

# CASE 22

## eBay and the Online Auction and Retail Sales Industry in 2011

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With almost 18,000 employees, eBay, headquartered in San Jose, California, manages and hosts the well-known global online auction and shopping Website that people all around the world visit to buy and sell goods and services. In 2010, eBay generated \$9.5 billion in revenue, up from \$4.5 billion in 2005, but it generated only \$3.5 billion in earnings (measured by EBITDA) compared to \$2.1 billion in 2005. Prior to 2007, eBay had been a stellar performer on the stock exchange under the guidance of Meg Whitman, its first CEO; the company's stock market valuation was \$46 billion in 2007, making investors extremely happy. But since 2007, eBay has experienced increasing competition and so many problems that its stock price has dramatically fallen—so much so that in July 2011, its market valuation had dropped to \$43 billion. Why? Investors became worried its business model would not be so profitable in the future because the online auction market was becoming mature and opportunities for growth were declining. In addition, the nature of competition in online retailing was changing and Amazon.com had emerged as the top online retail portal. Its stock plunged in value as it seemed likely that eBay's business model had run out of steam. But to understand the sources of eBay's success and the current challenges it faces, it is necessary to explore the way eBay's business model and strategies have changed over time.

### eBay's Beginnings

Until the 1990s, the auction business was largely fragmented; thousands of small city-based auction houses offered a wide range of merchandise to local

buyers. And a few famous global houses, such as Sotheby's and Christie's, offered carefully chosen selections of high-priced antiques and collectibles to limited numbers of dealers and wealthy collectors. However, the auction market was not very efficient, for there was often a shortage of sellers and buyers, and so it was difficult to determine the fair price of a product. Dealers were often able to influence auction prices and obtain bargains at the expense of sellers. Typically, dealers were able to buy at low prices and then charge buyers high prices in the bricks-and-mortar (B&M) antique stores that are found in every town and city around the world; they reaped high profits. The auction business was changed forever in 1995, when Pierre Omidyar developed innovative software that allowed buyers around the world to bid online against each other to determine the fair price for a seller's product.

Omidyar founded his online auction site in San Jose on September 4, 1995, under the name "Auction Web." A computer programmer, Omidyar had previously worked for Microsoft, but he left that company when he realized the potential opportunity to develop new software that provided an online platform to connect Internet buyers and sellers. The entrepreneurial Omidyar changed his company's name to eBay in September 1997, and the first item sold on eBay was Omidyar's broken laser pointer for \$13.83. A frequently repeated story that eBay was founded to help Omidyar's fiancée trade PEZ Candy dispensers was fabricated by an eBay public relations manager in 1997 to interest the media. Apparently the story worked, for eBay's popularity grew quickly by word of mouth, and the company did not need to

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advertise until the early-2000s. Omidyar had tapped into a huge unmet buyer need and people flocked to use auction software platform. Another major reason eBay did not advertise in its early years was that its growing global popularity had put major pressure on its internal computer information systems, both its hardware and software. In particular, the technology behind its search engine—which was not developed by Omidyar but furnished by independent specialist software companies—could not keep pace with the hundreds of millions of search requests that eBay's users generated each day. eBay was also installing powerful servers as quickly as it could to manage its fast-growing global database, and it was recruiting computer programmers and IT managers to run its systems at a rapid rate.

To finance eBay's rapid growth, Omidyar turned to venture capitalists to supply the hundreds of millions of dollars his company required to build its online IT infrastructure. Seeing the success of his business model, he was quickly able to find willing investors. As part of the loan agreement, however, the venture capitalists insisted that Omidyar give control of the running of his company to an experienced dot.com top manager. They were very aware that founding entrepreneurs often have problems in building and implementing a successful business model over time. They recommended that Meg Whitman, an executive who had had great success as a manager of several software start-up companies, be recruited to become eBay's CEO, while Omidyar would assume the role of chairman of the company.

## eBay's Evolving Business Model

From the beginning, eBay's business model and strategies were based on developing and refining Omidyar's auction software to create an easy-to-use online market platform that would allow buyers and sellers to meet and transact easily and inexpensively. eBay's software was created to make it easy for sellers to list and describe their products, and easy for buyers to search for, compare, and bid on the products they wanted to purchase. The magic of eBay's software is that the company simply provides the electronic conduit between buyers and sellers; it never takes physical possession of the products that are listed, and their shipping is the responsibility of sellers and payment the responsibility of buyers.

Thus, eBay does not need to develop all the high-cost functional activities like inventory, shipping, and purchasing to deliver products to customers, unlike Amazon.com, for example. So, eBay operates with a low cost structure given the huge volume of products it sells and sales revenues it generates—hence the high revenues and profits it earned before until 2007, as mentioned earlier. Also, word of mouth enabled eBay to avoid paying high advertising costs, an especially important consideration early on because these are a major expense for many online portals seeking to gain a reputation. And, as far as buyers are concerned, eBay is also low cost, for under current U.S. law, sellers located outside a buyer's state do not have to collect sales tax on a purchase. This allows buyers to avoid paying state taxes on expensive items such as jewelry and computers, which can save them tens or even hundreds of dollars, and makes purchasing on eBay more attractive.

