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**EVIDENCE**

**Monday, November 21, 2011**

**Chair**

**Mr. David Sweet**



# Standing Committee on Industry, Science and Technology

Monday, November 21, 2011

• (1530)

[English]

**The Chair (Mr. David Sweet (Ancaster—Dundas—Flamborough—Westdale, CPC)):** Good afternoon, ladies and gentlemen.

[Translation]

Good afternoon, everyone.

[English]

Welcome to the 14th meeting of the Standing Committee on Industry, Science and Technology.

It's good that we've had an update on Movember now, and now we have to move to the actual meeting.

We have the following witnesses before us: from the Canadian Advanced Technology Alliance, Sorin Cohn, executive in residence; and from PayPal, Darrell MacMullin, managing director, and Martha Cass, head of public relations.

Mr. MacMullin, I understand you'll be giving the opening remarks. Is that correct?

Okay.

From the Canadian Federation of Independent Business is Dan Kelly, the senior vice-president of legislative affairs; and from the Entertainment Software Association of Canada, we have Jason Kee, director of policy and legal affairs.

Ladies and gentlemen of the committee, you'll remember that both the Canadian Federation of Independent Business and the Entertainment Software Association were previously before us and gave their opening remarks. During that meeting we had to leave for a vote, so they're back with us to actually get some time before the committee now. Since they've given their opening remarks, I'll just give them maybe two minutes to highlight some of those remarks to refresh your memory, but we'll follow the order as usual and the agenda that's before you.

Mr. Cohn, please start with your opening remarks for six minutes.

**Mr. Sorin Cohn (Executive in Residence, Canadian Advanced Technology Alliance):** Thank you very much.

Let me open my presentation here quickly.

**The Chair:** I understand, Mr. Cohn, that your presentation will be in English, but the documents were distributed in both official languages, so members should have those in front of them *en français* and in English.

**Mr. Sorin Cohn:** Thank you very much.

I'm very pleased and honoured to be here on behalf of the Canadian Advanced Technology Alliance, which has been leading the field for the past—

**The Chair:** Just one moment, Mr. Cohn. We're just waiting for the distribution of the text of your remarks to members.

**Mr. Sorin Cohn:** Thank you very much.

By the way, I'm going to do just the second part of the presentation that my colleague, Barry Gander, and I have prepared on the issues related to e-commerce and commercialization. I will talk about the pan-industry study CATA led over the past year, together with a number of industry associations and national and provincial organizations, to try to understand the critical issues concerning commercialization in Canada. I do this in the context of the fact that for a number of years, there has been a lot of wringing of hands and biting off of heads because of how poorly Canada is doing in terms of innovation and the huge innovation gap we are facing. E-commerce is one significant technology in the process of creating a more effective environment for commercialization in Canada.

I'll just go very quickly through these charts. If at any time you need more information, I would be pleased to come here gain, in whatever format, to discuss the issues.

Research is nothing else but the transformation of money into knowledge. The transformation of knowledge is imbedded in products and services and in an understanding of market requirements. The transformation of that knowledge into money is called commercialization. I want to point to the fact that we have been moving for some years from the industrial era, during which the name of the game in most industrial concerns was product control and direct-cost minimization. For that game companies would try to do as much as possible inside the corporation.

We are moving into what I call an integrated knowledge-services economy in which one company may do design services, another company manufacturing, another company marketing, and another company development. The name of the game is collaborative value creation in intelligent communities. Those intelligent communities may be virtual ones, which are globalized, or they may be geographic ones. In parallel, CATA is driving what we call the i-Canada initiative—meaning the intelligent Canada initiative—to try to raise the competitiveness of Canadian communities, community by community, through the use of collaborative ecosystems, ultra-fast broadband, and intelligent services. Collaboration is the key to the game.

The study we carried out was supported by BDC, EDC, the Ontario Ministry of Research and Innovation, and a number of other institutions. The goal was to understand what industry thinks and does and what it plans to do about commercialization effectiveness. We were also hoping that some of the results would be of interest to key policy-makers in terms of policy and programs that work and policy and programs that do not work.

Basically, the continuum of innovation goes from ideas to technology to product. It then goes through some good market channels to customers and then hopefully to satisfied customers. It's only through that process that you create a viable business that by itself can provide the necessary feedback for the economy to grow.

The conclusion of our study—and I'll show you a number of findings here—is that Canada does not suffer from an innovation gap. The innovation gap has received traditional support in terms of science and technology culture, in terms of discovery skills, in terms of labs, and in terms of big “R” for research and small “d” for development. But there has been no “c” for commercialization. What Canada suffers from is a commercialization gap, which requires focus and adequate support. This involves a business and product-service culture, production operations, financial processes, marketing and sales skills, global connectivity, and customer focus. If at the end of a commercialization process there is no money created and no economic value, we cannot talk about real commercialization.

One of the key findings of our study was that about 17% of the Canadian companies that participated—more than 1,000 companies actually responded to the survey—did not have any new products or services in the past five years. Unless these companies are selling iron ore or metal bars that have not changed for the past 50 years, how can they stay competitive? That's a major issue.

Also, a high number of companies have tried but have failed to commercialize their innovations. Other companies, about 56%, have not yet finished their most significant innovation in terms of its commercialization.

The obstacles to commercialization are first, lack of financing. Second, and the most significant, is insufficient marketing effort, uncertain market demand, lack of market knowledge, inappropriate customer targeting, and lack of sales experience and such. Poor collaboration is another thing that is significant in terms of success in commercialization.

• (1535)

Those are the major issues telling us that Canada suffers from such a commercialization gap.

In principle, Canada is very much a nation of small and medium-sized enterprises. More than 99% of companies in Canada are small and medium-sized enterprises with less than 500 people. Actually, 80% of those have less than 50 people.

A complete company, in order to be successful in its competition—and now the competition is global—requires technology and industry expertise in whatever domain it operates. It requires management and operational skills, including marketing, in whatever domain it operates. It requires market access and connectivity in whatever industry sector it operates.

A small company cannot afford to bring all of that expertise inside; in order to succeed, they need to collaborate. Among the issues in Canada are the lack of commercialization expertise, as we have seen before; a weak culture of collaboration; and insufficient funding. Startups in Canada are only getting about 36% of the funding that equivalent or similar kinds of U.S. companies get.

More significantly, we did a study and found out that the average innovation time in Canada, from the time someone gets the idea to the time a product is ready for market, is about 22 months. Surprise, surprise: the commercialization time, that is, the time from when the product is in the market to the time it breaks even, is one and a half times longer.

Also, usually companies are putting all their efforts into the innovation time, and then they find out that they do not have enough room to survive in the commercialization time; they've...*[Inaudible—Editor]* and are being acquired largely by U.S. businesses that reap the benefits of Canadian innovation.

Anything that can be done to enhance the commercialization effectiveness would be very significant for Canadian industry, and that includes commerce technologies. So we are making a number of recommendations—and the white paper is going to be issued by the end of this week—given the fact that greatest risk factors involve not the science and technology aspects, but the business leadership and the commercialization effectiveness of companies.

First of all, we are making recommendations to industry itself in terms of each company focusing on competitiveness, and strategizing, planning, and structuring their activities according to their business plan, collaborating to conquer, and targeting marketing and sales in advance of getting the product ready.

In terms of recommendations to governments, both federal and provincial, we are making recommendations to create a flexible framework, with accountability and coherent structures for coordinated programs—and we are very much in line with some of what the Jenkins report recommended—to revitalize the Canadian VC industry; to provide direct innovation investment in industry, as well as purchases from industry; and to support Canadian IP protection. And my surprise, there I found out that none of the government programs support Canadians saving their innovations, or protect them from other businesses. We also recommend promoting anchor company relationships, and support for marketing and e-commerce technologies—

• (1540)

**The Chair:** Thank you, Mr. Cohn. I'm sorry that I have to interrupt you there, but we need to move on now.

Mr. MacMullin, for six minutes, please.

**Mr. Darrell MacMullin (Managing Director, PayPal Canada):**  
Good afternoon, Mr. Chairman, and members of the committee.

My name is Darrell MacMullin. I'm the Managing Director of PayPal in Canada. I'd like to thank you all for the opportunity for PayPal to be here. I'd be happy to answer any questions during the question and answer period as well.

I have personally worked in the e-commerce industry in Canada nearly since its inception, in the early days launching retailers like Chapters and Chapters online. I also helped bring eBay into Canada. About six years ago, I built up the Canadian operation for PayPal as well. I've seen the evolution of PayPal and the evolution of the marketplace into e-commerce over many years. It's intriguing to see where the industry is going and some of the things we can do as an industry to make it excel further.

From our perspective, PayPal is actually growing now at about three times the rate of e-commerce in this market, and it has been for several years. Being part of PayPal, I'm excited about that, but I don't know what that necessarily says about the state of e-commerce in this market. There is some "static-ness", but we believe we're helping the industry grow in a lot of ways. We're helping merchants build e-commerce businesses very cost-effectively and to compete internationally. We're bringing a lot of consumer confidence to the table. But there's a lot more the overall industry can be doing as well.

First and foremost, one of the most important things is consumer confidence. This actually hasn't changed a lot over time. The whole issue encompassing privacy concerns and security is still one of the biggest issues why people don't transact online.

From a merchant adoption standpoint, although we are seeing more merchants building a website presence, they have still found it very cost-prohibitive or not cost-effective to actually make transactions online.

Finally, one of our strengths that we don't leverage enough is actually Canadian innovation. From a developer's standpoint and a technology standpoint, this market is actually very ripe in terms of young entrepreneurs, universities, and people who are able to build out and leverage a lot of the new technologies. But as an industry, we haven't been able to connect them to commerce as effectively as we could.

Here I'd like to talk about PayPal in general and what we actually do. Sometimes it's confusing as to whom PayPal actually is and what we do. Probably the best way to describe PayPal is as the payments provider that sits on top of a lot of the other payment networks. If you think of the Internet, you think of a very open network that's global in scale. In you think of payments in general, they're typically closed and domestic in nature. Those two worlds often don't mesh well together in a lot of ways, and we've seen that cause a lot of issues over time, whether with domestic markets, new technologies, building out payments infrastructure, or cross-border buying and cross-border selling. Probably the best way to describe PayPal is that

it's like a universal adaptor that bridges these two worlds. We enable and take a lot of the friction out of the process for both merchants and consumers to transact effectively online.

One of the reasons why we do that, from a consumer's standpoint, is that the core of our offering is what we call the PayPal account. A lot of people consider it to be the original digital wallet for the Internet. There's a lot of talk about digital wallets these days in the industry, and later on we can get into where we think the industry is going. But generally how the PayPal account works today is via a very simple process for someone to sign up for an account. It's free for any consumer to set up a PayPal account. You can enter and store your billing and shipping information. You can add credit cards, bank accounts, and maintain a cash balance in multiple currencies. It adds a lot of basic utility for you to be able to transact online very effectively. Most importantly, it delivers a much more seamless customer experience. You're not having to pull out your financial information every time you're transacting, or every time you're re-entering information for your credit card, billing, and shipping—all of those pieces where we've seen tons of data that slow down the e-commerce process and has people drop off in the conversion process.

