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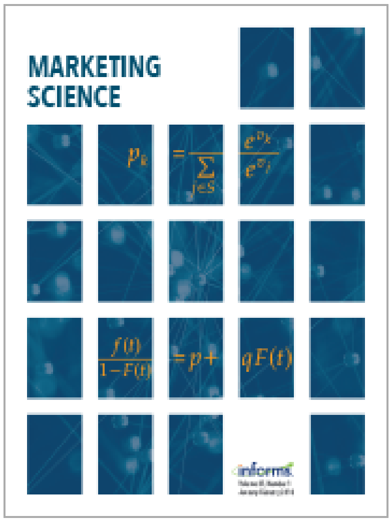

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Invited Commentary—Internet-Based Service Institutions

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Invited Commentary

Internet-Based Service Institutions

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Introduction

The economic importance of services is reflected in the growing focus of academics, practitioners, and policy makers with issues examining the role of services in firm strategy, consumer welfare, and public policy. Rust and Chung (2006) should be congratulated for a very timely contribution to this discussion. They provide a comprehensive review of the literature and highlight several important areas for future investigation.

The growth of the Internet has led to the emergence of many new online intermediary services. An important development is the growth of third-party infomediaries like mySimon, Pricescan, Autobytel, and Healthadvocates, which do not sell goods directly themselves but rather facilitate the selling process by providing informational and selling inputs to consumers and/or to firms. These institutions are already having significant impact on the functioning of firms and on competitive interactions in many online and traditional markets. Our objective is to discuss this phenomenon, highlight the findings of extant research, and suggest some questions for further research.

We focus on two types of online intermediary services—comparison-shopping agents and referral services. We choose these two because they help illustrate the impact of these services in two different marketplaces. Comparison-shopping agents affect the competition between Internet retailers, whereas referral services affect the competition between conventional brick-and-mortar retailers. Collectively, they help demonstrate the influence of online infomediaries in shaping consumer behavior, firm strategy, and channel performance.

Comparison-Shopping Agents

Comparison-shopping agents are search services that provide consumers with price and product information from a number of competing firms in an online market. Essentially, they allow a consumer to costlessly search for the price of a good at many retailers with a single search. The initial predictions of industry analysts had been that the growth of these services would intensify price competition and would lead competing sellers to charge similar prices. However, there is enough empirical evidence from shopping agents (see, for example, Iyer and Pazgal 2003, Baye et al. 2004) that points to the existence of persistent and significant price dispersion as one of the hallmarks of comparison-shopping agent environments. Baye and Morgan (2001) explain this by highlighting the idea of a price information service as a strategic player and show that this service will set fees for the firms such that price dispersion is induced in the marketplace. Iyer and Pazgal (2003) analyze the effect of a shopping agent on the pricing strategies of Internet retailers and their motivation to join the service. They show how price dispersion results from the need of the joining firms to mitigate the increased competition created by the service.

There are some interesting avenues for future research in this area. Much of the literature has focused on the role of comparison-shopping agents in providing price information to consumers. However, equally important is the provision of nonprice and product information. Shopping agents that provide comparative information on product specifications might not always increase competition but might provide improved value to all firms by allowing better matching between consumers and firms. An interesting

Although invited commentaries are not formally peer-reviewed and represent the opinion of the author, authors were carefully chosen based on their outstanding expertise in the areas of their respective commentaries.

aspect of this question is the provision of online rating services that help consumers compare across different competing products. Chen and Xie (2005) is a recent attempt at understanding how a firm must adapt its marketing strategy in the face of product review information. Another interesting question is the design of revenue models for these services. Comparison-shopping services can be seen as two-sided markets involving consumers on one side and the member firms on the other. Clearly, they can be subject to the chicken-and-egg type dilemma: The service is attractive to consumers only if there are enough firms, while firms will join only if they are assured access to a large enough number of potential consumers. The proper design of the revenue system is therefore important for the long-term existence of this service.

Referral Services

While comparison-shopping services affect consumer search and thereby the competition among online firms, referral services or "infomediaries" are third-party institutions that facilitate trade in the conventional brick-and-mortar marketplace. They do this by allowing firms to target various types of informational and selling inputs to consumers. These services have emerged in a wide range of industries, such as autobytel.com in the automobile industry, avviva.com in real estate, and healthadvocates.com in medicine.

Referral infomediaries have two essential economic characteristics. On the consumer side, they perform the function of price discovery (most also offer consumers information on product specifications and performance).[1] On the firm side, these services endow the enrolled retailers with a price discrimination mechanism. A retailer that joins the service can price discriminate between online consumers who come through the service and offline consumers who come directly to the retail store.

The conventional wisdom that these services are a boon for consumers does not help shed light on the impact of this service on the functioning of retail markets. Chen et al. (2002) analyze the strategic impact of referral infomediaries on the competition between retailers and show that the use of an infomediary as a competitive price-discrimination mechanism leads to lower online prices. They also investigate the contracting strategy for a referral infomediary in selling its service to downstream retailers and highlight the rationale for exclusive distribution. On the empirical side, Morton et al. (2001) show in the transaction data obtained from Autobytel that customers (with referral from Autobytel) indeed paid lower purchase prices than those who did not use the service. Other types of infomediary services have also been examined in recent research. Fay (2004) analyzes the name-your-own-price (or NYOP) service, which allows consumers rather than sellers to quote a price for the product, with a transaction occurring only if a seller is willing to accept the quoted price. The ability of an infomediary to endow a channel with a price-discrimination mechanism translates well into this setting. Finally, Fitzsimmons and Lehmann (2004) show that there are conditions under which unsolicited referrals can lead to adverse reactions from consumers, and examine the implications of this for the service provider.

There are several directions for future research in this area. The first is to explore the implications of these services for the relationships between manufacturers and retailers in a channel. For instance, do referral services present a means for manufacturers to coordinate downstream retailer behavior? Another interesting research issue is competition between infomediaries and the manner in which they would enroll retailers. Finally, referral services might be able to easily track and collect information on consumer purchase and shopping behaviors. Such information about past consumer behavior might help retailers to offer targeted prices based on past purchase behavior (Villas-Boas 1999). It would be interesting to examine how such targeting helps the retailers enrolled in the referral service and, consequently, its effect on the contracting strategy of the service.

Conclusion

The Internet has given rise to a variety of new online third-party intermediation institutions. Unlike a standard vertical distribution channel, online intermediaries typically do not directly sell any goods. Rather, they provide information or selling inputs to consumers or to other firms in the channel. Central to the third-party role of these new service institutions is either (a) the provision of price, product, and performance information to consumers, or (b) the offer to firms of the ability to target consumers with different types of marketing activities. There is a growing body of research that examines the effect of these services on online and traditional markets. The continued growth of the Internet will provide further impetus to the spread of these types of e-service providers and to research in this area.

[1] For example, in the automobile market, a consumer can costlessly get a quote on a specific car from a dealer before starting to search among other dealers in the automobile market.

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