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PayPal: The Next Chapter

The responsibility of corporations has moved beyond simply delivering shareholder profits. The growing expectation from stakeholders is that companies need to take action to affect positive social and environmental impact. Purpose and profit are becoming increasingly intertwined.

— Dan Schulman, President and CEO, PayPal

PayPal, founded in December 1998, was one of the earliest Internet payment companies, enabling money to be transferred securely between and among people and businesses online. In February 2002, the company went public and eight months later it was acquired by eBay for $1.4 billion. After 12 years as an eBay subsidiary, PayPal was spun off as an independently traded company in July 2015 with a new management team, led by Dan Schulman as President and CEO.

By 2015, digital financial services for consumers (known as fintech) had become a highly competitive industry. In addition to numerous well-funded start-ups, many of the world's largest retailers, banks, credit card companies and Internet titans, such as Google and Apple in the U.S. and Alibaba, Tencent, and Baidu in China, had their own digital payment services. Schulman recognized that PayPal needed a distinctive position to compete effectively. He proposed that the company adopt a social purpose based on "democratizing financial services" by providing fast, secure and inexpensive money management tools to financially underserved consumers and small businesses.

Articulating and consistently acting on this purpose spurred innovation and growth, but also incurred additional costs. PayPal further differentiated itself by embracing the idea of "stakeholder capitalism," investing heavily in initiatives that would create value not only for shareholders, but also for employees, customers, merchants, regulators and communities. By 2020, the strategy appeared to have paid off: Total payment volume reach $936 billion from processing 15 billion payment transactions, or roughly 40 million transactions per day, in 100 currencies across 200 countries. In the five years since its IPO, the number of active user accounts had grown from 170 million to 377 million, the average annual transactions per user had increased from 27.5[1] to 40.9, and total shareholder return exceeded 500%.[2]

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Early in 2020, the world economy faced a profound recession because of the COVID-19 coronavirus pandemic. Hourly workers were among the hardest hit and many small businesses failed. People of color in the U.S. and other marginalized populations around the world faced the most disastrous health and financial consequences, raising public awareness of deeply entrenched racial inequities.

As stores and restaurants shuttered and people quarantined at home, digital commerce expanded dramatically. Compared to 2019, PayPal's 2020 revenue grew 22% to $21.5 billion, gross margin expanded from 23% to 25%, and free cash flow grew 47% to $5 billion. Schulman and his team pondered how much the company's sense of purpose had driven this growth, and how to further expand their competitive edge in the rapidly evolving global market for digital payments. (For financial statements, see **Exhibit 1a** and **Exhibit 1b**; for share price over time, see **Exhibit 2**; for net number of payments and active registered user accounts, see **Exhibit 3a** and **Exhibit 3b**.)

The Digital Payments Ecosystem

Although most consumer and merchant transactions still relied on the use of cash, the shift to digital payments had been growing steadily over the past two decades and accelerated with unexpected speed as a result of the COVID-19 pandemic. PayPal competed in a complex ecosystem that included four types of digital financial services: person-to-person payments, point-of-sale (POS) payments for purchases, international remittances, and lending to consumers and merchants. These transactions could occur online, in-app, via mobile device, or in-store.

Historically, most transactions had been handled by financial institutions such as banks and credit card companies. However, major Internet platforms, retailers, cellphone carriers and fintech start-ups all began to develop their own offerings that were generally less expensive and more convenient than the offerings from financial institutions. These new players recognized that payment services could be a competitive differentiator, increase user engagement, and provide valuable customer data. Past purchases could be used to tailor future recommendations, fine-tune advertising or search results, and adjust pricing or merchandising. Financial data and consumer behavior could also be monetized by selling it to other companies, although PayPal elected not to do so.

In person-to-person transfer, PayPal subsidiary Venmo was by far the largest player in the U.S., although the free service did not generate any revenues for the company.

POS payment systems had originally been designed differently for in-store purchases, online shopping and mobile devices, but all players were moving toward a single omni-channel platform. (See **Exhibit 4** for expanding competition across platforms.) Amazon dominated ecommerce with a 44% market share and the most sophisticated ability to use past purchase data to optimize performance.[3] Each of the major cellphone manufacturers had developed its own payment software or digital wallet: ApplePay, Google Pay, and Samsung Pay.[4] AT&T, T-Mobile, and Verizon joined together in 2010 to develop their own digital POS system, which was discontinued in 2015. In 2019, American Express, Discover, MasterCard and Visa joined together to create a new click-to-pay option for use on vendor websites.[5] Major retailers, such as Walmart and Target, developed their own systems as well. (See **Exhibit 5** for an example of the competitive ecosystem.)

In China, the Internet giants Alibaba and Tencent also offered a full range of digital payment and financial services and, by 2020, each company had more than 1.2 billion active annual users. Although these companies were early in their international expansion, they were able to follow Chinese tourists and workers abroad and were aggressively acquiring hundreds of fintech companies around the world.

By 2020, more than 10% of Alibaba's ecommerce revenue occurred outside China, and Tencent's WeChat had more than 100 million users outside China.

Remittances involved payment sent by immigrants back to their families in their country of origin. The roughly $600 billion market for remittances was dominated by Western Union and MoneyGram with a 15% and 5% market share respectively.[6]

Services such as saving, investing and borrowing proliferated online. Fintech companies had much lower costs than conventional banks with no need for branch offices, reduced regulatory requirements, and the use of automated transactions and algorithms rather than loan officers to assess credit.[7] Annual venture capital investment in fintech had jumped from $1.89 billion in 2010 to $53.3 billion in 2019.[8] Newer fintech and online payment players were growing rapidly: From 2019 to 2020, Shopify revenues increased from $1.6 billion to $2.9 billion and Square grew from $3.7 billion to $9.5 billion.[9] (See **Exhibit 6** for the relative scale of different platforms.)

Underserved Customer Segments

Despite the growth of digital payments, traditional retail banks still dominated the market for financial transactions. Retail banks favored higher-income customers who kept larger cash balances, paid interest on loans, credit cards and mortgages, and utilized a wider range of fee-generating services. Banks served customers in person at retail-branch locations, each of which typically required $20 million in deposits to be profitable. Less affluent branches made up for their costs through higher fees. In 2019, for example, U.S. banks collected more than $11 billion in overdraft fees; just 9% of all customers paid 84% of these fees.[10]

Retail and commercial banks also offered loans to businesses, although lending to small and medium-size enterprises (SMEs) was not very profitable and generally depended on the personal credit rating and guarantee of the business owner. Interest and fees on loans under $25,000 rarely covered the underwriting and processing costs.

Most consumers in developed countries still used retail banks for their financial transactions, although 1.7 billion people, or about 22% of the global population, were considered unbanked.[11,12] One analyst estimated that giving unbanked consumers in developing countries access to traditional financial services could create $100 trillion in financial assets over the next 50 years.[13]

In the U.S., 6.5% of all U.S. households were unbanked and 18.7% were underbanked,[a] representing a potential market of $144 billion.[14] These consumers had widely fluctuating weekly income and little capacity to maintain the minimum bank-account balances needed to avoid fees and service charges.[15] Nearly one-third of U.S. households had less than $400 in savings.[16]

Expensive payday loans[b] and credit-card debt were often the only sources of credit available to those without a home as collateral or a steady and predictable salary. Interest on payday loans averaged 391% annually,[17] typically consuming 36% of the average borrower's gross paycheck, leading to multiple loan extensions and roll-overs. Seventy-five percent of payday loan borrowers took out 11 or

[a] Underbanked consumers had a bank account but still relied on costly financial services outside of the banking system, such as payday loans.

