CASE STUDY – Group Exercise 1

Part A. Read the information about PayPal on the next page and the answer the following questions:

Q1. What does PayPal do?

Q2. What are the core components of the PayPal business?

Q3. How does PayPal make money?

Q4. What are the ethical issues raised in how PayPal collects and disburses funds?

Q5. What are the complaints brought by some PayPal users about the service?

Q6. Is the claim that the company is acting in an unethical manner fair?

Q7. In what ways could PayPal improve the management of its service?

Part B. For strategic planning answer the following generic analytical questions. The company below refers to PayPal.

QSP-1. What business is the company in? What is it related but not in?

QSP-2. What value does the business provide to the customer?

QSP-3. What are the most important issues facing the business?

QSP-4. What are the apparent problems?

QSP-5. Are the apparent problems the real problems or only symptoms of the real problems?

QSP-6. Your recommendations. On first reading what do you think the company should do?

QSP-7. What are the possible problems you anticipate will arise with your suggested recommendations?

QSP-8. What are the characteristics of the environment that the company operates in?

QSP-9. What are the characteristics of the industry that the company is in?

QSP-10. How does the company compare with other similar companies?
INFORMATION FOR CASE STUDY
Company: PayPal

1. About PayPal

Founded in 1998, PayPal, an eBay Company, enables any individual or business with an email address to securely, easily and quickly send and receive payments online. PayPal’s service builds on the existing financial infrastructure of bank accounts and credit cards and utilizes the world’s most advanced proprietary fraud prevention systems to create a safe, global, real-time payment solution.

PayPal has quickly become a global leader in online payment solutions with 86.6 million account members worldwide. Available in 56 countries and regions around the world, buyers and sellers on eBay, online retailers, online businesses, as well as traditional offline businesses are transacting with PayPal.

PayPal has received close to 20 awards for technical excellence from the internet industry and the business community at large -most recently the 2003 Webby Award for Best Finance Site and the 2003 Webby People’s Voice Award for Best Finance Site.

Located in San Jose, California, PayPal was acquired by eBay Inc. in October, 2002.

2. Frequently Asked Questions

2.1 What does PayPal do?

PayPal is a quick and easy way for businesses and entrepreneurs to accept credit card payments online, and a popular way for people to send money to each other on the Internet. PayPal enables any business or consumer with an email address to securely, conveniently, and cost-effectively send and receive these payments.

The PayPal network extends the existing financial infrastructure of bank accounts and credit cards and creates a global payment solution. PayPal products are ideally suited for small businesses, online merchants, individuals and others currently underserved by traditional payment mechanisms.

2.2 What are the core components of the PayPal business?

e-commerce services for businesses & individuals - PayPal enables quick and easy payment processing for websites, classified ads, auction sites, and email - anywhere a person wants to collect payments online. Use PayPal to:

- accept credit card and/or bank account payments for single or multiple item purchases
- sell products to PayPal users in 38 countries
- collect subscription or recurring payments
- gather donations or "tips"
- get instant notification when you receive payments
Online auction services - Automated tools for auction sellers shorten sales cycles and reduce administration time.

- insert PayPal logos to any number of listings automatically
- notify winning bidders instantly

Person-to-person payment services - Forget the checks, stamps & envelopes when you send money to friends and family. With PayPal you can:

- send money online from a credit card or bank account
- request money from an individual or group
- use a virtual debit card for safe and easy online shopping

2.3 How does PayPal make money?

PayPal offers its payment service free of charge to U.S. consumers for personal use. Business use requires a Premier or Business account, which provides premium features for a low fee. These transaction fees provide the great majority of PayPal's revenues.

In addition, PayPal provides international and vendor services for which there are additional charges. PayPal also earns revenue from use of the PayPal credit card and the PayPal ATM/debit card.

2.4 How long has PayPal been in business?

Co-founders Peter Thiel and Max Levchin began creating the PayPal service in December 1998. They launched the service to the public in October 1999. The company was incorporated in March 1999 in the state of Delaware.

2.5 Who are PayPal's leaders?

For information about our management and Board of Directors, see PayPal Executive Team.

2.6 How many employees does PayPal have?

As of March 31, 2002, PayPal had more than 600 employees.

2.7 What are the details of PayPal's initial public offering?

PayPal began trading as a public company on February 15, 2002. The initial public offering price was $13.00 USD.

2.8 Where is PayPal traded?

PayPal is traded on the NASDAQ National Market.

2.9 What is the ticker symbol for PayPal?

PayPal's stock trading symbol is PYPL.
2.10 Does PayPal offer a direct stock purchase plan?

