GRAVITY PAYMENTS: SETTING THE WORLD OR ITSELF ON FIRE?

SCOTT BRYANT
Montana State University

KENMAN WONG
Seattle Pacific University

The Announcement

"Is anyone else freaking out right now? I'm kind of freaking out right now," Dan Price half-worriedly mused immediately following his enthusiastic announcement of a radical change in his company's compensation policy. After several weeks of sleepless nights during which he was continually haunted by the thought that he should just forget the whole idea, Price, co-founder and CEO of Seattle-based Gravity Payments, announced at an April 2015 employee meeting that he had decided to give many of his employees raises—big raises. He informed all that the company would have a minimum wage of $70,000, phased in over a three-year period. Starting that very day, every employee would earn a minimum of $50,000. Since some employees were only making $35,000 at the time, the $70k target would eventually double their pay. In addition, Price announced he would reduce his own million-dollar plus salary to just $70,000 to help fund the wage increases.

The announcement was initially met by shocked silence, and then the packed meeting room erupted into cheers. Gravity employees were ecstatic. The company's new minimum wage became the top-ranking news story on numerous national Critics called it a misguided socialist experiment that would divert cash from other needs, such as research and development.

The authors developed the case for class discussion rather than to illustrate either effective or ineffective handling of the situation. The case and its accompanying instructor's manual were anonymously peer reviewed and accepted by the ***Journal of Case Research and Inquiry***, Vol. 3, 2017, a publication of the Western Casewriters Association. Contact: Scott Bryant, Montana State University, PO Box 173040, (406) 994-6191, Bryant@montana.edu.

Others wondered if higher paid employees would lose their motivation since wage differentials would no longer be commensurate with performance and/or experience. In fact, a few months after the announcement, *The New York Times* reported that two key employees quit, citing concerns about fairness to high performers. Several customers changed providers fearing a future price increase and/or a decreased level of customer service by employees who would no longer work as hard (Cohen 2015).

Amid these concerns, how should Price proceed? Should he press forward with his plan in hopes that a positive response from employees would result in an increased level of productivity that would overcome any potential de-motivating effects? How significant a role, if any, should he continue to give to non-economic concerns about ethics and justice in setting wages? How should he weigh the interests of key stakeholders (i.e., customers) in his decision?

Company Background

Gravity Payments specialized in providing credit card processing services to small and medium sized, independently owned businesses. Credit card transactions were fast, smooth and seamless for consumers. However, behind the scenes lay a lengthy value chain with many organizations (i.e., the merchant's bank, the card issuing bank, and the credit card company) supplying short-term funds, hardware, services and/or technology to allow secure efficient payment and the settling of merchant accounts with a simple swipe of a card. When a customer initiated a credit card transaction with a merchant, the transaction was first processed by a merchant service provider. Standing behind the merchant service provider was another company that actually processed the transactions, handled fees, and provided the card reader. Fees were charged at each phase of the transaction.

Dan Price got his start in the industry while playing in a rock 'n roll band in high school. While performing, he became acquainted with the owner of a local venue and saw the negative effects on her business of high card processing fees and spotty service. Price put his negotiating skills to use, made a call and secured a better rate on the venue owner's behalf. He studied the business and realized that most, if not all, small independent businesses were in the same vulnerable position: they had difficulty dealing with an industry dominated by large financial organizations. He also learned that opaque pricing with hidden fees and price changes were not uncommon. This fueled his desire to help smaller merchants get better and fairer prices, prompting him to start a service business. Price offered merchants a clear fee structure as well as a competitive rate to use his services to process credit card transactions, typically saving clients 10% to 15% in fees. The savings added up to about $1,000 per client per year. Price made money on the small service fees that he charged clients for each transaction.