[b] Payday loans were short-term loans with high fees and interest rates, designed to provide the borrower with needed cash until his or her next payday. The borrower incurred new fees every time he or she extended the loan. Source: "Payday Loans," Federal Trade Commission, https://www.consumer.ftc.gov/articles/0097-payday-loans, accessed April 2020.

more payday loans annually.[18] Overall, the working poor in the U.S. spent an estimated $170 billion a year in fees and interest to manage their money.[19]

The unbanked population heavily skewed toward women and people of color, most of whom did not own a home.[20] A history of federally institutionalized residential mortgage lending practices, known as redlining, intentionally restricted people of color from buying homes in neighborhoods populated by white families.[21] Lower rates of homeownership among black families was the biggest contributing factor to the nearly ten-to-one wealth gap between black and white households in the U.S.[22] Lacking home equity, black households had far less borrowing power to invest, start a business, pay for higher education, or recover from temporary financial setbacks.[23]

Although redlining and other forms of explicit racial profiling had become illegal, there was considerable evidence that women and people of color still had less access to financial services and paid more for the services they received.[24] For example, research showed that the minimum opening deposit to establish a bank account was 40% higher in communities with majority black populations when compared to majority white communities.[25] Entrepreneurs of color paid interest rates that were, on average, 32% higher than those paid by their white counterparts.[26] Only 1% of venture capital funding went to black-led businesses. According to a 2016 report, the financial services sector overall was barely servicing over 1.1 million businesses owned by people of color.[27]

In the aftermath of the Great Recession of 2008[28] banks faced new regulations, higher capital requirements, and reduced income. Consequently, many banks closed less profitable branches, especially in lower-income neighborhoods, and raised credit requirements for individuals and small businesses. Small business lending decreased substantially and, by 2020, still had not recovered to pre-2008 levels.

Many fintech companies used online data, from utility bills to social media, to predict the creditworthiness of borrowers, enabling them to grant credit to those who would not otherwise have qualified. While these startups could help equalize financial opportunity, they could also end up preying on consumers who had few alternatives. One observer wrote:

> [F]intech platforms can afford to serve harder-to-reach customers who need small loans—something that traditional banks won't do. But the same data and efficiency . . . can just as easily allow them to be exploited. Predatory lenders can target a larger, often less financially savvy audience, providing easy access to capital that comes with lots of strings attached like hidden fees and high interest rates that lead to a cycle of over-indebtedness.[29]

PayPal History (1998-2015)

In August 1998, hedge fund manager Peter Thiel and Max Levchin founded Confinity, later renamed PayPal, as a company that offered person-to-person money transfers online.[30] At the time, there was little demand but the company found a niche as an easy way for purchasers to pay for items bought on the online auction site eBay.[31] PayPal offered an alternative to small merchants and individual sellers who could neither afford the fees required to use major credit cards for payment[c] nor

[c] Average credit-card processing fees were about 1.95% to 2.00% for Visa, Discover, and MasterCard swipe transactions at retail businesses. At online merchants, and in other transactions lacking the card itself, fees rose to 2.30% to 2.50%. Source: "Average Credit Card Processing Fees," CardFellow.com, April 6, 2020, https://bit.ly/3h92vvN, accessed April 2020.

wait for checks to arrive by mail, as well as to early online buyers who were reluctant to share personal credit card or bank account information with strangers.

In 2000, the competing online-payment company X.com, led by entrepreneur Elon Musk, merged with PayPal. The merged entity began to offer $10 credits that could be used as cash to new users and to those who referred them. With this incentive, eBay sellers began to promote PayPal as their preferred payment mechanism, and the company grew rapidly, leaping from 12,000 accounts to 2.7 million accounts in less than one year.[32]

PayPal's losses increased to $10 million per month, however, and the company was spending as much as $100,000 per day in incentive payments. PayPal did not charge for its services, intending to make money from interest on the funds held in customer accounts. Purchases made with those funds or by automated clearinghouse (ACH) transfers[d] cost PayPal nothing, and PayPal's software automatically defaulted to those no-cost payments. Customers withdrew their funds more quickly than expected, however, and many chose to pay for purchases with credit cards, leaving PayPal to absorb the 1.9% processing fee. PayPal also had to cover the costs of numerous fraudulent transactions. And in 1999, eBay threatened PayPal's major revenue stream by purchasing the competing payment system Billpoint and featuring it as the preferred option on eBay's checkout screen.

By 2000, PayPal had improved its fraud detection software. Unlike other payment processors, PayPal represented both the buyer and seller in the transaction, and was therefore able to further reduce fraud by monitoring the past transactions and creditworthiness of both parties. The company also began to charge merchants $0.25 plus 1.9% of the sale for credit card transactions, bringing the company to profitability.

In 2002, banking regulators in 13 states alleged that PayPal was acting illegally as an unregistered bank, because it had taken deposits for use in paying bills. PayPal argued that it was merely a money transmitter, similar to Western Union. The Federal Deposit Insurance Corporation (FDIC) ruled that PayPal was not a bank as long as customers' money sat in banks outside of PayPal.

A successful IPO followed in February 2002 at $13 per share.[33] eBay transactions then accounted for more than two-thirds of PayPal's revenue.[34] Eight months later, eBay discontinued Billpoint and acquired PayPal in a stock exchange valued at $58 per share.[35]

After the acquisition, PayPal developed a merchant services division to support non-eBay transactions. By 2013, merchant services was generating 70% of PayPal's revenues.[36] The same year, PayPal also acquired online payment processing company Braintree, including its subsidiary, Venmo. By 2019, Venmo was processing $100 billion in transactions annually.[37] PayPal was making efforts to monetize the free service, but had not yet found a way to generate significant revenues.

Activist investor Carl Icahn took a position in eBay stock and pressured eBay's management team to spin off PayPal as an independent public company.[38] In June 2014, Schulman joined PayPal as President and CEO. Schulman had been the founding CEO of Virgin Mobile, before taking charge of mobile and online payments as Executive Vice President at American Express. He also served as Chairman of Symantec. Schulman commented: "What attracted me to PayPal was the opportunity to redefine a company. There was a platform to leverage, unburdened by old baggage, and eager for its next chapter. It was a substantive company at the time, but we needed to have a new vision."

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[d] ACH transfers were electronic money transfers between accounts at different banks. Source: Rebecca Lake, "ACH Transfers: What Are They and How Do They Work?" Investopedia.com, https://bit.ly/3fCabXi, accessed July 2020.

In July 2015, PayPal launched its second IPO at a valuation of $47 billion, considerably larger than eBay's post-transaction valuation of $34 billion. For calendar year 2014, PayPal had $8 billion[39] in revenues with 170 million users, each of whom averaged 24.5[40] transactions per year.

In November 2015, PayPal completed its acquisition of Xoom for $890 million, a remittances service that allowed for the transfer of funds, bill payments and currency conversions in 40 countries.[41]

PayPal: A New Strategy and Purpose

In preparing for the 2015 IPO, Schulman knew that he had to bring a fresh vision to the company. Subscriber growth was slowing, engagement was low, and payment processing was becoming commoditized. PayPal was seen as a dinosaur with antiquated software, unable to attract or retain the right talent. Schulman explained: "I think leaders define reality, inspire hope, and then create the path between those two things. We needed to clearly define why we needed to move into the next chapter."