PayPal does not have a direct purchase plan. Shares of PayPal can be purchased through a registered broker of your choosing.

2.11 Has PayPal had any stock splits?

PayPal has not had any stock splits since becoming a public company.

2.12 Does PayPal pay a cash dividend?

PayPal intends to reinvest its profits back into the company and has no current plans to pay a cash dividend.

2.13 Who are the financial analysts that follow PayPal?

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<thead>
<tr>
<th>Person</th>
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<tr>
<td>Patrick Burton</td>
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<td>David Scharf</td>
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2.14 When does PayPal's fiscal year end?

PayPal's fiscal year ends on December 31st. Reporting quarters correspond with calendar quarters.

2.15 Who are PayPal's auditors?

PricewaterhouseCoopers LLP.

2.16 Where are my stock certificates?

Most PayPal stockholders hold their shares in street name with their broker. If you would like to discuss other possession options, please contact American Stock Transfer & Trust Company.

2.17 Who do I contact about stock transfers?

American Stock Transfer & Trust Company (ASTTC) is PayPal's transfer agent. ASTTC is responsible for maintaining all records of registered stockholders (including change of address, telephone number and name), cancelling or issuing stock certificates, and resolving problems related to lost, destroyed or stolen certificates. If your shares are held in street name, you will have to contact your broker for these services.

2.18 How can I contact PayPal Investor Relations?

You can contact PayPal Investor Relations by submitting an inquiry here. We will respond to your request promptly.
3. PayPal Security Center

http://www.paypal.com/cgi-bin/webscr?cmd=_security-center-outside

4. PayPal Fraud Prevention Tips For Sellers

Although the vast majority of PayPal transactions are completed without incident, it's impossible to completely eliminate the risk of fraud or chargebacks. Sellers can do their part to stay safe by following the tips below.

4.1 Seller Tips: Decrease Fraud Risk

**Insure your package**
Buying postal insurance for your item will protect you should your shipment get lost in the mail or if the buyer claims the package was never delivered.

**Track your package**
Maintain proof that the buyer received your package and create a better customer experience. Promptly send the tracking number to your buyer so they can feel satisfied as they monitor its delivery progress. Use delivery confirmation as an added precaution.

**Watch for address inconsistencies**
A shipping address that is different from the billing address is fairly common; however this could be a fraud indicator. For instance, a high-priced item that has a billing address in one country and a shipping address in another may be suspicious.

**Beware of unusual buyer requests**
Unusual requests should put you on alert to suspicious activity. A few examples are buyers who:
- Want a rush shipment at any cost
- Send partial payments from different PayPal accounts
- Do not make their payment in full

**Check out your buyers**
- Do they have a Confirmed address?
- What is their eBay feedback score?
- Is their PayPal account verified?

4.2 Seller Tips: Avoid Buyer Disputes

**Provide clear and detailed descriptions**
Let your buyer know exactly what to expect. Give a detailed description of your item and include pictures. Also make sure to state your return policy clearly in a place where your buyer will be sure to see it.

**Respond to buyer inquiries promptly**
Let your buyer know that you are listening. Respond promptly and courteously to their questions.
Give realistic delivery times early on
Give your buyers a delivery time estimate as soon as possible. It’s better to overestimate delivery time than to risk disappointing them with a package that shows up “late.”

Be willing to compromise
Offer a partial refund. Although you are losing some money, you can often stop a buyer from filing a chargeback.

Encourage mediation
If a buyer threatens to file a chargeback against you, remain professional and encourage them to instead file a claim at the Resolution Center on the PayPal website. This process is faster and often less painful for both parties. PayPal’s Resolution Team will arbitrate the dispute and work toward a fair resolution that satisfies both seller and buyer. And PayPal’s resolution services are free of charge.

5. PayPal Buyer Protection

5.1 100% protection against unauthorized payments sent from your account.

With PayPal, you’re protected against unauthorized payments sent from your account.

- PayPal sends an email confirmation of every account transaction.

- If you receive confirmation of a transaction you don’t recognize, our 24/7 customer support team will help you sort out the situation.

5.2 Dispute resolution on PayPal purchases.

When you pay with PayPal, you gain access to a forum for dispute resolution called the Resolution Center. Through it, you can file a claim against:

- A physical good that you paid for but never received.

- A physical good you purchased on eBay that is significantly different than what was described in the listing.

Dispute Resolution specialists gather information about your transaction and help you resolve the issue. Throughout the process, you’ll be advised of your claim’s status via email and on your Account Overview page.

For specific terms and conditions, please review the Buyer Complaint Policy in our User Agreement.
5.3 Purchase protection on eBay — PayPal Buyer Protection.

