Chapter 6
Online Auctions, Virtual Communities, and Web Portals

At a Glance

Instructor’s Manual Table of Contents

- Chapter Overview
- Chapter Objectives
- Instructor Notes
- Quick Quizzes
- Discussion Questions
- Additional Resources
- Key Terms
Chapter Overview

In Chapters 3 and 4, you learned how businesses are using the Web to create online identities, reach customers, and sell to them. In Chapter 5, you learned how businesses are using the Web to purchase goods and work with their suppliers more effectively. In all three of these chapters, the focus was on how companies can use the Web to improve the things that they have been doing for years: buying and selling. In this chapter, you will learn how companies are using the Web to do things that they have never done before. These new things include running auctions, creating virtual communities, and operating Web portals.

Chapter Objectives

In this chapter, you will learn about:

- Origins and key characteristics of the seven major auction types
- Strategies for Web auction sites and auction-related businesses
- Virtual communities and Web portals

Instructor Notes

Auction Overview

In many ways, online auctions provide a business opportunity that is perfect for the Web. An auction site can charge both buyers and sellers to participate, and it can sell advertising on its pages. People interested in trading specific items can form a market segment that advertisers will pay extra to reach. Thus, the same kind of targeted advertising opportunities that search engine sites generate with their results pages are available to advertisers on auction sites. This combination of revenue-generating characteristics makes it relatively easy to develop online auctions that yield profits early in the life of the project.

 Origins of Auctions

In an auction, a seller offers an item or items for sale, but does not establish a price. This is called “putting an item up for bid” or “putting an item on the (auction) block.” Potential buyers are given information about the item or some opportunity to examine it; they then offer bids, which are the prices they are willing to pay for the item. The potential buyers, or bidders, each have developed private valuations, or amounts they are willing to pay for the item. The whole auction process is managed by an auctioneer. In some auctions, people employed by the seller or the auctioneer can make bids on behalf of the seller. These people are called shill bidders. Shill bidders can artificially inflate the price of an item and may be prohibited from bidding by the rules of a particular auction.
English Auctions

Most people who have attended or seen an auction on television have experienced only one type of auction, the English auction, in which bidders publicly announce their successive higher bids until no higher bid is forthcoming. At that point, the auctioneer pronounces the item sold to the highest bidder at that bidder’s price. This type of auction is also called an ascending-price auction. An English auction is sometimes called an open auction (or open-outcry auction) because the bids are publicly announced; however, there are other types of auctions that use publicly announced bids that are also called open auctions.

English auctions that offer multiple units of an item for sale and allow bidders to specify the quantity they want to buy are called Yankee auctions. When the bidding concludes in a Yankee auction, the highest bidder is allotted the quantity he or she bid. If items remain after satisfying the highest bidder, those remaining items are allocated to successive lower (next-highest) bidders until all items are distributed.

<table>
<thead>
<tr>
<th>Types of Auctions:</th>
</tr>
</thead>
<tbody>
<tr>
<td>♦ <strong>Dutch auctions</strong>: A form of open auction in which bidding starts at a high price and drops until a bidder accepts the price. Because the price drops until a bidder claims the item, Dutch auctions are also called descending-price auctions.</td>
</tr>
<tr>
<td>♦ <strong>First-Price Sealed-Bid Auctions</strong>: In sealed-bid auctions, bidders submit their bids independently and are usually prohibited from sharing information with each other. In a first-price sealed-bid auction, the highest bidder wins.</td>
</tr>
<tr>
<td>♦ <strong>Second-price sealed-bid auction</strong>: The same as the first-price sealed-bid auction except that the highest bidder is awarded the item at the price bid by the second-highest bidder.</td>
</tr>
<tr>
<td>♦ <strong>Open-outcry double auctions</strong>: Buy and sell offers are shouted by traders standing in a small area on the exchange floor called a trading pit.</td>
</tr>
<tr>
<td>♦ <strong>Double auction</strong>: Buyers and sellers each submit combined price-quantity bids to an auctioneer. The auctioneer matches the sellers’ offers (starting with the lowest price and then going up) to the buyers’ offers (starting with the highest price and then going down) until all the quantities offered for sale are sold to buyers.</td>
</tr>
<tr>
<td>♦ <strong>Reverse auction</strong>: Multiple sellers submit price bids to an auctioneer who represents a single buyer. The bids are for a given amount of a specific item that the buyer wants to purchase. The prices go down as the bidding continues until no seller is willing to bid lower.</td>
</tr>
</tbody>
</table>