According to Jonathan Auerbach, PayPal's chief strategy, growth and data officer, two decisions drove the company's post-IPO strategy. First, PayPal broadened its vision beyond online payments. Auerbach observed, "You're never offline anymore. I may be in a physical store, but I'm still online, so we decided that we would have the right to move into the offline environment. And that really changed the way we were thinking about where we had permission to offer services."

The second decision came from analysis of the highly competitive payments ecosystem. Auerbach continued:

> We had approximately a billion credit and debit cards on file—but our economic model led us to steer customers to make payments from their bank accounts instead of using cards because that was where we made the most money. So, the card networks and banks saw PayPal as potentially their largest competitor, and they weren't supportive of PayPal's success. How were we, as an independent company, going to succeed against these huge competitors?

Giving customers free choice to use a credit or debit card would increase PayPal's transaction costs but, Auerbach continued, "We believed that giving customers complete choice in terms of how they wanted to pay would build trust. That decision also enabled us to partner with the credit card networks and banks, saying 'we are no longer your biggest potential enemy. We are now your largest digital channel.'"

By 2017, PayPal had 38 partnership agreements to process payments for retailers, financial institutions, credit card networks, and telecom and technology companies, including MasterCard and Visa, Walmart, Paymentus, and HSBC, representing 75% of all U.S. credit card volume, as well as with Google and Facebook. In 2017, there were almost 40 bank-led marketing campaigns to encourage their customers to use PayPal.[42] PayPal further expanded through "white label" services, offering their technology to be used under their partners' brands. According to Schulman:

> Not many people truly want to move into financial services—it's fast moving, highly regulated, and fully global. It has balance sheet implications, and the fraud potential is enormous if you don't know what you are doing. Most of these businesses want to use financial services to keep people on their platform to monetize in other areas. Our decision to partner rather than compete with these other players unleashed all the energy of that ecosystem to work with us. Five years ago, you would never have imagined banks incentivizing their customers to sign up for PayPal.

On the consumer side, PayPal was searching for an opportunity to offer additional financial services and expand its user base. Auerbach explained:

> We spent a lot of time thinking about competitive advantage, asking, 'What is it that I do that others really don't do as well that makes a difference?' And we realized that, outside of China, we're the largest two-sided network, in the sense that we serve and know both the buyers and the sellers. Our competitive advantage is that we can bring hundreds of millions of buyers and tens of millions of sellers together in whatever context they want to transact safely, securely, and in an increasingly personalized way. And the more buyers I have in our network, the more merchants want to participate. So, it's mutually reinforcing.

Schulman added:

> Having a two-sided network at scale gives you a large competitive moat. We have a group that looks at consumers and a group that looks at merchants and then they look at the intersection together, because that's where the secret sauce is made. No merchant is going to put a checkout button on their site if customers aren't using it. Some of the largest banks tried to come in with their own digital wallets and then shut them down. Scale begets scale. It's hard for a merchant not to have PayPal now because we have almost 350 million consumers who use it. (see **Exhibit 7** for serviesc to the two sided network

In 2018, PayPal began to offer additional financial services for consumers, including direct-deposit options, the ability to deposit a check on a smartphone, a consumer debit card for use at ATMs, and FDIC-insured balances.[43] PayPal provided these services through "a hodgepodge of small banks that stay anonymous and behind the scenes."[44] PayPal did not charge a monthly fee or require a minimum balance.[45] Schulman claimed that PayPal should be able to do things at a cost 80% lower than a traditional bricks-and-mortar financial services institution, enabling the company to serve "millions of people and businesses around the world, including those who have been underserved by the traditional financial system."[46]

At first, some managers doubted that targeting financially underserved customers was a viable strategy. Schulman proposed an exercise: He divided the senior management team into groups of four, and gave each group a $100 check with instructions to do three things: first, cash the check without using a bank account; second, buy a prepaid credit card; and third, transfer $50 to another team member. Cashing the check carried a $6 fee, and the bank had to be able to call the issuer on the phone to confirm the validity of the check. The prepaid card cost $3 and sending the money to another teammate cost $5. A few transactions added up to 14% in fees. The exercise demonstrated that the poorest customers pay the highest fees, and that the transactions had to be made in person at a bank branch, which often required time-consuming travel outside the neighborhood. They also realized that these transactions take a lot of time and are completed in person, and that time costs money. Schulman concluded:

> We saw a huge opportunity. The exercise really got people to buy in. So, we laid out this vision of using technology to 'democratize access to financial services.' How do we allow [consumers] to manage and move their money at low cost, easily, and with the highest security? On the seller side, how do help small businesses compete against large global online merchants? Only 7% of small businesses in the U.S. had international sales, but 77% of those using PayPal sold internationally. It was a really expansive and inclusive vision, and it was exciting because it was tangible and doable. We called it 'PayPal, the Next Chapter.'

In 2019, PayPal expanded its vision further by acquiring Guofubao Information Technologies (GoPay), the first foreign payment platform licensed to provide online payment services in China offering cross-border payment solutions to China's merchants and consumers. According to Schulman:

> Cross-border sales are exploding for us—and shrinking for everyone else—because people trust us. PayPal customers are 57% more likely to complete their purchases when there is a PayPal check-out button because they trust it. We have the data and information to provide protections. If you buy from merchant in China you don't know, we will protect you if you don't get what you need, and we'll protect that merchant as well. Scale, brand trust and scope of services together are what fuel our growth. (See **Exhibit 8** for a comparison of trust levels among financial service companies.)

Embracing Stakeholder Capitalism

In August 2019, the Business Roundtable reversed its position that "corporations exist principally to serve shareholders,"[47] and released a statement, signed by 181 CEOs of major companies, stating that a corporation's purpose is to benefit all stakeholders—customers, employees, suppliers, and communities as well as shareholders.[48] Schulman agreed:

> I actually think that you sub-optimize shareholder value when you place them first, because you make short-term decisions. If you don't attract the right talent, then you don't satisfy customers; you don't satisfy regulators, and then, inevitably, that leads to worse returns. I think capitalism will be a better system if we prioritize multiple stakeholders, and we will be a better society as a result.

John Kunze, senior vice president of global consumer product and technology added:

> We can bring goodness to the world and be profitable on good growth rates to satisfy our shareholders, which is necessary for us to be able to serve all of the other stakeholders. That's why this multi-stakeholder approach is so important. If you [overlook] one stakeholder group, you are making other stakeholders more vulnerable.

At the same time, the needs of each stakeholder group had to be considered separately.

Employees

Competition for employees, especially for top software engineers, was a major concern among tech companies in Silicon Valley. Many leading companies were criticized for an almost entirely white male workforce and leadership team. In addition, employee relations had soured at a number of leading tech companies, leading to unionization efforts at Amazon, employee walkouts at Google, and high rates of turnover throughout the industry.

Schulman considered PayPal's employees as its most important constituency, commenting:

> This idea of managing by mission and values is the most powerful thing we did as a company to be successful because it enabled us to attract the best talent. The vision of democratizing financial services became a beacon to attract employees. They see us live up to our values. Employees consistently choose to join PayPal over offers from other companies. It was the only way to do this turnaround. A great software engineer is, at a minimum, ten times better than an average one. If you don't have great talent, it doesn't matter how good your strategy is.

In 2014, Schulman's very first move was to examine pay equity of his employees by ethnicity in the U.S. and by gender worldwide, and to close the pay gaps that existed. "We're making adjustments all the time. It's more of a compensation philosophy, rather than a big moment in the company calendar," said Louise Pentland, PayPal's chief business affairs and legal officer. Before joining PayPal, Pentland had spent 16 years working for Nokia, then took two years off volunteering with a human rights organization in Texas. "I had been toying with going into a nonprofit until I met Dan, and he convinced me that PayPal could actually leverage much more impact than a nonprofit with the purpose and vision he had in mind," explained Pentland.