When you’re shopping on eBay, look for items that are covered by PayPal Buyer Protection.

With it, you get free protection of up to $1,000.00 USD on your purchases. To determine if your item is eligible, look for PayPal Buyer Protection in the Seller Information box on the View Item page. When your transaction isn’t covered by PayPal Buyer Protection, you may still be covered by our Buyer Complaint Policy.

To review guidelines for filing a claim and for specific terms and conditions, please review the PayPal Buyer Protection Policy and Buyer Complaint Policy in our User Agreement.

6. Online Payment Services from AuctionBytes

http://www.auctionbytes.com/cab/pages/payment

7. AboutPayPal.org

http://www.aboutpaypal.org/home

7.1 "PAYPAL PROBLEMS"
AboutPayPal.org is an Anti-Paypal website created with the sole purpose of exposing the horrors of doing business "The PayPal Way". We are committed to assisting the public in making an informed decision about PayPal.

7.2 VIRUS ALERT!
If you see the email below, DO NOT click on the link. Just delete the email from your mailbox.

"Congratulations! PayPal has successfully charged $175 to your credit card. Your order tracking number is A866DEC0, and your item will be shipped within three business days.

DO NOT REPLY TO THIS MESSAGE VIA EMAIL! This email is being sent by an automated message system and the reply will not be received." Thank you for using PayPal.

"Largest Service Interruption in PayPal History"
October 13, 2004

Paypal merchants were outraged again this month due to one of the largest service interruptions in PayPal history. The interruption, which left thousands of paypal merchants without service, resulted in millions of dollars in lost sales for merchants across the country. "We let our community down, and I want to apologize to the users who were affected by these issues," chief executive Meg Whitman said in a
conference call with investors. The sad thing is that most PayPal merchants don't understand the importance of having a REAL MERCHANT ACCOUNT of their own. PayPal is not a real merchant account. PayPal's week-long service interruptions certainly won't help anyone's business (including their own).

### 7.3 Should I use PayPal to Accept Credit Cards Online?

PayPal provides you with a PayPal Account and not a Real Merchant Account. Your money is deposited into a PayPal account, which PayPal Controls, rather than your own bank account. If PayPal even wonders for a second about the validity of a transaction, they can Freeze Your PayPal Account immediately and suck all your money out. They can even pull your money directly out of your personal bank account, many times without even a phone call or e-mail. If you think PayPal treated you unfairly and want to dispute their decision, You Will Be At Their Mercy as PayPal plays the role of the Investigator, Judge, Jury and Executioner in all issues regarding your account. (You agreed to all of this, when you signed up.)

### 7.4 Sound fair? We don't think so.

Explaining your version of what happened, in most cases seems to make no difference. They will refuse to provide you with detailed information from their investigation and will not disclose documents they relied upon to make their decisions.

You should expect to wait At Least 6 Months Before You See Your Money Again. In some cases, the wait time can exceed 6 months and run into a shady Grey area, where "Never" Seems To Be A More Realistic Time-Frame.

If you want to complain about it, Paypal seems more than happy to give you the run around with Terrible Customer Service including extra long hold times, delays, and dead-end auto-responder e-mails like this one:

[Thank you for contacting PayPal. We apologize for the delay in responding to your service request. After review, the decision has been made to keep your account locked. This decision cannot be appealed. If you have any further questions, please reply to this email.]

Press them a bit harder and you may convince them to do an investigation. However, don't count on PayPal considering your side of the story in the investigation. Just consider this an easy way to Blow You Off And Get You Off The Phone.

### 7.5 PayPal Won't Do That To Me

Are You Sure? After all, there are thousands of detailed horror stories posted all over the web about people being Robbed, Abused, Unfairly Treated, Lied To And Scammed By Paypal. If you don't believe it, just type in (PayPal froze my account) into any major search engine. You'll discover thousands of businesses that were ruined by PayPal (And these are only the ones that decided to post their stories online.)
Sadly, everyone who gets burned by PayPal thought it couldn't happen to them, and then it did. We strongly suggest getting a Real Merchant Account so this won't happen to you.

If you would like, you may Submit Your Own PayPal Horror Story. As long as it is truthful, we will be more than happy to post it on our website for everyone to read.

**7.6 I Can't Find a Paypal Contact Number**

Isn't it obvious that PayPal doesn't want you to find it? The number is buried in their website on purpose. However, it's easy to find right here, on our home page: (402) 935-7733 or 877 672-9725

Unfortunately, Your Wait Time Can Exceed 20 Minutes. This will give you plenty of time to calm down and absorb the realization that you just lost control of your money and the credibility of your business.

