Case Study- **EBay Inc.**

**Company Overview**

EBay Incorporation is one of the leading and extremely close to be the top best place for buyers and sellers to meet and be able to exchange practically anything. eBay Inc. provides online trading services by developing eBay Marketplace, an Internet-based community in which buyers and sellers are brought together to buy and sell various products. The Company's online service permits sellers to list items for sale, buyers to bid on items of interest, and eBay users to browse through listed items in a fully automated service that is available online seven days a week. Through its PayPal service, eBay enables various businesses or consumers with e-mail in 45 countries to send, and in 44 countries to receive online payments.

EBay’s role is to create, maintain and expand the functionality, safety and reliability of its trading platform while, at the same time, support the growth and success of its community of users. EBay falls under the category of **online market makers** as it facilitates the trade and exchange of various kinds of products without having any ownership or liability. EBay possesses all the characteristics of a market maker which are to provide a platform for the traders to meet, market governance and have the infrastructure to enhance the transactions. EBay has the potential of being a clear winner in the online market maker industry with billions of dollar worth of auctions involving a vast variety of products from pens to automobiles being processed everyday.

**Industry Overview**
The market maker industry was popular at the time EBay came into existence. EBay simply is an online version of traditional auctions, acting as the intermediary. Because access to the online trade channel (i.e. Internet) is universal, and the physical assets required to setup an auctioning site are all commercially available, barriers to entry in the auctioning industry are minimal. Being in a market with huge network externalities makes it extremely difficult for a competitor to get a large share of the user base, since most users tend to gravitate towards the service which already offers the most users (since it will presumable have the greatest number of offerings.) This tremendous switching cost has the effect of locking in customers to EBay.

**History and Origin**

EBay was founded by Pierre Omidyar in his living room in Saint Jose back in September 1995. It was from the start meant to be a marketplace for the sale of goods and services for individuals. Pierre Omidyar, born in Paris, immigrated with his family to the United States when he was six. He graduated from Tufts University in 1988 with a degree in computer science. According to records, encouraged by his wife’s hobby, Omidyar decided to create a small online auction service. Auction Web was launched Labor Day weekend in 1995. Omidyar past experience included working at the General Magic Corporation as a software developer, Apple and he had written a software program for his high school library at the age of 14. In May 1996 he incorporated eBay (which stood for "electronic Bay Area"), becoming its chief executive. EBay was free of charge for its users except for the sellers.

Before Auction Web came into existence, there was nothing such as online exchange of products of all kinds on the internet in an auction manner. There were
traditional auctions but nothing comparable to Omidyar's concept either online or offline. Flea markets and yard sales were the most similar kind of person-to-person interaction offered by the precursor of eBay. In mid-1997 Benchmark Capital, a venture capital firm in Menlo Park, California, put $5 million into the company to acquire a 22 percent stake. With their advice, the company began targeted advertising, renamed itself eBay in September, and launched a second-generation service with a redesigned site.

**Management structure**

During 1996 the site hosted more than 250,000 auctions in some 60 categories including Beanie Babies, stamps, coins, and computers. By the end of the year it was overseeing about 15,000 simultaneous auctions daily, with 2,000 of them new each day. The site received over two million hits a week, and the amount of money exchanged for goods sold exceeded $6 million for the year. By the end of 1996 the company had six employees, including Jerry Skoll, eBay's original president. During this period, Omidyar and Skoll realized that the company had wide range of opportunities looking at the industry and rapid growth in the number of auctions being processed. Experts predicted the online auction field would grow to 17.5 million registered buyers and sales of $15.5 billion by 2001, up from 1.5 millions users and $1.5 billion in sales in 1998.

These analyses lead Omidyar and Skoll to reach a conclusion that at that time they needed better expertise in management and online business to lead the company to a successful path. In May 98, Meg Whitman was appointed president and CEO of EBay. Whitman came from Hasbro Inc.’s preschool division, where she had been general manager. She had previously headed FTD Inc., where she launched its web site and oversaw the transition of the organization from a network of individual florists to a
private company. Known for her experience in managing and marketing consumer brands, Whitman concentrated on raising eBay's profile through increased advertising aimed at hobbyists and groups of collectors. The EB Trudeau management structure is shown below:

In addition, to the above senior management positions, EBay has a board of directors chaired by Omidyar himself.