The company also set aside five million dollars as an employee emergency relief fund. Pentland gave an example: "One of our best call center employees had her car break down. She couldn't get to work and handed in her resignation. That was our test case. The fund paid $1,500 for a new engine. It was a life-changing moment for her. She said, 'As long as I can work, I want to work for PayPal.'"

In 2019, PayPal conducted a series of financial wellness audits for its thousands of hourly and call center employees. The company found that nearly 60% were struggling to make ends meet, with only 5% to 6% net disposable income after covering essential expenses. In response, the company set a goal for every employee to have at least 20% disposable income. PayPal lowered employee healthcare costs close to zero, reviewed and raised basic wages in the locations where it was most needed, offered stock ownership to every full-time PayPal employee, enhanced benefits, and provided free tools and resources to teach long-term financial planning.[49]

Schulman drove an inclusiveness agenda at every level, intentionally hiring employees with differences in cultural backgrounds, life experiences, appearance, and outlook. "It is foundational to have a diverse team that can drive diversity of thought and accurately reflect your customer base," he said. In 2019, PayPal launched a conscious-inclusion training program for more than 90% of its employees.

Diversity in hiring was a constant challenge in Silicon Valley, however, Pentland noted PayPal had no trouble recruiting women and people of color. "It's not as hard as Silicon Valley would have you believe. Employees are voting with their feet, saying 'I don't want to work for that company because they don't embrace people who look like me or think like me.' Why would you work in a toxic environment? Tone from the top and culture-setting is the antidote." Finding diverse talent had also meant communicating to recruiters that PayPal would not accept the typical pool of white male executives. "Recruiters were given very explicit direction, and yet still brought us the same cast of characters. It wasn't until Dan took them out to the woodshed, to say, 'Look, what is it about what I'm asking you that you are not listening to?' It takes that sort of determination, and it shouldn't. Talent is absolutely out there," Pentland said.

By 2019, the board, which had been one woman and nine white men in 2015, had shifted to four women and one person of color. Gender and racial diversity was 58% for the company as a whole and 52% at the vice president level and above. Forty percent of the vice presidents were women.

Franz Paasche, senior vice president of corporate affairs, added, "We had to create values that were mutually reinforcing with the mission: Our values were inclusion, innovation, collaboration, and wellness. And we had to show that we live those values."

For example, after an eight-month search for a new operations center, the company announced its selection of a site in North Carolina in a press conference with the state governor. Shortly thereafter, North Carolina passed a bill that, among other restrictions, excluded transgender people from using public toilets, and was described by the ACLU as the "most extreme anti-LGBT measure in the country."[50] Schulman immediately cancelled the operations center plans. He explained:

> It was a very easy decision. It had many ramifications, but for me, it was one of our proudest moments, because it really showed that we were going to act on our values. Our employees realized that our values were real, and they still bring that moment up. . . . Many of these issues dress themselves up as political issues, but they are really just about values. There's no room for discrimination. None. We're not going to tolerate it. . . . We got a lot of customer hate letters and I got death threats. Not every employee necessarily agreed with that decision, but every employee respected that decision. This is what PayPal stands for.

Regulators and Law Enforcement

PayPal operated in more than 200 markets around the world, creating tremendous regulatory complexity. "We are not a bank but we are highly regulated, and we take that seriously," said Aaron Karczmer, chief risk officer and executive vice president, risk and platforms. Karczmer joined PayPal after a career at the New York County District Attorney's office responsible for identity theft and cybercrime, followed by building out financial crime and risk management practices for American Express. He viewed regulators as partners, despite the natural tension that came with oversight. Karczmer explained:

> We proactively invest in our relationships with regulators, and seek to build confidence and credibility with them through frequent communication. We don't just deal with regulators when we have to. As our technologies and products evolve, we make sure to take time to share those developments with our regulators.

PayPal expanded its core compliance function well beyond other financial institutions with a financial crime practice of nearly 4,000 professionals led by former law enforcement prosecutors and military intelligence. Armed with sophisticated data analytics, PayPal investigators combed through transaction and social media data to help uncover perpetrators of fraud, illegal firearms sales, human trafficking, child sexual predators, terrorists and other crimes. Karczmer continued:

> We go beyond what is required of us from a regulatory perspective because it is part of our DNA to do good in the world. Dan [Schulman] challenged us to not just help identify bad actors after terrorist events, but to see if we could help law enforcement prevent those events. For example, we successfully undertook an initiative, working closely with law enforcement agencies, to better understand tools and techniques utilized in purchasing and making incendiary devices. We then used that knowledge to identify potential bad actors before they acted. We have helped law enforcement in jurisdictions all over the world—seizing bomb materials and preventing what would have been terrorist attacks. Those cases hit the press, but we weren't recognized—purposefully—because, for us, it's about leveraging our common purpose with government agencies and doing the right thing.

Another area where PayPal dedicated significant resources was to actively block individuals or associations who raised funds to promote hatred or racial intolerance, banning roughly 100 sites a month and uncovering hate-speech groups that tried to conceal their identities. Schulman observed: "It is not easy to distinguish between free speech and hatred. You need to look deeply and understand the code. For example, something that is priced at $14.88—that's the white supremacy, or Nazi code—

14 words of the white supremacy national anthem, and eight is the eighth letter of the alphabet, which is H. So, 88 is HH, which is Heil Hitler."

Although this work required significant investment, Schulman saw this as a source of competitive advantage, building employee pride, increasing trust with regulators and avoiding the hate group controversies that had engulfed Facebook and Twitter.

Consumers

"Our strategy," Kunze observed, "is to have as much empathy as one can have by immersing ourselves in our customers' lives." He continued:

> We have a sort of standard operating procedure for immersing ourselves in a market. We will put our employees in a neighborhood with $20 in cash and ask them to live for a couple days with no phone, credit cards or debit cards. We also interview people in their homes and commute with them to work. When you walk in our customers' shoes, when you sit down at their kitchen tables, you see how they manage their incomes. One person has sticky notes under the glass on her kitchen table reminding her when she needs to pay certain bills. If she forgets one, she enters a punitive debt cycle with that provider. This cohort of customers, which is about two-thirds of all Americans, can't even imagine saving because they are worried about the payments they need to make on the 28th or 29th of the month, while they are waiting for a check.

Schulman believed that understanding and caring about the well-being of customers would drive growth in the number of users and average transactions per user. Becoming part of a user's daily life was essential to maintaining PayPal's competitive advantage as well as to achieving its social purpose. Kunze continued: "Anything we're doing to achieve scale or better engagement with consumers means we have built a better defense against competitors. Middle-income to low-income cohorts are the majority of all markets. All roads to a billion customers lead through these cohorts."

The concern for customers' welfare also drove PayPal's acquisition strategy. For example, in January 2020 PayPal acquired Honey, a free software service that optimized discounts, scouring the internet to find the best deals available and showing them to consumers at checkout to ensure that they received the best price. Honey customers could also manage their payroll through the app, set savings goals and track their progress.

According to Kunze: "Most people don't want to be told how to save. It's very similar to physical fitness where you can tell people to exercise, but most people don't. So, you have to come up with software techniques to motivate customers to take advantage of discounts they wouldn't have known about. The motto of Honey is 'put money back in the pockets of our customers.' We felt like we had found a company that was a long-lost brother to PayPal."

