

Comparison Sites*

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Abstract

Web search technologies are fundamental tools to easily navigate through the huge amount of information available in the Internet. One particular type of search technologies are the so-called *shopbots*, or *comparison sites*. The emergence of Internet shopbots and their implications for price competition and market efficiency are the focus of this chapter. We develop a simple model where a price comparison site tries to attract (possibly vertically and horizontally differentiated) online retailers on the one hand, and consumers on the other hand. The analysis of the model reveals that differentiation among the products of the retailers as well as their ability to price discriminate between on- and off-comparison-site consumers play a critical role. When products are homogeneous, if online retailers cannot charge different on- and off-the-comparison-site prices, then the comparison site has incentives to charge fees so high that some firms are excluded, which generates price dispersion and an inefficient outcome. By contrast, when on- and off-comparison-site prices can be different, the comparison site attracts all the players to the platform and the allocation is efficient. A similar result obtains when products are horizontally differentiated. In that case, the comparison site becomes an aggregator of product information and no matter whether firms can price discriminate or not, the comparison site attracts all the players to the platform and an efficient outcome ensues. We argue that the lack of vertical product differentiation may also be critical for this efficiency result. In fact, we show that when quality differences are large, the comparison site may find it profitable to charge fees such that low quality producers are excluded, thereby inducing an inefficient outcome.

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1 Introduction

Not so long ago individuals used atlases, books, magazines, newspapers, and encyclopedias to find content. To locate businesses and their products, it was customary to use yellow pages, directories, newspapers, and advertisements, while family and friends were also a relevant source of information. Nowadays things are quite different: many individuals interested in content, a good or a service usually conduct a first search on the Internet.

Through the Internet individuals can easily access an immense amount of information. Handling such a vast amount of information has become a complex task. Internet browsers constitute a first tool to ease the navigation experience. Thanks to the browsers, users move easily across documents and reach a large amount of information in just a few mouse-clicks. Search technologies are a second tool to facilitate the browsing experience. They are fundamental to navigate the Internet because they help users locate and aggregate content closely related to what they are interested in.

Search engines like Google, Yahoo, Bing, etc. constitute one type of search technologies. These search tools are often offered at no cost for users and the placing of advertisements constitutes the most important way through which these search engines are financed. By taking advantage of the keywords the user provides while searching for information, search engines can pick and deliver targeted advertisements to the most interested audience. In this way, search engines become a relatively precise channel through which producers and retailers can reach consumers. This raises the search engines' value and so their scope to extract rents from producers or retailers. The study of the business model of search engines constitutes a fascinating research area in economics (see e.g. Chen and He, 2006; Athey and Ellison, 2008; Spiegler and Eliaz, 2010; and Gomes, 2011).

Comparison sites, or shopping robots (shopbots) like PriceGrabber.com, Shopper.com, Google Product Search, and Bing Shopping, are a second type of search technologies. These sites help users find goods or services that are sold online. For multiple online vendors, shopbots provide a significant amount of information including the products they sell, the prices they charge, indicators about the quality of their services, their delivery costs as well as their payment methods. By using shopbots, consumers can easily compare a large number of alternatives available in the market and ultimately choose the most satisfactory one. Because they collate information from various offers relatively quickly, shopbots reduce consumer search costs considerably. Business models vary across comparison sites. Most shopbots do not charge consumers for access to their sites and therefore the bulk of their profits is obtained via commercial relationships with the shops they list. They get paid via subscription fees, click-through fees, or commission fees. Some comparison sites list

sellers at no cost and get their revenue from sponsored links or sponsored ads. Finally, some charge consumers to obtain access to its information, while firms do not pay any fees.

The emergence of Internet shopbots in the marketplace raises questions not only about the competitiveness and efficiency of product markets but also about the most profitable business model. Do all types of firms have incentives to be listed in comparison sites? Why are the prices listed in these sites dispersed, even if the advertised products are seemingly homogeneous? Do comparison sites enhance social welfare? How much should each side of the market pay for the services offered by comparison sites? Addressing these questions will be the main focus of this chapter. We will do this within a framework where a comparison site designs its fee structure to attract (possibly vertically and horizontally differentiated) online retailers on the one hand, and consumers on the other hand. While analyzing our model, we will describe the received wisdom in some detail.

The study of search engines other than comparison sites raises alternative interesting economic questions. The economics of search engines is described in Anderson (2011) in this volume, in his chapter entitled “Advertising and the Internet.” Of particular importance is the management of sponsored search advertisements. This is because search engines cannot limit themselves to just deliver consumer access to the advertiser placing the highest bid. They must carefully manage the quality of the ads for otherwise they can lose the ability to obtain surplus from advertisers.

The rest of this chapter is organized as follows. In Section 2, we describe the way comparison sites operate, as well as their main economic roles. We also summarize the main results obtained in the small existing theoretical literature in economics, and discuss empirical research on the topic. In Section 3, we present a model of a comparison site. The model is then applied to comparison sites dealing with homogeneous products. Later we discuss the role of product differentiation, both horizontal and vertical. Price discrimination across channels is also an important issue so we dedicate some time to explain its role. The chapter concludes with a summary of theoretical and empirical considerations and puts forward some ideas for further research.

2 Comparison sites

Comparison sites or shopbots are electronic intermediaries that assist buyers when they search for product and price information in the Internet. Shopbots have been operating on the Internet since the late 1990s. Compared to other more traditional intermediary institutions, most shopbots do not sell items themselves—instead they gather and aggregate price, product, and other relevant

information from third-party sellers and present it to the consumers in an accessible way. By doing this, consumers can easily compare offers. Shopbots also display links to the vendors' websites. These links allow a buyer to quickly navigate to the site of the seller that offers her the best deal.

Shopbots operate according to several different business models. The most common is that users can access the comparison site for free, while sellers have to pay a fee. Initially, most comparison sites charged firms a flat fee for the right to be listed. More recently, this fee usually takes the form of a cost-per-click and is paid every time a consumer is referred to the seller's website from the comparison site. Most traditional shopbots, like for instance PriceGrabber.com, and Shopping.com operate in this way. Fees typically depend on product category—current rates at PriceGrabber range from \$0.25 per click for clothing to \$1.05 per click for plasma televisions. Alternatively, the fee can be based on the execution of a transaction. This is the case of Pricefight.com, which operates according to a cost-per-acquisition model. This model implies that sellers only pay a fee if a consumer buys the product. Other fees may exist for additional services. For example, sellers are often given the possibility to obtain priority positioning in the list after paying an extra fee.

A second business model consists of offering product and price comparison services for free to both sellers and buyers and relies on advertising as a source of revenue. Both Google Product Search and Microsoft's Bing Shopping are examples of comparison sites that have adopted this type of business model. Any seller can list products in these websites by uploading and maintaining a product data feed containing information about the product price, availability, shipping costs, etc.

A third, although less common model is to have consumers pay a membership fee to access the comparison site, while sellers are listed for free. AngiesList.com for instance aggregates consumer reviews about local service companies, which can be accessed by consumers for an annual membership fee between \$10 and \$50, depending on where the consumer lives.

Early intermediation literature

Shopbots are platforms through which buyers and sellers can establish contact with one another. In this sense, comparison sites essentially play an intermediation role. As a result, we are first led to the literature on intermediation, which has been a topic of interest in economics in general, and in finance in particular. Spulber (1999), in his study of the economic role and relevance of intermediaries, describes various value-adding roles played by intermediaries. The following aspects are prominent: buyer and seller aggregation, lowering of search and matching costs, and facilitation of pricing and clearing services.

In a market where buyers and sellers meet and negotiate over the terms of trade, a number of

business risks and costs exist. Reducing such risks and costs is a key role played by intermediaries. In terms of forgone welfare opportunities, not finding a suitable counter-party is in itself the most costly hazard trading partners face; sometimes a trading partner is found at a cost but either rationing occurs, or the failure to reach a satisfactory agreement takes place, in which case similar welfare losses are realized. In all these situations, an intermediary can enter the market and reduce the inefficiencies. By announcing prices publicly, and by committing to serve orders immediately, intermediaries reduce significantly the costs of transacting.

