The Economics of Reputational Information

Prof. Eric Goldman
Director, High Tech Law Institute
http://www.ericgoldman.org • http://hightechlaw.scu.edu
egoldman@gmail.com
Reputational information = information about an actor’s past performance that helps a decision-maker predict the actor’s future performance.

Examples:

<table>
<thead>
<tr>
<th>Unmediated</th>
<th>Mediated</th>
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<tr>
<td>• Word of mouth</td>
<td>• Credit scores</td>
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<td>• Recommendation letters and references</td>
<td>• Investment ratings (bonds, mutual funds)</td>
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<td>• Job evaluations and student evaluations</td>
<td>• GPAs</td>
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<td>• Consumer product reviews and ratings (Amazon star ratings; Ratemyprofessor.com; Avvo; Ripoff Report; BBB)</td>
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<td>• Voting systems?  PageRank, Digg</td>
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Unmediated Reputation

- Unmediated reputation
  - Idiosyncratic
  - Often based on small data sets
  - High transaction costs to find/transmit and assess
  - Hard to police against shills
Mediated Reputation

- **Strengths**
  - Wisdom of the crowds/opinion “portfolio”
  - Editorial filtering => manage infoglut
  - Marketplace incentives to manage database

- **Potential Weaknesses**
  - Users may misinterpret data
    - Faux precision/margin of error
    - Mischaracterization of data outputs
  - Outputs may be one-size-fits-all (insufficiently granular)
  - Editorial filtering/algorithms may be opaque
  - Data sources may not be credible (or credibility too hard to assess)
    - Risks of user attacks, shilling and gaming
  - Mediator may move to pay-for-play
  - Error correction mechanisms can distort database

- **Which weaknesses can be left to market solutions, and which deserve regulatory intervention?**