Abstract

Information asymmetry and the buyer’s information deficit reduces buyers’ willingness to pay, and in extreme cases can lead to market collapse. buySAFE’s certification of sellers and bonding their transactions for amounts up to $25,000 improves buyers’ information endowment, increases willingness to pay, and increase sellers’ margins and total revenues. The company is moving beyond its initial positioning on eBay to become a more general guarantor of online transactions.

1. Introduction

Internet sales are growing rapidly, but internet auctions are no longer among the fastest growing segment of online commerce. Jeff Grass, CEO of buySAFE, notes that eBay’s growth has slowed dramatically over the past year so that it is no longer growing faster than the rest of eCommerce. He attributes this to increased maturity and choice among other online buying alternatives, and falling buyer confidence in internet auctions, as evidenced by lower selling prices. Along with the growth in internet auctions, internet auction fraud is among the fastest growing problem area for retail sales; indeed, the Federal Trade Commission notes that:

“Among the thousands of consumer fraud complaints the FTC receives every year, those dealing with online auction fraud consistently rank near the top of the list. The complaints generally deal with late shipments, no shipments, or shipments of products that aren’t the same quality as advertised: bogus online payment or escrow services; and fraudulent dealers who lure bidders from legitimate auction sites with seemingly better deals.”

The FTC website goes on to detail a fascinating array of mechanisms for implementing internet fraud.

buySAFE’s mission is to combat internet fraud and reduce consumer uncertainty, and to do so in a way that is effortless and cost effective for buyers and sellers. It provides sound and verifiable third party guarantees for online commerce transactions, does so in a way that is faster and safer than requiring the buyer to use escrow accounts or letters of credit, and doesn’t tie up the seller’s working capital like online escrow accounts. The buySAFE management team believes the company currently provides a competitive advantage to Bonded Sellers, but will ultimately prove to be a strategic necessity for all surviving internet auction and e-commerce sellers.

Steve Woda, buySAFE’s Founder, Chairman, and Senior VP – Strategic Growth, elaborates on the mission, saying, “buySAFE has a two part value proposition – we provide a very strong trust signal to help shoppers know they are dealing with reliable and trusted merchants (so they can avoid problems in the first place) and we will back up our brand promise to buyers with a bond that guarantees all the terms of sale.” Steve elaborates further by adding, “signals are credible only when they are hard to get and costly — we make our signal credible by rigorously screening the merchants and then putting money on the line by guaranteeing the seller will deliver on the promises they make the shopper.”

2. The market for bad pennies, automotive lemons, and forged Tiffany jewelry

It has been known for centuries that bad money drives out good, and that bad coins drive good coins out of circulation (Gresham’s law, 16th century). Only in the 20th century was the mathematics worked out to explain this in terms of information asymmetries and to make the very reasonable prediction of market failure—if I merely know that used cars vary in condition and value, I will have to discount what I am willing to pay for yours; indeed, my willingness to pay will approach the average value for that make and model. Of course, if you know that your particular used car is in better than average shape, you will not sell it in a market that will offer you less than you know the car is worth. Pretty soon, as more of the better vehicles are withheld from sale, the vehicles available in the market will be predominantly those worth the previous average amount or less, and the average value of the cars actually available in the marketplace will drop. Subsequent buyers will revise their estimate of value of cars in the market and lower their bids, more cars in the total set of cars will now be above the average of cars offered for sale in the marketplace, and more potential sellers will withhold their automobiles since the market offers them inadequate payment. Ultimately, this information asymmetry will cause the collapse of the used car market, and this collapse occurs even if the buyer is risk neutral, and even if the buyer places a higher value on every car
than the seller does [1]. A range of mechanisms has been developed to prevent market collapse. In the automotive industry, inspections and warranties on used cars attempt to reduce the buyer’s information disadvantage; in the securities industry brokers protect investors from counter-party risk, clearing corporations protect securities firms from counter-party risk, and insider trading laws and listing requirements are intended to protect buyers of securities from excessive structural information disadvantages.

In the 21st century the advent of online auction systems, in which unknown vendors sell unseen merchandise to distant buyers who may never interact with them again, has created almost limitless opportunities for information asymmetry, and thus for fraud and ultimately for market collapse. Sellers can go bankrupt and fail to send merchandise, or they can simply go “NARU” on eBay (the seller’s eBay status changes to “Not A Registered User”), and for no reason, shut down shop, and disappear. Sellers can also offer damaged or counterfeit items for sale; indeed, by 2004, the percentage of Tiffany items sold on eBay that were fake was 74% and recent estimates are even higher; ultimately, the consumer discount demanded because of the presence of fakes will drive all genuine Tiffany items off eBay, and lead to the collapse of the secondary market for Tiffany merchandise through this channel, much as Akerlof described in the collapse of the automotive market. Although eBay has received numerous complaints from dissatisfied consumers and has a history of allegedly refusing to remove counterfeit listings after receiving complaints, its official position is that eBay has no responsibility for fakes listed on its website because it is nothing more than a website that links buyers and sellers.

The company explains that it has neither the expertise nor the obligation to supervise sellers beyond its current activities:

“We never take possession of the goods sold through eBay, and we don’t have any expertise,” said Hani Durzy, an eBay spokesman. "We're not clothing experts. We're not car experts, and we're not jewelry experts. We're experts at building a marketplace and bringing buyers and sellers together."

Although eBay officially denies responsibility, consumers and injured customers now appear to be "blaming eBay for allowing this to happen." In response, eBay spokesperson Chris Donnelly said they only "provide the space. How people come together and trade on the space is really up to those individuals."

The Wall Street Journal performed a small and informal survey, to assess how serious the problem of fraudulent merchandise was, and to determine what buyers’ recourse might be. The extent of the problem can be inferred from the paragraphs below:

“A Gucci wallet for $120. A Burberry scarf for $32. A pair of Tiffany earrings for $35. If prices like that for some of the hottest luxury brands seem unreal, it very well may be because the goods themselves aren't real. The estimated multibillion-dollar counterfeit market has become a major headache for the luxury-product industry -- and for unwary consumers. Though many fakes are sold in stores, others wind up listed on auction Web sites such as those of eBay Inc., Yahoo Inc. and Overstock.com Inc., bearing attention-grabbing low prices.

