

New York University Stern School of Business MBA Candidates Mark Abramowitz, Theresa Harpster, Justina Nixon-Saintil, Carol Szeto, and Josh Witx prepared this case under the supervision of Professor Christopher L. Tucci for the purpose of class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Copyright © 2001 by McGraw-Hill/Irwin. All rights reserved.

eBAY, INC.: DIVERSIFICATION IN THE INTERNET AUCTION MARKET

"eBay Agrees to Buy Butterfield & Butterfield"

—eBay press releases, April 26, 1999

"eBay Purchases Respected Automobile Auctioneer"

—eBay press releases, May 18, 1999

"eBay Halts Auction of Human Kidney; Bidding Had Reached \$5.7 Million"

—CBS MarketWatch, September 2, 1999

"eBay Comes to Tampa-St. Petersburg With New Local Web Site"

—PR Newswire, October 27, 1999

"eBay Starts Business-to-Business Auctions"

—Reuters, November 4, 1999

Nineteen ninety-nine was a tremendous year for eBay, the champion of the person-to-person online auction business. Gross merchandise sales rose 280 percent, to \$741 million from \$195 million a year ago, and registered users jumped 509 percent, to 7.7 million from 1.3 million.¹ eBay has emerged as one of the leading Internet companies among online giants such as Amazon and Yahoo! However, given the increasingly competitive online auction market, Margaret C. Whitman, the CEO of eBay, knew that the battle ahead would not be easy. As she retraced the events that happened in the last six months, she pondered eBay's strategy to manage both the external competitive situation and the internal hypergrowth of the company.

Several issues were troubling Whitman. eBay had always focused on the person-to-person auction market. But given the recent hype about the growth prospects in the business-to-consumer (B2C) and business-to-business (B2B) markets, was eBay missing out on these opportunities? Besides, this year the company started pursuing a regional and international expansion strategy as well as an off-line strategy by purchasing two auction houses. Even if eBay did enter the new markets, would it be spreading itself too thin? How could it integrate these different ideas without losing focus on the core business? eBay's revenue model was another concern. Some competitors were relying on their retail revenue and offering auction services for free. Was eBay's main revenue stream from placement fees and commissions on transactions sustainable?

THE HISTORY OF eBAY

We started with commerce, and what grew out of that was community.²

—Meg Whitman, CEO of eBay

eBay was conceived initially as a result of a conversation between Pierre Omidyar, an engineer at General Magic, and his fiancée. His fiancée was an avid Pex collector and trader. She commented to Omidyar how great it would be if she were able to trade dispensers with other collectors over the Internet. As an early Internet enthusiasts, Omidyar knew that people needed a central location to buy and sell unique items and to meet other users with similar interests. He started the first online auction website to fulfill this need.

With a BS in computer science from Tufts University and years of experience running start-ups, Omidyar was not a newcomer to the Internet industry (see Exhibit 10.1 for company biographies). He brought in his friend Jeff Skoll, a Stanford MBA, as the company's first president. Together, they wrote the company's first business plan and launched the first online auction service, Auction Web, on Labor Day in September 1995. Within a few weeks, buyers and sellers began flocking to the service as news of it spread by work of mouth. A few months of heavy traffic later, Omidyar realized he had a company on his hands and quit his job.³

Auction Web was incorporated in 1996 and changed its name to eBay in 1997, when it began promoting itself through banner ads and advertising. By the middle of that year, eBay was boasting nearly 800,000 auctions each day. eBay was profitable from the beginning and solicited offers from venture capitalists began to pour in. It secured a \$3 million round of venture financing from Benchmark Capital that it put in the bank and never touched. "We wanted a good mentor, not money," explained Jeff Skoll.⁴

EXHIBIT 10.1 eBay Management Biography

	Pierre Omidyar	Jeff Skoll	Margaret C. Whitman
Title	Founder	First president	Current CEO
Education	BS, computer science, Tufts University	MBA, Stanford University	MBA, Harvard University; BA, economics, Princeton University
Experience	Engineer, General Magic; Cofounder, Ink Development (online shopping)	Founder, Skoll Engineering (computer consultancy); Founder, Micros on the move, Ltd. (computer rentals)	General manager, Hasbro, CEO, Florists Transworld Delivery (FTD); President, Stride Rite; Senior VP, Disney's Consumer Products unit; VP, Bain Consulting; Brand manager, Procter & Gamble

Source: Red Herring.

