 'virtual' companies, E*Trade and Disnat, is price. These companies offer no other significant value proposition. When comparing the three banks, the analysis shows that TDW is the overall market leader and that its competitive advantages lie in customer service, brand recognition, the firm's network of investor centres and its technological expertise.

When deciding upon future strategy, therefore, TDW should concentrate on leveraging these specific strengths. This will be the focus of the final chapter of this paper.

CHAPTER 5: STRATEGIC ALTERNATIVES

TDW's current value proposition in the discount brokerage segment is not clear and appears to be "stuck in the middle". This situation has the potential to seriously affect TDW's ability to remain competitive in this rapidly changing business niche. Without a well defined position, potential investors are unable to get a clear sense of what benefits TDW offers over its competitors; low price, excellent service or something else entirely.

Michael Porter has proposed three general business strategies that provide a good starting point for strategic thinking (Porter, 1980):

1. Overall Cost Leadership
2. Differentiation
3. Focus

In this chapter, and in light of the findings from previous chapters, we will examine the benefits and risks of the above strategic alternatives with respect to the overall values of TDW. We will then make a recommendation as to which option the firm should pursue. The most important aspect of this strategic choice is to clarify TDW's position in the market. We know the firm's stated goal for Wealth Management includes leveraging its brand, branch network and technology for greater efficiency. We must ensure a future strategy is consistent with these overriding goals.

Cost Leadership

Within a cost strategy, a business works hard to achieve the lowest possible production and distribution costs. In this way, it can price its products and services lower than its competitors and win large market share. In such a strategy, cost is the most important factor to the customer and the organization competes with others almost exclusively in this regard. This is the strategy that most supports Porter's suggestion that technology requires businesses to move more quickly to the bottom line and to "engage in destructive price competition" (Porter, 2001). There are two options available to TDW Discount Brokerage in terms of cost competition;

1. Move immediately to 'no fee' trading
2. Move progressively toward 'no fee' trading

Eliminating trading fees, either immediately or gradually, effectively cuts off price competition. In theory, this would allow TDW to gain market share at the expense of its competitors and perhaps drive some of them out of the market altogether. The common problem with a cost leadership strategy, however, is that competitors often respond by lowering their own costs even further, initiating a textbook price war.

Immediate 'No Fee' Trading

Benefits

Immediate elimination of trading fees would allow TDW to win new customers quickly and would accelerate the demise of those competitors not able to do the same. The firm could leverage its extensive array of other businesses to help soften the resulting blow to trading revenues. This option would be unavailable to the firm's 'virtual' competitors, such as Disnat and E*Trade, which focus solely on discount brokerage.

Risk

With the immediate elimination of trading commissions, TDW would certainly lose revenue. Based on its 2006 trading revenue, this could amount to more than $100 million annually, a large stream of income for any business to lose. Moreover, if the strategy to 'buy' market share was unsuccessful, or if competitors respond in an unexpected and successful way, this could be a costly mistake. Once the 'tap is turned off,' the stream of revenue from commissions would be forever lost. It would be very difficult to reinstitute trading fees after building a brand around 'no fee' pricing.

Gradual 'No Fee' Pricing

Benefits

Eliminating fees more gradually would allow TDW to build capabilities in other areas to replace revenue. Such areas might be research or technology that improves the quality of trades. This strategy would allow TDW to monitor pricing continuously and extract maximum trading revenues for as long as possible, while still remaining competitive on price.

Risk

A gradual approach to pricing reduction may be pre-empted by competitors. A slower strategy may appear more obvious to the market and would allow others to plan their responses, thereby reducing the competitive advantage that no fee pricing might bring.

Depending on how it is employed, a cost leadership strategy does offer the potential for increased market share. In the on-line business of discount brokerage, this is very important. TDW could offer pricing reductions to different segments of the market at different stages; for example, the firm could begin by changing its pricing in the Long Term Investor segment, where the company is currently least competitive. Then it could make changes in the Active Trader segment.

Differentiation

With a differentiation strategy, a business concentrates on achieving superior performance in an area already proven to be of high value to a large segment of the market. The firm cultivates whichever strengths will enhance the intended differentiation. In the case of TDW, this might take two different forms:

1. Leverage the 'bricks and mortar" (Branch Network and Investor Centres)
2. Leverage the firm's long-standing commitment to Customer Service

Leveraging 'Bricks and Mortar'

From the external, internal and Value Matrix analyses, it is clear that TDW enjoys significant competitive advantages from its extensive network of branches and Investor Centres. While these 'bricks and mortar' networks add costs, they act as an interface with otherwise inaccessible customers.

