

Comments on “Does the Internet Make Markets More Competitive?”

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Overview

- Churchill's famous characterization of the former Soviet Union as "a riddle wrapped in a mystery inside an enigma" aptly describes how consumers have traditionally viewed the products and services offered by insurers.

Overview

- However, by lowering search transactions costs, the Internet will make insurance pricing and service quality more transparent to consumers.
 - By reducing transactions costs, the Internet will cause insurance products and services to become even more highly intermediated; thus new intermediaries (such as the online insurance sites mentioned by B&G) will come into being.
 - Consumers should gain in the form of lower insurance premiums (B&G provide us with some preliminary evidence).
 - Insurers should also gain by being able to more accurately classify, underwrite and price risks (I don't think that this will necessarily be a zero sum game!)

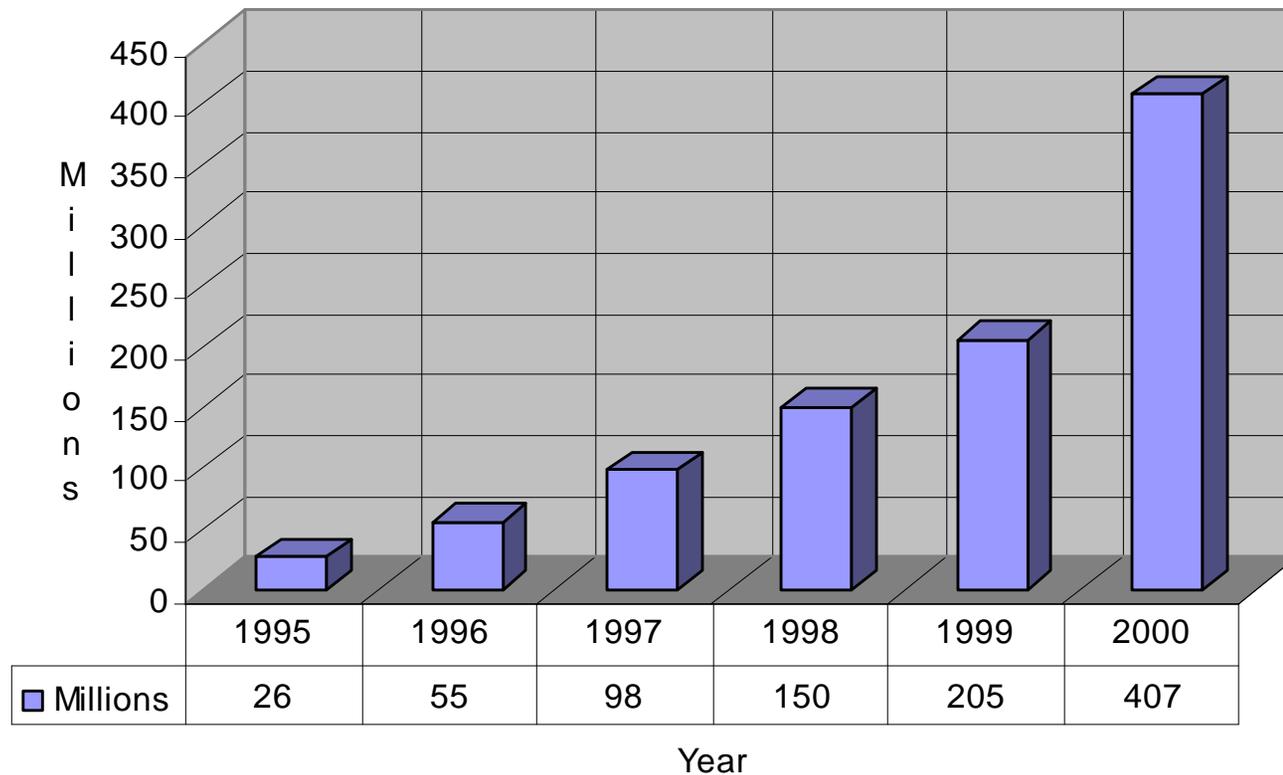
Empirical Results

- As the share of consumers using the Internet to compare prices online rises from zero, price dispersion should initially rise, and then eventually fall. B&G appear to empirically confirm this search theory prediction.
- Brown & Goolsbee's empirical results suggest that the Internet reduced term life insurance prices 8-15 percent, representing an annual increase in consumer surplus of \$115-\$215 million (based upon 1995 data on term life insurance premiums).
 - The magnitude of B&G's results are remarkable, considering the online population is now 4-8 times larger (and much more likely to research insurance online) than it was during the period studied.
 - If similar results hold in other lines of insurance, the overall Internet-derived welfare gains for insurance consumers are potentially of a much larger order of magnitude than reported here.

Worldwide Online Population, 1995-2000

Source: Nua Internet Surveys

(http://www.nua.ie/surveys/how_many_online/index.html)



Growth in Online Insurance

- There has been very limited academic research on the Internet as an alternative distribution channel for insurance products.
- What little “research” exists has been conducted primarily by various consulting firms (e.g., Forrester, Booz Allen Hamilton) using survey methods to forecast the growth in online insurance. The forecasts have tended to significantly underestimate what has actually occurred.

Dollars in New Premiums Expected From Insurance E-commerce (1997-2001)

<i>Dollars in New Premiums (millions)</i>						
	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>	<i>Annual Growth</i>
Auto	\$21.0	\$45.5	\$129.1	\$289.3	\$846.9	152.00%
Homeowners	\$1.1	\$2.4	\$14.3	\$61.4	\$151.9	242.80%
Life	\$16.9	\$28.2	\$41.9	\$66.0	\$108.6	59.22%
Total	\$39.0	\$76.1	\$185.3	\$416.7	\$1,107.4	130.84%

**Source: Gomez, Weistman, and Wooley,
Forrester Research, April 1997.**

Dollars in New Premiums Expected From Insurance E-commerce (2000-2004)

<i>Dollars in New Premiums (millions)</i>						
	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>Annual Growth</i>
Auto	\$1,180.0	\$2,471.0	\$4,794.0	\$9,121.0	\$11,834.0	77.96%
Homeowners	\$474.0	\$573.0	\$679.0	\$946.0	\$1,163.0	25.16%
Life	\$203.0	\$269.0	\$348.0	\$375.0	\$410.0	19.21%
Total	\$1,857.0	\$3,313.0	\$5,821.0	\$10,442.0	\$13,407.0	63.92%

Source: Eyler, Shevlin and Renyi, Forrester Research, April 2000.

Future Directions?

- Update the analysis – we now have more data points, and there is a movement toward transacting online in addition to providing price information in the fashion described by B&G.
- Extend to other lines of insurance?
- What are the implications of the Internet for market structure and performance of the insurance industry? How does this compare with other industries and sectors of the financial services industry?
- Are there gains in producer as well as consumer surplus?