Do Online Reviews Affect an Online Intermediary’s Reputation? A Transaction Cost Economics Perspective

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Abstract
Online reviews have been shown to have an important impact on consumer purchase decisions. In addition, existing research has demonstrated the impact of online reviews on electronic commerce outcomes such as sales. Yet, very little attention has been paid to how online reviews affect one of the important parties in electronic commerce, the online intermediary. Drawing from transaction cost economies and using data from eBay, this study demonstrates that both positive and negative online reviews have a significant impact on an online seller’s reputation. However, an online seller’s reputation does not affect an online intermediary’s reputation significantly. Moreover, consumer loyalty is affected by an online intermediary’s reputation. Being one of the first few studies that analyse on online intermediaries, this study provides important practical implications. The results of this study, therefore, can be used by online sellers and intermediaries to manage online review systems and marketplaces more effectively.

Keywords: Online reviews, Online seller reputation, Online intermediary reputation, Consumer loyalty
Introduction

Because of the improvement of electronic commerce (e.g., better security protocols), consumers are more willing to shop online than before (Picazo-Vela et al., 2010). Among various improvements, online review systems have a critical impact on electronic commerce. An online review system allows consumers to obtain information such as product descriptions, other users’ experience, or product ratings. Because online reviews have a great impact on prospective buyers’ decisions, online reviews have been considered a proxy of overall word of mouth (Zhu & Zhang, 2010).

Since consumers can utilize online reviews to obtain information related to a product or a seller, previous studies have investigated the relationship between online reviews and sales (e.g., Chevalier & Mayzlin, 2006; Hu et al., 2008; Resnick et al., 2006). Another important research stream focuses on the impact of online reviews on seller’s reputation. In general, previous studies have demonstrated that there is a significant relationship between online reviews and seller’s reputation. For instance, Ba and Pavlou (2002) found that feedback mechanisms partly influence seller’s credibility. Similarly, Pavlou and Dimoka (2006) showed that text-comment reviews affect a seller’s benevolence and credibility.

Meanwhile, several studies have shown that a firm’s reputation could affect consumer loyalty. For instance, Bontis et al. (2007) demonstrated that corporate profitability might reside in reputation’s influence on customer loyalty. Casalo et al. (2008) showed a significant positive relationship between reputation and website loyalty. Valenzuela et al. (2010) found that a firm’s ethical reputation helps in retaining customers.

Since one of the major purposes of an online review system is to provide prospective buyers an online seller’s information, this design might affect an intermediary (e.g., Amazon.com, eBay, and Buy.com) as well. Specifically, an intermediary provides an online marketplace for online sellers to sell their products and services. Consumers of these online sellers are encouraged by the intermediary to provide online reviews describing their shopping experience. These online reviews, therefore, provide existing and prospective consumers an insight into the reputation of the online sellers. However, whether the reputation and consumer loyalty of an intermediary are affected by the reputations of online sellers have not been investigated. Thus, the major objectives of this study are to examine how online reviews affect
the reputation of online sellers and whether the reputation of online sellers affects an intermediary’s reputation. To do this, this study uses transaction cost economies as the theoretical base and analyses the relationships among online reviews, online seller reputation, online intermediary reputation, and consumer loyalty systematically. Figure 1 shows the proposed research model.

**Figure 1: Proposed research model**

**Literature review and hypotheses**

In order to survive in the market, firms not only need to offer quality products and/or services but also need to provide convenient shopping alternatives. This competitive pressure results in the adoption of electronic commerce. Using the Internet, firms are able to sell their products and/or services ubiquitously. This phenomenon has led to the increase in the Internet sales from $27 billion in 2000 to $133.6 billion in 2008 (www.usatoday.com).

Although the development and improvement of online marketplaces have significantly reduced consumers’ time and effort to locate products and/or services, online marketplaces are not without risks. These risks include privacy concerns, credit card frauds, and not being able to touch and feel the product. To overcome these issues, many firms have adopted one of the most important electronic commerce mechanisms: online review systems. An online review system is generally defined as a platform that collects, distributes, and aggregates opinions and comments about participants’ past behaviour (Resnick et al., 2000).

Since an online review system is designed to solicit previous buyers’ shopping experience, online review systems have been designed in various ways. For instance, eBay buyers are able to rate sellers in three ways: positive, neutral, and negative. In addition, eBay’s online review platform provides buyers 4 criteria to rate a product including “item as described”,

<table>
<thead>
<tr>
<th>Positive Online Reviews</th>
<th>Online Seller Reputation</th>
<th>Online Intermediary Reputation</th>
<th>Consumer Loyalty</th>
</tr>
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<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Negative Online Reviews</td>
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<td></td>
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</tr>
</tbody>
</table>
“communication”, “shipping time”, and “shipping and handling charges”. Using a 5-point star rating system, buyers are able to provide prospective consumers details about an online seller related to these 4 criteria. Similarly, Amazon.com allows buyers to rate an online seller in three options: positive, neutral, and negative. Amazon.com also uses a 5-point star rating system to show buyers an online seller’s overall online review profile. In summary, modern online review platforms have been designed to allow users to use numerical rating and text comments.

