

SUPERIOR SELLER REPUTATION YIELDS HIGHER PRICES: EVIDENCE FROM ONLINE AUCTIONS

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What is the value of a good reputation to a company? Can a company with a better reputation command a premium price for its products? This paper touches on the concepts of goodwill, brand equity, and price setting to examine the value of reputation. An analysis of 252 online auctions found that, on average, sellers with good reputations received a price premium of 4.8 percent over lower-rated sellers of nearly identical products. These results are important because they quantify the relationship between reputation and price, and underscore the need for companies to build and maintain good reputations.

INTRODUCTION

What is the value of a good reputation to a company? Federal Reserve Board Chairman Alan Greenspan said about modern information-economy firms that their "market value largely rests on capitalized reputation" (Melloan 2002). The precipitous fall of accounting firm Arthur Anderson after the Enron scandal showed how costly a damaged reputation could be for a firm that relies on its credibility. The following discussion touches on the concepts of goodwill, brand equity, and price setting to examine the value of reputation.

Goodwill is an accounting term defined as the "excess of the cost of an acquired company over the sum of the market values of its net assets" (Harrison and Horngren 1998, p. 345). Goodwill is "the value of all favorable attributes" of a business, including "exceptional management, desirable location, good customer relations, skilled employees, high quality products, fair pricing policies, and harmonious relations with labor unions" (Weygandt and Kieso 1995, p. 415).

The value of a company's brands is part of a company's goodwill. Brand equity is "the added

value a given brand name gives to the product beyond the functional benefits provided" (Aaker 1995; Kerin, et al. 2003, p. 306). A brand with a high level of brand awareness and associated positive images or meanings has high brand equity (Shimp 2000). As with a company's goodwill, a financial value is attached to a brand when it is sold. For example, Procter & Gamble sold the Hawaiian Punch brand to Cadbury Schweppes in 1999 for \$203 million, after purchasing it from Del Monte for \$150 million nine years earlier (*Wall Street Journal* 1999, p. B2).

A brand with high awareness and loyalty among consumers enables a company to have lower promotion costs, gives a company bargaining power with its distributors, can be extended to add value to related products, and allows the firm to charge a premium price relative to competitors (Kotler 2001, p. 189). "Consumers are often willing to pay a higher price for a product with brand equity," according to Kerin, et al. (2003, p. 306), who also state "brand equity is represented by the premium a consumer will pay for one brand over another when the functional benefits provided are identical."

Although research has shown that firms which use promotion to differentiate their brands from competitive offerings are less vulnerable to price competition (Boulding, et al. 1994), the role of brand equity in the pricing literature is subordinate to the major determinants of price: cost, demand, strategic concerns relative to competition and production

strategy, and legal constraints (Monroe 1990; Urbany 2000, p. 510).

What is the effect of a firm's reputation on the prices it can charge? Reputation is the "overall quality or character as seen or judged by people in general" or "recognition by other people of some characteristic or ability" (Merriam-Webster 2000). This paper deals with reputation as recognition of the characteristics of a good seller, such as dealing honestly and in good faith, and striving to satisfy a customer. If brand equity is the value a consumer places on a known and preferred product, then reputation is the value that a consumer places on a known and credible seller of a product. This paper is a study of the value of a good reputation to a company, independent of the equity in its brands.

The economics and marketing literature support the idea that a seller with "better" reputation should receive a higher price than another seller, all other things being equal. Klein and contributors (1997) see reputation as a mechanism for rewarding good conduct and punishing misbehavior. Good behavior is rational in a society that remembers and reports it to others via one's reputation. In a marketing context, Weiss, Anderson and MacInnis (1999) explain why a manufacturer would vertically integrate its sales force to control misbehavior and protect its reputation. Basically, reputation theory states that a social entity (person or organization) recognizes the importance of, and actively monitors and manages, its reputation (Bromley 1993).

Auction Feedback as Reputation

Online auctions provide an opportunity to explore the effect of reputation on price. The online auction marketplace is very robust with respect to bidders, sellers, and items available. A bidder can often find multiple offers to sell identical (or nearly identical) products. The equity of branded products accrues equally to all sellers of the products. Offers, bids, and transactions are conducted between faceless bidders and sellers. The standardized auction format gives a seller little opportunity to differentiate his offer in a meaningful way, and hence not much

chance to build "reputation equity" by promotional means. Most often bidders and sellers have no prior trading experience with each other, so the bidder has no preference for a particular seller. The reciprocity effect on trading behavior is small because the parties seldom expect to do business again in the future.