Benefits

TDBFG has over 14 million customers worldwide but just 4.5 million customers online (TDBFG, 2006b). This implies an opportunity to move several million current customers into an online environment. Currently, almost 70 percent of TDW Discount

Brokerage customers open their trading accounts through a TD Canada Trust retail branch (Daley, 2007) but only 8 percent of TD Canada Trust customers have a direct trading account. It would make sense to try to increase the number of discount brokerage customers from TDW's existing customer base. These customers are likely to be more loyal to TDW and the search-cost of acquiring them is much lower. In turn, the customers would enjoy the increased convenience of online transfers to and from their TDCT bank accounts as well as access to information from the Internet and the branch.

TDW also has a competitive advantage with its Investor Centres (ICs) scattered throughout the country. These centres educate, service and support self-advised investors. They attract new clients, refer clients to business partners and deliver personalized service in an otherwise impersonal business. Accounts initiated through ICs hold larger balances and generate higher commissions than their TDCT Retail-generated counterparts. The average IC-originated account balance of $102,000 is 66 percent greater than those acquired through TDCT. The average commission of $441 per account generated on IC-originated accounts is 60 percent higher than the $275 per account for TDCT (Sheikh, 2005).

Risk

'Bricks and Mortar' are expensive. The cost of building, maintaining and staffing branches and Investor Centres is costly and eats into profits. Although the branches would exist with or without the Discount Brokerage business, the Investor Centres would not. 'Virtual' businesses such as E*Trade do not share these expenses, making it harder to compete with them on cost. The other banks, such as BMO and RBC do not maintain Investor Centres to support their Discount Brokerage operations and therefore have a slight cost advantage.

Time is another cost. The process of educating in-branch customers about the benefits of on-line trading is time-consuming and demands additional staff. Business Development Managers service a number of branches and educate staff and customers about Discount Brokerage, but with employee turnover at approximately 35 percent per year in the branches, this is an on-going process. Client seminars, designed to disseminate and enhance knowledge, are similarly time-consuming.

Customer Service

Customer satisfaction depends on the perceived performance of the offered product or service relative to the buyer's expectations. If performance falls short of expectations, the customer is dissatisfied; if performance exceeds expectations, the customer is highly satisfied.

In discount brokerage, perceived performance and expectations are further complicated by the unpredictability of the stock market. Customer service in this niche revolves around creating realistic customer expectations by educating and consulting with investors. Therefore, exceptional customer service in discount brokerage is a strong competitive advantage because it can be very difficult to deliver.

Benefits

TDW is well positioned to make customer service a strategic focus going forward. The firm has a 150-year history of superior customer service and continues to garner awards for its efforts. Though operating in an online environment, the organization's culture is strongly geared towards client satisfaction. This is exemplified by the monthly telephone surveys it conducts with its customers and the personal contact the firm maintains with its clients through the telephone, its branches and its Investor Centres. TDW is the only discount brokerage in the Canadian market that offers 24-hour telephone operator assistance, and the firm has the highest number of Investor Centres.

Risk

In the past decade, there has been a shift in favour of the customer in the corporate-client relationship. Customers are becoming more sophisticated in terms of products and support services and have become empowered by the internet to vent their displeasure promptly and often publicly. Companies that provide differentiated levels of service must be careful about claiming superior service – the customers who receive poor service will bad-mouth the company and injure its reputation. In an online forum, this can happen at the speed of light.

Focus

In a Focus Strategy, a business focuses on one or more narrow market segments. The firm learns these segments intimately and pursues either cost leadership or differentiation within each target segment. In 2006, TDW made the strategic decision to build an Active Trader capability. The Ameritrade Canada acquisition 'jump started' execution of this strategy. However, E*Trade quickly responded with a similar strategy, and now, for reasons mentioned previously, many companies are competing in the Active Traders niche.