**Business Model:**

EBay's business model was very simple and based on basic traditional auction procedure without a physical auctioneer. Before being named as EBay, AuctionWeb sellers posted information about their items, and buyers were able to browse the site and submit bids by electronic mail. The actual auction for an item was held over three to four days, with bidders receiving e-mail notices when someone made a higher bid. They could then counter the bid or drop out. The winning bidder made arrangements with the seller for payment and shipping.

When an item is listed on EBay, a nonrefundable insertion Fee is charged, which ranges between 30 cents and $3.30, depending on the seller's opening bid on the item. A
fee is charged for additional listing options to promote the item, such as highlighted or bold listing. A Final Value (final sale price) fee is charged at the end of the seller's auction. This fee generally ranges from 1.25% to 5% of the final sale price. EBay notifies the buyer and seller via e-mail at the end of the auction if a bid exceeds the seller's minimum price, and the seller and buyer finish the transaction independently of eBay. The binding contract of the auction is between the winning bidder and the seller only. EBay served the role of a broker; the firm did not own any of the items being sold and was not responsible for distribution. In addition to the regular online auction service, EBay has expanded in a lot of other areas and industry which are summarized as following:

- PayPal online bill payment service
- Half.com fixed-price trading service
- eBay International country specific sites
- eBay Motors marketplace for automotive products and services
- eBay Stores customizable marketplace service for sellers
- eBay Professional Services small business marketplace
- eBay local trading
- eBay Premier specialty and luxury goods marketplace.
- Skype Communications

**Competition:**

During the tremendous success of EBay as it entered its second year of existence, the website was increasingly popular and the management viewed this success as clear demonstration of the receptivity and the eagerness of the general public to participate in
online commerce. “Our goal is to provide a fun, efficient, and reliable forum for both buyers and sellers” {Skoll}. Along with recognizing the success of the company, the management team did not ignore the competition. During late 1997, a business-to-business auction service OnSale Inc. added person to person auction services. Also, Auction Universe Inc, a web auction firm owned by Los Angeles Times parent Times Mirror Company came into existence. During 1998 Auction Universe began providing city-oriented auction sites through a group of affiliated newspapers, each offering its own local auction site.

Such web sites, aimed primarily at the newspapers' local areas, made it easier to auction large items, since it was expensive to ship a used car or a large piece of furniture across the country. This was an opportunity that EBay’s management wanted to exploit and hence become one major online market maker and their strategy geared towards this was through creating a link between the buyer and seller without taking any liabilities. Today Yahoo.com, amazon.com and Google are major competitors that are competing head to head with EBay’s core business.

**The Growth:**

First quarter of 1997 AuctionWeb saw over 330,000 completed auctions, with the total transaction value of goods sold worth more than $10.25 million. By the end of the year the company had about 340,000 registered users and was hosting approximately 200,000 auctions. EBay grew phenomenally, recording gross merchandise sales of $100 million and revenues of $6 million in the first quarter of 1998. The first quarter had become the company's best, as eBay promoted the auctioning off of unwanted Christmas gifts. By August 1999, the company rated number 3 in a survey of online brands behind
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Amazon.com and Priceline.com. Even at that early date, more than 46% of the American population had become aware of the brand. Under the stewardship of the Whitman, eBay had 5.6 million registered users and listed over 3.1 million items for sale; by 2004 there were an estimated 65 million registered users from 150 countries, 971 million items for sale, and gross merchandise sales hit $15 billion. EBay owned local sites in 19 countries, had stakes in another eight foreign nations.

Whitman and the management of eBay were very well aware of the fact that online auction industry has a lot of potential, at the same time this industry could attract predators very easily. The barrier to entry in the market was low to none and more and more companies on daily basis were realizing the power of selling on the internet. EBay decided to move and develop their dominance in the market ahead of time before the competitors got to that point. Following the growth pattern, EBay went public in 1998 and immediately after the IPO; EBay stock went flying high in the stock market with a turnaround of more than 100% over very short period of time. At the end of 1998 eBay was hosting nearly 1.8 million auctions and reported a profit of $2.4 million on revenues of $47.4 million, making it one of the few Internet retailers to return solid profits. At the same time, its growth and popularity were putting the spotlight on the company and user expectations became more sophisticated. EBay’s strategy to expand faster was inspired by the general facts of enormous potential in the market, simple business model and threat of entrants. As eBay's service evolved, its applicability expanded to broader categories of items, and to a broader and more global user base. As a result, eBay's product mix shifted from primarily collectible items to practical everyday items, such as household goods, computers, consumer electronics and other items. With the shift to a
broader product offering, its competition also broadened, and now included distributors, liquidators, retailers, import and export companies, catalog and mail order companies, and virtually all online and offline commerce participants (consumer-to-consumer, business-to-consumer, and business-to-business).