Auctions at the online marketplace eBay will be used in this paper, although other auction sites report reputation data. eBay is the "world's largest online trading community," with 46.1 million registered users in 2002 (eBay 2002a). eBay attracted over 29 million unique visitors in April 2002, putting it practically even with Amazon.com as the most popular shopping site, and the eighth most popular Web property on the Internet, according to Jupiter Media Metrix (2002). eBay brokered more than \$3.1 billion in gross merchandise sales (value of goods traded on the eBay site) in the first quarter of 2002 (Swartz 2002).

The Feedback Profile serves as a proxy for a seller's reputation in this study. According to eBay's Feedback Forum (eBay 2002b), "Every eBay user has a Feedback Profile made up of comments from other eBay users - an official reputation." Both sellers and buyers on eBay have a Feedback Profile. The profile is the sum of positive feedback ratings made by other parties in transactions with the eBay member, less the sum of negative ratings. Each feedback rating has an associated brief written comment. Buyers and sellers are encouraged to communicate and resolve their disputes, and thereby avoid giving or receiving a "permanent" negative feedback rating; hence negative ratings are rare.

Wingfield (2002) stated "feedback is an invaluable index of reputation without a close parallel in the physical world." He compared the eBay feedback system with a world in which "all merchants were required to post a marquee on their front windows with a running tally of their customers' level of satisfaction with the shop. That's essentially what eBay forces its users to do with their online identities."

Table 1 shows the information that appears on the "eBay ID card" for the member named "talitim" (eBay, 2002c). One can see that talitim has been an eBay member since Nov. 15, 1998, has a Feedback Profile of 263, and has received 20 positive feedback items in the past six months. Associated with these feedback data are the actual comments. One, by a seller named "lazysummer," reads: "Praise: Excellent Ebayer!! Fast Payment!!! Thank You!!! AAA+++" Another, by a buyer named "mom2jacob," reads "Complaint: Took a long time to ship item. I waited over three weeks after I sent payment," to which talitim wrote: "Response: My bad. My wife had our first baby and I got very distracted from eBay. Sorry." The two complaints are subtracted from 265 praises to yield a net Feedback Profile of 263. Based on this Feedback Profile, talitim has earned a "Turquoise Star," the third level of eBay's seller categories (explained later in this paper). One can view the feedback that talitim gave to other members. Also, one can link to "Bid retractions" when online to see if talitim has abused this bidder privilege.

The feedback system has shortcomings. The overall Feedback Profile does not differentiate between feedback ratings that a member received in the seller's role from feedback received as a buyer. This has led to abuse by unscrupulous members. A member can win auctions for several inexpensive goods, and thereby build up a positive Feedback Profile as a buyer. The member can then offer goods for sale at auction to bidders as a "reputable" eBay member, when in fact the seller's Feedback Profile reflects no successful sales. The seller can collect many auction payments without delivering the goods before being stopped (Herschlag and Zwick 2000).

Complaints about Internet auction sites comprised 43 percent of the 50,000 online fraud complaints that the Internet Fraud Complaint Center received in 2001. EBay claimed that .01 percent of listed auctions result in confirmed cases of fraud (eBay listed 422 million items for sale in 2001 (Swartz 2002)). EBay has taken steps to minimize fraud, such as changing the feedback comment format to include a "B" or "S" to signify if each comment refers to the member as a buyer or seller, requiring sellers to register with a

credit card, offering escrow services, and taking legal action against fraudulent sellers.

Despite its shortcomings, the feedback system has benefits as an indicator of reputation. A buyer or seller can read the comments to see what is behind a Feedback Profile, such as whether the comments are from buyers or sellers, and the reasons for negative ratings. A member can even contact the recipient or author of a comment by email to get "the rest of the story." The feedback system offers a benefit to researchers in quantifying the reputation of the seller (and buyer) at the time an auction was successfully concluded. One can see the Feedback Profiles of the parties, the final price, the description of the item and terms of sale, photos, pattern of bids, etc. for 30 days after an auction closes. This paper used these data to investigate the relationship between seller Feedback Profiles and final price.

