



eBay Calling Skype: Is It a Good Connection?

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When online auctioneer eBay announced its intentions last week to buy Internet communications services provider Skype in a potential \$4.1 billion deal that will consolidate three of the biggest Internet brands -- eBay, PayPal and Skype -- under one roof and eliminate e-commerce "friction," the questions began.



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What, people are asking, is the rationale behind the acquisition, and isn't \$4.1 billion a bit steep? After all, it takes some imagination to see how eBay's e-commerce activities -- auctions and payment systems -- will be combined with Skype, a Voice over Internet Protocol (VoIP) and PC-to-PC calling company that has signed up 54 million users globally in a little more than two years.

Under the terms of the deal, eBay will pay \$2.6 billion in stock and cash plus "potential performance-based consideration" that could make the deal worth \$4.1 billion over time. The acquisition of Skype is eBay's largest ever (PayPal is the second largest at \$1.5 billion). With Skype, eBay gets a way to enter the voice communications business, integrate Skype with its auctions and payment systems, and deliver sales growth. Skype gets the resources to compete with rivals ranging from Google, Microsoft and Yahoo to Verizon, Vonage and SBC.

"We have evolved over the years and our goal is to grow faster than [the rate] of e-commerce," said eBay CEO Meg Whitman on a September 12 conference call with financial analysts.

While that goal sounds fine, Wharton professors are struggling to nail down the reasoning behind the deal. "I understand it from the Skype perspective," says marketing professor [Xavier Dreze](#). "Skype gets money and more visibility. It's less clear for eBay." Business and public policy professor [Gerald Faulhaber](#) was more direct. "I don't understand it at all," he says. "I see Internet voice as a natural adjunct to IM (instant messaging). It would have made sense if Google had bought Skype, but I just don't see the synergy" in the eBay-Skype deal.

Whitman begs to differ. She sees eBay integrating Skype with its auction and payment systems to enable faster communication between buyers and sellers and allow the completion of more transactions.

Among the benefits highlighted by Whitman:

Skype is a fast-growing business that will fuel future growth for eBay properties as a stand alone business. Skype is currently adding about 150,000 users a day to its member base of 54 million in 225 countries and territories. Skype generated about \$7 million in revenues in 2004, and is expected to have \$60 million in revenues in 2005 and more than \$200 million in 2006.

The combined networks of eBay, PayPal and Skype will cross-pollinate and create more paying users. Skype's basic service, which will remain free, will be integrated into eBay and

PayPal with the possibility of additional pay services. Skype's popularity internationally will also help eBay increase its presence abroad.

Skype's video and voice communications software can be used to develop additional commissions for eBay, say through a phone lead on a real estate purchase. "Some categories don't fit with our model," says Whitman, citing new cars, travel and real estate as examples. "These markets are very interesting to us."

According to [Kevin Werbach](#), legal studies and business ethics professor at Wharton, it would be foolish to count eBay out. "If you think eBay is a big auction house and Skype is just a phone company, then the deal doesn't make sense," he says. "Does real-time communication play a role in e-commerce? The answer is clearly yes. If that's the case, do you rely on a phone network or build a new communication platform that can be integrated with e-commerce? eBay is betting that next-generation communications will be an important sector over the next 10 years."

Werbach acknowledges that the price tag for Skype could be viewed as high, but also notes that there "was only one VoIP company with the brand and the user adoption out there." Wharton marketing professor [Barbara Kahn](#) adds that Skype could make international transactions easier for eBay and help buyers and sellers iron out complicated transactions with real-time communications. "The argument is that the ability to talk to each other easily will help e-commerce," she says.

A Tough Sell?

Werbach predicts that eBay's acquisition of Skype will be closely watched. "Given what eBay paid, investors will expect a lot from the deal," he says. "Whitman and her team in short order will have to show some synergies." Indeed, Wall Street is closely scrutinizing the Skype acquisition. Many analysts, such as Christa Sober Quarles at Thomas Weisel Partners, note that Skype would need \$1 billion in revenue with 25% operating cash flow margins to justify the price eBay paid.

Meanwhile, Quarles adds, it's not clear that Skype will hold up as a stand-alone business. "While we believe the company does have a competitive advantage by offering low-cost phone calls, we do not feel that this is a sustainable strategy to generate revenue over the long run," she writes in a research note. "For example, in the United States there are many low-cost, fixed-price phone plans from most cell phone companies, some cable providers and VoIP competitors such as Vonage."