“To find out what recourse people have when buying counterfeit goods through an online auction, we purchased five designer items on eBay, the leading auction site, at bargain prices for goods sellers advertised as being authentic: Chloé and Fendi handbags, a Gucci wallet, Tiffany earrings and a Burberry scarf. Finding the items was easy -- a search for any designer's name turned up dozens of results, with prices ranging from as little as 10% of the retail price to as much as full price. We picked the listings with the best deals from sellers who had mostly positive feedback and who guaranteed the authenticity of the products. Though our sample was small, four of the five products we purchased turned out to be fakes. (We couldn't determine the authenticity of the fifth one.)

The article notes that eBay claims that these experiences are quite rare, and then goes on to describe in great detail how unsatisfactory the eBay

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2 Indeed, the problem has become so severe that Tiffany became the first company to sue eBay over providing an internet market for counterfeit goods. http://www.matrixwatch.org/forums/archive/index.php?t-1274.html; http://www.law.com/jsp/article.jsp?id=1090180362167


4 See, for example, “eBay responds to alleged fraud complaints” http://www.nbc-2.com/articles/readarticle.asp?articleid=5334&z=3&p
buyer protection programs are when the buyer experiences deliberate fraud from an uncooperative seller.5

More generally, when surveyed by buySAFE, a significant percentage of consumers indicated that they had serious reservations about purchasing items online. These consumers indicated that these concerns either kept them from bidding entirely on items listed on eBay or limited their willingness to pay for items and consequently lowered the amount that they were willing to bid, or even led them to decide ultimately not to bid. Similarly, lack of familiarity with or lack of confidence in online sellers more generally limits consumers’ participation in online transactions and limits their willingness to pay, leading to their discounting of all online transactions.

Figure 1 shows how consumers’ perceptions of risk vary across channels and confirm that the risk discount demanded by potential shoppers is among the highest of any channel for eBay transactions. The data for this figure were determined by surveys conducted by buySAFE.

Figure 1.—Consumers’ relative perceptions of risk and the discounts they demand based on these perceptions of risk.

Figure 2 shows the discount that consumers demand for purchases through different vendors, based on their perceptions of risk. Demonstrably, consumers’ perception of risk is quite expensive for eBay sellers. The data for figure 2 were determined by average selling price of two products frequently sold online. Again, the data in this table illustrates consumers’ problems with online purchases generally, and not merely concerns with eBay.

Figure 2.—Price discounts demanded by buyers for online purchases, based on their perception of risk.

3. Protecting eBay from Market Collapse

Of course, eBay has taken actions to protect its customers. eBay relies upon a voluntary form of mutual satisfaction rating, whereby buyers and sellers rate each other’s performance after a sale, allowing a reputational history to evolve.6 Buyers rate the seller on ability to deliver goods as promised, in the condition promised, promptly; sellers rate the buyer on prompt payment, completion of the transaction, and an absence of post-transaction problems. The efficacy of these measures is demonstrably less than perfect, as shown by the experience with Tiffany merchandise, which prompted a lawsuit from Tiffany, and by the consumer survey data reported above.

Why do problems persist, even after the presence of a highly publicized participant-driven reputation rating system? Problems with feedback-based rating systems and reputation-based systems in general have been extensively studied [3, 4, 5, 6, 7, 8, 9, 11, 12]. Several mechanisms have been proposed for the breakdown of the rating system:

- Fear of reprisal —Fear of reprisal will often cause a buyer to avoid criticizing a seller for poor performance, and even for non-performance, if the sum is small enough and the buyer has sufficient concern for his eBay reputation. This phenomenon has been studied by Chris Dellarocas

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6 eBay’s voluntary feedback mechanism is described on their website. It allows potential counterparties to determine what percentage of former counterparties left positive feedback, as well as the total number of positive feedback assessments received. It does not provide information on the number of times no feedback was provided after a transaction, or the number of counterparties who provided no feedback. More information is available on the eBay website, at http://pages.ebay.com/help/feedback/evaluating-feedback.html.

- Deliberate manipulation of ratings — Again, anecdotal evidence and experience with other industries suggests that a successful strategy for a fraudulent operator would be to engage in several successful small transactions over time, in order to achieve a high enough number of satisfied customers. As the history of customer satisfaction develops, and as the seller’s rating score improves, the seller will begin to capture a larger number of transactions, and a number of transactions for larger dollar amounts; when the number of open customer orders is large enough, and the amount of money received for goods not yet shipped is large enough, the seller merely shuts down operations, pockets the money, and vanishes. While this is costly in the physical world, with reputational damage that might cause a retailer to have to move to reopen operations elsewhere and to leave valuable physical resources behind, in the online world a retailer can shut operations and begin the process of developing and then disposing of yet-another new identity without adversely affecting the rest of his “real” persona and his “real” life. With more subtle “feedback rings” a small collection of fake users conduct a large set of fake transactions among themselves, leaving very high satisfaction ratings. When a large enough feedback score is attained, sellers are free to “go for the big scam.”

- Unintended and unanticipated change in status — Parrothead88, a seller of shipping supplies, ‘made eBay history when he became the first ‘shooting star’ PowerSeller in 1999 when he earned 10,000 feedback ratings. On Thursday [that is, May 11, 2006], eBayers were shocked to see that with close to 75,000 unique feedback ratings, Parrothead88 had suddenly emptied his eBay Store and had no active listings on the eBay website” and ultimately filed for bankruptcy.8 Earlier the same year, a top ranked Titanium PowerSeller on eBay (with close to 300,000 positive feedback ratings), Glacier Bay, also ceased operations, leaving thousands of customers with outstanding unfilled orders for merchandise for which the seller had already been paid. There is no indication of intentional fraud in these cases. However, in both cases, the PowerSeller clearly became financially over-extended, sold goods that it did not yet have and could no longer pay to acquire, and ceased operations after collecting payment from buyers. Unprotected buyers had few options other than posting negative reviews and complaining: "This is huge tragedy in our eBay Community, when one of the biggest eBayers with their stature, disappears and leaves a trail of Negs and crying victims."9

Clearly a certain degree of cynicism is emerging among experienced users of internet auction sites. When yet another eBay PowerSeller, BuyEssex, went NARU, a user expressed both pleasure that they were gone and skepticism that they or their ability to defraud buyers would be gone for long: “That's refreshing to see BuyEssex is no longer a registered Ebay seller, surprised it took so long, but hmmm... -- what name are they selling under now???”