**7.7 If Not PayPal, Then Who Should We Use?**

Without a doubt, you should get a Real Merchant Account. Years ago, Real Merchant Accounts used to cost a lot upfront, making PayPal the next best thing. However, many merchant account companies are now offering free setup, free application, instant approvals and charge nothing upfront. Incredibly, the transaction rates are usually lower with a real merchant account. And unlike PayPal, with a real merchant account, you are in control of your own money. Click Here for our Top Merchant Account Pick.

**7.8 How Does PayPal Affect My Credibility?**

Many people associate businesses that accept PayPal with start-up/on-line garage sale/here today, gone tomorrow auction sites etc. Why start your business out by associating yourself with that classification of business? You could be setting yourself up for a quick failure. If you are already using PayPal, save yourself the likelihood of suffering damage to your business by switching to a Real Merchant Account.

**7.9 I am a 100% Legitimate Company Accepting PayPal**

Great! Well,..it's great that you have a legitimate company, not that you accept PayPal.

First of all, the mere fact that you offer PayPal as the preferred credit card processing method on your site Can Add Question To Your Legitimacy. Potential customers could have questions in their mind like: "How old is this company" or "Is this company's credit so bad that they couldn't get set up with a Real Merchant Account?" or "Is this company just a start-up, garage sale/auction site of some kind?" Don't feel bad. Many businesses have been led to believe that PayPal is the best solution for their business. Accepting Credit Cards with a Real Merchant Account will actually add to your credibility. Offering Paypal can cause the opposite effect.

**7.10 Does PayPal Care At All About Your Concerns?**

Here is a clip from the San Francisco Chronicle:
Plaintiffs in the proposed class action suit say PayPal has a backlog of more than 100,000 unanswered complaints (are any of these yours?). A common allegation is that the company brushes off or stalls customer grievances for months and meanwhile freezes the customer's account and pockets the interest (that's how they make their money). The ruling by U.S. District Judge Jeremy Fogel of San Jose says PayPal has a mandatory arbitration policy that is unfair to customers who complain that their accounts are being mishandled. (finally, the truth is revealed!).

7.11 Do Everyone A Favor And Link To Us

If you are on this site, chances are that you have been burned by PayPal. Here is your chance to get back at them, while helping others avoid the nightmare you went through. Place a link to www.aboutpaypal.org on your website. Help Spread The Word. Tell others to link to us. Submit Your Own PayPal Horror Story. Take advantage of your constitutional right to speak freely. Why sit quietly while others get bullied by PayPal?

8. Assessing Criticism of PayPal by Dr. Ralph F. Wilson

http://www.wilsonweb.com/wct5/paypal_assess.htm

PayPal serves the small business market. Right now they may seem to be riding high, having just completed an IPO (Initial Public [stock] Offering) with a market capitalization of $1 billion (at least this week). But over the past couple of years, they have attracted a number of vocal critics. One of my readers wrote this week, "I'm convinced they are setting up a LOT of people for a HUGE scam." They're defending themselves against several lawsuits and some of the anti-PayPal websites are pretty in-your-face: PayPalWarning.com and PayPalSucks.com.

How are merchants like you and me to decide whether or not to trust PayPal? How are we to understand and evaluate the criticism? This week I spent several hours on the phone with PayPal's VP of Corporate Communications, Vince Sollitto, PayPal's Senior VP, International, Sandeep Lal., and Dave McClure Director of Geek Marketing for the PayPal Developer Network (yes, that's what he calls himself).

I tried to ask the hard questions raised by PayPal's critics and compare the answers with my own experience as an Internet merchant for the past four or five years. I've also spent hundreds of hours researching e-commerce from merchant accounts to payment gateways. I've tried to get to what I believe is the truth. I'm sure my conclusions won't satisfy the rabid PayPal-haters. But they need to satisfy me -- since I use PayPal for some affiliate payments and take very seriously my responsibility to point my readers in the right direction.

First, though, it's important to understand that PayPal is a brand new kind of entity - - neither a bank nor a credit card, but more of an online payments processor. PayPal has enabled millions of sellers and merchants. The financial services industry doesn't have a neat category for this kind of service yet, nor do government regulations.

PayPal's niche is primarily new, bootstrap businesses run by merchants who have never done business on the Web before -- most auction sellers, but increasingly e-
tailers. They allow start-up merchants in more than a dozen countries to take credit cards and sell online in US dollars without having to pay the upfront and monthly costs of a merchant credit card account -- all for 2.9% and a 30% transaction fee -- lower for higher-volume merchants (average $1000 per month or more).

To understand PayPal, we need to understand the kind of fraud risks they face. They struggle with two kinds of fraud -- buyer fraud and seller fraud.