In early 1998 Omidyar turned over the CEO position to Margaret ("Meg") Whitman, formerly of Bain Consulting, Procter & Gamble, Disney, StrideRite, FTD, and Hasbro, so he could concentrate on strategy. eBay's highly successful IPO occurred in September of that year. With heavy marketing through national advertising campaigns and alliances with America Online and WebTV, eBay had become a household name identified with the largest online auction trading community. The number of registered users had grown to more than 6 million (see Exhibit 10.2) and eBay was deemed the "stickiest" site on the Internet, according to the Nielsen/NetRatings research in the first quarter of 1999 (see eExhibit 10.3). One year after its initial public offering (IPO), eBay now had a market capitalization of \$19 billion. Unlike most of the Internet start-ups, eBay was actually making a profit—\$2.4 million on sales of \$47.3 million in fiscal 1998 (see Exhibit 10.4 for eBay's quarterly financial statements).

HOW DOES eBAY WORK?

Online Auction Mechanism

Functioning as an Internet-based garage sale, consumers participate in eBay's online trading community for four main reasons: It's fun, you meet people with similar interests, you get a great deal (most of the time), and you find valuable collectibles. Goods are sold through an auction that lasts several days. Many bids are usually garnered for each item. Each day, more than 2 million new auctions are conducted and over 200,000 new items are listed.

EXHIBIT 10.2 Number of eBay Registered Users

Users (in millions)	0,5	0,8	1,2	2,2	3,8	5,7	6,6	7,85
	1QA-98	2QA-98	3QA-98	4QA-98	1QA-99	2QA-99	3QE-99	4QE-99

Source: Deutsche Banc Alex.Brown estimates; company reports.

EXHIBIT 10.3 "Stickiest" Online Activities

Property	Type	Monthly Rank Time Spent (hours:minutes:seconds)	By Unique Audience	Pages per Person
eBay	Auction	3:08:19	17	233
Yahoo!	Portal	1:02:34	2	75
MSN	Portal	1:00:03	3	48
Uproar	Gaming	0:44:21	65	33
The Excite Network	Portal	0:33:10	7	30
AOL sites	Portal	0:32:01	1	24
Prodigy	Portal	0:31:47	56	11
Knight Ridder Real Cities Network	Newspapers	0:29:18	59	22
GO Network	Portal Plus	0:27:46	5	27
CNN	News	0:26:43	20	25

Source: Nielsen/NetRatings, March 1999.

EXHIBIT 10.4A eBay, Inc., Annual Financials

eBay INC.
CONSOLIDATED STATEMENT OF INCOME
 (in thousands, except per share amounts)

	Year Ended December 31,		
	1996	1997	1998
Net revenues	\$ 372	\$ 5,744	\$ 47,352
Cost of net revenues	14	746	6,859
Gross profit	358	4,998	40,493
Operating expenses:			
Sales and marketing	32	1,730	19,841
Product development	28	831	4,606
General and administrative	45	950	9,080
Amortization of acquired intangibles	—	—	805
Total operating expenses	105	3,511	34,332
Income from operations	253	1,487	6,161
Interest and other income, net	1	59	908
Interest expense	—	(3)	(39)
Income before income taxes	254	1,453	7,030
Provision for income taxes	(106)	(669)	(4,632)
Net income	\$ 148	\$ 874	\$ 2,398
Net income per share:			
Basic	\$ 0.02	\$ 0.04	\$0.05
Weighted average shares—basic	6,375	22,313	49,895
Diluted	\$ 0.00	\$ 0.01	\$ 0.02
Weighted average shares—diluted	\$ 42,945	\$ 82,660	\$ 114,590

Source: eBay 10-K filed on March 29, 1999.