A similar rationale had been behind the earlier acquisition of the remittance company Xoom, where Kunze had been CEO. He explained:

> The remittance industry was egregiously overpriced. A first-generation immigrant typically had to go to a store during business hours, speak through bulletproof glass, fill out a form and pay a 20% fee to send money back to their loved ones so they could live a better life. I know about this because my wife was born in the Philippines and moved to the U.S. as a young girl. I asked my mother-in-law what it meant to have money sent home. She said, 'it means putting chicken on the table.' That became kind of a tagline for

> Xoom—providing sustenance at fair and respectful rates with a service that was better than the incumbent competitors.

Xoom helped lower the cost of international transfers by more than 80% and enabled almost instantaneous global money transfers 24/7/365, using mobile phones for people who were unbanked. Fees on high volume routes, such as U.S. to India, were as low as 1%.

Merchants

A consistent message PayPal heard from its small business merchants was the need for access to capital, especially after the 2008-2009 recession. This led PayPal to create PayPal Working Capital (PPWC) in 2013. A PayPal merchant could obtain a Working Capital loan in less than five minutes without any credit checks or personal guarantees. Because PayPal had visibility into the cash flows in their merchants' PayPal accounts, the company could easily advance loans and collect repayments. Darrell Esch, who joined PayPal after 15 years running small business lending at Bank of America, oversaw the development of PPWC before his promotion to senior vice president and general manager of Venmo. He explained: "We saw a chance to differentiate by being fast, flexible and fair."

PPWC was unlike a normal loan product. Cash was immediately credited to the merchant's PayPal account and then a percentage of future sales were deducted from the daily revenue passing through the account to repay the loan. The merchant could choose the percentage to be deducted from 10% to 30%, and was charged a flat fee for the loan based on the percentage chosen. Having a fixed repayment percentage meant that if the merchant's sales declined, the debt service automatically decreased, extending the time for repayment without any additional cost. This reduced the burden on the borrower during a period of slow sales, unlike a fixed bank loan repayment schedule. PayPal never charged late fees or penalties. If the merchant closed down or left the PayPal system, PayPal had no further recourse to collect the debt.

PayPal's fee equated to an effective interest rate of roughly 25% per annum, similar to credit card debt. According to Esch, merchants preferred the simplicity of knowing that the fee would be a fixed dollar amount, such as $500, instead of having to calculate the effective cost of an annual percentage rate. Esch acknowledged:

> You could probably get a term loan from a bank that is cheaper than PPWC, if you could qualify and if you wanted to spend 33 hours on the application process, which is the average amount of time it takes to apply for a small business loan. But most of our customers wouldn't dream of seeking service from the traditional system because their personal credit score is low, they may have gone through a bankruptcy, or their business is just too small. Our average loan size is $15,000 and given its expenses, no big bank can afford to make loans that small. Our rates may seem high, but there are many fintech and other public companies out there making small business loans at 40-50% interest rates. We want to make a profit, but we also want our merchants to do well. And our merchants love the product. We have lots of repeat business. In my three decades in the financial services industry, this is hands down the most loved product I've ever seen.

A study in the U.S. found that 70% of PPWC loans were made to businesses in low-income areas that had lost 10 or more bank branches since 2008. Compared to SME lending by conventional banks, twice the percentage of loans went to women-owned companies. Although lenders are not legally permitted to track borrowers' race, PayPal estimated that, based on zip code data, a substantially larger proportion of PPWC loans went to businesses owned by people of color than conventional bank loans.

In one study, a sample of businesses that used PPWC registered year-over-year revenue growth of 22%, compared to a control group of non-borrowers that grew only 2%.

The PPWC loan portfolio expanded very quickly. It had taken two years to reach $1 billion in loans, but by 2019 PayPal was lending $1 billion each quarter. PayPal rapidly became one the top five lenders to small businesses in the U.S., cumulatively providing $14.5 billion in more than 860,000 loans to more than 290,000 small businesses.

Responding to COVID-19

The COVID-19 crisis put PayPal's products and services abruptly in the spotlight. As tens of millions of people lost their jobs or were unable to work and governments mandated lockdowns, the ability to move money quickly, inexpensively and without physical contact was of paramount importance to relief efforts. According to Paasche: "We were in a better position to help our employees and the government because our understanding of our employees' financial situation and our depth of experience working with small businesses."

The company promised its employees that there would be no COVID-related layoffs, introduced a crisis relief program, continued to pay those who could not work because they needed to care for dependents, and increased medical coverage for COVID-related care. Employees were surveyed weekly to understand their circumstances and concerns. Employees could also identify "unsung heroes" in their community and up to $50 would be credited to that person's PayPal or Venmo account.

The U.S. government sent millions of financial relief payments to all taxpayers earning less than $75,000, but the processing and time to mail 60 million checks imposed hardship on unemployed workers without savings. PayPal customers could receive their government relief payments more quickly through direct deposit to their PayPal Cash Plus accounts, even if they lacked a bank account. Person-to-person money transfers through PayPal and Venmo also helped alleviate financial distress. The usual Venmo payments related to social events such as splitting the cost of a dinner out declined, however, customers began used Venmo to help each other, raising money for hospital workers or sending tips to their favorite service providers. A "Venmo It Forward" meme emerged to recognize those who were doing good deeds. PayPal also offered a discounted fee for charitable contributions and processed $17 billion in donations during 2020.

The $349 billion first round of the U.S. government's Paycheck Protection Program (PPP), intended to assist businesses in sustaining payroll for their workers, was exhausted within two weeks.[51] PPP Funds were dispersed primarily by banks, who favored large companies and existing clients rather than the small businesses that needed help more urgently. The Small Business Administration had been tasked with distributing funds to smaller companies, but quickly became overwhelmed, receiving as many requests for loans in a single day as they normally processed in a year. When a second round of $310 billion became available,[52] PayPal became one of the first non-bank institutions to provide access to PPP loans. As of July 23, 2020, PayPal had distributed $2.1 billion to 76,000 small businesses with an average loan size of $28,100 and supporting payroll for 308,000 employees.

PayPal also adjusted its own products in response to the crisis. It waived the usual fees to transferring money out of a PayPal business account. PayPal customers could also defer repayment on business loans and cash advances with no additional cost. Although the bricks-and-mortar economy collapsed, ecommerce grew stronger. Many small businesses were forced to shut down, but repayment of PPWC loans, based exclusively on the volume of online sales, continued to perform well. Over 40% of Black-owned businesses were shut down due to COVID-19,[53] however, PayPal found that those using PPWC were equally likely to stay afloat as white-owned businesses with comparable revenues and liquidity.[54]

In response to the heightened awareness of structural racism in the U.S., PayPal committed $530M to support Black businesses including $10 million in grants of up to $10,000 for Black-owned businesses impacted by COVID-19, $5 million in grants to non-profits provide technical assistance to Black-owned businesses, and a $500 million economic opportunity fund that will investment in Black and underrepresented minority businesses, Black- and Latinx-led venture capital funds, and Black-owned financial institutions.

The crisis also served as a source of innovation, helping to accelerate the launch and global roll-out of a new PayPal product that used QR codes to enable touch-free payments at grocery stores. The shift away from cash and in-person transactions accelerated PayPal's growth. From February to December 2020, PayPal's stock price increased from $123 to $234.