To make transactions between anonymous Internet buyers and sellers possible, however, Omidyar's software had to reduce the risks facing buyers and sellers. In particular, it had to convince buyers that they would receive what they paid for, and that sellers would accurately describe their products online. Also, sellers had to be convinced that buyers would pay for the products they committed to purchase on eBay, although of course they were able to wait for the money to arrive in the mail, so their risk was lower; however, many buyers do not pay or pay extremely late. To minimize the ever-present possibility of fraud from sellers misrepresenting their products, or from buyers unethically bidding for pleasure and then not paying, eBay's software contains a method for building and establishing trust between buyers and sellers—building a reputation over time.

After every transaction, buyers and sellers can leave online feedback about their view of the other's behavior and the value of the transaction they have completed. They can fill in an online comment form, which is then published on the Web for each seller and buyer. When sellers and buyers consistently act in an honest way in more and more transactions over time, they are able to build an increasingly stronger positive feedback score that provides them with a good reputation for honesty. More buyers are attracted to a reputable seller, so the seller obtains higher prices for their products. Sellers can also decide if they are dealing with a reputable buyer—one who pays promptly, for example. Over time, this

became more difficult because new “unknown” buyers come into the market continuously, so eBay developed online mechanisms so sellers can refuse to deal with any new or existing buyer if they wish, and can remove that buyer’s bid from an auction.

eBay generates the revenues that allow it to operate and profit from its electronic auction platform by charging a number of fees to sellers (buyers pay no specific fees). In the original eBay model, sellers paid a fee to list a product on eBay’s site and paid a fee if the product was sold by the end of the auction. As its platform’s popularity increased and the number of buyers grew, eBay increased the fees it charged sellers. The eBay fee system is quite complex, but in the United States in 2006, eBay took between \$0.20 and \$80 per listing, and 2%–8% of the final price, depending on the particular product being sold, and the format in which the product sold. In addition, eBay acquired the PayPal payment system that charges substantial fees of its own; this is discussed in detail below.

This core auction business model worked well for the first years of eBay’s existence. Using this basic software platform, every day tens of millions of products such as antiques and collectibles, cars, computers, furniture, clothing, books, DVDs and a myriad of other items are listed by sellers all around the world on eBay and bought by the highest bidders. The incredible variety of items sold on eBay suggests why eBay’s business model has been so successful—the same set of auction platform programs, constantly improved and refined over time from Omidyar’s original programs, can be used to sell almost every kind of product, from low-priced books and magazines costing only cents, to cars and antiques costing tens or hundreds of thousands of dollars. Some of the most expensive items sold include a Frank Mulder 4Yacht Gigayacht (\$85 million), a Grumman Gulfstream II jet (\$4.9 million), and a 1993 San Lorenzo 80 Motor Yacht (just under \$2 million). One of the largest items ever sold was a World War II submarine that had been auctioned off by a small town in New England that decided it did not need the historical relic anymore.

Meg Whitman’s biggest problem was to find search engine software that could keep pace with the increasing volume of buyers’ inquiries. Initially, small independent suppliers provided this software; then IBM provided this service. But as search technology advanced in the 2000s, eBay recruited its

own search experts from other companies such as Yahoo! and Google. Today, it has its own in-house search technology teams who continually refine and improve its own proprietary search engine software to make it more appealing to its sellers and buyers—and to keep up with competitors. CEO Whitman looked for new ways to improve eBay’s business model, while the most pressing concerns were keeping the eBay Website up and running 24 hours per day, and keeping its online storefront meeting the needs of its rapidly increasing number of buyers and sellers.

First, to take advantage of the capabilities of eBay’s software, the company began to expand the range and categories of the products it offered for sale to increase revenue. Second, it increased the number of retail or “selling” formats used to bring sellers and buyers together. For example, its original retail format was the 7-day auction format, where the last bidder within this time period “won” the auction, provided the bid met the seller’s reserve or minimum price. Then, it introduced the “buy-it-now” format where a buyer could make an instant purchase at the seller’s specified price, and later a real-time auction format in which online bidders, and bidders at a B&M auction site, compete against each other in real time to purchase the product up for bid. In this format, a live auctioneer, not the eBay auction clock, decides when to close an auction.

Beyond introducing new kinds of retail formats, over time eBay continuously strived to improve the range and sophistication of the information services it provides its users—to make it easier for sellers to list, describe, present, and ship their products, and for buyers to make better purchasing decisions. For example, software was developed to make it easier for sellers to list their products for sale and upload photographs and add or change information to the listing—however eBay began to charge more for these services. Buyers were also able to take advantage of the new services offered in what is called My eBay; buyers can now keep a list of “watched” items so that over the life of a particular auction they can see how the price of a product has changed and how many bidders are interested in it. This is a useful service for buyers because frequently bidders for many items enter in the last few minutes to try to “snipe” an item or obtain it at the lowest possible cost. As the price of an item becomes higher, this often

encourages more buyers to bid on it, so there is value to buyers (although not sellers, who want the highest prices possible) to wait or just bid a minimal amount so they can easily track the item.

By creating and then continually improving its easy-to-use retail platform for sellers and buyers, eBay revolutionized the auction market, bringing together international buyers and sellers in a huge, never-ending yard sale. eBay became the means of cleaning out the "closets of the world" with its user-friendly platform.

## New Types of Sellers

Over time, eBay also encouraged the entry of new kinds of sellers into its electronic auction platform. Initially, it focused on individual, small-scale sellers; however, it then sought to attract larger-scale sellers using its eBay Stores selling platform, which allows sellers to list not only products up for auction but also all the items they have available for sale, perhaps in a B&M antique store or warehouse. Store sellers then pay eBay a fee for these "buy it now" sales. Hundreds of thousands of eBay stores became established in the 2000s, greatly adding to eBay's revenues.