Intermediaries “make the market” by choosing input and output prices to maximize their profits. Market makers trade on their own account and so they are ready to buy and sell in the market in which they operate. Provision of *immediacy*, which is a key aspect emphasized in the seminal articles of Demsetz (1968) and Rubinstein and Wolinsky (1987), distinguishes market makers from other intermediating agents in the value chain. An example of a market maker is a supermarket chain with sufficient upstream bargaining power so as to have an influence on bid and ask prices. In finance, perhaps the most common examples of market-makers are stock exchange specialists (such as commercial banks, investment financial institutions, brokers, etc.). Market makers are also the subject of study in Gehrig (1993), Yavas (1996), Stahl (1988), and Spulber (1999). Watanabe (2010) extends the analysis by making the intermediation institution endogenous. Rust and Hall (2003) distinguish between market-makers that post take-it-or-leave-it prices and middlemen who operate in the over-the-counter market at prices that can be negotiated. They study the conditions under which brokers and market-makers can coexist, and study the welfare properties of intermediated equilibria.

Price comparison sites are similar to traditional intermediaries in that they “facilitate” trade between online shoppers and retailers. However, what distinguishes a comparison site from a traditional intermediary is that the latter typically buys goods or services from upstream producers or sellers and re-sell them to consumers. Shopbots do not trade goods, but add value by aggregating information. In that sense, shopbots are more similar to employment agencies and realtors, who also serve the purpose of establishing a bridge between the supply and the demand side of the market.

How can a price comparison site enter the market and survive in the long run? Do comparison sites increase the competitiveness of product markets? Do they enhance market efficiency? This chapter will revolve around these three questions. Whether a comparison site can stay in business in the long run is not, a priori, clear. The problem is that, given that retailers and consumers can encounter each other outside the platform and conduct transactions, the *search* market constitutes

a feasible outside option for the agents. In fact, a comparison site can only stay in business if it chooses its intermediation fees carefully enough to out-compete the search market, or at least to make intermediated search as attractive as the search market. The question is then whether a comparison site can indeed create value for retailers and consumers.

The first paper studying these questions is Yavas (1994). Yavas studies the match-making role of a monopolistic intermediary in a competitive environment. He shows that the intermediary can obtain a profit by attracting high valuation sellers and low valuation buyers; the rest of the agents trade in the decentralized market. Interestingly, relative to the market without intermediary, buyers and sellers lower their search intensity, which can ultimately decrease matching rates and cause a social welfare loss. Though Yavas' analysis is compelling, most markets are populated by firms that hold a significant amount of market power. Since market power drives a wedge between the market outcome and the social optimum, it cannot be ignored when modelling the interaction between comparison sites, retailers, and consumers in real-world markets. Our work specially adds in this direction.

Our model and results, and their relation to the literature

Our model, whose details are in Section 3, aims at understanding how comparison sites can overcome “local” market power and emerge in the marketplace. In addition, we study whether comparison sites enhance social welfare. “Local” market power can stem from geographical considerations, from loyalty, or from behavioral-type of assumptions such as random-shopping or default-bias (Spiegler, 2011).

Our model is inspired from Baye and Morgan's (2001) seminal paper. Baye and Morgan had geographical considerations in mind when they developed their model so in their case “local” market power arises from geographical market segmentation. From a general point of view, however, the particular source of “local” market power is not very important. We will assume buyers opting out of the comparison site will buy at random, and therefore this will be the main source of “local” market power. In essence, the model we study is as follows. Suppose that in a market initially characterized by some sort of segmentation, a price comparison site is opened up. Suppose that the comparison site initially succeeds at attracting some of the buyers from the various consumer segments. A comparison site this creates value for firms since a firm that advertises its product on the comparison site can access consumers “located” in other segmented markets. This is reinforcing in that consumers, by registering with the shopbot, can observe a number of product offerings from the advertising firms in addition to the usual one. We study the extent to which the market becomes

centralized. We also compare the levels of welfare attained with and without a comparison site. It turns out that product differentiation, both vertical and horizontal, as well as the possibility to price discriminate between the centralized and the decentralized marketplaces play an important role. We describe next the results we obtain and how they connect with earlier work.

We first study the case where retailers sell homogeneous products. This is the case examined in Baye and Morgan (2001). We show that a crucial issue is whether online retailers can practice price discrimination across marketplaces or not. If price discrimination is not possible, as in Baye and Morgan, then the platform's manager has an incentive to raise firms' participation fees above zero so as to induce less than complete participation of the retailers. This results in an equilibrium with price dispersion, which enhances the gains users obtain from registering with the shopbot. Although establishing a price comparison site is welfare improving, the equilibrium is not efficient because prices are above marginal costs and the comparison site only attracts a share of the transactions.

We show that the market outcome is quite different when retailers can price discriminate across marketplaces, that is, when they are allowed to advertise on the price comparison site a price different from the one they charge in their websites. In that case, the utility consumers derive from buying randomly, which is the outside option of consumers, is significantly reduced and the price comparison site can choose its tariffs such that both consumers and firms fully participate, while still extracting all rents from the market. This means that with price discrimination the market allocation is efficient and all trade is centralized.

We then move to study the case in which retailers sell horizontally differentiated products. This case was examined by Galeotti and Moraga-González (2009). We employ here the random utility framework that gives rise to logit demands. In such a model, we show that the price comparison site can choose fees that fully internalize the network externalities present in the market. These fees attract all firms to the platform, which maximizes the quality of the matches consumers obtain and thereby the overall economic rents. The market allocation is not fully efficient because product sellers have market power. However, the monopolist intermediary does not introduce distortions over and above those arising from the market power of the differentiated product sellers. The fact that the comparison site attracts all retailers and buyers to the platform does not depend on whether the retailers can price discriminate across marketplaces or not. This result stems from the aggregation role played by the (product and price) comparison site. By luring firms into the platform not only price competition is fostered so consumers benefit from lower prices but also more choice is offered to consumers. Since the comparison site becomes an aggregator of variety, the comparison site becomes a marketplace more attractive for the buyers than the search market.

In our last model, we allow for vertical product differentiation in addition to horizontal product differentiation. The main result we obtain is that the nature of the pricing policy of the comparison site can change significantly, and produce an inefficient outcome. Note that when quality differences across retailers are absent, the comparison site obtains the bulk of its profits from the buyers. By lowering the fees charged to the firms, more value is created at the platform for consumers and this value is in turn extracted by the comparison site via consumer fees. We show that when quality differences are large, the comparison site may find it profitable to do otherwise by charging firm fees sufficiently high so as to prevent low quality producers from participating in the comparison site. This raises the rents of the high quality sellers, and at the same time creates value for consumers. These rents are in turn extracted by the comparison site via firm and consumer participation fees. In this equilibrium, the intermediary produces a market allocation that is inefficient.

Empirical literature

Empirical studies centered around shopbots have focused on distinct issues. A number of these studies look at whether predictions derived from the theoretical comparison site models are in line with the data. Using micro data on individual insurance policies, Brown and Goolsbee (2002) provide empirical evidence that increased usage of comparison sites significantly reduced the price of term life insurance in the 1990s, while prices did not fall with increased Internet usage in the period before these comparison sites began. Brynjolfsson and Smith (2001) use click-through data to analyze behavior of consumers searching for books on Dealtime.com. They find that shopbot consumers put substantial brand value on the biggest three retailers (Amazon, Barnes and Noble, and Borders), which suggests it is indeed important to model product differentiation. Baye, Morgan and Scholten (2004) analyze more than four million price observations from Shopper.com and find that price dispersion is quite persistent in spite of the increased usage of comparison sites. Baye, Gatti, Kattuman, and Morgan (2006) look at how the introduction of the Euro affected prices and price dispersion using data from Kelkoo, a large comparison site in the European Union. They find price patterns broadly consistent with predictions from comparison site models.

More recently, Moraga-González and Wildenbeest (2008) estimate a model of search using price data for memory chips obtained from the comparison site MySimon.com. Their estimates can be interpreted so as to suggest that consumer participation rates are relatively low –between 4% and 13% of the consumers use the search engine. They find significant price dispersion. An, Baye, Hu, Morgan, and Shum (2010) structurally estimate a model of a comparison site using British data from Kelkoo and use the estimates to simulate the competitive effects of horizontal mergers.

Finally, some papers use data from comparison sites to estimate demand models. Ellison and Ellison (2009) study competition between sellers in a market in which the comparison site Price-watch.com played a dominant role and, using sales data for one of the retailers, find that demand is tremendously price sensitive for the lowest quality memory modules. In addition Ellison and Ellison find evidence that sellers are using obfuscation strategies, with less elastic demand for higher quality items as a result. Koulayev (2010) estimates demand and search costs in a discrete choice product differentiation model using click-through data for hotel searches on Kayak.com, and finds that search frictions have a significant impact on demand elasticity estimates.