According to Paasche:

> In responding to the COVID crisis, we have again taken a stakeholder capitalism approach. We've focused on the wellness and safety our employees first. Then we focused on our customers, which was something our employees were very concerned about. Then we reached out to local governments to ask what we could do to help, as they are our third stakeholder. We have a major platform for charitable donations and we put it to work to support our customers' generosity by raising money for COVID-related efforts. Our employees wanted to help, so we offered a double match for employees who want to give to COVID-related efforts. We have leveraged our core capabilities to fulfill our purpose, which is to try to serve all of our stakeholders.

Looking Ahead

Schulman was immensely proud of PayPal's purpose-driven success, but he had not lost sight of the intensely competitive markets in which the company operated. "Our vision, over the next five years, is to have a billion people on our platform using PayPal every single day. We think that is necessary because scale provides data, and data is how we create great products and solutions."

Yet challenges remained. PayPal was in competition with some of the world's largest and most innovative companies as well as an ever-expanding list of nimble and well-funded start-ups. Payment processing was a commodity service, and PayPal did not control the physical or virtual marketplaces through which its merchants sold their goods and decided which payment options to offer. Amazon continued to displace smaller merchants, and many had failed during the pandemic. PayPal had only a very small presence in China, while the Chinese companies were aggressively expanding globally, especially in emerging markets. None of PayPal's competitors had embraced a social purpose and stakeholder capitalism to the same degree, but was that enough to sustain PayPal's success?

Exhibit 1a PayPal Income Statements, 2018-2020

(In millions, except for per share amounts)	2020	2019	2018
Net revenues	$21,454	$17,772	$15,451
Operating expenses:			
Transaction expense	7,934	6,790	5,581
Transaction and credit losses	1,741	1,380	1,274
Customer support and operations	1,778	1,615	1,407
Sales and marketing	1,861	1,401	1,314
Technology and development	2,642	2,085	1,831
General and administrative	2,070	1,711	1,541
Restructuring and other charges	139	71	309
Total operating expenses	18,165	15,053	13,257
Operating income	3,289	2,719	2,194
Other income (expense), net	1,776	279	182
Income before income taxes	5,065	2,998	2,376
Income tax expense	863	539	319
NET INCOME	**4,202**	**2,459**	**2,057**
Net income per share:			
Basic	3.58	2.09	1.74
Diluted	3.54	2.07	1.71

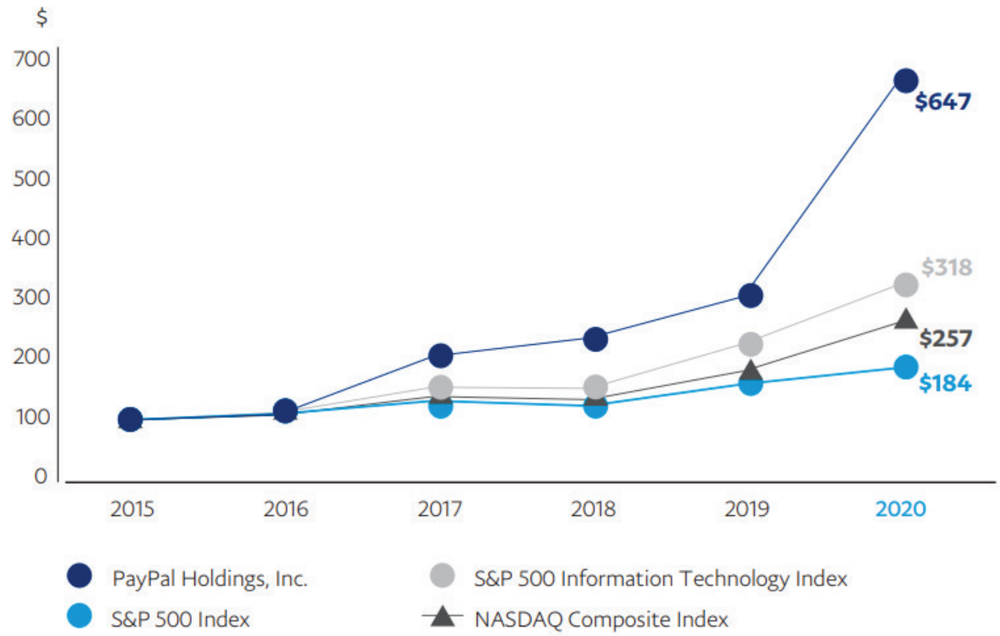
Source: PayPal 2020 Annual Report p. 52.

Exhibit 1b PayPal Balance Sheets, 2019-2020 (U.S. $millions)

(In millions, except par value)	2020	2019
ASSETS		
Current assets:		
Cash and cash equivalents	4,794	7,349
Short-term investments	8,289	3,412
Accounts receivable, net	577	435
Loans and interest receivable, net of allowances of $838 and $258 as of December 31, 2020 and 2019, respectively	2,769	3,972
Funds receivable and customer accounts	33,418	22,527
Prepaid expenses and other current assets	1,148	800
Total current assets	**50,995**	**38,495**
Long-term investments	6,089	2,863
Property and equipment, net	1,807	1,693
Goodwill	9,135	6,212
Intangible assets, net	1,048	778
Other assets	1,305	1,292
TOTAL ASSETS	**70,379**	**51,333**
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	252	232
Funds payable and amounts due to customers	35,418	24,527
Accrued expenses and other current liabilities	2,648	2,087
Income taxes payable	129	73
Total Current Liabilities	**38,447**	**26,919**
Deferred tax liability and other long-term liabilities	2,930	2,520
Long-term debt	8,939	4,965
Total Liabilities	**50,316**	**34,404**
Commitments and contingencies (Note 13)		
Equity:		
Common stock, $0.0001 par value; 4,000 shares authorized; 1,172 and 1,173 shares outstanding as of December 31, 2020 and 2019, respectively		
Preferred stock, $0.0001 par value; 100 shares authorized, unissued	—	—
treasury stock at cost, 117 and 105 shares as of December 31, 2020 and 2019, respectively	-8,507	-6,872
Additional paid-in-capital	16,644	15,588
Retained earnings	12,366	8,342
Accumulated other comprehensive income (loss)	-484	-173
total PayPal Stockholders' equity	20,019	16,885
Noncontrolling interest	44	44
Total Equity	**20,063**	**16,929**
TOTAL LIABILITIES AND EQUITY	**70,379**	**51,333**

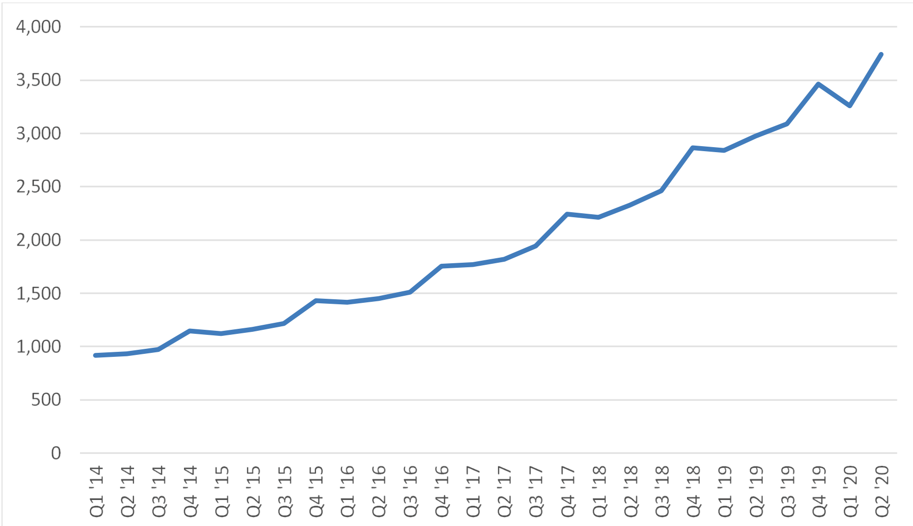
Source: PayPal 202 Annual Report p. 54.

