

# The Need for Self Regulation and Alternative Dispute Resolution to Moderate Consumer Perceptions of Perceived Risk with Internet Gambling

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## Abstract

The legislative gaps in international eCommerce and specifically in the gambling industry mean that many consumers face the market condition of caveat emptor (let the buyer beware). In terms of consumer psychology, caveat emptor increases consumer perceptions of risk and slows the diffusion of Internet gambling. This paper discusses the specific risks associated with Internet gambling and presents an industry structure designed to off-set consumer perceptions of perceived risk through industry self regulation and alternative dispute management techniques.

Keywords: Internet, risk, dispute resolution, self-regulation, gambling

## Risk and Internet Gambling

The potential risks consumers face when making financial transactions on the Internet are widespread. Lansing and Hubbard (2003) note that the U. S. Federal Trade Commission received over 10,700 complaints in 1999, and that even the most reputable websites (e.g. eBay, Sotheby's, Amazon) have been rocked by scandals that have affected consumers. More recently, a report in *Marketing Matters* claims the Internet Crime Complaint Centre received 207,449 complaints in 2004 (a 66.6% increase over 2003) and that the total monetary loss from fraud cases was \$68.14 million (American Marketing Association, 2005). The National Consumers League, (2006) Internet fraud website reports the number of complaints they received increased from 10,794 in 2004 to 12,315 in 2005, with lotteries/lottery clubs ranked fifth on the top scam category.

The organic structure of the Internet gambling industry makes it difficult to estimate levels of complaint in the industry. Data specific to complaints with Internet gambling come from the self proclaimed "independent standards authority for the online gaming industry called E-Commerce and Online Gaming Regulation and Assurances (e-cogra) which reports receiving a total of 439 complaints for 2005 and of those only 10% of complaints turned out to be valid complaints demanding redress. In addition, the Interactive Gaming Council, an industry body of Internet gambling providers which are licensed to operate from a jurisdiction (or defined political boundary), reports receiving approximately 1000 complaints since 2001 (Smith and Catania 2005).

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Although the Internet gambling industry produces data suggesting strong growth from inception to predicted turnover of almost \$12 billion in 2005 (e.g., *Christiansen Capital Advisors, 2006*), the industry's market penetration remains low and its diffusion slow relative to other forms of gambling. For example, in the U. S. there are an estimated six million Internet gamblers (*Christiansen Capital Advisors, LLC & River City 2005*) out of a resident U. S. population aged over eighteen years of over 220 million people (or 2.7% market penetration). By comparison, the American Gaming Association (2005) cites data from Harrah's Casinos that estimate 54.1 million people over 18 years of age left their home to visit a casino in 2004 (25% market penetration). The American Gaming Association also refers to Luntz Research Companies data that 53% of the U. S. adult population played lotteries in 2004. From one of the few studies that examine gambling from inception and over time, it can be seen the diffusion of all lottery products in Florida was far more rapid than the growth experienced by Internet gambling (Mizerski, Miller, Mizerski and Lam, 2004). In Australia Roy Morgan Research (2004) indicates Internet gambling has been growing at approximately .1% to .2% per annum, and market penetration is approximately 1% of people aged 18+ years. This diffusion rate compares poorly with other new forms of gambling introduced since the 1990s and by contrast, an estimated 80+% of Australians report gambling each year. The Internet's slow rate of diffusion and low market penetration occur regardless of the Internet's competitive advantages whereby consumers can choose from a vast number of gambling formats from the comfort of their home and (potentially) better odds due to few brick and mortar overheads and potential tax and compliance advantages.

It has been suggested that U. S. citizens comprise as much as 80% of global Internet gambling, but that the activity is 100% illegal in the U. S. (Payne, 2005). However, these data and the legal status of Internet gambling are contested by some members of the interactive gambling industry, especially those operating with a license from a politically recognised nation. Still, heightened levels of consumer risk resulting from the absence of regulation are manifest through concerns for security, respect for privacy, customer service, timely delivery, full and fair disclosure and responsiveness to complaints (e.g., Coventry, 2000). Cabot (2001) adds that the Internet gambling operators' integrity, possible intentions to defraud and jurisdictional and other legal issues are factors that may adversely influence consumer perceptions of Internet gambling. According to the CEO of London based Sportsbet, regulation of the Internet gambling industry "would eliminate some of the less-than-reputable sites" (Tedesco, 2005).