**8.1 Buyer Fraud**

In the first kind of buyer fraud, the buyer makes a purchase with a stolen credit card and the merchant ships the goods. Only later does the real card owner make a complaint, the merchant credit card company initiates a chargeback, and payment is reclaimed from the merchant. With the second type of buyer fraud, the buyer uses his own credit card, the goods are shipped, and then the buyer initiates chargeback -- claiming that he never ordered the product or never received it. If you've been an online merchant, you know that the banks automatically rule against the Internet merchant. If there is a question, the merchant eats it -- it's an unfortunate fact of life. Industry experts estimate that 1% to 3% of Internet transactions are fraudulent. I've been fortunate to have a rate of about 0.5%, but buyer fraud is real, and merchant vigilance is the only remedy.

PayPal got a wake-up call in the summer of 2000 when Russian hackers found thousands of credit card numbers. Instead of using them to buy goods and services, they decided to go after PayPal where they could quickly turn these stolen credit cards numbers into cash. They wrote computer programs that opened thousands of PayPal accounts, and then transferred money from one account to another until they withdrew it in cash, costing PayPal $5 to $10 million. Oops. No wonder PayPal is fraud-shy.

To combat this type of fraud, their Chief Technology Officer developed software, aptly named "Igor," that scans transactions looking for patterns of suspicious behavior. When Igor spots something fishy, bells go off and whistles scream (virtually, of course), and a human operator looks at what is going on.

Prevention is the negative strategy. PayPal's positive strategy was to implement a Seller Protection Policy. In a nutshell, so long as a merchant ships goods to an address where PayPal confirmed the buyer, the merchant is not liable for either the chargeback fee or the customer refund amount.

Of course, merchants may decide to ship to unconfirmed addresses, but at least they have some way of assessing their risk. Experienced Internet merchants know that occasional chargebacks are one of the costs of doing business on the Internet. Sad but true.

In 2000 buyer fraud hit PayPal pretty hard. The hackers quickly turned from PayPal to their competitors with the result that most of them went out of business. eMoneyMail.com now limits its e-mail payment service to BankOne members.

**8.2 Seller fraud**

If 2000 was the year of buyer fraud for PayPal, 2001 was the year of seller fraud. In too many instances, merchants would collect payments but not ship goods in a
timely fashion -- if at all. Irates consumers would contact PayPal. This resulted in
another computer program, this one named "Ilya," who scans for patterns that might
indicate a fraudulent merchant -- a sudden influx of payments, sudden high dollar
value sales, recent changes to a merchant's address, etc.

If Ilya spots a suspicious merchant, a human investigates. Often, a security person
will call the phone number given in the merchant's profile or check the address --
and sometimes these turn up invalid. Often this is an innocent oversight, but
sometimes it's just plain fraud. To protect buyers, PayPal may have to step in and
freeze the merchant's account until they can get it sorted out.

But the result of PayPal's diligence is a transaction fraud rate of 0.42%, substantially
below Internet fraud rates as a whole. PayPal has succeeded in their chief goal -- to
make the entire PayPal network a safer place for buyers and sellers to do business.

8.3 Freezing PayPal Accounts

But freezing PayPal accounts has raised the ire of many vocal critics. How should we
evaluate this?

PayPal handles 200,000 transactions per day. The vast majority of transactions flow
through the system instantly. Only 1% of those indicate some problem. But 1% of
200,000 is 2,000 transactions per day that PayPal flags for some reason, and
potentially 2,000 unhappy sellers or buyers.

PayPal doesn't freeze PayPal accounts as a first line of defense. Often it'll spot a
suspicious payment made late at night from a bad IP address. It may be flagged as
"pending reversal." This gives the merchant a warning not to ship goods yet, but also
means that those funds won't be released immediately to the merchant.

I know something about bad IP addresses. I have personally accumulated more than
50 IP addresses on which I have detected fraudulent transactions through using
open proxy servers to conduct IP-spoofing. I check the IP address location (yes, you
can do that) against the address of the buyer. I check for a phone number and a
"free" e-mail address. If they don't check out, I'll pick up the phone and call or send
an e-mail inquiry before shipping. I've been burned far too often to be careless. I
can't blame PayPal for being careful -- even if inexperienced merchants see it as
PayPal withholding "their" money.