After moving away to college, Price expanded the range of services but decided that to serve his customer base better, he really needed to move up the value chain. By developing his own technical product for processing transactions, he could do the actual processing in house. Racking up about a $100,000 in debt via savings, credit cards and diverted student loans, Price and his older brother Lucas (then a 50/50 partner) successfully launched Gravity Payments from his dorm room at Seattle Pacific University in 2004. (It was so named, he said, because it was easy to understand on the phone.) Despite his young age and boyish appearance, he was able to secure a number of early clients from merchants at the Seattle landmark—Pike Place Market (many of whom remained as customers many years later).

From the very beginning, Price's vision for Gravity was a "disruptive" one. He sought to "blow up" the industry by offering small and medium sized businesses less expensive credit card processing with transparent pricing and extraordinary levels of customer service. Price was emphatic that Gravity's primary mission was to serve independent businesses by helping them engage their customers and grow. Gravity prioritized the needs of its clients above its own concern for profit.

> *We started Gravity Payments because we saw independent businesses being over-charged and underserved by their **credit card processing company**. Our community businesses needed help, guidance, and a trusted ally to make **credit card processing** fair. We exist to support community businesses and help them achieve incredible success.*
>
> *Our mission is to help independent business owners thrive by reducing the cost and headaches associated with accepting credit card payments. Although credit card processing is our core service, we added more low-cost payment solutions to our ever-growing suite of **merchant services**. Our team is consistently looking for the best and most affordable payment processing options to help our clients remain successful and on the cutting-edge of payment solution technology.* (Gravitypayments.com 2015)

Building a Business with Values and Integrity

In 2015, Gravity employed a staff of approximately 120, served 12,000 clients and processed close to $7 billion in transactions annually. In fiscal year 2014, revenues were $150 million, growing at 15% per year, with a net profit of $2.2 million (Keegan 2015).

In addition to the company's core credit card processing business, Gravity administered gift and loyalty programs and had recently begun to offer analytic services to enable business owners to gain more insight into their consumers. The company's unique capital structure (no debt) allowed it to explore some risky ventures such as providing financing to small businesses that filled the gap between a credit card and bank borrowing. As of 2015, Gravity had provided about $35 million in small business financing. As Dan Price noted:

> *"We started our company to help our community businesses, because they deserve the same great customer service and low prices that big corporate businesses get. And we've grown our company by earning the trust of each and every one of our valued customers."* (Evans 2015)

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Price himself had won numerous awards including: *Entrepreneur* magazine's Entrepreneur of the Year for 2014 and the 2010 *Small Business Association National Young Entrepreneur of the Year* and had appeared in countless articles including *Forbes, CNBC*, and *Bloomberg BusinessWeek* (Gravitypayments.com 2015).

While Gravity had grown to the point where it would attract a tidy sum from a potential buyer, Price did not intend to cash out. In contrast, he said he would like to run Gravity "forever" because his long-term goals were beyond monetary. He stated:

> *"I have a 40-year goal to be a small part of a change in the way business is done, where it's more about service and helping others than greed and financial engineering"* (Evans 2015).

Visitors to Gravity's offices noticed a tech startup culture. Employees, most of whom looked like they were in in their 20's, occupied shared worked spaces or cubicles and seemed busily engaged in their work. The culture at Gravity was described as collegial, high energy and purpose-driven. Management prioritized the personal growth and development of employees. The work environment was casual, but the work was fast paced and demanding and the performance feedback straightforward and unvarnished. Price himself had promised not to punish negative feedback and held regular open forums and kept open door office policies (Glassdoor.com 2015).

Salaries made up a large share of Gravity's total expenses, with technology costs taking a large share as well. This meant that reducing turnover and increasing worker productivity could increase profits.

The Reasons behind the Raise

Price was raised in an Evangelical Christian household in rural Idaho (near Nampa) and was homeschooled until age 12. He explained that this upbringing provided him with a different understanding of business. His parents raised him to be driven by values and to make an impact by bucking conventional ways of doing things. Price stated: *"To me, it's a values thing – I learned those values through Christianity, the Bible and my upbringing"* (Helm 2015). The small businesses he interacted with while growing up had also made a lasting impact. He noted:

> *"We had an ethos of small business much different than what you see in bigger cities...You should strive to give the most value you possibly can to your clients and to your community while charging a fair amount, or less than a fair amount, because you want to give back… Some might say that's the stupidest business model in the world, but to me it made sense. And it still makes sense today"* (Nelson 2015).

