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The eBay Phenomenon

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Frank Miller, a retired high school English teacher, had lots of stuff he no longer wanted, including various memorabilia he had collected over the years: books and old magazines; signatures of politicians, actors, and poets. He'd enjoyed having these things around his apartment. They were like old friends. But it was now time to part company and pass these old companions on to someone else. But how could he divest himself of these special things—and maybe pick up some extra money?

Frank didn't know a Word.doc from a dot-com, but a friend of his did and suggested auctioning off certain items on eBay. This friend, whose online user name was oscarwildcat, had just made his first purchase on the site and encouraged Frank to give it a try. "I've never sold anything on eBay," he told Frank, "but I'll auction your things if you'd like. It might be fun." Frank was game.

Getting the first item listed, a signed 1941 letter from

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FDR's son James Roosevelt was anything but fun. Oscar hunted around for the right auction category to list it under. With thousands available on eBay, it wasn't obvious where this item should go. And it had to be in a category where potential buyers would find it. Eventually he settled on "Collectibles-Autographs-Political" as the right category and wrote up a description:

JAMES ROOSEVELT White House Letter

From the White House. James Roosevelt, FDR's son. Original signed letter on White House stationery. Dated 22 September 1941. To Mr. Sidney Katzman of Girard College, Philadelphia.

Good condition. Slight crease, and slight yellowed. Buyer to pay for 2-day UPS letter shipping.

He continued down eBay's online selling tool, clicking off his location, a minimum bid (\$3), the length of the auction period (5 days), the forms of payment he'd accept (money order, cashier's check, or personal check), and other choices. "This is easy," he told himself.

Then he got to the picture. Everything he'd heard and read told him that bidders opened their wallets wider when they could see the goods. "Makes sense," he told himself as he scanned the Roosevelt letter into a JPEG file on his hard drive.

But now what? Somehow he had to upload this JPEG to a location on the Web, and then link it to the Roosevelt auction. Following eBay's seller instructions, he surfed over to www.pongo.com, a pay-for-space uploader. For 50 cents per file, Pongo would give him his own little spot in cyberspace—and the first three uploads were free! "I'm practically finished," he thought as the Pongo site flashed *Your upload is successful*.

One thing remained to be done: Link the uploaded JPEG to the listing and fire it off to eBay. Twenty minutes

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later, Oscar was still trying to make the link and was getting more and more frustrated. Fortunately, his wife, a person who believed in reading instructions *carefully*, was in the room. Within a moment she had resolved the problem and made the link. A few minutes later, the Roosevelt letter appeared on the eBay site, where millions of users in North America and around the world could see it and bid on Frank Miller's small artifact of American history. With the picture-linking problem resolved, Oscar was able to quickly list five more of Frank's items:

- A signed letter from then-Congresswoman Clare Booth Luce
- Autographed photos of Newt Gingrich and Dan Rostenkowski
- The Playbill from Neil Simon's *Jake's Women*, autographed by cast member Alan Alda
- The official press kit issued by Miramax films in connection with its release of *Shakespeare in Love*, complete with color slides and 8-by-10 glossies
- The game program from the 1926 football matchup between Stanford and the University of California

"Nothing to do now but wait for the bids to come in," Oscar told Frank over the phone the next morning.

■ EBAY AS A WAY OF LIFE

Frank and Oscarwildcat are just two of the millions of users scattered across the world who have made eBay a phenomenon in the expanding universe of e-commerce. For them, eBay auctions provide a convenient, efficient, and entertaining marketplace in which to sell and to shop. Though most users are casual participants who log on intermit-

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tently during the week to seek out bargains or find items for their personal collections, many have made eBay an important part of their lives and businesses.

Consider Shirley Bryant of Muskogee, Oklahoma. For years, Shirley operated a shop in Boulder, Colorado, featuring first-edition books. But even with a printed mail-order catalog she found that most of her customers lived within a two-hour drive of the shop. Beginning in the fall of 1997, Shirley began listing her more expensive books on eBay auctions. To her surprise and delight, items that would normally linger for months in her store sold quickly and at good prices. Better still, her local business took on global proportions. She was soon dealing with buyers from all over the United States, Japan, South Africa, Australia, and parts of Europe. "You get access to a customer base you'd never have through a catalog or store."

Thanks to eBay, Shirley has been able to relocate to her hometown of Muskogee, Oklahoma, where her operating expenses are one-third those in pricey Boulder. Today, eBay accounts for over half of her sales. "I just love eBay," says Shirley. "It has opened up a whole new sales avenue for me."