If the antidote for suspected buyer fraud is to flag a transaction for "pending
reversal," the antidote for suspected seller fraud is freezing or suspending the
merchant's PayPal account until things can be sorted out. This is the only way to
protect buyers -- and PayPal -- from rip-offs. Upon investigation, sometimes PayPal
finds actual seller fraud, such as selling phony PlayStation 2s and not delivering.
More often, it finds evidence of seller inexperience, such as delaying shipment until
the merchant can accumulate enough orders to purchase the product at a discount,
or some other naive mistake. Sometimes PayPal will require merchants to supply
them with identifying documents to prove that they are legitimate. Some merchants
take offence at having to fax in their driver's license.

Recently, PayPal has been sued for not thawing frozen PayPal accounts. (See Lisa
Napoli, "PayPal sued over frozen funds," MSNBC, February 21, 2002.)
http://www.msnbc.com/news/712822.asp) I ask Vince Sollitto about the cases. "We feel they are completely without merit," he replies. Time will tell.

In PayPal's defense, however, Sollitto notes that many novice merchants are coming at PayPal accounts with a "consumer mindset" rather than a "merchant mindset." Experienced Internet merchants know that the alternative to PayPal's seemingly arbitrary actions are merchant credit card processors that are more expensive and no less arbitrary. I've had to deal with that first-hand.

What about strident complaints concerning PayPal freezing accounts? Isn't there some truth here? After all, where there's smoke, there's usually fire. I have no way of determining the validity of each case. I expect that sometimes PayPal has acted incorrectly and will need to reverse itself. Sometimes the complainers don't understand or take time to understand, and aren't being realistic.

8.4 Customer Service Complaints

But what happens when there's a problem that PayPal doesn't handle right? How can you get your problem addressed in a timely fashion? I've heard a number of complaints from my own readers about repeated e-mails to PayPal that don't get answered promptly. Inadequate customer service is a big PR problem for PayPal right now -- and causes frustration for PayPal members.

Detractors charge that PayPal intentionally makes phone numbers hard to find. I think they're right. I asked Sollitto about this. He responded, rather candidly, "We have two types of customers -- those who pay to use our service and those who don't. Paid customers get an 800 number to which the average response time is 9 seconds. Others must use e-mail to resolve problems. 85% of the e-mails are resolved and closed in 24 hours. 99% within 4 days." He has his numbers down pat. He's had to answer this question before.

Sollitto adds that users are given a phone number and address for complaints when they sign up. I check carefully, and yes, indeed, there is such a number. Is it obvious or easy to find? Hardly.

I decide to test the customer service number given to paying Business and Premium members. Sure enough, there it is, under PayPal's online complaint form, alongside a mailing address. I have to go three clicks deep to get to the phone number and must know where to look, but it's there. I call on a Friday afternoon about 4 pm. A machine tells me the wait time is currently two minutes. Less than two minutes later a real person picks up the phone, asks questions to identify that I am the account owner, and then inquires how she can help. "This is a test," I tell her, "and you pass the test."

Now I call the regular complaint number. By this time, it's about 5:40 pm Friday evening. This number isn't toll free, but I have a low long distance rate and some time. "Please wait for the next available caller," the machine says, but doesn't tell me the expected wait time. I wait and listen to soft rock music interspersed with promos for PayPal's services. Finally, 23 minutes later, a friendly voice comes on the line, "This is PayPal, may I help you?"

In all fairness, I know from calling my Merchant Customer Service phone number that instant response isn't all that common. I've spent literally hours waiting to talk
to the right person for this service I'm paying for. Is the existence of poor customer service from my Merchant Customer Service any excuse for PayPal's long wait times? No. But it gives me a comparison to the real world.

"Why don't you put the phone number in the 'contact us' section?" I ask Sollitto.

He replies, "Fraud reports are handled more efficiently for both PayPal and the member when submitted on our online form, not by phone. We're able to offer an inexpensive service because we provide customer service through e-mail."

Then I think about my own experience. For years, I put both my phone number and mailto e-mail address at the bottom of every page on my website. I finally had to move that information to the contact page next to an online form that was much more efficient, with the words "I prefer you to send me e-mail before phoning." That helped cut down substantially on the calls from non-paying but well-meaning readers who wanted to pick my brain for free. The new method works much better for me and allows me to survive and meet customer needs.

I keep pressing Sollitto on the customer service matter. He acknowledges, "We're planning to hire another 50 customer service personnel this year." Good.

8.5 Disclaimers and Protections

One of the complaints I see on anti-PayPal websites is that the Terms of Service are not fully disclosed to new sign-ups. That's not true. To sign up, you need to check a box affirming that you've read them. I read through it -- well, "scanned through" is more accurate -- and found that the Terms of Service are quite thorough. They outline 19 different reasons that an account might be frozen. Is this a simple document? No. But it is written in English, not legalese. Of course, the business relationships are complex, not simple.