Prior to the recent pay increases, there were complaints on Glassdoor.com about the low pay at Gravity, particularly for sales people (Glassdoor.com 2015).

While Gravity grew at a steady clip for its first few years, the company nearly folded during the recession in 2008 after two large customers abruptly closed their doors, wiping out about 20%

of the company's revenue. By tightening the financial reins - partially by freezing salaries - the company survived without layoffs or fee increases and began a healthy cycle of growth soon thereafter. The belt tightening actions began in the recession but continued afterward during the growth cycle.

In 2011, an informal conversation with an early employee named Jason Haley began to sow the seeds for Price's radical minimum wage decision. Haley angrily told Price what the belt-tightening actions really translated to was Gravity ripping off its employees. Although their wages were competitive by market standards, employees (Haley was earning $35k at the time) couldn't get very far in an expensive city like Seattle (Keegan 2015). Price looked back at that conversation as, at first, very difficult to accept, but seminal for his radical pay plan. Contrite, Price implemented significant raises for the next three years and something surprising happened: profit growth outpaced wage growth through productivity gains of 30-40% (Keegan 2015).

By 2015, the issue of income inequality had become an increasing (and contentious) part of the national conversation. Frequent news stories appeared highlighting lagging wages despite higher corporate profits and worker productivity. Also constantly mentioned were statistics that showed the wage gap between U.S. chief executives of large companies and the average employee was among the highest in the world, reaching a multiple of approximately 350 to 1, this up from 20 to 1 in 1970. By comparison, Switzerland (the country with the second largest ratio), had a ratio of 148 to 1 while Japan's was 67 to 1 and United Kingdom's 84 to 1 (Ferdman 2014). In Seattle (the location of Gravity's headquarters), voters approved legislation to increase the minimum wage eventually to $15 per hour, which affected many Gravity clients.

Around this same time, Price went on a hike with a friend (not an employee of Gravity) who was well educated and had served several tours in the Armed Forces. She shared her uncertainty about how she was going to adapt to an upcoming rent hike on her salary of less than $50k. Thinking about his own employees - some of whom earned less than his friend - he didn't feel right about earning a high CEO salary. Many of his employees had made huge personal sacrifices to provide extraordinary levels of customer service to make Gravity successful, yet could barely afford the cost of living in Seattle. The average rent for a two-bedroom apartment in Seattle at the time was over $2,100 per month. Price figured employees were paying an average rent of $1,266, which for the majority of his employees represented over 40% of their salaries. Economists had concluded that over 30% was "unaffordable" (Nelson 2015).

Heading into the office each day simply reinforced his troubled thoughts. Gravity's office was located in the Ballard neighborhood, which was a rapidly gentrifying area of Seattle. Along with luxurious condominium complexes, renovated homes, and trendy espresso shops, there were many homeless people on the streets near Gravity's office, including some living under a bridge just a few blocks away. This also pricked Dan Price's conscience and sparked in him a desire to find a way to make a difference.

Price thought that most people would have considered him generous (or perhaps, foolish) even if he had had chosen a figure far below $70k. Price arrived at the company's new minimum wage figure after reading a Princeton University study (Kahneman & Deaton 2010) that concluded that happiness rises with income, but not past $75k per year. The part of the study that struck the deepest chord with Price was that incomes short of the threshold could *harm* one's emotional well-being (Aspen Institute blog). Price worried that money troubles would prevent employees from both thriving in their own lives and giving their best service to Gravity's customers. While a positive effect on productivity was a part of the equation, Price stated that paying less than $70k went against his values, so it was a moral imperative. He said, "*I don't care if I have to stop paying myself or I have to work 20 hours per day. I'm going to do it*" (Keegan 2015). Somewhat skeptical about the broad sweeping consequences of steep government mandated wage increases on small businesses, Price's aim was to set an example of how business leaders could turn the tide of income equality.