The key component of what PayPal provides is that when a consumer makes a transaction with PayPal, they can use their existing credit card, bank account, or cash balance without any of their financial information ever being shared as part of that transaction. That's probably one of the primary reasons why consumers love using our service. No matter whom they are transacting with—a larger retailer, or a small site they've never done business with, domestically or internationally—they know that their credit card information is never shared with that merchant, and they don't know where that information is being stored if they're just entering it somewhere else. The flip side of that as well, as to why merchants love PayPal, is they don't have to worry about collecting and storing credit card information.

• (1545)

We know that dealing with PCI compliance has been very problematic for a lot of merchants. It's an additional cost and barrier to doing e-commerce. From PayPal's perspective, we take the merchants completely out of the scope of that whole process. They never have to deal with PCI compliance to begin with, because they never get that financial information.

Along with that, we've essentially created a very closed-loop network for merchants and consumers to be able to transact safely, and a lot more seamlessly in how their information is shared. It also allows us to monitor those transactions a lot more effectively from a fraud management standpoint. We know a lot about the buyer and the seller as part of that closed-loop network. It doesn't matter where the buyer and seller are located or what type of financial instrument they are using, we can monitor those transactions far differently compared to conventional credit card payments online.

The result is that the fraud rate through PayPal is significantly lower than any other payment network. It's less than half the overall industry average. We're protecting consumers and merchants at the same time, while delivering better buyer and seller experiences.

As we move forward this whole notion of e-commerce has historically been perceived as another channel to do business. But the way e-commerce is going, it's not about being online and offline and it's not about e-commerce. The mobile phone is certainly coming along and morphing those worlds together. In PayPal's perspective, the notion of one versus the other is going away very quickly. We embrace the idea of the convergence of the two worlds.

There are some interesting roles that PayPal can play to enable commerce to happen for merchants, whether they are looking to transact through mobile phones, tablets, televisions, or in-store with their mobile phones. There is one seamless experience and there's one wallet that can essentially deliver a lot of utility, regardless of how they are interacting.

We don't believe that taking credit card credentials and simply stuffing them on a phone is the way to transform that experience to the next level. PayPal has been very focused on actually taking PayPal credentials and making them available in the cloud. That allows people to be able to access their PayPal credentials from any device, any time, and in any way. Whether they are using a tablet, a mobile phone in a store, their card, or their Xbox gaming system, they are accessing their PayPal account at any time to make transactions at any time. Their financial information is never stored, shared, or transmitted across any of these networks.

**The Chair:** Mr. MacMullin, I have to cut you off there. That's all of your time.

Now we will have Mr. Kelly for two minutes to give us the highlights of his opening statements from a previous meeting.

• (1550)

**Mr. Dan Kelly (Senior Vice-President, Legislative Affairs, Canadian Federation of Independent Business):** Thanks.

I know that my colleague, Corinne Pohlmann, shared with you the views and surveys that CFIB has done on this important subject over the last couple of years. There are a couple of other points I would note.

First, governments are still trying to get their heads around how to regulate and tax firms in this world. That is a major struggle and creates a lot of uncertainty for a number of firms that are looking to be involved in this business, particularly for technology and other high-innovation sectors of the economy. I agree with Mr. Cohn's comments.

We're hearing a lot about the CRA impediments around taxing IT contractors and others in this industry. Regulations at the provincial level are often significant impediments. This is a new kind of work, and governments can't really get their heads around it, try as they might.

The other thing I want to mention quickly is the cost of accepting online payments. I know you had presentations from some in the financial services sector, and I want to throw one note of caution in there.

No impediment has been put in place by the code of conduct for the credit and debit card industries in Canada. Minister Flaherty's code of conduct is an excellent tool. It's working well and is completely flexible to allow e-commerce and mobile payments to happen in a robust way. There is no impediment in the code to that happening. I just wanted to reinforce that message. I think Interac shared some similar views on that front.

The biggest problem we've had with electronic payments has been the cost, particularly the cost imposed by the banks, and Visa and Mastercard. Of course, that is the bridge by which PayPal often works too.

Thank you.

**The Chair:** Thank you, Mr. Kelly.

Mr. Kee, for a couple of minutes, to recap, please.

**Mr. Jason Kee (Director, Policy and Legal Affairs, Entertainment Software Association of Canada):** Thank you very much.

The Entertainment Software Association of Canada represents the Canadian video game industry. Something that some people don't know is that Canada is actually a global powerhouse in video game development. We're ranked third in the world in video game production. We directly employ over 16,000 people across the country in a wide variety of high-paying jobs. More importantly, we're actually still growing at a rate of 17% year over year. In fact, Eidos just announced that they're going to be adding 150 new employees to their roster over the next year. Given the fact that our average salaries are about two and a half times the Canadian average, it will amount to just shy of \$10 million being added directly to the Quebec economy, which is great.

For our industry the e-commerce marketplace is critically important. We're in the process of transitioning from a packaged-good retail model into a digital distribution model, so the development of a robust marketplace is very important to us. There's a wide variety of issues that go into developing and maintaining a robust marketplace, but my previous statement listed three of them.

First and foremost from our perspective is updating and modernizing our copyright regime. Essentially, our products are copyrighted products; they need to be properly protected in the online marketplace. A properly updated and modern regime will include robust protection of technological protection measures, or digital locks, as they're sometimes referred to, primarily because they're used to protect products in the online marketplace and to support not just music CDs and DVDs, but also Netflix and the next generation of streaming platforms, Xbox LIVE, and those kinds of digital distribution platforms as well.

Other key points are, first, to make sure that we have widespread broadband penetration. Essentially, the e-commerce marketplace is not going to exist if everyone does not have access to it. That's a critical priority for all of us, I think. Also, similar to copyright, there's the broader range of legislation that will apply to the e-commerce marketplace, including things like anti-spam and e-commerce law, privacy, and so forth. We have to be very careful about these kinds of pieces of legislation when we're implementing them to make sure we're not having any unintended consequences that may adversely affect the development of the market.

**The Chair:** Thank you very much, Mr. Kee, for your brevity and succinctness.

Now we go to Mr. Lake, for seven minutes.

**Mr. Mike Lake (Edmonton—Mill Woods—Beaumont, CPC):** Thank you, Mr. Chair, and thank you to the witnesses, some of whom are here for the second time.

It's good to see you again.

If I could, I'll start with PayPal and refer to Mr. Kelly's comments here about the cost of payment methods. We have heard a lot about that.

From listening to your presentation, I'm just not 100% clear on where your company's revenues come from. Could you expand on how your revenue model works? For example, we hear a lot about merchant fees in your competitors' worlds. I don't even know if they're competitors or partners, actually.

How do you receive revenue?

• (1555)

**Mr. Darrell MacMullin:** There are a couple of different ways of looking at this. One of the biggest things that has driven the popularity of PayPal from a merchant's standpoint is the cost. The ongoing cost of getting set up as a merchant if you're just starting out your business is the following. To set up a merchant account in Canada—and we can talk about transaction fees in a second—you typically need to sign a two- to three-year contract. There's some sort of annual fee, a minimum monthly fee, and there could be a number of other fees associated with that, statement fees and the like. Sometimes there are large thresholds that you need to hit, certain levels of volume, or your money will be held back. So it's very cost prohibitive for businesses to start up when they have to pay a lot of upfront costs just to get a merchant account set up and processed.

From PayPal's perspective, we don't charge any contract fee, or any annual or monthly fee. In fact, if you set up a PayPal account and never do any transactions, you never pay any fee at all to us.

We're very transparent in our transaction fees. There's a sliding scale from 1.9% to 2.9%, plus 30 cents a transaction, and we've made that as simple as possible for merchants to understand, because it is a net rate as well. So it doesn't matter if you're using a basic credit card, a premium credit card with loyalty points, a Visa, a MasterCard or an American Express card, whether you're processing a China Union-Pay card, a Switch Solo card from the UK, or a bank transfer from Germany. You don't need to figure out how to connect to all of those different payment types—and you wouldn't know what type of rate you'd be getting from each one of those transactions. We have a very simple blended rate, so you don't have to worry about what your transaction costs are going to be depending on the funding type.

**Mr. Mike Lake:** How does that transaction work?

**Mr. Darrell MacMullin:** If you're paying PayPal, you're not paying a Visa fee to Visa, as well as a PayPal fee to PayPal. PayPal is essentially taking that fee and charging it to the merchant. We're taking the cost from Visa and bearing that cost.

**Mr. Mike Lake:** So you're Visa's client in effect?

**Mr. Darrell MacMullin:** Yes. If it's a Visa transaction, we will pay a cost to Visa and pay for the value of whatever that interchange cost is, and then we will charge the merchant.

**Mr. Mike Lake:** If you receive a payment on a premium card, that would cost you—

**Mr. Darrell MacMullin:** We absorb the high cost, but we don't pass any additional cost on to the merchant for observing premium cards.

**Mr. Mike Lake:** If people are using premium cards more or everybody just started using premium cards, you would have to pass that on in the form of an increase, I would imagine.

**Mr. Darrell MacMullin:** No, it doesn't matter if they're processing 100% American Express card transactions that may be at a higher rate, we don't charge the merchant any different pricing. Whatever the funding mix is—that being a variable cost that's going to vary from merchant to merchant, from time period to time period, and by how many of their transactions are basic cards, premium cards, Visa, MasterCard, Amex, bank transfers, or cash balances—we don't charge any different rate to the merchant for that. It's a flat net rate that's published on our website, and that hasn't changed in over eight years.

**Mr. Mike Lake:** Seven minutes isn't enough time for me to get in to the “naff” behind that. I'll go on to one other question I had for you.

**Mr. Darrell MacMullin:** Generally speaking, though, most merchants have seen, especially on the smaller end.... The larger enterprise merchants tend to negotiate a lot more heavily with Visa and MasterCard to get their rates down. We're probably a little less competitive on the enterprise level, but the small and medium-sized businesses typically see significant cost savings from PayPal versus typical merchant accounts at the transaction level. And then those additional infrastructure costs don't exist with PayPal as well.

**Mr. Mike Lake:** We talk a lot about convergence in other ways. In your world is there any convergence with traditional forms of payment? For example, PayPal started as an online transactor. Is there a way that one day I may walk into an Apple store or a Best Buy to buy one of RIM's fine products, for example, and use my PayPal account to make that purchase?

**Mr. Darrell MacMullin:** Yes. We have made it public that we have every intention of making PayPal available any time, anywhere, and any way. If that means paying at a bricks-and-mortar retailer at the point of sale, or it means buying through your television set, through your Xbox, or through your car, we're running a number of different tests with different retailers as well as different technology companies to enable PayPal to facilitate those transactions in different ways.

What was the first part of your question?

•(1600)

**Mr. Mike Lake:** That was basically it.

**Mr. Darrell MacMullin:** In terms of being able to enable merchants, probably the biggest challenges these merchants have is "Oh, great, another technology, more infrastructure costs. How do I deal with that?"