Exhibit 2 Cumulative Total Shareholder Return of $100 for the Period 2015-2020



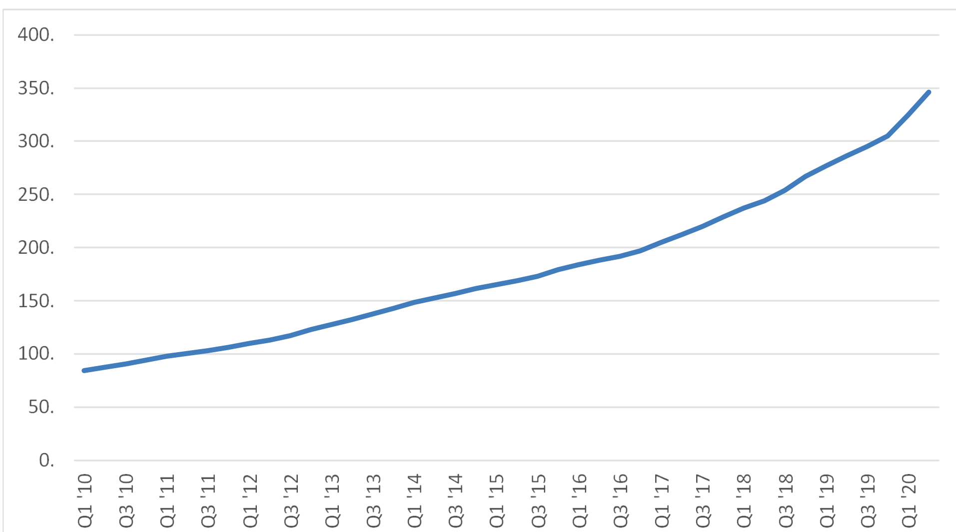
Source: PayPal 2020 Annual Report p. 105.

Exhibit 3a PayPal's net number of payments from 1Q2014 to 2Q2020 (in millions)



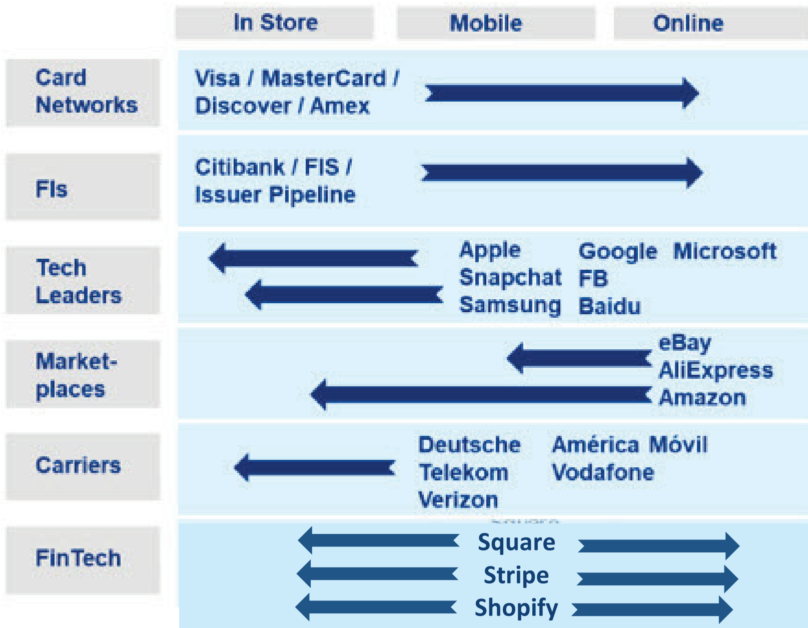
Source: Statista.

Exhibit 3b Number of Active Registered User Accounts on PayPal, 1Q2010-2Q2020 (in millions)



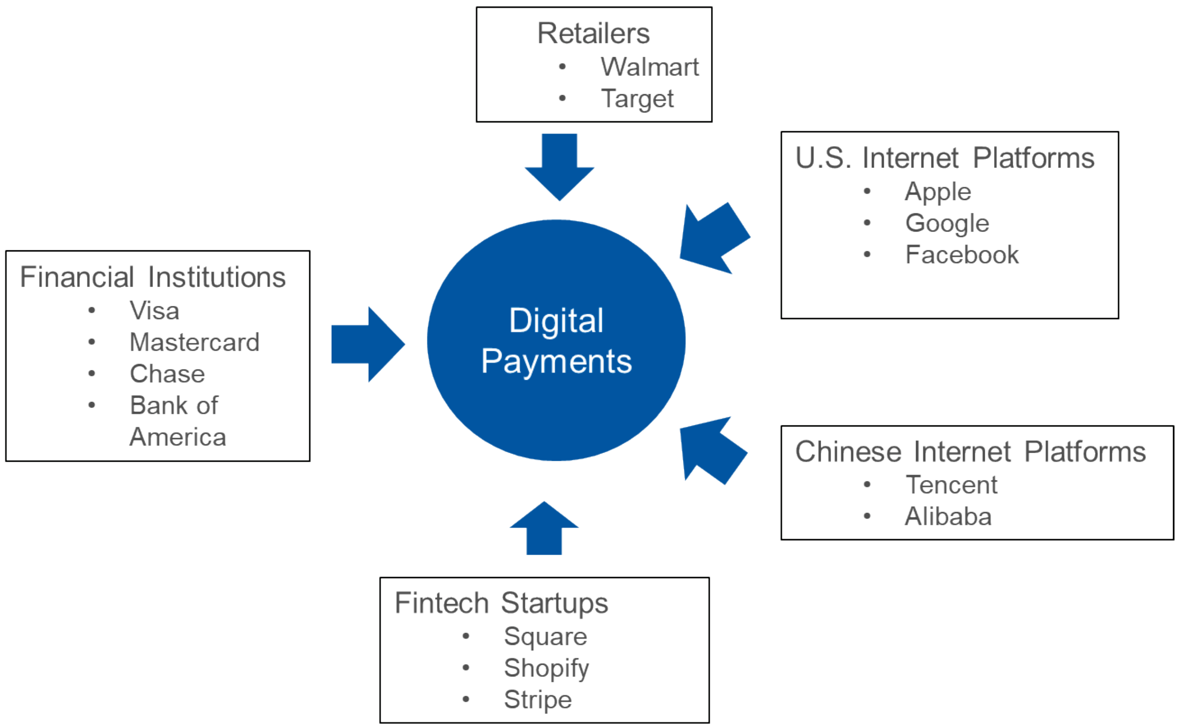
Source: Statista.

Exhibit 4 Expanding Competition across Platforms



Source: Company documents.