This paper suggests that the absence of effective consumer laws governing Internet commerce (c.f. Johnson and Post, 1996; Donahey, 2003) heightens perceptions of risk to levels so high as to render the risks unacceptable to many consumers. The absence of high levels of regulation normally associated with gambling and the intangible nature of Internet gambling may exacerbate consumer perceptions of risk with the Internet and make consumers reluctant to trial Internet gambling. As perceived risk is a major behavioural determinant for consumers (Cox and Rich, 1964) and there is an inverse relationship between product trial and perceived risk (Dash, Schiffman and Berenson, 1976), the absence of an effective legal framework protecting consumers increases the risks faced by consumers and seems a likely inhibitor for consumer transactions over the Internet. Indeed, heightened levels of perceived risk have been found to be an inhibitor of consumer transactions over the Internet (Jarvenpaa and Tractinsky, 1999; Pavlou, 2001; Featherman and Pavlou, 2003).

Internet gambling occurs under conditions of caveat emptor (let the buyer beware). It is the seller's problem how to alleviate the risks perceived in his product (Roselius, 1971). Internet gambling will only fulfil its market potential when credible solutions can be found to the consumer issues of: to whom does one turn when something goes wrong, what laws apply and is it practical to seek redress? This paper presents an integrated model of industry self regulation that incorporates constructs of trust and service recovery, and specialised alternative dispute resolution procedures to neutralise actual and perceived consumer risk.

### **Moderating Consumer Perceptions of Perceived Risk with Internet Gambling**

The absence of legal frameworks that specifically permit and regulate Internet gambling in markets such as the U. S. and Australia represents a considerable structural difference compared to terrestrial gambling. In terrestrial gambling the rights of consumers are well defined and the operating conditions of casinos and other gambling providers highly regulated and readily controllable within physical structures. Firms that supply gambling facilities over the Internet are at a competitive disadvantage as consumers have no obvious assurances about the validity of licenses, the honesty of the games played and their rights if there is a disagreement. As reflected in Figure 1, this paper suggests that intentions to gamble on the Internet will improve with a better understanding of consumer risks and the moderating variables of self regulation and alternative dispute resolution.

*Internet gambling occurs under conditions of caveat emptor.*

### **Risk**

The literature suggests that there are several different types of risk associated with consumer behaviour. Cunningham (1967) considered risk had six dimensions: (1) performance, (2) financial, (3) opportunity/time, (4) safety, (5) social, (6) psychological loss, but that all risk ultimately stemmed from performance risk. Featherman and Pavlou (2003) later suggest the addition of (7) Privacy risk be added to the general typology of risk relevant to an online environment. Cunningham's proposition that all risk stemmed from performance risk was empirically tested in an online environment using structural equation modelling by Featherman and Pavlou (2003) and was strongly supported as the antecedent to other forms of risk. It is apparent that the absence of effective legal protocols and recognised avenues by which consumers can take recourse heightens the level of environmental (privacy and financial) and performance (including satisfaction with the product) risk faced by consumers. There is no clear theoretical justification that the Internet can meaningfully influence consumer perceptions of risk associated with opportunity/time, safety, social, or psychological dimensions.

For the purposes of this paper, financial risk represents the opportunity of monetary losses. This is consistent with McCorkle's (1990) definition of financial risk as concern over any financial loss that might be incurred because of the product purchase. Privacy has previously been defined as the ability of the individual to control the terms under which personal information is acquired and used (Westin 1967, cited by Culnan and Armstrong 1999). To be more relevant for research into the Internet, this definition is refined to include the theft of private information or illegal disclosure. The third dimension of risk is performance risk. Jacoby and Kaplan (1972) suggest that concern over whether the product will perform as expected is perceived as performance risk. This paper broadly applies transaction satisfaction (often associated with services) as the measure of performance risk. This is appropriate as the Internet industry for which the conceptual model is constructed is a pure service industry (e.g., Jarvenpaa and Tractinsky 1999).

### **Industry Self Regulation**

The need to create an environment of trust, predictability and certainty that features good arbitration and jurisdiction has been recognised as necessary for e-commerce to flourish (Endeshaw, 1999). Electronic commerce will not realise its full potential unless consumers can be sure that they can resolve their grievances in an expeditious and cost effective manner (Donahey, 2003). This paper suggests a framework of industry self regulation (consisting of accredited service recovery and trust tags) and alternative dispute resolution (ADR) as the means to neutralise perceived consumer risk associated with the Internet as a marketing channel and thereby reduce sizeable barriers to purchase. Industry accreditation is proposed as the marque for minimum standards for firms that operate over the Internet, conceptually replacing a permit or license to trade that may be issued by government in more traditional forms of commerce.