The reality is that one thing that we've made very clear is that we are not dictating any particular technology for anyone to embrace. We've taken a very ubiquitous stance, where we're not saying we're endorsing NFC and this operating system, or this handset. In fact, we figured out ways to be able to leverage existing infrastructure in a completely new way, thus not bearing any additional cost for merchants.

One of our most popular products for small and medium-sized businesses is a product called Website Payments Standard, which is a very basic payment button that you put on your website allowing you to enable payments on your website very quickly. We were able to flip the switch last week, and for the hundreds of thousands of Canadian merchants who have that product, we've now created a mobile version. So rather than them trying to bear the cost and figure out how to get their website to look good on an iPhone or a BlackBerry, we've actually enabled that for them. So now they have mobile checkouts from PayPal, and we bore all the cost on that.

We haven't pushed any cost down to the merchants. We just think it's the right thing to do for our merchants.

**Mr. Mike Lake:** Thank you.

**The Chair:** Thank you, Mr. Lake.

Now on to Mr. Thibeault for seven minutes.

**Mr. Glenn Thibeault (Sudbury, NDP):** Thank you, Mr. Chair. Thank you witnesses for being here today.

Mr. Kelly, I think I'll start with you. We're starting to truly see the emergence of mobile payments, with everyone putting something on their phone. I think we've heard at this committee from some of the witnesses that in about 18 to 36 months, mobile payment is going to be common practice.

With that, we're starting to hear of other transaction fees. For example, when I asked Visa, Visa said they couldn't tell us if they're going to put any other type of transaction fee on a mobile payment. MasterCard came out and said they won't. Google Wallet says there are other ways of them generating revenue.

At some point I think small and medium-sized businesses are hitting that tipping point as to how long they can keep absorbing the little, tiny fees—and here I'm citing some of the witnesses—before breaking their backs, and therefore not being able to expand their businesses and hire employees, but God forbid, shutting their doors.

What are you hearing from your members in relation to mobile payments and what's coming?

**Mr. Dan Kelly:** We're hearing lots. We did a fairly intensive survey to prepare for the payments task force. One of the smartest things that's happened is when Minister Flaherty put together that group to look at the future of the payments industry as a whole. It was very timely. But you're quite right, the time is ticking very quickly and we need to start making some decisions as to how this is going to happen.

My members are regulated to the point that if they offer a cup of coffee to their customers, they have to pass through a whole bunch of government inspectors—and yet there's this huge section of the economy in the payments industry has had virtually no regulation. It's effectively been the wild west.

We have promoted and have seen a voluntary code of conduct adopted, which we feel is working. There are flexibilities within that code to make mobile payments work, but we do need to move quickly.

The payments task force is looking at this. We're part of it, so we're at the table. They've been taking the views of small and medium-sized businesses seriously.

The point that has been made with some of the provisions of the code of conduct that disallow the idea of co-badging—that of having, say, an Interac capacity and a VISA or MasterCard debit capacity on the same card, or perhaps even a PayPal initiative along those lines—is whether that means, if it's applied to the mobile payment technology, that you have to carry four cellphones with one type of payment on each.



Those kind of things can be resolved. There are infrastructure changes that can be made to comply with the code of conduct and still allow the adoption of mobile technologies. But you're quite right that many small businesses are afraid of this because they've seen the abuse that VISA and MasterCard have imposed on small and medium-sized firms over the last number of years.

We're very open to and interested in how this is all going to roll out. We think it is possible. The code is our best defence. We need to make sure that the code continues to be a living document to make that happen.

**Mr. Glenn Thibeault:** I agree that it has to be a living document because the technology that we're seeing—and here I'd like to get a question to Mr. Kee in a bit—and the apps we're seeing for iPads and the software that's coming out is fantastic.

Mr. Kelly, again, I come from an urban area in northern Ontario and there are many small and medium-sized enterprises 20 minutes outside of my community. So in a city of 160,000 people, you go 20 minutes outside and you can't get broadband.

What type of impact do you feel the lack of broadband and lack of affordability to get into the e-commerce and mobile payment world will have on small and medium-sized enterprises?

• (1605)

**Mr. Dan Kelly:** It's huge. Broadband—and I think other presenters have said this—is fundamental to making any of this work. We need to make sure that if you're at a gas station, you're not going to have somebody dialing up on some sort of connection to check whether or not your payment is valid. That just can't work.

We need to have inexpensive broadband across the country to make this happen, but on top of that we need to make sure that the payments players do not do what they've done on the credit card side to date.

**Mr. Glenn Thibeault:** Mr. Kee, you mentioned that Canada is this fantastic place for entertainment software, not only entertainment software but also software in general.

I think if you look at RIM apps or Apple apps, or whatever, to purchase something like this, there's something new coming out on a daily basis by some great software designer. But I think the worry is that I can make it in my basement, put it in the apps world and people will buy it, and all of a sudden I'm charging the small and medium-sized businesses a portion of the proceeds.

Is there any type of regulation or scrutiny of the software developers when they put apps up for sale?

**Mr. Jason Kee:** It depends a lot on the specific platform. In fact, this is one of the fantastic things that we've seen developing.

We've seen a proliferation of these platforms, such as the App World for RIM, the App Store for Apple, and the Android marketplace for Android-based devices, all of which are subject to their own philosophies and each of which has benefits and drawbacks.

What happens, for example, if you submit an app to the App Store is that it goes through a pretty rigorous quality assurance process, so that when it finally makes it into the App Store and you can purchase

it, you can basically be assured that it's going to work, and so forth. The drawbacks of that is it means that Apple acts as the gatekeeper. It has a series of policies that it can implement and there are circumstances where it won't let apps through, which has led to some complaints.

The Android, on the other hand, is a much more open marketplace and, as a consequence, it's a bit more like the wild west. Essentially the apps that make it into the Android marketplace don't go through this kind of vetting process, so as a consumer buying the app, you're frankly taking a bigger chance, because you don't know if it is going to work or not. However, my understanding is that Google has policies in place that you can get a refund or a return, if things aren't properly functioning.

**Mr. Glenn Thibeault:** It's like buyer beware then, if I'm buying a software app to buy whatever, because I'm getting hit with extra fees on top of that. There's no real scrutiny. It's buyer beware when you go to these sites.

**Mr. Jason Kee:** Yes. It is important to note that the way these sites essentially operate is by word of mouth very quickly and by reporting. What drives the sales of apps is the fact that people will comment on the apps and rate them.

We call “vapourware” any app that's been produced and is out there but doesn't mean anything and doesn't work. Essentially, the first couple of buyers will quickly realize that, and will tell others not to buy it under any circumstances. Even worse it could end up being malware, which also happens.

There are unscrupulous folks in these open stores who will abuse the system and tell others to buy the next “Mildly Upset Birds” app, which actually turns out to be a virus that's transmitting all your personal information from your phone. But that will quickly get caught and be pulled down.

**The Chair:** Sorry to interrupt you there, but your time has elapsed.

Now I'll go to Madam Gallant for seven minutes, please.

**Mrs. Cheryl Gallant (Renfrew—Nipissing—Pembroke, CPC):** Thank you, Mr. Chair, and through you, to our witnesses.

First of all, what are the PayPal advantages over the vendor providing their own fields for the credit card information?

**Mr. Darrell MacMullin:** Sorry.

**Mrs. Cheryl Gallant:** When we construct a website, we can just develop our own fields, so that customers can plug in their own information from their credit card. What is the advantage?

**Mr. Darrell MacMullin:** I guess what you're talking about is the advantage that PayPal brings from optimizing the checkout.

We've studied this for years now. The average shopping cart abandonment rate, as we call it, meaning the number of people who browse and search on a website, drop things into the shopping cart, and actually complete their purchase is about 50% to 53%. It hasn't changed much in years.

One of the big barriers that we've seen at a lot of different checkouts is having to register for the website, having to enter billing and shipping information. The average time it takes is 15 minutes, and it's a lot of inconvenience to go through that hassle.

We've created something called PayPal Express Checkout. This came from our own customers who said that we had their information already and asked us why they couldn't only click once, log into their PayPal account, complete the purchase, and be done. Your billing and shipping information is already verified and validated and passed over to the merchant, so you can complete that purchase significantly faster.

Completion rates, on average, have gone up from the low 50s to 72% to 73% when PayPal is enabled. We're helping sites that are driving traffic to their website to convert those browsing the site into buyers just by streamlining the checkout process.

That gets even more complicated when you're talking about mobile phones. Sitting there and entering all that information on your phone can be very cost prohibitive. Cineplex Entertainment is a great example, where you can browse movie theatre show times. Now you can pick the movie, the theatre, and the time you want and pay with PayPal in one click. Your tickets are then brought up to your phone right there, and then you can walk into the theatre.

• (1610)

**Mrs. Cheryl Gallant:** Great.

When vendors are constructing their websites, they get the webmaster to put the content in the inventory. Do you then plug and play the PayPal component?

**Mr. Darrell MacMullin:** It's a good example.

We see three customers. We have consumers, merchants, and the developer community, everybody from independent developers to shopping cart providers and e-commerce platform builders. It's what we've done. We've worked very diligently with the e-commerce providers, whether it's on shopping cart technology or for e-commerce platforms.

We've created a very rich set of APIs that have allowed all of these cart partners to pre-integrate PayPal into their checkout and shopping flows. In order for merchants to enable PayPal or optimize their website, they simply set up their PayPal account, and then in the administrative part of their shopping cart technology, they just link their PayPal account to their e-commerce website and they can have their checkout optimized automatically. They don't have to figure out how to do all of the coding themselves.

**Mrs. Cheryl Gallant:** Does the bank charge the merchant a fee for accepting deposits electronically?

**Mr. Darrell MacMullin:** Any transaction, regardless of the funding source.... Keep in mind that when a PayPal transaction can happen, you can actually do one transaction from multiple funding sources. Maybe I have a \$50 cash balance sitting in my PayPal account, and I see a pair of jeans for \$100 that I want to buy. I may use the \$50 from my cash balance and then use the rest as a bank transfer or a credit card payment.

As merchants, they don't need to understand or know how the transaction gets divided by funding type. As I mentioned earlier,

PayPal is providing a flat rate regardless of the funding type and funding source.

**Mrs. Cheryl Gallant:** I understand that part, but aside from credit card fees they have to pay per transaction, when a merchant deals with PayPal, is there a fee that has to be paid on every deposit that comes into his bank account?

**Mr. Darrell MacMullin:** When a merchant is receiving funds via PayPal, those funds are deposited in his PayPal account. You can maintain that entire balance in your PayPal account and reuse it, or you can withdraw and settle those funds out to your bank account. This can be done on a daily basis. It's called an auto sweep functionality. We do not charge merchants for the ability to withdraw their money into a bank account, and they can do that on a regular basis. It comes in as a deposit that their bank, as far as I know, should not be charging for.

I've never heard of any fees from banks for accepting donations from PayPal. I've never heard of that, but I'd be happy to get a formal answer for you afterwards. I can investigate it for you.