Benefits

One percent of TDW's existing clients are Active Investors. These investors, however, account for approximately 42 percent of total trade volume. Statistically, one Active Investor will place as many trades as 78 infrequent traders over the course of a year. Forrester Research (2006) has found that Active Investors are also more resilient. They are "far less likely to say that the volatile markets has made them a more conservative and less frequent trader," and they are "more attractive cross-sell prospects". Active investors are almost twice as likely to say they're interested in buying multiple financial products from a single provider" (Forrester, 2007). If TDW could find a way to increase its number of Active Traders, it could increase the number of transactions and continue to offer lower prices to this segment without a negative impact to its bottom line.

Risks

The problem with focusing on only one segment of the market is that other TDW customers (i.e., Long Term Investors) may become dissatisfied with the level of attention and value they feel they are receiving from the firm. These investors may consider leaving the firm altogether in favour of a discount brokerage that focuses specifically on the Long Term Investor. This would erode the asset base at TDW and eliminate those commission revenues.

Finally, although price is the key driver in a focus strategy, there is the risk that firm's may place too much importance on low price, to the exclusion of other important factors such as customer service or technological innovation. If competitors are somehow able to include these aspects within a low-price framework, firm's focused solely on cost reduction may not remain competitive.

Decision Analysis Matrix

Before making a final recommendation as to the best strategy for TDW Discount Brokerage, I created a Decision Analysis Matrix and solicited input from key leaders at the firm. Participants were asked to choose the most profitable strategy for TDW Discount Brokerage from among the above five strategies. Indicators represented those activities that are most likely to drive profitability such as "minimize cost," "maximize market share" and "improve customer satisfaction". This Decision Analysis Matrix was sent to Marvin Daley, Vice-President of Business Development at TDW Discount Brokerage and Human Alghabi, Western Area Manager for TDW Discount Brokerage (to read their responses, please see Appendices).

In the Decision Matrix, both respondents rated the Differentiation through Customer Service strategy well above the other four strategies. The Indicators rated highest were "reduce reliance on trade fees," "maximize market share," "improve customer satisfaction" and "leverage brand image". Differentiation through Customer Service scored well in all of these areas.

CHAPTER 6: STRATEGIC RECOMMENDATION

Based on the above industry and organizational analyses, it is evident that TD Waterhouse needs to clarify its strategic position with respect to its Discount Brokerage activities in Canada. The industry is characterized by strong competitive forces, such as high supplier and group-buyer power, low switching costs, intense rivalry and the constant threat of new, tech-savvy entrants. It is also highly price-competitive and is characterized by swift changes in technology and consumer sophistication. The keys to success range from reliable and secure IT systems, brand recognition, a focus on customer service and access to new customers through existing networks.

Discount brokerage contributes significantly to TDBFG's annual revenues, as it does at all major financial institutions in the country, and promises to become even more lucrative and competitive in the future. Strategic clarity, as opposed to the current ambiguity at TDW, is therefore an unqualified requirement for success in this business. It is important to emphasize here that the firm is well-positioned with respect to the above success factors; the firm just needs to decide which course of action to take.

After considering the benefits and risks associated with the five strategic alternatives available to TDW, and after analysing the Decision Matrix, our recommendation is that the best strategy for TDW Discount Brokerage to pursue going forward is Differentiation based on Customer Service.

Porter (1996) defines strategy as "the creation of a unique and valuable position involving a different set of activities." (Porter, 1996) An effective strategy must also embrace the existing culture and values of an organization. Differentiation based on Customer Service is the clear winner here. This strategy not only makes sense in terms of profitability for the business but it is also consistent with TDBFG's long-standing values of superior customer service, using technology to improve efficiency, and sustained growth. Such a strategy also leverages TDW's existing strengths very well (i.e., customer service, brand recognition, existing networks and technology).

Implementing The New Strategy

Although recommendations for the implementation of this new strategy are beyond the scope of this paper, we would like to end with a few general suggestions as to what TDW might do to initiate the proposed differentiation strategy. Just as strategic direction should complement the organization's values, the implementation of that strategy should build on existing organizational strengths. For TDW these are; Investor Centres, the Branch Network, Business Development Managers, 24-7 Telephone Centres and a system of measuring customer satisfaction.

Opportunities exist to expand both the number of Investor Centres and the role of those centres. With only 23 ICs across Canada, and with their profitability well established, it makes sense to expand here. These centres provide a valuable 'touch point' for otherwise 'untouched' customers. Each interaction in an Investor Centre, whether it is an informational seminar, a casual customer interaction or a customer complaint, is an opportunity to enhance the TDW brand and to develop new business.