■ THE EBAY PHENOMENON

From its origin as a home business of founder Pierre Omidyar ("o-mid-ee-yar"), the company has become the world's leading auction market and one of a handful of major dot-com companies to actually turn a profit. Its growth has been nothing short of explosive since 1996, the year in which it reorganized as a corporation. And registered eBay user numbers have skyrocketed, growing to 10 million by the end of 1999. On an average day, 1.8 million unique visitors enter the site. Every second, five items are listed for sale on eBay—that translates to \$113 of gross merchandise sales *every second*.

At any given time, Web surfers can find over 4 million

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items in over 2,000 different product categories on eBay. In calendar year 1999, 129.6 million items were listed, and at \$2.8 billion in 1999 (Figure 1.1), gross merchandise sales topped those of any other Internet site, making it the world's largest market for person-to-person online trading. Jupiter Communications estimates that eBay controls 94 percent of the *existing* person-to-person online auction market, a market that is anticipated to grow substantially in the years ahead.

According to a 1999 report issued by Forrester Research, spending on person-to-person auction sites like eBay is predicted to grow to \$6.4 billion by 2004. Some portion of that growth will likely come from traditional person-to-person trading forums—classified ads, collectibles shows, and auction houses—which are estimated to exceed \$100 billion in the United States alone. Many items traditionally listed in classified ads or sold at flea markets, estate sales, and tradi-

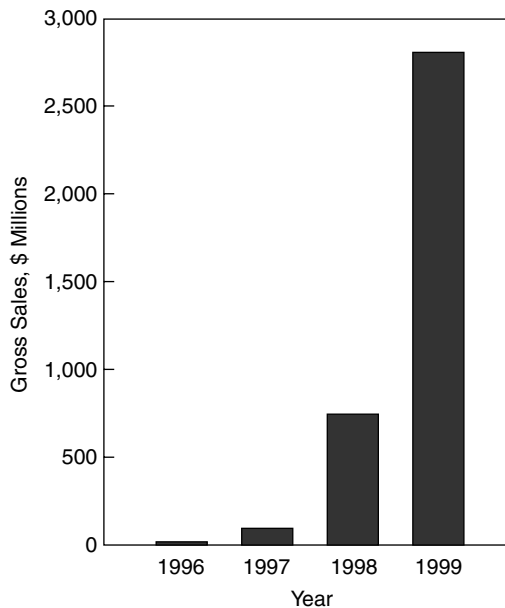


Figure 1.1 Gross merchandise sales on the eBay site, 1996–1999.

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tional live auctions are already finding buyers online. The reason, as Shirley Bryant and thousands of others have discovered, is that online auctions enormously expand the geographic reach of sellers. And with more buyers available, sellers have a higher probability of obtaining higher prices.

Shoppers, too, like online auctions. Have you ever tried to track down Volume 3 of a multivolume chronicle of World War II? Finding it can mean endless hours of schlepping around to flea markets, used bookstores, and garage sales. Go online and the odds of success turn in your favor. In just a few seconds, an auction site search engine can sort through thousands of books and take you to *exactly* what you want. If Volume 3 is there, you'll know it in an instant. You may find that 10 sellers are offering Volume 3, some in better condition than others. Put in a bid, and you may get the one you want.

eBay isn't simply the biggest of the online sites, it's also one of the most appealing to consumers and corporate partners. In company with Yahoo! and Microsoft Network, it received a Media Matrix/Industry Standard award as a "best all-around" Web site. It ranked fifth among the most popular of *all* Internet sites in terms of the number of unique visitors who clicked on it during 1999, and first in terms of "most engaging." Even more impressive, eBay visitors spent an average of 105 minutes per month at the site, nearly 20 percent more than the second-place finisher (FreeRide.com).¹ And in the quarterly rating published by Gomez.com, it consistently captures the highest overall score, and is rated number one from the perspective of all key user groups: bargain hunters, hobbyists and collectors, and sellers.

■ EBAY AND THE NEW WORLD OF E-COMMERCE

eBay is just one of many important players in an expanding e-commerce industry. Estimates of the size of that

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industry in the United States alone, its rate of growth, and the number of Internet users are widely scattered—primarily because of how *user* is defined. Researchers like International Data Corporation (IDC), CyberDialogue, Forrester Research, CommerceNet, and Jupiter Communications all have their own estimates and growth forecasts. There is no way of proving who's on target, and being on the money probably isn't even important, since everyone agrees on two things: E-commerce is big, and it is getting bigger very fast.

