RANK

307

PAYPAL COMPANY PROFILE

REVENUES

$9.2 BILLION

PROFITS

$1.2 BILLION

EMPLOYEES

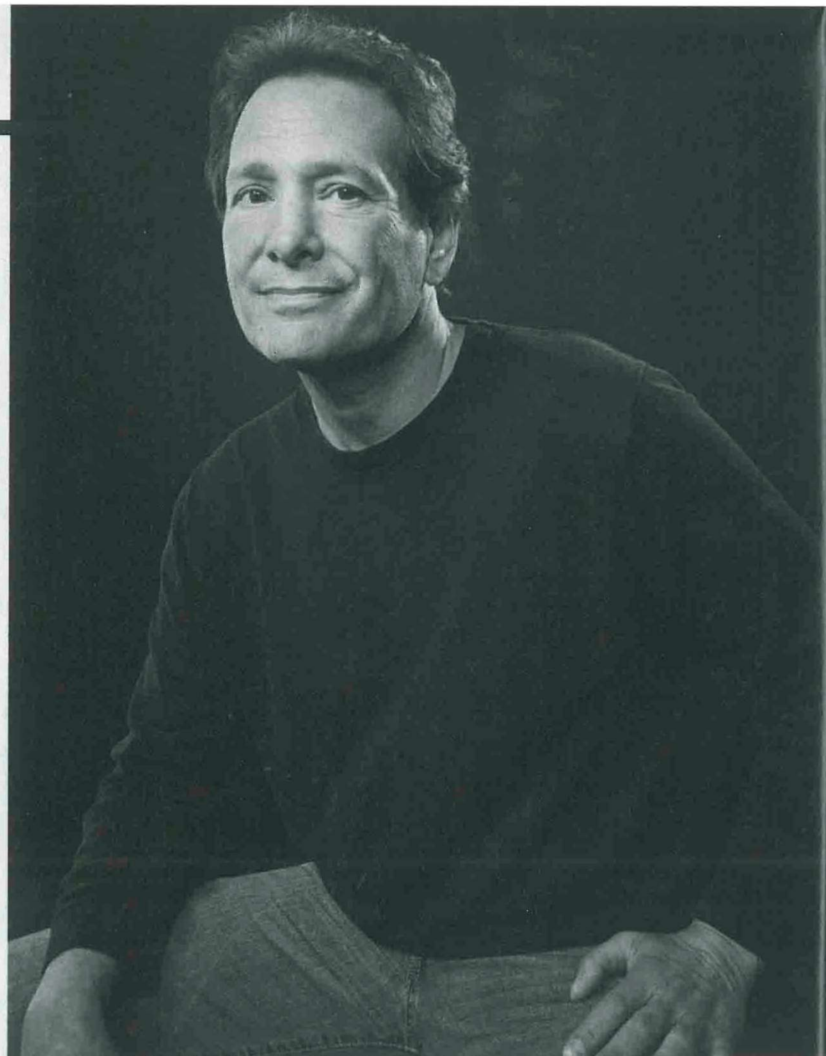
16,800

TOTAL RETURN TO SHAREHOLDERS (JULY 7, 2015–DEC. 31, 2015)

-1.4%

PLAYS CATCH-UP

THE COMPANY ONCE DOMINATED THE ONLINE-PAYMENT WORLD. BUT FOR YEARS ITS TECHNOLOGY LANGUISHED AS COMPETITORS GAINED GROUND. CAN AN INDEPENDENT PAYPAL GET BACK ON TOP? BY **LEENA RAO**



During the gloomy spring of 2009, few tech companies were under a darker cloud than online auction giant eBay.

Its online marketplace, one of the breakout Internet businesses of the 1990s, had seen its revenue stall. Competitors like Amazon had cut into its market share, consumers had slashed their spending, and the company's stock was down more than 80% from its 2007 peak.

