

# PART 3 CASES

## Case 3-1: eBay's Outsourcing Strategy\*

"If we are to continue outsourcing, and even consider expanding it, why should we keep paying someone else to do what we can do for ourselves?"

Kathy Dalton leaned forward in her chair. She read the message on her computer screen and let the words sink in. Why had she not anticipated that? After all, she was adept at asking insightful questions. She felt her heart rate quicken.

She would have stared out her office window and pondered this question, but she didn't have an office. In keeping with a well-established Silicon Valley tradition, everyone at eBay, including CEO Meg Whitman, occupied a cubicle. Dalton, an attractive, 38-year-old executive, had joined eBay in late 2002 after years of call center experience for major long distance carriers. Now, nearly two years later, she couldn't think of doing business any other way. She liked being in the center of the action. Sitting in a transparent cube, surrounded by hundreds of service representatives, added to her already high level of energy and kept her in touch with eBay's internal and external customers.

Dalton reflected on the e-mail she had just received from her boss, Wendy Moss, vice president of Global Customer Support. She knew she would pick up the phone

soon, call Moss, and ask her clarifying questions about her e-mail. Her mind raced through the details of the proposed outsourcing strategy she had submitted to Moss last week. She quizzed herself:

- "Did my team and I make a strong enough case for proposing almost a 100 percent increase in the amount of volume to be outsourced?"
- "Will eBay management concur with our recommendation to begin outsourcing potentially sensitive risk-related inquiries for the first time?"
- "How will senior management react to the addition of a second outsourcing vendor?"
- "Did we cover adequately the types of proposed volumes targeted and how these would be transitioned to the outsourcing vendors?"
- "In the event of a major vendor problem, systems issue, or natural disaster, how executable is our back-out plan?"
- "Will the data in our proposal allay the growing concerns among executives about offshore outsourcing altogether?"

She wondered, "How would eBay senior managers react to our proposal to reorganize and expand outsourcing in a new three-tiered approach? And would they even consider expansion in light of recent headlines about companies reducing the amount of work outsourced to India because of quality issues?"

This last question had perplexed her for several months. Not only was it a personal issue for Dalton—she felt her job security at eBay depended largely on the company's continuing commitment to offshore outsourcing—but one she recognized as a business practice whose time perhaps had come and gone. Several leading consultants were claiming that offshoring had lost much of its cachet in recent years as companies were coming to grips with the real costs, logistics, management commitment, and service quality associated with third-party partners in India, the Philippines, and elsewhere. In her proposal, Dalton had

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\*Professors Scott Newman, Gary Grikscheit, and Rohit Verma and Research Assistant Vivek Malapati prepared this case solely as the basis for class discussion. The information presented in this case is based on publicly available information and insights gained through numerous interactions between University of Utah MBA students, their faculty advisors, and local eBay managers during a field study project (sponsored by the University of Utah and approved by the eBay Salt Lake City Service Center). The case contains writer-compiled, disguised information and is not intended to endorse and/or illustrate effective or ineffective service management practices. Certain sections of the case study have been fabricated based on current service management and customer service literature to provide a realistic and stimulating classroom experience. The numbers in the case are available from public information or estimates or are fictitious. This case was the winner of the 2006 CIBER-Production and Operations Management Society International Case Competition.

reinforced the benefits to eBay of continuing to outsource outside the United States and had woven into her new strategy more "nearshoring" alternatives as well.

Dalton was scheduled to fly to San Jose in just two weeks to present her outsourcing strategy to Whitman and her executive staff. Now, here was Moss's e-mail, questioning why she had not addressed the option of cutting out the middleman and building eBay-owned outsourcing locations in other countries.

## A Little History

eBay called itself "The World's Online Marketplace." For the sale of goods and services by a diverse community of individuals and small businesses no venue was more appropriate. eBay's mission was to provide a robust trading platform where practically anyone could trade practically anything. Sellers included individual collectors of the rare and eclectic, as well as major corporations like Microsoft and IBM. Items sold on eBay ranged from collectibles like trading cards, antiques, dolls, and housewares to everyday items like used cars, clothing, books, CDs, and electronics. With 11 million or more items available on eBay at any one time, it was the largest and most popular person-to-person trading community on the Internet.

eBay came a long way from being a pet project for founder Pierre Omidyar and holding its first auction on Labor Day in September 1995. Omidyar developed a program and launched it on a Web site called Auction Web. According to eBay legend, he was trying to help his wife find other people with whom she could trade Pez dispensers. Omidyar found he was continually adding storage space to handle the amount of e-mail generated, reflecting the pent-up demand for an online meeting place for sellers and buyers. The site soon began to outgrow his personal Internet account.

Realizing the potential this Web service could have, he quit his job as a services development engineer at General Magic, a San Jose-based software company, and devoted full-time attention to managing Auction Web. As traffic increased, he also began charging a fee of \$0.25 per listing to compensate for the cost involved in maintaining a business Internet account.

In 1996, Jeff Skoll, a Stanford Business School graduate and friend of Omidyar's, joined him to further develop Auction Web. They changed the name to eBay, short for East Bay Technologies. In mid-1997, a Menlo Park-based venture capital firm invested \$5 million for a 22 percent stake in eBay. Omidyar knew that the venture capital

would be critical in building infrastructure and attracting top-tier management to the company.

In early 1998, Omidyar and Skoll realized eBay needed an experienced CEO to lead and develop an effective management team as well as to solidify the company's financial position with an IPO. In March of that year, Whitman accepted the position of president and CEO. A graduate of the Harvard Business School, Whitman had learned the importance of branding at companies such as Hasbro and Walt Disney. She hired senior staff from companies like Pepsico and Disney. She built a management team with an average of 20 years of business experience per executive and developed a strong vision for the company. Whitman immediately understood that the eBay community of users was the foundation of the company's business model. A central tenant of eBay's culture was captured in the phrase "The community was not built for eBay, but eBay was built by and for the community." It was not about just selling things on the Internet; it was about bonding people through the Web site.

## Business Model and Market Share

Unlike many companies that were born before the Internet and then had to scramble to get online, eBay was born with the Net. Its transaction-based business model was perfectly suited for the Internet. Sellers "listed" items for sale on the Web site. Interested buyers could either bid higher than the previous bid in an auction format or use the "Buy It Now" feature and pay a predetermined price. The seller and buyer worked out the shipping method. Payment was usually made through PayPal, the world's leading online payment company, which eBay acquired in 2002. Because eBay never handled the items being sold, it did not incur warehousing expense and, of course, did not hold any inventory. For a company with almost \$8 billion in assets, not a single dollar was invested in inventory (Exhibit 1).

In 2004, eBay reported revenue of nearly \$3.3 billion. Revenue was mainly generated from two categories. The first, called the Listing Fee, involved a nominal fee incurred by the seller in posting an item for sale. This fee ranged from \$0.25 to \$2.00. The second, the Final Value Fee, was charged to the seller as a percentage of the final price when a sale was made. This amounted to between 1.25 percent and 5 percent of the selling price, depending on the price of the item. The Final Value Fee on a \$4.00 Beanie Baby would be \$0.20, representing a 5 percent fee. The same fee on a mainframe computer selling for \$400,000.00 would be 1.25 percent, or \$5,000.00.