It is both possible and desirable to develop a rating system that will do a better job of protecting consumers than can be done by eBay’s current reputational history rating system alone. As importantly, there would appear to be a significant business opportunity in doing so. Bond rating companies Moody’s and S&P perform a public service when they rate corporations’ debt offerings. These firms have large and profitable businesses, and although they provide information that buyers treat as a public good, they are paid for their independent rating services by corporations that choose to have their bonds rated before they are issued. The corporations pay Moody’s and S&P, not to contribute

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8 “Third High Profile PowerSeller Gone,”
http://ebay.business-opportunities.biz/2006/05/12/3rd-high-profile-powerseller-gone/.

9 “Top eBay Seller Disappears from Site,”
http://www.auctionbytes.com/cab/abn/y06/m02/i06/s03.

10 See entries on thread Thread: Next Class Auction Lawsuit Filed: Ebay, Paypal & Essex Technolo,
charitably to their good work, but because their rating services decrease investors’ uncertainty and increase their willingness to pay for the bonds that these companies issue. By analogy, some sort of independent rating service for online transactions could reduce consumers’ uncertainty and increase their willingness to pay for online goods from unknown sellers, and the increased margins of sellers could provide a surplus out of which sellers could compensate raters.

4. Enter the buySAFE Team

Recognizing the need to protect both buyers and sellers from the Akerlof-style collapse of their eBay marketplace, and recognizing that even in markets that continue to function eBay sellers could earn more by addressing consumer risk, Steve Woda and Jeff Grass decided to found a company dedicated to bonding and certifying online auctions, and ultimately, any online transaction. Much as S&P and Moody’s provide independent audits and assessments of corporate debt, buySAFE provides independent assessment of online sellers; indeed, the buySAFE team would argue that their business model requires an even greater degree of careful and independent audit; should they develop a history of bonding unreliable online merchants, the cost to buySAFE of obtaining surety bonds would destroy their costs of operations, and it would also cause irreparable damage to the buySAFE brand as well. The buySAFE value proposition is straightforward and is described on their website in a short audio visual clip 11:

• One of consumers’ biggest concerns with online auction sites is risk resulting from the possibility of various forms of internet fraud. This results in fewer sales and in lower prices for goods that are sold.

• More customers are willing to bid on items, and customers are willing to pay more for items when they know that their purchases are guaranteed. More items actually sell, items sell faster, and the seller receives higher prices for items sold when they have a buySAFE bond guarantee.

• If consumers buy from a buySAFE Bonded Seller, their purchases are guaranteed. Various dispute resolution mechanisms come into play, but ultimately, if the consumer did not receive the merchandise as promised, in the condition as promised, for whatever reason, then the consumer obtains a full refund, up to $25,000. This guarantee is backed up by a surety bond. 12

• In order to qualify as a buySAFE Bonded Seller, the seller has to be audited as part of the buySAFE Business Inspection, which confirms the seller’s identity, experience, reputation, financial stability, and history of successful completion of online transactions.

• Once approved, the seller can post a buySAFE Bonded Seller trust seal on the website along with the merchandise offered for sale.

The seller also has to agree to pay buySAFE 1% of the final selling price as payment for the trust seal and bond guarantee.

Normally, if the seller defaults on a transaction to an individual buyer, that buyer may have limited recourse available. Complaining and posting a negative feedback may result in retribution from the


12 The concept of a surety bond is somewhere between insurance and a letter of credit. With insurance the principal or buyer of the policy is protecting himself against the possibility of bad outcomes caused to him by actions largely outside his control and should these bad outcomes occur the insurance seller pays the buyer to make up for his loss. With a surety bond the principal or buyer of the bond is protecting another party (the obligee) against the possibility of bad outcomes for the party that the principal himself might cause and should these bad outcomes occur the seller of the bond (the surety) pays the injured party. Unlike a letter of credit, in which a party is required to post bond of the full amount of potential future disputes, with a surety bond the principal pays the surety only a sum large enough to induce the surety to post the full bond. This reduces the capital requirements of the principal, but requires the surety to do adequate risk management. Surety bonds are well-established commercial instruments; a web search for “surety bonds” results in almost 1.5 million entries, roughly comparable to the 2.0 million entries found for “commercial mortgage.” More information can be found on the following websites:
http://www.jwsuretybonds.com/blog/surety-bond-myths
http://www.jwsuretybonds.com/blog/surety-bonds-not-insurance
http://www.jwsuretybonds.com/blog/what-is-a-surety-bond
seller. More significantly, it may be extremely difficult for the buyer to track down a vanished seller and recover any portion of his loss, and unless the transaction involves an item with a very large price, it is seldom economical or reasonable for an individual buyer to locate and sue a fraudulent seller. In contrast, it is very important for the surety bond company to minimize its losses. Since a single fraudulent vendor may be involved in a very large number of guaranteed transactions, there are scale advantages in the surety bond company’s pursuit of a fraudulent seller that are not available to individual buyers, and since surety bond companies have professional staff dedicated specifically to loss control and recovery, it is easier for them to do so.

Woda notes that although there is no company that has duplicated buySAFE’s business model or their services, there are companies that do attempt to compete with buySAFE:

“Our primary source of competition comes from other seller trust signals like feedback ratings, merchant ratings, the merchant’s own brand, etc. Our secondary competition is back end protection programs that reimburse buyers for loss (e.g. credit card charge back and PayPal Buyer Protection). The trust signal is the most valuable aspect of buySAFE to buyers as buyers would much rather avoid a problem than have to get reimbursed after suffering a loss.

