Electronic Intermediaries: Trust Building and Market Differentiation

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Abstract

As electronic commerce becomes increasingly popular, new intermediaries are emerging and transforming marketing and distribution channels. Intermediaries in electronic marketplaces provide the IT and business infrastructure to facilitate the completion of commercial transaction over interorganizational computer networks. If electronic intermediary services are introduced to wholesale markets where qualities vary, the provision of IT alone cannot create reliable electronic marketplaces for traders who have no pre-established relationships. To build trust among market participants, electronic intermediaries should establish policies and processes that regulate responsibilities and duties of market participants and legitimate transactions. Institutional policies and processes reduce risks and help establish trust among market participants. This paper provides empirical evidence that trust building processes by electronic intermediaries can lead to concentration of electronic transactions on high quality products, thus differentiating electronic and traditional markets.

1. Introduction

Electronic markets have become increasingly popular alternatives to traditional markets as communications costs fall and as the ability to convey complex information electronically increases. The popularity of electronic commerce has generated significant interest in new market intermediaries who interpose themselves between suppliers and customers to take advantage of a computer network's capacity to reduce transaction costs. These new electronic intermediaries, established either by traditional intermediary firms or by new entrants to the market, are expected to bring significant changes in the economics of marketing channels and the structure of distribution, which will lead to a reconfiguration of the industry value chain [15].

Electronic intermediaries provide an information infrastructure, by which traders can realize commerce over electronic networks [8]. Information technology (IT), such as standard interface, cost-effective inter-organizational networks and search techniques, is a substantial component for electronic intermediary services. However, the use of computer and communications for commercial transactions raises challenges beyond IT issues, in particular when electronic intermediary services are adopted for wholesale markets, where qualities of offered products widely vary (e.g., the cut-flower or used-car markets). Buyers execute transactions based on electronic information without inspecting products, thus encountering risks of uncertain product qualities for the buyer. In addition to quality risks, market participants may experience trade defaults from trading partners unless the deals made over the networks are enforced and legitimized. The provision of IT infrastructure alone will not automatically create open and trustworthy electronic intermediary services for buying and selling firms who have no pre-established business relationships or trust.

Successful implementations of electronic intermediary services for wholesale-level transactions require developing institutional policies and processes to build trust among market participants. Electronic intermediaries for wholesale markets can be regarded as social institutions, in which electronic commerce regularly takes place and is facilitated and structured by institutional rules governing the exchange. Commercial transactions involve contractual agreements and the exchange of property rights. Commerce, if executed over electronic networks, can generate new types of transaction risks. Electronic intermediaries should provide mechanisms to structure, organize and legitimate these activities, so that market participants can trust services offered by new electronic markets.

The central claim of this paper is that trust building by new electronic intermediaries for wholesale markets can create a differentiated market online focusing on high quality products. Since electronic commerce is typical viewed as more risky than traditional markets, the ability to create lower-risk and higher-value electronic commerce...
markets than traditional physical distribution channels may seem counter-intuitive. Buyers executing transactions in electronic marketplaces have to make purchasing decisions without physically inspecting products. If product qualities widely vary, buyers would tend to purchase only high quality products in an attempt to reduce transaction risks of uncertain product qualities. Electronic intermediaries have incentives to prevent lower quality products from being offered to protect buyers, thus, building trust in the electronic intermediaries and creating differentiated markets focused on higher quality products. Thus, average prices in electronic intermediary markets can be higher than in traditional markets.

This paper investigates AUCNET to demonstrate that a trust building mechanism by electronic intermediaries creates differentiated markets from traditional markets. AUCNET is an electronic intermediary for used-car transactions in Japan. Transactions of used-cars are risky for buyers who have to purchase secondhand vehicles only through electronic information. AUCNET established several institutional policies and rules to build an open and trustworthy market for used-car transactions. We provide empirical evidence that used-cars traded over AUCNET have higher qualities than traditional markets. This market differentiation leads to higher transaction prices in AUCNET.