The following hypotheses were tested in this research. Hypothesis One: A seller with a good reputation will receive a higher price than will a lower-reputation seller of an identical product. In other words, if two sellers offer identical products in online auctions, the seller with the higher Feedback Profile will receive a higher price. This hypothesis is based on the discussion of brand equity and reputation. If consumers find value in dealing with a reputable seller, then they should be willing to pay a premium for the superior reputation.

Hypothesis Two: The price premium will increase with greater differences in reputation between the sellers. In other words, increases in the magnitude of the difference in reputation between sellers will yield increasing price premiums to the higher rated seller. This is a stronger test of the relationship between reputation and price. If a somewhat superior seller reputation is worth a higher price to a buyer, then a vastly superior reputation should be worth a commensurately higher price premium

METHODOLOGY

The goal of the data gathering process was to find two completed auctions that were similar to each

Table 1
eBay Feedback Profile for talltim

eBay ID card		Talltim (263)*	
Member since: Sunday, Nov 15, 1998			
Location: United States			
Summary of Most Recent Comments			
	Past 7 days	Past month	Past 6 mo.
Positive	0	0	20
Neutral	0	0	0
Negative	0	0	0
Total	0	0	20
Bid Retractions	0	0	0

* Turquoise Star Feedback Category

other, but from different sellers. Each pair of auctions was obtained by following this protocol: (1) launch an Internet browser on a computer and point it to eBay.com; (2) choose an item for which to search-- "anything of interest for which it would be easy to find two very similar ones that have recently sold" such as a music CD, a book, a video game, a DVD or VHS video, a toy, a calculator, etc.; (3) search for the item by keyword in the completed auctions database; (4) choose a successfully completed auction; (5) find a second completed auction that is "nearly identical"; and (6) print out the results of both auctions. Auctions were avoided (1) for items with dissimilar descriptions, such as different conditions or specifications; (2) that were a duplicate by the same seller; and (3) that were not completed, such as those with no bids or where the reserve price was not met.

The seller Feedback Profiles, winning bids, shipping costs, and the presence of photos of the goods were recorded for each auction pair. For pairs in which both auctions had shipping costs, the final price plus shipping was used. For pairs in which only one auction had shipping cost, this cost was deleted and only the winning bid amounts were used. The author evaluated the auctions and removed any pairs in which the items were different or the descriptions of condition varied greatly between the two auctions. No adjustments for the quality of the design of the auction presentation or for the auction terms were

made. All auctions had been completed (e.g., resulted in a sale) within a 30-day time period.

RESULTS

The data consisted of prices and seller Feedback Profiles from 126 matched auction pairs (or 252 auctions). The mean values of prices paid to Seller A and Seller B were approximately \$32.00. This reflects the fact that most of the auctions were for "small-ticket" items. About 82 percent of the auction pairs were for movies (in DVD and VHS format) and recorded music (in CD format). It was relatively easy to identify branded, "nearly identical" pairs of authentic products with identical artists, publishers, and editions. The remaining 18 percent of the auctions pairs were for a variety of branded items, including video games, board games, toys, etc. The prices ranged from \$0.55 to about \$600.00 for the recently introduced Sony PlayStation 2 game console.

The auction pairs were ordered such that Auction A was offered by higher-rated Seller A, and lower-rated Seller B conducted Auction B. To compare price differences, the price in Auction B was subtracted from the price in Auction A. The values of the Price Difference (Pricedif) ranged from negative \$13.45 to positive \$15.00. Negative Price Differences reflect cases in which the buyer in the lower-rated seller's auction paid more than the buyer of the higher-rated seller's auction. This occurred in 45 percent of the

cases. Clearly factors other than the Reputation Difference between sellers determined the prices. Other factors that may have influenced prices will be discussed later. The mean value of the price premium of Auction A over Auction B (Pricep) was \$0.19. While this is a small absolute amount, it does support Hypothesis One: that a higher-rated seller should receive a higher price than a lower-rated seller, all other things being equal.