Exhibit 1 Income Statement and Balance Sheet (abridged)

eBay's Income Statement (in 000s Dollars)	12/31/2004	12/31/2003	12/31/2002
Net revenues	\$ 3,271,309	\$ 2,165,096	\$ 1,214,100
Cost of net revenues	614,415	416,058	213,876
Gross profit (loss)	2,656,894	1,749,038	1,000,224
Sales and marketing expenses	857,874	567,565	349,650
Product development expenses	240,647	159,315	104,636
General and administrative expenses	415,725	302,703	171,785
Patent litigation expense		29,965	
Payroll expense on employee stock options	17,479	9,590	4,015
Amortization of acquired intangible assets	65,927	50,659	15,941
Total operating expenses	1,597,652	1,119,797	646,027
Income (loss) from operations	1,059,242	629,241	354,197
Interest and other income, net	77,867	37,803	49,209
Interest expense	8,879	4,314	1,492
Impairment of certain equity investments		-1,230	-3,781
Income before income tax—United States	820,892		
Income before Income tax—international	307,338		
Net income (loss)	778,223	441,771	249,891
Net income (loss) per share-diluted	0.57	0.335	0.213
Net income (loss)	778,223	441,771	249,891
Cumulative effect of accounting change		5,413	
Provision for doubtful accounts and auth cred	90,942	46,049	25,455
Provision for transaction losses	50,459	36,401	7,832
Depreciation and amortization	253,690	159,003	76,576
Stock-based compensation		5,492	5,953
Amortization of unearned stock-based compens	5,832		
Tax benefit on the exer of employ stock opts	261,983	130,638	91,237
Impairment of certain equity investments		1,230	3,781
Minority interests	6,122		
Minority interest and other net income adj		7,784	1,324
Gain (loss) on sale of assets			-21,378
Accounts receivable	-105,540	-153,373	-54,583
Funds receivable from customers	-44,751	-38,879	-11,819
Other current assets	-312,756	-13,133	10,716
Other non-current assets	-308	-4,111	-1,195
Deferred tax assets, net		69,770	8,134
Deferred tax liabilities, net	28,652		
Accounts payable	-33,975	17,348	14,631
Net cash flows from investing activities	-2,013,220	-1,319,542	-157,759
Proceeds from issuance of common stock, net	650,638	700,817	252,181
Proceeds (principal pmts) on long-term obligs	-2,969	-11,951	-64
Partnership distributions			-50
Net cash flows from financing activities	647,669	688,866	252,067
Eff of exch rate change on cash and cash equivs	28,768	28,757	11,133
Net incr (decr) in cash and cash equivalents	-51,468	272,200	585,344
Cash and cash equivalents, beginning of year	1,381,513	1,109,313	523,969
Cash and cash equivalents, end of year	1,330,045	1,381,513	1,109,313
Cash paid for interest	8,234	3,237	1,492

Source: Case writers' estimates, compilations, and public records.

Being first to market in the e-commerce world was frequently an insurmountable competitive edge. eBay capitalized on being the first online auction house. Early competition came from companies like OnSale, Auction Universe, Amazon, Yahoo!, and Classified2000. These companies battled eBay on a number of fronts, mainly pricing, advertising

online, and attempting to lure key eBay employees away to join their ranks. eBay's biggest and most formidable competitive threat came from Amazon.com when it spent more than \$12 million launching its person-to-person auction service in 1999. eBay withstood all of these challenges. Amazon's efforts ultimately failed because it could not

Exhibit 2 Online Auction Market Share

	2001		2002		2003		2004	
	U.S.	Int'l	U.S.	Int'l	U.S.	Int'l	U.S.	Int'l
eBay	83%	41%	87%	50%	90%	65%	92%	74%
Yahoo!	7%	28%	6%	25%	4%	16%	3%	11%
Amazon	6%	10%	4%	8%	2%	5%	1%	2%
Overstock	N/A	N/A	1%	1%	2%	2%	2%	2%
uBid	1%	1%	1%	1%	1%	N/A	1%	N/A
All others	3%	20%	1%	15%	1%	12%	1%	11%

Source: Case writers' estimates, compilations, and public records.

generate enough site traffic. Auction buyers went where the most items were available for sale, and sellers went where the most buyers were found for their products. eBay had more buyers, more sellers, and more items—more than 1.4 billion items were listed on the site in 2004! These numbers dwarfed the nearest competitor by a factor of more than 50. eBay enjoyed a dominant 92 percent market share of the domestic online auction business and a 74 percent share of the international market (Exhibit 2).

### eBay's Customer Support Organization

In December 2004, Dalton was an operations director in eBay's Customer Support organization. She had several major responsibilities; the most critical one was customer support outsourcing, both domestic and offshore (Exhibit 3). This role occupied approximately 80 percent