2. Electronic Wholesaler Intermediaries

The advent of national information infrastructures, such as Internet, has led many to predict that electronic markets will bypass or replace market intermediaries. This prediction is based on the assumption that intermediaries add significant costs to the value chain and that the ability of electronic networks to reduce transaction costs enables suppliers to internalize activities that have been traditionally performed by intermediaries [4, 20]. If parts of savings resulting from this bypass are transferable to customers in the form of price reduction, direct exchanges without middlemen may more than compensate for the costs of searching and matching, and could become a preferred alternative to existing markets.

While it is possible that the electronic network's ability to support direct exchanges enables suppliers and customers to leap over some intermediaries, it is equally plausible that electronic commerce promotes the growth of a new generation of intermediaries who exploit new types of economic benefits enabled by computer networks [15]. Intermediaries exist to support exchanges between producers and buyers by aggregating transactions to create economies of scale and scope. They provide suppliers and buyers with explicit and implicit services (such as search, distribution and risk management) that cannot be easily absorbed by suppliers or buyers. We predict that increasing use of electronic networks for commercial transactions will result in the growth of new generation of intermediaries who perform the mediating tasks in the world of electronic commerce.

Industry value chains typically link vendors with end consumers through wholesalers and retailers: market intermediaries can mediate transactions for either wholesale markets or retail markets. The tremendous growth of the Internet, and particularly the World Wide Web, has recently increased the number of new intermediaries for retail markets, such as Amazon, CDNow, and Internet Shopping Network. These intermediaries establish electronic retail malls for a wide variety of products and enable consumers to compare retail products from several vendors and to purchase these retail products electronically. Similarly, market intermediaries can establish electronic marketplaces for wholesalers, who buy commodities in bulk at the wholesale level and distribute the purchased items to retail chains.

In this paper, we focus on market intermediaries for wholesalers, rather than for retail consumers. Electronic intermediaries for wholesale transactions differ from those for retail sales. Electronic retail commerce systems generally do not include the function of discovering the market price of goods [10], although they have potential to influence retail prices by increasing competition among suppliers [2]. They usually employ posted pricing [16], where suppliers post selling prices and consumers decide how many items to buy at the posted price. By contrast, suppliers in wholesale markets often bring fixed quantities of products without predetermined price tags, in which case the suppliers are not price-makers but price-takers. Electronic intermediaries for these wholesale markets need to provide mechanisms to determine the market price of goods through either electronic auctions or electronic negotiations.

In addition, transactions in wholesale markets take place regularly (every day or every week) for a restricted range of goods. Buyers in wholesale markets are generally not consumers, but instead, resell purchased items to retailers or to consumers. Since qualities of products offered in wholesale markets may widely vary (even products from the same producer differ in qualities time to time, as in the case of agricultural products such as livestock or cut flowers), detailed descriptions of product qualities are essential for potential buyers. This contrasts 1

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1 Wholesale markets exist in most industries for commodity goods such as used-cars, cut flowers, cotton and so on. In some industries, such as the fresh meat industry of the US, for instance, the Consent Decree of late 1920s prohibits some meat packers from retailing and thus the wholesaling is necessary for market transactions.
with electronic retail shopping systems, where consumers purchase goods based on price tags and brand names because offered products are mostly standardized and mass-produced (products of same brand are identical).

3. Research Model

In wholesale markets, sellers typically bring their products to a physical trading site (such as auctions) to offer their products. Buyers wishing to purchase goods also need to be present at the marketplace in order to inspect the offered goods and to bargain or bid for the products offered. Goods sold either by negotiations or auctions are then handed over to buyers, who pay for the purchased goods and transport them back to their locations. Thus, product flows and market transactions are typically coupled in traditional wholesale markets.

