

## Important Lessons from eBay about Business Ethics

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### **Article:**

The issue of business ethics is on a lot of people's minds these days. Scandals at Enron and Worldcom got it started. Since then there has been a steady drumbeat of reports about corporate accounting irregularities, some of them serious. And there is a persistent pessimism on Wall Street, purportedly because of fears of even more accounting surprises.

Recently, Federal Reserve chairman Alan Greenspan coined a new term when appearing before the Senate Banking Committee. The man who told us that the stock market of the 1990s was gripped by an "irrational exuberance" now believes that the American corporate community is gripped by an "infectious greed."

But Greenspan noted that people aren't inherently more greedy than they used to be. Rather, he claimed, adverse incentives created by poorly designed stock options have brought out the worst in corporate managers.

Whether or not stock options are the particular cause of the current mess, Greenspan's distinction was an important one. Evil financier Gordon Gecko was wrong when he said in the 1983 movie "Wall Street" that "greed is good." However, greed has always been a part of human nature, and social policy cannot ignore that fact of life. When greedy actions cause big problems, it's almost always a failure of policies, incentives, and oversight. Greed itself was there before the problem arose, and it'll be there after the problem is solved.

This is a big reason why government oversight of the economy is so important. There have to be enforceable standards to ensure that people follow the right incentives. It's fine to educate people about ethics and to try to influence the culture to promote ethical behavior, but at the end of the day, nothing works like incentives. And unfortunately, when it comes to ethics, the best incentives are often negative ones: punishment for wrong-doing.

I was thinking about this while reading the new book, *The Perfect Store: Inside eBay*, by Adam Cohen. In case you didn't know, eBay is the Internet's biggest and most successful auction site, where sellers and buyers interact via webpages to make transactions. More and more sellers on eBay are companies, some of them big corporations, but it's still an avenue for individuals and small firms to do business.

eBay founder Pierre Omidyar wanted to create an Internet trading forum that would come as close as possible to what economics textbooks describe as a perfect market. He especially wanted to build notions of community into the workings of eBay because he believed (in Cohen's words) "that people are basically good, and given the chance to do right, they generally will."

Oh, really?

Don't get me wrong. I like people. Some of my best friends are people. And most of the people in my life, both in business and in private, have treated me well. But that's my micro perspective. My macro perspective is more cynical. Give people the chance to do right, and they generally will? Tell that to investors and employees at Enron and Worldcom. Tell that to investors who have been duped by over-hyping Wall Street analysts.

I'll grant that most people are honest. But it doesn't always take many dishonest people to generate horrible results in the business arena. And deviations from ethical behavior can creep in at the margins of what otherwise good people do. It can be easy to rationalize things like insider trading, tax evasion, and long-distance phone calls from work.

But I'm an enlightened cynic, not an incurable one. The existence of rules can lead people to do the right thing, sometimes even without direct sanctions for doing the wrong thing. And communities can generate organically their own sanctions and incentives, as anyone who grew up in a small town can attest.

As I read Cohen's history of eBay, I saw evidence to support my enlightened cynicism. The eBay community is mostly civil and functional because eBay has managed to mimic some of the workings of a small town. Moreover, it maintains a staff of about a dozen to control fraud among eBay users. Even in the magic world of eBay, there has to be a police department.

eBay founder Omidyar cites the Golden Rule as an organizing principle for the eBay community. The Golden Rule is often seen as a purely ethical dictum, and that might be true of the version used by the Jewish sage Hillel to summarize the ethical content of the Hebrew Bible: "what is hateful to you, do not do to others."

But the version that most of us know, the version that influenced Omidyar's conception of eBay, is "do unto others as you would have them do unto you." That version reads less like pure ethics and more like an exchange. The apparent reason for treating others well is the hope that you will be treated well by them.

It's the practicality of this version of the Golden Rule that makes eBay's community work. Every exchange on eBay generates up to two pieces of feedback, with the buyer rating the seller and the seller rating the buyer. One soon realizes that it makes sense to rate your counterpart in an eBay exchange as you would like him or her to rate you. Otherwise, a negative rating could shoot back at you.

But negative ratings are sometimes justified, and are a service to the rest of the community. Someone who receives a negative rating can make a comment or provide an explanation, but he or she cannot (without resorting to extraordinary measures) erase it.

Also important to this mechanism of community is the quick flow of information within eBay. A hyperlinked webpage is a potential font of information, and the more hyperlinks, the more dimensions of information there are. On an eBay auction page, you can't always get immediate and accurate information about the product for sale, because that product is often unusual, if not unique. But you can get immediate information about the seller and the current high bidder. And that tends to induce sellers to be frank about the item for sale.

Nowhere else in commerce is such information so readily available. In the grocery store we have to decipher lists of ingredients and *then* assess them in the light of the ever-changing terrain of nutritional advice. When buying a car we research different makes and models, using everything from high-tech automobile websites to low-tech walks around car lots. When lining up plumbers, electricians, and contractors, we depend heavily on reputation and word of mouth.

But at eBay, much of that information is right there, right next to the product and only a click away. The impressive transparency of eBay's auctions is a tremendous tool to enhance on-line ethics.

The eBay community isn't perfect, of course. Some unscrupulous trader/hackers have hijacked the accounts of people in good standing in the community. Others have sold fake items without identifying them as such. But by and large, the system seems to work.

Outside of eBay, some have suggested that the marketplace already provides sanctions for unethical behavior. But aside from activists, do consumers really care about the corporate policies of the companies that make the

products they buy? I doubt it. I haven't cancelled my MCI long-distance service, in spite of Worldcom's malfeasance. Not only does my calling plan work for me, but I don't feel like reducing the flow of revenue that pays those workers who are still with Worldcom.

And clients didn't flee Arthur Andersen in the wake of the Enron debacle because Andersen had engaged in unethical acts. They did so because Andersen's business is assurance and it had broken a trust. Could it be trusted anymore?

I believe that eBay can teach us some distinctive and important lessons about business ethics. But it's not because the world of eBay gives people the opportunity to be good to each other. The ethics lesson of eBay lies in its transparency, its information flows, and the on-line community that enforces its standards. As Hillary Rodham Clinton might have put it, it takes a village to operate a market.