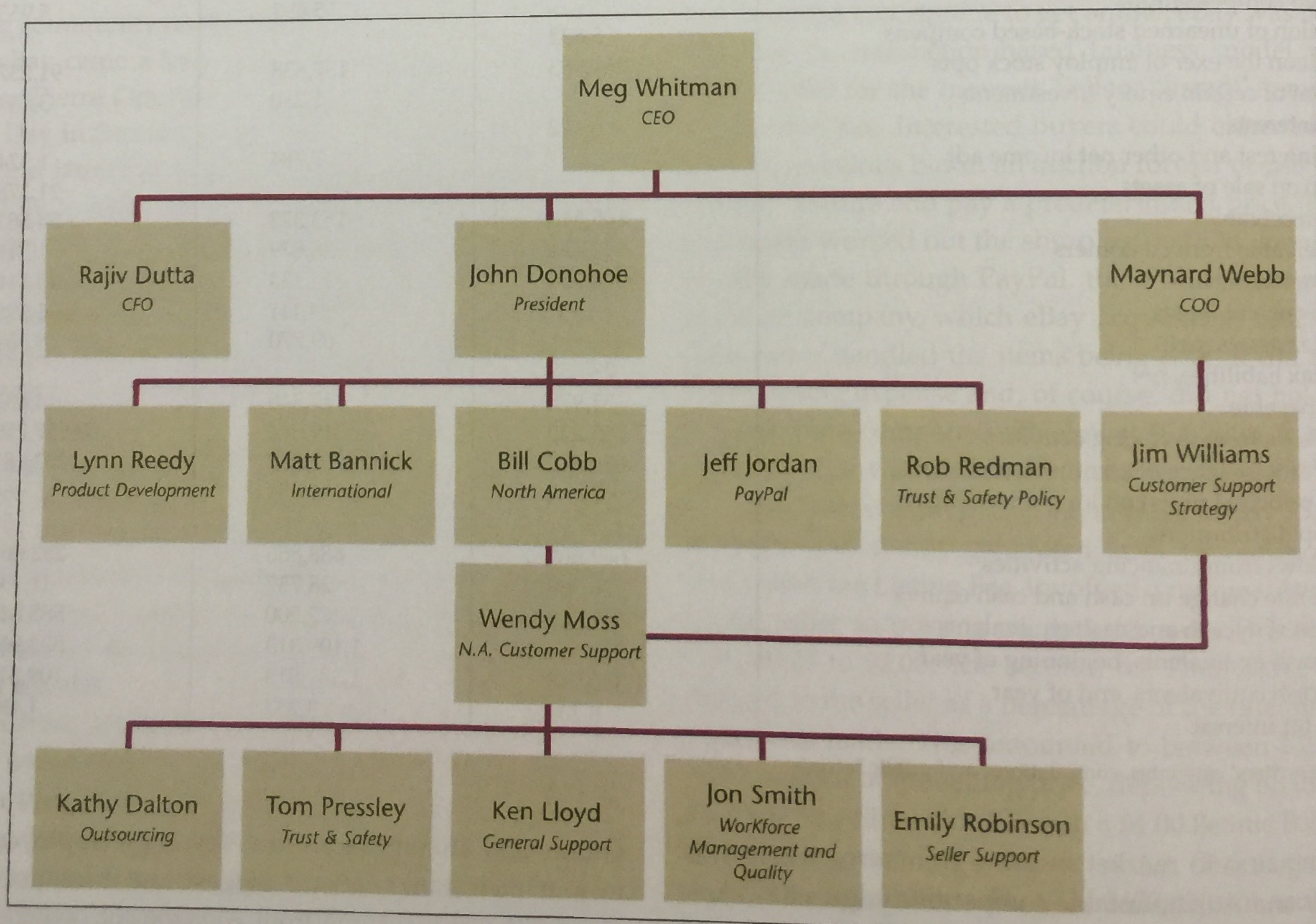


Exhibit 3 eBay Organization Chart

Source: Case writers' compilations and public records.

of her time. Upon joining the company, she had relocated to Salt Lake City, Utah, the site of eBay's largest customer service center. Utah's four seasons and mountainous terrain suited her. She loved to ski knee-deep powder in the winter and navigate forest trails on her mountain bike in summer. While thoughts of early season skiing had entered her mind, she had in fact spent the past three weekends in her cube and in conference rooms with her managers hammering out the strategy she had passed on to Moss for review.

Worldwide, eBay's Customer Support staff consisted of an estimated 3,000 FTE, comprising roughly two-thirds of the corporate workforce. eBay operated major service centers in Salt Lake City, Omaha, Vancouver, Berlin, and Dublin. Smaller company-owned Customer Support groups were located in Sydney, Hong Kong, London, and Seoul. The majority of these employees spent their workdays responding to customer e-mails. In 2004, eBay answered more than 30 million customer inquiries, covering everything from questions about selling, bidding, product categories, billing, and pricing to thornier issues involving illegal or prohibited listings and auction security (Exhibit 4).

The Customer Support organization was made up of two major units: (1) General Support and (2) Trust and Safety. Historically, most of the customer contacts were handled by the General Support unit. The communications consisted of questions regarding bidding on

auctions, listing and selling items, and account adjustments. By mid-2004, however, nearly 45 percent of inquiries were directed toward the Trust and Safety function. Here hundreds of employees were responsible for ensuring that the items listed on eBay were legitimate and legal, did not infringe on copyrighted, patented, or original material, and fell within the company's policies (i.e., no firearms, tobacco, alcohol, human body parts, and so on). It also enforced eBay's guidelines for proper member behavior by policing activities such as shill bidding, merchandise misrepresentation, and outright fraud.

### PowerSellers

Approximately 94 percent of eBay's customer service volume was e-mail-based. However, live chat and phone inquiries were growing as the company opened up these channels to more customers, based on their profitability. Live chat volume was predicted to increase to 1.5 million communications in 2005, up 50 percent over 2004. Phone calls handled in 2005 were anticipated to reach 1.4 million, almost double the number in the previous year. This phone volume was expected to come primarily from "PowerSellers," who represented less than 7 percent of eBay users but, due to the volume of merchandise they traded on the site, accounted for nearly 90 percent of the company's profit.

Phone and live chat access to Customer Support was designed to enlarge the pool of PowerSellers. Dedicated service representatives received additional training in up-sell, cross-sell, and auction display techniques to share with sellers to increase the number of items they sold and qualify them for higher PowerSeller monthly sales volume thresholds (Bronze, Silver, Gold, Platinum, Titanium). Once attained, these thresholds qualified sellers for dedicated phone and chat support as well as for the coveted PowerSeller logo (Exhibit 5).

### Trust and Safety

No other company was able to harness the ubiquity of the Web and marry it to the auction concept as successfully as eBay. At the same time, eBay had to confront challenges never faced before, particularly in the arena of auction security and fraud prevention. *Caveat emptor*, "let the buyer beware," had been a rule in the auction world since the middle ages. With the advent of eBay, buyers had to deal with unknown sellers over the Internet, sight unseen, often in a totally different country, without the

**Exhibit 4 eBay Customer Support Volumes by Channel**  
(in millions)

	2001	2002	2003	2004
<b>General Support</b>				
E-mail	8.1	12.1	14.6	16.1
Phone	0.1	0.3	0.4	0.8
Chat	NA	NA	0.4	0.4
Total	8.2	12.4	15.4	17.3
<b>Trust and Safety</b>				
E-mail	4	6.8	9.8	12.6
Phone	0	0	0	0
Chat	NA	NA	0.1	0.6
Total	4	6.8	9.9	13.2
<b>Combined GS and T&amp;S</b>				
E-mail	12.1	18.9	24.4	28.7
Phone	0.1	0.3	0.4	0.8
Chat	NA	NA	0.5	1
Total	12.2	19.2	25.3	30.5

Source: Case writers' estimates, compilations, and public records.

**Exhibit 5 PowerSeller Criteria**

To qualify, members must:

- Uphold the eBay community values, including honesty, timeliness, and mutual respect
- Average a minimum of \$1,000 in sales per month for three consecutive months
- Achieve an overall Feedback rating of 100, of which 98 percent or more is positive
- Have been an active member for 90 days
- Have an account in good financial standing
- Not violate any severe policies in a 60-day period
- Not violate three or more of **any** eBay policies in a 60-day period
- Maintain a minimum of four average monthly listings for the past three months

PowerSeller program eligibility is reviewed every month. To remain PowerSellers, members must:

- Uphold eBay community values, including honesty, timeliness, and mutual respect
- Maintain the minimum average monthly sales amount for your PowerSeller level
- Maintain a 98 percent positive total feedback rating
- Maintain an account in good financial standing
- Comply with all eBay listing and marketplace *policies*—Not violate any severe policies in a 60-day period and not violate three or more of **any** eBay policies in a 60-day period

**PowerSeller Levels**

There are five tiers that distinguish PowerSellers, based on their gross monthly sales. Some benefits and services vary with each tier. eBay automatically calculates eligibility each month and notifies qualified sellers via e-mail.

**Gross Sales Criteria for Each PowerSeller Tier**

<b>Bronze</b>	<b>Silver</b>	<b>Gold</b>	<b>Platinum</b>	<b>Titanium</b>
\$1,000	\$3,000	\$10,000	\$25,000	\$150,000

*Sources:* eBay Web site; case writers' estimates, compilations, and public records.

ability to personally examine the goods, and with little information about the seller except some written feedback from other buyers who had previously done business with him or her. It was absolutely critical for eBay's survival to create and nurture an environment of trust where millions of people around the globe could feel secure in trading online. The Trust and Safety Department was given this task. Procedural complexities, the differing legal environments and customs between countries, and the sophistication of online identity theft scams combined to make Trust and Safety a challenging business unit to manage.

