

**CASE STUDY: eBay.com**

eBay is the world's largest online auction. In late 1999, the service listed over 2,000 categories of items from sports memorabilia to automobiles. In total, eBay hosted more than 2.5 million auctions a day. Sellers pay a few dollars to eBay to list their items. They provide a description of the item, photographs, the minimum acceptable bid, accepted forms of payment, and other relevant information. Bidders submit electronic bids over the Internet. After the auction closes (auctions usually last several days), the high bidder receives an e-mail. The high bidder must contact the seller within 3 business days to claim the item as well as arrange for payment and delivery of the item. eBay provides other support services.

- *The Feedback Forum* is a place where eBay users leave comments about each other's buying and selling experiences. If you're a bidder, you can check the seller's Feedback Profile easily before you place a bid to learn about the other person's experience with previous buyers. If you're a seller, you can do the same with your bidders. Every eBay user is covered by *insurance* at no additional charge under the terms of eBay's program. If a buyer pays for an item and never receives it (or receives the item, but it was less than expected), eBay reimburses the buyer up to \$200, less a \$25 deductible.

**Discussion Questions**

1. How does eBay create value?
2. What potential contracting problems exist on eBay?
3. How does eBay address these problems?
4. What are the contracting costs at eBay?
5. eBay claims that it has only a small problem with fraud and misuse of the system. Does this imply that it is overinvesting in addressing potential contracting problems? Underinvesting? Explain.

- Buyers and sellers can use an *escrow service* in transactions involving expensive items. eBay's escrow partner, i-Escrow, holds a buyer's payment and sends it to the seller only after the buyer has inspected the merchandise and gives approval. Sellers have the same opportunity to inspect and approve a returned item before the buyer gets a refund.
- To obtain more detailed information, go to [www.ebay.com](http://www.ebay.com).
- *SafeHarbor*, eBay's safety staff, investigates alleged misuses at eBay such as fraud, trading offenses, and illegally listed items. Potential resolutions include things like banning a person from future trading on eBay.

Treating a firm as if it were an individual decision maker who maximizes profits is a useful abstraction in some contexts. For example, this characterization has been used in previous chapters in analyzing output and pricing decisions. But to analyze organizational issues within the firm requires a richer definition. A particularly useful definition for our purposes is that the *firm is a focal point for a set of contracts*. Since individuals are creative maximizers of their own well-being, there are likely to be incentive conflicts among the parties that contract with the firm. Examples include owner-manager, buyer-supplier, and free-rider conflicts. Contracts (explicit and implicit) specify a firm's *organizational architecture* (its decision rights, performance evaluation, and reward systems). This architecture establishes a set of constraints and incentives that can reduce the costs of incentive conflicts. Contracts are unlikely to resolve incentive problems completely because they are costly to negotiate, administer, and enforce. *Asymmetric information* causes particularly important problems.