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When do I profit? Uncovering boundary conditions on reputation effects in online auctions

Michelle Carter^{a,*}, Stefan Tams^b, Varun Grover^c

^a Department of Management, Information Systems, and Entrepreneurship, Carson College of Business, PO Box 644743, Washington State University, Pullman, WA 991164-4743, USA

^b HEC Montréal 3000, Chemin de la Côte-Sainte-Catherine, Montréal, Québec H3T 2A7, Canada

^c Department of Management, Clemson University, Suite 132F, Surrin Hall, Clemson, SC 29634, USA

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ABSTRACT

Reputation profiles, based on customer feedback ratings, are important for achieving above average sales prices in online auctions. However, contradictory results in past research suggest that reputation effects may depend on information alternatives to customer feedback that sellers can provide to buyers. By explicitly modeling the competing assumptions of classical and contemporary approaches to buyer decision-making and using hierarchical linear modeling to analyse data from 363 online auctions, we found that sellers may benefit from carefully evaluating what information alternatives they combine with reputation profile to realize higher sales prices.

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1. Introduction

In online auctions (e.g., eBay), which are largely characterized by unfamiliar sellers and an absence of merchant branding, it is difficult for buyers to ascertain product quality [1,5,18,20,73]. Moreover, unscrupulous sellers may misrepresent the products they are selling [34,46,55]. Consequently, in these settings, reputation systems based on customer feedback constitute an important informational resource for buyers that reduce their perceptions of transaction risk [1,5,13,58,74]. Customer feedback is solicited in a variety of ways that help otherwise unknown sellers establish a reputation. For example, eBay's system uses individual evaluations left after each transaction to rate registered users [58]. Reputation systems such as these discourage fraudulent trading by ensuring that trading behaviors are made publicly available to an entire community via information technology (IT)-enabled summary statistics, referred to here as *reputation profiles*.

As it takes time to establish a good reputation, sellers must be rewarded or at least compensated for costs incurred during the reputation-building process. At the same time, the penalty for bad reputation should exceed any benefits sellers might expect to gain by behaving opportunistically—thus, “in equilibrium, a good

reputation must command a price premium” [8,p. 82]. Price premium has been defined in the literature as the additional monetary amount buyers are willing to pay for a product above the average price received by multiple sellers for an identical product [1]. The present paper adopts this definition and henceforth uses “price premium” to refer to above average prices.

Many studies have investigated the relationship between reputation profile and online auction outcomes [13]. Although this literature stream suggests that a seller's reputation profile is influential in buyer decision-making, past research presents contradictory results for the precise impacts of positive and negative feedback ratings on final sales prices [48]; see Table 1 for an overview). Although some studies show that negative feedback has little [13] or no impact [1,3,19], others find that it reduces final sales prices [31,41,45]. Furthermore, while many studies show that positive feedback increases final sales prices [1,3,31,45], others find no such effect [41,58], or that these effects taper off for established sellers with high percentages of positive feedback [8,39].

Some previous studies have suggested that the ambiguous relationship found between feedback ratings and final sales prices may be due to boundary conditions on reputation profile's influence on price premiums [10]. Buyers might have a different understanding of reputation profiles in the presence of other information provided by sellers. Consequently, to determine under which conditions reputation profile is effective, there is a need to examine the interplay between this informational resource and

* Corresponding author.

E-mail addresses: michelle.carter@wsu.edu (M. Carter), stefan.tams@hec.ca (S. Tams), vgrover@clemson.edu (V. Grover).

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Table 1
Impact of Reputation Profile on Final Sales Prices: Summary of Previous Results (adapted from [13].