Figure 3 below shows how Jeff Grass and Steve Woda view the competitive space in which they operate. Clearly, they believe that credit card companies provide a high degree of protection with the guarantees provided by some cards, but that consumers do not place a high value or trust in the sellers that accept those cards. Merely accepting credit cards does not lead to consumer confidence regarding seller performance. Likewise, they believe that feedback/merchant rating systems have earned a fair degree of consumers’ trust as a signal regarding the sellers’ likelihood of successfully completing a transaction, but that these systems actually provide almost no protection to consumers. Clearly, with its certification and $25,000 bond guarantees, buySAFE provides a greater degree of protection than the available alternatives, and Grass and Woda believe that buySAFE is acquiring a higher level of consumer trust due to its intensive seller certification processes.

Any time a company earns its revenue billing one party for services performed for another, there will be opportunities for misaligned incentives and for resulting principal agent problems [Alchian and Demsetz]. Consumer Reports avoids principal agent problems by accepting no advertising or samples from any company, to ensure that it has no incentive to provide positive reviews of any company’s products or services. This is explained explicitly on their website:

Consumer Reports® and Consumer-Reports.org® are published by Consumers Union, an expert, independent nonprofit organization whose mission is to work for a fair, just, and safe marketplace for all consumers and to empower consumers to protect themselves. To achieve this mission, we test, inform, and protect. To maintain our independence and impartiality, CU accepts no outside advertising, no free test samples, and has no agenda other than the interests of consumers. CU supports itself through the sale of our information products and services, individual contributions, and a few noncommercial grants.

With less complete separation of ratings from revenues, organizations as such as Moody’s, S&P, and every investment bank that both provides corporate finance and advises retail investors has potential conflicts. A Google search on “retaliation analyst report” provides numerous examples of analysts fired for filing reports that offended clients of their firms’ corporate finance departments and of lawsuits filed

and settlements reached.\textsuperscript{14} Even Moody’s and S&P have been investigated by the SEC, which has sought to ensure that they provide unbiased ratings in an environment where their fees are paid entirely by the firms whose bonds they are trying to assess independently and fairly.\textsuperscript{15}

Steve Woda believes that it is possible for buySAFE to provide ratings that are far more accurate and independent than those provided by eBay and, indeed, that his firm’s business model provides structural guarantees that ensure the accuracy and fairness of the buySAFE certification processes. As he says, “If a Wall Street analyst deliberately gives an overly rosy Buy recommendation to satisfy someone in the firm’s corporate finance group, an investor ends up suffering the loss. If a bond rating agency gives a corporation too favorable a credit rating, again it’s investors who lose. If we certify a listing and the seller defaults on the transaction for any reason, it is us — buySAFE and our financial partner surety companies — who lose money. We really want to get it right!”

5. Making it Work — The Systems

The idea behind buySAFE is simple. As long as the customer trusts the buySAFE’s certification of the seller, and as long as the customer trusts Liberty Mutual’s pledge to guarantee the seller’s transactions, the customer should have confidence in the transaction.

Clicking on the buySAFE Seal reveals that each seal is unique, and if the seller is genuine and the seal is genuine, the buySAFE system will correctly identify the item and the seller.

Although there have been few cases of consumers actually requiring payment of a buySAFE bond guarantee, in some highly visible cases of failed eBay sellers such as Glacier Bay DVD, the buySAFE bond guarantee worked perfectly.

BuySafe President Jeff Grass said his company is working with Glacier Bay DVD owner Randy Smythe as he winds down his business. Grass said BuySafe has sent emails to every buyer of an item from Glacier Bay DVD that still had an active bond in force, going out to thousands of buyers who had bought bonded items in the last 30 days.

BuySafe said it has been aggressively paying all buyers who it has confirmed were not sent merchandise and said as of Thursday, it had already sent thousands of dollars worth of checks to buyers of bonded items from Glacier Bay DVD.

Grass said that while the situation is unfortunate, it is not bad for BuySafe, but rather highlights why the service is valuable for the community.\textsuperscript{16}

6. Making it Work — Gaining Customer Acceptance

Of course, a system that is based on customer acceptance does not work unless the customer trusts and accepts it. Figure 4 is designed to explain to potential customers how the buySAFE Seal works and how the buySAFE bond guarantee works. Consumer acceptance is increasing, and the vast majority of customers prefer to see the buySAFE certification rather than a high eBay feedback rating.

On several levels, customer acceptance appears to be satisfactory. buySAFE management has conducted surveys of potential internet buyers to determine what a buySAFE bond guarantee would be worth to them. Perhaps more important than these “expressed preferences,” buySAFE has also attempted to assess “revealed preferences” by comparing customers’ willingness to pay for comparable items, offered by comparable sellers, with and without buySAFE bond guarantees. The data are quite compelling, with 91.5% of buyers saying that a buySAFE Seal made them feel safer about bidding online and over 85% saying that they would be more likely to bid and to purchase an item with the buySAFE Seal, and 97%...
saying that they would prefer to purchase from the buySAFE Bonded Seller even if the competing seller has a higher feedback rating. Consistent with these data, actual experiences shows that Bonded Items had a sell-through rate more than 4.5% greater than non-bonded items.

While growth of buySAFE is rapid, at present there appear to be two challenges associated with customer acceptance that limit its growth:

- **Limited customer awareness** — At present, customer awareness of buySAFE has not reached the critical mass, where buyers demand to see it, and sellers feel it is a strategic necessity. This lack of critical mass limits the pressure that would driver sellers to adopt the service. Clearly, the rapid growth in seller adoption and buyer experience that buySAFE has already been achieved, and the word of mouth reputational effects associated with this experience lead Jeff Grass and Steve Woda to expect rapidly increasing customer adoption; this is described more completely at the end of this section.

- **Insufficient integration with eBay’s search mechanisms** — At present it is not possible for a potential eBay buyer to specify that he or she only wants to see merchandise offered by a buySAFE Bonded Seller, likewise limiting the pressure on sellers to adopt buySAFE. As buySAFE’s operations extend beyond certifying eBay auctions, and as the company moves towards becoming a more general independent rating service for all online transactions, this lack of integration with eBay will be less significant to buySAFE; additionally, if other sites provide more easy location of certified sellers, eBay may feel competitive pressure to permit search based on the presence of buySAFE certification.