3 A model of a comparison site

We study a model of a comparison site where subscribing consumers can compare the prices charged by the different advertising retailers and the characteristics of their products. A comparison site has therefore the features of a *two-sided market*. Two-sided markets are characterized by the existence of two groups of agents which derive gains from conducting transactions with one another, and the existence of intermediaries that facilitate these transactions. Exhibitions, employment agencies, videogame platforms, Internet portals, dating agencies, magazines, newspapers and journals are other examples of two-sided markets (see Armstrong, 2006; Caillaud and Jullien, 2003; Evans, 2003; and Rochet and Tirole, 2003).¹

In our model the comparison site is controlled by a monopolist. One group of users consists of firms selling products and the other group of users is made of consumers. From the point of view of a firm, participating in the comparison site is a way to exhibit its product and post its price to a potentially larger audience. An individual firm that does not advertise on the comparison site limits itself to selling to those customers who remain outside the platform. Likewise, for a consumer, visiting the platform is a way to learn the characteristics and the prices of all the products of the participating firms. A consumer who does not register with the comparison site can only trade outside the platform. We will assume consumers who opt out of the platform randomly visit a firm.²

The monopoly platform sets participation fees for consumers and firms to attract business to the platform. Traditionally, comparison sites have used fixed advertising fees, or flat fees, paid by

¹Weyl (2010) presents a general model. The literature on two-sided markets has typically focused on situations where network effects are mainly *across* sides. As we will see later, for profit-making of comparison sites, managing the externalities *within* retailers is of paramount importance.

²Alternatively, and without affecting the results qualitatively, these consumers can be seen as buying from a “local” firm, or from a firm to which they are loyal.

firms that participate. For the moment we shall assume other fees, like per-click or per-transaction fees, are equal to zero.³ Let a denote the (fixed) fee the platform charges firms for participation. While the platform can charge different fees to firms and consumers, we assume the platform cannot price discriminate among firms by charging them different participation fees. Likewise, let s denote the fee charged to consumers for registering with the platform. For simplicity, assume the platform incurs no cost.

On the supply side of the market, there are two possibly vertically and horizontally differentiated retailers competing in prices. Let us normalize their unit production cost to zero. A retailer may decide to advertise its product and price on the platform (A) or not to advertise it at all (NA). Advertising may involve certain cost k associated to the feeding up product and price information into the comparison site. For the moment, we will ignore this cost. Let $E_i = \{A, NA\}$ be the set of advertising strategies available to a firm i . A firm i 's participation strategy is then a probability function over the set E_i . We refer to α_i as the probability with which a firm i chooses A , while $1 - \alpha_i$ denotes the probability with which such a firm chooses NA . A firm i 's pricing strategy on the platform is a price (distribution) F_i . The firm may charge a different price (distribution), denoted F_{io} , to the consumers who show up at the shop directly.⁴ A strategy for firm i is thus denoted by $\sigma_i = \{\alpha_i, F_i, F_{io}\}$, $i = 1, 2$. The strategies of both firms are denoted by σ and the (expected) payoff to a firm i given the strategy profile σ is denoted $\pi_i(\sigma)$.

There is a unit mass of consumers. Consumers can either pick a firm at random and buy there, or else subscribe to the platform, view the offerings of the advertising firms and buy the most attractive one. We assume that consumers are distributed uniformly across firms so each firm receives half of the non-subscribing consumers. Those buyers who choose not to register with the platform visit a retailer at random and buy there at the price p_{io} . If they participate in the centralized market, they see all the products available and choose the one that matches them best. To keep things simple, we assume that a consumer who registers with the platform cannot trade outside the platform within the current trading period, even if she finds no suitable product in the platform.

³Later in the chapter, we show that our main results hold when per-click fees are used. As mentioned in the Introduction, some comparison sites may obtain the bulk of their revenue from the selling of advertising space instead. This alternative business model is considered elsewhere in this volume.

⁴In this chapter we will allow for price discrimination *across*, but not within, marketplaces. That is, the firms may be able to post on the price comparison site a price different from the one they charge to local/loyal consumers. Things are different when retailers can price discriminate across loyal consumers. This is often the case in over-the-counter (OTC) markets, where the bargaining institution is predominant. For a model that studies the role of price discrimination over-the-counter in a two-sided market setting see Van Eijkel (2011).

Consumer m 's willingness to pay for the good sold by firm i is

$$u_{im} = \delta_i + \varepsilon_{im}.$$

The parameter ε_{im} is assumed to be independently and identically double exponentially distributed across consumers and products with zero mean and unit variance and can be interpreted as a match parameter that measures the quality of the match between consumer i and product m . We assume there is an outside option with $u_0 = \varepsilon_{0m}$. Let G and g denote the cumulative and probability distribution functions of ε_{im} , respectively.⁵ A buyer demands a maximum of one unit. To allow for vertical product differentiation, let $\Delta \equiv \delta_1 - \delta_2 > 0$ be the (ex-ante) quality differential between the two products. Ex-ante, consumers do not know which firm sells which quality; like match values, the quality of a particular firm is only known after consumers visit such firm. Buyers may decide to register with the platform (S) or not at all (NS). The set of consumers' pure strategies is denoted $R = \{S, NS\}$. A consumer's mixed strategy is a probability function over the set R . We refer to $\mu \in [0, 1]$ as the probability with which a consumer registers with the platform. Given all other agents' strategies, $u(\mu)$ denotes the (expected) utility of a consumer who subscribes with probability μ .

The timing of moves is the following. In the first stage, the comparison site chooses the participation fees. In the second stage, firms simultaneously decide on their participation and pricing decisions, while consumers decide whether to register with the platform or not. Firms and consumers that do not enter the platform can only conduct transactions when they match in the decentralized market; likewise, consumers who register with the comparison site can only conduct transactions there. The market clears when transactions between firms and consumers take place. We study subgame perfect equilibria.⁶

3.1 Homogeneous products

It is convenient to start by assuming that firms sell homogeneous products. Therefore, we assume that $\varepsilon_{im} = 0$ for all i, m , including the outside option, and that $\delta_i = \delta_j$. As a result, $u_{im} = \delta$ for all i and m . This is the case analyzed in the seminal contribution of Baye and Morgan (2001).⁷ In

⁵Matching values are realized only after consumers visit the platform or the individual shops. This implies that ex-ante all consumers are identical. This modelling seems to be appropriate when firms sell newly introduced products.

⁶It is well known that in models with network externalities multiple equilibria can exist. In our model there is always an equilibrium where no agent uses the comparison site. This equilibrium is uninteresting and will therefore be ignored.

⁷To be sure, the model of Baye and Morgan (2001) is more general because they study the N -retailers case and because consumers have elastic demands. In addition, for later use, we have assumed that consumers who register

what follows, we will only sketch the procedure to derive a SPE. For details, we refer the reader to the original contribution of Baye and Morgan.

Let us proceed backwards and suppose that the participation fees a and s are such that firms and consumers are indifferent between participating in the price comparison site or not. Recall that μ denotes the fraction of participating consumers and α the probability with which a firm advertises its price on the platform. To allow for mixed pricing strategies, refer to $F(p)$ as the advertised price.

Consider a firm that does not advertise at the price comparison site. This firm will only sell to a fraction $(1 - \mu)/2$ of non-participating consumers and therefore it is optimal for this firm to charge the monopoly price δ . As a result, a firm that does not advertise at the price comparison site obtains a profit:

$$\pi_i(0, \delta; \sigma_{-i}^*) = \frac{1 - \mu}{2} \delta.$$

Consider now a firm that decides to charge a price p and advertise it at the price comparison site. This firm will sell to a fraction $(1 - \mu)/2$ of non-participating consumers as well as to the participating consumers if the rival either does not advertise or advertises a higher price. Therefore, the profit this firm will obtain is⁸

$$\pi_i(1, p; \sigma_{-i}^*) = p \left(\frac{1 - \mu}{2} + \mu \left(1 - \alpha + \alpha(1 - F(p)) \right) \right) - a.$$

It is easy to see that for advertising fees $0 \leq a < \mu\delta$ an equilibrium in pure advertising strategies does not exist. In fact, if the rival firm did not advertise for sure, then firm i would obtain a profit equal to $(1 - \mu)\delta/2$ if it did not advertise either, while if it did advertise a price just below δ , this firm would obtain a profit equal to $((1 - \mu)/2 + \mu)\delta - a$. Likewise, an equilibrium where firms advertise with probability 1 does not exist either if $a > 0$. If the two firms advertised with probability 1, the price comparison site would resemble a standard Bertrand market so both firms would charge a price equal to the marginal cost and then firms would not obtain sufficient profits to cover the advertising fees. Therefore an equilibrium must have $\alpha \in (0, 1)$.