Dalton wrestled with a number of questions related to Trust and Safety and its potential for outsourcing:

- "What kind of Trust and Safety volume could be safely outsourced?"
- "What kind of Trust and Safety volume could not be outsourced?"
- "How could she and eBay determine the credibility and quality of the potential outsourcing vendors?"

- "How could she guarantee the vendors' ability to safeguard the eBay information entrusted to them?"

A number of eBay's executives had expressed concern and outright hostility to the idea of outsourcing any Trust and Safety volume. Rob Redman headed up the Trust and Safety Policy group in San Jose. He and other executives worried about outside vendors handling the sensitive type of customer inquiries common to this unit, especially when personal information such as Social Security numbers and credit card account numbers could be accessed. In addition, many of the jobs within Trust and Safety required direct and ongoing contact with local, national, and international law enforcement agencies in the hunt for and prosecution of fraudsters. Redman believed outsourcing vendors would never be as skilled at developing and nurturing these key liaisons as eBay's own personnel, and he had made this known to Whitman, Moss, and Dalton on numerous occasions.

Underneath her confident exterior, Dalton worried about these issues as well. She did not have any hands-on

background in Trust and Safety herself. Still, she was intrigued by the possibility that several categories of inquiries within the department might be outsourced without undue risk.

## Outsourcing Beginnings

By late 1999, eBay had enrolled four million registered members, nearly all in the United States. Five years later, the eBay community had burgeoned to more than 135 million members, living in every country in the world. If eBay were its own country, it would have been the ninth largest on earth, behind Russia.

To stay abreast of the growth of its customer base, eBay significantly increased the resources dedicated to its Customer Support group. In the very early days of 1995-1996, founder Omidyar would reserve part of his Saturday afternoons in a local San Jose park to respond directly to member questions. He soon could not manage the volume himself so the first customer service staff was organized. A measure of the power of the eBay community was the fact that these first service staffers were not employees at all, but members who had shown a penchant for helping other eBayers. These people worked on a contract basis out of their homes responding to customers' e-mails. At one time, there were close to 75 such employees, called "remotes," living in 17 different states across the country, handling an average of five e-mails per hour at all hours of the day and night, often while sitting in their pajamas!

In early 1998, eBay Customer Support took another step to simplify management and improve the consistency and quality of service. The company hired a small corps of "in-house" customer service personnel in the San Jose, California, headquarters to supplement its remote contractors. The "remotes" had been a creative solution for a time, but one that could not be scaled as the technology, logistics, and training requirements of the Customer Support group increased in sophistication.

## Kana

One such technological advancement occurred when eBay purchased the Kana e-mail management system later that year to provide service personnel with a variety of "canned" responses and performance statistics similar to an automatic call distributor. Kana allowed representatives to answer common questions, such as "How do I list an item for sale?" "How do I leave feedback?" or "What do I do with an item I received that is damaged in shipment?" with a few quick keystrokes to input the code number of a pre-scripted e-mail reply. The representatives then took a moment to personalize the e-mail with their name and the recipients' names.

The Kana technology enabled service employees to be trained more quickly and effectively. Most importantly, it reduced response time to customer inquiries and increased the accuracy of information the customer received. It doubled the service representatives' e-mail productivity from five responses per hour to 10 and more. Without Kana, there was no way that eBay could have ever considered outsourcing even a portion of its overall Customer Support volume, let alone, as Dalton's new strategy proposed, increasing it to more than 50 percent.

By early 1999, nearly twice as many in-house representatives were employed as compared to the "remotes." This staffing strategy had paid off in improved productivity and in the rising customer satisfaction scores received from the hundreds of customers polled by mail each month (Exhibit 6). More in-house staff was needed, and a search was begun to build a dedicated center for Customer Support outside of California in a more cost-efficient locale. Three potential sites were considered—Salt Lake City, Tucson, and Albuquerque. In the end, the Utah location was selected due to the availability of a ready-made facility as well as a communications infrastructure, generous incentives offered by the state, and the educational level, work ethic, and foreign language capabilities of the potential employees.

