

Does the Internet Make Markets More Competitive?
Evidence from the Life Insurance Industry

This paper seeks to provide empirical evidence on how Internet comparison shopping sites affected the prices of life insurance in the 1990s since the search cost and markups is high before the growth of the internet. The question that this paper tries to answer is “Does the internet make markets more competitive?”. The data type that used in this study was the panel data by examining the market for term life insurance from 1992 to 1997. The authors used individual policy-level micro data from LIMRA international on the prices of insurance policies as well as various owner and policy characteristics and match them to microdata on the growth of the internet usage and online insurance research from Forrester by the same owner characteristic. The authors have fitted hedonic regression for the price of life insurance on characteristics of the policies and the individuals and include a measure of how individual has used the internet overtime or have researched insurance online.

The Regression Model: $P = qa F/(1+r)$

The regression model attempted to explain the price paid for term policies. The dependent variable is log of annual premium per \$1,000 of face value insurance and the independent variables are the face value that pays out on last day of the year (F), probabilities of dying during the period (qa) and the interest rate (r). The occupation dummies and states dummies are included to account for the differences in health or demographic characteristics across group. The result also indicated that when interest rate rises, price will reduce.

As a result, the Internet should reduce search costs for consumers and thereby reduce prices and make markets to be more competitive. The results also indicate that the growth of the Internet has reduced term life prices by 8–15 percent. This implies an increase in consumer surplus of about \$115–\$215 million annually for these specific policies. Using more internet tended to increase price dispersion first but after the usage has spread the dispersion will decrease. This result shows

that the internet has a significant impact on market power and it may lead to large consumer welfare gain.

The question of this research paper is interesting since it shows that at least for some financial product on the internet can reduce search costs and can have a significant impact on market power. It will lead to large consumer welfare gains at the expense of supplier profits and the implication for market value of online and offline companies would not be that important. Moreover, the explanations in this paper can lead to the implication of other products.

Theory that was used in this paper is search theory but the most relevant for their work is the Stahl model. It was used to analyze the impact of search cost and differential information on the distribution of market prices.

In my opinion, The method adopted to answer research question is appropriate but the variable does not include the effect of brading since the range of price cannot be observed for each policy. Therefore, this may mislead people to choose policies without knowing the information.

Lastly, I think the results are quite convincing because the results confirm that, consistent with the theory of search, as comparison shopping has become easier, average prices have fallen significantly and the authors can clearly explained how the rise of the internet make the market to be more competitive thereby reduce prices of term life insurance and lead to large consumer welfare gain.