EXHIBIT 10.4B eBay Quarterly Financials

eBAY INC.				
CONDENSED CONSOLIDATED STATEMENT OF INCOME				
(in thousand, except per share amounts; unaudited)				
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	1998	1999	1998	1999
Net revenues:				
Fees and services	\$ 20,816	\$57,632	\$ 52,143	\$ 147,827
Real estate rentals	915	893	3,056	2,978
Total net revenues	21,731	58,525	55,199	150,805
Cost of net revenues:				
Fees and services	3,947	16,687	8,635	34,821
Real estate rentals	420	394	1,509	1,182
Total cost of net revenues 4,367	17,081	10,144	36,003	
Gross profit	17,364	41,444	45,055	114,802
Operating expenses:				
Sales and marketing	9,414	27,230	21,317	67,104
Product development	1,514	6,851	3,062	14,490
General and administrative	4,249	11,779	11,049	29,481
Amortization of acquired intangibles	327	328	477	983
Merger related costs	—	—	—	4,359
Total operating expenses	15,504	46,188	35,905	116,417
Income (loss) from operations	1,860	(4,744)	9,150	(1,615)
Interest and other income, net	190	7,524	686	14,880
Interest expense	(351)	(449)	(1,279)	(1,491)
Income before income taxes	1,699	2,331	8,557	11,774
Provision for income taxes	(1,238)	(979)	(3,923)	(5,841)
Net income	\$ 461	\$ 1,352	\$ 4,634	\$ 5,933
Net income per share:				
Basic	\$ 0.01	\$ 0.01	\$ 0.12	\$ 0.06
Diluted	0.00	\$ 0.01	\$ 0.04	\$ 0.04
Weighted average shares:				
Basic	48,385	115,980	39,002	105,864
Diluted	113,619	140,082	109,625	135,358
Supplemental pro forma information:				
Income before income taxes	\$ 1,699	\$ 2,331	\$ 8,557	\$ 11,774
Provision for income taxes as reported	(1,238)	(979)	(3,923)	(5,841)
Pro forma adjustment to provision				
for income taxes	274	—	(1,239)	(677)
Pro forma net income	\$ 735	\$ 1,352	\$ 3,395	\$ 5,256
Pro forma net income per share:				
Basic	\$ 0.02	\$ 0.01	\$ 0.09	\$ 0.05
Diluted	\$ 0.01	\$ 0.01	\$ 0.03	\$ 0.04

Source: eBay 10Q filed on November 15, 1999.