*Issues Box: Reverse auctions bring bids to travelers*
In travel, the "reverse auction" is the craze du jour among a small but growing segment of vacationers. It's a much less obvious procedure, and it requires some study. But if you're willing to spend the time on this painfully slow method of buying air tickets or cruise cabins, you can sometimes pick up a spectacular bargain.

In a reverse auction for travel, you specify the cruise ship and date of sailing in which you're interested. Or else you name the city to which you wish to fly and the date of travel. The operator of the reverse auction submits your needs to an assortment of travel agents, ticket brokers, airlines and cruise companies scattered around America, and those companies send you e-mails setting forth the price at which they're willing to provide the cruise or ticket.

In effect, they bid for your business (a "reverse auction"), and within a few hours, you have a variety of offers from which to choose. Most bids reach you within two to three hours after you've expressed your desires; some come in five or six hours later; some the next day.

As a full-blown program, the reverse auction began seven months ago in the cruise industry. A company called CruiseCompete created a Web site (www.cruisecompete.com), which asks the public to name the cruise ships and dates that they're interested in and then select from more than 40 cruise discounters and cruise-specializing travel agents (some big, some small, some regional, some national) who respond to those requests with price offers.

Judging from the comments of well-satisfied customers that now appear on the site, a great many members of the public have thus obtained cruise vacations that they regard as significantly less expensive and yet high-quality ships. And approximately 10,000 people a month now request quotes from CruiseCompete.

A longer-established firm, CruiseMates.com, has been offering the reverse auction for several years, but only as a lesser alternative to its more traditional methods of disclosing the prices offered by individual cruise brokers. If you favor the reverse auction approach, you first access CruiseMates' main menu, then click on "cruise shopping," and then on "cruise quotes." CruiseMates.com will transmit your request for a price to its own group of cruise travel agents, and afterward forward the quotes to you.


Question

1. Why would a price solicited from a group of cruise travel agents, large and small, be better than a price obtained from a single large cruise discounter?
2. How does a reverse auction differ from a regular auction?
Quick Quiz

1. In a(n) _____ bidders publicly announce their successive higher bids until no higher bid is forthcoming.
   Answer: English

2. The _____ is a form of open auction in which bidding starts at a high price and drops until a bidder accepts the price.
   Answer: Dutch auction

3. True or False: Second-price sealed-bid auctions are commonly called Vickrey auctions.
   Answer: True

4. In a(n) _____, buyers and sellers each submit combined price-quantity bids to an auctioneer.
   Answer: double auction

Online Auctions and Related Businesses

Online auctions are one of the fastest growing segments of online business today. Millions of people buy and sell all types of goods on consumer auction sites each year. Although the online auction business is changing rapidly as it grows, three broad categories of auction Web sites have emerged: general consumer auctions, specialty consumer auctions, and business-to-business auctions.

