

BY THE NUMBERS by Jack Hough

4 eBay Tips Gleaned From the Laws of Economics

U.S. LISTINGS on **eBay** (*EBAY*¹) are up 17% versus a year ago, according to Jefferies & Company, an investment bank. That makes sense. Money's tight, jobs are scarce, and the credit bubble of a few years ago left consumers well-stocked with stuff they don't need.

The miracle of eBay is that sellers can use it to turn almost anything into cash. There are rules, of course: No alcohol, tobacco or firearms, or anything illegal. Also, no body parts, stocks, prescription drugs, raffle tickets, dinosaur bones dug up from federal land or items that some people believe exist but that really don't, like souls. There are a few other restrictions. Mostly, though, you'll be amazed at what you can sell. Just ask four-year-old Golden Palace Benedetto. Her parents collected \$15,500 from a casino in 2005 in exchange for the right to name her.

So, what can economists tell us about how best to do business on eBay? Now that the company is 14 years old, with operations in 26 countries and yearly trading worth more than \$60 billion, it's a fertile source for research on auction behavior. I recently went hunting through academic papers for, if not laws of eBay economics, some good theories. Here are four.

1. Buyers, beware the winner's curse.

In auctions where the actual value of the item is uncertain, naïve buyers are prone to overpaying. Economics professors sometimes illustrate the point by asking students to bid on a jar of pennies. If it holds \$10, and the average guess is \$10, one student might think it holds \$15, and bid \$13. The winner's curse helps explain why it's generally a bad idea for stock investors to buy into initial public offerings. Bidders are likely to guess too high on the company's market value, judging by the long-documented tendency of IPOs to underperform other stocks in subsequent months. This isn't to say that buyers on eBay tend to get bad deals. But they should avoid auctions where they're likely to compete with naïve bidders. The best way to do that might be to avoid auctions that have heaps of bidders from the start. In a 2003 study, Patrick Bajari, now at the University of Minnesota, and Ali Hortacsu, now at the University of Chicago, found a direct relationship between the number of competing bidders and the size of the winning bid.

2. Sellers, be aware that experienced buyers know about the winner's curse.

"The second time a professor passes around that penny jar, students tend to bid more cautiously," Bajari says. Most experienced eBay bidders mentally discount items to reflect their uncertainty over the actual value. A seller who fails to attract enough bidders runs the risk that none of them will be inexperienced enough to pay a lot. The way around that is to entice experienced bidders to offer more by revealing as much information as possible about the item. Studies of eBay car auctions suggest that the number of pictures is directly related to the final bid price. In a 2003 study, Pai-Ling Yin, now at the Massachusetts Institute of Technology, asked subjects to guess the value of computers shown on various auction pages. The more broadly scattered the guesses were, the lower the winning

amount. If you want to collect more money from a small group of bidders, make them as sure as possible about the quality of the item.

3. Go long, and scrap the high reserve price.

Longer auctions tend to result in higher sale prices, according to a 2000 study by professors at Vanderbilt University, Andersen Consulting and the University of Michigan. They allow more time for bidders to enter the fray, thereby increasing the chances that a big spender will show up. List your item for the maximum allowable time. On reserve prices, or minimum prices at which a seller is willing to part with an item, the data are mixed. The presence of a reserve price tends to increase the winning bid, but a high reserve price reduces the number of bidders who enter the auction, thereby reducing the winning bid. With enough data, and perhaps a math Ph.D., a seller could calculate an optimal, revenue-maximizing reserve price for each item. Those who lack either or both should resist the temptation to start the bidding at the price they want, and instead start low to attract more bidders.

4. Seek positive reviews, but mostly, avoid negative ones.

Like most online auction sites, eBay has a feedback mechanism whereby users rate each other. Not surprisingly, the aforementioned 2000 study showed that the most-recommended sellers tend to collect the highest auction prices. But it also found that the price effect of a negative rating was more than three times as large as that of a positive one. To boost sale prices, make buyers happy. To boost them much more, keep buyers from becoming angry.

¹<http://www.smartmoney.com/quote/EBAY/>

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