To solve for equilibrium, we impose the following indifference conditions:

$$\pi_i(0, \delta; \sigma_{-i}^*) = \pi_i(1, \delta; \sigma_{-i}^*) = \pi_i(1, p; \sigma_{-i}^*).$$

with the platform cannot visit the local shop any longer. The results do not depend on this assumption and we will also make it here for overall consistency of our chapter.

⁸For the moment, we are ignoring the possibility firms advertise on the platform a price different from the one they charge to the non-participating consumers.

These conditions tell us that (i) a firm must be indifferent between advertising and not advertising (first equality) and also that (ii) a firm that advertises the monopoly price on the platform gets the same profits that a firm that advertises any other price in the support of the price distribution (second equality). Setting the condition $\pi_i(0, \delta; \sigma_{-i}^*) = \pi_i(1, \delta; \sigma_{-i}^*)$ and solving for α gives the equilibrium advertising policy of the firms:

$$\alpha^* = 1 - \frac{a}{\delta\mu}$$

Using the condition $\pi_i(0, \delta; \sigma_{-i}^*) = \pi_i(1, p; \sigma_{-i}^*)$ and solving for $F(p)$, gives the pricing policy of the firms:

$$F^*(p) = 1 - \frac{1}{\alpha^*} \left(\frac{1-\mu}{2\mu} + 1 - \alpha^* \right) \left(\frac{\delta}{p} - 1 \right).$$

The lower bound of the equilibrium price distribution is found by setting $F^*(\underline{p}) = 0$ and solving for \underline{p} , which gives $\underline{p} = \delta - 2\alpha^*\delta\mu/(1 + \mu)$.

We now turn to the users' side of the market. Users take as given firms' behavior so they believe firms to advertise with probability α^* a price drawn from the support of F^* . A user who registers with the platform encounters two prices in the price comparison site with probability α^{*2} , in which case she picks the lowest one; with probability $2\alpha^*(1 - \alpha^*)$ there is just one price advertised on the platform. The expected utility to a user who registers with the price comparison site is then

$$u(1) = \alpha^{*2}(\delta - \mathbf{E}[\min\{p_1, p_2\}]) + 2\alpha^*(1 - \alpha^*)(\delta - \mathbf{E}[p]) - s,$$

where $\mathbf{E}[\min\{p_1, p_2\}] = \int_{\underline{p}}^{\delta} 2p(1 - F(p))f(p)dp$ and $\mathbf{E}[p] = \int_{\underline{p}}^{\delta} pf(p)dp$. A user who does not register with the price comparison site always buys from one of the firms at random so her utility will be equal to zero if the chosen firm does not advertise, while it will be equal to $\delta - \mathbf{E}[p]$ otherwise. Therefore,

$$u(0) = \alpha^*(\delta - \mathbf{E}[p]).$$

As a result, for given advertising and subscription fees, we may have two types of market equilibria. One is when users participate surely. In that case, users must derive a strictly positive utility from subscribing. The other is when users' participation rate is less than one. In that case, they must be indifferent between participating and not participating so μ must solve the following equation

$$u(1) = u(0).$$

Whether one equilibrium prevails over the other is a matter of expectations: if firms expect users to be pretty active then it is optimal for consumers to do so, and vice-versa.

We now fold the game backwards and consider the stage of the game where the manager of the price comparison site chooses the pair of advertising and subscription fees $\{a, s\}$ to maximize its profits. The profits of the intermediary are:

$$\Pi(a, s) = 2\alpha^* a + \mu^* s. \tag{1}$$

a	s	$E[p]$	$E[\min p_1, p_2]$	α	μ	π_i	u^*	Π
0.500	0.010	0.933	0.912	0.170	0.602	0.199	0.011	0.176
0.500	0.020	0.899	0.868	0.238	0.656	0.172	0.024	0.251
0.500	0.030	0.870	0.831	0.289	0.703	0.148	0.038	0.310
0.550	0.030	0.867	0.827	0.281	0.765	0.118	0.037	0.332
0.600	0.030	0.864	0.824	0.274	0.826	0.087	0.037	0.353
0.650	0.030	0.862	0.821	0.268	0.887	0.056	0.037	0.374
0.650	0.040	0.834	0.785	0.307	0.938	0.031	0.051	0.437
0.650	0.050	0.807	0.751	0.342	0.988	0.006	0.066	0.494
0.650	0.053	0.800	0.743	0.350	1.000	0.000	0.070	0.508

Notes: The quality parameter δ is set to 1.

Table 1: Homogeneous products: comparison site’s profits increase in consumer fee s

We now argue that a SPE with partial firm and user participation cannot be sustained. Suppose that at the equilibrium fees a and s , we have a continuation game equilibrium with $\alpha^*, \mu^* < 1$. Then, the participation rate of the users μ^* is given by the solution to $u(1) = u(0)$ and the participation rate of the firms $\alpha^* = 1 - a/\delta\mu^*$. Table 1 shows that the intermediary’s profits increase monotonically in s . The idea is that in this continuation equilibrium the elasticity of user demand for participation in the price comparison site is strictly positive. In the putative equilibrium $u(1) = u(0)$. Keeping everything else fixed, an increase in s makes utility outside the platform lower than inside the platform. To restore equilibrium firms must advertise more frequently, which can only occur if the fraction of subscribing consumers increases. So an increase in s is accompanied by an increase in the participation rates of both retailers and users, as it can be seen in the table. This clearly shows than in SPE it must be the case that $\mu = 1$.

Given this result, to maximize the profits of the price comparison site we need to solve the problem

$$\max_a \{2\alpha^* a + s\} \text{ s.t. } u(1) \geq u(0).$$

Table 2 shows the solution of this problem for $\delta = 1$. The profits of the intermediary are maximized when $a = 0.426$ and $s = 0.119$ (in bold) so in SPE user participation is maximized but firm participation is not. The intuition for this result is clear. If the firms did participate surely, then

a	s	$E[p]$	$E[\min p_1, p_2]$	α	μ	π_i	u^*	Π
0.100	0.140	0.256	0.165	0.900	1.000	0.000	0.670	0.320
0.200	0.162	0.402	0.299	0.800	1.000	0.000	0.478	0.482
0.300	0.151	0.516	0.415	0.700	1.000	0.000	0.339	0.571
0.400	0.127	0.611	0.519	0.600	1.000	0.000	0.233	0.607
0.426	0.119	0.633	0.544	0.574	1.000	0.000	0.210	0.608
0.450	0.111	0.653	0.567	0.550	1.000	0.000	0.191	0.607
0.500	0.097	0.693	0.614	0.500	1.000	0.000	0.153	0.597
0.600	0.066	0.766	0.701	0.400	1.000	0.000	0.094	0.546
0.700	0.040	0.832	0.783	0.300	1.000	0.000	0.050	0.460

Notes: The quality parameter δ is set to 1.

Table 2: Homogeneous products model: maximum profits intermediary

the price advertised on the platform would be equal to the marginal cost and the firms would not make any money. In such a case the bulk of the profits of the price comparison site would have to be extracted from the consumers. However, in the absence of price dispersion no consumer would be willing to pay anything to register with the platform. To summarize, the key insights from Baye and Morgan (2001) are that the profits of the price comparison site are maximized when consumers participate with probability one but firms do not, in this way creating price dispersion and so subscription value for consumers. As we have mentioned above, price dispersion is ubiquitous also on the Internet (Baye, Morgan and Scholten, 2004) and, moreover, it is difficult to reject the null hypothesis that advertised prices on comparison sites are random (Moraga-González and Wildenbeest, 2008).