General Consumer Auctions

The most successful consumer auction Web sites is eBay and the most common format used is a computerized version of the English auction. Note that in the eBay English auction sellers are allowed to set a reserve price. In this type of auction, bidders are listed, but the bid amounts are not disclosed until after the auction is over. This is a slight variation on the in-person English auction, but because eBay always shows a continually updated high bid amount, a bidder who monitors the auction can see the bidding pattern as it occurs. The main difference between eBay and a live English auction is that bidders do not know who placed which bid until the auction is over. The eBay English auction also allows sellers to specify that an auction be made private. In an eBay private auction, the site never discloses bidders’ identities and the prices they bid. At the conclusion of the auction, eBay notifies only the seller and the highest bidder. Another auction type offered by eBay is an increasing-price format for multiple-item auctions that eBay calls a Dutch auction. This format is not a true Dutch auction, but is instead a Yankee auction.
In either type of eBay auction, bidders must constantly monitor the bidding activity. All eBay auctions have a minimum bid increment, the amount by which one bid must exceed the previous bid, which is about 3 percent of the bid amount. To make bidding easier, eBay allows bidders to make a proxy bid. In a proxy bid, the bidder specifies a maximum bid. If that maximum bid exceeds the current bid, the eBay site automatically enters a bid that is one minimum bid increment higher than the current bid. As new bidders enter the auction, the eBay site software continually enters higher bids for all bidders who placed proxy bids. Although this feature is designed to make bidding require less bidder attention, if a number of bidders enter proxy bids on one item, the bidding rises rapidly to the highest proxy bid offered. This rapid rise in the current bid often occurs in the closing hours of an eBay auction.

**Teaching Tip:**
♦ Invite students to share their experiences with different online auctions.

### Specialty Consumer Auctions

Rather than struggle to compete with a well-established rival such as eBay in the general consumer auction market, a number of firms have decided to identify special-interest market targets and create specialized Web auction sites that meet the needs of those market segments. Several early Web auction sites started by featuring technology items such as computers, computer parts, photographic equipment, and consumer electronics.

### Consumer Reverse Auctions and Group Purchasing Sites

A new type of business made possible by the Internet is the group purchasing site, which is similar to a consumer reverse auction. On a group purchasing site, the seller posts an item with a price. As individual buyers enter bids on an item (these bids are agreements to buy one unit of that item, but no price is specified), the site can negotiate a better price with the item’s provider. The posted price ultimately decreases as the number of bids increases, but only if the number of bids increases. Thus, a group purchasing site builds up a number of buyers who will force the seller to reduce its price. The effect is very much like the one achieved by a consumer reverse auction. The types of products that are ideal for group purchasing sites are branded products with well-established reputations. This allows buyers to feel confident that they are getting a good bargain and are not trading off price for reduced quality. The products should also have a high value-to-size ratio and should not be perishable.

### Business-to-Business Auctions

Depending on its size, a firm typically uses one of two methods to distribute excess inventory. Large companies sometimes have liquidation specialists who find buyers for these unusable inventory items. Smaller businesses often sell their unusable and excess inventory to liquidation brokers, which are firms that find buyers for these items. Online auctions are the logical extension of these inventory liquidation activities to a new and more efficient channel, the Internet.
Two of the three emerging business-to-business Web auction models are direct descendants of these two traditional methods for handling excess inventory. In the large company model, the business creates its own auction site that sells excess inventory. In the small-company model, a third-party Web auction site takes the place of the liquidation broker and auctions excess inventory listed on the site by a number of smaller sellers. The third business-to-business Web auction model resembles consumer online auctions. In this model, a new business entity enters a market that lacked efficiency and creates a site at which buyers and sellers who have not historically done business with each other can participate in auctions. An alternative implementation of this model occurs when a Web auction replaces an existing sales channel.

**Business-to-Business Reverse Auctions**

In 2001, glass and building materials producer Owens Corning held more than 200 reverse auctions for a variety of items including chemicals (direct materials), conveyors (fixed assets), and pipe fittings (MRO). Owens Corning even held a reverse auction to buy bottled water. Asking its suppliers to bid has reduced the cost of those items by an average of 10 percent. Because Owens Corning buys billions of dollars worth of materials, fixed assets, and MRO items each year, the potential for cost savings is significant. Both the U.S. Navy and the federal government’s General Services Administration are experimenting with reverse auctions to acquire a small part of the billions of dollars worth of materials and supplies they purchase each year. Companies that use reverse auctions include Agilent, BankOne, Bechtel, Boeing, Raytheon, and Sony.