The higher-rated sellers (Seller A) had Feedback Profiles that ranged from 5 to 3875. The Seller B profiles ranged from 0 to 3528. To compare differences in reputation, the Feedback Profile of Seller B was subtracted from the Feedback Profile of higher-rated Seller A. The values of "Reputation Difference" (Repdif) ranged from 0 to 3528. The mean Reputation Difference was about 645 feedback "points." The mean of Repdif was at about the 69th percentile, which shows that the mean was skewed higher by a few cases with very large Reputation Differences.

These continuous data on Price Difference and Reputation Difference were used to examine the relationship between reputation and price. The Pearson correlation for the full data set was not statistically significant ($p=.068$; significance(2-tailed)=.45; $n=126$). The following is a discussion of the factors that may have detracted from finding a correlation.

The ideal case would consist of two auctions that were identical in all ways except the Feedback Profiles of the sellers. This is difficult to obtain. First, the buyers were two different people. There could be a myriad of individual differences between the buyers that could have influenced the prices they were willing to pay. Although the auctions in each pair had been completed within a 30-day window, the buyers may not have seen both auctions and hence may not have made the tradeoffs between reputation and price. The buyers may have experienced unique bidding patterns, levels of rivalry, timing of the auction end, etc.

Second, the auctions were only "nearly identical." Although the products may have been very similar, the auctions may have differed in their graphic design, item description, use of photos, terms such as payment and shipping, etc. Finally, the Feedback Profile may not fully describe the seller's reputation. The Feedback Profile captures the net number of positive feedback comments. A bidder can also view the number of negative ratings in the profile, as well as read the nature of praises and complaints. It is not likely that a bidder would evaluate a seller with 120 positive and 20 negative feedback items the same as a seller with 100 positive and zero negative items, although the Feedback Profiles of each would be 100.

The results of analysis on subsets of the data follow. A scatter plot of the data showed a great degree of variation in Pricedif at low levels of Repdif. A data subset was created by selecting cases where Repdif was less than 100. The Pearson correlation of this subset revealed a negative correlation between Price Difference and Reputation Difference ($p=-.25$; significance(2-tailed)=.10; $n=43$). This result is counterintuitive and fails to support the hypotheses that price and reputation have a positive relationship. One possible explanation is that small differences in reputation between the sellers have little influence on bidders, and other uncontrolled factors account for variance in price.

Do bidders recognize a small difference in reputation? Does a bidder recognize, and pay more, if a seller has a five-point advantage in Feedback Profile? Are five additional points to a seller "worth more" to a bidder if the seller has a Feedback Profile of 10, as compared to adding five points to a seller profile of 100? Weber's law suggests "individuals typically do not notice relative small differences between brands or changes in brand attributes" (Miller 1962; Hawkins, Best and Coney 2001, p. 302). This could be applied to auctions to suggest that bidders do not notice small differences between the reputations of sellers. Weber's law is used to calculate the "just noticeable difference" in an attribute of a seller, which is the minimum amount that one seller can differ from another and have the difference be noticed by bidders. The just noticeable difference is based on the initial

level of reputation and the change in reputation. In other words, the difference in reputation must be "big enough" relative to the reputation profiles to be noticed.

The cases with low levels of Reputation Difference were removed from the data set. An analysis of the subset of the remaining cases (with $\text{Repdif} > 100$) revealed a positive and statistically significant correlation between the reputation and price difference variables ($p = .30$; significance(2-tailed) = .01; $n = 73$). This finding supports Hypothesis Two by showing that price premium increases with increasing differences in reputation.

A regression analysis of these data yielded Equation 1:

$$\text{Pricedif} = (.002) * \text{Repdif} - 1.19 \quad (1)$$

The regression coefficient for Reputation Difference is positive and significant at the .01 level, which supports its hypothesized effect on Price Difference. However, the R-squared measure of .09 shows that the power of the model at predicting Pricedif is low. This model finds that the value of reputation for a seller is one cent for each additional five feedback items, as shown in Equation 2:

$$$.01 = $.002 * (5 feedbacks) \quad (2)$$

For this subset of cases, the regression analysis results support Hypothesis Two: an increasing price premium with increasing differences in sellers' reputations. This subset excluded cases with relatively small differences in reputation, as previously explained.