**Mrs. Cheryl Gallant:** Thank you.

This question is for the CFIB. Our government is committed to removing the red tape for businesses, and you are a part of that Red Tape Reduction Commission headed by Minister Bernier. Can you speak to the importance of reducing red tape for your members, and possibly speak to any red tape that's harming the adoption of digital technologies in e-commerce?

**Mr. Dan Kelly:** There has been a lot of progress made. But there is a huge road still to go on that front.

Briefly, on your question about deposit fees, virtually every institution has deposit fees for businesses. If they receive it from Visa, MasterCard, or their processor, or from PayPal, the bank will charge a fee for each transaction. Desjardins was one of the holdouts. They didn't charge these fees. But now these have just been imposed. So now it's across the board. When you get paid by whoever provides the money to you—Chase Paymentech or Menarys or PayPal—you will receive a fee as a merchant when the money hits your bank account. I just wanted to answer that quickly.

Those fees are in the few-dollar range, but if you're settling Visa, MasterCard, Interac, or PayPal on a daily basis, you could be hit with a fee for each of those every single day. This is adding up to significant dollars for members. Our members in Quebec have been sensitive about this very point, so it was a good question.

You asked about regulations affecting the adoption of e-commerce. The CRA is the main thing that most businesses are concerned about, quite apart from e-commerce. With respect to e-commerce, one of the impediments is the ability for small companies in the IT field to be able to work and still gain access to things like the small business deduction, and things like that. The CRA has a very black-and-white view of this kind of thing. It's the employer-contractor rules that are at play here. This is an area that absolutely needs to be fixed to ensure that people in the IT business can gain access to the same tax advantages that any other small business enjoys.

• (1615)

**The Chair:** Thanks, Mr. Kelly.

Now on to Mr. Hsu.

**Mr. Ted Hsu (Kingston and the Islands, Lib.):** Thank you, Mr. Chair.

My first question is for Mr. MacMullin. It's about PayPal. I've used PayPal from both sides: as a customer and as a merchant. It's nice for people to be able to purchase something and know that their credit card information is not going to a merchant they haven't dealt with before.

My question is related to the costs for small businesses. I want to know what the competitive landscape is in your business. What other companies comparable to PayPal remove the need to send credit card information to vendors and then remove the need for merchants to manage credit card information? Who are your competitors? Is it easy for a competitor to come into this sector?

**Mr. Darrell MacMullin:** That's a good question.

In terms of competitors, we look at a lot of different people. There may not be an exact replica of, say, a PayPal, but merchants have many different choices for accepting different forms of payment. Obviously there are different acquirers in Canada. There are different technology companies that have tried many different ways of forming digital wallets.

What's been interesting over the last several years is that we have seen more and more of the industry trying to look a lot more like PayPal. Even last week, Visa announced its initiative to look like a PayPal digital wallet. And there are other technology companies like Google and the like that have imitated us. I think it was six years ago that Google launched Google Checkout, which was an exact replica of PayPal's checkout system.

So many companies have come along and provided different and similar technologies. I think PayPal plays in the middle in a sense. One of the things we've been able to establish very closely with our users is trust. Payments are what we do; we don't do anything else. So the PayPal account provides this inherent utility that seems a little bit more ubiquitous and neutral than just another feature or function. PayPal works very hard at listening to our customers. I would say that we are probably one of the technology companies most maniacally focused on consumers. We've adopted a "customer to code" philosophy in everything we build.

I think probably the biggest advantage that we've been able to provide is for the developer community. It's not actually about the

products we're trying to sell, because we've enabled the developer community with a rich set of APIs, from which they can go off and build different products and new business opportunities.

**Mr. Ted Hsu:** I like PayPal. I guess what I'm getting at is whether in the longer term there's a risk of a monopoly developing here, and I'm wondering what effect that would have on transaction costs and the whole e-commerce part of the economy.

• (1620)

**Mr. Darrell MacMullin:** I think we're trying actually to provide a choice more than anything else. So I think especially on the consumer side—and I'll use this country as an example—there's always been a drastic difference between offline and online transactions in terms of the number of debit versus credit card transactions. Before PayPal came along in Canada, the credit card was the only way to pay online. So PayPal has been able to provide people the ability to pay with debit, the ability to do bank transfers or manage cash balances, to be able to accept purchases internationally. That's the one really unique thing about small to medium-sized businesses. Offline, they think locally. Online, they absolutely think globally, and they want to be able to accept transactions from people in Europe or the United States or in emerging markets. But they don't want to bear that risk. And there are a lot of Canadian merchants I talk to all the time who will actually use their merchant account for domestic business along with PayPal. But internationally, PayPal might be the only form of payment they accept, because if they get a credit card from Sweden, they don't know how to call up that Bank in Sweden and to figure out how to get an authorization on that card, whereas PayPal bears all of that risk and manages the front of that transaction for them.

There isn't anything in what we're doing that's prohibiting other companies from doing the same. I think by listening to our customers really well, we've been able to build really good solutions for them.

**Mr. Ted Hsu:** Okay.

My second question is for Mr. Kee, and it's related to international e-commerce. We like to see a lot of the entertainment software that's developed in Canada being sold around the world. Especially now with digital distribution, are there things that we should be paying attention to in negotiations of international trade agreements with regards to their effect on the entertainment software industry in Canada?

**Mr. Jason Kee:** Absolutely. It relates, actually, to what Darrell was just saying. The video game industry has always been a global industry. We have never made content that we sold purely domestically. The Canadian market is not big enough to sustain our industry. So we actually always sell overseas and are predominantly export-oriented. As a consequence, issues such as market access and so forth become critically important to us.

Because our products have been predominantly digital, and because the rules that apply to markets in the digital sphere versus the physical sphere have been different, we actually haven't had to deal with some of the customs tariffs and other challenges that some of the other industries have dealt with—although these still actually apply in some jurisdictions. So the rules that are developed around this are actually critically important.

In fact, the WTO has been doing an e-commerce moratorium that it renews every two years as part of the Doha Round that has somewhat faded into the background. That is something that we support, that is, the moratorium on e-commerce. We don't want to see e-commerce transactions getting caught in the same kinds of tariff issues that sometimes the physical transactions can.

There's a whole series of issues that actually now interrelate when it comes to these international trade issues. It's not only the issue of market access any more—which is critically important—but also labour mobility, which is a huge issue for us. We're a global industry. We actually tend to have a lot of labour that comes and goes in our industry. In Canada the biggest challenge we have is that the growth of our industry has outstripped our ability to staff it. So while we get a lot of great undergrads coming out of university at the junior levels, at the intermediate and senior levels we are actually running into major problems finding domestic talent to staff these positions. So we need to look abroad. But then we run into challenges with respect to temporary foreign workers, issues with respect to work permits, and so forth.

So the ability to leverage international agreements to take some of the friction out of that is actually hugely important to us, and making sure there's an equal amount of intellectual property protection across the board. As I say, when you're in a global marketplace, when you have differing levels of IP protection in Canada versus the States versus Europe versus Japan versus China, it's a huge problem because it means that each market is being treated differently.

**Mr. Ted Hsu:** Okay.

**The Chair:** Thank you very much, Mr. Kee, and Mr. Hsu. The time is up.

We've finished our first round of seven minutes, which means we've done something that is a landmark—at least in recent times—in moving into our second round without the bells having gone off. So we're okay.

Now we'll go to Mr. Richardson for five minutes.

**Mr. Lee Richardson (Calgary Centre, CPC):** I want to ask you, Mr. Kee, this. If your business is changing, what percentage of it is downloaded as opposed to sold in boxes?

**Mr. Jason Kee:** It has changed pretty significantly. It went from 5% being downloaded in 2009 to 20% this year—and to 50% by 2013 is what we project. So it's pretty significant.

• (1625)

**Mr. Lee Richardson:** I'm asking you this because we have an ongoing concern on another related matter, and that is the copyright modernization act and the digital locks you touched upon. I take it, then, that it's the same software that someone would download as they would buy in a box, and that the lock is obtained whether you download the software or buy it in the box.

**Mr. Jason Kee:** That's generally the case. That's right.

**Mr. Lee Richardson:** There's still some debate out there from consumers about individual and personal use. We try to find the right balance in developing this act. How do you respond to consumers who really just don't get why they must have digital locks on some of your software?

**Mr. Jason Kee:** It's primarily to protect the content itself. The biggest challenge we have when people discuss tying the notion of circumvention to infringement—because the issue is that we prohibit circumvention of these digital locks, these TPMs—is that from an enforcement perspective, which is the practical way we are looking at it, it makes the provisions almost useless to us. The problem is that there are these services that exist out there that literally hack the Xbox. They hack the various devices, and basically do so for money, to enable people to play pirated games. People can go onto the Internet, download a free copy of the game, and play that instead of actually going to the digital retail store to download the proper, legitimate copy of it.

By tying those two together, the people who offer those services will basically just say that they don't know what anyone is doing with this product; they're just doing the hacking and not enabling anything. It basically makes it impossible for us to actually enforce. That's the biggest challenge. So it's a matter of trying to hold that line and find where the balance is there.

In our view, the TPM provisions, the anti-circumvention provisions, in legislation as crafted actually are balanced, because they do include a wide array of specific exceptions to deal with specific circumstances. They have a regulation-making power that allows additional exceptions to be added as needed.

The important thing is that the big challenge for all of the content industry is that we're in a massive period of transition, which your first question highlights. As we move into the online environment, the notion of actually having to make a backup copy or transfer is actually fading away.

When you are a Netflix subscriber, for example, you have access to Netflix across all devices. You pay a subscription. You get access to it everywhere. It doesn't matter that you need to make a transfer or don't have to transfer, because there's nothing to transfer any more. You literally are just watching the movie and downloading it or streaming it as you go. Similarly with the digital distribution platforms for games, what happens is that you buy the game online. You get the digital copy of the game that can sit on your PlayStation or Xbox. You can delete it and you can download it again. There's no notion of needing to make a backup, because you have a perpetual backup. It's stored in the cloud. In fact, it means you don't have to worry about the physical media any more. It's already permanently stored for you because you bought that game. As a result, a lot of—

**Mr. Lee Richardson:** I presume that you can retrieve it from the cloud with any device.

**Mr. Jason Kee:** Precisely. Actually, in the case of games you can retrieve it from the cloud on the device that it will play on. If you buy a game for a PlayStation, it won't work on a Xbox because it's a different platform.

**Mr. Lee Richardson:** So it has to be the same Xbox.

**Mr. Jason Kee:** That's right. That's exactly right. In fact, actually, if you buy the next Xbox, the new one, for example, you can actually just transfer everything, transfer your account, onto the new device and just pull all the content down again. And so it doesn't require you to buy the content again and again and again.

**Mr. Lee Richardson:** I have one final one. What's the sense of piracy now in your business? What kind of percentage is there?

**Mr. Jason Kee:** It is significant. It does vary from platform to platform, but it's been growing year over year. The main problem that we have, particularly in Canada, is that because we haven't had a prohibition on these hacking devices, these circumvention devices, we've actually become a major transshipment point. It's not just an issue in Canada, where about 22% of people have basically reported having hacked their consoles, but it's actually people who are importing these devices in from Asia and then exporting them to the United States that's becoming a major problem.