Not all companies are enthusiastic about reverse auctions. Some purchasing executives argue that reverse auctions cause suppliers to compete on price alone, which can lead suppliers to cut corners on quality or miss scheduled delivery dates. Others argue that reverse auctions can be useful for nonstrategic commodity items with established quality standards.

<table>
<thead>
<tr>
<th><strong>Auction-Related Services:</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>♦ <strong>Auction escrow services:</strong> An independent party that holds a buyer’s payment until the buyer receives the purchased item and is satisfied that the item is what the seller represented it to be.</td>
</tr>
<tr>
<td>♦ <strong>Auction directory and information services:</strong> Offer guidance for new auction participants and helpful hints and tips for more experienced buyers and sellers along with directories of online auction sites.</td>
</tr>
<tr>
<td>♦ <strong>Auction software:</strong> For sellers, these companies offer software and services that can help with or automate tasks such as image hosting, advertising, page design, bulk repeatable listings, feedback tracking and management, report tracking, and email management. For buyers, a number of companies sell auction sniping software. Sniping software observes auction progress until the last second or two of the auction clock. Just as the auction is about to expire, the sniping software places a bid high enough to win the auction.</td>
</tr>
</tbody>
</table>
Auction consignment services: Take an item and create an online auction for that item, handle the transaction, and remit the balance of the proceeds after deducting a fee that ranges from 10 percent to 40 percent of the selling price obtained. Items that do not sell are returned or donated to charity.

Quick Quiz

1. A(n) _____, is the amount by which one bid must exceed the previous bid.
   Answer: minimum bid increment

2. A third-party _____, holds the buyer’s payment until he or she receives and is satisfied with the purchased item.
   Answer: escrow service

3. True or False: Small businesses often sell their unusable and excess inventory to liquidation specialists.
   Answer: False

4. _____ uses its software and hardware tools to coordinate private online auctions that allow businesses to solicit bids from suppliers.
   Answer: FreeMarkets

Virtual Communities and Web Portals

The Internet reduces transaction costs in value chains and offers an efficient means of communication to anyone with an Internet connection. Combining the Internet’s transaction cost reduction potential with its role as a facilitator of communication among people, companies have developed two other new approaches to making money on the Internet and the Web: virtual communities and Web portals.

- Mobile communications technology: Wireless Application Protocol (WAP) allows Web pages formatted in HTML to be displayed on devices with small screens, such as PDAs and mobile phones. As mobile technology improves, more and more devices will become Web-enabled and will include other features that will open doors to a second wave of electronic commerce.
Mobile Business: Most industry observers agree that revenue models for mobile business can be developed once mobile phones, notebook computers with wireless Internet connections, and online marketplaces are interconnected in ways that let people switch among modes of access seamlessly.

Intelligent software agents: Programs that search the Web and find items for sale that meet a buyer’s specifications.

Virtual communities: A gathering place for people and businesses that does not have a physical existence. Exist on the Internet today in various forms, including Usenet newsgroups, chat rooms, and Web sites. These communities offer people a way to connect with each other and discuss common issues and interests.

Early Web Communities

One of the first Web communities was the WELL. The WELL, which is an acronym for “whole earth ‘lectronic link,” predates the Web. It began as a series of dialogs among the authors and readers of the Whole Earth Review in 1985. Most WELL members were originally from the San Francisco Bay area, and the influence of that area’s counterculture heritage is a significant part of the WELL’s ambiance. Members of the WELL pay a monthly fee to participate in its forums and conferences. The WELL has been home to many important researchers and participants in the growth of the Internet and the Web.