The continuous Feedback Profile of eBay's buyers and sellers are classified into discrete categories by eBay's "star" recognition system, shown in Table 2. Ebay awards "stars" for achieving a particular Feedback Profile according to the "Star Chart." A "Yellow Star" represents a Feedback Profile of 10 to 99; a "Turquoise Star" is 100 to 499; and so on with the highest category "Red Shooting Star" representing a Feedback Profile of 100,000 or higher (eBay,

2001d). A seller is "promoted" to a higher reputation category as his or her Feedback Profile crosses a threshold.

Using categories of reputation reflects the idea that bidders may not recognize small changes in Feedback Profile, and that the effect of reputation on price is discrete rather than continuous. Does a difference in star category between sellers influence the price that buyers are willing to pay? Hypothesis One would predict that Seller A would receive a higher price than Seller B (in a lower star category), other things being equal. Hypothesis Two would predict that the greater the number of category differences between sellers, the greater the price premium to the seller with superior reputation.

An analysis was performed on the discrete star categories of reputation data. A "Seller Feedback Advantage" (Sellfba) variable was defined as the number of star categories difference between Seller A and Seller B. For example, a Seller A with a Feedback Profile of 600 is in the third category (Purple Star). A Seller B with a Feedback Profile of 400 would be in the second category (Turquoise Star). Therefore Seller A would have a Seller Feedback Advantage of one over Seller B (Sellfba = 1). Again, the auctions are ordered within the pair such that Seller A has a greater Feedback Profile than Seller B; hence the Seller Feedback Advantage is greater than or equal to zero.

A Price Premium (Pricep) variable was created to reflect the percentage difference in prices paid between the auctions. Price Premium was defined as the price paid in Auction A minus the price paid in Auction B, divided by the price in Auction B. This variable reflects the fact that a \$1 price difference is proportionately greater if the Auction B price is \$10 (Pricep = 10 percent) than if the price is \$100 (Pricep = 1 percent). Table 3 shows the data from a sample pair of auctions for the CD soundtrack to "Dumb and Dumber." Seller A (1249 Feedback Profile) has a Seller Feedback Advantage (Sellfba) of 2 over Seller B (135 Feedback Profile). Seller A enjoys an 88 percent price premium over Seller B's

Table 2
eBay Reputation Categories

The Star Chart Stars are awarded for achieving a particular Feedback Profile
A Yellow Star represents a Feedback Profile of 10 to 99. A Turquoise Star represents a Feedback Profile of 100 to 499. A Purple Star represents a Feedback Profile of 500 to 999. A Red Star represents a Feedback Profile of 1,000 to 4,999. A Green Star represents a Feedback Profile of 5,000 to 9,999. A Yellow Shooting Star represents a Profile of 10,000 to 24,999. A Turquoise Shooting Star represents a Profile of 25,000 to 49,999. A Purple Shooting Star represents a Profile of 50,000 to 99,999. A Red Shooting Star represents a Profile of 100,000 or higher.

Table 3
Data From Sample Pair of Auctions

Seller	Feedback	Sellfba	Bid + Ship	Pricep
A	1249	2	\$8.00	88%
B	135		\$4.25	

auction for the “nearly identical” item (\$8.00 versus \$4.25, including shipping).

The mean Price Premium is positive for auction pairs with all five values of Seller Feedback Advantage (see Table 4). The mean values of Price Premium range from a high of a 27.1 percent for auction pairs in which Seller A had a four-category advantage over the Seller B (Sellfba=4), to a low of a 2.1 percent for auction pairs with a one-category difference in reputation (Sellfba=1). Note that this holds true even when Sellfba=0, which reflects cases in which the Feedback Profiles of the sellers are within the same star category. On average, Seller A received a 4.8 percent higher price than a Seller B. This supports Hypothesis One: Seller A would receive a higher price than Seller B (in a lower star category), other things being equal.

Hypothesis Two would predict that the mean Price Premium would increase with increased Seller Feedback Advantage. This was not the case, as there is no apparent pattern to the relationship between

Price Premium percentages and Seller Feedback Advantage categories. Standard deviations of Price Premium are given, but since no random sampling model was used to collect the data, no “significance” tests were done on the means. The variation in Price Premium within Sellfba categories may reflect the impact of other variables not measured (such as auction timing, number of bidders, design of the auction page, etc.) as well as error.