Citation	Impact of Reputation Profile on Final Sales Prices	
	Positive Feedback	Negative Feedback
Ba and Pavlou [1]	Increases final sales price	No effect
Bajari and Hortaçsu [3]	Significant effect on final price	No effect
Bockstedt and Goh [8]	Seller feedback scores are less effective tools for differentiation in competitive auction environments	
Dewan and Hsu [14]	Higher net feedback score increases price	
Eaton [19]		Reduces likelihood of sale but not final sales price
Houser and Wooders [31]	Increases final sales price	Reduces final sales price
Lee [37]		Reduces final sales price but only for used items
Livingston [39]	Effect tapers off for established sellers	
Lucking-Reiley et al. [41]	No effect	Reduces final sales price
Melnik and Alm [45]	Increases final sales price	Reduces final sales price
McDonald and Slawson [75]	Higher net feedback score increases price	
Resnick and Zeckhauser [59]	No effect on prices contingent on sale	
Resnick et al. [60]	Controlled experiment; established seller commands higher prices than new seller	Among new sellers, a small amount of negative feedback has little effect

other types of information in the choice context (henceforth referred to as *information alternatives*; [13,37,67]. As contradictory findings limit knowledge creation [2], developing a clear understanding of the boundaries of the effects of reputation profile is important if sellers are to manage the information they provide effectively [21]. For example, the pragmatic question remains of whether sellers can, and should, leverage information alternatives that are under their direct control to influence the effect of reputation profile on price premiums. For sellers with a damaged reputation, leveraging information alternatives could help persuade reluctant buyers to transact with them, increasing the likelihood of sales and making it possible to restore reputation profiles more quickly. For reputable sellers, information alternatives may enhance positive reputation effects to increase price premiums. Thus, to tease out the underlying dynamics of these relationships, this study examines the following research question: *In online auctions, what information alternatives are open to sellers to compensate for a poor reputation profile or to boost a good reputation profile?*

The value in this work is in developing a more nuanced understanding of the relationships between customer-based reputation profile and seller-provided information alternatives in online auctions. We begin by reviewing the online auction

literature on information alternatives to reputation profile in online auctions. Next, we frame our arguments by contrasting oft-used economic theories of rational choice (e.g., utility theory) with more contemporary perspectives. Previous information system (IS) research has drawn on economic theories of rational choice to predict the direct effects of information alternatives on final sales prices. Under classical assumptions – for example, that rational buyers have perfect information and unlimited computational capacity [61]—information alternatives would be expected to compensate for negative feedback and add to the effects of positive feedback on price premiums. However, some argue that due to bounded rationality, classical assumptions do not adequately explain buyer behavior in practice [6,13]. Contemporary perspectives suggest that negative and positive feedback may interact with information alternatives in unexpected ways to influence buyers' willingness to pay more or less for the same product from different sellers [33,44,65]. Although both classical and contemporary perspectives suggest that sellers' choices with respect to information alternatives can significantly influence final sales prices, their competing assumptions have not been explicitly modeled or empirically examined. Because moderation hypotheses are relatively complex and, thus, entail a relatively high risk of error in reasoning, testing competing moderation hypotheses may help

Table 2
Information Alternatives to Reputation Profile Found in Previous Studies.

Source	Information Examined	Findings
Bajari and Hortaçsu [3]	Detailed item descriptions and photos of items being auctioned	No empirical test. Describes eBay sellers' effort to post detailed descriptions and photos of items being auctioned
Kauffman and Wood [36]	Photos and textual item description	Photos and description length lead to higher utility for buyers
Vishwanath [69]	Photos, initial price, reserve price icon, and textual item description	Multimedia information (i.e., text, photos, and reserve price icon), initial prices, and photos influence final sales price
Eaton [19]	Photos	Number of stock photos increases final sales price for sellers with negative feedback
Stern and Stafford [63]	Photos and number of bids	Number of stock photos influences number of bids and higher winning bid
Bland et al. [7]	Photo of an actual item versus stock photos, starting bid	The use of photo of an item versus stock photos and starting bid influence final sales prices
Hou [30]	Photos	Number of stock photos positively influenced end price in eBay (China) auctions
Gregg and Walczak [24]	e-image (information quality, presentation, and customer service policies)	e-image positively influences final sales prices
van Heijst et al. [68]	Textual item description	Textual item description influences end price
Gonzalez et al. [23]	Item description in terms of keyword usage	Keywords contained in item descriptions influence end price
Highfill and O'Brien [27]	Photo of an actual item versus stock photos	Photo of an item significantly increases final sales price; however, stock photo has no effect

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