As mentioned earlier, the major purpose of an online review system is to provide prospective buyers information about a product and an online seller. A number of previous studies have investigated and found that online reviews have a significant impact on sales (e.g., Clemons et al., 2006; Dellarocas et al., 2007; Forman et al., 2008; Hu et al., 2008; Zhu & Zhang, 2010). Another research stream suggests that online reviews could have an important influence on seller’s reputation and customer loyalty (e.g., Ba & Pavlou, 2002; Pavlou & Dimoka, 2006).

Yet, past research on online reviews has not focused on the impact of the reputation of online sellers affected by online reviews on an intermediary’s reputation and consumer loyalty. Understanding this research gap is crucial as many intermediaries such as eBay, Amazon.com, and Buy.com have been providing their online marketplaces for online sellers to sell their products. Thus, this study uses the transaction cost economics as the theoretical base since it has been suggested to be a viable theory for explaining online consumer behaviour (Hu et al., 2008).

Transaction cost economies

Developed by Williamson (1979), the theory of transaction cost economics (TCE) argues that asset specificity, uncertainty, and transaction frequency determine whether a transaction is conducted in a market, hierarchy, or hybrid form. TCE consists of two simple yet important assumptions. First, human beings have bounded rationality. Second, people behave in opportunistic ways. Using these concepts, TCE suggests that since people have bounded rationality, they are not able to consider and to assess every possible scenario and therefore engage in opportunistic behaviours.

Although TCE has been adopted as the theoretical base at the organizational level, several researchers have used TCE to explain consumer behaviour in electronic commerce. For instance, Liang and Huang (1998) applied TCE to investigate consumer acceptance of products
in electronic market and found that the acceptance is determined by the uncertainty and asset specificity. Hu et al. (2008) adopted TCE to assess the effectiveness of the online review market and found that consumers pay more attention to both review scores and contextual information including reviewer reputation and reviewer exposure.

In the context of electronic commerce, it is suggested that when consumers intend to purchase on a given online marketplace, they must go through a transaction process (Hu et al., 2008). When engaging in online purchasing, a consumer may not be able to verify the quality of a product or the reputation of a seller’s using descriptions posted on an online review system. This may result in psychological uncertainties and therefore a higher transaction cost is perceived by the consumer. According to TCE, people prefer to engage in transactions that minimize their transaction costs. Using this concept, one can argue that an online consumer will prefer to purchase a product from a reputable online seller. In other words, positive online reviews will have a significant impact on an online seller’s reputation. Thus, this study hypothesizes the following:

Hypothesis 1a: Positive online reviews will have a positive impact on an online seller’s reputation.

Hypothesis 1b: Negative online reviews will have a negative impact on an online seller’s reputation.

As mentioned earlier, many firms and sellers have started to sell their products on their websites and/or on intermediaries’ online marketplaces. Although many previous studies have investigated the relationship between online reviews and seller’s reputation, very little attention has been paid to how seller’s reputation affects an online marketplace provider, an intermediary.

Online reviews are usually used as a means for online shoppers to acquire information. However, unlike traditional face-to-face transactions, online transactions involve process uncertainty, which refers to the case where consumers purchase products from undesired vendors (Hu et al., 2008). The decision to purchase from undesired vendors might result from a consumer’s lack of information of the vendors. Because of the inability to obtain information
about the undesired vendors, consumers are then engaging in uncertainty reduction activities in order to reduce or to eliminate the risk associated with this uncertainty (Berger & Calabrese, 1975; Hu et al., 2008).

In the context of electronic commerce, an intermediary provides an online marketplace for sellers who sell their products and/or services in the marketplace. In order to provide better shopping experience, many intermediaries have also launched online reputation systems where both sellers and buyers are able to provide online reviews regarding their transaction experience. This close relationship between an intermediary and an online seller might create an impact on the intermediary’s reputation. Specifically, an online review system provided by an intermediary offers buyers an opportunity to describe their shopping experience. Therefore, if buyers perceive that there are many disreputable sellers and/or existing buyers have had negative shopping experience in an online marketplace, they might attribute this situation to an intermediary’s lack of effort in quality control and assurance. Buyers, therefore, may perceive the intermediary as a disreputable party. Thus, this study hypothesizes the following:

Hypothesis 2: The reputation of an online seller will have a positive impact on the reputation of an intermediary.