In summary, the hypothesis that a seller with a good reputation would receive a higher price than a lower-reputation seller of an identical product (Hypothesis One) was supported by the data. An analysis of the data in continuous form found that sellers with superior reputations received a \$0.19 price difference, on average. Placing reputation data into categories revealed that sellers in all reputation advantage categories received a Price Premium in percentage terms. On average, higher-rated sellers received a 4.8 percent Price Premium.

Table 4
Means of Price Premium by Seller Feedback Advantage

Sellfba	0	1	2	3	4	All
Pricep: Mean	7.6%	2.1%	2.2%	9.2%	27.1%	4.8%
Std dev	29.7	21.6	26.8	28.8	37.1	26.1
No. Cases	34	50	28	11	3	126

The hypothesis that the price premium will increase with greater differences in reputation between the sellers (Hypothesis Two) was partially supported. A regression analysis of cases with relatively high (greater than 100 ratings) differences in reputation found a positive relationship between the difference in sellers' reputations and the difference in prices paid by the buyers. The model suggests that an additional five feedback ratings are worth a penny.

CONCLUSION

This research investigated the effect of seller reputation on price by analyzing pairs of auctions of "nearly identical" products. This research was limited by sample size that was relatively small and not selected according to a random model. Additional variables that could have affected prices, such as buyer Feedback Profile (in addition to the seller Profile), the timing of the end of the auction, length of the auction, pattern of bidding, visual design of the auction page, etc. were not considered.

Despite these limitations, the data of this sample show that sellers with higher Feedback Profiles received an average 4.8 percent Price Premium over other sellers. Sellers whose Feedback Profile placed them in a higher category over another seller received premiums of 2.1 percent to 27.1 percent, although greater category advantages did not yield commensurately higher Price Premiums. These findings are generally consistent with other research on determinants of price in online auctions. Lucking-Reiley, et al. (2001) estimated a regression model of 461 auctions of Indian head pennies, and found a positive relationship between seller Feedback Profile and price.

Online auctions are a combination of auction types. An eBay auction begins as an English auction (in which bidders raise the price in increments), but because it has a fixed end time it essentially switches to a sealed bid in the last few seconds of the auction. An eBay auction that "fails" (to reach a reserve price, for instance) can be re-listed, so in this case the auction is a series of iterative auctions. A bidder may also have the opportunity to "buy it now" for a fixed price and end the auction before bidding begins. These features make difficult the use of auction theory to predict or explain online auction behavior (Whinston 2001). Changes by eBay have further muddled the clarity of their auction format, such as the Buy It Now fixed price option to end an auction, the acquisition and integration of the Half.com fixed price format, and the introduction of other new fixed price techniques.

Future research should investigate how bidders use feedback data. The author's experience suggests some phenomena to explore. First, bidders may find more information in lower levels of feedback; jumps from 0 to 10 to 100 Feedback Profiles may be more meaningful than increases after a threshold level, e.g., 1000. Second, any seller with more than a few negative ratings is highly suspect, unless the seller has a Feedback Profile in the thousands. Negative feedback ratings are rare; consequently negative comments are read and considered by potential bidders. Taken together, these observations suggest that a seller may enjoy no additional price premium if the Feedback Profile rises above a threshold level and contains few or no negative rating "red flags." Finally, what is the effect of the bidder's Feedback Profile? Is a bidder with a high Feedback Profile

unimpressed by high profiles of sellers, or the opposite?

Internet auctions are a unique real-world laboratory of buyer and seller interactions. The quantifiable and publicly available nature of auction data provides an opportunity for researchers to investigate online transactions. This research shows that the benefits of a seller's good reputation are quantifiable. Further insights into online auction behavior may shed light onto the role of reputation in buyer and seller behavior more generally.

The findings of this research may give managers solace in that they should expect a return on their reputation-building investments. Companies generally do not have a quantifiable reputation in the form of a Feedback Profile attached to their names. But companies can promote surrogates for reputation, such as testimonials, membership in trade associations and the Better Business Bureau, and independent surveys of the performance of customer-facing operations and customer satisfaction. Reputation may be especially important for resellers who may find that the equity of their branded products may benefit themselves and rivals alike. The reputation of the company may embody the factors that differentiate a reseller from its rival, and enable a company to enjoy a price premium in an otherwise competitive marketplace.

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