

PayPal - The new world currency?

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Date: 2002-09-26

Abstract:

PayPal is an online (internet) payment system that allows customers easy and fast payments via email. In contrast to other systems PayPal was able to prevail within the internet. Through the recent acquisition of PayPal by eBay PayPal's position will become even stronger. This document explains the reasons why PayPal is used and describes in detail the functionality PayPal offers its customers up to now.



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Introduction

The announcement of PayPal's acquisition by eBay International caused furore and astonishment throughout the financial industry. The biggest internet auction company and a payment service provider with more than 17 million customers join forces.

What exactly is PayPal?

PayPal is an online (internet) payment system that allows customers easy and fast payments via email.

The idea of using the internet, especially emails, for payment transactions is obvious since the costs are low and it is available almost everywhere. Besides PayPal other companies and even several banks tried to establish similar internet payments. For example, First Virtual started in October 1994, i.e. about 5 years before PayPal's market entrance. Nevertheless, First Virtual did not succeed in the market.

Why could just PayPal establish itself?

The secret behind PayPal's success is not mainly the technical innovation but the customer focus, the knowledge about the market needs and the strength of the management team.

From the start, PayPal focussed on the customer. The payment transaction should be easy and self-explanatory. New customers as well as customers that recruited new members got a bonus. From \$ 10 in the beginning it was decreased to \$ 5 now, but the avalanche of new registrations set off did not stop any more. Today, PayPal states that about 28,000 new customers register per day. This number is reasonable since an internet user is able to register as PayPal customer within a few minutes by only a couple of mouse clicks.

History

End of 1998 Peter Thiel founded Confinity together with friends, former fellow students and professors of Stanford University.

Thiel decided to financially support Max Levchin, a dedicated software engineer. Levchin had the idea of setting up a secure software system that allows person-to-person money transfer via the internet. Based on the fact that the payment infrastructure within the USA is much less developed than in Europe – e.g. there is (was) no system in USA comparable to money transfer or debit – PayPal could gain this market quickly.

Investors for this idea were rapidly found. At July 12th, 1999 Nokia Ventures invested \$ 3 million; Deutsche Bank gave further \$ 1.5 million. After market entry at November 16th, 1999 further support came from Idealab Capital Partners and Goldman, Sachs & Co. Through the rapid growth of eBay, which needed a person-to-person payment system to perform private auctions, PayPal was able to quickly establish a large customer basis. By the end of 1999 most of the eBay transactions within the US were already paid using PayPal.

At February 16th, 2002 PayPal attracted attention at U.S. stock exchange: as first internet company since almost one year the payment provider started an IPO at NASDAQ. On its first day the stock price rose from the initial value of \$ 13.00 to \$ 20.09.

For what purposes do I need PayPal?

PayPal enables its customers to send, receive or order money online via email. Compared to classical bank services PayPal basically includes:

- Money transfer
- Virtual POS payments
- International money transfer
- Bills

In order to use PayPal customers need to register. This is done online by typing the required information like name, address, email address, etc. into a web form on PayPal's homepage (www.paypal.com) and therefore opening a PayPal account.

PayPal Accounts

A PayPal account may be easiest compared with a German bank giro account, normally attached to a credit card (VISA, MasterCard, Discover, American Express). In order to open a PayPal account the customer is asked for his credit card number during Registration. If he decides to disclose his credit card number at a later date, his account will be strictly limited until then.

PayPal distinguishes between three kinds of accounts:

1. Personal Accounts
are for personal, non-commercial use only. With a personal account the main functionality is sending money. In addition to this one can receive money in some special cases; in general a Premier Account is required to receive money.
2. Premier Accounts
are especially for private customers who want to use their account to pay and receive money.
3. Business Accounts
are - in contrast to Personal and Premier Accounts - usable for business purposes only. Besides that the functionality offered is the same as for Premier Accounts.

As a basic principle sending money is free of charge. The receiver of money is charged between 0.7% and 2.9% plus 30¢. In case the money is sent by a user from another country an additional charge of 1% is taken.¹ Exception: Personal Accounts may receive payments free of charge if these are directly

¹ Currently Canadian merchants don't need to pay this charge for payments from U.S. customers.

taken from the money on the sender's PayPal account. In case the money has to be taken from the underlying credit card the payment to a Personal Account will fail. Since credit card based payments are the standard case and since the receiver of a payment normally doesn't know whether or not the sender can pay the amount out of his account one can say that a Premier Account is minimal to receive payments in general.