Figure 1 shows trust as one of the two basic components of industry self regulation. A number of studies have confirmed that low levels of trust and satisfaction exist between buyers and sellers on the Internet (e.g. Yoon, 2002; Culnan and Armstrong, 1999). Reichheld and Schefter (2000; 107) go so far as to claim that “price does not rule the web, trust does”. Keen (1999) identified a lack of trust as a major reason why consumers do not purchase over the Internet. Hoffman, Novak and Peralta (1999) suggest that a lack of trust is a barrier to consumer transactions over the Internet and that seller opportunism and concerns about the misuse of Internet infrastructure are causes of low consumer trust. In general, the higher the perception of risk, the higher the trust needed to facilitate a transaction (Jarvenpaa and Tractinsky, 1999; Koller, 1988).

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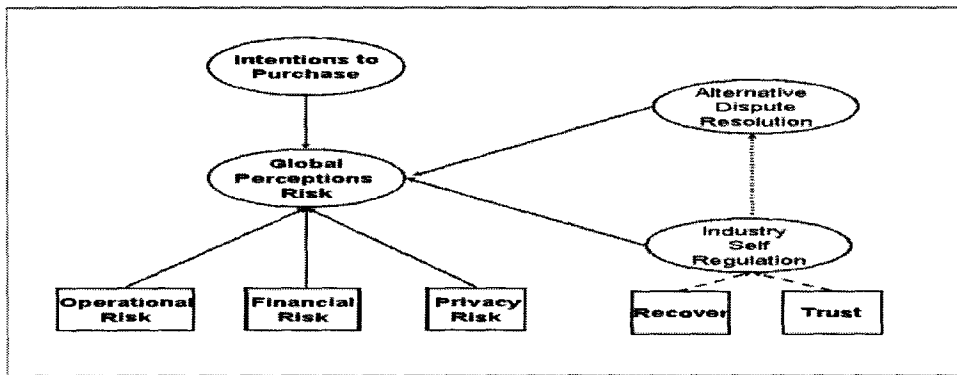


Figure 1: Consumer Risk, Self Regulation and Alternative Dispute Resolution

This paper advocates the development of a trust tag as a component for industry self regulation. In this instance, a trust tag should be a binding agreement by industry members to maintain a minimum standard of service recovery processes, and a formal agreement to utilise specialist alternative dispute resolution (ADR) processes should attempts at service recovery be deficient. While a trust tag may indicate minimum operating standards to consumers, the threat of withdrawal of a trust tag by an industry organisation becomes part of the enforcement tool-kit. The Cyberspace business community has strong self interests in the creation and enforcement of rules for Internet trade (Johnson and Post, 1996). In practice, and areas worthy of further research, strategies are required to deal with “rogue” sites displaying the trust tag when they are not members and the development of efficient marketing campaigns to convey the benefits of the trust tag to consumers.

*A lack of trust is a barrier to consumer transactions over the Internet.*

The second component of industry self regulation is service recovery. The short term commercial rationale of service recovery and defensive marketing schemes can be justified to members as the cost of generating new customers generally exceeds the cost of retaining existing customers (Fornell and Wernerfelt, 1987; Fornell and Westbrook, 1984; Brown, 2000) by as much as five times (Hart, Heskett and Sasser 1990; Keaveney, 1995). A customer’s long term value to the firm is usually higher than the value of the purchase complained about (Fornell and Westbrook, 1984) and customer exit implies a direct loss of revenue (e.g. Fornell and Wernerfelt, 1987). In the general e-commerce environment, Mainspring and Bain & Company (2000, cited in Long and McMellon, 2004) estimate that the average consumer must shop four times at an online store before profits are realised from that customer. There is no publicly available information on the profitability of customers and the need for customer repeat purchase associated with Internet gambling.

A more strategic view of service recovery is espoused for this model. Minimum levels of service recovery are required to build consumer trust and reduce their perceptions of risk, thereby reducing barriers to product trial. Documented and minimum service recovery standards should be required for accreditation to the self-regulating industry body to reinforce the perception that Internet gambling firms and the industry are striving to assist consumers.

*The cornerstone of service recovery is the employment of resources designed to increase consumer voice.*

The cornerstone of service recovery is the employment of resources designed to increase consumer voice. Customers give voice in the expectation of service recovery and to seek redress (Dasu and Rao, 1999). When viewed positively, customer complaints can give an organisation a chance to turn a dissatisfied consumer into a satisfied and loyal customer (Fornell and Wernerfelt, 1987) with even stronger brand loyalty than customers who did not complain (e.g. Hart et al., 1990; Kelley et al., 1993). It has also been shown that effective service recovery can enhance consumer perceptions of satisfaction, purchase intent and positive word of mouth (Maxham, 2001). Other research has identified that satisfaction varies with the level of service recovery effort and likely increases with excellent service recovery practices (McCullough, Hoffman and Berry, 1996; Kelley and Davis, 1994). For online businesses, additional benefits of accepting feedback can include: more knowledge of consumer (i.e., preferences and past behaviour), customer education, the opportunity to prevent further service errors, and the bases for mass customisation of products (Meuter et al., 2000).