**The Chair:** Thank you very much, Mr. Lee.

[Translation]

Ms. LeBlanc, you now have five minutes.

**Ms. Hélène LeBlanc (LaSalle—Émard, NDP):** Thank you, Mr. Chairman.

Thanks to the witnesses for coming to provide us with even more information.

My question is for Mr. Cohn. Your "Innovation Nation" strategy recommends a major transfer of resources of \$3.5 billion, granted in the form of tax credits under a program known as the scientific research and experimental development program, SR&ED. You're in favour of direct funding measures for small and medium-sized businesses.

Could you explain what currently isn't working in the funding program known as the SR&ED program, these tax credits granted by the government?

**Mr. Sorin Cohn:** May I answer in English?

• (1630)

**Ms. Hélène LeBlanc:** Please do.

**Mr. Sorin Cohn:** That's easier for me. Thank you.

[English]

SR and ED is a very good program and is the largest program supporting innovation in Canadian industry. It is supposed to be an enabling program, and for a number of reasons the Canada Revenue Agency has been placing a lot of stumbling blocks before companies seeking to take full advantage of the program, and there's a lot of wastage in the administration of the program.

As I mentioned earlier, we are issuing a white paper on how to deal with the innovation and commercialization gap in Canada, and a good portion of that white paper is going to deal with the issues of SR and ED.

For instance, there is a lot of waste in terms of back claims that do not really support innovation. There are issues with applicability of SR and ED, for instance, to IP protection. It does not allow for that, which puts Canadian companies at a disadvantage. There's a belief that a measure of direct support, in terms of innovation and commercialization, would be of much greater effect in helping Canadian industry to become more competitive.

[Translation]

**Ms. Hélène LeBlanc:** Talking about changes, this would involve direct changes in businesses. What improvements are you considering to assist mainly the small and medium-sized businesses in adopting information and communications technologies and adapting to e-commerce? What government programs could help them in that regard?

[English]

**Mr. Sorin Cohn:** *Absolument.* There are a number of aspects described in my presentation and, again, if I have the occasion, I would like to talk at length with you and the other members of the committee about this aspect.

For instance, there is a federal program called IRAP, the industrial research assistance program, which is of great value as a direct investment in the development of technologies and innovations in Canadian companies. Unfortunately, this program is quite low in value, at about \$80 million a year, and runs out of funds by September. Small companies are being told: wait until next year, that maybe we are going to have money for you next year. But, again, for a small company waiting six months to maybe get or not get some support is quite critical. They cannot afford to do that. That's very uncompetitive for them, as timing is so critical to success in the global market.

There is another good program that has been positioned as an exploratory program. It belongs to Public Works and Government Services Canada, part of the Office of Small and Medium Enterprises. It's called the Canadian innovation commercialization program, which enables federal agencies and departments to purchase innovations from Canadian companies. It's a very small program, but is very effective in helping companies raise their commercialization capabilities.

One of the proposals that CATA is making is to create a program similar to the industrial research assistance program, a program that would be aimed at commercialization readiness assistance. What technology companies are doing, as I mentioned, is that they put all their efforts into making the product, expecting that the product will sell overnight, which doesn't happen. It takes years for the products to be accepted by the market and companies do not have enough capabilities to handle those difficult years. So a program aimed at commercialization readiness preparedness would help Canadian companies tremendously in becoming more competitive globally.

[Translation]

**Ms. Hélène LeBlanc:** You mentioned a number of programs. Are small and medium-sized businesses aware of all these programs available to them, and, if so, are they using them to innovate?

**Mr. Sorin Cohn:** A lot of businesses are taking advantage of them, but they aren't all doing it.

[English]

There are too many programs. At last count in Canada, there were about 470 programs to help Canadians be more innovative, of which about 50 were federal programs. The poor businessmen or business women are just bewildered by the complexity of all of these programs. It does not make sense. All of that information about companies and their innovations and their need for commercialization should be centralized—like the great job PayPal is doing in coordinating all of the financial information—such that an application to one program may be of value for other programs as well.

**The Chair:** Thank you, Mr. Cohn.

Now on to Mr. Carmichael for five minutes.

**Mr. John Carmichael (Don Valley West, CPC):** Thank you, Mr. Chair, and thank you to our guests today.

Mr. MacMullin, I'd like to ask you a couple of questions about the fee structure again, because I'm just not getting it. I apologize if it's redundant.

Mr. Kelly, I'll hopefully leverage over to you.

As a merchant, I'm trying to clearly understand this. When I as a business person complete a transaction in selling a product out of my business through one of the card carriers, I pre-agreed to a fee structure, and those fees range from some of the higher cost fees down to the lower costs. One thing we were told early on in this study is that the fees are one of the largest hurdles to the whole e-commerce evolution of business, small business in particular.

Am I correct in understanding that your fee structure is a simple, all-inclusive deal? If I do business with your company, regardless of which credit card or plastic is used to pay for the product, it's a single fee, consistently time after time, and it's all inclusive with that credit card fee built into it?

• (1635)

**Mr. Darrell MacMullin:** There are a couple of points of clarification. The credit card fee is inclusive of the PayPal fee. You're not paying a PayPal fee plus whatever your agreed-upon credit card agreement says.

**Mr. John Carmichael:** It doesn't matter which fee it is? You have one fee for all credit card carriers?

**Mr. Darrell MacMullin:** Correct. So if you're using a Gold TD card, or a basic Royal card, or an Amex card, the fee is going to be the same.

How PayPal fees are structured, as I mentioned, at 1.9% plus 30¢, up to 2.9% plus 30¢, depending on your monthly sales volume. So whether you're doing \$3,000 a month or \$100,000 a month, there's a sliding scale. It has four tiers and it's a published rate. Unlike most other acquirers who don't publish any of their fees anywhere, our fees are online—at PayPal.ca/fees. It's very transparent. It's based on your monthly sales volume and it doesn't matter what the funding mix is in any given month or any given time period whatever card payment you're processing, because that is a burden. Sometimes you have no control over what credit card a consumer is going to pay with, and you shouldn't have to worry about that burden either. So on top of other things like the incremental costs you may have downgrade fees, I think the acquirers sometimes call them. That is,

when you process a certain percentage of premium cards, there may actually be an additional fee on top of the transaction fee. There are no other hidden fees like that.

Probably the best way to describe it is that the fee PayPal provides you is a net rate. Often fees published elsewhere are gross rates, and they will vary depending on the type of volume and type of card mix you have.

**Mr. John Carmichael:** You're at 1.9% to 2.9%.

**Mr. Darrell MacMullin:** Yes, 1.9% to 2.9%, plus 30¢ per transaction.

**Mr. John Carmichael:** Plus 30¢ per transaction. That's on the retail value.

**Mr. Darrell MacMullin:** Yes.

**Mr. John Carmichael:** My understanding is that we have some cards in Canada that charge a good deal more than 1.9% to 2.9%.

**Mr. Darrell MacMullin:** Absolutely. That's why I was saying, in particular for the small and medium—

**Mr. John Carmichael:** You just factor that in?

**Mr. Darrell MacMullin:** —for the small and medium-sized businesses. The reason we can afford to do that too is that some of our transactions are cash-based transactions. We are taking on the funding mix risk in that cost structure in order to lower the overall processing fees we pass on to the merchants. We simplify it as part of that process and we manage the risk on the funding mix side.

**Mr. John Carmichael:** Okay, it's clear. I'm not quite sure how it works in terms of the numbers.

So, Mr. Kelly, then....

Sorry, go ahead.

**Mr. Darrell MacMullin:** I have one point of elaboration.

**Mr. John Carmichael:** There's one minute. Go ahead really quickly.

**Mr. Darrell MacMullin:** As the emergence of on-line and off-line get together, I'm concerned about determining what is an on-line transaction and what is an off-line transaction. Today, there are two rulings: card present and card not present. A card present transaction is when you swipe or enter your chip and PIN at a store. If I walk in with a mobile phone and I pay with my mobile phone, that's considered an Internet card not present transaction, based on VISA or MasterCard rulings. Those are typically higher interchange rates that are regulated by the credit card companies, not regulated by us or the government.

**Mr. John Carmichael:** Mr. Kelly, can you be really quick, as I only have a couple of seconds left?

What's happening with the trends now, with PayPal now being in the mix with these credit card companies?

**Mr. Dan Kelly:** We welcome any competition to this business whatsoever. The PayPal fees, to be fair, sound good on the surface, but a plain-Jane VISA fee for our small members could be around 1.7%. There are additional fees built in. If you're using an Amex card, then PayPal is a pretty good deal. There's no question about that.

The only thing that's happened since the code of conduct on the fee side—

• (1640)

**The Chair:** Mr. Kelly, I'm sorry. That's all the time we have and I apologize for that.

Try to squeeze it in with another answer, if you can.

[Translation]

Mr. Caron, you have five minutes.

**Mr. Guy Caron (Rimouski-Neigette—Témiscouata—Les Basques, NDP):** Thank you very much, Mr. Chairman.

My first question is for Mr. Kelly.

I briefly looked at the research you've conducted at the Canadian Federation of Independent Business. For all kinds of reasons, it seems that sometimes there is some reluctance to adopt information and communications technologies quickly.

Does your research show in a quantifiable way the benefits of using new information and communications technologies, particularly e-commerce? Let's suppose, for example, that for every dollar of investment you can save two dollars in management costs or in new contracts.

Are there quantifiable methods?

[English]

**Mr. Dan Kelly:** I'm afraid we don't have that kind of debt.

There have been some academic studies of this kind of thing. For a lot of our members, the small businesses, it's whether they can afford any dollars right now to make these kinds of investments. It is very challenging for many of them. We certainly have not done any cost-benefit analysis of this kind of technology adaptation.

[Translation]

**Mr. Guy Caron:** Do you get the impression that, for your members, this is more an investment than an expenditure, that is to say that, if it's economic for them, it represents an investment rather than a necessary expense?

[English]

**Mr. Dan Kelly:** Again, it's difficult to generalize for the entire small business population. There are sectors of the economy that are absolutely seeing the benefits of this very early. By adopting these kinds of technologies, they're able to make that money back and to benefit from it for the future. It is difficult to generalize. When you look at this, you also have to include within our membership the small businesses like the local dry cleaner and the local restaurant. There are some products that are very easy to move into an e-commerce setting. There are others that are more intrinsically linked to an in-person transaction. Some of them are still finding creative ways to use e-commerce for those kinds of more localized and

mainstream businesses. I'm afraid I don't have any kind of rule of thumb to suggest for the small business community as a whole.

[Translation]

**Mr. Guy Caron:** Thank you.

Mr. MacMullin, you talked about trust in using e-commerce and services such as PayPal. I probably could have put the question as well to the Canadian Bankers Association, which testified earlier, or to the representatives of the credit card companies. There is a specific security problem, and it's called phishing.

To what extent can that affect PayPal and, more particularly, consumers' trust? Is it a very difficult obstacle to overcome? What measures are you taking to overcome it, and—I don't know whether you can answer this—how are your competitors doing it?