Also, during the 2000s, small specialized online stores and large international manufacturers and retailers such as Sears, IBM, and Dell began to open their own online stores on eBay to sell their products using competitive auctions for "clearance goods" and fixed-priced buy-it-now storefronts to sell their latest products. By using eBay, these companies established a new delivery channel for their products, and they were able to bypass wholesalers such as discount stores or warehouses that take a much larger share of the profit than eBay does through its selling fees.

Software advances arrived faster and faster in the 2000s, in part due to eBay's new Developers Program that allowed independent software developers to create new specialized applications that seamlessly integrate with eBay's electronic platform. By 2005, there were over 15,000 members in the eBay Developers Program, comprising a broad range of companies creating software applications to support specialized eBay sellers and buyers, as well as eBay Affiliates. All this progress helped speed and smooth

transactions between buyers and sellers and drove up eBay's revenues and profits, something that resulted in a huge increase in the value of its stock.

## Competition in the Retail Auction Industry

eBay's growing popularity and growing user or customer base made it increasingly difficult for the hundreds of other online auction houses that had also come online to compete effectively against it. Indeed, its competitive advantage was increasing because both sellers and buyers discovered that they were more likely to find what they wanted and get the best prices from a bigger auction Website's user base or market. And, from the beginning, eBay controlled the biggest market of buyers and sellers, and new users became increasingly loyal over time. So even when large, well-known online companies such as Yahoo! and AOL attempted to enter the online auction business, and even when they offered buyers and sellers *no-fee* auction transactions, they found it was impossible to grow their user bases and establish themselves in this market. From network effects, eBay had obtained a first-mover advantage and was benefiting from this.

The first-mover advantage eBay gained from Pierre Omidyar's auction software created an unsailable business model that effectively gave eBay a monopoly position in the global online auction market. Even today, there are few online or B&M substitutes for the auction service that eBay provides. For example, sellers can list their items for sale on any kind of Website or bulletin board, and specialist kinds of Websites exist to sell highly specialized kinds of products like heavy machinery or large sailboats, but for most products, the sheer reach of eBay guarantees it a dominant position in the marketplace. Because there has been little new entry into the online auction business, the fees eBay charges to sellers steadily increased as it grew, and skimmed off ever more of the profit in the auction value chain. eBay decided it did not have to worry about the power of buyers or sellers to complain about fee increases because it has access to millions of individual buyers and sellers. Sellers would only be a threat to eBay if they could band together and demand reductions in eBay's fees and charges.

This happened first during the early-2000s. Meg Whitman, desperate to keep eBay's revenues growing to protect its stock price, started to continuously increase the fees charged to eBay stores to list their items on eBay. Store sellers rebelled and used the eBay community bulletin boards and chat rooms to register their complaints. eBay realized there was a limit to how much it could charge sellers. It would have to find new ways to attract more buyers to the sellers' products, and get them better prices, if it was going to be able to increase the fees it charged sellers. Or it would have to find new ways to extract profit from the auction value chain.

## New Ways to Grow eBay's Value Chain

Meg Whitman always preached to eBay's employees that to maintain and increase the value of its stock (and many employees own stock options in the company), eBay must (1) continually attract more buyers and sellers to its auction site, and (2) search for ways to generate more revenue from these buyers and sellers. To create more value from its auction business model, eBay has adopted many other kinds of strategies to grow profitability over time.

## International Expansion

Online, buyers from any country in the world can bid on an auction, and so it became clear early on that one way to grow eBay's business would be to replicate its business model in different countries around the world. Accordingly, eBay quickly moved to establish storefronts around the world customized to the needs and language of a particular country's citizens. Globally, eBay established its own online presence in countries like the United Kingdom and Australia, but in other countries, particularly non-English-speaking countries, it often acquired the national start-up online auction company that had stolen the first-mover advantage in a particular country. In 1999, for example, eBay acquired the German auction house Alando for \$43 million and changed it into eBay Germany. In 2001, eBay acquired MercadoLibre, Lokau, and iBazar, Latin American auction sites, and established eBay Latin America. In 2003, eBay acquired

EachNet, a leading e-commerce company in China, for \$150 million to enter the Chinese market. And, in 2004, it bought Baazee.com, an Indian auction site, and took a large stake in Korean rival Internet Auction Co. In 2006, eBay acquired Tradera.com, Sweden's leading online auction-style marketplace, for \$48 million, in 2009 it acquired Gmarket, Korea's leading online marketplace.

All these global acquisitions helped eBay to retain its dominant presence in the global online auction business to facilitate transactions both inside countries and between countries to build up revenue. Once eBay was up and running in a particular country, network dynamics took effect, and it became difficult for a new auction start-up to establish a strong foothold in its domestic online auction market. But, eBay has faced serious competition in countries such as Japan and Hong Kong, where Yahoo! gained a head start over eBay and thus gained the first-mover advantage in these countries; in China, too, eBay has run into major opposition. Thus, by 2011, significant global expansion was difficult because the cost of overseas online auctions sites had become extremely expensive and eBay's goal was to protect its market share around the world.

## Expanding its Value Chain Activities

Providing more kinds of value-chain services that add value and create revenue and profit at different stages of the online auction and retail value chain is a second way in which eBay has grown the revenues from its auction model. This strategy emerged gradually as it sought new sources of revenues to bolster its bottom line.