Exhibit 5 Digital Payments Ecosystem



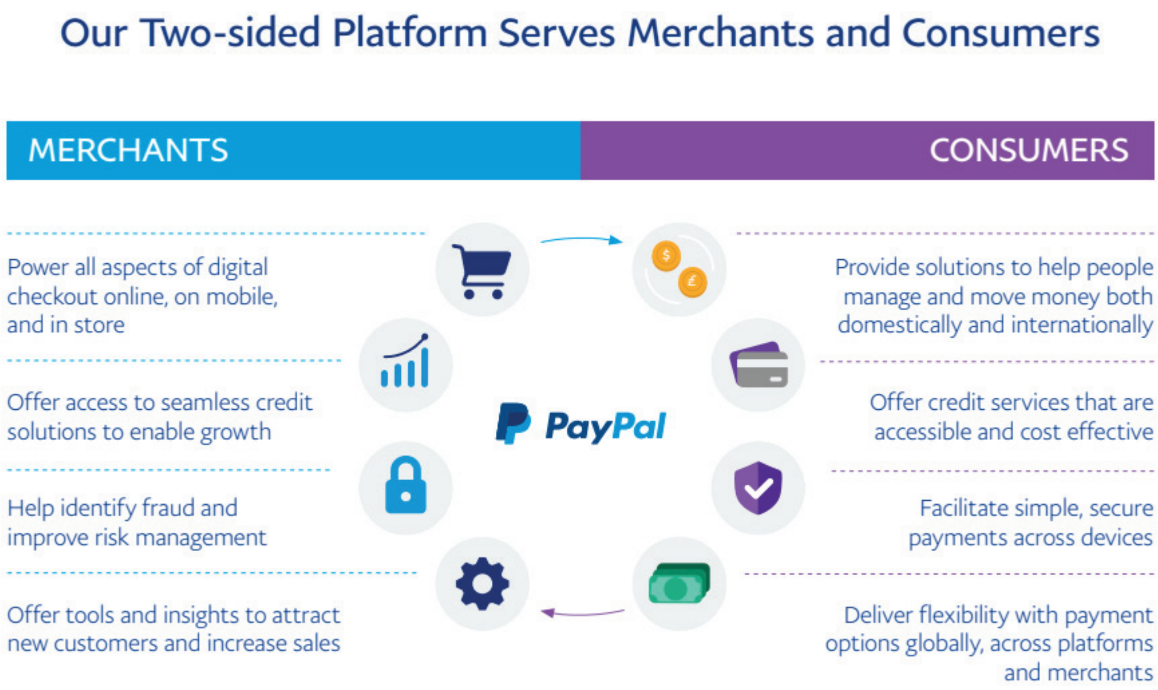
Source: Adapted from company documents.

Exhibit 6 Digital Payment Companies and Users, 2019 (in millions)

Company	Description	Number of Users in 2019-2020
AliPay	China-based Ant Financial's mobile payment service.	1,300
WeChat Pay	Cashless payment service offered by Chinese messaging app WeChat.	1,200
Apple Pay	Apple's mobile payment service for Apple devices.	441
PayPal	Online payment system used by consumers and businesses.	305
Google Pay	Google's mobile payment for Android devices.	67
Square	Mobile payment system used by businesses to process transactions in person and online.	24
Samsung Pay	Samsung's mobile payment app compatible with Samsung devices.	14
Zelle	P2P cashless payment service created by JPMorgan, Bank of America, Wells Fargo, US Bancorp, Capital One, BB&T, and PNC.	9

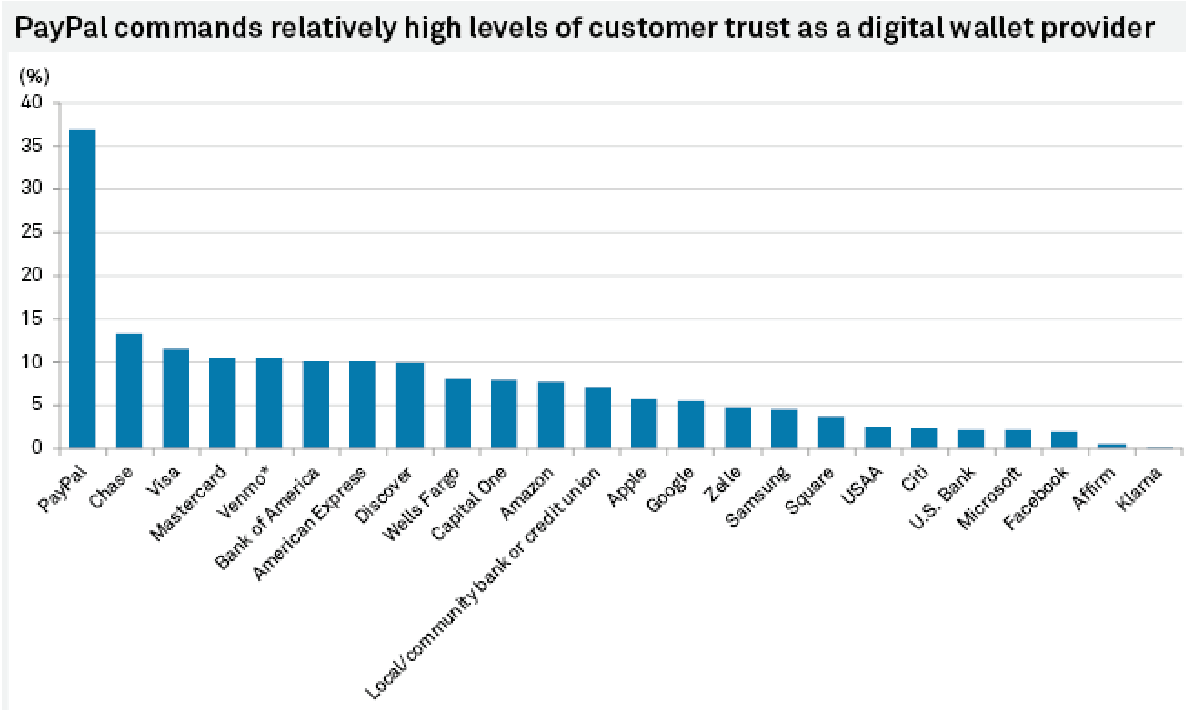
Source: Casewriter compiled from Alipay, https://techcrunch.com/2020/07/14/ant-alibaba-1-3-billion-users; WeChat, https://www.statista.com/statistics/255778/number-of-active-wechat-messenger-accounts (both accessed May 2020); Square.com, Q4 2019 Shareholder Letter, p. 2, https://bit.ly/30XPDn7; Statista, "PayPal: active registered user accounts 2010-2020," https://bit.ly/3ax3qEs; "Bank of America Reports Surge in Zelle Users in 2019," Mobile Payments Today, August 21, 2019, https://bit.ly/3iKS0jj; "Google Pay active user-base grows three times to reach 67 mn in September," *The Hindu Business Line*, November 6, 2019, https://bit.ly/3iKpxdt; Statista, "Apple Pay usage among iPhone user base worldwide 2016-2019," June 29, 2020, https://bit.ly/2DZNvlU; Tencent, Tencent Announces 2019 Fourth Quarter and Annual Results, p. 5, https://bit.ly/3iH5IDL; "Samsung Pay user base hits 14 million worldwide, cutting across over 25 countries," Gizmochina, May 15, 2019, https://bit.ly/30Xnixc; "Alipay mobile wallet growth up 20% in first-half of 2019," Mobile Payments Today, https://bit.ly/341BEPg; (all accessed August 2020).

Exhibit 7 Two-sided Platform Services



Source: PayPal 2020 Annual Report p. 2.

Exhibit 8 Trust in financial companies



Data compiled April 15, 2020.
* Venmo is owned by PayPal Inc.
Based on responses to the following question asked to respondents who indicated they trust banks, credit card companies, tech companies, or payment companies as digital wallet providers: "Please select the specific companies you trust most. Choose no more than three."
N = 456. N = number of respondents who indicated they trust banks, credit card companies, tech companies, or payment companies as digital wallet providers.

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