When new intermediary firms introduce on-line wholesale trading systems in the industry value chain, they reengineer the traditional transaction processes by separating product flows from market transactions. In electronic commerce mediated by market-making firms, buyers and sellers place bids and offers via terminals connected to the host computer of the intermediary, instead of coming to a physical market site. Goods are sold through online transactions without physical presence of offered products. In this virtual marketplace, transactions take place based on information provided (descriptions) and products move from sellers directly to buyers only after on-line transactions are completed [13]. The electronic intermediaries initiate this market process innovation to separate the product movement from transactions by utilizing computers and advanced communication technologies.

Figure 1. Research model

Our research model for this study is shown in Figure 1. On the one hand, electronic market systems introduced by electronic intermediaries improve market efficiency by reengineering transaction processes. On the other hand, the separation of product movements from market transactions through electronic commerce systems creates new transaction risks for market participants. Electronic intermediaries should minimize transaction risks by establishing policies and rules to build trust among market participants. These institutional rules differentiate electronic markets from traditional markets by focusing on transactions of higher quality products. As a result, contract prices in electronic intermediary markets are higher than other markets.

3.1 Increased Market Efficiency

Market transactions consist of search, contract formation and trade settlement [7, 11]. The search reflects the process by which traders obtain information on potential trading counterparts that best fit their preferences. Once trading opportunities are discovered, the next step is contract formation, such as agreement on transaction prices. If potential trading parties fail to reach an agreement on transaction terms, negotiations may have to be repeated with many firms before a contract is finally formulated. The trade settlement process clears the transactions through physical exchanges of goods and accompanied payments.

The introduction of electronic intermediary services - separation of product flows from market transactions - can increase efficiency for search, contract formation and trade settlement involved with wholesale trading [10]. Electronic intermediaries can offer information regarding available products in markets that can be accessed by market participants through their computer terminals at any time, thus significantly reducing search cost of buyers [2]. Traders who used to get information regarding available trading partners upon their arrival at the traditional market can be informed in advance about prospective trading partners. Furthermore, electronic intermediaries can provide information on recent transactions, including quantities of products recently sold and prices paid. This post-trading information will keep traders well informed of the market price of goods with specific characteristics of interest to buyers or sellers, thus facilitating selling and buying decisions.

Sellers in wholesale markets establish reserve prices for transactions because they do not have perfect information about the consequences of their actions in markets. The reserve price plays a role as sequentially rational rules under incomplete market information [17]. Suppliers in traditional wholesale markets are often forced to accept prices lower than their reserve prices during the negotiation, especially when the transportation cost of bringing unsold products back to the seller's location is high. If the product movement is separated from the market transactions, sellers can keep their reserve prices relatively firm since unsold products do not incur return transportation costs [9].
In return, buyers using the electronic intermediary services can enjoy wider choices. Traditional wholesale markets (such as auctions for agricultural products) typically consist of several regional markets scattered around the country. Regional markets have limits in the amount of offered products since they need to hold the inventory until the moment of transaction. The electronic intermediaries can enlarge the pool of product offers without expanding physical infrastructure, such as a storage capacity. The establishment of national markets, rather than regional markets, increases the possibility that buyers can find preferred suppliers in terms of prices and product characteristics.

3.2 New Transaction Risks

Two important assumptions about human behaviors in transaction cost analysis are opportunism and bounded rationality [21, 22].

Buyers and sellers enter into contracts with each other subject to potential opportunistic behaviors of trading counterparts: trading parties can conceal or distort information to their benefit and to the detriment of their trading partners. Since individuals have limited information-processing capacity, traders are unable to foresee and prepare for all undesirable contingencies that might be caused by opportunistic behaviors of their trading counterparts.