Consider the number of people who surf the Internet. If you simply took an average of the number of U.S. Internet users estimated by the research firms just mentioned, you'd have 83.5 million users in 1999, with an average forecast of 143 million by 2003—more than half of the adult U.S. population. Research indicates that 40 percent of those users are college graduates with substantial household incomes. Web use outside the United States is less intense, but it's picking up momentum, and IDC estimates that the number of Web users will grow to approximately 500 million worldwide by year-end 2003.

If the number of Internet-connected people is growing, the magnitude of business conducted by the average user should grow even faster. There is simply more to be purchased over the Net every year, both by consumers and businesses. A few years ago, e-tailer sites were few, and people who would routinely give a credit-card number over the phone to a catalog sales rep were terrified about using plastic to buy a flannel shirt over the Net from squeaky-clean L.L. Bean. Today, Internet surfers have lost that fear, and they can now buy everything from airline tickets to prescription drugs to groceries to automobiles online. And they're doing it in greater and greater numbers. From less than \$8 billion in 1998, Forrester Research predicts that online retail sales will reach \$108 billion by 2003—that's about 6 percent of all forecasted U.S. retail sales.

Retail sales on the Net get most of the headlines, but the business-to-business (B2B) segment of e-commerce,

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THE BIGGEST DAY

The biggest single day of online consumer business as of this writing occurred on December 14, 1999, when, according to BizRate.com, consumers placed 2.5 million online merchandise orders worth more than \$240 million.

estimated at \$114 billion in 1999 by Goldman Sachs, has far outpaced consumer transactions. B2B is forecasted to dominate online sales in the years ahead, representing 70 to 75 percent of all online transactions. The effects of this form of commerce should be good for the economy as a whole. According to the Federal Reserve Bank of New York, the shift from traditional to online B2B commerce will lead to lower prices, greater productivity, and reduced labor costs.

All told, B2B, business-to-consumer (B2C), and person-to-person (P2P) e-commerce may approach \$400 billion in 2003. Again, there are wide projection variations, if only because a universally accepted definition of *e-commerce* is hard to come by.²

▶ **The Explosive Online Auction Economy**

eBay participates in the *demand-based* or *dynamic pricing* segment of online commerce. There, transaction prices are determined entirely by buyers. This is fundamentally different from what most of us are accustomed to. Usually, vendors make the pricing decisions, and we either accept their prices or look elsewhere for a better deal. In demand-based pricing, buyers make these critical decisions.

The auction is the most familiar form of demand-based pricing. Auction forums have been around since ancient times, and everything from foodstuffs, minerals, timber,

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animals, securities, and human beings have been bought and sold through them.

Bringing the auction online was an important innovation, and is one of the greatest uses of Internet technology. The Internet has facilitated a variety of commercial activities. Many are lifted directly from offline models and provide no greater value or convenience for customers. Ordering a pair of gloves from an e-tail site is a prime example. From the customer's perspective, this is neither cheaper nor more convenient than buying the same gloves from the retailer's catalog using an 800 number. Online auctions, in contrast, have created something very new. Michael May, auction analyst for Jupiter Communications, views them as an ideal use of the Internet as a medium. "Of all the things you can do with the Internet," he noted in our interview, "this is one of the great ones. The resources necessary to launch and maintain this type of business, and the risks associated with it, are tiny compared with other online retail operations. And the cost of goods sold is simply the cost of transferring information electronically."

Many see the origins of online auction business in Priceline.com, which went on the Internet in 1995. Priceline created a *reverse* auction, a system through which buyers specify the amount they are willing to pay for a generic product or service—for example, an airline ticket between Chicago and Los Angeles, or a hotel room in New York City. If one of Priceline's sellers is willing to let its product or service go at that price, a transaction takes place. Both parties benefit from this type of transaction. The buyer gets a low price, and the seller unloads something that might otherwise expire as worthless. Because, according to Priceline, airlines fly with over 500,000 seats empty every day, and thousands of hotel rooms are vacant every night, any sale that covers the cost of the airline's snack food or the hotel's cost of cleaning a room contributes to profits and overhead, and is worth taking.

Since its introduction, Priceline has extended its offer-

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ings to other categories: home mortgages, cars, and even groceries (through WebHouse). By early 2000 it aimed to follow with other “perishables” such as rental cars and cruise ship vacations.

Priceline provides a venue for demand-based pricing, but it is not an auction in which many buyers can bid against each other. That changed in 1995, when eBay (then AuctionWeb) went online. Other sites soon followed.