[English]

**Mr. Darrell MacMullin:** Thank you, Mr. Caron.

There are a number of things that PayPal does to protect our customers. Phishing and spoof emails and scams have been going on for many years. PayPal was actually an early victim of that, probably an early target, given our global nature and our scale. We have over 103 million active users around the world.

One of the things we've been really good at is fighting and detecting fraud in our system. By nature of the way our system works, as soon as someone attempts to access your account or there's some suspicious activity going on within your account, we may let that happen to monitor what's actually going on. From a consumer standpoint, though, we make sure that none of your financial information is ever transmitted as part of that. We also have very strict buyer and seller protection policies in place for any unauthorized use of your account, so if by chance you do fall victim to a spoof email and someone attempts to do a transaction, you're 100% covered against any unauthorized use of your account.

[Translation]

**Mr. Guy Caron:** There are about 30 or 45 seconds left.

Do you sense that the measures you're taking are inspiring consumers' trust? Or do you think there is a level of scepticism that will be impossible to overcome and that will impede the expansion of e-commerce?

[English]

**Mr. Darrell MacMullin:** This is one of the reasons people are skeptical about doing transactions online. Part of it is comprehension, and there we do a lot for our customers in teaching them, for instance, that we will never send them an email asking them to log into their account or to update their information. If you ever get an email like that from PayPal, you know right away it's a spoof.

There's a lot of that sort of comprehension that we attempt to do with our customers. Along with protecting them, there is proactive education to help people understand what they can do to protect themselves.

• (1645)

**The Chair:** Now we'll move on to Mr. Braid. If you have questions for Mr. Cohn before he goes, you might want to ask them now.

**Mr. Peter Braid (Kitchener—Waterloo, CPC):** That's a perfect setup, Mr. Chair. Thank you.

Mr. Cohn, I really appreciated your presentation. The importance of collaboration really resonates with me. I'm from Kitchener—Waterloo, and we often say collaboration is one of the reasons we have such a successful ecosystem for innovation and for high-tech.

In your presentation, you said a lack of commercialization expertise was one of the challenges in Canada. Could you describe what you mean by commercialization expertise? What are the elements of commercialization expertise, and how can we increase that expertise?

**Mr. Sorin Cohn:** Commercialization expertise includes all elements or knowledge of the market and the customers, understanding what the customers need, understanding how they can be satisfied and, equally important, understanding the ways that one can reach the right customers in the process. This is not quite as developed in Canada as it is in other countries.

As to enhancing the level of expertise in commercialization, one of the major recommendations we are making is to educate people in business management. Education in business management, including marketing and relationship management, should become compulsory for all science and technology students and should be an option for all other students. We should also nurture, even in high school, what I call the commercialization competencies: confidence, competitiveness, and knowledge of the world. High school is when people's character is being created and developed.

**Mr. Peter Braid:** You also briefly mentioned the Jenkins panel report. Could you speak to the recommendations within the report that you think deserve support?

**Mr. Sorin Cohn:** First of all, there is a generic recommendation on the need for better coordination of the variety of federal programs aimed at supporting industry, especially research and development. There is a requirement for some way to structure these programs to make them more effective in their dealings with industry. That's number one. We very much support that. We are adding to that recommendation the need for the structures to become flexible. They need to be adjustable, depending on their performance and the changes in the market. Creating legislation for new structures that doesn't allow them to change in the next 50 years is not going to be helpful, because the global market is changing much faster.

Second, all of these organizations and programs should be accountable, and the accountability should be based on industry-value methods. Rather than judging government officials on how many companies they meet in a year, it's important to judge the effectiveness of the programs they have managed for those companies. Has the return on investment increased? Are those companies becoming more viable as a business—not next year, but three to five years afterwards? This is the time that counts in the life of a business.

**Mr. Peter Braid:** You also spoke about the importance of more strongly supporting the protection of intellectual property in Canada, and I wanted to ask how we do that. I presume that one of the important elements of that is our upcoming Copyright Modernization Act. Beyond that, what do you suggest is important for us to do in Canada?

**Mr. Sorin Cohn:** Another aspect is the expense and timing required for the IP to be protected. Today there is very little support for technology companies to protect their IP. There is no support from IRAP, and SR and ED does not cover that aspect of industrial evolution. That is very critical.

We asked Canadian companies whether they collaborated, and 53% said they did not have any collaborative agreements. That is a huge number. These companies are trying to be successful in the global market by themselves, and most of them will fail because they do not have the strength to be successful.

I worked for 25 years with Nortel Networks. Whenever we went into a new territory, we always made sure we had local partners to present a local face to the market. Small companies that do not do that are going to fail.

• (1650)

**The Chair:** Thank you, Mr. Cohn. Sorry, that's all the time we have.

We'll now go to Mr. Toone for five minutes.

**Mr. Philip Toone (Gaspésie—Îles-de-la-Madeleine, NDP):** Thank you, Chair.

I'll repeat what my colleagues have said and thank you very much for your presentations. They were quite enlightening.

I come from a rural riding, and we have difficulty accessing a strong backbone infrastructure. We have a few companies that have set up satellite operations, including software developers. Telephone companies have call centre operations. But it's very limited.

Mr. Kee, to what extent does your association feel that having software designers living in regions and developing software in our regions contributes—or is that a hindrance? Is that a priority for members of your association?

**Mr. Jason Kee:** It's certainly not a hindrance. The challenge is that we are an industry that tends to cluster, and we tend to cluster in urban areas. There are a number of reasons for that, not the least of which is access to high-speed infrastructure. That is critical. But we also have very good Canadian success stories that are not in urban areas. The most notable is HB Studios in Lunenburg, Nova Scotia. They decided that they didn't want to go to Halifax. They wanted to stay in Lunenburg and build their studio there, and they did. They are world-renowned for some of the games they produce.

The challenge is getting over that chicken-and-egg problem. Your developers may be in rural areas, and in order for them to stay in rural areas there has to be access to the infrastructure that enables them to do their jobs remotely.



The beauty of a lot of the emerging platforms in the digital space—the app stores and the online platforms—is that they're ubiquitously accessible no matter where you are, provided you have access to the Internet. So it doesn't matter if you're developing your app in the middle of nowhere versus the middle of downtown Toronto; it's irrelevant. It's a matter of having the ability to submit that app for approval, regardless of where you are.

So access to broadband will facilitate developers actually staying in more rural areas, because there won't be the same drive for them to go to the urban areas.

**Mr. Philip Toone:** That's certainly a problem in our rural areas. Broadband is very hit and miss. In about half of the riding I come from, you can forget about having any access to the Internet whatsoever.

When it comes to your association—and maybe this is more a question for Mr. Kelly—what steps can we take to have better access to broadband in regions? In particular, there seems to be reticence on the part of telephone companies to actually start supplying broadband in a lot of our regions in Canada. There's a bit of an entrepreneurial spirit, where some people are now setting up microwave services that seem to be more accessible.

Do you have any input, any ideas, on that front? Are any of your members thinking of moving forward with setting up a different kind of infrastructure so that we can bypass the larger telcos, or are we really stuck with having to go with the telcos and their timetables, which seem to be glacial?

**Mr. Jason Kee:** My answer to that is very brief. Is it just about a coherent approach? No. It's something that we strongly encourage and support, and we support the development of plans to assist with that.

To be honest, I think first and foremost we need to start thinking about a coherent digital strategy that encompasses access to rural broadband in particular as a key element of the strategy. It's part and parcel of that.

Certainly, I have to give credit where credit is due. The Government of Canada has taken steps to provide funding specifically for rural broadband initiatives, but it's one piece of a much larger puzzle that we need to start working on.

•(1655)

**Mr. Dan Kelly:** I'm afraid I don't have any easier answers than that.

I do know that a variety of provinces are at the table as well, and that they are trying to do something similar to what the federal government has done to incent this kind of development. Almost 40% of our members say that they're not happy with the degree of competitive options they have for the provision of Internet across Canada, and that is pretty bad.

There is no question that you are quite right. This is an absolute impediment to the adoption of e-commerce in a more rural setting. I'm hoping that there will be some entrepreneurs and technology changes that will allow this to happen. I don't have any easy answers for how to get us there.

**Mr. Philip Toone:** All right.

**The Chair:** We've run out of time, Mr. Toone, but I noticed Mr. Cohn wants to make a comment.

I'll give you a few seconds, if you can do it very briefly.

**Mr. Sorin Cohn:** On broadband, it is the mission of i-Canada to work with all communities—urban and rural—to help them take advantage of broadband availability.

At last week's i-Canada conference in Windsor, Ontario, we heard from a guest speaker, Suvi Lindén, who is the Minister of Communications in Finland. In Finland they made access to broadband a fundamental right. It's the first country in the world to do that, because they realize that access to broadband is absolutely critical for the competitiveness of their entire country.

**The Chair:** Thank you, Mr. Cohn.

We're now on to Mr. Lake for five minutes.

**Mr. Mike Lake:** Thank you, Mr. Chair.

I'm going to direct my questions to Mr. Kee.

We spend a lot of time in a committee like this studying what's wrong and what we need to do better—and rightfully so. But I think we could learn something from where we're doing things correctly. Clearly, the entertainment software industry in Canada is a world leader.

What can we learn from the entertainment software industry as we're moving forward? Why is it a world leader? And along the line of what we can maybe do better, what are the risks you see to that?

**Mr. Jason Kee:** Certainly, it's a great question.

I would say that first and foremost, the entertainment software industry is a great example of a domestic Canadian industry that has always been global in view and scope. We haven't been focused on developing content for our domestic market, but have always been looking at the United States, Europe, and Asia as marketplaces. Because this has been pretty much baked into the industry from the get-go, it's made it a lot easier for us to transition to global marketplaces. The world has become a lot smaller in the past 10 to 15 years, and we've certainly been in a good position to capitalize on that.

In a similar vein, our industry would not exist—at least not in the way it does today—without foreign direct investment. Essentially, our industry has been built on the investments made by companies like Electronic Arts from the United States or Ubisoft from France, which have poured millions of dollars into the studios here that employ thousands of people in these high-paying jobs and develop world-class content that is distributed throughout the world.

These investments in turn led to the formation of studios. People would go off and form their own independent studios and be their own independent Canadian businesses, which has really built the entire ecosystem that we see today. It's one of the reasons among many that we actually see the clustering effect. It's also because you do have these investments that were made, and you have a kind of acorn—it's like a tree that grows and spreads out from those initial investments.

I think it's a valuable lesson to be learned and there's actually a lot to be said about it, especially when you're investing in the creation of a studio or a permanent firm. Again, there is no risk of Ubisoft picking everyone in Ubisoft Montreal and then shipping them back to France. No one is going to go; they're all Canadians and they work at a Canadian company.

As a result, we've actually seen a significant development because of that kind of investment.

**Mr. Mike Lake:** One of the things you mentioned earlier in your opening statement and the last time you were here is the digital locks. Your organization is among the biggest proponents of digital locks. You touched on it a little.

What's the risk of not having those? Maybe you can give an example of the risk to one of your creators of not having digital lock provisions in the Copyright Act.