Web Community Consolidation

Virtual communities for consumers can succeed as money-making propositions if they offer something sufficiently valuable to justify a charge for membership. For example, people joining the WELL community obtain access to a very interesting set of existing members who frequent the WELL’s discussion areas. These areas are open only to members. Thus, WELL owner Salon.com can charge a subscription fee for access to the WELL community.

Web Communities in the Second Wave of Electronic Commerce

In the early days of the Internet, virtual communities were an essential part of the online experience for the small number of people who regularly used the medium. As the Internet and Web grew, some of these communities grew, but others found that their purpose as a place for sharing the new experiences of online communication began to fade. In the second wave of electronic commerce, a new phenomenon in online communication began. People who were now using the Internet no longer found a common bond in the fact that they were using the Internet. Multiple common bonds joined people with all types of common interests. The Internet was no longer the focus of the community, but was simply a tool that enabled communication among members of the community.
Revenue Models for Web Portals and Virtual Communities

By the late 1990s, virtual communities were selling advertising to generate revenue. Search engine sites and Web directories were also selling advertising to generate revenue. Beginning in 1998, a wave of purchases and mergers occurred among these sites. The new sites that emerged still used an advertising-only revenue generation model and included all the features offered by virtual community sites, search engine sites, Web directories, and other information-providing and entertainment sites.

<table>
<thead>
<tr>
<th>Web Portal Revenue Models:</th>
</tr>
</thead>
<tbody>
<tr>
<td>♦ Advertising-supported Web portals: Some Web observers believe that Web portal sites could be the great revenue-generating businesses of the future. They argue that adding portal features to existing sites or converting sites to portals can be a wise business strategy. They believe that combining Web communities’ sense of belonging with search engine and Web directory tools will yield Web sites with high degrees of stickiness that will be extremely attractive to advertisers.</td>
</tr>
<tr>
<td>♦ Mixed-Revenue Web portals and Virtual Communities: One of the of the most successful Web portals is Time Warner’s AOL unit, which has always charged a fee to its users and has always run advertising on its site. Many Web portals that have struggled with their advertising-supported revenue models have been moving toward AOL’s strategy.</td>
</tr>
<tr>
<td>♦ Internal Web portals: A growing number of large organizations have built Web portals to provide information to their employees. These portals can save significant amounts of money by replacing the printing and distribution of paper memos, newsletters, and other correspondence with a Web site. Organizations use internal Web portals to publish employee handbooks, newsletters, and employee benefits information. These organizations are also finding that the internal portal Web site can become a good way of creating a virtual community among employees who are dispersed over a wide geographic area.</td>
</tr>
</tbody>
</table>

Quick Quiz

1. _____ allows Web pages formatted in HTML to be displayed on devices with small screens, such as PDAs and mobile phones.
   Answer: Wireless Application Protocol (WAP)

2. Intelligent agents are also called _____.
   Answer: software robots, bots
3. A(n) _____ is a gathering place for people and businesses that does not have a physical existence.
   Answer: virtual community

4. _____ refers to the conversion of existing regular site visitors seeking free information or services into fee-paying subscribers or purchasers of services.
   Answer: Monetizing

Discussion Questions

- To what do you attribute eBay’s popularity?
- With respect to online auctions, what are some of the risks faced by sellers?
- Discuss some of the marketing tactics used by Web sites to promote their auctions.

Additional Resources


Key Terms

- **Double auction**: Buyers and sellers each submit combined price-quantity bids to an auctioneer.
- **Dutch auction**: A form of open auction in which bidding starts at a high price and drops until a bidder accepts the price.
- **English auction**: Bidders publicly announce their successive higher bids until no higher bid is forthcoming.
- **Escrow service**: Holds the buyer’s payment until he or she receives and is satisfied with the purchased item.
- **Intelligent software agent (software robot or bot)**: Programs that search the Web and find items for sale that meet a buyer’s specifications.
- **Sniping software**: Observes auction progress until the last second or two of the auction clock.