## eBay Drop-Off Stores

One service it created in the early-2000s to encourage more business from individuals who want to sell their goods online—but lacked the computer skills to do so—was eBay Drop Off. eBay licenses reputable eBay sellers that have consistently sold hundreds of items using its platform to open B&M consignment stores in cities where anybody can “drop off” the products they want to sell. The owner of the



Drop-Off Store describes, photographs, and lists the item on eBay and then handles all the payment and shipping activities involved in the auction process. The store owner receives a commission, often 15% or more of the final selling price (not including eBay's commission) for providing this service. These stores have proved highly profitable for their owners and thousands have sprung up across the United States and the world (a search request on eBay's site allows buyers to identify the closest eBay Drop-Off Store). The advantage for eBay is that this drop-off service gives it access to the millions of people who have no experience in posting photographs online, organizing payment, or opening an eBay account and learning how to list an item, and so eBay gains from increased listing fees.

## Increased Advertising

To promote the millions of products it has for sale on its site, eBay increased its use of advertising—on television, newspapers, and on popular Websites—to expand its user base in the 2000s. Its goal was to make eBay *the* preferred place to shop online by demonstrating two things: first, the incredible diversity of products available for purchase on its site, and second, the fact that its products generally cost less than buyers would pay in B&M stores—or even on other online stores. New and used DVDs, books, designer clothing, electronics and computers are some of the multitude of products that can be obtained at a steep discount on eBay. Thus, while the range of the products eBay sells provides it with a differentiation advantage, the low prices that buyers can often obtain gives it a low-price advantage too—provided buyers are prepared to wait a few days to receive their newly purchased products.

## PayPal Payment Service

Meg Whitman was also working to find ways to make transactions easier for eBay buyers and sellers to increase the ease, security, and volume of online sales. One way to do this was to get involved in an extremely profitable part of any company's value chain activity—the payment system involved in managing the financial transactions necessary to complete

online transactions—to both purchase and sell products online. The effective management of financial transactions is vital in online transactions for this poses the greatest risks to buyers, who may be taken advantage of by unscrupulous or fraudulent sellers who take money and then fail to deliver the expected product. Sellers also faced problems. When eBay first started, sellers usually demanded money orders or bank cashiers' checks as secure forms of payment from buyers, or insisted that ordinary checks had to be cleared through their accounts before mailing the product to customers. This increased the length of time and effort involved in a transaction for sellers and buyers and led to lost sales—customers don't like to wait a long time to receive their purchases.

By the early-2000s, online companies like PayPal and Billpoint had emerged that offered secure online electronic payment services that greatly facilitated online commerce. To work efficiently, these services require sellers and buyers to register and enter a valid bank account number, and usually a credit card number, to authenticate the sellers' and buyers' identities and their ability to pay for the items purchased. Now payment became instantaneous; the money was taken directly from the buyer's bank account or paid for by credit card. Buyers could now purchase on credit, while sellers could immediately send off the product to the buyer. When buyers paid sellers, the online payment company collected a 3% commission, which was taken from the seller's proceeds—a very profitable source of revenue.

eBay recognized this was highly profitable value-chain activity because by becoming involved in online payment services it would increase its share of the fees involved in eBay transactions. But, eBay also realized that ownership of a secure online payment system would reinforce its attempts to increase the reputation of both buyers and sellers to encourage the growth of online sales by preventing fraud. Major synergies between selling and payment activities were possible. Since it was late to enter this business and would take a long time to develop its own payment service from scratch, eBay acquired the online payment service Billpoint and worked to get eBay buyers and sellers to register with Billpoint. However, eBay found itself running up against a brick wall; just as eBay had gained the first-mover advantage in the auction business, so PayPal had gained it in the online payment business. Millions of eBay users were already signed up with PayPal. After

...failing to make Billpoint the market leader, in 2002 eBay acquired PayPal for \$1.5 billion in stock—a great return for PayPal's stockholders. Then, to reduce costs, eBay switched all Billpoint customers to PayPal and shut down Billpoint. This purchase has been very profitable for eBay, for it now owns the world's leading online payment system. The PayPal acquisition has paid for itself many times over, as discussed below.

## More Retail Formats

eBay also began to make many acquisitions to facilitate its entry into new kinds of specialized retail and auction formats to increase its market reach—and its revenues and profits. In 1999, it acquired the well-known auction house Butterfield & Butterfield to facilitate its entry into the auctioning of high-priced antiques and collectibles and compete with upper-end auction houses such as Sotheby's and Christie's. However, eBay's managers discovered that a lot more involvement was needed to correctly identify, price, list, and then auction rare, high-priced antiques, and it exited the upper-end auction niche in 2002 when it sold Butterfield & Butterfield to Bonhams, an upscale auction house that wanted to develop a much bigger online presence.

To further its expansion into the highly profitable motor vehicle segment of the market, in 2003 eBay acquired CARad.com, an auction management service for car dealers, to strengthen eBay Motors. Now eBay controls the auctions in which vehicle dealers bid on cars that they then resell to individual buyers, often on eBay Motors. In another move to enter a new retail market in 2004, eBay acquired Rent.com for \$415 million. This online site offers a completely free rental and roommate search service; it offers to pay users who have signed a new lease at a property found on its Website \$100 when they inform Rent.com. Once again, the "sellers" of the rentals on its Websites are charged the fees; the online roommate search is free. Rent.com has millions of up-to-date rental listings, with thousands added every day; listings include a property's address and phone number, a detailed description, photos, floor plans, and so on, which makes it easier for prospective renters to research and select a rental.

