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

This study wants to examine whether the rise of internet usage had raised the competition in term of price movement and price dispersion, specifically in insurance industry as the internet could reduce customers' search costs. The author conducted regression by using the data on life insurance that had been collected from LIMRA International who conducted surveys of purchases of individual life insurance contracts in the US. For the internet use, authors acquired the data from 1999 survey of Forrester about how long they have been online, as they match demographic information with the data from LIMRA, which were assumed that use of insurance site is proportional to the use of internet began in 1996 when the site had been established. So that the measurement before were all zero. To explain the price paid for term policies, the independent variables used by the researchers were annual premium per $1000 face value of insurance in log form, dummies of age, nonsmoking, gender, marital status, state, occupation, and whether the individual belongs to special risk class, and whether the policy was purchased from an agent or it was a participating policy. To allow economies of scale and diseconomies of scale, they also included policy length and the value of policy dummies in the regression.

As a result, these variables highly explained the variation in prices as policy for men cost 20% more than women and being smoker would cost 45% more compare to nonsmokers. The real price of term policies were continuously falling as the samples were closer to the late part of the data collected while the whole life insurance, which seemed to follow similar pattern at the start, remained constant in 1996 and 1997. As the study included the internet usage in the regression, the result showed that the price fell more during those periods in which the group that adopted the internet site of insurance faster. They observed that during 1992-95 when the insurance site had not existed yet, the growth of internet use wouldn't be correlated to the study even though the price of insurance were falling during those periods so there might be some other unobserved factors. The price dispersion decreased when internet use became more widespread. From 1995 to 1997 the price of life insurance reduced by 8-15% which implied as incremental consumer surplus around $115-$215 million annually.

From my perspective, this paper can prove the effect of search cost significantly as the internet brought information to the customers' hands the insurers weren't able to exploit their surplus similar to the past anymore since the real price and price dispersion had been reduced as concluded by the paper. This situation follow the search cost theory, as people has information in hand due to the lower search cost, they would be able to find the price that match them better therefore the equilibrium price would eventually decreased. The theoretical and logical approach from this paper can be applied in business strategy that related to the customers' information and search costs or we can applied it as the consumer to consider the listed prices and be more eager to acquire information about the price or the availability of the products. For the better result, the researchers should have more specifically acquired the information about the use of internet related to the site of insurance since they had assumed the proportion of internet usage for searching about insurance to be constant.