The role of price discrimination across marketplaces

In Baye and Morgan (2001) price comparison sites have incentives to create price dispersion since by doing so they create value for consumers. If prices on- and off-platform are similar, consumers are not interested in the platform services so the bulk of the money has to be made on the firms' side. By raising firms participation fees, a price comparison site achieves two objectives at once. On the one hand, competition between firms is weakened and this increases the possibility to extract rents from the firm side; on the other hand, price dispersion goes up and this in turn increases the possibility to extract rents from the user side of the market. This interesting result is intimately related to the assumption that online retailers cannot price discriminate across marketplaces. To see this, suppose that a firm could set a price at its own website which is different from the one advertised on the platform. Since consumers who do not register with the platform are assumed to pick a website at random, it is then obvious that the website's price would be equal to δ . A firm

participating in the price comparison site would then obtain a profit equal to

$$\pi_i(1, p; \sigma_{-i}^*) = \frac{1-\mu}{2}\delta + p \left(\mu \left(1 - \alpha + \alpha(1 - F(p)) \right) \right) - a.$$

In such a case, imposing the indifference conditions for equilibrium that

$$\pi_i(0, \delta; \sigma_{-i}^*) = \pi_i(1, \delta; \sigma_{-i}^*) = \pi_i(1, p; \sigma_{-i}^*)$$

would yield

$$\alpha^* = 1 - \frac{a}{\delta\mu};$$

$$F^*(p) = 1 - \frac{1}{\alpha^*} \left(\frac{a}{\mu p} - 1 - \alpha^* \right).$$

Now we argue that, to maximize profits, the price comparison site wishes to induce full participation of firms and consumers, thereby maximizing social welfare and extracting all the surplus. The expected utility to a user who registers with the price comparison site is given by the same expression for $u(1)$ above, i.e., $u(1) = \alpha^{*2}(\delta - \mathbf{E}[\min\{p_1, p_2\}]) + 2\alpha^*(1 - \alpha^*)(\delta - \mathbf{E}[p]) - s$. A user who does not register with the price comparison site buys at the price δ so her utility will be $u(0) = 0$.

Consider now the stage of the game where the price comparison site's manager chooses firm and consumer participation fees. Suppose that at the equilibrium fees firms and consumers mix between participating and not participating. Table 3 shows that the elasticity of consumer participation is also positive in this case. As a result, the intermediary will continue to raise the user fees until all consumers participate with probability one.

a	s	$E[p]$	$E[\min p_1, p_2]$	α	μ	π_i	u^*	Π
0.500	0.010	0.948	0.932	0.100	0.556	0.222	0.000	0.106
0.500	0.025	0.916	0.890	0.158	0.594	0.203	0.000	0.173
0.500	0.050	0.879	0.842	0.224	0.644	0.188	0.000	0.256
0.550	0.050	0.879	0.842	0.224	0.708	0.146	0.000	0.281
0.600	0.050	0.879	0.842	0.224	0.773	0.114	0.000	0.307
0.650	0.050	0.879	0.842	0.224	0.837	0.081	0.000	0.333
0.650	0.075	0.849	0.803	0.274	0.895	0.052	0.000	0.423
0.650	0.100	0.822	0.770	0.316	0.951	0.025	0.000	0.506
0.650	0.123	0.800	0.743	0.350	1.000	0.000	0.000	0.508

Notes: The quality parameter δ is set to 1.

Table 3: Homogeneous products with price discrimination: intermediary's profits increase in s

In Table 4 we show that the price comparison site's profits increase by lowering the firms fee and increasing the users charge until they reach 0 and 1 respectively, which implies that all firms and consumers participate with probability one. In that case, product prices are driven down to

marginal cost and the bulk of the profits of the intermediary is obtained from the consumers.

a	s	$E[p]$	$E[\min p_1, p_2]$	α	μ	π_i	u^*	Π
0.750	0.063	0.863	0.822	0.250	1.000	0.000	0.000	0.438
0.650	0.123	0.800	0.743	0.350	1.000	0.000	0.000	0.508
0.500	0.250	0.693	0.614	0.500	1.000	0.000	0.000	0.750
0.250	0.563	0.462	0.359	0.750	1.000	0.000	0.000	0.938
0.100	0.810	0.256	0.166	0.900	1.000	0.000	0.000	0.990
0.010	0.980	0.047	0.019	0.990	1.000	0.000	0.000	1.000
0.001	0.998	0.007	0.002	1.000	1.000	0.000	0.000	1.000
0.000	1.000	0.000	0.000	1.000	1.000	0.000	0.000	1.000

Notes: The quality parameter δ is set to 1.

Table 4: Homogeneous products model with price discrimination: intermediary’s maximum profits

Notice that with price discrimination, the market allocation is efficient. The intuition is the following. By increasing competition in the platform, prices go down and more surplus is generated for consumers. This surplus, since buyers have in practice no outside option, can be extracted from consumers via participation fees. Interestingly, the fact that firms can price discriminate eliminates the surplus consumers obtain by opting out of the price comparison site and this ultimately destroys the profits of the retailers.

Click-through fees

In recent years many comparison sites have replaced the fixed-fees by a cost-per-click (CPC) tariff structure. In this subsection we show that the CPC business model does not alter the main insights we have obtained so far.⁹ Let c be the click-through fee. Assume also that there still exists a (small) fixed cost a firm has to pay for advertising on the platform, denoted k , which can be interpreted as a hassle cost for feeding up the comparison site information system. The profits of a firm that advertises on the platform then become

$$\pi_i(1, p; \sigma_{-i}^*) = p \frac{1 - \mu}{2} + (p - c) \left(\mu \left(1 - \alpha + \alpha(1 - F(p)) \right) \right) - k.$$

The first part of this profits expression comes from the consumers who do not register with the platform and buy at random. The second part comes from the consumers who participate in the comparison site. These consumers click on firm i ’s offer when firm i is the only advertising firm, which occurs with probability $1 - \alpha$, or when firm j also participates at the clearinghouse but advertises a higher price than firm i , which occurs with probability $\alpha(1 - F(p))$.

⁹One reason why CPC tariffs may recently have become more widely used is that they involve less risk for the platform. An, Baye, Hu, Morgan, and Shum (2010) also allow for a click-through fee in a Baye and Morgan (2001) type model, but do not model the optimal fee structure of the comparison site.

Using the condition $\pi_i(0, \delta; \sigma_{-i}^*) = \pi_i(1, \delta; \sigma_{-i}^*)$ and solving for α gives

$$\alpha^* = 1 - \frac{k}{(\delta - c)\mu}.$$

If μ consumers participate in the platform, the total expected number of clicks is then $\mu(1 - (1 - \alpha^*)^2)$. Using the condition $\pi_i(1, p; \sigma_{-i}^*) = \pi_i(1, \delta; \sigma_{-i}^*)$ and solving for F gives

$$F^*(p) = 1 - \frac{1}{\alpha^*} \left(\frac{1 - \mu}{2\mu} + 1 - \alpha^* \right) \left(\frac{\delta - p}{p - c} \right).$$

The decision of consumers does not change—they participate with a probability μ^* , which is the solution to $u(1) = u(0)$. The profits of the intermediary are then

$$\Pi(c, s) = \mu^* s + \mu^* (1 - (1 - \alpha^*)^2) c$$

Table 5 shows that the property that the elasticity of the consumer demand for participation is positive still holds. As a result, the platform will increase s until all consumers register with the price comparison site.

k	c	s	$E[p]$	$E[\min p_1, p_2]$	α	μ	π_i	u^*	Π
0.200	0.500	0.010	0.952	0.938	0.255	0.537	0.231	0.012	0.125
0.200	0.500	0.020	0.925	0.903	0.355	0.620	0.190	0.027	0.193
0.200	0.500	0.030	0.899	0.870	0.428	0.700	0.150	0.043	0.257
0.200	0.550	0.030	0.900	0.872	0.436	0.788	0.106	0.044	0.319
0.200	0.600	0.030	0.900	0.873	0.445	0.901	0.050	0.044	0.401
0.200	0.600	0.033	0.892	0.864	0.465	0.935	0.033	0.050	0.431
0.200	0.600	0.036	0.884	0.854	0.484	0.969	0.015	0.056	0.462
0.200	0.600	0.039	0.877	0.846	0.500	1.000	0.000	0.061	0.488

Notes: The quality parameter δ is set to 1.

Table 5: Homogeneous products model with CPC: platform's profits increase in consumer fees

Given this observation, to maximize the profits of the comparison site we need to solve

$$\max_c \{s + (1 - (1 - \alpha^*)^2)c\} \text{ s.t. } u(1) \geq u(0).$$

Table 6 shows the solution of this problem for $\delta = 1$ and $k = 0.2$. The profits of the intermediary are maximized when $c = 0.563$ so again in SPE user participation is maximized but firm participation is not. The intuition for this result is the same as above.

k	c	s	$E[p]$	$E[\min p_1, p_2]$	α	μ	π_i	u^*	Π
0.200	0.100	0.145	0.487	0.393	0.778	1.000	0.000	0.399	0.240
0.200	0.200	0.127	0.570	0.487	0.750	1.000	0.000	0.323	0.315
0.200	0.300	0.108	0.651	0.579	0.714	1.000	0.000	0.249	0.383
0.200	0.400	0.086	0.730	0.670	0.667	1.000	0.000	0.180	0.442
0.200	0.500	0.063	0.805	0.759	0.600	1.000	0.000	0.117	0.483
0.200	0.563	0.048	0.851	0.814	0.542	1.000	0.000	0.081	0.493
0.200	0.600	0.039	0.877	0.845	0.500	1.000	0.000	0.061	0.489
0.200	0.700	0.014	0.943	0.927	0.333	1.000	0.000	0.019	0.403

Notes: The quality parameter δ is set to 1.