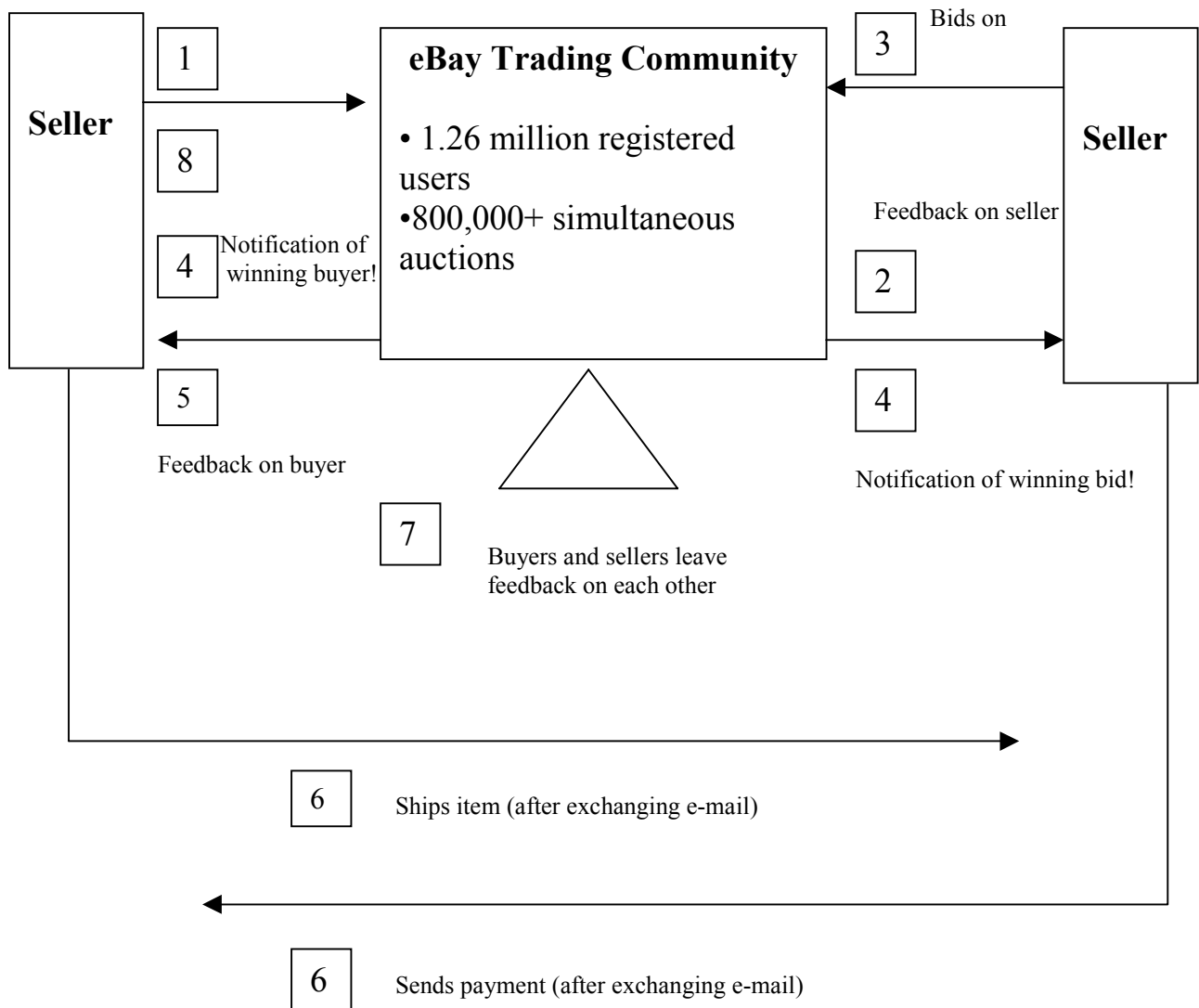
Conceptually, the online auction is similar to that of physical auctions. In a nutshell: Items are listed and viewed, bids are entered, and items are purchased and delivered (see Exhibit 10.5 for the eBay trading community). Since only very expensive rare items are typically sold at physical auctions, an online auction fills the void for all other goods.

Before bidders can bid and sellers can list items for sale, each must register with eBay, indicating some personal contact and credit card information, and acknowledging acceptance of disclaimer and disclosure rules. Like the off-line world, a bid invokes a legally binding contract.

To list an item for sale, a seller must choose which category to list it under. Categories include antiques, collectibles, sports memorabilia, dolls, jewelry, pottery, toys, and so forth. Each category is divided into more specific subcategories. For example, the computer category is broken up into hardware and software; the hardware subcategory is divided into areas such as modems, printers, monitors, and so on. Once selected, the seller indicates the duration of the auction (three days minimum), lowest bid acceptable, purchase description and photo (if available), payment (currency specified), and delivery terms.

During the auction period, eBay updates bidders about the status of their bid—whether they are high or have been outbid. To avoid having to monitor an auction continuously, bidders can invoke the "bid proxy." Here, bidders specify up front the maximum they would pay for an item; eBay then monitors the auction and adjusts the bid as needed without exceeding the maximum level. Upon auction closing, eBay sends e-mail messages to seller and bidders notifying them of the results and reminding the high bidder of the need to contact the seller within three business days to claim the item.

EXHIBIT 10.5 eBay Trading Community



Source: eBay and BT Alex. Brown Research Report, October 27, 1998.

Security and Technology Issues

Trust is an important element in the online auction environment. eBay addresses fraud and unscrupulous deals in two primary ways: a feedback system that encourages users to rate each other and indicate comments regarding the reliability and credibility of the buyer or seller, and an optional escrow system (i-Escrow) through which payment will be released to the seller only when the buyer gives approval. With these additional value-added services, eBay is able to address consumer concerns about security and to attract more users to its site.