Wherever possible, it would be ideal to co-locate ICs with TD Canada Trust branches. We know that only 8 percent of branch customers have discount brokerage accounts, that over 60 percent of all DB customers originated from the branch network and that there are DB customers who do not do their personal banking with TD Canada Trust. The possibilities of leveraging cross-referrals would be myriad with additional ICs co-located with branches. This would also provide a smooth handoff from one business to another and maximize convenience for the customer.

TDW already has a competitive advantage with its workforce of Business Development Managers (BDMs). This, too, should be leveraged. These individuals are responsible for sourcing new DB business in their respective markets. If the geography of those markets is narrowed, it logically follows that more new business would be developed. TDW should look at expanding this workforce and narrowing their individual territories.

TDW's call centres operate for, by far, the longest hours of any call centre in the industry (i.e., 24/7). The format of telephone inquiry nicely matches the nature of the self-service aspect of discount brokerage. Customers can access their DB accounts any time of day or night, from the convenience of their own homes, and the 24/7 telephone support complements that by providing immediate access to live support. Such service provides TDW another important 'touch point 'for its otherwise virtual customers.

Finally, although measurement of customer satisfaction can be difficult because of its subjective nature, TDBFG does it very well. The firm measures customer experiences at a branch level on a monthly basis with its Customer Experience Index (CEI). To ensure success in a Differentiation strategy focused on customer service, measurement of satisfaction will be critical. TDBFG already has this CEI system of measurement in place and TDW simply needs to roll it into discount brokerage.

TDW has been without a defined strategy for its discount brokerage operations for a long time. It is our hope that this strategic analysis of the company will help initiate discussions within the firm as to its strategic direction and provide a useful road-map for this crucial conversation.

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Appendix 1: Value Matrix completed by Marvin Daley

DECISION STATEMENT Select the most profitable strategy for TD Waterhouse Discount Brokerage											
		Overall Cost Leadership				**Differentiation**				**Focus**	
		Reduce Fees Immediately		Reduce Fees Gradually		Customer Service		Bricks and Mortar		Active Trader	
INDICATORS	WT	SC	WT SC	SC	WT SC	SC	WT SC	SC	WT SC	SC	WT SC
Increase Trade Volume	9	6	54	5	45	5	45	1	9	6	54
Maximize Large Corporation Status (scope and scale)	10	2	20	2	20	9	90	7	70	2	20
Maximize target demographic (Active Trader)	10	9	90	6	60	6	60	2	20	9	90
Reduce reliance on trade fees	10	2	20	4	40	10	100	7	70	7	70
Minimize costs	8	1	8	1	8	3	24	2	16	1	8
Minimize operational risk	9	1	9	1	9	10	90	4	36	1	9
Maximize Market Share	10	5	50	5	50	10	100	7	70	2	20
Improve customer satisfaction	8	7	56	7	56	10	80	8	64	2	16
Leverage brand image	10	4	40	5	50	9	90	8	80	5	50
Maximize demand	7	7	49	7	49	7	49	5	35	7	49
TOTAL WEIGHTED SCORE			396		387		728		470		386

Appendix 2: Value Matrix completed by Human Alghabi

		Overall Cost Leadership				Differentiation				Focus	
		Reduce Fees Immediately		Reduce Fees Gradually		Customer Service		Bricks and Mortar		Active Trader	
INDICATORS	WT	SC	WT SC	SC	WT SC	SC	WT SC	SC	WT SC	SC	WT SC
Increase Trade Volume	9	9	81	6	54	10	90	7	63	10	90
Maximize Large Corporation Status (scope and scale)	5	8	40	6	30	9	45	10	50	10	50
Maximize target demographic (Active Trader)	9	9	81	7	63	8	72	8	72	10	90
Reduce reliance on trade fees	10	6	60	8	80	10	100	0	0	0	0
Minimize costs	10	0	0	0	0	5	50	0	0	3	30
Minimize operational risk	8	0	0	0	0	5	40	0	0	8	64
Maximize Market Share	8	6	48	4	32	10	80	10	80	8	64
Improve customer satisfaction	10	8	80	6	60	10	100	10	100	8	80
Leverage brand image	8	4	32	4	32	10	80	10	80	8	64
Maximize demand	7	8	56	5	35	9	63	10	70	10	70
TOTAL WEIGHTED SCORE			478		386		720		515		602