

The Real Reason eBay Is Stuck

[Victoria Barret](#), 10.06.08, 3:10 PM ET

BURLINGAME, CALIF. –

During the decade of Meg Whitman's reign, **eBay** clung fiercely to the auction model that made it a multibillion-dollar hit. The oft-repeated phrase inside the company's San Jose, Calif., headquarters: "Don't screw it up." Somehow they did.

eBay (nasdaq: [EBAY](#) - [news](#) - [people](#)) is stuck. Traffic to the site has declined 11% over the past two years. The volume of sales flowing through eBay (which Whitman long insisted is the best metric of health) was \$16 billion last quarter, but it isn't growing. eBay's stock is trading at a five-year low and for a very unglamorous 12 times likely 2008 earnings, despite \$4.7 billion in stock buybacks since 2006. Revenue for 2008 will probably gain 17% from 2007, to \$9 billion. On Monday, the company announced a 10% layoff, cutting about 1,000 full-time employees and several hundred temporary workers.

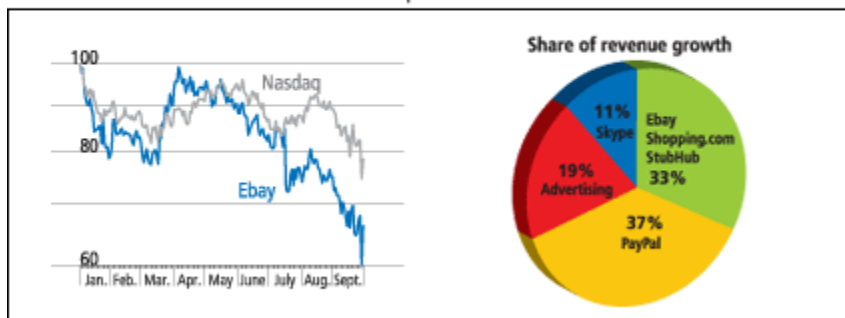
Growth has come from other assets: eBay is getting two-thirds of its sales growth from acquired businesses Skype (Internet telephone), PayPal (online money) and StubHub (event tickets), as well as advertising on the site.

Also on Monday, eBay said it would pay \$945 million in cash and options for Bill Me Later, an online-payment company. That's a little over six times sales. (See "[Ebay's Ax and Acquire Strategy.](#)")

Google (nasdaq: [GOOG](#) - [news](#) - [people](#)) and Amazon are courting eBay's sellers and its 71 million unique visitors every month. Google is testing the display of "shopping results" within regular search results that with a single click redirect people to merchants' sites instead of to eBay. Amazon is charging sellers a flat \$40 monthly fee to list an unlimited number of items and grants many of them the right to send goods using its wildly popular free shipping service, Amazon Prime. In July it launched a checkout system to rival PayPal.

Now What?

Investors aren't optimistic about Donahoe's ability to stoke growth in eBay's main business, which now accounts for only a third of revenue growth. eBay says it deserves more credit for those smart acquisitions.



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eBay's newly anointed chief executive, John Donahoe, sees these trends and is trying to make eBay a cleaner, safer online mall instead of a bargain basement. A group of its merchandisers has been deputized to balance the selection so there aren't 1,000 used iPods for every one pair of new Jimmy Choo stilettos.

To get more goods on the site, Donahoe lowered the fees for listing and promoting items. In May he cut a deal with Buy.com to land more books, DVDs and electronics, big categories for Amazon. eBay's search technology no longer defaults to listing the auction ending soonest, which guaranteed every seller a shot at prime placement. Now it uses a more Google-like relevancy criteria for results.

But Donahoe's problems lie far deeper than what a tweak to the listing fees can fix. In the company's trenches the joke is that eBay has become "the **IBM** (nyse: [IBM](#) - [news](#) - [people](#)) of [Silicon Valley](#)," referring to the computer maker's infamously bureaucratic rituals that bogged it down two decades ago. Interviews with a score of current and former eBay employees point to endless meetings and an overemphasis on getting ideas "put in a deck" (PowerPoint slides) rather than on true innovation.