In 2000, eBay acquired Half.com for \$318 million. Half.com is an online retail platform that specializes

in the sale of new and used fixed-price consumer products such as books, movies, video games, DVDs, and so on that are offered at a fixed price and sold on a first-come-first-served basis, not by auction. eBay's "Buy It Now" feature is similar, although sellers are allowed to set a lower start price than the buy-it-now price, and the selling process can develop into an auction if bidders start to compete for the product. In the 2000s, the popularity of fixed-price online retailing led to a significant expansion in eBay's activities in this segment of the retail market. In 2006, eBay opened its new eBay Express site, which was designed to work like a standard Internet shopping site to consumers with U.S. addresses. Select eBay items are mirrored on eBay Express, where buyers use a shopping cart to purchase products from multiple sellers. A UK version of eBay Express is also in development.

In 2005, eBay acquired Shopping.com, an online price-comparison shopping site, for \$635 million. With millions of products, thousands of merchants, and millions of reviews from the Epinions community, Shopping.com empowers consumers to make informed choices and, as a result, encourages more buyers to purchase products. Information provided by Shopping.com also facilitates eBay sellers' pricing knowledge about their online competitors and helps them price their products competitively so that they can sell them more quickly. The site also allows customers to purchase products from various eBay retail formats.

In the 2000s, online local classifieds have become an increasingly popular way for people to sell their unwanted products, especially because there are usually no fees associated with them. Local classifieds are very popular for bulky products like furniture, appliances, exercise equipment, and so on, where high transportation costs represent a significant percentage of the purchase price. In 2004, to ensure its foothold in this online retail segment, eBay bought a 25% stake in the popular free online classifieds Website Craigslist by buying the stock of one of Craigslist's founders.

These free local classified services have been hurting newspapers whose classified sales have sharply decreased. It remains to be seen in the future whether these classified services will remain free or whether they will also be charging fees. Clearly, eBay would like to charge a fee if it owned a controlling stake in Craigslist. Perhaps preparing for the future when money will be made from online classifieds, in 2004, eBay acquired Marktplaats, a Dutch

competitor that had achieved an 80% market share in the Netherlands by focusing on small fixed-price ads, not auctions. Then, in 2005, eBay acquired Gumtree, a network of UK local city classifieds sites; the Spanish classifieds site, Loquo; and the German language classifieds site, Opus Forum. In 2005 eBay launched Kijiji, a local classifieds site it made available in nearly a dozen countries to try to dominate this growing retailing market.

## The Skype Acquisition

Perhaps going furthest away from its core business, in 2005, eBay acquired Skype, the dominant Voice-Over-Internet-Provider (VOIP) telephone company, for \$2.6 billion. Meg Whitman's rationale for this expensive purchase was that Skype would provide eBay with the ability to perform an important service for its users, specifically, to give them a quick, inexpensive way to communicate and exchange the information required to complete online transactions. Skype's software allows users to make free calls from their computers over the Internet to anyone, anywhere in the world. Skype boasts superior call quality and the ability to allow users not just to make phone calls but also to send instant messages, transfer big files, chat, and make video conference calls. It is a full-scale online communications company.

According to Whitman, Skype would help eBay sellers build their online businesses. Using Skype, buyers can contact sellers anytime on their Skype phone number. Sellers can also call regular phone numbers anywhere in the world using SkypeOut at very low rates, and with a SkypeIn phone number, buyers can call a regular telephone number wherever the seller is in the world. Also, in the case of large sellers, Skype allows continuous contact between all the members of the store with SkypeIn numbers and Skype Voicemail. For buyers, Skype allows them to get all the product information they need to buy with confidence and to get answers immediately, without waiting for e-mail.

Many analysts believed it was questionable whether eBay needed to buy a VOIP company given that so many alternative methods of instant communication were offered by so many online companies as AOL, MSN, Yahoo!, Google, and so on. Nevertheless, eBay quickly developed strategies to get

sellers to integrate Skype into their storefronts and to find new ways to include it in the regular transaction process just as it was doing with its PayPal service.

## eBay ProStores

Another strategy eBay has used to grow its revenues was to create a new online retail consulting service called ProStores in 2005 that allows potential sellers to utilize eBay's functional competencies in online retailing to create their own online storefront using eBay's software—for a fee of course. ProStores offers sellers a fully featured Web store that can be customized specifically for each online seller and that is then maintained and hosted by eBay. Sellers using the ProStores service might be specialist B&M stores searching for a quick and easy way to establish an online presence, or any entrepreneur who wishes to start an online store. The difference between eBay ProStores and regular eBay Stores is that ProStores sites are accessed through a URL unique to each seller and are not required to carry eBay branding. ProStores sellers are responsible for driving their own store traffic. While items on ProStores sites sell at fixed prices only, they can be simultaneously listed on the eBay marketplace in either the auction or fixed-price formats.

ProStores provides all software needed to build a storefront and then create the listing, promotion, and payment systems needed to make it work. ProStores uses templates and wizards that allow users to quickly and easily build an attractive, feature-rich store with no technical or design skills whatsoever. In return, eBay charges two basic fees to all sellers who purchase a ProStores Web store: (1) a monthly subscription fee and (2) a monthly successful transaction fee calculated as a percentage of the sales price of items sold in the store. The subscription fee ranges from \$6.95 to \$249.95, depending on the size of the store. The successful transaction fee varies between 1.5 and 2.5%.

