Internet Payments: Momentum or Muddle?

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As movements in the Internet payments market indicate, the state of payment transaction processing in the Internet space remains nearly as liquid as ever. SET is late coming to market and now battles firmly entrenched SSL-based offerings. Payment companies, both public and private, are having a slippery time of it trying to establish strong market share and turn a profit - or in some cases even recoup money sunk in R&D holes.

Following the jagged path of one company, CyberCash, gives an indication of the difficulty even the earliest mover has had in making a living selling payment systems geared toward the Internet. Looking to crack the consumer and merchant behavior problems it has faced since the public introduction of its wallet in late 1994, CyberCash has now released its thin wallet - aimed at reducing the high transaction drop-off rate. Earlier this year, the company made a series of announcements: acquisition of competitor ICVerify to move it beyond the Internet payments space; a technology swap with IBM to gain a SET solution while giving IBM an SSL-based product; and the acquisition of customers from the payments business of First Virtual Holdings, another early mover.

The list of fluid business models continues. VeriFone, the market share leader in physical POS solutions has struggled with its SET product and has recently undergone a restructuring into hardware and software business lines. IBM, as mentioned, has had to look to CyberCash for a near-term solution. On the SET side, Irish firm Trintech has not met great success with its products and has gotten more funding tweak its products, and even ambitious must wait in part for other powers (such as the credit card associations) to make SET happen. SET in itself is a story - and bodies are falling to the wayside with frequency over the slow-moving standard, including heads of SET teams at VeriFone and MasterCard.

SSL, Anyone?

Looking over the remaining landscape reveals a patchwork of out-of-the-box and homegrown solutions for getting payments from the consumer to the bank and the money in the merchant's till. Clearinghouse solutions such as CyberSource and OrderTrust co-exist with POS product/service combos such as ClearCommerce, and Open Market's Transact. All of these are SSL-based systems, but none take into account the unique business model of the Internet and all use the time-tested physical electronic payment infrastructure. Lowest on the food chain are the likely thousands of merchants who take a credit card number unsecured, secure over SSL but hand-entered into a POS box, or just have the buyer call or fax the number.

This diversity of methods and solutions (though some would call it chaos rather than diversity) maps somewhat to the development of the non-Internet electronic payments world some 20 years ago. However, in today's market, several market leaders have emerged - such as VeriFone on the POS terminal side and First Data on the processor side. In this market, the processors have remained the same, but the POS market that has changed and middlemen such as PaymentNet and CyberCash have emerged. The fundamental difference between old-school electronic payments and the Internet is that the POS environment is more distributed, with more pieces scattered to the client, merchant, acquirer, and sometimes the processor. The penetration is contingent upon both the brand of "cash register" chosen as merchant server and the flavor of Internet payment available from the merchant's bank - if the merchant can even get an account at all.

Controlling the Chain

While this distribution schema is also somewhat existent in the physical payment schemes of today, in the Internet space vendors fight to control the whole payment chain from end to end - which makes breaking into the market harder. At the same time, payment technology vendors struggle with the paradox of asking the consumer to form loyalties to a client component for which the vendor's brand is secondary, while asking the financial institution to stake its brand on untested and untrusted new software. This is the fundamental reason why some vendors, such as CyberCash and the SET vendors, have lowered their profiles even more and receded into the background as a processor.

Transparency has become one of the top priorities in the industry, with efforts made to lift the download, installation, and maintenance burdens off of the merchant and customer. CyberCash lightened the load on merchants with CashRegister3 and will do so again with the thin wallet Product, InstaBuy and the Agile Wallet. GlobeSet has gone server-side with some of its components, and we expect similar announcements to follow. It seems thin is now "in" for Internet payments.

Banks Must Take Over

It hardly seems to need mentioning, considering that banks are in the payment business, but banks now have a golden opportunity for additional service revenue laid at their feet. Banks, of all parties involved, have the most arrows in their quiver when it comes to being successful payment merchants. They have large operation center environments and big iron in the back office, which can handle not only large volumes but hosting of server-side wallets and public key infrastructure as well. They also need new sources of service revenues as lucrative assets bleed off to mutual funds, insurers, etc. Lastly, but most importantly, they remain the most trusted link in the chain.

Opportunities for banks to increase their presence in this space are multiplying quickly. Internet user numbers are reaching the critical mass needed to justify the medium as a stable channel. Likewise, the big merchants that banks love to serve are now moving online and high-traffic points are becoming clear. Citibank's deal with Netscape's Netcenter and buy-in to TransPoint demonstrates that some banks are recognizing the value of the medium for branding, and with the competitive nature of the portal business alone, we expect copycat deals will follow quickly. This will create, among other things, a co-branding opportunity for payment client distribution and joint marketing opportunities for merchant customers.

Conclusion: Time To Strike Is Now

We believe some banks will soon take up this challenge and see the obvious (and now stable) connections between marketing, payments, and the Internet - as is occurring in the smart card and bill payment markets. We believe some large partnerships will soon emerge, spurring activity among banks to grab the branding opportunities that have been present for several years. We expect this to be a marketing land-grab at first, as smart cards, SET, and bill payment are backed up behind Y2K and Internet banking in the technology queue. Nonetheless, we believe opportunities inherent in the integration of the Internet and its related opportunities will be a key differentiator between banks that will fully realize the value of their technology investments in the next decade and those that won't. Internet payments remain a muddle at present, but in our opinion the chance to turn that muddle into momentum for a group of key players is at hand.