After running financial models and consulting with his senior leadership team, Price reached the conclusion that Gravity could change its compensation systems to reach a minimum of $70k per employee in three years, though not without substantial risk. The raises would not "pay for themselves," so their sustainability (and that of the entire company) rested upon the growth of the business. Price hoped that 90% of the pay raises would be covered by increased employee productivity, and the other 10% through positive publicity resulting in new clients. Price concluded that if Gravity could recover its profit in 2-3 years, the plan will have been a financial success and will have proven that his concept worked. If profit increased by 4-5 times, he said, Gravity will have *"set the world on fire"* (Evans 2015).

Repercussions

After an initial wave of positive national and even international publicity, some negative consequences for the company began to surface. Sitting down on a paint bucket in his garage for an interview with *The New York Times*, Price pulled out a box of hand-written letters. While most praised his decision, some suggested he was an arrogant fool and that it wouldn't be long before the novelty wore off and employees would start complaining about how much harder they worked than their colleagues who also earned $70k.

Some members of the national media offered similar sentiments. For instance, radio commentator Rush Limbaugh (to whom Price listened several hours per day while growing up) said:

> *"If there are profits, they will go to salaries, not growth of the business, not research and development, none of that…He's not tying it to performance… That's why I hope this company is a case study in MBA programs on how socialism does not work, because it's gonna fail… And —he's gonna find out—it isn't gonna take long because once everybody figures out they're all making the same, not* [for] *what they do, the slackers are gonna surface. Human nature."* (Limbaugh 2015)

Contributors to *Entrepreneur* magazine (which had earlier named him its 2014 Entrepreneur of the Year) also offered stinging criticism. One suggested that high pay might even be **counterproductive** to the goal of well-being, hypothesizing that pay that was too far removed from the norm would breed resentment among peers (both co-workers and friends outside the company); it might also generate feelings of guilt, thus diminishing happiness (Tobak 2015). Others suggested he look at the *Bible* and learn a lesson from the adverse reaction of the workers who toiled all day yet received the same wages as those who came later in the [Parable of the Vineyard workers](#) (Mt. 20:1-16) (Cohen 2015).

As a direct result of the new pay policy, two key long-term employees quit. They questioned the fairness of paying less experienced and/or lower performing employees as well as they were paid. One employee who left said,

> *"Now the people who were just clocking in and out were making the same as me… It shackles high performers to less motivated team members"*
> (Cohen 2015).

Price himself acknowledged the inherent unfairness of the policy for a seasoned employee who had taken years to earn his or her level of pay (Helm 2015). In fact, after the announcement, he gave more experienced employees small raises and wrote to them apologizing and telling them that he valued them *"more than this program would suggest;"* he promised that Gravity would try to invest more in them too (Helm 2015).

Several of Gravity's clients were not pleased with the pay decision. Some thought Price was out to make a political statement. Others believed that the new pay levels would result in an eventual increase in fees or that customer service would suffer (Cohen 2015). Although Gravity reached out to clients to let them know that fees would remain the same, several clients switched to other providers.

Price's plan also stirred the pot with other entrepreneurs in his social network in Seattle. Brian Canlis, co-owner of a high-end restaurant in Seattle, expressed frustration with Price's decision to raise employees' pay, saying it was going to make it harder for other employers like himself who were already struggling to adapt to Seattle's $15 per hour minimum wage target (Cohen 2015).

While being interviewed by *The New York Times*, Price acknowledged he was in the process of renting out his own house and moving to less expensive living quarters in order to "make ends *meet"* to uphold his commitment to make the plan work. Price also said he sold financial assets to provide Gravity with a $3 million loan.

Seemingly, non-defensive in his responses, Price said that neither his two former employees nor his critics were necessarily wrong. He said,

> *"There's no perfect way to do this and no way to handle complex workplace issues that doesn't have any downsides or trade-offs…I came up with the best solution I could"* (Cohen 2015).