Table 6: Homogeneous products model with CPC: intermediary's maximum profits

3.2 Differentiated products

We continue with the case in which firms sell products that are both horizontally and vertically differentiated. Galeotti and Moraga-González (2009) study a similar model, but without vertical product differentiation, that is, $\delta_i = \delta$ for all i , and with match values uniformly distributed. Here we explore the role of vertical product differentiation and we choose to work with logit demands for convenience. Later, we shall see the relationship between these two models.

Recall that μ is the proportion of consumers in the market registering with the comparison site and that α_i is the probability firm i advertises her product at the comparison site. We first look at the price set by a firm that does not advertise at the comparison site. Denoting by p_{io} such a price, it should be chosen to maximize the profits a firm obtains from the consumers who visit a vendor at random. Since consumer m 's outside option generates utility $u_0 = \varepsilon_{0m}$, we have

$$\begin{aligned}
\pi_i(0, p_{io}; \sigma_{-i}^*) &= \frac{1 - \mu}{2} p_{io} \cdot \Pr[u_i \geq u_0]; \\
&= \frac{1 - \mu}{2} p_{io} \cdot \frac{\exp(\delta_i - p_{io})}{1 + \exp(\delta_i - p_{io})},
\end{aligned} \tag{2}$$

Let p_{io}^* denote the monopoly price of firm i , and $\pi_i^*(0, p_{io}^*)$ the profits this firm obtains if it does not advertise. Taking the first-order condition of equation (2) with respect to p_{io} and solving for p_{io} gives

$$p_{io}^* = 1 + W[\exp(\delta_i - 1)],$$

where $W[\exp(\delta_i - 1)]$ is the Lambert W-Function evaluated at $\exp(\delta_i - 1)$, i.e., the W that solves $\exp(\delta_i - 1) = W \exp(W)$.

Suppose firm i decides to advertise a price p_i at the comparison site. The expected profits of

this firm are

$$\begin{aligned}
\pi_i(1, p_i; \sigma_{-i}^*) &= p_i \left(\mu \left(\alpha_j \Pr[u_i \geq \max\{u_0, u_j\}] + (1 - \alpha_j) \Pr[u_i \geq u_0] \right) + \frac{1 - \mu}{2} \Pr[u_i \geq u_0] \right) - a; \\
&= p_i \left(\mu \left(\alpha_j \frac{\exp(\delta_i - p_i)}{1 + \sum_{k=i,j} \exp(\delta_k - p_k)} + (1 - \alpha_j) \frac{\exp(\delta_i - p_i)}{1 + \exp(\delta_i - p_i)} \right) + \right. \\
&\quad \left. \frac{1 - \mu}{2} \frac{\exp(\delta_i - p_i)}{1 + \exp(\delta_i - p_i)} \right) - a,
\end{aligned}$$

where α_j is the probability the rival firm advertises at the comparison site. As can be seen from this equation, demand depends on whether or not the rival firm advertises. With probability α_j seller i competes with seller j for the proportion μ of consumers visiting the comparison site, which means that in order to make a sale the utility offered by firm i needs to be larger than the utility offered by firm j as well as the outside good. Since we are assuming ε_{im} is i.i.d. type I extreme value distributed this happens with probability $\exp(\delta_i - p_i)/(1 + \sum_{k=i,j} \exp(\delta_k - p_k))$. Similarly, with probability $(1 - \alpha_j)$ seller i is the only firm competing on the platform, which means u_i only has to be larger than u_0 for firm i to gain these consumers, i.e., $\exp(\delta_i - p_i)/(1 + \exp(\delta_i - p_i))$. Finally, a proportion $(1 - \mu)/2$ of consumers buy at random, and the probability of selling to these consumers is $\exp(\delta_i - p_i)/(1 + \exp(\delta_i - p_i))$.

The expression for the profits of firm j is similar. Taking the first-order conditions with respect to p_i and p_j yields a system of equations that characterizes the equilibrium prices. Unfortunately it is difficult to derive a closed-form expression for these prices. Figure 1(a), however, shows for selected parameter values that the equilibrium price of firm i decreases in α_j .¹⁰ Intuitively, as α_j increases, the probability a firm meets a competitor at the comparison site goes up and this fosters competition. As shown in Figure 1(b) the profits of firm i also decrease in α_j .

We now study the behavior of consumers in the market. If a user does not register with the comparison site, she just visits a firm at random. Therefore, the expected utility from this strategy is

$$\begin{aligned}
u^*(0) &= \frac{1}{2} \mathbf{E}[\max\{u_i, u_0\}] + \frac{1}{2} \mathbf{E}[\max\{u_j, u_0\}]; \\
&= \frac{1}{2} (1 - \alpha_j) \log[1 + \exp(\delta_i - p_{io}^*)] + \frac{1}{2} \alpha_j \log[1 + \exp(\delta_i - p_i)] \\
&\quad + \frac{1}{2} (1 - \alpha_j) \log[1 + \exp(\delta_j - p_{jo})] + \frac{1}{2} \alpha_j \log[1 + \exp(\delta_j - p_j)] + \gamma. \tag{3}
\end{aligned}$$

¹⁰The parameter values used in Figure 1 are $\mu_i = \mu_j = 1$, $\alpha_i = 1$, $\delta_i = 1$, and $\delta_j = 0$.

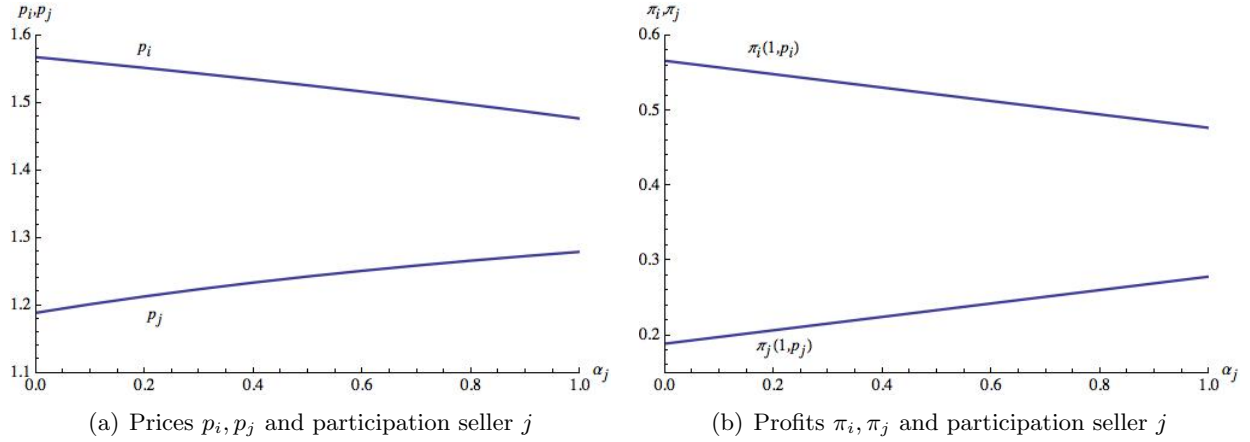


Figure 1: Prices and profits as function of participation seller j

where γ is Euler's constant. The utility a consumer obtains when remaining unregistered with the comparison site should increase in α_i and α_j because of the increased competition in the comparison site. If a user registers with the intermediary, her expected utility is

$$\begin{aligned}
u^*(1) &= \alpha_i \alpha_j \mathbf{E}[\max\{u_i, u_j, u_0\}] + \alpha_i(1 - \alpha_j) \mathbf{E}[\max\{u_i, u_0\}] + \alpha_j(1 - \alpha_i) \mathbf{E}[\max\{u_j, u_0\}] + \\
&\quad (1 - \alpha_i)(1 - \alpha_j) \mathbf{E}[u_0] - s; \\
&= \alpha_i \alpha_j \log[1 + \exp(\delta_i - p_i) + \exp(\delta_j - p_j)] + \alpha_i(1 - \alpha_j) \log[1 + \exp(\delta_i - p_i)] \\
&\quad (\alpha_j(1 - \alpha_i) \log[1 + \exp(\delta_j - p_j)] + \gamma - s.
\end{aligned} \tag{4}$$