To survive in the competitive market environment, firms have to establish a long-term relationship with customers. Since the development of electronic commerce, the number of participants in electronic commerce has increased dramatically. Because of this phenomenon, many researchers have paid attentions to factors that influence consumer loyalty. For instance, Casalo et al. (2008) found that website familiarity and usability have a significant impact on consumer loyalty. Hansen et al. (2008) demonstrated that corporate reputation affects customer perceived value, which in turn affects word-of-mouth and customer loyalty. By examining electronic commerce in two cultures (i.e., Korean and USA), Jin et al. (2008) found that firm customer satisfaction leads to firm reputation, which in turn contributes to customer loyalty in both cultures.

Meanwhile, it is suggested that reputation can be seen as the result of a firm’s relational history with the context where it operates (Casalo et al., 2008). Based upon this concept, a firm’s
reputation is one of the indicators to the quality of the products and/or it provides (Kijewski et al., 1993). In the context of electronic commerce, an online intermediary’s reputation can affect consumer’s perceived quality of the sellers, which in turn may determine whether consumers are loyal to the intermediary. In other words, one can expect that an intermediary’s consumer loyalty can be affected by its reputation determined by consumer’s perceived quality of the sellers in the marketplace. Thus, this study hypothesizes the following:

Hypothesis 3: An intermediary’s reputation will have a positive impact on its consumer loyalty.

Research methodology
Sample and procedure
This study used a cross-sectional survey approach. Instruments were distributed to undergraduate students at a mid size U.S. university in the Southwest region. This study considered using undergraduate students a viable approach as young people (i.e., between 18 and 32-year old) are the dominant Internet users (Jones & Fox, 2009; McGann, 2005) and college students are the major Internet shoppers (Lim et al., 2006).

A total number of 162 students were invited to participate in this study. After eliminating 28 unusable responses, the total number of usable responses was 134, which yielded a response rate of 82.72%. The average age of the participants was 20 years, 39% of the participants were female, and 91% of the participants have read online reviews in the past.

Measures
Online seller reputation and online intermediary reputation were measured by adapting and modifying the 10-item scale developed by Fuller et al. (2007) using a 7-point Likert scale ranging from 1 (strongly disagree) to 7 (strongly agree). The scale consists of three dimensions including competence, benevolence, and integrity. The internal reliability measured by Cronbach’s alpha for each dimension was 0.87, 0.83, and 0.84, respectively.

Consumer loyalty to an intermediary was measured by using a 7-item questionnaire developed by Zeithaml et al. (1996) with a 1 (strongly disagree) to 7-point (strongly agree) Likert scale. The internal reliability measured by Cronbach’s alpha was 0.91.
Data analysis

The data analysis contained four steps including online review profile analysis, validity and reliability analyses, descriptive data analysis, and hypothesis testing using partial least squares (PLS) technique. In the following sections, each of the steps is discussed.

Online review profile analysis

In order to examine the impact of online reviews, this study followed the procedures used in Ba and Pavlou’s (2002) study. Specifically, this study randomly examined 253 online review profiles of the eBay sellers. Next, each of the online sellers’ review profiles was logarithmically transformed into the number positive reviews and negative reviews. The purpose of performing logarithmic transformation is that because this study involved reputation and loyalty and concave function might play an important impact on individual perception (Ba & Pavlou, 2002).

Reliability and validity analyses

To assess reliability of measurement scales for the 3 constructs (i.e., online seller reputation, online intermediary reputation, and consumer loyalty), Cronbach’s alpha was calculated using SPSS17. The results of reliability analysis indicated that all scales had an acceptable Cronbach’s alpha (i.e., > 0.60) recommended by Hair et al. (2006). To assess validity, three analyses were performed including construct, discriminant, and convergent validity analyses. Construct validity was assessed via SmartPLS2.0. After 17 iterations of the first factor analysis, a 3-factor measurement model emerged, where all indicators loaded as expected (i.e., > 0.60) on its corresponding construct (see Table 1). The analysis also demonstrated that variance extracted of the 3 construct (see Table 2) exceeded the recommended composite reliability value a value of 0.50 or above (Fornell & Larcker, 1981). Thus, convergent validity was assumed. Discriminant validity was tested by verifying that all items loaded high (i.e., > 0.50) only on one factor. As indicated in Table 1, all items loaded high on the corresponding constructs and therefore, discriminant validity was achieved.

Reliability of the scales was assessed by using Cronbach’s alpha. Table 3 shows the internal reliability of the scales used in this study. Cronbach’s alpha for all constructs fell within
acceptable ranges (≥ 0.70) (Robinson et al., 1991). Thus, the reliability of the scales was considered adequate.

