

## Week 8: Case Study – eBay

Based on “The Auctioneer” (WSJ, 11/22/99), “Ebay Blocks Move to Index its Web Auctions” (Boston Globe, 11/10/99), data from Ebay’s web-site (2000 Annual Report), “Yahoo vs Ebay” Motely Fool web-site.

### 1. Overview of Company

- a. Product of company – provides market-place for customer to customer transactions; mode of transaction – auction (not two-party bargaining but rather many buyers bidding for each item put up by a seller). Secondary product: old-line auction house (Butterfield & Butterfield).
- b. Product sold in the auctions – wide variety of products (more than 8000 categories) and large number of products. Of 265 million items listed for sale in 2000, the percentage breakdown is: collectibles – 32%, sports (gold-topped Alan Iverson card?) – 12%, toys (beanie babies?) – 10%, books – 6%, pottery & glass – 6%, music – 5%, and a bunch of things less than 5% in share. Largest on-line destination for: Computer and Electronics, Used Cars, Toys, Sporting Goods.
- c. Company History – Started in September 1995 Labor Day; grew rapidly in terms of number of registered users and items offered for sale. For example, CEO interview in September reports 5.6 million registered users; in November 1999 there were 7.7 million registered users and today there are 42.4 million registered users (How many is that per day of new additions?)
- d. Pricing – charge a modest price for listing (between 30c and \$3.30). Also charges a commission between 1.25% and 5% when an item sells.
- e. Cost structure – little by way of variable costs other than advertising costs although advertising costs are high (details later). Shipping, procurement (& manufacture) costs borne by market participants.
- f. Revenues – Has grown rapidly. \$372,000 in 1996, \$5.74 m in '97, \$47.35m in '98 & projected revenues of \$223m in '99, \$431.4 millions in 2000 (\$392 millions of on-line revenue) (Incidentally, the average price is low; currently, \$20 per transaction). Some high-price items have moved (Rolls Royce Phantom III Aero Coupe for \$955,000 & Chicago Bulls Courtside Season Tickets for \$260,000)
- g. Profits – Has grown rapidly but remains modest. \$148,000 in '96 to \$874,000 in '97 to \$2.4 m in '98. Question: why are profits so low if variable costs are non-existent? Answer – marketing expenses have grown from \$32,000 to \$1.73m to \$20m in same time-period.. As of 2000, marketing expenses are \$166.8 millions, 38.7% of revenues.
- h. Stock price history – spectacular; IPO at \$9 in Sept. 98, now \$150 & went from \$9 to \$90 in 10 weeks.

### 2. Competition

- a. Three sorts of competition – e-auction sites such as yahoo auctions & amazon.com auctions (also a bunch of smaller ones); old-style auction houses some with a web presence (Sotheby’s & Christie’s); intermediaries in the auction business including auction search engines such as Auction Watch.com & Bidder’s Edge.
- b. Category 1: Yahooauction crossed 1 million users mark Nov. 1. Also, Yahoo & Amazon have users for other products (& an international presence). FREE
- c. Category 2: Sell higher priced items. Sotheby’s average price per lot is \$10,000 (altho’ 80% of lots sells for less than \$5,000). Revenues essentially flat; Sotheby’s increased from \$337m to \$367m between '97 & '98.
- d. Category 3 – smaller but potentially the most threatening for Ebay; an auction search engine searches every site that is listing beanie babies for example. Allows customers to then go to the relevant site.

### 3. Network Externalities

- a. CEO Whitman – talking about why she thinks Ebay will win out against the competition – “We have the largest market-place by far. That does matter because the sellers want to be where the buyers are and the buyers want to be where the sellers are.” WSJ op.cit.
- b. Price evidence – Ebay charges but Yahoo etc. do not. (Or is that something else such as quality control as Whitman claims?)
- c. Theory: recall, two predictions of the theory: I) initial advantage even if small can matter (recall  $Q_2 > Q_2$  even by a small amount today can force firm 1 to drop out of the market completely tomorrow – btw, might have been the Christie’s story) and II) the more intrinsic non-network differences exist, the

more likely is the market going to be a competitive market (i.e., the less will competitors drop out). (Go back & check the network externality model carefully).

- d. Is Ebay in situation 1 or 2? Maybe 2 because Yahoo & Amazon are offering other services that are not network-related (e.g., books, gifts, etc. in non-auction format).
- e. Bigger problem – don't the search engines create one large public network? (No wonder Ebay is fighting to block access to Auction Watch!)
- f. Entry easy? By Ebay's own admission technology not a problem. With large public network, is entry easier from a financial standpoint as well?

## **2. Looking Ahead**

- a. Niche markets – EbayLA, Ebay Great Collectors, etc
- b. Real growth might be business to business. How big is that market & what does Ebay lose by sitting that one out?
- c. Prices will begin to fall? Giveaways?