They say eBay is cluttered with business-consultant types who are out of touch with customers, lacking in technological vision and prone to sheeplike thinking, while the iconoclastic engineers just take orders. Meg Whitman cut her teeth at Bain & Co. before layovers at **Disney** (nyse: [DIS](#) - [news](#) - [people](#)) and FTD. Donahoe was at Bain for 20 years. Bain alums include the heads of eBay in Spain, Canada and Belgium. Beth Axelrod, eBay's chief of personnel, came from McKinsey & Co. The head of U.K. eBay and a country manager in Germany both came from Boston Consulting Group.

eBay's senior ranks, in true management-consultant form, worship data above all, even when it steers them wrong. A glaring example of the perils of data-driven decision making still haunts eBay. Around 2002, executives hired McKinsey to answer a crucial question: Is Google a threat? After months of data mining the consultants concluded not really. The company stuck with that flawed insight for too long. Search technology remained a rump effort inside eBay until 2006, when it began investing more heavily in search. eBay's search still lags behind Google's and, arguably, Amazon's. It gets 15% of its traffic via paid search results from Google. If it had aimed to be the search site for online commerce, it wouldn't be paying a competitor for traffic.

Making eBay less consultant-minded may be hard for Bain-trained Donahoe, but he is known for diplomacy skills. Donahoe and other executives declined to cooperate for this story, but a spokesperson added this: "We are still in the early stages of our long-term plan, which we believe is progressing as anticipated. We have been very clear about our objectives all year; we are executing toward those goals and will continue to do so."

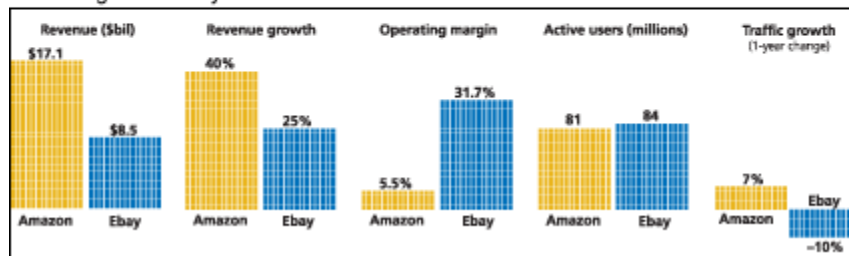
eBay was never just a retail destination. It was a Web chronicle of human nuttiness, where you could find everything from 19th-century American dolls to car mufflers. Executives quickly learned the one thing they had to avoid at all costs: downtime. In 1999 the site went dark for 22 hours, causing \$4 million in lost fees and a \$5 billion drop in eBay's market value. From then on efficiency and availability drove eBay's engineering ethos. "Just keep the marketplaces running--

that was the biggest priority, and that was smart," says Leonard Speiser, who was a group product manager at eBay from 2000 until 2005.

eBay employees in the early days often were asked to announce how many items they'd bought and sold on the site. It was a badge of pride to be in the community. But that routine faded as eBay grew and the loyalty was obviously missing when eBay's mail rooms were flooded with Amazon boxes in the weeks leading up to Christmas in 2006. A public relations staffer with a sense of humor had stickers from an [ad campaign](#) slapped on inbound Amazon boxes that read: "Next time get it on eBay."

Who Will Wear the Crown?

eBay and Amazon are vying to be the king of online commerce. Amazon has much higher sales and is growing more quickly but has far thinner margins. eBay might have to give up some of that margin to catch Amazon and reverse its own traffic declines. Amazon has made it harder for eBay by launching its own payment service in July to rival eBay's PayPal. eBay has responded by improving its search and rewarding trustworthy sellers.



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"eBay is run by smart people who don't use eBay and spend hours debating the data about how other people use eBay," says a former strategist who left a few months ago. "That is the problem. You can't solve your way into the future."

The quirkiness eBay brought to the Web eventually moved elsewhere. Laurence Toney was running eBay's collectibles category in 2005 and tried to push through a plan to let fans of collectibles display their stuff free of charge on eBay and then chat and post comments. "It would make eBay more sticky, make it a place where people could hang out," he says.