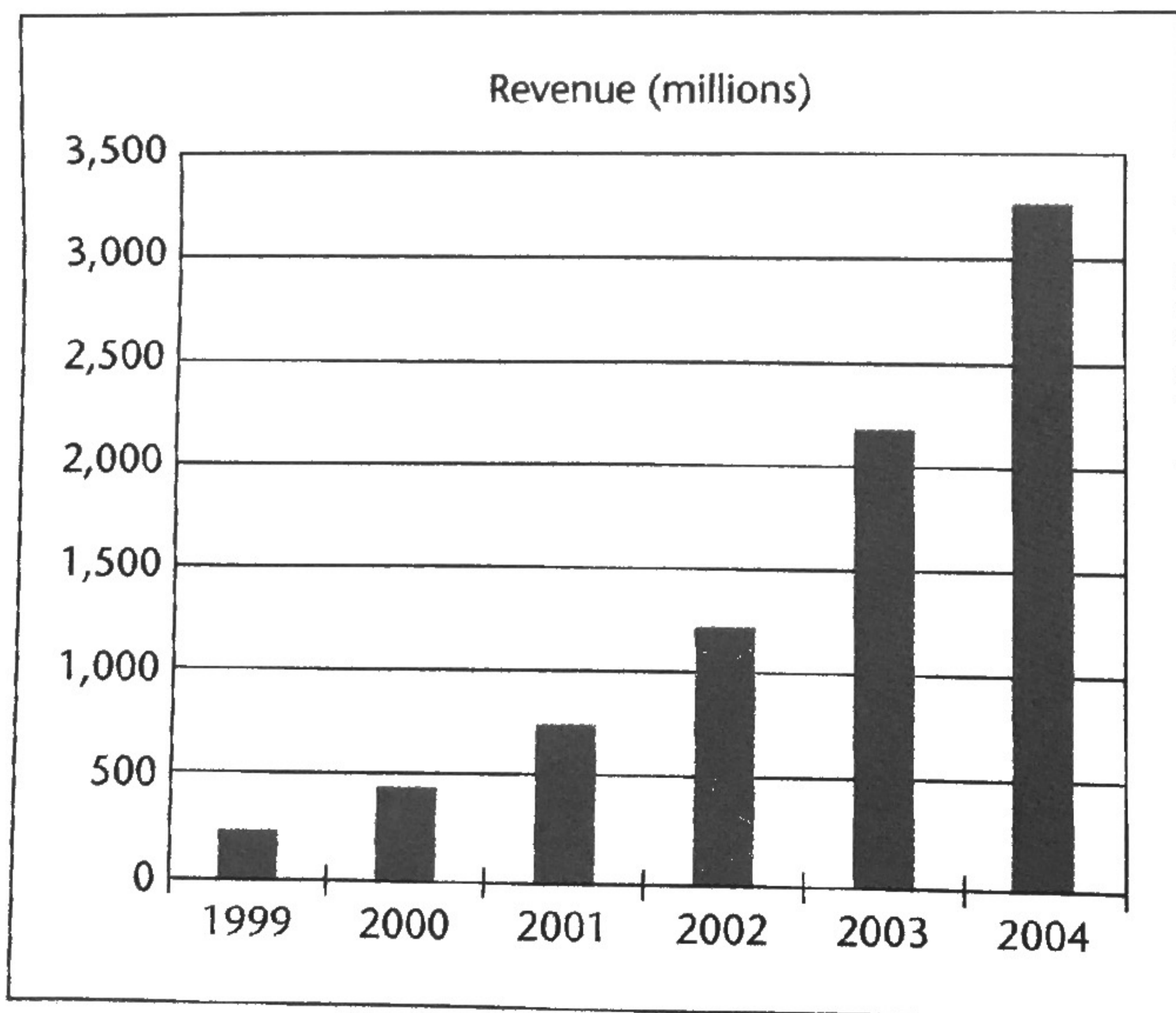
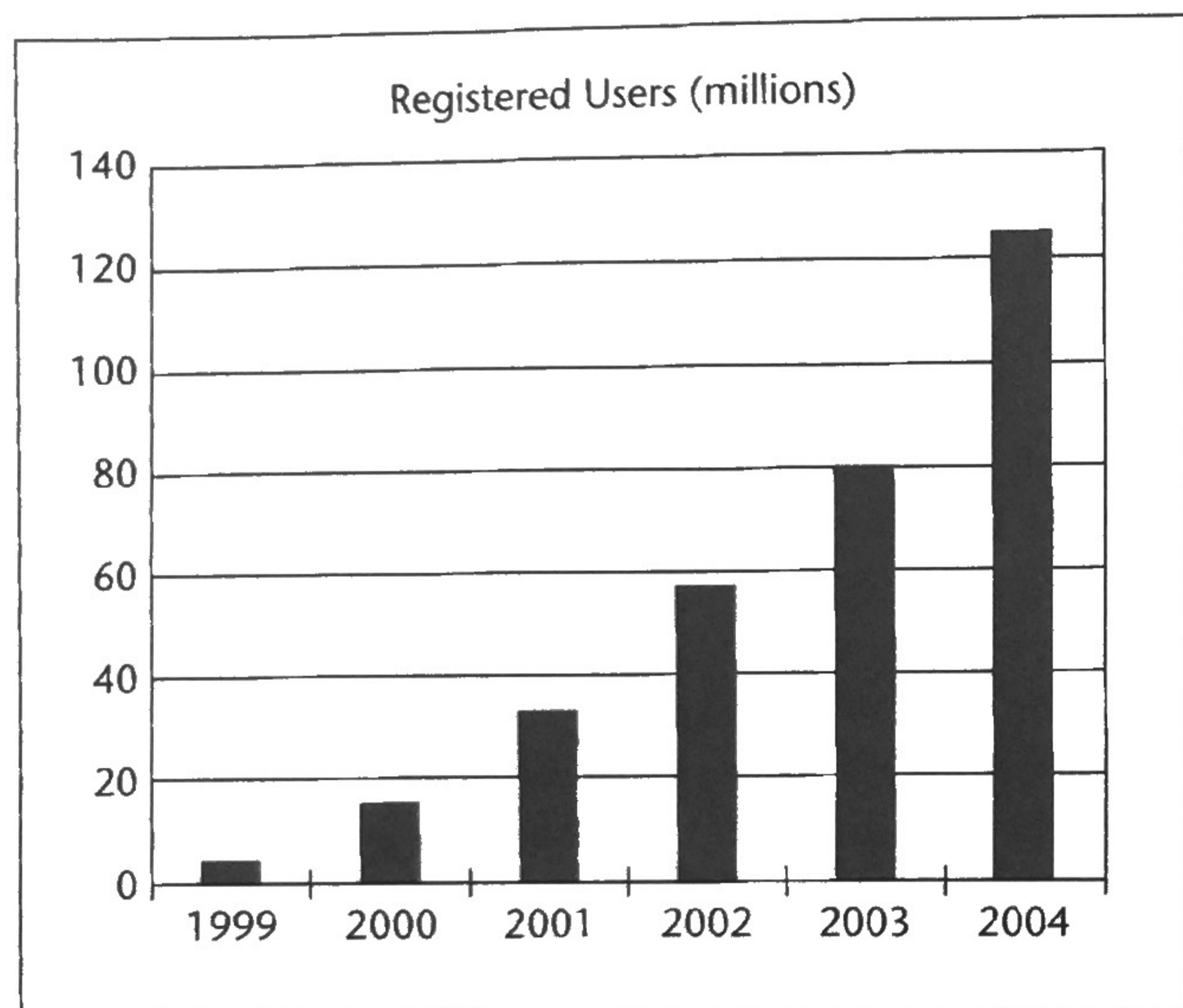
**Exhibit 6 eBay Customer Support Productivity and Quality**

	1998	1999	2000	2001	2002	2003	2004
E-mails Productivity/Hr	4.7	9.5	11.1	13.8	15.3	16	16.1
E-mails per FTE/Month	571	1254	1475	1980	2078	2225	2280
E-mail Quality %	N/A	83%	89%	91%	94%	95%	94%
Customer Satisfaction %	N/A	N/A	84%	86%	87%	88%	88%

Source: Case writers' estimates, compilations, and public records.

## PC 3-8 Corporate Strategies

Designed originally for about 300 personnel, the Salt Lake facility was enlarged to accommodate more than 1,000 by year-end 2000. In addition, a staff of 125 was added in both the newly opened Berlin and the Sydney locations to handle customer service inquiries. Still, with the worldwide popularity of eBay growing at a rate of 250,000 new members each month, it was apparent by 2001 that eBay could hire only so many of its own service personnel and build only so much of its own brick-and-mortar contact centers and that even trying to do so would not keep up with the demand (Exhibit 7). Alternatives like outsourcing had to be explored.



**Exhibit 7** Growth in eBay Users and Revenues

Source: Case writers' estimates, compilations, and public records.