Jeff Grass and Steve Woda note that buySAFE’s business model has two aspects in common with businesses that exhibit network effects or participation externalities, and therefore they believe that the bigger they get, the easier it will be for them to grow further. First, since consumer awareness is a limitation to their growth, and advertising is costly, consumers’ satisfaction with buySAFE vendors is buySAFE’s best source of promotion; the more positive experiences that consumers have with buySAFE, the more additional consumers will learn about buySAFE. Second, since buySAFE’s core service is free to buyers, consumer satisfaction with buySAFE will eventually translate into consumer demand for the buySAFE certification, making buySAFE a strategic necessity for reputable merchants, much as S&P and Moody’s ratings are essential to corporations attempting to issue corporate debt.

7. Making it Work — Gaining Seller Acceptance

At present, buySAFE has been adopted by 8 of the 10 largest sellers on eBay and buySAFE Bonded Sellers account for over $500,000,000 in sales on eBay annually, but in spite of this growth, seller acceptance of buySAFE could be faster. Perhaps the greatest challenge facing the firm today is in demonstrating precise and quantifiable relationships between obtaining buySAFE bond guarantees and the actual selling prices achieved, and doing so across a wide range of products and product categories. Extreme variance in item attributes has made this a challenging undertaking. buySAFE has developed a fairly sophisticated method for measuring the quantifiable value of buySAFE’s service via an A/B testing methodology, but this has not yet completely solved the value measurement challenges. Ultimately, when these relationships are understood, buySAFE will likely achieve even greater acceptance among online sellers. It is expected that buySAFE’s pricing mechanisms will also become more sensitive, with higher rates in those categories for which consumers place the greatest importance on guarantees, and for which the financial benefit to sellers consequently is greatest.

In order to obtain the data needed to demonstrate their value proposition more thoroughly, buySAFE has recently studied the selling history of 1.6 million item listings from 188 internet retailers. Jeff Grass and Steve Woda feel that the results of their most recent study will significantly accelerate seller acceptance. Principal results include: (1) The visitor-to-buyer conversion rate of Bonded Items was 2.1 percent higher than that of non-Bonded items; (2) Bonded Items received 4.7 percent higher prices than non-Bonded items; (3) Overall, using buySAFE increased revenues by 6.8 percent and (4) buySAFE improved both high and low-end product sales. For example, in
the high-end jewelry category, Bonded Items saw the average sales price increase 40 percent. In the lower-end camera and photography accessory category, Bonded Items saw an increase in the average sales price of 9 percent.

“We’ve run this program for eight months now, and each month the ROI that our merchants see has continued to improve. In May, for example, sellers realized a 550% return on their investment with buySAFE. Bonding items is a clear win for merchants,” said Jeff Grass, buySAFE’s CEO. Grass continued, “The buySAFE Impact Test demonstrates what we knew all along: consumers who trust are consumers who buy. buySAFE helps online retailers offer a virtually risk-free shopping experience to consumers by providing a trust signal and a broad guarantee -- something no other company can do.”

Steve Woda and Jeff Grass believe that there are participation externalities associated with buySAFE certification. The greater the number of reputable sellers that adopt buySAFE, the more consumers will come to associate buySAFE certification as a mark of quality in sellers; this will initially make certification a source of competitive advantage, desirable to sellers who adopt it early. The founders hope that ultimately buySAFE certification will become a strategic necessity, required by all legitimate online sellers as a cost of doing business.

8. Progress to Date

Figure 5 shows growth in the number of buySAFE seals posted each month. The company is growing at the impressive rate of close to 37% per month, or more than 3,200% annually. In 2004, the company’s first full year of operation, buySAFE certified 862,642 item listings, and by 2005 the number had grown to 29,326,306.

Additionally, buySAFE has created its own marketplace, in which a consumer can locate all items sold on the net in a particular category that have a buySAFE bond guarantee.

![Figure 5.—Growth in buySAFE seals, month to month.](image)

buySAFE has prepared a short description, “buySAFE by the Numbers,” which summarizes their progress as of June 2006:

- **More than $10 billion**: the amount of product that has been sealed by buySAFE
- **More than 40 million**: the amount of buySAFE seals that appeared on item listings since November 2003
- **¾ billion**: the amount of times shoppers viewed the buySAFE Seal in 2005
- **$25,000**: the highest dollar amount of protection buySAFE has bonded (in 2005)
- **147 percent**: the amount buySAFE has grown each quarter since Q4’04
- **60 million**: how many online buyers avoid auctions because of various risks
- **$0**: the dollar amount it costs consumers to use buySAFE

Additional statistics are summarized in Table 1, below, which shows buySAFE’s growth as a percentage of total eBay volume.

![Table 1.—buySAFE’s growth as a function of eBay volumes](table)

9. Future Developments

9.1. New buySAFE Pricing Strategies

The buySAFE team understands that the risks of fraud vary across categories; as importantly, the buySAFE team believes that consumer perceptions of risk differ across categories, and that these differences in risk perception significantly affect the consumer confidence discount the sellers suffer in different categories. Clearly, items that are easy to manufacture
but have a high design cost or a high “logo value,” like designer luggage, handbags shoes, and clothing, will be attractive to counterfeiters. Other items where cheap knockoffs can be produced and that will pass initial inspection, like perfumes or jewelry, are attractive targets for counterfeiters. Finally, items that can be easily stolen or damaged, like consumer electronics, iPods, cameras, and cell phones, can be dumped on eBay. It is becoming clear that this problem is now widespread and not confined solely to the American eBay market (European studies confirm the high incidence of forgeries in categories such as perfumes).

http://www.markenbusiness.com/en/news.php?newsid=4026). Likewise, while eBay is now taking action to clamp down on the sales of stolen phones (http://addict3d.org/index.php?page=viewarticle&type=news&ID=27088), it appears that this action was taken only in response to highly visible arrests after police “carried out a major operation against criminals using online auction site eBay to sell stolen mobile phones.” Interestingly, the article reporting the police action and arrests and the decision by eBay to take action against stolen phones appeared in the same day. (http://www.thisismoney.co.uk/money-savers/article.html?in_article_id=411468&in_page_id=2&ito=1565)."

