ANALYZING MANAGERIAL DECISIONS: *eBay.com**

eBay operates the world's largest online auction. In early 2008, eBay operated in 39 counties with 276 million registered users worldwide. The total value of all successfully closed items in 2007 was $59 billion with an average of $2,039 worth of goods trading on the site every second. Sellers pay a small fee 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. Items can be sold at a fixed price or through an auction. In an auction, 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 and arrange payment and delivery. 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 are a bidder, you can check the seller's Feedback Profile easily before you place a bid to learn about the other buyers' experience. If you're a seller, you can do the same thing to check out buyers. Each participant is given a Feedback Score based on the number of positive and negative ratings that they have received. Participants with sufficient positive ratings are flagged by colored stars. The highest rating is the "Red shooting star." eBay has created a set of policies to guard against "feedback manipulation" and "feedback abuse."
- eBay users are encouraged to settle transactions through *PayPal*. *PayPal* provides free insurance of up to $2,000 on some items to protect buyers in cases where they do not receive the item or it was less than expected.
- Participants sign user agreements that specify the trading rules and expectations. eBay's safety staff investigates alleged misuses at eBay such as fraud, trading offenses, and illegally listed items. Potential resolutions include such things as banning a person from future trading on eBay.

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.

*To obtain more detailed information, go to www.ebay.com.

more pieces of fruit per hour if paid by the piece than by the hour. However, piecework payments generate their own set of incentive problems. These payments motivate people to focus more on output and less on quality. In fruit picking, a supervisor can monitor the quality of the output inexpensively through direct inspection of the harvested fruit. In the case of airplanes, quality problems may not be detected until after the employee leaves the job (for example, after the plane is delivered, put into service, and—in the most extreme case—crashes). In this situation, the contracting costs of piecework payments are larger than the benefits. We apply this type of logic throughout the book to explain the design of organizations.

Summary

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.*