## Outsourcing Pilot

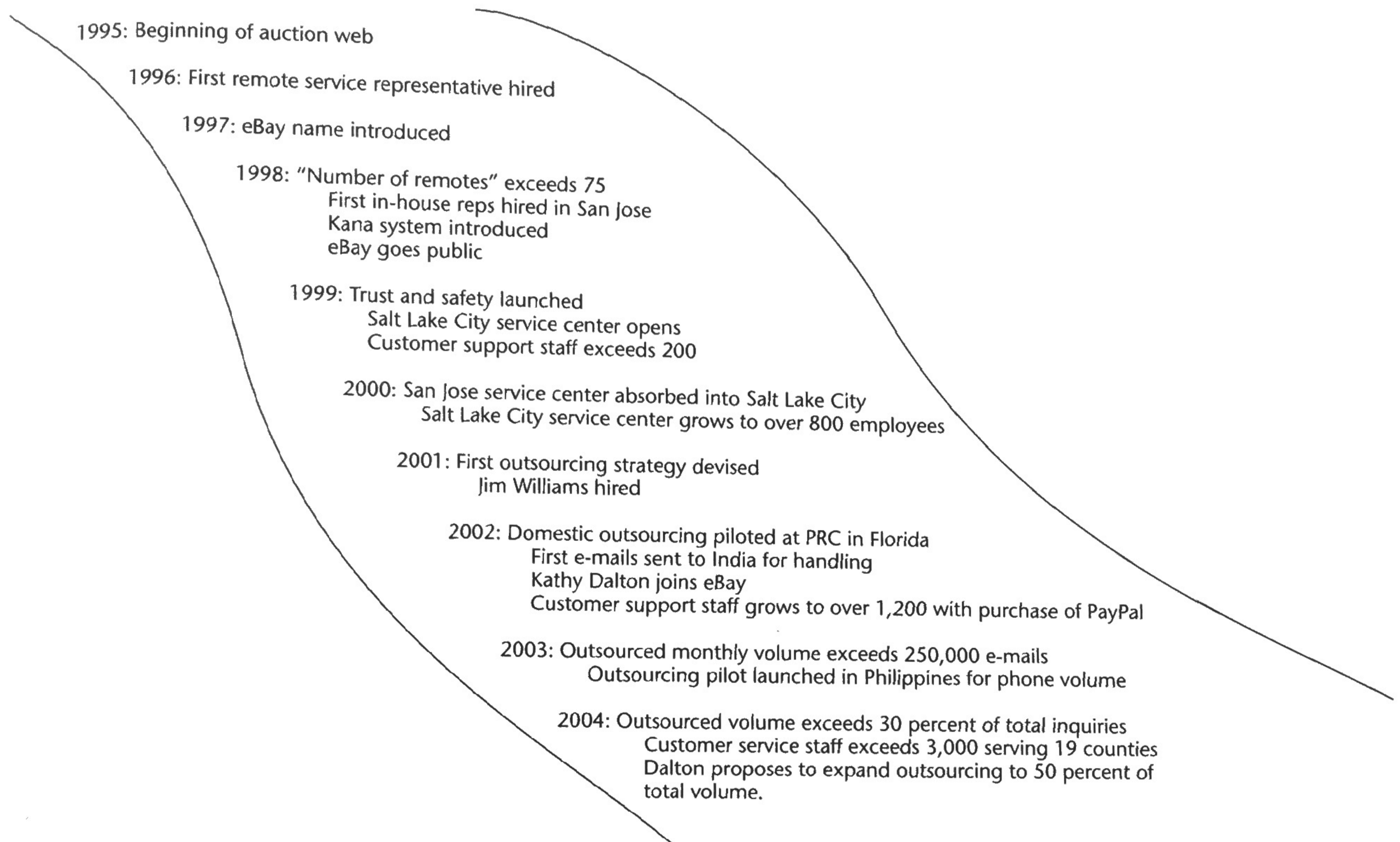
eBay had made headlines for years for its innovation in the online auction space, its market leadership, its product and technological ingenuity, such as member feedback, the Buy It Now feature, item search capabilities, and Kana, and its irresistible pace and can-do attitude. eBay did not manage itself by "the seat of its pants," contrary to what others may consider to be a trademark of dotcoms. Far from it, the company was thoughtfully led, financially disciplined, and extremely customer conscious. These were the underpinnings of its tremendous success. eBay let others serve as lab mice, test and bleed, stub their toe, and work out the wrinkles. Then, and only then, it stepped in and adopted the "latest and greatest" business practices.

Such was the case with outsourcing the elementary portions of its Customer Support operation. Leading companies like American Express, GE, and Citibank had been outsourcing some of their customer service functions for 10 to 15 years domestically and for at least half that time offshore before eBay felt comfortable in considering outsourcing. By mid-2001, outsourcing surfaced as a viable way for eBay Customer Support to scale to demand, avoid capital outlays, reduce unit costs, and leverage its investment in technology and management talent.

But the senior staff in San Jose, including Whitman, was concerned about the potential reaction of the eBay community. If you traded on eBay, you were not a customer. You were a member of a passionate and vocal community of users, who felt strongly (and rightly so) that eBay's success was directly attributable more to them than to any business savvy of headquarters staff in San Jose. How would the community react to knowing that some customer support inquiries were answered by staff not employed by eBay—or not even residing within the United States?

Another concern at headquarters was the lack of talent inside eBay who had experience with outsourcing. For eBay to uphold its philosophy of "prudent adoption," it needed a team of managers who could thoroughly investigate how other companies had successfully outsourced and then actually run the day-to-day operation.

In December 2001, eBay hired Jim Williams, an executive vice president from Precision Response Corporation (PRC), one of the country's top echelon outsourcing vendors, and gave him responsibility for customer service worldwide. Williams brought instant credibility to the outsourcing initiative. His knowledge of the industry from the providers' point of view reinforced the research already compiled on other companies that had been successfully outsourcing elements of customer service in India and the Philippines



**Exhibit 8** eBay Customer Support Timeline

Source: Case writers' estimates, compilations, and public records.

for years. Furthermore, his intimate association with PRC, its management team, and its training and technological capabilities made Whitman and her executives comfortable utilizing PRC as eBay's first global outsourcing partner.

When it came to the issue of how the eBay community would react to the new venture, Williams had an answer for that, too. Rather than launch a pilot in India, he proposed beginning with a small test near PRC's domestic headquarters in Fort Lauderdale. He essentially hand-picked the most talented customer service representatives at PRC to handle the eBay business. By February 2002, all preparations for the pilot were completed, and eBay's first-ever outsourcing effort was launched (Exhibit 8).

## Expansion of Outsourcing

Dalton reflected on the progress made in outsourcing over the past several years. The outsourcing pilot program begun in Fort Lauderdale in 2002 had been relatively seamless. The plan had been to run the pilot for six months before attempting to route volume offshore to one of PRC's

service centers in Bangalore, India. Yet the service quality and e-mail productivity results from the vendor were on par with eBay's own staff after only three months. Williams and his Customer Support team decided to cut the pilot short and sent the first e-mails to India in June 2002.

The eBay community's reaction to outsourcing portions of its customer service was essentially only a small ripple in a big pond. There had been some issues with the written English of the agents in India. A handful of complaints found their way to Whitman's desk. Still, the service quality and productivity metrics of the outsource providers, both domestic and foreign, rivaled and frequently surpassed the same measurements of eBay's own employees (Exhibit 9).

And who could argue with the cost differential? While eBay honored its community, it was also a publicly traded company with shareholders who were accustomed to a compounded annual growth rate in revenues of more than 65 percent. The domestic outsourcing cost per contact for the volume handled in Fort Lauderdale was not that much less than eBay's own staff results. This was perfectly acceptable because a significant driver for outsourcing to another location within the United States had been, in

Exhibit 9 Metric Comparison for eBay In-house and Outsourcing Vendors (comparison for similar volume types)

	Jul-02		Dec-02		Jul-03		Dec-03		Jul-04		Dec-04	
	In	Out	In	Out	In	Out	In	Out	In	Out	In	Out
E-mails Productivity/Hr	14.8	13.1	15.2	14.7	15.5	15.4	15.7	16.1	15.8	16.3	15.8	16.3
E-mails per FTE/Month	2050	1963	2181	2095	2202	2189	2240	2255	2250	2291	2250	2285
E-mail Quality %	94%	88%	95%	94%	95%	95%	94%	95%	93%	95%	93%	96%
Customer Satisfaction %	87%	83%	87%	86%	87%	88%	88%	88%	87%	88%	87%	89%
E-mail Unit Cost (\$)	1.59	0.87	1.55	0.86	1.56	0.85	1.49	0.82	1.48	0.81	1.48	0.81

Source: Case writers' estimates, compilations, and public records.

addition to initially testing the outsourcing model, to avoid the capital outlay of building more plant and equipment for Customer Support.

