

PayPal's Stumbles Demonstrate the Risk of Person-to-Person E-Payments

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PayPal has received bad publicity over consumer complaints. One reason is that PayPal is the largest person-to-person (P2P) e-payment vendor. Nevertheless, the market needs some regulation.

NEWS ANALYSIS

Event

On 24 January 2001, e-payment vendor PayPal met with the Better Business Bureau in San Jose, Calif., to discuss a growing number of reports from consumers that PayPal has not responded effectively to their complaints. These include PayPal's failure to notify customers when it has frozen their accounts, such as for suspicious activity.

Analysis

PayPal (a subsidiary of X.com) operates in a new market, P2P e-payments, which has grown rapidly. P2P solutions began to emerge in the United States in early 2000 to enable payments between individuals on the Internet. PayPal and about half a dozen other early providers (many backed by banks and online merchants) soon found other uses for P2P systems, such as business-to-consumer, consumer-to-business and even business-to-business payments. As might be expected, the vendors made some missteps. For example, PayPal enabled auction payments without first authenticating sellers at these sites. Moving money between unknown parties without authentication and established dispute processes brought out the inevitable fraudulent sellers. PayPal has since begun attempting to authenticate sellers at these sites. Meanwhile, the appetite for these services grew quickly. PayPal, the largest vendor, already has more than 5 million registered users, is looking to expand to Europe through a partnership with the ING Group in the Netherlands and has enabled its platform for use on mobile devices. All of these circumstances have made it difficult for P2P vendors to deliver customer service as well as vendors in established markets, and PayPal has received the most attention because it is the most widely used.

Even discounting for these conditions, the market exhibits a disturbing lack of oversight, which has not helped to reduce the problems that frustrate customers. In addition, customers that run into trouble with a P2P vendor often feel they have no recourse. They do not know what laws protect them, and in fact, banking regulations do not cover P2P vendors. Gartner believes that P2P vendors should take their cue from e-commerce vendors that issue explicit privacy policies and rules governing their enforcement. In part, vendors have done so to stave off stricter government regulation of privacy, but the move also reassures customers and makes them more loyal and likelier to do more business with the vendor. P2P vendors would reap the same benefits if they issued guidelines and procedures on consumer rights.

Although no one is forced to use P2P e-payment services, consumers and enterprises should more clearly understand the risks when they do choose such services — particularly those of unknown startups rather than trusted financial institutions. Enterprises should consider P2P e-payment vendors where appropriate for e-commerce; however, they should ask their vendor to state explicit policies and procedures for dispute resolution.

Analytical Sources: Kenneth Kerr and Avivah Litan, Financial Services Payment Strategies

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