Faulhaber agrees that Skype faces intense competition and that eBay may be overestimating the acquisitions' potential. When America Online acquired Time Warner, Faulhaber says, the deal just didn't make sense on the surface. "From a business perspective, it was a dumb merger." Likewise, he adds, the eBay and Skype deal "is an egregious example of something that doesn't make sense."

But Whitman sees no reason that having Skype in the family can't be successful. Skype is focused on one goal -- making communications easy; all the great web brands, from eBay and Yahoo to Amazon and Google, have identified a singular mission. "Focus matters," says Whitman.

For his part, Skype cofounder and CEO Niklas Zennström says eBay provides Skype the best platform to make "talking over the Internet the most natural thing in the world." Zennström notes that Skype's business will continue as a standalone entity and be integrated with eBay and PayPal to smooth out e-commerce delays that come with e-mail, the primary way eBay users communicate.

To understand the Skype acquisition, Werbach adds, you have to look at it from eBay's perch as an Internet giant. "It's a clash of the titans. eBay sees itself as one of the Internet's behemoths along with

Google, Yahoo and Amazon. This was a preemptive strike."

Skype-fueled Commerce

The payoff from the deal -- assuming eBay is successful -- will be the ability to generate a phone call lead to land a sale. Werbach says eBay would couple contextual links -- a buyer searching for an Audi with a link to a local auto dealer, for example. That link could then launch Skype to generate a call to the auto dealer and potentially close a sale. eBay would take a commission on the phone call for the lead.

To Whitman, this "pay for call" model would help reduce "friction" in e-commerce. Say, for instance, that a buyer wanted more detail on an antique collectable or a car. With email, a response could take hours and the buyer could change her mind. With Skype, there would be instant communication to work out any concerns and cut down on the 5 million eBay email messages sent every day. "Communication is the fabric of commerce," says Whitman.

Despite her skepticism about Skype's ability to survive on its own, Quarles is receptive to the integration possibilities. "We believe that eBay's experience in advertising, e-commerce and search could be paramount in shaping Skype's future business outlook," she writes. "Specifically, we believe a lead generation model in the form of a pay-for-call model could present a compelling opportunity for Skype." She adds that Skype could increase conversion rates for sales of big ticket items such as automobiles, real estate and high-end jewelry and launch new businesses for eBay. For instance, the online auctioneer could offer financial, legal and healthcare services.

Quarles estimates that some of these services, say an eBay referral to a lawyer, could command price-per-call rates as high as \$10. This capability could be integrated with a classified advertising site such as Kijiji, an international eBay site that resembles the popular Craigslist.

Yet while those possibilities are enticing, eBay's rationale for buying Skype may have a fundamental flaw, Dreze suggests. "PayPal clearly filled a hole for eBay. This deal is like eBay saying, 'Let's add the ability to talk' without asking the user base. I don't want to talk to anyone on eBay. I make my listing and want the transaction done so I don't have to worry about it." If eBay users refrain from chatting their way through transactions, Werbach speculates that Skype as a stand-alone business could fuel growth.

One big challenge for eBay will be adequately juggling its acquisitions as it tries to maintain growth. It has purchased nine companies in the last 18 months. "We believe management time and company resources could be thinned out, making execution more difficult," writes Quarles. Indeed, eBay bought Shopping.com for \$634 million on August 30, just a few days before acquiring Skype.

Werbach acknowledges the challenges. For instance, Skype is a small international company that will be combined with a relatively established eBay. "Culturally, Skype is rebellious," says Werbach. "eBay is mature." That said, this merger isn't complicated like the Hewlett-Packard-Compaq combination. "Given the size of Skype, the actual integration will be easy." Indeed, integration may not even occur. Although it had a number of suitors, Skype chose eBay for the deal because of assurances that eBay would basically leave the company alone.

Despite the challenges and naysayers, the eBay and Skype integration will be interesting to watch. If eBay, PayPal and Skype users feed off each other, there could be some interesting revenue possibilities. Dreze wouldn't be surprised if eBay has a master plan that will play out, but until Whitman and her crew deliver he will reserve judgment. "I could see Skype being used for high-end auctions like they have at Sotheby's," says Dreze. "I wouldn't rule out the possibility that eBay may have another plan, but I'm still waiting. I haven't heard anything that makes me

think this deal is outstanding."

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