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WEEKLY INSIGHT
Ebay to buy payment system PayPal
Sold! The world’s largest online auction business has agreed to buy PayPal, the world’s largest online payment system, in an all-stock deal worth about $1.42bn. The deal, which still requires shareholder approval, lets eBay manage the payment platform favoured by many of its customers and, more than likely, the online auction company will shut down its own system, Billpoint. EBay bought that company in May 1999 but users preferred the PayPal service. Meanwhile, Microsoft has allied with Arcot Systems, a security software vendor, to become its solution for enabling single sign-in on the Internet, Passport in a payment authentication platform. An online payment war has begun. (From Financial Times) [Full Story]

Highlights
- Created in October 1999, PayPal merged with online bank X.com in 2000. Over its first year, it processed more than $1 billion in payments.
- In March 2001, PayPal closed $90 million in equity financing. The list of financial institutions partnering with PayPal includes Spanish bank Bankinter and Japanese Internet bank eBANK, in addition to ING Direct, Providian Financial and Crédit Agricole. In February 2002, PayPal debuted on Wall Street successfully. Company shares increased 45% in just one day.
- Currently, some 17 million people have signed up for a Paypal account, into which they can transfer
money from a bank or a credit card account. When they make a purchase using their PayPal account, the seller pays a fee of roughly 3%. This let it get, in the first quarter of 2002, $48.8 million and profits of $1.2 million.

- **Forty percent of eBay payments are electronic.** With PayPal's acquisition, the company hopes to increase that amount to 60 or 70%. By integrating the two businesses, the steps for buyers will be reduced and, hence, the number of transactions will increase.

- According to the TowerGroup consulting firm, in 2000 the **person-to-person payment systems** accounted for 42 million transactions. The firm forecasts that in 2005, this kind of platform will process 95% of electronic payments.

**Press Review**

**From New York Times**
"PayPal has become an increasingly popular payment mechanism with a **viral effect**; the more people who sign up for PayPal, the more it becomes attractive to new users looking to buy and sell online and who have a bigger network to interact with. It has become an alternative and a threat to credit cards, which owners of small businesses say they cannot afford, and sometimes are prohibited from using altogether.

(...)
Shawn Milne, an analyst with the SoundView Technology Group who follows both companies, said PayPal faced a tough decision, but made the right one, in deciding to sell to eBay, given that the company was constantly worried that eBay would find a way to cut into its business."

[Full Story]

**From Upside**
"George Sutton, managing director and business-to-consumer e-commerce analyst for RBC Capital Markets, points out that the **acquisition favors PayPal**. The deal amounts to an 18 percent premium over PayPal's closing price on July 5.

(...)
Sutton expects the **integration process** to be **complex** and cites a number of factors that present more risk in the combined business model. 'PayPal offers a lower gross- and operating-margin structure and operates in areas such as gaming, which will require EBay to exit not only its own Billpoint payments effort, but also some of PayPal's non-EBay businesses as well,' he says."

[Full Story]

**From Gartner**
"Once the PayPal deal closes, **eBay assumes outstanding legal challenges**, including class action lawsuits, patent violation claims and state regulators’ attempts to get PayPal licensed. Although eBay will gain from PayPal's strong capability to fight online fraud and make its site less risky for buyers, PayPal's antifraud efforts led it to freeze suspected fraudulent accounts. Without support to investigate all cases quickly, many suspected but legitimate sellers had funds frozen indefinitely. Fraud risk and the need to invest heavily in customer support and to make timely determinations about suspected fraud cases threatened PayPal's profitability. eBay will have to pay damages from pending suits as well as to make investments avoid similar disputes in the future. Gartner believes that **eBay's investment in PayPal will therefore grow**. Eventually, eBay will likely scale back the payment system primarily to serve known customers or raise fees to noncustomers."

[Full Story]

**From News.com**
"With the acquisition, eBay gains control of the popular electronic payment service favoured by many of its customers. 'PayPal is the 'gorilla' in the online payment market, as eBay is the 'gorilla' in the online auction market,' Merrill Lynch analyst Justin Baldauf said in a research note."

eBay bought Billpoint in May 1999 but did not fully launch the service until spring 2000. Despite heavy promotion, Billpoint has struggled to win market share from PayPal. According to PayPal, it handles payment for one in four winning auctions on eBay. Given that eBay is hoping to boost the use of electronic payments for auctions, analysts said it was easier to buy its rival than to beat it.