#### **Alternative Dispute Resolution**

The active participation of Internet gambling firms in a specialised ADR scheme would be a condition of membership in the peak industry organisation. The basic tenet of a successful ADR scheme is that it should be fair and equitable for all parties. These general principles include: the impartiality of any decision-makers; accessibility of the systems and procedures; the need to ensure that the mechanisms are at low or no cost to the consumer relative to the amount in dispute; transparency, including the importance of providing consumers with clear and conspicuous information about the procedures and commitments involved sufficient to enable informed choice and decision-making; the timeliness of redress (Coventry, 2000).

*Just as technology has facilitated Internet gambling, there is a growing body of research relating to Internet based ADR.*

Just as technology has facilitated Internet gambling, there is a growing body of research relating to Internet based ADR. The benefits of utilizing the Internet for dispute resolutions, particularly for services vended online are considered to be: efficiency, convenience, accessibility and cost-effectiveness (Gordon, 2001). Online methods of ADR could offer consumers a dispute resolution mechanism to install confidence in the transaction of online commerce (Donahay, 2003). Further, it is argued that ADR online can be particularly useful in large multiparty disputes from different countries, and that because all cyberspace communicants are considered equal, the Internet reduces barriers and imbalances between large and small disputants (Gordon, 2001).

The two dominant forms of ADR applicable for the model presented in this paper are mediation and arbitration. Mediation may be compared with arbitration whereby a third party holds a hearing at which time, disputants state their positions on the issues, call their witnesses and offer supporting evidence for their respective positions (Ross and Conlon, 2000). All mediation practices are organised around the idea that the mediator's job is to help the parties tell their story – to help the parties talk (Katsh Rifkin and Gaitenby, 2000). In their study into online dispute resolutions for eBay transactions, Katsh et al. (2000) preferred mediation to arbitration, and a single mediator to a group of mediators as it would be easier to obtain the co-operation of the second party. By contrast, Arbitration is an adjudicatory ADR process that requires the disputing

parties to submit their cases to an independent third party (an arbitrator) for a decision (Lansing and Hubbard, 2002). An arbitrator's decision is usually binding; however rules that require legal enforcement are problematic over the Internet.

### Conclusions

Already some of the components suggested in this paper are starting to be developed. For example, there is some strengthening of industry bodies that may facilitate moves to self regulation over time. An online search of "ADR" reveals a number of different organisations are offering online-ADR services and a number of international bodies are debating the effectiveness of ADR. What is required to accelerate the path to lower levels of consumer risk are industry specific frameworks for the integrated development, management and monitoring of each of the components suggested in this model at an industry level. Each organization within an industry (e.g. online gambling) must also make it a formal and priority objective to shift consumer attitudes towards online commerce.

In the proposed model of industry self regulation, the substantive rules that constitute the core of the social system or the operational intentions of the peak industry organisation should be developed collectively by firms with the express purpose of defining acceptable conduct towards consumers and paths to enforce and reward desirable behavior. It suggests minimum standards will be required for the accreditation of Trust (tags) and Service Recovery processes on individual forms. Remedial rules should be prescribed by the industry group to specify the magnitude and nature of any sanction required should the substantial rules be breached. Both remedial and substantive rules are administered by a regulator or steward charged with independence and operating from within the industry body. The regulator or steward would be empowered to use a combination of formal (e.g., fines, withdrawal of trust marks, cancellation of membership) and informal (e.g., social instruction, education) processes to administer the substantive and remedial rules. The opt-in nature of industry organisations and the contribution firms can make in the creation of remedial and substantive rules (rule agreement) suggest member firms will not be opportunistic in their compliance to codes of conduct and treatment of customers. This implies that the peak body's policing of industry policies will predominantly rely on informal processes (such as communication and education). Informal processes are also consistent with the dependency that peak industry bodies ultimately have to their constituents. However, there will be the need to have and be seen to have "lines in the sand" across which formal rules will be stringently administered in order to build consumer confidence (Donahy, 2003). Under the proposed model, the ultimate sanctions may include the withdrawal of membership accreditation and law suits (including breach of contract in non-compliance of the conditions of the ADR processes). Coventry (2000) suggests that self-regulatory codes of conduct and technologies can be used to gain consumer confidence in electronic commerce.

The model outlined in this paper was guided, and to some extent limited, by the existing literature. There is the need for a new paradigm for Internet gambling, and this may in turn be useful for other industries. The next step in this research is data collection from e-consumers and those yet to consume through the Internet to better understand consumer motivations. Thereafter it will be possible to refine the suggested model to moderate consumer perceptions of risk specific for Internet gambling. Further research into self regulation and the operation of online alternative dispute resolution methods is also warranted.

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