It made for an ugly plateful of problems for John Donahoe, the former Bain chief who had succeeded Meg Whitman as CEO in 2008. But he and his board had a plan for a turnaround. Two subsidiaries owned by eBay had great potential but were never a great fit with its core business: Internet calling service Skype and online-payment pioneer PayPal. Spinning them off would raise some welcome cash while freeing eBay to focus on its auctions and retail sales. Early in 2009, the board voted to divest itself of both units. "It was almost a done deal," Donahoe recently told *Fortune.*

The key word here is *almost.*

On April 14, the company announced its plan to let Skype go. But even as the news went out, Donahoe was having second thoughts about PayPal. Apple had just disclosed that its App Store had crossed the 1-billion-download mark. And thanks to the soaring popularity of the iPhone, tech executives were urgently pondering the potential of the smartphone as a tool for commerce. PayPal, meanwhile, was the world's only major digital-payment brand; it already had 70 million users, and payment volume was growing 20% annually.

The more Donahoe pondered, the more foolish a spin-off seemed. "Mobile was exploding," he recalls, and "there were obvious synergies between eBay and PayPal." Canvassing board members, he found that their feet were as cold as his. Sentiment turned to action: In July, at a retreat at the Rosewood Sand Hill, the resort in Menlo Park, Calif., where Silicon Valley's elite swap gossip over Cobb salad, the board rescinded its decision on PayPal, choosing long-term potential over a short-term fix.

TEAM BUILDER DAN SCHULMAN, PAYPAL'S FIRST POST-SPLIT CEO, HAS BEEN AGGRESSIVE ABOUT ACQUISITIONS—BUT GIVES NEW SUBSIDIARIES PLENTY OF AUTONOMY.

THAT POTENTIAL went unfulfilled. The spin-off that wasn't has never been reported until now. But in hindsight, the decision cost PayPal six years of freedom and changed the history of the digital-payment industry. Insiders and analysts agree that eBay never took sufficient advantage of PayPal's "first mover" status by branching out or innovating; instead, it lost valuable time while rivals established themselves. That delay cost PayPal a chance to dominate the digital side of the $900 billion payment-processing industry the way that Facebook dominates social media and Google dominates search. Keith Rabois, an early PayPal employee who's now a venture capitalist, puts

PHOTOGRAPH BY ROBYN TWOMEY

it succinctly. The eBay years, he says, were PayPal's "lost decade."

The irony, of course, is that eBay eventually *did* spin off PayPal. The company became independent in July 2015, and it makes its debut on the *Fortune* 500 this year. And make no mistake: PayPal is big. The company, whose "virtual wallet" lets consumers make online payments connected to their debit and credit cards, has 184 million active users and serves 14 million merchants. In 2015 it processed $278 billion in payments, generating $9.2 billion in revenue.

But most of that revenue comes from website commerce—from the familiar checkout-button interface that feels almost quaint in a mobile era. On other fronts, PayPal has fallen behind, says Sucharita Mulpuru, an e-commerce analyst at Forrester Research. Square has captured the in-store payment market for small merchants. Entrenched credit card giants are muscling into the digital-payment turf. Want to tap your phone to a cash register to pay for an item? It's a piece of cake with Apple Pay or Google's Android Pay in the U.S., but PayPal has only a limited pilot for such payments, in Europe. "When I look at PayPal, I don't see a company as innovative as Amazon or Google," says Mulpuru.

It falls to PayPal's first post-spin-off CEO, Dan Schulman, 58, to change that. "I want consumers to use PayPal not just twice a month but twice a week and then from there, every day," says the effusive New Jersey native, a Richard Branson protégé and former American Express exec who favors cowboy boots and jeans. He's sprinting to make that a reality: In less than two years, PayPal has acquired valuable new technology while building on promising holdovers from the eBay years, like Venmo, a peer-to-peer payment app popular with millennials.

The big question is whether PayPal can make up for lost time and compete in an increasingly cutthroat digital-payment world—or join companies like AOL and Yahoo in the ranks of Internet 1.0 afterthoughts. As Brendan Miller, an analyst at Forrester Research, puts it, "PayPal's biggest challenge right now is shaking off its past."