Donna Pelletier [eBay customer] said the acquisition of PayPal gives eBay too much control over her business. Pelletier, who sells books and collectibles on eBay, had avoided using eBay's Billpoint service. She said she might abandon PayPal, even though her customers use the service to pay for about 80 percent of her auctions.

'I don't want to get rid of PayPal, but I may have to down the road because I just don't think it's right,' Pelletier said. 'My auctions are supposed to be my business. I don't want eBay having total control of it.' "

[Full Story]

From ePaynews.com
"PayPal is going to lose significant agility' once eBay drops its online gaming operations, which comprise about 10 per cent of PayPal transactions

(...) 'the acquisition... is kind of the end of the story', given eBay's failure to grow Billpoint outside of its site. Further, Gwenn Bezard [Celent analyst] suggests, PayPal, which seemed likely 'to create a unique payment platform on the Internet, is ending up a company whose focus is a niche market' "

[Full Story]

Commentary by...
Susanna Arasa, eBusiness Center content manager

PayPal: a very personal issue
Development of reliable and widespread accepted payment systems is still one of the major obstacles to e-commerce deployment.

To create a trustworthy environment, systems providers have tested formulae that guarantee the authentication and authorisation of the parties implicated in the transaction, the privacy and integrity of the communications, and the non-repudiation from the payer. Not only are these concepts technically complex, but they are also difficult for users to adopt.

PayPal has overcome these obstacles with an innovative formula: taking advantage of the trust among known people to send each other money through e-mails. The system transfers money from some users to others. That turns it into an ubiquitous system (specially indicated for long distances and to certain users without access to funds) and independent of the financial operator (who works through interbanking networks and traditional payment systems).

But the real force of these person-to-person payment systems -a new meaning of the P2P concept- lies in the users network. To receive a loan or a bank transfer in cash, the payee must subscribe to the system, hence the network grows at the same rate as the economic relations of its members. So it is especially useful to online auctions, where the website acts as a meeting point, while logistic and economic exchanges are agreed to by the users.

This acquisition provides PayPal with the ideal travelling companion. However, the system is in danger of losing its appeal to friends and restricting itself to the auction market.

EBCENTER ARTICLE
The Internet encourages new businesses in the import market
By Joaquim Barberà, Research Assistant, ebCenter
Parallel importers, who buy products in one country to later resell them in another at a higher price, have found in the net a useful tool to collect information and save on costs. [Full Story]

REPORTS

United States, Australia and Finland, top of productivity level thanks to ICT
Title: Information Technology Outlook 2002
Source: Organization for Economic Cooperation & Development (OECD)
Date: 2002
Abstract: During the late 1990s, ICTs accounted for a large and growing share of investment and contributed significantly to output growth, particularly in the United States, Australia and Finland. In the OECD area, ICT intensity (total ICT markets/GDP) increased, driven by strong growth in telecommunications services, to an average 8.3% in 2001 for goods and services combined. Software still represents less than 10% of the total ICT market, but is growing fastest, at almost 16% a year since 1992.

Innovation is a particularly important driver of change. In the United States, for example, the number of software-related patents has grown much faster than total patents granted and now account for 10% of all patents.

Recent official surveys show that while Internet and electronic commerce transactions are rising fast, they still play a small role. In the few countries that currently measure the value of Internet or electronic sales, total Internet sales in 2000 ranged between 0.4% and 1.8% of total sales. Electronic sales were over 10% in Sweden. Moreover, in most countries, sales via electronic data interchange (EDI) are at least twice the sales via the Internet. [Full Story]

Lack of understanding, the greatest obstacle to online financial services success
Title: Financial Services Survey
Source: PricewaterhouseCoppers
Date: June 2002
Abstract: The PwC survey results show that the Internet is increasingly established as a significant channel for financial services companies, but it is far from being the dominant medium that many were predicting a couple of years ago.

