



Changing commerce

New person-to-person payments advance in the U.S.



Suzie Eads worked in sales, mainly selling cars, before she started a business in the 1990s. Her business was a creation of the dot-com bubble, when young entrepreneurs developed new avenues of doing business, relaying information and connecting with people. She found her niche with the online auction company eBay and became a micro-merchant.

Online person-to-person payment methods were new at the time. Eads took checks and money orders by mail at first. She had to wait for checks to clear her bank and there was a risk with fraudulent money orders, she said. Eads started using X.com out of California, which later rolled into PayPal, headquartered in California. Nonbank payment services startups like X.com were starving for customers, so much so the company paid Eads \$50 to join and an additional \$10 for every person she recruited as a new member.

Eads used other merchant services such as Amazon and operated her own website. As she began using these new online merchant and payment services for transactions, her bank became suspicious when she transferred money from her online accounts into her bank account.

“They called me and asked what this transfer from Amazon was about,” she said. “They don’t even think anything about it now.”

Before this century, person-to-person payments (in the United States) were almost entirely by cash and check, said Terri Bradford, a payments system research specialist at the Kansas City Fed, and William Keeton, a former vice president and economist for the Kansas City Fed, in their new research, “New Person-to-Person Payment Methods: Have Checks Met Their Match?” And today, the use of checks for person-to-person payments is quiet strong, they said.

Time and inconvenience were the costs associated with making cash transactions, they said, and the risk was the possibility of accepting counterfeit currency. Checks came with a cost—the seller didn’t know if the check was good, and the buyer, when making a purchase, such as through the mail, didn’t know whether the seller would deliver the goods. Banks also began to charge fees for the amount of checks an account holder wrote and the cost of maintaining a checking account.

Nonbank person-to-person methods existed before the technology boom. Western Union and other companies provided wire cash transfers for a fee, but buyers also were

required to visit a brick-and-mortar branch of the company.

As the 20th century came to a close, the spread of the Internet made it possible for consumers to make such payments from their personal computers.

The first commercial bank website launched in 1995 and provided customers the opportunity to make transactions online. By 2000, 53 percent of commercial banks had websites, and by 2011, it was 90 percent. Smaller banks were slower to provide such services; by 2011, only 40 percent of banks under \$25 million in assets offered transactional websites.

Bradford and Keeton said the Internet also ushered in the rapid growth of online auctions and direct-purchasing and further Internet expansion and advances in mobile devices and applications spread the use of bank and nonbank financial services in the 2000s.

New methods of making person-to-person payments developed from the simple market principle of supply and demand. On the

demand side, the driving influences have been the emergence of new forums for commerce, such as online auctions and the increasing desire by consumers to monitor and control payments. On the supply side, the main elements have been technological advancements, such as faster Internet speeds, increased computing power and now smartphones.

Bradford and Keeton looked at these various methods and consumers' attitudes toward them. They found that these distinct models for person-to-person payments have emerged: nonbank-centric, bank centric and card-centric.

Some of the new methods are faster than checks, especially the card-centric methods that give cardholders immediate access to funds, and the bank-centric methods that require only a single payment between bank accounts. In addition, because the new person-to-person payments are electronic and can be used with mobile devices, the methods have lower resource costs and greater convenience than the

NEW PERSON-TO-PERSON PAYMENT METHODS such as PayPal, which is owned by eBay, have made it more convenient and secure for consumers to shop online.



PHOTO BY GARY BARBER

traditional person-to-person payments.

Most consumers have taken advantage of the card-centric and bank-centric payment methods and online banking and consumer services like Western Union, but this doesn't mean the check is obsolete.

For Eads, the advancement in technology and person-to-person payments gave her and many other micro-merchants the ability to start their own businesses at a very low startup cost.

Eads was pregnant with her third-oldest child when she started on eBay, hoping that her extra income would help build a new family home. Four more children and 50,000 transactions later, Eads now gives advice to users on how to navigate eBay and PayPal. She has written her advice column, "Ask the eBay Queen," since 2004.

"I'm sure I wouldn't have started a business if it wasn't for eBay and PayPal," she said.

Eads oldest daughter, Rachel, also helps with the business, taking photos of items, posting online, tracking inventory and shipping sold items to customers—all done from their home that the family built outside Rantoul, Kan., about 40 miles south of the Kansas City metro area.

Eads still uses her community bank just down the road from her house, but she also uses her PayPal card, which she receives 1.5 percent cash back on every purchase. And though most of her business is done online and through PayPal, which is owned by eBay, she still wouldn't turn down a check. She sees a day, however, when the conveniences and securities of new payment methods could make the check obsolete.

PayPal and other person-to-person payment services, such as 2Checkout, have made it safer to conduct online transactions, Eads said.

Bradford and Keeton say the new person-to-person payment methods are more secure than checks "in the sense of protecting account information." And bank-centric and card-

centric methods "have the additional advantage of securely verifying the payer's identity." New payment methods will continue to move forward with advances in technology—online, cards and mobile applications—but consumer and merchant acceptance for the new payment methods is the main obstacle in the United States.

In a survey of major credit card customers, Lightspeed Research found that most customers thought the ability to make payments from a smartphone as unimportant.

Within the area of mobile payments, the United States is far behind other countries in its acceptance. The Bank of Japan reported that \$22 billion in contactless mobile payments were made in 2010. Consumers in the United States, with a larger population, made \$1.5 billion in contactless payments in 2009.

Eads views the new technology and payments methods as opportunities for doing business, whether online or in a store. It also fosters an entrepreneurial spirit, providing a way for people to create new businesses and making it more convenient for consumers, she said.

"To pay someone with an (online account) or a PayPal card seemed a little screwy at first, but it's pretty savvy now," she said.



KEVIN WRIGHT, EDITOR

FURTHER RESOURCES

"New Person-to-Person Payment Methods: Have Checks Met Their Match?"

by Terri Bradford and William R. Keeton
www.KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.