Another factor vital to eBay's existence is technology. In the second and third quarters of 1999, eBay experienced several outages that resulted in the company's loss of millions of dollars in revenue. While eBay has traditionally relied chiefly on internal resources to maintain and service its technology infrastructure, it

recently announced that it would outsource its back-end Internet technology to Abovenet Communications and Exodus Communications. thus, the maintenance and performance responsibilities for Web servers, database servers, and Internet routers will switch to an external provider. As eBay continues to grow, it hopes these measures will help ensure success.

INDUSTRY OVERVIEW

The public has embraced online bidding ever since eBay pioneered person-to-person online auctions. The Internet has collapsed the distance between buyers and sellers, thereby creating a dynamic marketplace where prices are more fluid than ever. Now, the market has evolved to include not only personal collectibles, but also surplus inventory offered by retail merchants. The auction market has become increasingly crowded because barriers to entry are very low. Auction technologies such as LiveExchange and AuctionNow are readily available, essentially allowing any online merchant to offer these services. In the consumer auction space, eBay competes with many players, including Amazon, Yahoo!, and FairMarket.

Amazon.com

Amazon.com is the largest and broadest online consumer retailer, with close to 12 million registered customers as of the second quarter of 1998. The company's mission is to help people find almost anything they want to buy online, including books, toys, pets, and furniture. In March 1999 Amazon moved into the online auction space to compete head-to-head with eBay. Its online auction house is called "zShops" and it conducts both person-to-person and business-to-consumer auctions.

To distinguish its auction services, Amazon provides a \$250 guarantee for consumers, and a \$1,000 guarantee if the transaction is conducted through its 1-Click ordering capability. These guarantees address the fraud issue. The well-known brand name, an established customer base, and the ability to cross-market its retail and auction merchandise certainly helps Amazon build a strong presence in the online auction world.

Yahoo!

Yahoo!, founded in 1995, is currently the most popular Internet portal site. It offers a branded network of comprehensive information, communication, and shopping services to millions of users daily, and it boasts more monthly usage hours than any other site on the Internet. To start its own auction service, Yahoo! first licensed Onsale's technology and then took over Exchange, Onsale's person-to-person auction service. The Yahoo! auction is free and is supported only by advertising revenues.

FairMarket AuctionPlace

FairMarket, founded in 1997, represents the newest competitor in the online auction market that poses a significant threat to eBay. In September 1999 it announced a plan to aggregate the bidders and sellers across about 100 portal, retail, and community sites, including MSN, Excite, Lycos, Dell, and Ticketmaster

Online, and allows goods to be shared among these member sites. This means that someone listing a used Palm Pilot for sale on Lycos, for instance, will automatically have the gadget posted on the auction sites of Microsoft and Excite as well.⁵ Pulling together an instant critical mass of a combined 50 million users, FairMarket is helping companies to extend their reach to consumers and challenge the leading auctioneer eBay.

STRATEGY FOR GROWTH

As the pioneer of online person-to-person trading, eBay has been able to leverage its first-mover advantage into the creation of critical mass. With roughly 80 percent of the person-to-person auction space on the Internet and the largest offering of individual auctions (over 3 million items), eBay has created a solid brand name and a loyal customer base. Over the last year, the company has employed an aggressive growth plan to solidify its leadership position in the auction market. This includes a focus on product and service offerings, and regional and international expansion.

Product and Service Offerings

Since eBay is a virtual company—one that never actually physically handles merchandise—the company believes that it must offer better customer service and marketing than most. To foster a stronger community, eBay offers a number of venues such as News Features, Library, and Charity to help users meet and exchange information. Additionally, the company has forged innovative partnerships with companies like Kodak (for digitizing customer photos), Mailboxes Etc. (for shipping), i-Escrow (for releasing funds after items are received), and Collectors Universe (for authenticating auction items) to improve its customer service. In 1999 the company acquired Billpoint to enable customer to pay with credit cards.