EBay had established relationships with America Online Inc. (AOL), and became featured in AOL’s Hobby and Classifieds prompts. In 1998, eBay became the exclusive auctioneer in the Classifieds area, paying AOL a guaranteed $12 million over three years. Continuing with the goal of getting big fast, EBay did significant acquisitions in the U.S. and international market. Some of those included Butterfield, a 135-year-old San Francisco auction house, and Kruse International, an automobile auctioneer in Indiana known for collector cars, helped eBay move into a higher-priced market and Billpoint Inc., was a California company specializing in credit card payments over the Internet.

Sellers on eBay could now use Billpoint to instantly accept credit cards and buyers would be able to receive reference reports listing all their transactions. In mid-2000 eBay bought the Philadelphia-based Half.com, an auction site specializing in used goods, for $312 million. EBay also established strategic alliances with other major players in the market such as Microsoft and others to serve as default auction provider. At this time, competition intensified with Priceline.com and Sothebys.com started investing heavily in marketing efforts and having an impact on eBay’s market share. Four days after Independence Day celebrations in the U.S, eBay had a pyrotechnic event of its own by announcing it would acquire PayPal in a deal valued at $1.5 billion. PayPal was acquired to replace the existing BillPoint.
Moving into international markets eBay entered a joint venture with Australia-based PBL Online. It moved into Europe with the acquisition of Alando de AG, Germany's largest online trading site, and considered adding a Japanese-language corner to provide support for its 6,500 members in Japan. At the end of 2000 a new service called Business Exchange, a business-to-business marketplace for small companies to buy office products and equipment, was launched by eBay to maintain its lead as the world's top online auctioneer. Despite the intelligent efforts in the international markets, eBay fell behind yahoo in September 1999 when yahoo was launched and thus got the first mover advantage. Amazon.com, which had acquired a minority stake in Sotheby's Holding Inc., paired up with its new partner to launch a joint auction site. Christie's International indicated it would soon be adding an interactive section to its web site, and smaller companies handling decorative and fine art or antiques were also going online. Even though ebay has gained a lot of market share in the Asian and European market, yahoo’s first mover advantage hurt ebay in the long run.

EBay’s increased popularity was based on the business strategy and encountering the threats as they even appeared in the horizon. A different kind of threat was not a direct competitor but a service which can act as a substitute to auctioning, of which Half.com is a good example. Half.com designed a site which allows people to sell used books, music, movies and games at a fixed price. EBay dealt with that threat by buying the company and experimenting with adding their own fixed-price option to their auction listings.

**Strategic Issues:**
The biggest hurdle for such a business model was “fraud by customers” and eBay has been struggling with this issue till today. Omidyar recognized this issue at early stages of eBay and made certain rules and procedures through which customer frauds will be reduced to the minimum but despite his efforts controlling every aspect of customer behavior on the website was close to impossible. Some of the firm's more creative users, however, had learned how to rig bids and outcomes; buyers teamed up with bidding partners, while sellers had buddies submitting fake high bids. In November 1997 the U.S. Senate's Permanent Subcommittee on Investigations conducted hearings into Internet commerce. The National Consumers League found fraud reports had tripled after it created its Internet Fraud Watch project in March 1996. People were experiencing problems at auction sites such as eBay as well.