## eBay Express

Finally, reacting to growing buyer demand for a discounted, fixed-price retail format, in 2006, eBay established eBay Express, where a vast inventory of brand-new, brand-name, and hard-to-find products are offered at fixed prices by top eBay sellers. Buyers are able to obtain the products they want



with no bidding and no waiting; they can fill their shopping carts from multiple eBay merchants and pay for everything, including shipping, in a single, secure payment using PayPal. eBay is touting that every transaction is safe, secure, and fully covered by free buyer protection from PayPal. eBay Express was eBay's first major move to react to the growing threat it was facing from Amazon.com, whose rapid growth was based on the growing popularity among online customers for fixed-price retailing. As discussed below, eBay was too late to enter fixed-price retailing because Amazon.com had now gained the first mover advantage and this has resulted in growing problems, as discussed next.

## New Problems for eBay

Despite adopting all these new strategies to strengthen its business model, in the 12 months ending August 2006, eBay's stock declined 30% from its lofty height, while the stock market had risen about 8%. Why? The first major problem facing eBay was that while the number of its global users was increasing, it was increasing at a decreasing rate—even after all its promotional and advertising efforts and its emphasis on introducing new site features, functionality, retail formats and international expansion. Similarly, although the number of items listed on eBay's retail platforms was increasing (by 45% in 2004 and 33% in 2005), growth was also slowing. In fact, in eBay's U.S. retail segment, net transaction revenues increased only 31% in 2005 and 30% in 2004, compared to 43% in 2003, while gross merchandise volume increased 19% in 2005 and 27% in 2004, compared to 41% in 2003. eBay's revenue growth was slowing, and it seemed clear to investors that despite all its new strategies and entry into online payment and communications activities would not be able to sustain its future growth—and so justify its lofty stock price.

A second major problem was its failure to recognize the potential of online advertising revenues. By 2006, it was clear that leading Internet companies like Yahoo!, Microsoft, and eBay were all facing a major threat from Google, which was perfecting its incredibly lucrative online search and advertising model. Google was now the “new eBay” in terms of stock appreciation because of the way it was able to implant its advertising search software into its own

and any other Internet Website willing to share advertising revenues with Google. In fact, because eBay is one of the world's biggest buyers of Web search terms, it is one of Google's largest customers. eBay manages a portfolio of 15 million keywords on different search sites, such as Google, Yahoo!, and AOL. These searches are aimed at attracting bidders to one of eBay's retail formats, which is why eBay, or one of its subsidiaries, often comes up first on a search inquiry.

All the large Internet companies realized they had underestimated the enormous potential revenues to be earned from Internet advertising and were anxious to get a bigger share of the pie and copy Google's approach. eBay, which had not placed ads on its pages in the past to allow its users to focus on the products for sale, now began to have banner ads, pop-ups, and the other obtrusive and annoying ways of advertising developed by software advertising engineers. By 2007, it had placed several ads on each page in its desperate hurry to increase revenues. eBay became concerned Google would start to drain away even more of its revenues and customers, and it searched for ways to counter Google's threat. However, analysts noted that eBay could not abandon its “friendly” relationship with Google because Google is the most popular search engine on which eBay promotes its retail storefronts.

Third, in another controversial move, in the spring of 2006, eBay decided to sharply increase the fees it charged its fixed-cost storefronts to advertise on its site. By 2006, sales of fixed-price products, which carried smaller margins than auction products, had grown to over 80% of total retail sales. In charging higher fees, eBay risked alienating large fixed-cost sellers, which would be forced to pass on these increases to customers, and of alienating customers who now could choose a popular shopping comparison tool like eBay, MSN, or Google's shopping-specific Websites, all of which attempt to locate the lowest-priced products. They could also go and shop at Amazon.com. Analysts questioned if this strategy would backfire—and it did as discussed below.

## A 2007 Turnaround?

In 2007, eBay announced some impressive financial results that provided a lift to its stock price that had fallen from \$60 in 2005 to a low of \$25

in 2006. Shares of eBay jumped by 8% in February 2007 when eBay reported a fourth-quarter profit that climbed 24% as sales rose more than expected, helped by a surge in its PayPal electronic payments business and higher prices for the items eBay sells online. Net income for the fourth quarter rose to \$346 million, or \$0.25 a share, from \$279 million, or \$0.20, a year earlier. Revenue from eBay's PayPal payments business rose 37% to \$417 million, or 1/4 of the company's total, while sales in its online marketplace business rose 24%. These results suggested that eBay's decision to raise its charges to list items in eBay stores to some of its highest-volume sellers had paid off, the quality of the listing had improved, and more of these sellers had been encouraged to use the higher fee-paying auction method. eBay's stock price climbed to \$40 by October 2007, and that once again seemed to suggest to investors that its competitive advantage was secure, even in the face of challenges from Google and Amazon.com. However, the turnaround was short-lived.

## A New CEO and New Problems and Strategies

When eBay reported results in the next two quarters, however, it was clear that all was not well as its core auction business experienced sequential declines in listings. It was becoming clear that the company's growth was still slowing despite all of Meg Whitman's efforts to expand its sales and retail channels, payment services, and communication through Skype. When the company's stock had dropped back to \$26 by March 2008, Whitman decided to resign and a new CEO, John Donahoe, who had been president of eBay Marketplaces and its retail channels, was named to succeed her.