Armed with these equations, we can study the continuation game equilibria. Basically, there may be two kinds of equilibrium. An equilibrium with full consumer participation ($\mu^* = 1$) (and either full or partial firm participation), or an equilibrium with partial consumer participation ($\mu^* < 1$) (and either full or partial firm participation). In both types of equilibria, if the firms mix between advertising and not advertising the advertising probabilities must solve

$$\begin{aligned}
\pi_i^*(1, p^*) &= \pi_i^*(0, p_{io}^*); \\
\pi_j^*(1, p^*) &= \pi_j^*(0, p_{jo}^*).
\end{aligned}$$

In the second type of equilibrium, if the users mix between participating and not participating, the

participation probability μ^* must be the solution to

$$u^*(1) = u^*(0).$$

In the first stage of the game the owner of the comparison site chooses the pair of fees $\{a, s\}$ such that her profits are maximized. The profit of the intermediary is given by

$$\Pi = 2\alpha_i\alpha_j a + \alpha_i(1 - \alpha_j)a + \alpha_j(1 - \alpha_i)a + \mu s. \quad (5)$$

3.2.1 Horizontal product differentiation

It is convenient to first assume products are not vertically differentiated, i.e., $\delta_i = \delta_j = \delta$. This means firms are symmetric and therefore we only need to consider two participation probabilities, α and μ . This case has been studied by Galeotti and Moraga-González (2009) for the N -firm case and a uniform distribution of match-parameters. Galeotti and Moraga-González (2009) show that in SPE the comparison site chooses firm and user fees so that firms and consumers join with probability one. That this also holds for a double exponentially distributed match-parameter can be seen in Table 7. The table shows that when either α or μ are less than one the profits of the intermediary can go up by increasing the fees to firms, consumers, or both. As a result, the intermediary will set both a and s such that all agents participate, that is, $\alpha = \mu = 1$.

a	s	p^*	α	μ	π^*	u^*	Π
0.050	0.100	1.552	0.681	0.108	0.253	1.030	0.079
0.050	0.150	1.550	0.752	0.110	0.252	1.031	0.092
0.050	0.200	1.547	0.825	0.113	0.251	1.032	0.105
0.050	0.313	1.541	1.000	0.121	0.249	1.036	0.138
0.100	0.313	1.518	0.993	0.242	0.215	1.044	0.274
0.200	0.313	1.477	0.982	0.487	0.146	1.059	0.545
0.400	0.313	1.412	0.963	0.980	0.006	1.083	1.078
0.400	0.300	1.405	0.989	0.992	0.002	1.088	1.119
0.401	0.337	1.401	1.000	1.000	0.000	1.090	1.139

Notes: The quality parameter δ is set to 1.

Table 7: Model with horizontal product differentiation

The intuition is similar to that in the model with homogeneous products. Suppose users mix between registering with the comparison site and not doing so. A raise in their registration fees makes them less prone to participate. To restore equilibrium firms should be more active in the comparison site. A higher participation rate of the firms can then be consistent with the expectation that consumers also participate more often. These cross-group externalities imply the increasing shape of the profits function of the comparison site in s . Therefore, the intermediary will continue to increase s till either $\alpha = 1$ or $\mu = 1$. When $\alpha = 1$, the table shows how an increase in the firms

fee increases consumer participation, lowers the price as well as firm participation. Profits of the comparison site increase anyway because consumer demand for participation is more elastic than firm demand for participation. Since an increase in a decreases firm participation, this relaxes the $\alpha = 1$ constraint and then the intermediary can increase again the consumer fee. This process continues until the intermediary extracts all the rents in the market up to the value of the outside option of the agents. We note that this insight is not altered if the retailers are allowed to price discriminate across marketplaces (see Galeotti and Moraga-González, 2009).

One important assumption behind the efficiency result is that agents are all ex-ante symmetric. If for example firms are ex-ante heterogeneous, a monopolist intermediary may induce a suboptimal entry of agents into the platform (see Nocke, Peitz and Stahl, 2007).

Click-through fees

If we allow for a click-through fee c in addition to an implicit and exogenous fixed cost k of advertising at the comparison site, the expected profits of a firm i are

$$\begin{aligned} \pi_i(1, p_i; \sigma_{-i}^*) &= (p_i - c)\mu \left(\alpha_j \Pr[u_i \geq \max\{u_0, u_j\}] + (1 - \alpha_j) \Pr[u_i \geq u_0] \right) + p_i \frac{1 - \mu}{2} \Pr[u_i \geq u_0] - k; \\ &= (p_i - c)\mu \left(\alpha_j \frac{\exp(\delta_i - p_i)}{1 + \sum_{k=i,j} \exp(\delta_k - p_k)} + (1 - \alpha_j) \frac{\exp(\delta_i - p_i)}{1 + \exp(\delta_i - p_i)} \right) + \\ &\quad p_i \frac{1 - \mu}{2} \frac{\exp(\delta_i - p_i)}{1 + \exp(\delta_i - p_i)} - k, \end{aligned}$$

The first part of this profits expression comes from the consumers who participate in the comparison site. These consumers click on firm i 's product to get directed to firm i 's website when firm i is the only advertising firm and consumers prefer product i over the outside option, or when firm j also advertises its product but consumers prefer product i over product j and the outside option. The consumers who do not register with the platform buy at random and therefore do not generate any costs of clicks.

The formula for the profits of the rival firm is similar. The utility consumers obtain when they opt out of the platform is the same as equation (3), while the utility they get when they register with the intermediary is the same as in equation (4). As we have done above, if firms mix between advertising at the platform and not advertising, it must be that $\pi_i^*(1, p^*) = \pi_i^*(0, p_{i_o}^*)$ and $\pi_j^*(1, p^*) = \pi_j^*(0, p_{j_o}^*)$. If consumers mix between registering with the intermediary and opting out it must be that $u^*(1) = u^*(0)$.

The platform’s profits stem from consumer subscriptions and click-through traffic. Therefore,

$$\Pi = \mu s + \mu(1 - (1 - \alpha_i)(1 - \alpha_j))c.$$

The following table shows that the behavior of the profits function of the intermediary with click-through fees is qualitatively similar to the one with fixed fees. Suppose firms and consumers opt out with strictly positive probability. Then, for a given click-through fee, the intermediary can increase the consumer subscription fee and obtain a greater profit. Likewise, for a given subscription fee, the intermediary can increase the consumer subscription fee and increase benefits. As a result, firms and consumers must all participate surely.

k	c	s	p^*	α	μ	π^*	u^*	Π
0.200	0.500	0.050	1.763	0.655	0.595	0.115	0.983	0.292
0.200	0.500	0.100	1.759	0.727	0.608	0.111	0.979	0.342
0.200	0.500	0.150	1.755	0.801	0.622	0.107	0.975	0.392
0.200	0.600	0.150	1.824	0.817	0.668	0.094	0.957	0.488
0.200	0.800	0.150	1.985	0.855	0.771	0.065	0.914	0.720
0.200	1.000	0.175	2.179	0.940	0.891	0.031	0.856	1.044
0.200	1.186	0.182	2.386	1.000	1.000	0.000	0.800	1.369

Notes: The quality parameter δ is set to 1.

Table 8: Model with horizontally differentiated products and CPC

3.2.2 Vertical product differentiation

We now consider the case in which firms sell products that are also vertically differentiated. Without loss of generality we normalize firm j ’s quality level to zero and assume firm i offers higher quality than firm j , that is, $\delta_i > \delta_j = 0$.

We first hypothesize that at the equilibrium fees a and s , consumers participate with probability less than one, so $\mu < 1$. Moreover, for large enough differences in quality, the high quality firm i participates with probability one and firm j participates with probability less than one, so $\alpha_i = 1$ and $\alpha_j \in (0, 1)$. If this is so it must be the case that

$$\begin{aligned} \pi_i^*(1, p_i^*) &> \pi_i^*(0, p_{io}^*); \\ \pi_j^*(1, p_j^*) &= \pi_j^*(0, p_{jo}^*); \\ u^*(1) &= u^*(0). \end{aligned}$$

Since we are assuming the intermediary has to charge the same fee a to both firms, such an equilibrium could arise if the intermediary sets her fees such that the low quality firm is indifferent between participating or not participating—for large enough differences in quality this implies that

the high quality firm will always obtain higher profits by advertising on the comparison site than by selling to the non-participating consumers. From these equations we can obtain the equilibrium participation probabilities (α_j, μ) .

a	s	p_i	p_j	α_i	α_j	μ	π_i	π_j	u	Π	W
0.100	0.150	1.556	1.242	1.000	0.281	0.520	0.454	0.134	0.928	0.206	1.722
0.100	0.200	1.544	1.241	1.000	0.573	0.522	0.441	0.133	0.931	0.262	1.767
0.100	0.250	1.531	1.241	1.000	0.868	0.524	0.427	0.132	0.934	0.318	1.813
0.100	0.272	1.525	1.241	1.000	1.000	0.525	0.421	0.132	0.937	0.343	1.833
0.150	0.272	1.501	1.214	1.000	0.974	0.792	0.348	0.058	0.944	0.512	1.862
0.188	0.272	1.481	1.188	1.000	0.952	0.988	0.293	0.000	0.950	0.639	1.882
0.188	0.281	1.476	1.188	1.000	1.000	1.000	0.288	0.000	0.952	0.657	1.897
0.567	-0.122	1.567	1.193	1.000	0.000	1.000	0.000	0.000	1.148	0.445	1.594

Notes: The quality parameter δ_i is set to 1, while $\delta_j = 0$.