The unit cost for the e-mail volume being sent to India was another matter. It was literally half the cost per contact handled in the United States. An occasional complaint letter to Whitman about the way an e-mail response was worded by one of the service reps in India was not taken lightly, but it was still considered a small price to pay for the level of operational savings. No question about it, after both the domestic and offshore outsourcing performance of 2002, eBay executives were satisfied that outsourcing would remain a component of its customer support strategy. Dalton wondered, "What are the limits?"

Throughout 2003 and most of 2004, eBay had increased the volume of customer service sent offshore. Through analyses of e-mail complexity and available canned responses in Kana, about 40 percent of the General Support volume, representing close to 500,000 e-mails a month, had been earmarked as "outsourcable." As additional service staff was hired and uptrained in India, the throttle was opened and more e-mail was directed overseas for handling.

Dalton grabbed the hard copy of the strategy document she had submitted to Moss the previous week. She focused on several pages that highlighted the outsourcing expansion since her arrival at eBay. In a business as fluid as eBay's, it was realistic to expect that the original outsourcing strategy devised in 2002 would change over time. Indeed, even with eBay's penchant for hindsight learning from others' mishaps, Dalton's three-tiered strategy had only evolved after some operational missteps and plenty of analysis of test results.

## Customer Relationship Management

One such misstep occurred in late 2003, when eBay conducted an outsourcing pilot in the Philippines for phone volumes. Less than 2 percent of eBay's volume arrived via

telephone, but it was an expensive piece. The hope had been to cut eBay's phone unit cost in half, to just around \$2.00. It did not play out that well in reality. During the pilot, both the accents of the Philippino agents and their language comprehension were issues. Logistical issues with phone lines and data servers plagued the startup. The biggest concern, however, was that eBay at the same time was taking its first major steps into Customer Relationship Management (CRM).

The company's marketing group had just completed a thorough segmentation analysis of its community members and saw potential opportunities in building deeper service relationships with its more profitable customer segments. More than 40 distinct customer segments were identified, and strategies for increasing profitability were then prepared for each segment. One of the proposed strategies was to offer dedicated live phone support to certain segments, particularly PowerSellers and potential PowerSellers.

With its focus on optimizing the phone touch point to generate revenue, senior management wanted to keep its phone support group in-house, rather than outsource it to third parties offshore. Management reasoned that this not only allowed for more efficient rollout of profit-enhancing marketing programs, but also provided job enrichment and new career paths to eBay's own employees. In line with being more accessible by phone to high-value customers, Customer Support shut down its phone outsourcing pilot in the Philippines in early 2004. Whether the pilot could have eventually been successful was unclear.

The same logic was used for eBay's live chat channel, which represented 2 percent of total volume or about 45,000 chat sessions a month. The original plan was to outsource this volume overseas as well. However, with the vision of using the chat channel to cross-sell products and increase seller volume, it was determined to service chat line customers in-house, too. These CRM-led constraints for the phone and chat channels helped fashion the new outsourcing strategy that Dalton had proposed to her boss last week and that she was scheduled to present to Whitman.

## New Outsourcing Strategy

When she was given the responsibility for outsourcing in July 2004, Dalton dug deeply into the existing operation to understand the issues as well as the opportunities and threats facing the department. She identified three major opportunities for improvement. She needed to figure out how to analyze each one and implement programs within 12 months, which was the time frame she and Moss had agreed was feasible.

The first opportunity she saw was to increase the percentage of outsourcing from 30 percent of overall volume to at least 50 percent. She calculated that this would save an incremental \$3.9 million a year. What made this endeavor particularly difficult, however, was the CRM initiative that required her to keep the growing phone and chat volume with in-house service representatives only.

The second opportunity would help her to accomplish the first. It was to target for the first time specific volume types within Trust and Safety and demonstrate that these could be successfully handled by a third-party outsourcer. Several within Whitman's executive team felt strongly that it was too risky to outsource any of this volume and Dalton knew she would be in for a fight. She deemed it a worthwhile fight because, according to her analysis, between 20 percent and 25 percent of Trust and Safety's monthly volume was straightforward enough to be included in the outsourceable pool.

The third area of opportunity was to seek an outsourcing partner in addition to PRC with which to contract. Dalton was concerned that eBay had for two years used only one outsourcing vendor. She reasoned that adding a second one would benefit eBay by instilling competition both in pricing and performance metrics between the two vendors, as well as providing a measure of redundancy in the event of system outages.

She and her staff had wrestled with these three problems over the ensuing months. Selecting a second vendor that could meet eBay's criteria proved challenging. The candidate company had to have both a domestic and international presence, have a proven track record in servicing large quantities of phone, chat, and e-mail inquiries, and be willing to rival PRC's already attractive per unit pricing. Finding a vendor that had sufficient e-mail experience proved the toughest challenge. Dalton and her team finally settled on I-Sky, a medium-sized vendor, but one that could deliver impressive e-mail results out of its several service centers located in more rural parts of Canada.

### Three Tiers

In order to increase the outsourcing to 50 percent of total volume, while at the same time taking advantage of the opportunity for including Trust and Safety volume in the mix, Dalton had devised a strategy made up of three levels or tiers. Each tier represented a progressively more complex type of work, both in terms of the nature of the customer inquiry and the channel through which it accessed Customer Support (Exhibit 10).

- **TIER ONE:** Was composed of e-mail-only volume involving the most basic of General Support-type questions. These were typically simple bidding and selling questions that could be answered using a template of responses from Kana. Because these were less-complex customer inquiries, training for the service representatives was less demanding and could be conducted over a three-week period. Most of eBay's Tier One volume was already being handled by PRC's two outsourcing facilities in India. Dalton analyzed all remaining inquiry types to find an additional 260,000-plus e-mails

**Exhibit 10 Proposed Outsourced Volume and Unit Cost by Tiers**

	Current (Dec. 2004)			Proposed (Dec. 2004)		
	Monthly Volume	% of Total Volume	Unit Cost	Monthly Volume	% of Total Volume	Unit Cost
<b>Tier One</b>						
Gen'l Support	510000	21.30%	\$0.81	775000	32.40%	\$0.72
<b>Tier Two</b>						
Gen'l Support	68000	2.80%	\$1.45	186000	7.80%	\$1.15
<b>Tier Three</b>						
Gen'l Support	20000	0.80%	\$1.48	25000	1.04%	\$1.33
Trust and Safety	NA	NA	NA	210000	8.80%	\$1.33
<b>Total</b>	598000	24.20%		1196000	50.00%	

Source: Case writers' estimates, compilations, and public records.

per month that could be safely offloaded to India as well. If these volumes could be found, she thought she might be able to negotiate with the vendor for a price reduction from \$0.81 to \$0.72 per e-mail.