BEFORE TESLA, SPACEX, and LinkedIn, there was PayPal. The company, whose founders and early employees included Elon Musk, Peter Thiel, and Reid Hoffman, created the first reliable way for people to send money to each other digitally. PayPal survived the dotcom wipeout, accumulated 16 million users, and went public in 2002. Just a few months later, it was acquired by eBay for $1.5 billion.

PayPal's culture favored geeky mathematicians and computer scientists who made decisions quickly and then wrote code into the wee hours of the morning. But eBay's approach, veterans of the era say, was more bureaucratic, and new ideas took what seemed like ages to be approved. Most of the innovative leaders known as the "PayPal mafia" left the company. Rabois opines, "The right culture with the right acquirer—people would have stayed."

It's understandable that eBay didn't feel the need to reinvent PayPal. Owning the service enabled eBay to be paid twice for every auction: once for its own cut of the sale and once for PayPal's transaction fee. PayPal grew from being the payment method for 40% of eBay's auctions in 2002 to 90% by 2005, and it grew at a healthy rate. But what it missed was the early days of powering payments through mobile phones—an opportunity that was inspiring upstarts like Stripe, Square, and Braintree.

By 2009, eBay executives had realized that PayPal was late to the mobile game, and after they reversed course on the spin-off, they sought ways to catch up. PayPal got a crucial "acqui-hire" in 2011, when eBay acquired Zong, a startup focused on mobile payments, for $240 million. Zong founder David Marcus, an entrepreneur who had founded several mobile-focused companies, became the president of PayPal. He quickly launched a Square competitor called PayPal Here, providing small businesses with credit card readers that attached to mobile phones and iPads. He overhauled PayPal's website. And his crowning achievement, in 2013, was the acquisition of Braintree, a Chicago company that processed online and mobile payments for hot startups, including Airbnb and Uber. Better still, Braintree owned Venmo, the person-to-person app.

With the Braintree buy, PayPal went from having virtually no presence in mobile commerce to being affiliated with some of its fastest-growing brands. "This was a major turning point," says James Cakmak, an Internet equity research analyst at Monness Crespi Hardt. And its impact showed quickly. In 2014, Braintree processed $23 billion in payments; the following year, that figure more than doubled, to $50 billion.

Results like those fueled another trend: PayPal was growing noticeably faster than its parent. In 2013, PayPal revenue jumped 19%, to $6.6 billion, while eBay's marketplace sales rose only 12%, to $8.3 billion. Investors chafed, and in January 2014, activist Carl Icahn called for a PayPal spin-off, raising arguments that the board had considered five years earlier—PayPal would fare better independently, and eBay could use cash from a spin-off to shore itself up. In June the decision eBay could have made in 2009 was finalized; the board voted to separate the two companies.

Donahoe's next task was to find a CEO for an independent PayPal. Marcus made the short list, but in August 2014 he left to become head of Facebook Messenger. A headhunter brought Dan Schulman's name to Donahoe, and Schulman invited Donahoe to his vacation home in the Berkshires. Donahoe arrived at the tiny Pittsfield, Mass., airstrip on an August afternoon and spent the day with Schulman, walking amid the greenery and brainstorming what PayPal should look like post-split. On his way back to the airport, Donahoe called the board and told them he had found their next CEO.

IN A SUN-FILLED room in PayPal's Washington, D.C., office, Schulman sketches out his vision for the company. On this day he has ditched his cowboy boots in favor of penny loafers (though he's still wearing jeans); he has just finished meeting with Secretary of State John Kerry and World Bank president Jim Yong Kim to advise them on bringing payment technologies to developing countries. Schulman explains that PayPal should be offering services for every type of mobile transaction, whether it's reimbursing a friend for dinner, paying for a sandwich at Subway, or buying toilet paper online. PayPal's customers include both the merchant and the shopper—both of whom need help navigating a payment-technology scene that seems to change daily. "It's a complicated chessboard," he says.