Separation of product flows from market transactions through on-line trading is likely to increase the transaction risks and uncertainties for traders. Unlike traditional wholesale markets where all products are brought to a market site for evaluation, buyers using electronic intermediaries have to make purchasing decisions based on information from their terminals without physically inspecting the products, thus encountering risks of incomplete and distorted information by sellers. Since qualities of products offered to wholesale markets (e.g. cut flower markets) can widely vary depending on suppliers (even characteristics of products from the same supplier vary time to time), the use of electronic networks for market transaction can further magnify the information asymmetry phenomenon. If the electronic intermediaries fail to ensure that the information about products properly reflects the original products or if they are not equipped with means to protect buyers from misrepresentation, buyers are not likely to adopt the new on-line trading services.

3.3 Trust Building and Differentiated Markets

Large firms in auto and grocery industries in the US have been using the EDI-based electronic alliance (or electronic hierarchy) to decouple logistics from transactions in an attempt to improve channel performance [5, 14, 18]. These electronic alliance systems, where selling and buying firms adopt EDI-type standards for electronic commerce, also enable firms to realize commercial trades over computer networks [3, 12]. Electronic alliances exist in bilateral settings where a relationship between a supplier and a customer has already been established. Transactions using EDI are typically executed based on pre-established business contracts that regulate details of the on-line trading between firms and resolve risks and uncertainties involved with electronic commerce.

In contrast, electronic markets introduced by market intermediaries intend to serve for multilateral business settings where a large number of buying and selling firms, who may have no pre-established business relationships, execute on-line transactions. Cost-effective IT infrastructure, such as a standard interface, electronic product catalogues, telecommunication networks and powerful search mechanisms, is essential for the new intermediary to implement electronic commerce among these firms. It is a too simplistic view, however, that electronic networks will automatically create open and trusting inter-firm relations for instant or ad hoc transactions between multiple firms who have no previous business contacts with each other.

Take credit card firms as an example. Credit card firms, which mediate financial transactions between merchants and consumers, provide not just technologies but also institutional rules to protect both merchants and consumers from transaction risks. Their extensive institutional policies, which are developed to regulate duties and responsibilities of merchants and customers, enable a credit card holder to dine at a restaurant in a foreign country. Similarly, the institutional policy is a necessary component to establish trustworthy electronic intermediaries. The provision of IT infrastructure alone will produce electronic markets with relatively high transaction risks for market participants. Electronic intermediaries, through some trust building policies, should overcome the transaction risks resulting from on-line transactions and establish trustful marketplaces.

In order to build a trustful electronic market, electronic intermediaries should address product evaluation
processes. Because buyers purchase products based only on electronic descriptions, a rigorous process for product evaluations is important to protect buyers from misinformation. Electronic intermediaries would not allow products with lower quality to be offered in order to avoid disputes over quality of products sold in their markets. Buyers would prefer relatively higher quality products to reduce quality uncertainties in their transactions. These would make transactions focused on products with higher qualities, differentiating the electronic markets from traditional markets. Accordingly, average prices in electronic intermediary markets would be higher than prices in non-electronic marketplaces. In the following sections, we test this research model by comparing transactions in AUCNET and traditional markets.

4. AUCNET

Used-car dealers in Japan typically go to an auto auction site to locate a car if a vehicle desired by clients is not in their inventory. In traditional auto auction markets, buyers and sellers are assembled at a central auction site. Cars are brought onto the auction floor one at a time. Most buying dealers personally inspect the cars prior to the auction. Cars are sold by English auctions: the auctioneer starts with a low price and continues to increase the bid price until the highest bid is registered. Traditional auction markets adopt a POS (point of sales) system, introduced in late 1970s, in which buyers press a POS button to register their bid, instead of raising their hands [19]. The aggregate volume of cars sold at traditional auto auctions has been increasing at about 20% annually over the past decade. In 1996, over 4 million cars were brought to 144 auto auction sites and more than 2.2 million vehicles worth ¥1,615 billion (US$ 11.5 billion) were sold in the auction markets.