To expand its product portfolio, eBay took an unprecedented step in April 1999 to acquire Butterfield & Butterfield, the 134-year-old auction house, for approximately \$260 million. A month later it bought Kruse International, the high-end automobile auction house.⁶ Before these acquisitions, eBay had focused on collectibles that were worth less than \$500. These new businesses signaled eBay's drive in hosting higher-value auctions. But more importantly, they also marked the beginning of the company's off-line strategy.

Regional Auction Strategy

In October 1999 eBay shocked the market again by creating yet another source of new revenue. It rolled out regional auctions in 10 new markets and the list continues to grow. For example, "the San Francisco site has a Grateful Dead section, bundled-up Minneapolis residents can buy ice-fishing equipment, and Atlantans might bid on Braves paraphernalia."⁷ Through further segmentation of the auction market, eBay attempts to reach more customers and capture the share from smaller regional and niche market players.

International Expansion

As eBay continues to penetrate the auction market in the United States, it also plans to leverage its knowledge in this core market across international borders. In June 1999 eBay purchased alando.de, a German online trading community. In addition, the company has developed separate Web pages for several communities abroad and mechanisms to allow cross-border trading. eBay has been building up its management team according to specific markets, including (1) Germany, Switzerland, and Austria, (2) the U.K., France, and Scandinavia, (3) Asia (Japan and Korea), (4) China, and (5) Australia and New Zealand.⁸ It is expected that eBay will invest aggressively in these target markets to secure a leadership position in the online auction market.

THE FUTURE?

With the person-to-person auction market becoming increasingly competitive, Meg Whitman wonders what should be the next step for eBay. Although she has repeatedly told the press that the strategy for eBay is to focus on the person-to-person (P2P) market, the opportunity to bring in name-brand partners to offer business-to-consumer (B2C) auctions certainly sounds attractive. Forrester Research predicts that while P2P auctions constituted 70 percent of 1998 online auction sales, B2C auctions will gain momentum and generate 66 percent of total online auction market revenues by 2003.⁹ Competitors such as Amazon and FairMarket are already entering that market. Should eBay follow the lead?

Another opportunity for eBay is business-to-business (B2B) auctions. This fall, eBay started offering a B2B sales category on its German auction site alando.de. In addition, eBay recently made a capital investment in a U.S. privately held company, Tradeout.com. Tradeout.com provides auctions for corporate surplus materials, a fast growing segment of the B2B auction revenues. These two investments provide eBay with a foothold into this new market, but the plan to aggressively pursue this business is still questionable.

Whitman also wonders about the sustainability of eBay's revenue model. With competitors like Yahoo! offering their auction service for free, can eBay justify its placement fees and commission on sales? How should eBay integrate its product and service offerings in the person-to-person market, and regional and international sites?

REFERENCES

¹ Carolyn Koo, "eBay Beats Estimates But Stock Takes a Bath," www.thestreet.com/_yahoo/brknews/internet/805387.html.

² Linda Himelstein, "eBay vs. Amazon," *Business Week*, May 31, 1999, p. 128

³ Cate T. Corcoran, "Does eBay Represent a New Way of Doing Business?" *Red Herring*, www.redherring.com/mag/issue69/news-auctions.html

⁴ Ibid.

⁵ Jon G. Auerbach, "Internet Giants Pool Their Bids for Auctions Site to Rival eBay," *The Wall Street Journal*, September 17, 1999, p. B1.

⁶ Christina Stubbs, "Internet Upstarts Are Acquiring Complementary Real-World Operations to Expand Their Markets," *Red Herring*, www.redherring.com/mag/issue70/newsphysical.html.

⁷ Adam Lashinsky, "eBay's Not-So-Secret Strategy for World Domination," www.thestreet.com/comment/siliconstreet/805456.html.

⁸ Research on eBay Inc., Deutsche Banc Alex. Brown, August 11, 1999.

⁹ Evie Black Dykema, Kate Delhagen, and Carrie Ardito, "Consumers Catch Auction Fever," *The Forrester Report*, March 1999.