► Different Types of Online Auctions

Banking on the enormous number of Internet users who pass through their sites, Yahoo! and Amazon both entered the fray with auction formats strikingly similar to eBay's (more on these in Chapter 8). Others were less ambitious and were category specific: Guitarauction.com, BabyBid.com (no, you cannot buy a child here, but you can bid for baby and children's items), AntiquePhotos.com, and dozens more. Many readers are probably familiar with these P2P sites, and may even have bought or sold things through them. Less visible is the much larger B2B side of the online auction world—which, according to Forrester Research, may grow to \$52.6 billion in transactions by 2002. B2B auctions are now available for a wide variety of industries and goods. Many are highly specialized. AssetLine accepts online bids for construction, manufacturing, and transportation equipment. bLiquid.com features online auctions for industrial equipment and supplies. TexEx.com provides a site where textile companies can buy or sell raw materials peculiar to their industry. The exchange site announced in February 2000 by General Motors, Ford, and DaimlerChrysler is anticipated to handle auto component and materials transactions totaling \$500 billion per year.

The attraction of online B2B sites to industrial companies is powerful, and they are making our economy more efficient. Consider the personal computer industry. Most PCs and peripherals are now configured from standardized

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components. On any given day, hundreds of electronics companies are overstocked on certain of these components, while hundreds of others are short of the same items. Online auction sites that bring these industry participants together efficiently and in real time provide a cost-saving solution. Selling companies are able to unload unneeded inventory, while others can quickly locate the components they need—often at bargain prices. Both parties reduce their costs, and the savings are eventually divided between shareholders and end-use consumers.

FastParts.com is a good example of a B2B auction site in action. Founded in 1991 to bring buyers and sellers of semiconductors and other electronic parts together, the company took its trading floor online in 1996. It describes itself as a spot market where original equipment manufacturers, contract manufacturers, distributors, and part makers buy and sell electronic parts at market-driven prices. Trading is conducted anonymously between pre-qualified site members. Some trades are accomplished through auction, and others through a trading exchange patterned after the NASDAQ model used in the securities industry. In both instances, prices are driven by supply and demand, with FastParts compensating itself with a small percentage of each transaction.

Components and raw materials are not the only items found on these B2B auctions. A new site, Bid4geek.com, deals exclusively in human commerce. No, this is not a modern-day slave auction, but a place where human resource managers can check out and acquire technical personnel. “Welcome to a new way of finding and securing the best high-tech talent on the Internet,” it proclaims. “This site was created with the geek in mind, which means you’ll have access to the best IT [information technology] talent around.”

Together, P2P, B2C, and B2B auctions and demand-based exchanges are taking a larger and larger chunk of total e-commerce. One industry watcher, Keenan Vision,

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estimates that the various types of demand-based-pricing transactions will represent roughly one-third of all online transactions by 2002.

► Big Economic Benefits

The growth of market-pricing transactions is bound to make our economy more efficient, and nowhere more so than in the realm of person-to-person and small dealer-to-person exchanges of goods, which are chronically inefficient. In strictly economic terms, markets are *efficient* when the following conditions are met:

- The features of goods are fairly standard.
- Buyers and sellers are many.
- Information about the goods being offered is widely shared.
- Asking and bidding prices are not far apart.

Modern financial markets provide our best examples of market efficiency. In a transaction involving 100 shares of IBM common stock, for example, the features of those shares are identical. On any given day, thousands of individuals and institutions are buying and selling. All buyers and sellers have access to the same information about IBM's current business situation. So, as the many buyers and sellers of IBM common stock congregate around the company's trading post on the floor of the New York Stock Exchange, competition and shared information has the effect of bringing the prices asked and offered very close together—say, \$121 to sell and \$120¹/₄ to buy. Generally, buyers and sellers meet near the middle. Everything happens quickly, efficiently, and with relatively little “friction,” or trading costs.

The current retail market for automobiles is less perfect, but still qualifies as an efficient marketplace. The features of the various models are generally standard, and pricing

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can be readily adjusted to recognize unique features, such as sun roofs, high and low engine mileage, standard versus automatic transmissions, and so forth. Auto sellers and buyers are both numerous, eliminating the ability of any individual participant to exercise monopolistic pricing power. Finally, information about new and used automobiles is abundant and widely available. Thanks to the Internet and print publications like *Consumer Reports*, anyone hunting for the best buy on a particular new car model can easily determine the dealer's invoice cost, the dealer cost of different options, and the offering prices of dozen of competing sellers. Equally useful information is available on used cars.