In one of his first press conferences as CEO, Donahoe announced that eBay's biggest problem was that it was lagging behind in its attempts to develop an advanced search engine that would let users find the products they want: "Today our buyers tell us that we know you have unmatched selection, but we can't always find what we want and find values as fast as we want," Donahoe said. Donahoe's new goal for eBay's retail channels was to use its massive database on seller and buyer transactions to provide the most relevant search experience possible, Donahoe

also proposed to develop a much clearer way of combining fixed-price listings, which are appropriate for new current-model products, and auctions, which are the best way to find prices for unique, older and used merchandise. In 2008, buyers could purchase fixed-price goods on the main eBay site, as well as on its eBay Express site and Shopping.com site. In the future, Donahoe wants all these different options to be presented on a single page of search results from eBay's main site. This was an ambitious goal as the changes eBay's software designers had been making over time were often not well received by buyers or sellers, who had not liked the changes eBay had been making to its search engine. However, eBay was now increasingly under attack from Google and Amazon.com, that had been developing much more advanced search engines and were attracting more customers as a result.

Donahoe also noted that an increasing percentage of eBay's revenues and profits were coming from its PayPal operations and that one of his major priorities would be to promote the use and scale of PayPal's financial operations. On the other hand, he also noted that the Skype acquisition was not increasing the profitability of eBay's value-chain operations, and that he would look at the pros and cons of divesting it to free up working capital to be invested in eBay's Marketplaces retail channels.

Donahoe also announced that eBay would be creating a new fee structure for sellers that would reduce the initial cost of listing an item, including the cost of putting photographs on the listing, and shifting the burden to an increased percentage of the final sale price. He claimed that, as Amazon.com was doing, sellers prefer this model that only charges a fee when a sale is made because it involves less risk to them. However, as he said: "There definitely will be those that are concerned or upset about these changes, our clear belief is what's good for buyers is good for sellers, and is good for eBay." Little did he know what was in store for eBay.

## eBay's Seller's Revolt

As noted earlier, since its founding, eBay has sought to cultivate good relationships with the millions of sellers that advertise their goods on its Website. But, at the same time, to increase its revenues and profits it steadily increased the fees it charges sellers to list

and promote their products on its sites, to use its PayPal payment service, and so on. This had caused some grumbling and problems with sellers in the past because it reduced their profit margins. However, eBay had been increasing its advertising and developing new retail channels to attract millions more buyers to its Websites so sellers would receive better prices and this would offset their higher costs. As a result, sellers tolerated eBay's fee structure.

This all changed in February 2008 when Donohue's new fee structure took effect. For its small-scale sellers that already had thin profit margins the fee hikes that increased back-end commissions on completed sales and payments were painful. In addition, in the future, eBay announced it would block sellers from leaving negative feedback about buyers—feedback such as buyers who didn't pay for the goods they purchased or took too long to do so. Donohue's claimed this change was to improve the buyer's experience because many buyers had complained that if they left negative feedback for a seller—the seller would then leave negative feedback for the buyer!

Together, however, these changes resulted in a blaze of conflict between eBay and its millions of sellers who thought they were being harmed by these changes, that they had lost their prestige and standing at eBay, and their bad feelings resulted in a revolt. Blogs and forums across the Internet were filled with messages expressing feelings that eBay had abandoned its smaller sellers and was pushing them out of business in favor of high-volume "powersellers" who contributed more to eBay's profits. eBay and Donohue received millions of hostile e-mails and sellers threatened they would move their business elsewhere, such as onto Amazon.com. Sellers even organized a 1-week boycott of eBay during which they would list no items with the company to express their hostility. Many sellers did shut down their eBay online storefronts and moved to Amazon.com, which claimed in 2009 that for the first time its network of retail sites had overtaken eBay in monthly unique viewers or "hits." One informal survey found that while over 50% of buyers thought Amazon.com was an excellent sales channel, only 23% regarded Bay as being excellent.

Realizing his changes had backfired, Donohue reversed course in 2009 and eliminated several of eBay's fee increases and revamped its feedback system so that buyers and sellers can now respond to one another's comments in a fairer way. These moves

did smooth over the bad feeling between sellers and eBay, but the old "community relationship" it had enjoyed with sellers largely disappeared.

## Improving Retail Channels and Product Search

Clearly, Donahoe would not be able to significantly increase eBay's revenues by increasing fees to sellers in the future, so his focus now was on expanding and improving its retail channels and product search capabilities to increase revenues. In 2007, eBay had acquired StubHub, the world's largest online ticket marketplace, and Donahoe worked to increase its market share and profits, once again by increasing fees, but also by improving its search software capabilities. eBay has also launched its Kijiji classified sites in 200 U.S. cities during 2007, but had not had the success it expected. In 2010, eBay relaunched its Kijiji classifieds site as eBayClassifieds.com with major software enhancements that it claimed would create industry-leading standards in trust and safety, customer service and user experience. In 2008, eBay Marketplaces introduced gift cards to capitalize on the growing popularity of "private" credit cards.

In 2009, eBay introduced "Daily Deals" to compete with Groupon and Living Social, backed by Amazon.com. This new online coupon retail channel connects buyers with sellers faster than ever, and its popularity has exploded. In 2011, eBay launched a new home page design that offers more deals and personalization—especially for fixed-price goods the latest step in Donahoe's attempts to improve its search engine capabilities. Also, in 2011, it acquired local product search company, Milo.com, to enhance its daily deal channel offerings.