**Mr. Jason Kee:** What we have is a wide variety of digital distribution models. I touched on this when we were discussing the different kinds of mobile platforms. Some are open, so it's whatever you want, and some are closed. Closed platforms rely on digital locks to function. With digital locks, what we often refer to as access controls also stipulate the conditions under which one can access the content.

These enable the variety we see in digital models. Without digital locks, you live in a binary world of all or nothing. You don't have the content, because no one's willing to offer it. Or you have full access to the content and you can post it online and do whatever you want with it willy-nilly. This means that as a developer of these games, you have to build that into your business model. Every single unit that's being sold has to be price adjusted for every single unit being sold out there. As a consequence, without them you're not going to be able to offer a differentiated model.

With digital locks, you can. With digital locks, you can offer a trial, for example, where someone has temporary access to your game, or access to certain levels of the game. They can try before they buy and then decide for themselves whether or not they want to purchase the game. They protect the content in digital distribution platforms like Xbox LIVE. If you didn't have digital locks, anyone could download the game from the Internet, put it onto their Xbox, and they wouldn't have to pay for it. With the digital locks in place on the Xbox or PlayStation, you find out that if you put that game in your console, it will recognize that it's a pirated game and won't let you play it.

TPMs, the digital locks, are critical to the content development of the digital economy and the e-commerce market. The reason they need to be legally protected is that they can be circumvented; they can be broken. When they're broken, it breaks the model. Without their being legally protected, anyone can go and circumvent the model, circumvent the lock that has been placed on the content, do whatever they want with it, and then make it available. That's the major problem we see.

● (1700)

**The Chair:** Thank you, Mr. Kee.

Mr. Cohn, we can let you go graciously now. We thank you for your participation here.

Now we'll move on to the third round and Mr. Braid.

**Mr. Peter Braid:** Thank you, and my thanks to our remaining witnesses.

Mr. Kelly, you mentioned earlier that you found the credit card code of conduct to be particularly effective. You also described it as a living, growing document. Let's pretend there's a crystal ball in front of you. How do you think the code of conduct should evolve over the next two to three years?

**Mr. Dan Kelly:** There are a few things we have publicly asked Minister Flaherty for. One is to ensure that the issues under review by the Competition Bureau are codified. The Competition Bureau is asking to allow firms to refuse to accept certain cards if they don't like the price. It will also allow them to surcharge for accepting a credit card.

These are powers that would be seldom used by small business. But they would be important in pushing back against the tidal wave of fees that small and medium-sized firms have experienced over the last couple of years. These are powers that the Competition Bureau has said are anti-competitive on the part of VISA and MasterCard, and it is taking them to the Competition Tribunal on that. We're asking for those to be codified. We're also asking for some better dispute settlement processes in the code.

As to the whole e-commerce field, though, the code doesn't speak terribly loudly about mobile technologies. I think we need some additional provisions to ensure that we can offer mobile technologies compliant with the code. There are easy ways to make that happen. We're not suggesting for a second that anyone needs to carry multiple cellphones to be able to make different types of mobile payments. These things can happen. Our concern was about the attempts of VISA and MasterCard to piggyback on Interac's debit card network across Canada, to use it to expand their marketplace.

The most important provision is that VISA and MasterCard need to go out there, as PayPal has done, and try to convince individual merchants and consumers of the benefits of their model. If that's happening, we're happy. But under the earlier VISA and MasterCard proposals on debit, even with online debit, as happened with VISA and CIBC, there were some provisions that didn't allow that to happen.

● (1705)

**Mr. Peter Braid:** Thank you very much.

Mr. Kee, I have a couple of questions for you.

You mentioned that as part of the entertainment software industry, there's very much a digital distribution model now. I think I know what that is, but could you briefly describe what the digital distribution model is and how it works?

**Mr. Jason Kee:** Certainly, and it's actually a very complex question.

The key way that it works is that instead of actually taking your game and basically printing it onto plastic discs that you then give to retailers, so that you are basically putting them into a box and selling them, the game is instead distributed by some kind of centralized platform. In the case of a video game console, it's because Xbox has a platform called Xbox LIVE that you can use to download games. PlayStation has the PlayStation Network for the same thing. For mobile devices, it would be something like the App World for RIM, the App Store for Apple, or there's also a wide variety of open platforms that are available on the web. You can download games or play games online through the web.

**Mr. Peter Braid:** Great. Thank you.

Applying our current study of e-commerce to that, does the e-commerce platform, if you will, work well for your industry? Are there any friction points? Are there opportunities for improvement, because, again, as you've pointed out, this is very much a globalized industry.

**Mr. Jason Kee:** By and large, it actually works fairly well. One of the reasons that it works fairly well for us is that payment providers like PayPal, and for Apple for its App Store, and RIM for its App World, frankly, make it work a lot more easily for us. To their credit, especially Apple and RIM, they changed the entire mobile gaming sector because they developed a model where they basically said, "Give us your content, and we'll distribute it for you, we'll do a 70/30 split where you get 70% and we'll get 30%, and we'll take care of all the transactions and all the back-end". That was a huge change for us. As a consequence, it revolutionized the industry and made the markets much more accessible to small and independent gaming developers, the shops of one to five people, that wouldn't before have been able to afford the investment of \$10 million to \$15 million to make a game, but who can now actually afford to make a game for the Blackberry for, say, \$15,000, \$20,000, \$50,000.

**The Chair:** Thank you, Mr. Kee. I'm sorry, that's all the time we have there.

Now to Mr. Thibeault for five minutes.

**Mr. Glenn Thibeault:** Thank you, Chair. I'm also splitting my time with Mr. Caron.

Very quickly then, Mr. Kelly, we've been talking a lot about merchant fees and everything else, but this is not just coming, it's here. Let's be clear, e-commerce is here. Mobile payments are here.

What are the obstacles out there facing the small and medium-sized businesses, and is there anything we can do at this committee, at the government level, to ensure that we're helping Canadian small businesses prosper in e-commerce?

**Mr. Dan Kelly:** To the second part of that, we need to ensure that the payments task force reports quickly, and that any provisions related to mobile technologies are embedded in the code of conduct quickly. Those would be helpful measures, from our perspective. Ensuring that the game is not entirely a Visa or MasterCard game would also be very helpful, from our perspective.

The reason we've not been excited about the idea of regulating fees is that there are all sorts of unintended consequences that happen when you regulate fees. We've seen that happen in the U.S. where they regulated debit, and for many small merchants their fees

actually went up, as opposed to down. The code is really the solution to that. There are fairly easy ways of making that happen to allow mobile payments, without necessarily getting to the glue of a fee palooza that took place on the in-store side.

**Mr. Glenn Thibeault:** Thanks.

Mr. Caron.

[Translation]

**Mr. Guy Caron:** Thank you very much.

I'd like to go back to the phishing issue. Mr. MacMullin, you gave a lot of answers, but they were mainly about what you were doing to deal with the problem. I'd like to have some more quantifiable points regarding the barrier that can represent.

[English]

How much of a problem is phishing at this point? How far are you in terms of consumer confidence in solving the problem to the point at which consumers who haven't adopted, say, PayPal or online banking services, are convinced that the problem has been solved?

**Mr. Darrell MacMullin:** I think fraud is never 100% solved; it's continually evolving. It doesn't matter if you are creating new technologies or new forms of payment, there is always going to be some sort of an arms race. As soon as you think you've solved it, there's something else that's new. We've prided ourselves as a technology in being ahead of that curve, particularly for both merchants and consumers.

When we look at the number of instances that have happened, in particular with PayPal, they are down dramatically. I don't have the numbers off the top of my head, but I'd be happy to give you a written answer afterwards on what our stats have shown over the last several years.

Part of that is our building up better ways of identifying these frauds. But we're also working with other technology providers. With email distributors like Hotmail and Gmail, browser technology has improved to be able to identify what are true digital signatures, digital certificates within e-mails and websites. So if you click on an email that takes you to a website that looks like PayPal or looks like your bank, it's not only PayPal that's protecting you but also other technologies, such as browsers and the like, are helping there.

•(1710)

**Mr. Guy Caron:** I guess my question is more a question of perception. You're making efforts, obviously, to clamp down on fraud, but do you feel these efforts are recognized by consumers to the point where they might actually join or adopt a system of payment, like yours or like online banking, that they wouldn't previously have used? Do they have a perception that the problem is being addressed?

**Mr. Darrell MacMullin:** I'll go back to my comment in my opening remarks: we're still growing at three times the rate of e-commerce in this market. Canadians are transacting on PayPal once every second, and once every minute through mobile phones already, so they're typically already trying new technologies and are using them with PayPal because they're trusting us at that level.

Could it be better? Sure. We're always looking for ways to improve, always knowing that it's an evolutionary process. You always have to keep your eye out for what's next.

**Mr. Guy Caron:** As for the increase in that market share you're talking about, is it more because people are using it more often or because you have a broader—

**Mr. Darrell MacMullin:** Great question. It's actually both.

More and more merchants are accepting PayPal as a form of payment. Consumers are adopting us in more ways. If you had thought, years ago, that eBay might have been the only place to use it, now you would see its use in more and more places.

We're helping more businesses start up and they're using PayPal as perhaps one of their only ways of accepting payment, because they haven't figured out how to set up a merchant account yet, or because they are often declined merchant accounts due to their having no history yet, if they're just starting up. It's a very cost-prohibitive way for the acquiring side to service those small merchants, because they don't want to take on that risk, as well as for the merchants to bear any of the costs that get associated with a merchant account.

So we're enabling a lot of the startup community to actually get going a lot more effectively.

**The Chair:** *Merci, Monsieur MacMullin et Monsieur Caron.*

Now on to Mr. Carmichael for five minutes.

**Mr. John Carmichael:** Thank you, Mr. Chair.

Mr. Kelly, maybe we can go back to where we finished off, and I'll add to my initial question a little bit.

We talked about the trends and about the fees, and I think the merchants are becoming more and more accustomed to the fee structures. Do you see any trends that are evolving there?

In addition to that, you talked about codifying some of the credit card fees and the structure. As we wrap up our study and come to the end of that journey, I wonder if you have any recommendations you might leave for us, working on the other side with the reduction of red tape, etc. What are your thoughts on this whole area?

**Mr. Dan Kelly:** Terrific. Thank you.

On the first part of the question, with respect to the merchant fees, there are a couple of conflicting trends. One is that the only major change in credit card fees, after the adoption of the code of conduct, was MasterCard's issuance of even higher merchant fees with its new MasterCard World and World Elite credit cards that are even more costly for our members. They're approaching the 3% mark, the upper end of PayPal's segment. So that has been an unfortunate trend on the part of MasterCard.

There was a positive trend too. After urging both Visa and MasterCard to give us the list of the types of all of their different card

categories and the rates associated with each of those card categories, CIBC actually voluntarily lowered one of its credit cards, the one that can flip from low-cost to higher cost. They actually voluntarily lowered it to the lowest level of interchange, a move on their part that we appreciated. That was a positive development that came out of the disclosure provisions that were built in to the code of conduct itself.

So there are some conflicting trends on the credit card side. MasterCard is also looking at some other major changes, which we're waiting for anxiously, that may have some positive or potentially not-so-positive impacts on our membership. So that's something we're waiting for—another shoe to drop.