According to the report, one third (33%) of respondents are now transacting more than 10% of their customer business on the web, double the level of the last quarter. In contrast, only 12% of respondents transact more than 10% of supply chain business over the Internet.

Barriers to e-business have not changed significantly since the last quarter. Lack of understanding among customers and suppliers is cited by 62% of respondents as the greatest obstacle to online success, as financial institutions wait for users to catch up with the infrastructure they have developed. Security remains the second greatest concern (32%), and the speed of online transactions is the other significant barrier to development (25%). [Full Story]

Faulty software in the U.S. costs tens of billions of dollars per year
Title: The Economic Impacts of Inadequate Infrastructure for Software Testing
Source: National Institute of Standards and Technology
Date: May 2002
Abstract: Software has become an intrinsic part of business over the last decade. However, estimates of the economic costs of faulty software in the U.S. top the tens of billions of dollars per year and have been estimated to represent approximately just under 1% of the nation's gross domestic product (GDP).

According to the National Institute of Standards and Technology, 44% of the software developer effort is now spent on the requirements analysis phase, not on testing software. Numerous issues affect the software
testing infrastructure and may lead to inadequacies. For example, competitive market pressures may encourage the use of a less than optimal amount of time, resources, and training for the testing function. In the opinion of the US institute, software testing infrastructure improvements include enhanced integration and interoperability testing tools, automated generation of test codes, methods for determining sufficient quality for release, and performance metrics and measurement procedures. [Full Story]

COMPANIES

Doubleclick to sell its U.S. media unit
L90, an online marketing services company, will acquire DoubleClick's North American Media business for $5 million in cash and 4.8 million shares. The new company will be called MaxWorldwide. The agreement is DoubleClick's latest move to unload its media services divisions. From News.com. [Full Story]

Yahoo's first profit in six quarters
Yahoo! has broken a year-and-a-half-long losing streak by posting a net profit on sharply higher revenues. The Internet media company reported a net profit of $21.4 million or 3 cents per share in the second quarter, compared with a loss of $48.5 million. Revenues rose 24 percent to $225.8 million from $182.2 million a year earlier. From Reuters. [Full Story]

WE RECOMMEND

Open source success
Open source philosophy is going beyond software. OpenCola is the world's first "open source" consumer product. By calling it open source, its manufacturer is saying that instructions for making it are freely available. Anybody can make the drink, and anyone can modify and improve on the recipe as long as they, too, release their recipe into the public domain. Although originally intended as a promotional tool to explain open source software, the drink has taken on a life of its own. The Toronto-based OpenCola company has become better known for the drink than the software it was supposed to promote. A website selling the stuff has shifted 150,000 cans. Politically minded students in the US have started mixing up the recipe for parties. The article reviews this and other landmarks of the open source movement, originated in 1984 when computer scientist Richard Stallman quit his job at MIT and set up the Free Software Foundation. According to the author, in a world of growing opposition to corporate power, restrictive intellectual property rights and globalisation, open source is emerging as a possible alternative. From Alternet. [Full Story]

The rise of the creative class
IT teams are made up from very different people. The young developer, with a full-body tattoo, middle-aged analysts, working-mothers IT-service group managers.... Clearly, people need to be managed differently. Moreover, for most highly skilled people most of the time, work is not about money. Standard financial incentives-bonuses, stock options, the lure of a raise or corner office-will not motivate them to do their best work. Autonomy, challenge, flexibility, and responsibility are highly valued across the board in many studies but, what growing numbers of people seek in their work is basically creativity, according to Richard Florida, author of the book The Rise of the Creative Class. In his opinion, there are four important points that a manager should bear in mind: 1) Strike idiosyncratic deals. They may include not only a "sculpted" job description, but terms and conditions of employment tailored to what a valued person is seeking, 2) Let subcultures thrive, perhaps defined by function (developers, maintenance people, etc.), life stage (married people with children, singles), and so forth, 3) Act on intrinsic motivations. One good template for managing creative IT workers is that of the open-source...
software community, and 4) **Treat people as volunteers.** Management guru Peter Drucker observed that knowledge workers do not respond to financial incentives. The key to managing these workers is to treat them as "de facto volunteers"—people whose commitment is highly contingent and whose motivation comes largely from within. From *Optimize Magazine.* [Full Story]