To keep such disputes to a minimum, eBay instituted a feedback system for buyers to post reviews of their transactions. Sellers were then given a rating based on the number of their successful auctions: positive comments received one point, neutral responses a zero, and negative comments a minus one. Potential buyers were able to read the comments as well as view the rating. A rating of minus four (-4) resulted in a seller being denied use of the service. Some other measures included the ban on weapons, placing adult-themed items in a secure area, offering buyers insurance from the esteemed Lloyds of London, and allowing sellers a discounted rate at Equifax to run credit checks. These improvement measures resulted in continued customer confidence in their website and the company reported it had only 27 disputes from over one million transactions between May and August 1997. Unfortunately, payment defaults were just not the only matter eBay had to deal with.
On the technology front, company’s success was becoming its own enemy. With increasing number of customer accounts, live auctions and transactions being processed every day, eBay needed to update its technological infrastructure to support such traffic on a very rapid pace to keep up. In this regard, eBay took a big hit in June 1999 when a set of website crashes hurt the website traffic enormously. The company was a few days away from completing installation of a backup system when outages began, including one lasting 22 hours. Competitors such as Amazon.com and Auction Universe reported increased traffic at their sites as a result of eBay's problems.

**Capital analysis:**

Ebay has evolved into one of the biggest online companies in the United States and in most international markets. Some summarized company financial turnovers are presented below.

<table>
<thead>
<tr>
<th>Fiscal Year (Dec)</th>
<th>2003</th>
<th>2004</th>
<th>2005e</th>
<th>2006e</th>
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<tbody>
<tr>
<td>Rev, net ($ mm)</td>
<td>2,165</td>
<td>3,271</td>
<td>4,503</td>
<td>5,835</td>
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<tr>
<td>Pretax op profit ($ mm)</td>
<td>725</td>
<td>1,148</td>
<td>1,582</td>
<td>1,995</td>
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<tr>
<td>EPS ($)</td>
<td>0.39</td>
<td>0.61</td>
<td>0.84</td>
<td>1.01</td>
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<tr>
<td>P/E</td>
<td>83</td>
<td>96</td>
<td>51</td>
<td>42</td>
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Sources: Morgan Stanley estimates.
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<tbody>
<tr>
<td>Year-end registered users (000)</td>
<td>341</td>
<td>2,181</td>
<td>10,000</td>
<td>22,500</td>
</tr>
<tr>
<td>Annual Gross Sales (000)</td>
<td>$95</td>
<td>$745</td>
<td>$2,805</td>
<td>$5,450</td>
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Considering the costs, eBay’s cost of customer acquisition very minimum due to established standards and market leadership. EBay’s performance was above the market at most times after new millennium. The company’s profitability, as evidenced by its gross profit margin, was above industry average. Its ROE was significantly higher than the industry average. EBay also had higher liquidity as evidenced by its current and quick ratios. Low liability to assets ratio indicates that the company is highly solvent because its total assets outweigh its liabilities. Additionally EBay’s liability to equity ratio was lower than the industry numbers. Hence eBay’s deep pockets enabled the company to go for back to back acquisitions as well as massive marketing techniques.

**Get Big Fast**

Ebay certainly pursued the GBF strategy in order to become the world’s leading online trading platform.

**Network effects:**

EBay has expanded and developed existing product categories by introducing category-specific bulletin boards and chat rooms, integrating category-specific content, advertising its service in targeted publications and participating in targeted trade shows. There are major network effects in eBay’s business model due to the fact that ebay brings the seller and buyer together on a common platform to do a fair exchange. Hence eBay has also broadened the range of products that it offers to facilitate trading on the site, including
payment services, shipping services, authentication, appraisal, vehicle inspection and escrow services. One new customer account created opens up the buying or selling features of that new customer to all existing customers and visa versa. The entry costs to a customer is very minimal, items can be listen for few dollars and its for sure worthwhile for collector to bookmark ebay for further listings by other users. This accelerates the network effect and the benefit gained by exiting users through every new entrant.

**Economies of scale:**

For most market makers such as ebay, economies of scale are usually are high. This is due to the fact that ebay had initial investment of setting up the businesses which get thinner and thinner as the number of accounts increases and ebay makes mark up, on that many more transactions. There are significant variable costs associated with the new customer accounts being created in terms of infrastructure but those also get absorbed by the increased number of transactions being processed.

**Level of customer retention**

Ebay first mover advantage in the online auction market gave the company an unbeatable edge on the customer retention end. Ebay enjoys great customer retention rates due to the following factors:

- The brand name and reputation
- Customers can find practically anything
- Other than products customers get a chance to meet new people with similar interests.
- Secured and trusted association of Pay Pal.
✓ Multinational online auctions

The network effect is important in this market, since the number of buyers and sellers increases the value of the service for other buyers and sellers. If eBay remains price competitive with its competitors there is minimal incentive for the users to switch between auction sites, meaning it becomes more and more difficult for a competitor to displace eBay's trading community.

