

When reputations go on the line

by

Joshua Gans

13th November, 2004

Perhaps the best feature of eBay is their system for building and maintaining the reputations of both buyers and sellers. Basically, what happens is that, every time you do a transaction, as either a buyer or a seller, the counter-party has an opportunity to rate you. Your feedback can be good, bad, neutral or none at all. It is usually accompanied by a comment. To get good feedback you need to keep to the agreement, deliver goods or pay quickly and, if you are a seller, deal well when there are problems with the product. So when you go to eBay, you can see whether a seller has built up a good reputation; that is, how many ticks, crosses or none at all. This can give you lots of assurance of reliability; something that would be otherwise hard when there is no physical presence.

What is interesting about this system is it is rating *service* and not products themselves. Sell a Sony camera and the product's reputation depends on Sony. But deal well over eBay and that service is rewarded by the system. And it is pretty effective. Sellers who have built up a good reputation by engaging in lots of transactions with all green lights and no red flags are at a real advantage. In competitive markets, buyers will bid more at their auctions. For buyers, a good reputation means less hassles; no reason to use a third party to complete a transaction and trust that a payment will be made. Ultimately the system builds trust in service quality.

To give an example, I recently sold a Sony digital camera on eBay. It was the first time I had done this so I didn't have a reputation. My eventual buyer did have a solid reputation – 18 green lights, no red flags and lots of favourable comments. That assured me but he was concerned about me having no reputation. After all, I could have a bad reputation and simply be changing my identity to hide it. Nonetheless, all went well but my buyer was very anxious and wanted me to give him a good rating. Having built a reputation, a red flag would be very damaging. So not only do good reputations give assurance as to past behaviour they also tell me that the party will have a big incentive to maintain it and not see it damaged.

Given all of this, it is natural to wonder whether a similar system could be built up for many services especially when buyers do not have on-going purchase needs. Need a contractor to repair a roof or build a pavement, look up their reputation and get the assurance you need.

To be sure, there are systems that do this ranging from the informal – word of mouth – to the formal – professional associations that accredit and discipline members. But I suspect these don't have the same power.

As an academic I come from an environment where evaluations occur constantly and publicly. It really keeps you on your toes for every class. In this case, the direct link to my pay isn't there.

Put simply, the same power of reputation developed on eBay as it relates to every transaction does not yet exist in other markets.

To be sure, someone with a good reputation could be exploited by the unscrupulous who might threaten a bad review. Nonetheless, there seems ample scope for organizations – particularly professional associations to provide an eBay like system. Require members to register customers and log customers comments and reviews on a web site for all to see. They could also review the reviewers just in case exploitation of the high reputation providers is going on. This would build trust and, in the end, that will build value too.

Joshua Gans is Professor of Management (Information Economics) at Melbourne Business School, University of Melbourne, and an active researcher on competition and outsourcing issues using the tools of game theory. Details of his work are available at www.economics.com.au.