

EBay and PayPal

Better off alone

EBay's split should make investors happy—and corporate divorces more popular

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EXAMPLES of failed technology mergers abound, but spin-offs have a better record. The coming months will provide plenty of evidence on why they can be worth it. Several big tech divorces are in the works, as firms try to position themselves to respond more adeptly to new challenges that arise from the

growth of mobile and the cloud. First up is PayPal, a leading digital-payment service, which is to split from eBay, an e-commerce giant, on July 17th and will start trading as a separate company a few days later.



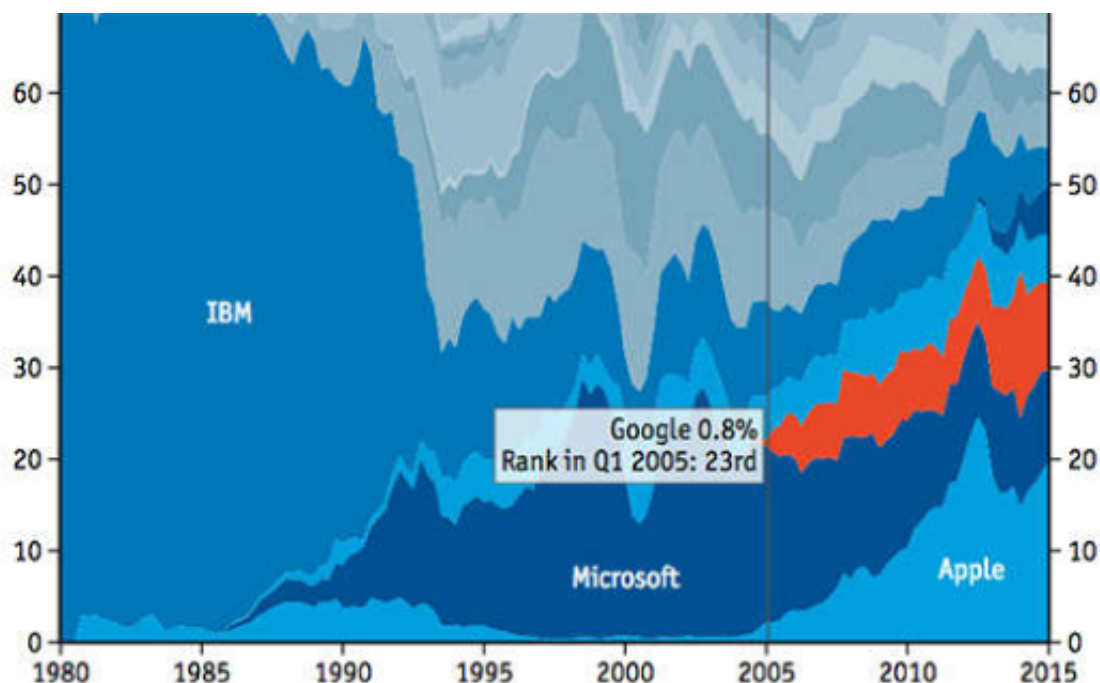
Just as divorces can cost more than getting married, spin-offs tend to be more complicated affairs than mergers, says Marco Sguazzin of Deloitte, a professional-services firm that has helped many firms to break up. In corporate marriages many things can only be decided after the deal is closed. In contrast, when firms split, everything needs to be settled up front: how assets will be divvied up, which employees will be on which payroll, how the IT systems will be disentangled, and so on. As a result, separation projects tend to be tedious affairs, keeping hundreds of people busy and costing hundreds of millions. In the case of eBay and PayPal the chief executives were decided early. Devin Wenig, who has run eBay's marketplaces, will take the helm at the parent company, and Dan Schulman, who joined the firm from American Express in 2014, will lead PayPal.

This will not be a demerger of equals. EBay bought PayPal for \$1.5 billion in 2002, but now PayPal is the bigger and stronger of the two. Analysts expect PayPal to be worth around \$45 billion, with eBay valued at around \$30 billion. The decade-long relationship between the firms means they cannot walk away from each other quickly. The two have settled on a long-term separation agreement, which is necessary for interdependent businesses. EBay has agreed to route about 80% of its sales through PayPal for the next five years, about the same share as before the spin-off.

As technology and markets change ever more rapidly, it helps to be independent, and shareholders tend to be enthusiastic about spin-offs. Faced with new competition, such as Apple Pay and Stripe, PayPal needs to be nimbler to reach its goal of becoming, in the words of James Wester of IDC, a market-research firm, the “Switzerland of online payment systems”, so that it is able to move money from every digital device to every online merchant. Right now it is most strongly associated with eBay’s platform, which limits its expansion because it makes rival e-commerce sites less inclined to partner with it.

These ambitions are reflected in PayPal’s recent acquisitions. Earlier this month the company—which already boasts 165m active accounts and annual transaction volume of some \$235 billion—announced it would pay \$890m for Xoom, which transfers remittances from America to many developing countries. In April PayPal took over Paydiant, which helps retailers to operate mobile wallets. And in late 2013 it spent \$800m buying Braintree, which processes transactions for mobile apps and came with Venmo, a popular service to transfer money between phones. More acquisitions are likely: the separation leaves PayPal with a war chest of \$6 billion.

For eBay, with its 155m active buyers and goods worth \$83 billion being sold on its marketplaces annually, the way forward is less clear. It is more profitable than PayPal, but its revenues are expected to be flat this year. What made eBay one of the winners of the dotcom boom is now holding it back. Having been an early mover in online auctions in the late 1990s, for example, today consumers prefer the certainty of quickly completing an online purchase. Today 80% of items are sold at a fixed price, but many still view eBay mainly as an auction site. Being a marketplace where others list their wares has spared the firm costly investments in warehouses and logistics, but today this lack of “vertical integration” makes it difficult to meet the increasing demands of buyers who expect rapid purchase and delivery, says Mark Mahaney of RBC, a Canadian bank.



Silicon rally: How the US technology sector has changed since 1980 (<http://www.economist.com/techfirms>)

It will be no shock then if eBay's share price lags behind PayPal's: parent companies tend to do worse than their spin-offs anyway, says Tom Kirchmaier of the London School of Economics. But eBay's share price could get a bounce because some anticipate that as a smaller, more focused company, it could be a takeover target. Alibaba, a Chinese e-commerce giant that has yet to gain a firm foothold abroad, is most talked about as a potential suitor. Amazon, Google and Microsoft might also bite but are less likely candidates. Some speculate that PayPal, too, could be eyed by banks or Alibaba, although its size makes it less easily digestible.

Spin room

If eBay's split goes off well, it could encourage other tech firms to follow through with their own spin-offs. JDSU, a maker of telecoms equipment, will float its laser and optical-component businesses in the third quarter. Yahoo, an online giant, is still planning to spin off its remaining 15% stake in Alibaba as a separate company in the following quarter, and may hive off Yahoo Japan. On November 1st HP will split itself into a corporate IT vendor and a maker of PCs and printers.

Many big technology firms are said to have spin-off plans in the drawer. Perhaps they will go through a phase similar to the one big industrial conglomerates did in the 1980s. Bloated and bureaucratic after doing various deals in unrelated industries, those firms decided to slim down to be able to focus on their main businesses. Let the auctions begin.

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