**Winner takes it all?**

eBay had gone from $372,000 in 1996 to an astounding $431 million in revenues for 2000 to projections of $4.5b with revenue of a $1B in 2006, with nearly 1 billion registered users. The company went on a rigorous chase for acquisitions and increasing its size. Early in January 2004, another acquisition was announced when eBay agreed to purchase mobile.de, one of the leading online classifieds websites for vehicles in Germany. During August 2004, eBay acquired Baazee.com to expand its business in India. Baazee.com, India’s largest Internet marketplace had about one million registered users at the time of the acquisition. In January 2005, the company signed an agreement to acquire Kurant’s (provider of e-business software for small and medium-sized businesses) technology assets, primarily advanced software relating to online stores.

The company completed its acquisition of Rent.com, leading Internet listing website in the apartment and rental housing industry, in February 2005. The basic summary of eBay’s success was summarized by its CEO Whitman in 3 major key points:
A: “First is the U.S. business, which continues to grow at a 30 to 75 percent compound annual growth rate. And we believe that we have a big opportunity left here. In every category in which we have sellers, we have less than 5 percent of the total sales in that category. Collectibles -- our most mature and oldest category -- is still only about 5 percent of the collectibles business in the United States. So we should be able to move that up somewhat across all categories”

B: “Second is international expansion. International is the fastest-growing segment of our business, and that's because in virtually every country in the world, eBay is nascent. We've been there one, two, three, four years maximum. So we think we have a lot of growth potential, and this concept is as relative in Germany as it is in France, as it is in Korea, as it is in China. It's universal. Trading is in the human DNA, and entrepreneurs like to be successful doing what they love”.

C: “The third leg of our strategy is PayPal. PayPal has become the de facto payment standard on eBay.com. PayPal's strategy is to continue to be the standard on eBay.com, and then secondarily follow eBay's footprint around the world. And then finally of course, PayPal has an off-eBay opportunity. If you have a website and you just sell on the Web, regardless of your affiliation with eBay, you can use PayPal to accept credit cards and accept payment electronically”.

While the company reviews are positive and flawless and analysts believe ebay has secured dominant place in the online auction and retail industry, still there are some vital issues that the ebay is struggling with internally and ebays’ management is busy finding solutions for the same. Fraud and unacceptable customer behaviour is getting harder and
harder to monitor mainly due to the size of the company and its operations. Despite eBay’s efforts, there is no foolproof way to combat misuse, since users may be tempted to wait until their reputation is good enough that they can start to trade in expensive items before running away with the buyer's money. This argument may mean decreased scalability of eBay in terms of item price, at least for person-to-person auctions — more users may be tempted to use traditional modes to decrease their risk. How would Ebay keep the balance between these frauds and government regulations and still continue to exist? Credit card fee changes could affect ebay’s revenue as well. One of the other bigger concerns are the revenue streams. Ever though the marup made on each transaction is good return but is it enough to support the infrastructural costs of processing those transactions.? May be the advertizing revenue need to be raised.? We clearly notice that ebay has come along as a successful survivor even after tuff competition from yahoo and amazon but still in Asian market, yahoo has gotten an edge, are those dollars being spend, a waste, and could be invested for better markets.? Analyst survey and market research shows that online shopping is not at boom during the holiday season due to aggressive shopping in discount stores such as Wal Mart. Is seasonality nature of this busines a threat to its sales and how should ebay’s management deal with it.? 

Competition has intensified over the years as major competitors such as Yahoo, Amazon and Google have been able to steal away some market share through aggressive marketing and publicity campaigns. Even though eBay's stock may still be overvalued, the business fundamentals are solid and the only risk is if eBay doesn't grow as fast as it has estimated. EBay has definitly proven itself to be the place to trade practically
anything on earth as compared to its competitors. The credit goes to the excellent
management team, good strategic decisions, aggressive GBF strategy and maintained
focus on core business. But as the internet retail and auction industry experiences major
 technological advances marking the huge return of E-commerce, the race between these
giants gets close and one minor mistake could result in major loss of market share.
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