E*Trade revolutionized the securities brokerage industry by “creating” Internet trading. E*Trade’s original strategy was to deliver cost savings to customers while amortizing fixed costs over a greater number of accounts. In 1997, several competitors established Internet sites and E*Trade was dethroned as the price leader. Its management team introduced a strategic initiative to transform the company into a financial, one-stop shop for investors. The initiative included expanding its information technology, improving its marketing and advertising program, and developing new strategic alliances.

By early 1999, E*Trade had established a popular Web site offering the convenience and control of automated stock, options, and mutual fund order placement at low commission rates. E*Trade’s success pleased management but was challenged by fierce competition and emerging ethical and operational problems.
BACKGROUND

The Securities Brokerage Industry

Before the securities industry deregulation on May 1, 1975, full-service brokerages charging fixed commissions were the only firms in the industry (Glasgall, 1999). A full-service broker is a stockbroker who gives personal attention and advice to clients and charges a flat fee or percentage of the transaction. Such a broker acts as an agent, providing advice and buying or selling securities for the client. The client interacts with the broker face to face or over the telephone. Full-service brokers provide a wide array of services, including investment strategizing, estate planning, and insurance advice, and they usually attempt to influence their clients’ investment decisions.

After deregulation, most full-service brokers began to target households with assets ranging from $100,000 into the millions. In addition, given that commissions were no longer fixed, discount brokerage firms began to appear that targeted price-sensitive, self-directed investors who did not require the level of service and high-priced advice offered by full-service firms. Discount brokerage firms made profit from margin balances and per-trade commissions; technology also enabled them to employ less-skilled labor. Fidelity and Charles Schwab, two of the dominant discounted brokerage firms in the mid-1990s, led the charge by introducing lower-cost investment services without advice at significantly lower commissions. Discount brokerage customers typically had assets ranging from $5,000 to $250,000. To execute trades, they could visit a branch office or they could call an “800” number to speak with a “live order taker,” who would place their trade orders but was prohibited from giving any investment advice. Over time, discount brokers added touch-tone trading, which offered further commission reductions to investors who would key-in their trade orders.

By 1995, with the continued expansion of the Internet, technology offered another alternative with more convenience, lower costs, and easy access to investment information: online trading. Most online trading firms were offering customers numerous ways to access their accounts and place trades, including individual company Websites, direct dial-up connections, online services (America Online, CompuServe, and Microsoft Network), interactive television, touch-tone telephone service, a broker on the telephone (as a situational alternative to online trading, for an additional fee), and 3Com Palm Pilots (available through selected online trading firms). With online trading, investors paid lower commissions—ranging from $10 to $30. They had full control over their investment decisions, with no one to blame but themselves—investors could enter trade orders any time of the day or night (Piper Jaffray, 1998d). Online brokerage accounts could be opened with as little as $1,000. While these firms first targeted frequent traders by offering
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