The Signal Effect of Buy-now Price in Internet Auctions

Abstract

In online auctions such as eBay, auctioneers frequently use buy-now prices. A buy-now price is a fixed price offer by the seller, which when met instantly ends an auction and sells the item to the bidder at the fixed price. Buy-now prices allow a bidder to purchase an item immediately without having to wait until the completion of the auction. Previous research on buy-now prices has examined its usage as a device to offer insurance to risk-averse bidders, or to segment bidders with different waiting costs. However, those studies do not provide an explanation for the difference in the usage rate of buy-now prices by both auctioneers and bidders across product categories. Nor do they provide an explanation for the asymmetric usage between auctioneers and bidders in certain product categories.

In this paper, we propose a conceptual model of the usage of buy-now prices by bidders and sellers in auctions. According to the model, auctioneers and bidders have different incentives to use buy-now prices, which are category-specific. Our model explains why, for some product categories, most auctioneers continue to set buy-now prices, even though few bidders utilize this option. We argue that when it is difficult for bidders to assess the value of an item, a buy-now price, if perceived credible, can be used by bidders as an external reference price to form values prior to bidding. Therefore, auctioneers can use a buy-now price to signal the value of an item, even though bidders may not utilize this option. We derive an analytical model to demonstrate auctioneer’s rationale to use buy-now prices as signals. Moreover, we test the existence of signal effect of the buy-now price in two empirical studies. Both studies provide strong support for our signal hypothesis.