On the regulatory side, the one area I would urge you to explore, which I mentioned briefly before, is that of regulations on IT professionals. Our other presenter, Mr. Cohn, talked about the collaborative nature of a lot of IT enterprises, where self-employed individuals are working across many different spectrums with many different partners on projects, and sometimes internationally. The regulatory setup in Canada, particularly the CRA setup in Canada, just doesn't know how to recognize that at all. It is still caught in this negative spiral where somebody's either an employee or they're an employer; but there are all sorts of enterprises now that are just different from that.

We need to make sure that those businesses are treated legitimately; they are legitimate businesses. They may, for two years as an IT professional, work on one project specifically, yet down the road are then deemed to be an employee and back payroll tax are then assessed on the contracting employer. These are the kinds of things that are just not recognized. There were some earlier recommendations made by either this committee or another that they have access to things like the small business deduction, etc.

So there are some simple regulatory steps that need to be made, particularly with respect to the tax treatment by the CRA, that we think would help a lot of IT professionals who are in this industry succeed.

● (1715)

**Mr. John Carmichael:** Thank you.

Mr. Kee, you talked about malware and some of the hurdles that you face in your industry. Security is a concern of mine, obviously, with privacy, etc. I wonder if you could talk to some of the deficiencies on the security side and what we might be aware of in that area, particularly for privacy of information.

**Mr. Jason Kee:** Certainly there are always challenges, and over the course of the past year there have certainly been some fairly high profile data breaches. The highest structured profile was Sony, who runs the PlayStation Network, which basically had been hacked. Someone broke in and apparently made off with some information. From all indications, luckily no financial information was made available. We haven't seen any negative consequences in that respect, but it's still a problem. Also, the Privacy Commissioner of Canada indicated that she was quite satisfied with Sony's response—but still, it was a major breach.

These things are seemingly occurring on a fairly regular basis. In order for us to facilitate electronic commerce, it is critical—I cannot overstate this—that the element of trust exist. I think Darrell talked about this. Without trust, e-commerce doesn't work. Without trust, no one is ever going to give their credit card information and no one is ever going to give their personal information. We have to build this regime of trust. That is done largely by building mechanisms like PayPal that have an established track record, that are themselves trustworthy, and that also operate very quickly to root out, identify, and squelch basic issues of breaches, violations of trust, or the abuses that occur.

**The Chair:** Thank you, Mr. Kee. Sorry, but we're over time again. I always need to be the referee here.

Now on to Mr. Andrews for five minutes.

**Mr. Scott Andrews (Avalon, Lib.):** Thank you very much, Chair. It's a pleasure to be back at your committee again. My apologies for being late. Sometimes coming from rural Canada, the transportation network doesn't work as efficiently—

**Some hon. members:** Oh, oh!

**Mr. Scott Andrews:** —as it does here in central Canada. That is a prelude to what I'm going to ask.

One of my colleagues, Mr. Toone, was talking about rural Canada.

Mr. Kee, you gave kudos to the government for expanding into rural Canada. We haven't seen any real move into rural Canada in about the last three years when it comes to broadband. We did it in the late 1990s and early 2000, but it petered out. We still have about 23% to 25% of rural Canada not accessing broadband. We want to see what your suggestions are for rural broadband to penetrate rural Canada.

I have the same line of questioning for Mr. Kelly, about small and medium-sized businesses in rural Canada. We have some examples of where there are success stories, but I know there is also a big hurdle to get into rural Canada because the broadband isn't there. Dial-up just doesn't cut it.

Mr. Kee and Mr. Kelly.

**Mr. Jason Kee:** As we alluded to before, offering concrete suggestions is challenging. Also, at the end of the day, we represent video game makers, and while we encourage and basically urge the deployment of broadband into rural areas, the specific means of doing that is something that, frankly, we tend to defer to those who are actually in the industry.

Our general philosophical stance is that the best way to overcome the inherent challenges of dealing with wide geography is to basically try to incentivize entrepreneurs to deploy. Satellite is one way where you can actually cover a fairly broad area. Satellite is not necessarily going to be as good as wireline technology, but I think the sheer expense of deploying wireline technology to some geographical areas is not economically feasible. It's to essentially somehow incent and encourage that kind of behaviour on behalf of small and medium-sized companies.

• (1720)

**Mr. Dan Kelly:** Since your colleague asked that question, I haven't come up with any brilliant solutions to that either. This is a challenge, no question, and hopefully technologies will advance to bypass some of this in the near future. We're not there yet, but there's no question you're right. This is imposing challenges on a lot of our members in a lot of rural communities in taking advantage of the opportunities this presents. Do I have a solution for you to offer today? I'm afraid I don't.

**Mr. Scott Andrews:** That leads to my next question, which goes to what Mr. MacMullin said when he talked about mobile infrastructure. The same problems are out there in a lot of rural parts of Canada. The infrastructure is just not there. The service is not at that level. I know Mr. Kee just talked about satellite technology. I see broadband and wireless as one and the same thing when it comes to rural Canada and some of the problems involved. Is it really holding us back in rural areas that we don't have access?

The second part of that question is about your experience in dealing with mobile companies. Too often we've seen the companies coming to the bigger areas to carve up that market. No one really looks at the outer fringes of rural Canada, because there's the cost and they need incentives to get into those areas. What are your comments on that?

And then you guys can hop in on that same issue on the wireless infrastructure.

**Mr. Darrell MacMullin:** We can talk about mobile for hours.

It is a bit of a catch-all phrase, though. I alluded earlier to one of the approaches that PayPal is taking toward mobile. We are making ourselves ubiquitous from that standpoint, so we're not reliant on a particular handset or a particular network. We may not be relying on the handset at all.

One of the things we've focused on is how we can take advantage of and leverage existing infrastructure and be able to use it in a whole new way. You used the example of how we can link and verify your mobile phone number with a PIN to your PayPal account. Now you can use an existing point of sale terminal, enter your phone number and a PIN, and pay with PayPal that way. You're not using your mobile phone, but you're using your mobile phone credentials and your PayPal credentials to facilitate a payment on an existing point of sale network.

That's another way for a merchant to be able to enable a mobile payment or a PayPal payment without having to worry about incremental infrastructure costs. The approach we're taking is not necessarily...because a lot of companies are saying we're going to make a wallet related to NFC, meaning that merchants would have to create NFC terminals, and then you'd have to rely on a network and a handset that has those capabilities. That's limiting in a lot of ways, both for consumers and merchants.

We're taking more than one approach and are trying to tackle it in quite a few different ways to make it much more effective for merchants to compete and keep up with the pace of innovation.

**The Chair:** Thank you very much, Mr. MacMullin, and Mr. Andrews.

We have about six minutes left, and with the indulgence of the committee, I want to ask one question to clear up some testimony about the cost to merchants for payments.

Mr. MacMullin, you mentioned that someone can sign up for a PayPal account.... I'm taking that as meaning that a customer can sign up for a PayPal account and do that at no cost. What does it cost a merchant to sign up for a PayPal account?

**Mr. Darrell MacMullin:** The same thing.

When a customer sets up a PayPal account, you can both buy and sell with that account. You can set it up in your business name or in a person's name so that it has a few different features to it, but from a cost standpoint, there is no cost difference. It is free to set up a PayPal account.

**The Chair:** All right. What other capital costs does a vendor incur to begin to use a PayPal account?

**Mr. Darrell MacMullin:** When you have your PayPal account essentially set up, when you're setting up your e-commerce website, you need some sort of a storefront, and that is not necessarily provided by PayPal.

We do have some capability there with one of our main products, Website Payments Standard. You could be a journalist, for instance, with a blog and you have a book that you just want to sell on your blog. You have one item. You don't need an entire e-commerce storefront and shopping cart technology, but just a button that says "pay now". You want it to be branded so that people are confident that even though you're a journalist with a blog, they can make the payment to you and feel comfortable and confident in making that payment.

In that instance, we're not charging you for that ability to make any sort of a payment. We don't charge any incremental costs for any of our technologies.

• (1725)

**The Chair:** In response to earlier questions, Mr. Kelly, you were saying that the costs for PayPal and some credit cards were similar, in the sense of being a percentage per transaction when you get to the higher cards, but that there's really no capital investment. One of the things for your members is that there is no capital investment required, as there has been with the credit card companies, in the sense that when a new technology comes out, your members don't have to invest in the infrastructure to execute that technology. Correct?

**Mr. Dan Kelly:** Yes, but there are many capital hurdles for small businesses to get into lots of games.

I don't want to overplay the difficulty for small businesses to get into making electronic payments. Many quality acquirers out there provide that kind of service to small businesses right now. Most of this equipment is rented. If you're buying this kind of stuff,

especially for an in-store capacity, you're fooling yourself. Lots of our members have been creamed by doing that.

For an in-store capacity, and now for some of the e-commerce capacities that are offered, it's not that bad on the capital front. The big ticket is the per-transaction costs, and that's where PayPal will look very expensive to some, if your business accepts a lot of Visa cards or regular MasterCard. If you're accepting a lot of premium credit cards, a lot of American Express cards, then the math starts to change for that.

Again, I think there are lots of impediments. I'm not suggesting for a second that there isn't an impediment to setting up an electronic payments network in Canada—and for brand new firms that don't have any track record yet, that can be a challenge. For the majority of our members, smaller and medium-sized businesses that are making this transition, this would not be particularly capital intensive.

**The Chair:** Thank you.

We have about two minutes left.

Are there any answers you wanted to finish off before we adjourn?

**Mr. Darrell MacMullin:** Just to elaborate on that point, when we look at the transaction cost, there is the per-transaction cost, but there are also other costs associated with transactions. For instance, if you refund a transaction, are the fees refunded? Often acquirers don't refund the fees. PayPal does refund the fees.

Probably one of the biggest issues, and also one reason that a lot of larger retailers like PayPal as well, is that if our fraud rates are at least half that, they can lower their fraud costs. So at the end of the month, when you look at your costs, between credit card processing, any other monthly fees, and fraud losses, for your full end-to-end costs against your sales, there are significant savings beyond just the per-transaction fee.

Whatever your rate is, I think is a little bit of window dressing, if you don't know the variable costs of which basic cards and premium cards and how many cards you're actually going to process. The reality is that most credit cards in Canada have some sort of premium loyalty linked to them. I don't know the exact distribution—

**A voice:** It's about a third.

**Mr. Darrell MacMullin:** Is it about a third? Okay.

That's of sales volume.

It's one of those things we're trying to make as simple as possible for customers to understand so they can build their business.

**The Chair:** Mr. Kelly.

**Mr. Dan Kelly:** There is one other quick point that government can do something about.

Obviously collection of provincial sales taxes is not your jurisdiction, but every merchant in Canada pays a merchant fee to Visa, MasterCard, and the banks for collecting the HST. That's something you can do something about.

**The Chair:** It's 5:30 now, according to my BlackBerry. It's time for us to adjourn.

On behalf of the committee, I want to thank all the witnesses very much for your testimony.

The meeting is adjourned.

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