One of my readers complained that PayPal had too many disclaimers. I look. They have no more disclaimers and clarifications than those contained in the fine print of my merchant credit card account, my bank account, and my consumer credit card accounts (except the latter are always in unreadable 8 pt. type that it takes a magnifying glass to even see, much less read).

One of the problems is that novice buyers and sellers expect to get the same kind of buyer protection from a PayPal account that they do with a credit card. But PayPal is not a credit card, but a different payment option. I ask Sollitto about this. He points out that consumers are faced with many payment options -- cash, credit card, debit card, checks -- and PayPal. Each has its advantages and disadvantages. The consumer needs to know what his protections are with each, and make wise choices.

Apparently, so long as PayPal purchases are funded by a credit card, those purchases receive the same legal protections as do credit card purchases. But if a PayPal purchase is made from money accumulated in the account and NOT from a credit card, then that purchase is not subject to the same legal protections as a credit card.
8.6 High Fees

On one of the PayPal-hater websites, someone makes the complaint that PayPal was good until it raised its prices to 2.9% plus 30% transaction fee. Prices are too high, says the complainer, and PayPal is raking in the money. This complainer compares PayPal's high rates with "the average merchant account of 1.5%." 

I find this complaint ignorant. PayPal's rates are not too high. The average merchant account discount rate in your neighborhood retail store may be 1.5%, but for online purchases the discount rate is usually between 2.3% and 2.5%, occasionally higher, plus a transaction fee of 10% to 30%. In addition, merchant accounts typically assess a $150 application fee, a monthly minimum of $25 in discount rate fees, and a $10 to $20 per month "report fee." On top of that, the merchant has to pay for a payment gateway that charges a set-up fee, costs $10 to $50 per month, and assesses an additional 10% transaction fee.

If you're used to free PayPal service, then 2.9% must sound expensive. According to my research, not until you are receiving $1,500 per month does the cost of a merchant account and payment gateway dip below the PayPal cost, and not by very much. And for higher volume PayPal merchants, the rate is 2.2% plus the 30%. That rate is excellent! The "high fees" complaint is bogus. I believe PayPal's prices are very good for merchants.

PayPal is able to offer these rates because they have aggregated millions of users to lower their own costs and have built a safe community where fraud is reduced. Yes, they've priced it so they make money. But if they don't make money, they're out of business. You and I need PayPal to make money so we can have a great service and increase our options.

Sollitto believes that PayPal's small merchant clients have been overcharged by other vendors because of their low sales volume. "We serve a lot of inherently-risky merchants," he says. "But we provide more service and access to their funds than the next more expensive alternative. We're cheaper than anywhere else." I can't disagree.

8.7 Patent Infringement Lawsuit

Now I move on in my questioning to another PayPal problem -- a patent infringement lawsuit just days before PayPal's scheduled IPO, filed by CertCo, a privately held, New York-based online security company. "What about it?" I ask Sollitto.

He replies, "We found it a malicious attempt to disrupt our IPO or extort money. CertCo had their patent for two years, and we've been providing our service for two-and-a-half years. But they sent a letter to us just days prior your IPO suggesting 'we license their patent.'" It'll be interesting to see how the courts handle this case -- and how they handle CertCo.

8.8 State Banking Regulation Inquiries

On top of a class action lawsuit and a patent infringement lawsuit, bank regulatory authorities in four states -- California, New York, Idaho, and Louisiana -- are investigating whether PayPal is engaged in a banking business. The charge is that
PayPal is a bank because they allow members to retain a balance for future transactions. A court in Louisiana barred PayPal transactions, but on appeal its ruling was overturned before it could take effect.

"What is a bank's business model?" asks Sollitto. "To take deposits at a lower rate, loan out the money at a higher rate, and make money on the spread." He argues that PayPal's model is much different. "We are a payment processor, a fee-for-service business. You give us money, tell us where to send it, and we charge a fee to the recipient for receiving the money. If the recipient doesn't want to pull his money out of our system, we give him that opportunity."

A crucial question that might define whether PayPal is a bank or not hinges on how they handle this money. PayPal members have an opportunity to put any balance in their accounts in the PayPal Money Market Fund and earn interest -- at a top rate. If a member hasn't elected for the money market fund, the balance is placed in an FDIC insured bank.