AUCNET is one of auto auction sites for used-car dealers. In contrast to traditional auto auction markets, cars are sold using video images, character-based data, and a standardized inspector rating in AUCNET. For selling dealers, the first step in the process is to apply for the consignment to offer cars through AUCNET. Once the consignment application is received, AUCNET dispatches one of its mechanics to inspect the offered vehicle. The inspector assesses the condition of cars and takes several photos (exterior and interior shots) of the vehicle. The inspection results (images and text data) are then entered into AUCNET central computer for the auction catalogue editing. The auction catalogue, which shows information on all cars to be sold and the time block (auction schedule) they would be sold in, is transmitted to all members prior to the electronic auction. If a dealer is interested in a specific car listed in the catalogue, he or she can access text-based information and can preview its images from his/her computer terminal.

During the electronic auction in AUCNET, buyers and sellers remain at their respective businesses. To attend the electronic auction, buyers use joysticks in their PCs that are connected to the central computer of AUCNET (see AUCNET equipment in Figure 2). Buyers bid by pressing
the button on the top of joysticks, which will increase the current bid by ¥3000. As the bid price approaches the reserve price, the system informs the bidders that the car would actually be sold if bid is raised slightly more. Finally, when the time between bids reaches a certain threshold, the system selects the last high bid as the winner, and the auctioneer announces that the car is sold (voice signal) with text signal of "SOLD" flashed on the screen. It typically takes about 20 to 25 seconds on average to auction off one car.

A car sold by AUCNET remains at the seller's location until the electronic transaction is completed. Sellers then have a transport company deliver purchased cars directly to buyer locations. Successful buyers and sellers receive a report detailing the transaction within two days. Buyers have to pay funds to AUCNET upon receiving the report. Sellers are paid from AUCNET once they send the document (title of the car) to AUCNET.

AUCNET started its service in May 1985 with 560 dealer members. It listed 33,458 vehicles in 1986 with 14,944 cars sold. Since then, AUCNET’s throughput (listed cars) has increased at an annual compound growth rate of 26%. Figure 3 shows the AUCNET’s performance over the past five years. In 1996 AUCNET listed 249,677 vehicles, of which 48% (118,840 vehicles) were sold through electronic auctions. The membership network among dealers has continued to expand at a rate of about 100 per quarter, reaching 4,850 of 20,000, so about 24% of dealers at the end of 1996.

AUCNET has become the largest among 144 auto auctions in Japan. In 1996 AUCNET's market share accounted for 6.2% (number of vehicles listed in AUCNET to that offered to all 144 auto auctions) of all sales. USS Tokyo, which was the largest auction market among traditional (non-electronic) markets in 1996, reported a market share of only 4.2%. AUCNET has carved out a large and attractive niche in the top end of the
wholesale used-car market using computer and advanced communications technology without owning a single parking space to store cars to be auctioned.

5. Market Efficiency and Transaction Risks

5.1 Increased Market Efficiency

AUCNET has created an electronic intermediary service that increases the efficiency of the search, negotiation, contract formation and settlement of used-car transactions. AUCNET's strength over traditional auto auctions is its ability to facilitate the search for cars by used-car dealers. Attending physical auto auctions is a time consuming process for most dealers. Because there is no precise schedule for when certain cars would be sold, a dealer may need to attend a traditional auction the entire day to bid on only one or two cars. Since used-car dealers usually engaged in sales activities themselves, they would lose sales opportunities while attending traditional auctions. In AUCNET, used-car dealers can limit their time involved in the auction process to only the cars they are interested in buying because AUCNET auction catalogue (including auction schedule) is distributed in advance. When a car desired by a client is not in his/her stock, a dealer can download the data and images of offered cars through the electronic network, show the information to the client, and include the car in his/her bidding list upon the client's request.

Furthermore, AUCNET provides member dealers with valuable post-transaction information. At any time, dealers can access the database that displays information on the most recent five transactions of the same model, including their quality characteristics and prices paid by buyers (minimum price, maximum price and average price). This post-trading information keeps market participants well informed of the market price of goods with specific characteristics of interest to used-car dealers.