The upshot of the market characteristics just described is that you're not likely to be screwed when you go out to buy a car—there are simply too many sellers and too much easily obtained information. If you are taken to the cleaners, you have no one to blame but yourself. On the flip side, the opportunity to screw the auto dealer is equally limited, since there are plenty of other potential buyers out there, and sellers have lots of information. This is market efficiency. Market efficiency has the beneficial effect of bringing selling and bidding prices closer together, and closer to *true* values.

Traditional person-to-person markets, in contrast, are highly inefficient. They are geographically fragmented, making it difficult for buyers and sellers to meet and do business. Transaction costs are high. Pricing benchmarks are difficult or impossible to find. If, for example, you are looking for a selection of Big Bopper albums, your only chance of hitting pay dirt is to comb through used record stores in a wide geographic area—a time-consuming process. The probability of finding the specific recordings you want through flea markets or classified ads is even more remote. And if you somehow luck out and find someone selling a Big Bopper album, you will have no reference point for pricing. The seller will be equally challenged; finding and connecting with you will be difficult and expensive, especially if he or she has to resort to classified ads.

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The beauty of eBay's vision is that it has eliminated many of the inefficiencies of traditional person-to-person commerce. It provides a place where buyers and sellers can conveniently meet, exchange information about goods and prices, and transact sales at minimum costs. And it has made collecting and bargain hunting fun.

One organization that has benefited from this more efficient market is the State of Oregon Property Distribution Center.³ By Oregon statute, recovered property and goods confiscated from drug dealers and other ne'er-do-wells belong to the state. Consequently, Oregon owns at any given time an assortment of odd merchandise that it must get rid of: shampoo, electric drills, computers, mountain bikes, gold rings and chains (street gang favorites), atmospheric monitors, porcelain dolls, umbrellas (listed as "Oregon winter survival gear"), snowboards, comic book collections, live cattle, and, on one occasion, a white leather halter top and vest. The agency's description of this last set of items is enough to make some healthy males faint:

The items included in this sale are offered by a local police agency having been obtained as a result of civil forfeiture and/or other criminal activity.

This lot contains a couple of real flashy leather garments!

1-White Leather Halter Top, Extra Small, Wilson's Leather, NEW!

1-Genuine Leather Vest by H.L. Spencer Limited, Natural/Tobacco in Color, NEW!

In the past, this state agency unloaded its goods through the usual channels: sealed bids, fixed price sales, general store sales, and public auctions. But when you think about it, how much would a proper Oregonian pay for a slutty leather halter top? Surely it would fetch twice as much in New Jersey. So the agency set itself up on eBay under the

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user name oregontrail 2000, an auction site described by one eBayer as “better than Wal-Mart.” It now has a much larger pool of potential buyers and is pulling down much better prices for its property.

► A Slice of the Big Pie

The slice of the online auction market occupied by eBay had lots of growth potential ahead as this book went to press, but most analysts at the time were already describing its limits. Forrester’s Evie Black Dykema predicted that consumer-oriented demand-driving pricing models would capture only a small percentage of total Web sales by 2004. “Bargain hunting is a hobby, not a way of life,” she wrote. “By 2003, only 22 percent of all online shoppers will religiously take the time to shop around. . . . And they will only do it for big-ticket, researched purchases like stereos and home theater systems—not cheap, easy-to-find products like cornflakes.”⁴

But even a small percentage of a huge number translates into major business potential, and eBay is well situated to

FRANK AND OSCAR REVISITED

The morning after Oscar listed Frank Miller’s six auction items, he surfed to his eBay page to check the number of incoming bids. Nothing! This was disappointing, but he had heard that the real action happens only when auctions are in their final days or hours.

By the next afternoon, things were looking better—a number of bids had floated in, though not more than a few dollars each. As the days passed and the auctions entered their final hours, the bids came in faster and rose as buyers

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competed with each other. When it was all over, the Roosevelt letter drew a disappointing final bid—only about \$15—but the buyer was happy as a clam. “My father loves history and politics,” she wrote. “He’ll love this.” Other items did much better than expected. The *Shakespeare in Love* press kit attracted a \$35 winning bid, and the UC–Stanford 1926 football program garnered \$152.

After he deducted his eBay fees and image-hosting charges, Oscar was able to send Frank a \$247 check for things that had been sitting around Frank’s apartment gathering dust.

grab the lion’s share of it. And though bargain hunting may be a hobby, it has created a vast community of eBay users. How the company latched onto that market and how it developed as a business entity is the subject of the next chapter.