"We just received a ruling from the FDIC (Federal Deposit Insurance Corporation)," says Sollitto, "that (1) PayPal is not a bank under FDIC guidelines, and that (2) money in member banks on behalf of customers qualifies for FDIC insurance." In other words, according to Sollitto, even though these funds are mingled in the account, in PayPal's records they are kept separate, and that legally qualifies each individual member for up to $100,000 in insurance. (See the press release on PayPal's site. http://www.paypal.com/cgi-bin/webscr?cmd=_ir-release&rid=268046)

According to PayPal's Dave McClure, about 2% of PayPal's revenues in Q4 2001 were based on interest on funds held for others; 98% was fee-based. In 2002 they will earn no money from the funds of others -- either on the money market fund that charges no management fees or on the FDIC insured deposit account where no one will get interest.

I think PayPal makes a good case that they are not a bank. "We need to get together, meet with regulators from these states, and explain our business model," says Sollitto.

It may be that states aren't pressing the investigation so much as jealous banks. Who knows?

8.9 Competition from eBay Payments BillPoint

I asked Sollitto about competition from eBay Payments BillPoint, eBay's in-house e-payment transfer network. He notes that PayPal is accepted on more than 70% of all eBay auctions, compared to BillPoint being accepted on 28% of them. He estimates that PayPal is used to consummate 28% to 30% of eBay auctions, with BillPoint used for another 5%. He points out that eBay is competing largely within their own eBay auction marketplace, while PayPal has diversified its base much beyond auctions.

eBay's price point is just about the same as PayPal's, and they, too, offer buyer and seller protections. But at present, only US and Canadian sellers can accept payments made through BillPoint, compared to a much broader international clientele that PayPal has developed.
8.10 International Growth

From my vantage point, PayPal is a tremendous asset to small merchants outside the US who want to sell in US dollars and who can't afford a US merchant credit card account. Currently PayPal members can come from 39 countries -- that is, they can buy and sell as PayPal members. But at present, only members from 12 countries outside the US can withdraw money from their PayPal account into a local bank account -- and if you can't withdraw money from your sales, it's hard to run much of a business.

I ask Sandeep Lal, from PayPal's international division, how they go about adding countries to this list. "We're adding countries with greatest 'traction,' " he says. By "traction" he means the largest numbers of existing PayPal members. He outlines three hurdles that face PayPal -- and any e-payments network -- as they seek to extend to new countries:

1. **A country’s financial infrastructure.**
   While western countries have a highly developed financial network of banks, credit card payments, and automated funds transfers, etc., less developed countries don't have an easy system to plug into. With a developed financial infrastructure, he observes, if PayPal has a relationship with one bank, it can route funds to other banks within the country. But countries like India don't have an electronic clearing system that enables this. Lacking that, PayPal would be forced to make arrangements with a number of banks, resort to the more expensive SWIFT system, or issue standard checks -- none of which are cost effective with PayPal's price structure.

2. **International money-laundering treaties.**
   Most countries are signatories to agreements designed to prevent money laundering. A number of Eastern European countries are not signers -- and Internet merchants and consumers have found them a haven for credit card fraud. You don't see these countries on anyone's list of network member countries.

3. **Country financial regulations.**
   Many countries have complex laws that require PayPal to register as a company to do business there -- with stiff costs and responsibilities. Since e-payment networks are a brand new financial model, most countries have to figure out how to handle them.

Fortunately, PayPal has been both diligent and successful in adding several countries in previous months, and plans to announce a new group of countries soon. If you've ever tried to transfer funds from one country to another inexpensively, then you know how refreshing and seamless PayPal's system is. PayPal is doing the pioneering spadework that will eventually ease e-payments transfer to much of the world.

I ask Sandeep about emerging systems in Europe. He mentions NoChex (UK), PayBox.de (Germany, Austria, Spain, UK), and MinutePay (France). I would add PayCash.ru (Russia, Ukraine, Latvia, and the US). But PayPal's 14 million members worldwide dwarf the size of all these networks put together. "Our competitors are finding that they have to go through the same pains as we have," says Sandeep, "but they are constrained by the scalability of their market" -- that is, the markets in
each of these countries is smaller than the US where PayPal gained its tremendous momentum.

8.11 The Bottom Line

From where I stand, PayPal still needs to work on its inadequate customer service system. Paying customers have a right to expect better, more responsive, service.

But when I consider other complaints against PayPal, I find several of them ignorant or unrealistic in their expectations.

Should merchants be hesitant to trust PayPal as a tool in their business? I don't think so. I think PayPal has a sound business model that they are pursuing aggressively to the benefit of all buyers and sellers. The company is not teetering, ready to collapse.

Instead of just complaining, we need to applaud when something is well done. PayPal provides us all a great service, and I for one am applauding -- even though it's physically challenging to applaud at the same time as I'm trying to balance the phone receiver on my shoulder waiting on hold for customer service.

CASE STUDY INFORMATION SOURCE:

http://digitalenterprise.org/cases/paypal.html