Fraud is certainly recognized as a serious issue by some of eBay’s competitors. Overstock.com Auctions has created a program for sellers it deems as Trusted Merchants. Overstock.com requires that all Trusted Merchants be bonded with buySAFE. In addition, Steve Woda notes that the categories that appear to be the easiest to counterfeit are more tightly controlled by Overstock.com than by eBay. Woda goes on to suggest that these two factors are why sellers report to him that the prices they receive on Overstock.com are dramatically higher than the prices they receive on the more laissez faire eBay.

The buySAFE team believes that there are large opportunities in the categories that consumers feel are most risky, and that in these categories the value of buySAFE certification is greatest. As a consequence, buySAFE has made it a priority to develop mechanisms to explain their benefits to sellers and to quantify the return that sellers receive as a result of their adding buySAFE certification.

At present, sellers do receive a significant return on the 1% that they pay to buySAFE to bond their sales; on average, weighted by category over all sales, for each dollar that sellers pay to buySAFE they receive $5.50 through higher selling prices, greater sales volumes, or both (May 2006 data). Categories that consumers consider the most risky, due to the danger of damaged or defective merchandise, or counterfeit goods, show the greatest gains from bonding. The data are summarized in Table 2, below. It is clear that the buySAFE certification program still has not fully resolved questions of consumer trust with eBay sales, and this lack of trust continues to place limits on merchant profits. Auction Trust Network estimates sellers receive 34% less for sales on eBay than they would for sales of comparable items on other auction sites."^18.

![Table 2.—Seller's incremental revenue from the 1% fee charged by buySAFE, as a function of merchandise category as of May 2006.](image)

<table>
<thead>
<tr>
<th>Category</th>
<th>ROI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Books</td>
<td>274%</td>
</tr>
<tr>
<td>Business &amp; Industrial</td>
<td>358%</td>
</tr>
<tr>
<td>Cameras &amp; Photo</td>
<td>523%</td>
</tr>
<tr>
<td>Cell Phones</td>
<td>106%</td>
</tr>
<tr>
<td>Clothing, Shoes &amp; Accessories</td>
<td>619%</td>
</tr>
<tr>
<td>Collectibles</td>
<td>136%</td>
</tr>
<tr>
<td>Computers &amp; Networking</td>
<td>192%</td>
</tr>
<tr>
<td>Consumer Electronics</td>
<td>331%</td>
</tr>
<tr>
<td>Crafts</td>
<td>326%</td>
</tr>
<tr>
<td>DVDs &amp; Movies</td>
<td>508%</td>
</tr>
<tr>
<td>Home &amp; Garden</td>
<td>605%</td>
</tr>
<tr>
<td>Jewelry &amp; Watches</td>
<td>194%</td>
</tr>
<tr>
<td>Music</td>
<td>485%</td>
</tr>
<tr>
<td>Sporting Goods</td>
<td>536%</td>
</tr>
<tr>
<td>Sports Mem, Cards &amp; Fan Shop</td>
<td>419%</td>
</tr>
<tr>
<td>Toys &amp; Hobbies</td>
<td>559%</td>
</tr>
<tr>
<td>Video Games</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>550%</td>
</tr>
</tbody>
</table>

Table 2.—Seller’s incremental revenue from the 1% fee charged by buySAFE, as a function of merchandise category as of May 2006.

Through its A/B testing program, buySAFE has been able to observe that many of eBay’s sellers no longer make reasonable profits on their eBay sales. Many sellers report that they make money only through cross-selling and up-selling of related items, and through moving subsequent purchases off eBay and onto their own websites. With margins from direct eBay sales that are vanishingly small and as merchants develop alternative sales channels beyond eBay, buySAFE management believes that it is critical to expand its business beyond eBay in order to support its multi-channel merchant customers. Consequently, buySAFE management has been working on entirely new corporate strategies.

9.2. A New buySAFE Strategy: Portable Trust Signals

It seems apparent that small and medium-sized online merchants are increasingly building their off-eBay sales channels in an effort to seek acceptable profit margins and to mitigate the dependency risks of a single, large market-maker.

Therefore, the buySAFE team believes that it is important to expand the buySAFE service beyond eBay to independent websites and search channels. As small and medium-sized merchants develop alternative sales channels, eBay’s feedback rating system will continue to lose its overall relevance in e-commerce, and an independent, portable trust signal will be necessary. Unlike marketplace ratings systems, the buySAFE Seal can be leveraged by merchants across multiple sales channels.

buySAFE believes that the current eBay feedback system, with self-reported evaluation of buyers’ and sellers’ experience with transactions, has been instrumental to eBay’s growth. However, it is also a demonstrably flawed trust system. Customers who are unlikely to report a complaint about a seller on eBay, out of fear of receiving a negative evaluation, should have no reluctance reporting a problem to buySAFE. Independent buySAFE service personnel will evaluate the complaint; if the complaint is legitimate the buyer will receive full compensation, and will not experience any negative rating or other form of retaliation.

Unlike subjective ratings systems, buySAFE is a regulated financial entity, and its trust signal is not based on voluntary feedback, but on actual claims history. buySAFE can revoke a merchant’s right to use the buySAFE Seal if legitimate claims are filed against that seller. buySAFE believes that it has far more reliable and comprehensive data on buyer and seller performance, and therefore, the buySAFE Seal can ultimately serve as an independent, portable, e-commerce trust signal. They plan to make some of this additional data available to shoppers via an expanded buySAFE Seal. An example of how buySAFE might provide additional contextual information to buyers via the buySAFE Seal is shown in figure 6, below:

![buySAFE Seal](image)

Figure 6.—The new, expanded and more detailed buySAFE seal.

9.3. A New buySAFE Strategy: Working with Sellers through Search

As buySAFE expands beyond eBay onto independent websites, natural search, paid search and comparison shopping engines become increasingly important to buySAFE and its Bonded Sellers. With this in mind, buySAFE has developed a set of application development tools and an application program interface (API) to enable search and comparison shopping engines and software providers to leverage the buySAFE Seal in their search results and applications.