But his idea didn't pass eBay's stiff test: instant, measurable profits. "Only ideas with obvious returns get resources," says Toney. He soon saw hobbyists shift their activities to MySpace and Facebook. He ended up doing a deal with online shopping site Kaboodle and had to pull it off with no engineers.

"For everything at eBay you do a little mini-consulting case, then you shop that around. Even just a couple days of a developers' time requires getting approval from a committee of executives, so things move very slowly and little gets through the approval process," says a product manager who left in 2007.

In 2004, eBay's ranks were jolted when the company missed earnings for the first time while Amazon raised its forecast. So eBay looked at the data. Internal studies showed rising categories of shoppers eBay grouped as "convenience-oriented buyers." In other words, people who didn't

have time to watch a seven-day auction just to buy something and wanted to be sure they were getting what they ordered.

To meet those needs, the company tapped contributions from 600 employees for two years and in the spring of 2006 launched eBay Express, a separate site that sold fixed-price items and charged sellers only if an item sold. Express had instant inventory by drawing items already selling on eBay sites at fixed prices. But traffic was tiny; eBay cut back investing in Express just months after the launch and the consultants moved on to the next project.

In the fall of 2006 a group of 30 senior managers from across the company convened for two months in the eBay Toys building, dropping everything else, to figure out what eBay should be. The effort was dubbed "eBay 3.0." They took a consciously un-eBay approach. No PowerPoints, no data analysis. Instead, they acted out the brand in skits and pictorial outlines called storyboards. Just before the year's end, group members presented their vision to Whitman, Donahoe and the board. The vision for eBay everyone agreed on was a return to the "fun" of auctions.

Plans were drafted to simplify and brighten eBay's home page and add features to make the auction process more lively and competitive (for example, a software widget that would show bidders who they were up against). A cryptic national ad campaign called "Windorphins" tried to evoke the idea of an endorphin rush from winning an auction. One ad featured people chasing a radio around a racetrack.

But without public explanation executives switched course months later and invested only a fifth of the amount earmarked for eBay 3.0, according to insiders. By the time Donahoe's succession was announced in January of this year, he was returning to those "convenience-oriented buyers" and talking up eBay as a channel for fixed-price sales.

Donahoe recently tasked 2,000 eBayers with the goal of making shopping on eBay safer; others are working to improve search on the site. In January he announced price cuts for sellers who have high satisfaction ratings from buyers. eBay calls this a success so far as the share of PowerSellers who qualify for the higher 15% discount is at 30% now, double what eBay expected when it started the program in January.

He is boldly making these changes even as the crucial holiday season approaches. Sellers, of course, hate this. "You can't do any testing when eBay changes its search technology and fees all the time," says former eBay seller and consultant Randy Smythe.

Donahoe's move to lower the fees for listing items has boosted the number of items on the site by 18%, according to Majestic Research. That's big compared with last year, when total listings were flat. But Scot Wingo, chief executive of online retailing software vendor ChannelAdvisor, points out that even though Donahoe lowered insertion fees from an average of \$1.58 an item to 35 cents, he hiked the fees for when an item sells.

Wingo, who sees \$3 billion worth of online sales flow through his customers, says eBay's share has stalled while Amazon's is doubling. "If you put all your inventory on eBay, you'll lose

money," says Wingo, remarkably candid for someone who has eBay as an investor in his company.

Yet, eBay would take a big hit if it did away with those fees. Nearly a third of its revenue comes from insertion and other listing fees. Still, says Wingo, "eBay needs to drop its obsession with return on investment metrics and think more iteratively and innovatively." He adds: "Engineers should be calling the strategy shots at eBay, not M.B.A.s."

There is no technology visionary at the top of eBay's organization chart, unless you want to include newly appointed board member and Netscape co-founder Marc Andreessen. Dozens of high-ranking veteran eBay employees have left since Donahoe joined the company in 2005. Some of that Bain drain was a much-needed shakeout, but custodians of the original flair are gone, too. Morale is likely to take a further hit after the layoffs.

Ultimately, Donahoe must describe what eBay is if it isn't an auction site. If not, he risks a repeat of eBay Express and the consultants will move on to the next project.