PayPal is no pawn, but it's not the queen, either. Figuring out exactly where it stands is tricky because many of its competitors, including Apple and Google, don't break out customer or revenue figures for payment services. No one can match PayPal's 184 million users yet, but the fact that few are using it in mobile is PayPal's biggest weakness. Global mobile payments are expected to reach $1.2 trillion in 2018, according to Transparency Market Research. Cakmak, the analyst, thinks mobile payments could generate $10 billion a year in revenue for PayPal—more than double its *total* revenue in 2015.

PILLARS OF A NEW PAYPAL

PayPal is still dominant in website-based e-commerce, but its future may hinge on services like these:

PROCESSING
In 2013, PayPal bought ***Braintree***, which processed $50 billion worth of mobile and digital payments last year for the likes of Airbnb, Uber, and StubHub.
COMPETITORS: STRIPE, AYDEN, CHASE PAYMENTECH

REMITTANCES
The money-transfer app ***Xoom***, which PayPal bought in 2015, lets people in the U.S. send money easily to family members and others in 53 countries.
COMPETITORS: WESTERN UNION, RIA FINANCIAL

PEER-TO-PEER
If a millennial has recently urged you to ***Venmo*** her some money, you've been interacting with the PayPal empire. Venmo, which PayPal obtained in the Braintree acquisition, lets users send money quickly to each other; PayPal is extending the service into consumer-to-merchant payments.
COMPETITORS: SQUARE CASH, FACEBOOK MESSENGER, GOOGLE WALLET

CREDIT LINES
PayPal Credit lets shoppers postpone payment and carry a balance, interest-free; after six months, a 19% interest rate kicks in.
COMPETITORS: MASTERCARD, VISA, AMERICAN EXPRESS, AFFIRM

To capture that revenue, PayPal will have to stand out in a tough crowd. Apple launched Apple Pay in 2014. It's now accepted by more than 2 million retailers and works as a payment service within other companies' apps. According to researcher Crone Consulting, Apple Pay has 12 million monthly users; Apple won't confirm that figure but says it's adding millions of users each month. Google's Android Pay is also rapidly ramping up. Steve Weinstein, an analyst at ITG Investment Research, notes that Apple and Google share a major advantage over PayPal: Each controls an operating system (iOS and Android, respectively) that enables it to integrate payment services seamlessly into phones.

On the merchant side, Braintree has helped PayPal stay competitive in payment processing. But the company lags in stores. Square brought in $1.2 billion in revenue in 2015 from its in-store payment service. PayPal's in-store tech, by contrast, is embryonic, and Alex Rampell, a former Visa executive turned venture capitalist at Andreessen Horowitz, says PayPal is too late to catch up to the early movers.

Silicon Valley isn't the only place where PayPal faces powerful foes. Credit card giants like Visa, MasterCard, and American Express are frenemies, at best. Although much of PayPal's business involves helping consumers buy things with their cards, these financial institutions—all of which generate plenty of revenue to plow into digital development—have launched competitors to PayPal's core business (Visa Checkout, MasterPass, and AmEx Express Checkout, respectively). The biggest of those, Visa Checkout, is being used by 250,000 merchants.

Schulman's vision involves competing on all these fronts simultaneously. Job No. 1 for his administration was separating PayPal's technology from eBay's. CTO Sri Shivananda has rebuilt PayPal's payment infrastructure, and he now oversees this empire from a new command center that looks like the bridge from a *Star Trek* set, where dozens of screens spreading across

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a 50-foot wall monitor roughly 15 million payments a day in 100 currencies.

Schulman hopes to boost that number by expanding PayPal's presence at the brick-and-mortar cash register. In March 2015, PayPal acquired payment startup Paydiant for $280 million. Paydiant technology is "white label," operating behind the scenes for other brands. Retailers and banks use it to add payment capability, loyalty programs, and digital coupons to their own apps. For example, Paydiant's tech enables Subway customers to order and pay for a sandwich from the app and skip the line to pick it up.