An upgrade from Personal Accounts to Premier or Business Accounts is easily possible at any time.

Functionality

Essentially PayPal offers its customers three basic functions:

- Send money
- Request money
- Receive money

Send money

Sending money is done in three easy steps:

1. The customer logs in at PayPal (www.paypal.com) using his email address and his password. During shopping he will be automatically forwarded to this page.
2. He clicks on "Send Money" and enters the email address of the receiver as well as the amount to be sent. In addition the reason for payment (service, goods – auctions, goods – non-auctions, quasi-cash) has to be named. In case of shopping the fields are pre-filled. Optionally a comment field may be used.
3. The customer clicks "Continue", double-checks the data and performs the transaction with an additional click.

PayPal then sends an email to the receiver of the payment which he can use to credit the money to his account.

Sending money can be compared to classical bank services like money transfer or virtual POS payment. Through the possibility to send money to PayPal customers in more

than 38 countries “international money transfer” is an implicit opportunity.

Receive money

PayPal sends an email to the receiver of money informing him that money arrived for him (“You've Got Cash!”).

This implies that, in contrast to net money systems like eCash™, no money in form of virtual coins or notes is sent via the internet but notifications. The money flow is therefore only within the PayPal system itself.

In order to credit the money at his PayPal account the receiver needs to log in at www.paypal.com and accept the payment amount. For Business Accounts all incoming payments can alternatively be automatically accepted.

Payments can also be sent to receivers which are not already registered at PayPal. To accept the payment these receivers first have to register. This approach is also called „viral marketing“, since through sending them money non-customers get “infected by the PayPal virus” and can be made customers this way.

Request money

PayPal supports to request money as well. This can be done in three steps:

1. After login at PayPal the customer clicks on “Request Money”.
2. The customer types in the email address of the payer, the amount and the reason of payment. He may optionally add a subject and comments.
3. He clicks on “Continue”, checks his input and confirms them with an additional click.

PayPal then sends an email to the payer which contains a link to the PayPal page with the pre-filled transaction data. In order to pay the payer performs the steps described in “Send Money”. Compared to classical bank services ordering money is therefore a

digital bill which, for example, could also be integrated into an EBBP system.

Admin Functions and Additional Services

To transfer payments into the “standard” bank cycle one needs the possibility to transfer money from a PayPal account to a bank account. PayPal calls this function “withdraw money”.

Withdraw money

PayPal customers may withdraw amounts credited to their PayPal account to their bank account independent from the underlying PayPal transactions. PayPal charges a country-specific fee (between € 0.00 and € 1.75). Since PayPal denominates in USD only, an exchange is performed based on the current exchange rate. In addition to this US customers may get a check sent. The fee for this service is currently \$ 1.50.

Deposit money

In analogy to withdrawal of money it is also possible to transfer money from a bank account to a PayPal account. The currency exchange is performed similar to “withdraw money”, for money transfer from German current accounts a fee of € 1.50 is currently charged.

Return on Account money

PayPal offers its U.S. customers the possibility to earn a rate of return on the money in their PayPal accounts through investing in a Money Market Reserve Fund. Customers need to sign up for this separately. The deposit of customers who did not open a Money Market Fund will be invested collectively. In this case the customer will not get any rate of return. This will be transferred to PayPal through the user agreement.

PayPal Direct Debit Card

U.S. Premier and Business Account customers may also apply for a physical PayPal debit card. The underlying card account is the PayPal account. The debit card is a MasterCard debit card which may also be used for withdrawals of money at ATMs.



Status Quo

Currently more than 17 million customers are registered at PayPal all over the world. Every day PayPal gains about 28,000 new customers.

Through the acquisition of PayPal by eBay the spread of PayPal will further increase its speed. The strongest opponent of PayPal so far – Billpoint – was discontinued by eBay after the merger.

Banks are not able or not willing to oppose. According to Peter Thiel PayPal does not want any less than the “world domination” for payment transactions. The hope of the competitors that PayPal may fail decreases – PayPal achieved profitability in April 2002.

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