

Chasing Stars: Firms' Strategic Responses to Online Consumer Ratings

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Abstract

In this paper, I show that a common way that platforms display firms' quality ratings incentivizes firms to strategically take costly short-run actions that improve their ratings. Most review platforms display star ratings of goods and services rounded to a half star, rather than display the exact average rating. Since the true average rating is not shown, firms have an incentive to remain just above the rounding threshold in order to have a higher displayed rating. However, once a firm's rating passes the rounding threshold, the incentive to improve the ratings drops as their rating moves farther from the threshold. I study this phenomena in the context of auto repair. I find that there is an excessive amount of bunching around ratings thresholds. The firms' actions toward improving their ratings are typically unobserved, but due to my novel data and the discontinuity of displayed ratings, I can model and infer firm behavior. Specifically, I provide evidence that firms change the services they provide and exert extra effort when they are close to rounding thresholds. Finally, I provide a theoretical framework in order to quantify the actions and provide optimal policies for firm actions depending on their rating and number of reviews in a variety of counterfactual settings.

Video Link:

<https://drive.google.com/file/d/17M4qHFvKpBt518eeL3VtWtAyIP4LQ6VN4/view?usp=sharing>

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