Sellers who brought their cars to the traditional auction were often forced to accept prices lower than their reserve prices because the transportation cost of bringing unsold products back home was high. The separation of transportation from the auction process enables sellers to keep their reserve prices relatively firm [9]. This is reflected in AUCNET's slightly lower contract rates relative to traditional auto auctions. In 1996, 55% of cars registered in traditional auto auctions were sold, while AUCNET sold 48% of cars listed.

In return, AUCNET provides buyers with more choices. Most traditional auto auctions in Japan are located in metropolitan areas where it is becoming increasingly difficult and costly to secure parking spaces for used-cars for sale. Thus, traditional auctions have limits in the number of used-car sales. AUCNET created the largest auto auction without a single parking space, listing around 250,000 vehicles in 1996. AUCNET can easily accommodate an increasing sales volume, with expected annual growth rate of 15% projected over the next five years. This contrasts with traditional auto auctions whose parking capacity limits the number of offered cars. As a result, buyers in AUCNET enjoy greater vehicle choices than are available in regional auto auctions.

5.2. New Transaction Risks and Trust Building

Although IT infrastructure was a necessary factor for AUCNET's success, the firm's ability to translate technical feasibility into institutional realities was real challenge in creating new electronic intermediary services. The separation of car movements from market transactions has created new transaction risks for buying dealers. In traditional auto auction markets, all vehicles are brought to a market site for evaluation and buying dealers personally inspect cars in the market location. In contrast, AUCNET does not allow a buying dealer to "kick the wheels" to formulate personal assessments of used-car qualities. Buyers in AUCNET have to make purchasing decisions based upon information alone without physically inspecting cars, thus facing risks of incomplete and distorted information by sellers. Transaction of secondhand vehicles is a classic example of a market with asymmetric information; there is always a great possibility that sellers may not reveal hidden defects of cars.4

In order to reduce these transaction risks resulting from uncertain product quality, AUCNET established a rigorous car inspection process. Used-car sellers must have their vehicles inspected by AUCNET mechanics. The inspection results are summarized in a single number between 1 and 10 (10 indicates a new car, and a car rated 5 or 6 could be resold to the consumer without additional repair work). Most buying dealers use this number as a key decision variable when purchasing a car, even though more detailed results of the inspection are available. To reduce the transaction risks of buyers further, AUCNET targets relatively high quality cars for its services. A car whose inspection rate is lower than 4 cannot be offered to AUCNET.

AUCNET has also introduced a standard procedure to resolve disputes over the condition of a car sold by its system. Once cars are delivered, buyers have five days to register complaints with AUCNET. The complaints

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4 Akerlof [1] presents transactions in second-hand cars as an example of a market with asymmetric information. It would be very costly for a buyer of the second-hand car to determine accurately its true quality. There is no guarantee that the seller of the car would uncover his/her knowledge on its history and quality during the transaction, particularly if the vehicle is a "lemon" that the seller is eager to sell.
typically involve a buyer's allegation regarding missing parts in the car or other mechanical defects. AUCNET then has the car assessed by a third party, usually a manufacturer's dealer, and obtains a judgment of the car's condition and estimate to repair it. The consignment contract requires that AUCNET members abide by AUCNET's decisions in such matters. If either party is not satisfied by this arbitration, AUCNET allows them to appeal to a "claims committee," which consists of peer dealers and makes a final decision over the claims. The rigorous inspection and standardized process have significantly reduced buyers' transaction risks resulting from the misinformation of cars.