Loss of consumer confidence and loss of seller profits is visibly and demonstrably affecting seller behavior. While eBay management and many eBay customers tend to view eBay shopping as a community experience and even as a form of recreation, for PowerSellers, eBay is purely a commercial venture, and increasingly an unattractive one. As noted above, the Auction Trust Network estimates sellers receive 34% less for sales on eBay than they would for sales of comparable items on other auction sites; ultimately, of course, this has to drive the best merchants to other sites. Many sellers are now moving even their initial customer interactions off eBay and onto their own websites. Similar observations on seller churn have been made by Bear Stearns in their assessment of eBay stock, noting that the surviving eBay sellers are being forced to reduce service, causing the buyers’ experience to deteriorate further.

The economic argument that buyer behavior is placing serious financial pressure on sellers is becoming hard to refute. The current Executive
Director of PESA (Professional eBay Sellers Association) and the CEO of Gotham City Online (http://www.gothamcityonline.com), Jonathan Garriss, argues that the prices he receives from eBay sales are substantially lower when compared to other sales channels, with price discounts ranging from 20-50%. He goes on to note that “Gotham City Online has shifted 100% of its marketing efforts to drive traffic to channels other than eBay.”. He and other PESA PowerSellers suggest that buyers’ lack of confidence has driven prices down to bare minimum levels. They also argue that when sellers have no capability to differentiate themselves on eBay, price competition is driven to the lowest possible levels, even for those sellers with the strongest ratings. This forces legitimate sellers to reduce the quality of service and customer support, justifying customers’ falling confidence levels, and putting even greater pressure on the prices that sellers can achieve. Indeed, PESA has been a strong voice supporting initiatives that might solve or mitigate these core marketplace problems including strong seller certification requirements. PESA represents close to 800 of the top sellers on eBay; it cannot be considered a group of fringe players or unsuccessful malcontents with grievances against eBay (http://www.gopesa.org and http://groups.ebay.com/forum.jspa?forumID=6362).

These changes in buyer and seller behavior are affecting eBay revenues and the power of eBay’s business model. This is reflected in figure 7, which shows the collapse of eBay’s share price over the past 2 years, and in figure 8, which compares this collapse to the steady maintenance of value by the Dow Jones Index over the same period. Indeed, eBay’s market capitalization has been reduced by over 52% since its 2006 high in January.

Steve Woda believes that many eBay sellers are beginning to use eBay principally as a bulletin board, or expression of available inventory. Merchants often offer items for sale on eBay in an attempt to acquire new customers that they ultimately hope to sell to again later via their independent website stores. Woda notes that while 18 months ago as few as 10% of eBay’s PowerSellers reported operating their own independent websites in addition to their eBay sites, that figure has recently grown to more than 70%. An August 2006 analysis of “The Sellathon 10,000” (http://www.sellathon.com/sellathon10k/), an extensive list of the top 10,000 eBay sellers in terms of feedback ratings, indicates that 100 of eBay’s top 1,000 U.S. sellers have left the eBay marketplace. While the merchant will not permit the use of his name in print, one eBay seller has confirmed to buySAFE that while he does close to $2 million a month in online sales, he has moved more than 97% of his business off eBay. When combined with this observable movement of the best sellers off eBay, the financial data in figures 6 and 7 suggest that eBay may indeed have already have entered the early stages of a death spiral and an Akerlof-type collapse.

The changes in buyer and seller behavior, and the growing weakness of the eBay business model, suggest a new business opportunity for buySAFE. buySAFE management has developed a new service offering and strategy that embraces the following:

- Sellers will increasingly want to reach buyers through channels other than eBay, especially channels that have successfully minimized the risk discounts buyers demand due to fraud concerns and uncertainties.
Sellers will increasingly want to differentiate themselves on the basis of reputational quality rather than based on the lowest possible selling price, and they will want to do so across diverse marketplaces. To do so will require a portable trust certification system, independent of their eBay ratings.

Buyers and sellers alike will benefit if it is possible to search across all marketplaces to find all sellers of a Tiffany pen or a Motorola Razr cell phone or 5th Generation iPod. Buyers and sellers alike will benefit if it is possible, to incorporate the presence of a buySAFE certification as a search criterion while using a popular search engine like Google.

BuySAFE has developed a set of application development tools and an API that allows search engines to incorporate buySAFE certification into the search mechanisms. The buySAFE portable, guaranteed, third-party vendor certification system enables certified sellers to use their buySAFE certification on marketplaces like eBay and Overstock.com, and on their own websites. With business partnerships or client-side application tools, buySAFE could easily enable the buySAFE trust signal in comparison-shopping services like Shopzilla, and paid search engines such as Yahoo! or Google as well. This would greatly extend buySAFE’s reach across internet transactions and extend its potential scope of operations. This extensibility would make buySAFE’s data far more reliable than the data provided by any self-reported feedback system and far more complete than the data available from any single marketplace. It would also help to limit the opportunities for competitors to gain a foothold in the internet seller certification marketplace by protecting and preemptively filling related niches before competitors can begin operations. The use of these Trust API tools to integrate buySAFE certification into a Google search via a client-side application is shown in figure 9.

Figure 9.—The results of a Google search for diamonds, indicating which sellers have buySAFE certification.

In order to implement this strategy, buySAFE needs to have enough certified sellers to make incorporating certification in search relevant to consumers. As a result, buySAFE has expanded its strategy to enable sellers to certify their websites, but without bonding specific sales. Buyers can pay for and purchase a guarantee on a per transaction basis. The guarantee is still a bond, rather than an insurance policy, in the sense that the bond is priced based on the expectation that the seller will perform according to the agreed upon terms of sale; the reasoning behind this is that a seller who defaults on a purchase will have this noted when the buyer collects on the bond, and that the seller will thus lose his certification. It is expected that with low price certification available, at a cost far less than the cost of providing a bond, many more sellers will choose to be certified and buySAFE will rapidly acquire critical mass. There is some concern that this will weaken the buySAFE certification, or that it will reduce consumer confidence in it, or that it will weaken the demand for bonding. Alternatively, there is a belief that this will lead to rapid acceptance of the buySAFE symbol of certification, and of the buySAFE reputation across multiple marketplaces and channels.