## New Moves with PayPal

Over the last several years, PayPal was contributing more and more to eBay's profits as the number of its active users, compared to eBay users, and the volume and value of PayPal's transactions increased (See Exhibit 1).

eBay has been working hard to make PayPal a financial powerhouse, and a leading conduit through which buyers and sellers can transact internationally,

**Exhibit 1** Changes in eBay and PayPal Users and PayPal Payments 2006–2010

	2006	2007	2008	2009	2010
Number of Active Global eBay Users (in millions)	82	85	88	90	94
Number of Active Global PayPal Users (in millions)	49	57	70	81	94
Total PayPal Payment Volume (in billions)	\$366	\$486	\$606	\$726	\$926

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something that often involves high fees for buyers and sellers. PayPal also issues eBay credit cards and it has become another important means to reassure buyers that sellers are honest and reputable. During the last decade complaints about fraud on eBay have received increasing publicity as the scams practiced by unethical sellers have been revealed. PayPal allows eBay to offer buyers who use PayPal to pay for their products free product insurance protection in the event that their purchases are either fraudulent or misrepresented. It also reassures sellers that they can trust buyers. Through PayPal, eBay can police sellers and buyers and suspend their accounts if necessary to increase the reliability and quality of its performance. Today, the eBay Buyer Protection program offered through PayPal is the most comprehensive online consumer protection provided by a global retailer.

eBay has also been working to expand PayPal's appeal in many other ways to make it the leading online payment company. In 2005, PayPal launched its Merchant Services division that allows sellers of all sizes to easily and securely accept payments across the Internet. In 2006, PayPal launched a mobile application that allows PayPal users to send money via their mobile phones. By 2008, 8% of all e-commerce worldwide was transacted via PayPal. In 2009, PayPal acquired Israel's Fraud Sciences Ltd. to enhance its security and fraud management systems. Also in 2009, eBay launched its iPhone application, giving millions of buyers mobile access to eBay so that they could buy their items and then pay for them online. To allow its customers more credit facilities, eBay also acquired "Bill Me Later," a leading online-oriented payments brand and began to offer Bill Me Later as an option to customers during checkout.

In 2009, PayPal also opened its platform, PayPal X to become the first major global payments company that was open to third-party development so

other companies could link in directly to the PayPal system and customize their payment approach. For example, in 2010

Facebook users became able to use PayPal to pay for Facebook Ads through the company's online advertising tool and for gaming services such as Zynga's Cityville and Farmville. In 2011, PayPal launched a new service that lets digital-game players pay for digital goods without leaving the content site—and it has already processed \$3.4 billion in digital-goods payments.

Given the growing importance of secure mobile payments in the 2010s as Apple and Google also began offering their own mobile online payments system, in 2011 eBay acquired privately-held Zong Inc. for \$240 million to strengthen PayPal's position in the fast-growing mobile payments and digital goods market. Zong allows consumers to pay for purchases from their mobile phones (or direct-carrier billing) on the Internet and offers a secure connection to more than 250 mobile operators in 45 countries. PayPal President Scott Thompson said that eBay expects that "Zong will strengthen PayPal's value by helping us reach the more than 4 billion people who have mobile phones, giving them more choice and security when they pay."

## The Skype Divestiture

Meg Whitman's strategy that Skype, by providing easy and free global communication, would speed information flow between sellers and buyers and drive eBay's global sales and revenues was not realized—most eBay users stayed with their own e-mail or SMS providers. Consequently, in 2009 announced that it would sell about 70% of Skype to a group of private investors for \$2.75 billion, which it bought for about \$3.1 billion in 2005. While this

seemed to be a poor return on eBay's investment, it received a pleasant surprise in 2011 when Microsoft announced that it was acquiring Skype for \$8.5 billion; that gave eBay a quick \$1.4 billion profit on its remaining 30% stake.

## A 2011 Turnaround?

After all these strategic changes to its business model, by October 2010, Donahoe's turnaround plan for eBay was showing signs of success; 2009 revenues were \$8.7 billion, or 14% higher than before Donahoe took over in 2008, and in 2010, revenues were \$9.5 billion while profit had also increased fueled by the Skype sale, growth in PayPal and growth in revenues from increased sales from its online retail channels." CEO John Donahoe announced that he was pleased with the progress that buyers and sellers were noticing, but also that there was still a lot of work to do. eBay's biggest challenge is still how to manage the threats posed by Amazon.com and Google, which have also been changing their business models to outcompete eBay.

One strategy eBay announced in July 2011 was that it was going to start rolling out a fulfillment service for its merchants, similar to Amazon.com's Marketplace service, and this will handle the storage

and shipping of inventory of the merchants who sell their products on its Websites. Merchants who use Amazon.com's value-chain services benefit enormously from its huge supply chain and the economies of scale that come with it, such as not having to handle inventory, and fast and often free shipping. In the past, eBay appeared to have a stronger business model than Amazon.com's because, unlike Amazon.com, it did not have to bear the costs of warehouses, inventory, and shipping. It provided the marketplace for buyers and sellers to meet, and then, of course, also provided the profitable PayPal payment service that has allowed it to take a greater percentage of the revenues from online transactions on its Website. However, Amazon.com, has shown that by using IT to manage the huge supply chain infrastructure of warehouses necessary to control transactions along the value chain it can provide a better experience for merchants and customers—driving merchants to sell through Amazon.com instead of eBay. Recall, that in the late-1990s Amazon.com tried to take on eBay in auctions and failed. Now eBay is playing catch-up to Amazon.com in the fixed-price product market and is establishing its own physical value chain. Will this work? In 2011, more and more of eBay's profits were coming from expanding its PayPal financial services and analysts worried that this was not a good strategy to increase the profitability of its business model.

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