Moreover, while he agreed that humans had a partially selfish nature, he was placing bets on our more positive side that responded to being treated well. He acknowledged that he was not sure the plan would be successful. Yet if he were to fail, at least he would do so while being true to his values (Evans 2015).

Gravity's average salary at the time of the announcement was $48k (Cohen 2015). The plan would eventually double the salaries of 30 employees. In addition, smaller immediate increases were given to 40 workers who earned less than $70k. Those who were earning between $50-70k received $5k raises (Keegan 2015). To reach $70k, $10k raises would be phased in over the next two years. Over 3 years, the salary plan would cost approximately $1.8 million. In addition, the company had to hire 10 new employees adding to overall salary and benefit costs. Much of the additional costs would be funded by Price's salary cut. However, unless revenues grew, the rest would need to be covered by profits ($2.2 million per year in 2014), potentially putting the company in cash-strapped position.

Was the Change Good for Business?

Even though several clients left Gravity, over 4,000 new customers signed up in 2015 (a 55% year-to-year increase in an industry where typical growth was 5% per year). Revenue increased as a result, but new customers might not pay off for at least 12-18 months after sign-up. About two dozen new employees were added to manage growth, handle the media, and respond to employment inquiries, putting more stress on the cash flow needed to meet the compensation goals. Nonetheless, Gravity reported that profits nearly doubled in 2015 and that employee turnover rates sharply declined (Davidson 2016; Murray 2016).

The "fair pay" initiative at Gravity had seemingly resonated with many 20-somethings across the country who felt stuck in low paying jobs; the company received thousands of new employee applications.

Early indicators demonstrated the social impact that Dan Price had intended. As reported in a variety of media outlets, several Gravity employees said that the raises were making real differences in their lives. One new client who switched to Gravity after seeing the story in the news used the $800 monthly savings on his processing fees to give his 8 employees raises (Cohen 2015). Price said that he had heard from other employers and employees: he believed that thousands if not tens of thousands of employees had received raises as a result of the example set by Gravity.

Even with the potential negative consequences for himself and for the company, Price was committed to the huge salary increases. Some research (Pfeffer 1994; Heymann 2010) indicated that higher pay, particularly for those on the bottom of the pay scale, could lead to lower turnover and higher productivity. Based on his reading of the research, Price concluded that while pay was a motivator, purpose and feeling part of a mission were stronger ones (Evans 2015). To that end, Gravity has long been able to attract highly motivated employees who chose to work at the company – even before the pay increases. After the announcement, one former Yahoo executive was hired at an 80-85% pay reduction, citing her desire to do something *"fun and meaningful"* (Keegan 2015).

Significant questions remained for Gravity—including whether or not the long-term benefits of the salary increase outweighed the short-term costs and negative feedback.

With all this on his plate, Price had some serious decisions to make. Should he continue with the huge salary increases in hopes that increased productivity would cover costs? Was the decision defensible from an ethics/ justice perspective?

With constraints on the amount of money that could be allocated for salaries, how could the company pay better at the bottom of the pay scale while maintaining salary differentials (and thereby “equity”) for higher performing and/or more experienced employees? What indicators should be used to gauge whether or not the plan was sustainable?

And finally, how could Dan Price balance the interests of all stakeholders? Even if the decision did not "pay" (in a direct financial sense) should he continue the policy for the sake of the social value created?

Scott Bryant currently serves as a Professor of Management at Montana State University. He received his Ph.D. in management and organizations from the University of Oregon in 2002. He has a BA (1990) and an MBA (1998) from Seattle Pacific University. Scott's recent research has focused on leadership, growth mindset, and emotional intelligence and has been published in management journals.

Kenman Wong is a Professor of Business Ethics at Seattle Pacific University. He holds an MBA from the University of Washington and completed his Ph.D. at the University of Southern California. His research has been published in management and business ethics journals.

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