6. Trust Building and Market Differentiation

Our research model hypothesizes that AUCNET's rigorous trust building processes, combined with buying dealers' preferences for relatively newer cars, would make AUCNET transactions focused on higher quality cars. To test this research hypothesis, data are obtained from both AUCNET and traditional auction markets. The source data include over one million transaction records of used-cars which were sold in auto auction markets from June 1996 to June 1997. The source data are provided by PROTO Corp., a used-car magazine company, which periodically collect transaction results from many auction sites around Japan. Each record contains information for each specific transaction result, such as transaction date, transaction site (auction market), transaction price, characteristics of the sold car (make, model, color, mileage, engine displacement, age, options), and so on.

In Japan, auto auction markets are divided into two groups depending on locations of auction sites: east-region auctions and west-region auctions. We use the transaction results of east-region auction sites to which AUCNET belongs. The total number of transaction records in the east-region markets accounts for 434,198. Out of these transactions, 10,619 records were from AUCNET while the remaining 423,579 records came from traditional auction markets.

An important factor to investigate is whether there is significance difference in qualities of vehicles sold in the two markets, after removing the effects of differences in mileage and age of cars sold in each auction format. Table 1 contrasts transaction records of AUCNET with those of traditional auction markets. Cars sold in AUCNET have average age of 4.2 years and average mileage of 36,800 km, while cars sold in traditional auction markets are 4.6 year old and have been driven 48,900 km on average. This mean value analysis between the two groups demonstrates that vehicles traded in AUCNET have better qualities (newer with less mileage) than those sold in traditional markets. As a result, the average price of cars in AUCNET is much higher than that of vehicles sold in other auction markets.

<table>
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<tr>
<th></th>
<th>AUCNET (N=10,619)</th>
<th>Traditional Markets (N=423,579)</th>
<th>t-test significance</th>
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<td>Age (year)</td>
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Table 1. Used car quality and price comparisons

According to Table 1, used-car prices in AUCNET are more than twice the prices realized in traditional auction markets. The difference in mileage and age is not large enough to explain this large price gap between the two markets: age of AUCNET vehicles is 9% younger and mileage is 25% less than secondhand cars traded in non-electronic markets. Thus, we can postulate that cars sold in AUCNET are in general more expensive models than those sold in traditional markets: expensive model used-cars generally are lower risk than cheaper cars. Nevertheless, the variance in key quality variables (age and mileage) presents evidence that vehicles traded in AUCNET have better qualities than those sold in traditional markets. As a result, the average price of cars in AUCNET is much higher than that of vehicles sold in non-electronic markets. The quality and price comparison in Table 1 reveals that the AUCNET market is differentiated from traditional auto auction markets: the electronic intermediary markets specialize in high quality and expensive models.

7. Conclusions

The advent of the Internet has recently generated significant interest in the development of electronic commerce applications. The Internet has the potential to evolve into an interconnected marketplace, facilitating the exchange of a wide variety of products and services. The development of this electronic marketplace is expected to bring significant changes in the economics of marketing and distribution channels by creating a new generation of market intermediaries. These electronic intermediaries interpose themselves between suppliers and consumers by taking advantage of new types of economies of scale, scope and knowledge, enabled by the Internet.
Building a cost-effective information infrastructure, which facilitates search for preferable trading partners and reduces transaction costs through online trading, is an important component of the electronic intermediary service. Equally important for successful intermediary is the establishment of trust for market participants. Traders in the electronic marketplace should be able to safely execute transactions with firms for which they have no pre-established business relations (or trust). Institutional policies and processes should be designed to reduce transaction risks of the electronic commerce within intermediary services.

This paper has investigated AUCNET to highlight the importance of trust building for electronic intermediaries in wholesale markets. The AUCNET case suggests that the product evaluation be an important part of intermediary services if electronic intermediary services are introduced to wholesale markets, where qualities of traded products widely vary depending on suppliers. The experience of AUCNET also suggests that trust building processes leads to changes of target markets: electronic intermediary services focus on transactions of relatively higher quality products than traditional markets. Our findings are based on a single industry, and are preliminary. We invite other empirical research to replicate and expand on the current findings.

8. References