- **TIER TWO:** Was designated for General Support e-mail volume that was considered a bit more complex than Tier One work. This accounted for more billing-related and account adjustment questions, where more in-depth training was needed for the service representatives. eBay had outsourced a small portion of this volume, but only to PRC's Florida center, where English was the native language. Now, utilizing I-Sky's locations in Canada, Dalton proposed another option for handling this volume. These locations could satisfy the native English requirement and prove very effective from a cost standpoint. Though not as low-cost an environment as India, the Canadian Tier Two locations were on average 22 percent more economical in cost per e-mail than PRC's domestic facilities and eBay's wholly owned service centers.
- **TIER THREE:** Was reserved for more complex General Support questions, those that required flexibility and some judgment on the part of the service employees. Also, it was in this tier that Dalton proposed that some simple Trust and Safety inquiries be handled. She was careful not to select work that was overly sensitive in terms of customers' personal information or that necessitated detailed investigative work. Types of inquiries that qualified included reports from eBay users on spam or potential scam sites and on listing violations or member misbehavior, such as not paying for items received, and shill bidding. This tier consisted mainly of e-mail volume, yet Dalton designed it so that some simple phone and chat inquiries were included as well. While this was contrary to eBay's CRM philosophy that phone calls and chat sessions be kept in-house with experienced eBay service agents, she asserted that top reps at both PRC and I-Sky could be taught to service this volume just as adeptly as eBay's own.

Tier Three was to be handled by outsourcing centers exclusively in the United States, located in close proximity to eBay's own contact centers. This "nearshoring" arrangement ensured that no language barrier existed and that Dalton and her managers were within close proximity if the outsourcer needed extra support and training.

In her recommendations to Moss the previous week, Dalton had made sure her boss understood that the arrangement for Tier Three volume would save the company only about \$500,000 per year from a pure cost reduction standpoint, but that it did pay off in keeping Customer

Support from having to invest in additional plant and equipment, as well as reducing the risk of spreading its management talent too thin. Plus, it opened the door to outsourcing approximately 20 percent of Trust and Safety work types, which was essential to meeting the goal of offloading upward of 50 percent of eBay's entire support volume.

Moss had readily acknowledged and appreciated Dalton's explanation on her team's strategy behind the logic for Tiers Two and Three. She was more inquisitive, however, about the Tier One work being serviced in India. The payoffs there in reduced operating expense were impressive, saving the company almost \$3 million annually, and Dalton had sensed right away Moss's interest in bringing more dollars to the bottom line. Moss had quizzed her in detail the previous week on PRC's Indian-based operations and I-Sky. How experienced, how financially muscled, how well led, how competitively positioned, how quick to market were these two companies? What kind of presence did Customer Support have in these centers? Were eBay managers always on site in India training new hires, sampling e-mails, admonishing the "eBay way"?

As she recounted these queries in her mind from the meeting, Dalton admitted that the question her boss had posed in her e-mail was really no surprise at all. Customer Support was heavily invested in making the Indian operation a long-term service and financial win. But why line someone else's pockets along the way? What Moss wanted to know, and what she had anticipated that Whitman and her staff would likewise want to know, was the feasibility of doing exactly what Dalton's outsourcing group was doing in India, but doing it without the middleman. "Imagine if Customer Support was saving approximately 45 percent per e-mail by offshore outsourcing. How much more could be saved by running our own sites in India?" Moss's e-mail concluded.

## To BOT or Not to BOT

Fortunately, Dalton had done research on the subject of developing eBay-owned and -managed sites offshore, though not in real depth. She had figured that opportunities would exist for her and her staff to still work out the minor kinks with the present outsourcing strategy. "Chalk up another one to the exhilarating eBay pace," she thought to herself.

She wanted to call Moss in San Jose and discuss her e-mail and the next steps in preparing for the upcoming presentation to Whitman. But first she opened her file drawer and pulled out a folder labeled across the top with the letters "BOT." It had been several months since she

Exhibit 11 Dalton's Spreadsheet

		Cost/Hr/Seat (250 seats)	Cost/Hr/Seat (500 seats)	Cost/Hr/Seat (1,000 seats)	Avg. Initial Investment/Seat (one-time cost)	Avg. Transfer Cost/Seat (one-time cost)
Scenario #1: Outsourcing to 3rd party vendors	<i>e-mail, phone, chat</i>	\$ 10.17	\$ 9.56	\$ 8.60	N/A	N/A
	<i>e-mail only</i>	\$ 6.24	\$ 5.38	\$ 4.66		
Scenario #2: Build eBay owned center	<i>e-mail, phone, chat</i>	\$ 9.73	\$ 8.85	\$ 7.77	\$ 12,000	N/A
	<i>e-mail only</i>	\$ 5.30	\$ 4.68	\$ 4.14	\$ 11,000	N/A
Scenario #3: Build, Operate, Transfer (BOT)	<i>e-mail, phone, chat</i>	\$ 9.88	\$ 9.03	\$ 8.10	N/A	\$ 3,500
	<i>e-mail only</i>	\$ 5.34	\$ 4.96	\$ 4.40	N/A	\$ 2,900

Source: Case writers' estimates, compilations, and public records.

gathered the contents. Before she knew it, an hour elapsed and she remained focused on sifting through the packet of information, occasionally pausing to run several scenarios through a quickly composed Excel spreadsheet.

After another 45 minutes of analysis, she was ready. She printed the spreadsheet and quickly surveyed it for clarity. It was not as detailed as it would need to be in the coming days, but it would help her frame a conversation with Moss about the question she asked in her e-mail, the one she asked on behalf of Whitman:

"Why should we keep paying someone else to do what we can do for ourselves?"

In her spreadsheet, Dalton outlined and quantified three alternatives (Exhibit 11). The first alternative was the Tier One of her proposed three-tiered strategy—maintain the relationships with eBay's offshore outsourcing partners, continue to improve the operation in India, and identify incremental volume to outsource in order to drive e-mail costs lower. She viewed this scenario as the least risky of the three alternatives.

The second alternative was to eliminate the outsourcing vendors altogether. In this option, she proposed that Customer Support not renew its contracts with the vendors and instead purchase or lease land or an already established facility in India and build its own operation. Dalton knew this alternative presented the most risks to eBay, including capital outlay, real estate commitments, governmental compliance, communications infrastructure,

and in-country management resources. Yet, according to her spreadsheet assumptions, this alternative promised the biggest potential payoff long-term in unit cost reduction, something that eBay's executive staff prized highly.

She believed her third alternative, called "Build, Operate, and Transfer," or "BOT" for short, was the most creative and represented a hybrid of the first two. She recommended that eBay contract with a third-party vendor that would acquire or build an operations center, staff and manage it, and then, after a specified period of time of perhaps a year or two, transfer full ownership to eBay. This option appealed to her more than the second one because the vendor would bear the initial risks for the startup phase, which she considered the most challenging and expensive. eBay could limit its cost exposure up front until the operation was ramped up and running. She planned to tell Moss that the most critical points of the BOT alternative were to negotiate the appropriate level of management fees with the outsourcing vendor and to work out the intricacies of the actual transfer of ownership down the road.

Dalton's biggest concern, however, was the fact that to date she had not been able to find any example of a domestic company utilizing a BOT approach with a vendor in India. To her knowledge, eBay would be the first customer service operation attempting such a strategy. As she prepared to pick up the phone and dial Moss's number, she was haunted by eBay's well-entrenched mantra of not being on the "bleeding edge" with any new unproven experiments.