10. Conclusions and Directions for Future Research

10.1. Conclusions

Internet sales, and internet auction sales in particular, currently suffer from consumer confidence challenges, slowing their growth and reducing the prices customers are willing to pay for items
purchased online. While only in rare instances has this lack of confidence led to collapse of an internet market, like the collapse of the market for Tiffany items on auction sites, it is clear that improving consumer confidence will increase the size of the online market. Obviously this will benefit sellers and auction site operators; to the extent that additional trades will occur that are now failing to occur due to consumer uncertainty, increasing consumer confidence will create gains from trade and benefit consumers as well.

The certification offered by buySAFE reduces consumers’ uncertainty, directly addressing the information asymmetry between buyer and seller that is the basis of an Akerlof-type market collapse. Of course, buySAFE merely shifts the information asymmetry problem from the buyer to itself; however, this does indeed resolve the information asymmetry problem:

• buySAFE has sufficient resources to do the quality assessment, resources that individual consumers may lack
• buySAFE can resolve the information asymmetry problems by acting as a centralized organization that performs the quality assessments for each vendor; the alternative, without buySAFE, requires each potential bidder to take action to assess the seller to reduce information asymmetry, greatly increasing cost and effort and reducing the quality of information available to any one buyer.

It appears clear that customer-driven feedback and ratings do not work. The short explanation for this includes:

• Bias introduced by customers who choose not to report unfavorable assessments due to fear of retaliation
• Relatively inexpensive mechanisms for masquerading, which make it possible for lower quality merchants to act initially in ways that allow them to achieve high ratings, and then to exploit customers, vanish, and reemerge to do business again under a new name with a reputation intact

There is little opportunity for customer-initiated screening mechanisms, and buyers must rely upon signals from the seller. For signaling mechanisms to work, sending false signals and masquerading as higher quality entities must be so truly expensive for lower quality entities that it is essentially blocked [10, 14].

In contrast to customer-driven feedback and ratings, online customers trust buySAFE’s assessments and certification. The certification and bonding ensures that customers will not suffer as a result of dealing with a poor quality seller. As importantly, the certification largely ensures that customers will be able to avoid poor quality sellers. The buySAFE bond guarantee sends a credible signal of quality because buySAFE is risking its own resources by guaranteeing the transactions, making this signal costly for it to send if it has not carefully done its quality assessments.

10.2. Directions for Future Research

As the company continues to operate and more experience is gained from future operations, it would be interesting to address the following questions:

• Can buySAFE make things better for the eBay market, and can it solve or mitigate eBay’s current challenges? If a seller would lie and cheat an individual buyer, won’t the seller just lie and cheat buySAFE and buySAFE’s surety bond partner, Liberty Mutual? Might that just be another form of the same information asymmetry problem that buySAFE wants to resolve, and might that make the cost of bonding impossibly high and lead to the collapse of the market for buySAFE certification?

• Can buySAFE actually make things worse for the eBay market? If the cost of bonding becomes high enough, could legitimate vendors decide not to pay for it out of their limited margins? Fraudulent vendors, of course, have margins close to 100% and would seem to have the most to gain from buySAFE certification. Are there adverse selection issues that must be addressed or does buySAFE’s stringent certification and monitoring processes mitigate the adverse selection risks?

• Can buySAFE extend its bond guarantees beyond the scope of Internet auctions to online sales more generally?

• How can buySAFE demonstrate the importance of its bond guarantees to consumers and quantify this in terms of higher selling prices, sell-through rates, and total revenues achieved by online retailers for their merchandise? How can buySAFE demonstrate the importance of its bond guarantees to sellers and quantify this, in order to justify its price to sellers? Will buySAFE become a source of competitive advantage for high quality sellers? Or will it become a strategic necessity, required for all high quality sellers but simply a cost of doing business that does not shift competitive position among these high quality sellers (much like participation in an ATM network is necessary for all banks but not a differentiator for any)?
Will the company be able to achieve some form of sustainable competitive advantage? How credible is the company’s argument that buySAFE participation is like a network effect, and that the more participating vendors the company engages the stronger the brand will become, much as telephone services or email services are only valuable to their users when they have a sufficient number of other users? Will buySAFE sustain its advantage through some other mechanism? Will this become a profitable oligopoly, like bond rating, or a lower margin commodity business?

How might buySAFE overcome the initial barriers to entry in its business? What additional incentives could buySAFE use with its prospective customers to get them to adopt buySAFE?

How can buySAFE construct barriers to entry that would delay or deter competitors?

11. References


About the Author — Eric K. Clemons

Dr. Eric K. Clemons is Professor of Operations and Information Management at The Wharton School of the University of Pennsylvania. He has been a pioneer in the systematic study of the transformational impacts of information on the strategy and practice of business. His research and teaching interests include strategic uses of information systems, the changes that information technology enables in the competitive balance between new entrants and established industry participants, transformation of distribution channels, the structure and governance of the IT functional area, and the impact of information technology on the risks and benefits of outsourcing and strategic alliances. Industries of focus include international securities markets and financial services firms, consumer packaged goods retailing, and travel. He specializes in assessing the competitive implications of information technology, and in managing the risks of large-scale implementation efforts. Additionally, Dr. Clemons is the founder and Project Director for the Wharton School’s Sponsored Research Project on Information: Strategy and Economics within the Program For Global Strategy and Knowledge Intensive Organizations, founder and area coordinator the School’s new major in Information: Strategy, and Economics, director of the School’s new eCommerce major and member of the Wharton eBusiness Initiative Curriculum Oversight Committee, an active participant in the School’s eCommerce Forum research program, and member of the Faculty Council of the SEI Center for Advanced Studies in Management.

Dr. Clemons is currently a member of the editorial board of the Journal of Management Information Systems and the Journal of Electronic Commerce. He has served on the Congressional Office of Technology Assessment study of securities markets and on the Quality of Markets Advisory Board of the London Stock Exchange and has three times been co-Chair of the international Workshop on Information Systems Economics. His education includes an S.B. in Physics from MIT and an M.S. and Ph.D. in Operations Research from Cornell University. Dr. Clemons has over thirty years experience on the faculties of Wharton, Cornell, and Harvard, and consulting experience in the private and public sectors both domestically and abroad.

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