PayPal subsidiaries like Paydiant and Braintree operate independently, keeping their offices, names, and leadership while under the PayPal umbrella. Schulman believes this helps them innovate more quickly—a far cry from the eBay days. As an example, he points to Braintree, where Bill Ready, who was Braintree's CEO when it was acquired, still oversees the division. Last year Ready launched One Touch, which lets PayPal users avoid having to log in multiple times from the same device. By this April, One Touch had more than 22 million users, making it PayPal's fastest-growing business in terms of user adoption.

Growing almost as fast is Venmo, an app that lets users send money to each other instantly. The app handled $7.5 billion in transactions in 2015, and in January 2016, it had its first $1 billion month. Venmo (and other apps like it, such as Square Cash and Google Wallet) don't generate much revenue. But Venmo may break that pattern. PayPal execs say Venmo customers are unusually loyal (they typically use the service three or four times a week) as well as social (a popular Venmo feature lets users share payment histories with friends). Schulman believes merchants eager to reach this engaged audience will gladly pay for the right to offer Venmo as a payment option. That in turn might help make Venmo the killer in-store app PayPal has lacked, says Weinstein of ITG.

And just in case consumers tire of banks and credit card issuers altogether, PayPal has taken its first steps toward embracing blockchain cryptocurrency technology. The firm has updated Braintree to allow merchants to use it to accept Bitcoin payments. And in January, PayPal appointed entrepreneur Wences Casares, who created Bitcoin wallet Xapo, to its board.

FLASH POINTS IN THE PAYMENT WARS

In the wake of changes in technology and consumer habits, digital payments have become a new battleground where banks and Silicon Valley vie for market share and customer loyalty. Here are some of the fastest-changing parts of the landscape.

MOBILE WALLET

PayPal created the first digital wallet, allowing consumers to upload credit or debit card data to make payments online. The migration to smartphones made that digital wallet portable, giving an edge to competitors who make phones and their operating systems. (Think Apple Pay, Android Pay, and Samsung Pay.) Now tech companies and banks strive to make these payments "hands free" so customers can simply wave a smartphone (or smartwatch) in front of a wireless reader at the cash register.

PEER-TO-PEER

Want to pay your babysitter without carrying a wad of cash? Or split a dinner check without making your server run eight credit cards? Peer-to-peer systems let people send money to each other via text or email, using apps linked to bank or card accounts. PayPal's Venmo leads the field, but Square Cash and Google Wallet are robust challengers, and Apple is reportedly considering joining the fray. And keep an eye on Facebook Messenger, which could leverage the social network's ubiquity to gain ground fast.

BLOCKCHAIN

Digital options have led some consumers to question whether they need banks at all. Blockchain technology lets users make secure financial transactions across a network of computers, with no need for a central authority like a bank. Bitcoin is the best known of the cryptocurrencies that rely on blockchain, and the number of merchants using it is small but growing. Key players are Bitcoin exchange Coinbase, Bitcoin wallet Xapo (whose founder is a PayPal board member), and payment app Circle.

WALK THROUGH SAN FRANCISCO'S Mission District, and you may stumble upon an unfamiliar economic ecosystem: the world of the money transfer. On one thoroughfare, you can pass three money-transfer outlets within three blocks of one another. On a recent Friday, one has lines flowing out the door; inside, Spanish is the dominant language exchanged at the cashier stations' bulletproof windows. It's payday, and the store is packed with workers sending money to families in their home countries.

Last July, PayPal paid $890 million to buy money-transfer service Xoom, which moves such transactions out of the physical store and on to the mobile screen. Xoom's app lets users transfer money to 53 countries, designating the recipient and specifying whether the payment should go to a bank account or involve a cash pickup or delivery. The app can't help unbanked senders—users must link transactions to a bank or credit card account—but it's safer and cheaper than using a money-transfer office. And while the recipient may have to wait, the sender never does.

Just as important, Xoom lets PayPal plant a flag in yet another corner of the financial world. If PayPal lives up to Schulman's vision, this breadth will compensate for the lack of innovation during its lost decade. "We think about reimagining the movement of money for the entire world," Schulman says. "We used to be a button on a website, but we aspire to be so much more."