Table 9: Model with vertical product differentiation ($\Delta = 1$)

Table 9 shows the behavior of firm and user participation rates and the profits of the intermediary when the quality difference $\Delta = \delta_i - \delta_j = 1$. Starting from a relatively low level of a and s , an increase in s increases both consumer and firm participation. As a result, the intermediary will continue to increase s till α_j is one. From that point onwards, an increase in the firms' fee increases the user participation rate and lowers the participation of firm j so the intermediary again finds it profitable to raise the consumer fees. This process continues until firm j and the consumers all participate with probability one. The intermediary maximizes its profit at $a = 0.188$ and $s = 0.281$.

So far we have looked at an equilibrium in which the fees are set such that both firms will participate. However, the intermediary could also set its fees such that only the high quality firm participates, which means it must be the case that

$$\begin{aligned}\pi_i^*(1, p_i^*) &= \pi_i^*(0, p_{io}^*); \\ \pi_j^*(1, p_j^*) &< \pi_j^*(0, p_{jo}^*); \\ u^*(1) &= u^*(0).\end{aligned}$$

The last line of Table 9 shows that if the intermediary sets her fees such that only the high quality firm participates, profits are lower than if it lets the two firms participate. Nevertheless, for relatively large differences in quality it might be the case that the intermediary prefers only the highly quality firm to advertise on its website. For instance, when $\Delta = 3$ the comparison site maximizes profits by setting a and s in such a way that firm j does not find it profitable to advertise on the platform, while firm i participates with probability one. This can be seen in Table 10 where we describe the behavior of firm and consumer decisions and the implications for the comparison site's profits for $\Delta = 3$. As shown in the table, since the high quality firm is the only

firm active at the comparison site, for all a and s the price found on the intermediary will be the same. Starting from relatively low fee levels a higher s leaves the participation rate of the consumers unchanged— α_i is changed in such way to keep consumers indifferent between participating and not participating. Increasing a leads to higher participation of the consumers, and as such to higher profits for the intermediary. As shown in the table the intermediary maximizes her profits when $a = 1.557$ and $s = 0.347$ (in bold). Comparing the last two lines of this table shows that in this case setting a relatively low a such that both firms will participate will generate lower overall profits for the platform in comparison to setting a relatively high a such that only the high quality firm participates. However, as shown by the last column of Table 10 welfare W is higher when everyone participates.

a	s	p_i	p_j	α_i	α_j	μ	π_i	π_j	u	Π	W
1.000	0.100	2.557	1.234	0.737	0.000	0.642	0.557	0.100	1.169	0.802	2.628
1.000	0.200	2.557	1.225	0.844	0.000	0.642	0.557	0.100	1.169	0.972	2.799
1.000	0.300	2.557	1.215	0.950	0.000	0.642	0.557	0.100	1.169	1.143	2.969
1.000	0.347	2.557	1.210	1.000	0.000	0.642	0.557	0.100	1.169	1.223	3.050
1.300	0.347	2.557	1.172	1.000	0.000	0.835	0.257	0.046	1.169	1.590	3.063
1.500	0.347	2.557	1.138	1.000	0.000	0.963	0.057	0.010	1.169	1.835	3.072
1.557	0.347	2.557	1.127	1.000	0.000	1.000	0.000	0.000	1.169	1.905	3.074
0.115	0.490	2.388	1.115	1.000	1.000	1.000	1.273	0.000	1.241	0.720	3.235

Notes: The quality parameter δ_i is set to 3, while $\delta_j = 0$.

Table 10: Model with vertical product differentiation ($\Delta = 3$)

4 Concluding remarks and open research lines

The emergence of Internet shopbots and their implications for price competition, product differentiation, and market efficiency have been the focus of this chapter. We have asked a number of questions. How can a comparison site create value for consumers? Do firms have incentives to be listed in comparison sites? Under which conditions are prices listed in these sites dispersed? Do comparison sites enhance social welfare? Can comparison sites generate efficient allocations?

To answer these questions we have developed a simple model of a comparison site. The intermediary platform tries to attract (possibly vertically and horizontally differentiated) online retailers and consumers. The analysis of the model has revealed that product differentiation and price discrimination play a critical role. For the case of homogeneous product sellers (Baye and Morgan, 2001), if the online retailers cannot charge different on- and off-the-comparison-site prices, then the comparison site has incentives to charge fees so high that some firms are excluded. The fact that some firms are excluded generates price dispersion, which creates value for consumers. This value, in turn, can be extracted by the comparison site via consumer participation fees. The market

allocation is not efficient since products are sold at prices that exceed marginal cost. By contrast, when on- and off-the-comparison-site prices can be different, the comparison site has an incentive to lure all the players to the site, which generates an allocation that is efficient.

When online retailers sell products that are horizontally differentiated, the comparison site creates value for consumers by aggregating product information. In this way, the comparison site easily becomes a more attractive marketplace than the decentralized one (Galeotti and Moraga-González, 2009). In equilibrium, even if firms cannot price discriminate the comparison site attracts all the players to the platform and an efficient outcome ensues.

Allowing for vertical product differentiation brings interesting additional insights. The platform faces the following trade-off. On the one hand, it can attract high and low quality producers to the platform so as to increase competition, aggregate information and generate rents for consumers that are ultimately extracted via registration fees. Alternatively, the comparison site can set advertising fees that are so high that low quality sellers are excluded, thereby creating value for the top sellers. When quality differences are large, the latter strategy pays off. The comparison site excludes low quality from the platform, and grants higher rents for advertising sellers. Part of these rents are ultimately extracted by the comparison site. Some value for consumers is destroyed and the resulting allocation is inefficient.

Along the way, we have kept things simple and therefore left aside important issues. One important assumption has been that firms and consumers could only use a single platform as an alternative to the search market. In practise, multiple comparison sites exist and questions about how they compete with one another and their sustainability in the long-run arise. Moreover, if retailers are ex-ante differentiated, one aspect worth to investigate is whether they distribute themselves across platforms randomly or else they are sorted in a top-down way across them. One practice we observe in recent days is that retailers are given the possibility to obtain priority positioning in comparison sites' lists after paying an extra fee. Adding this choice variable to the problem of the platform's manager would probably complicate matters much. One way to address this issue is to use the framework put forward in the literature on position auctions. Priority positions could be auctioned as it is the case in search engines advertising. In this connection, Xu, Chen and Whinston (2011) study a model where firms sell homogenous products and bid for prominent list positions. They relate the extent of market competitiveness to willingness to bid for prominent positions. Another realistic feature we have ignored throughout is incomplete information. When quality is private information of the retailers, the problem of the platform is how to screen out good from bad thereby creating value for consumers. For a mechanism design

approach in the context of search engines to this problem see Gomes (2011). Finally, another simplifying assumption has been that search costs are negligible within a platform. When searching the products displayed in the price comparison site is still costly for consumers, platforms may have incentives to manipulate the way the alternatives are presented, thereby inducing more search and higher click turnover (see Hagiu and Jullien, 2011).

On the empirical side, much research remains to be done. In fact, not much is yet known about the extent to which theoretical predictions are in line with the data, especially in settings where product differentiation is important. Comparison sites can potentially provide a wealth of data. Detailed data from comparison sites may be helpful to learn how exactly consumers search for products. Some consumers might sort by price, while others may sort by quality ratings or availability. This type of information may give firms indications about the best way to present their product lists. Click-through data can facilitate the estimation of structural models of demand. Finally, using data from bids for prominent positions may be a useful way to estimate the characteristics of the supply side of the market.

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