<table>
<thead>
<tr>
<th>Item</th>
<th>Online Seller Reputation</th>
<th>Online Intermediary Reputation</th>
<th>Consumer Loyalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>osr1</td>
<td>0.70</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr2</td>
<td>0.87</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr3</td>
<td>0.83</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr4</td>
<td>0.79</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr5</td>
<td>0.74</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr6</td>
<td>0.73</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr7</td>
<td>0.72</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr8</td>
<td>0.68</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr9</td>
<td>0.77</td>
<td></td>
<td></td>
</tr>
<tr>
<td>osr10</td>
<td>0.79</td>
<td></td>
<td></td>
</tr>
<tr>
<td>oir1</td>
<td></td>
<td>0.67</td>
<td></td>
</tr>
<tr>
<td>oir2</td>
<td></td>
<td>0.88</td>
<td></td>
</tr>
<tr>
<td>oir3</td>
<td></td>
<td>0.80</td>
<td></td>
</tr>
<tr>
<td>oir4</td>
<td></td>
<td>0.83</td>
<td></td>
</tr>
<tr>
<td>oir5</td>
<td></td>
<td>0.80</td>
<td></td>
</tr>
<tr>
<td>oir6</td>
<td></td>
<td>0.79</td>
<td></td>
</tr>
<tr>
<td>oir7</td>
<td></td>
<td>0.66</td>
<td></td>
</tr>
<tr>
<td>oir8</td>
<td></td>
<td>0.70</td>
<td></td>
</tr>
<tr>
<td>oir9</td>
<td></td>
<td>0.82</td>
<td></td>
</tr>
<tr>
<td>oir10</td>
<td></td>
<td>0.73</td>
<td></td>
</tr>
<tr>
<td>cl1</td>
<td></td>
<td></td>
<td>0.94</td>
</tr>
<tr>
<td>cl2</td>
<td></td>
<td></td>
<td>0.81</td>
</tr>
<tr>
<td>cl3</td>
<td></td>
<td></td>
<td>0.94</td>
</tr>
<tr>
<td>cl4</td>
<td></td>
<td></td>
<td>0.91</td>
</tr>
<tr>
<td>cl5</td>
<td></td>
<td></td>
<td>0.91</td>
</tr>
<tr>
<td>cl6</td>
<td></td>
<td></td>
<td>0.83</td>
</tr>
<tr>
<td>cl7</td>
<td></td>
<td></td>
<td>0.82</td>
</tr>
</tbody>
</table>

Note: osr = online seller reputation; oir = online intermediary reputation; cl = consumer loyalty

Table 1: Analysis of the measurement model
<table>
<thead>
<tr>
<th>Measure</th>
<th>Number of Indicators</th>
<th>Composite Reliability</th>
<th>Variance Extracted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Online Seller Reputation</td>
<td>10</td>
<td>0.89</td>
<td>0.55</td>
</tr>
<tr>
<td>Online Intermediary Reputation</td>
<td>10</td>
<td>0.90</td>
<td>0.60</td>
</tr>
<tr>
<td>Consumer Loyalty</td>
<td>7</td>
<td>0.96</td>
<td>0.79</td>
</tr>
</tbody>
</table>

**Table 2: Variance extracted for major constructs**

<table>
<thead>
<tr>
<th>Construct</th>
<th>Scale</th>
<th>Number of Items</th>
<th>Cronbach’s alpha</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Online Reviews</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Online Seller Reputation</td>
<td>7-point Likert Scale</td>
<td>10</td>
<td>0.87</td>
<td>Fuller et al. (2007)</td>
</tr>
<tr>
<td>Online Intermediary Reputation</td>
<td>7-point Likert Scale</td>
<td>10</td>
<td>0.88</td>
<td>Fuller et al. (2007)</td>
</tr>
<tr>
<td>Consumer Loyalty</td>
<td>7-point Likert Scale</td>
<td>7</td>
<td>0.75</td>
<td>Zeithaml et al. (1996)</td>
</tr>
</tbody>
</table>

**Table 3: Measurement instruments and internal reliability**

Descriptive data analysis

After assessing reliability and validity, this study performed a descriptive data analysis. Specifically, this study first examined the correlations for all variables. As shown in Table 4, online seller reputation and consumer loyalty were highly correlated. However, because consumer loyalty was the dependent variable, multicollinearity was not a potential issue and hypothesis testing was proceeded.
Table 4: Descriptive statistics and correlation matrix for all constructs (N = 134)

<table>
<thead>
<tr>
<th></th>
<th>M</th>
<th>S.D.</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Positive Reviews (Log)</td>
<td>85.12</td>
<td>2.913</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Negative Reviews (Log)</td>
<td>12.14</td>
<td>3.592</td>
<td>0.053</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Online Seller Reputation</td>
<td>5.482</td>
<td>1.162</td>
<td>0.135</td>
<td>0.140</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Online Intermediary Reputation</td>
<td>4.966</td>
<td>1.540</td>
<td>0.113</td>
<td>0.081</td>
<td>0.098</td>
<td></td>
</tr>
<tr>
<td>5. Consumer Loyalty</td>
<td>5.591</td>
<td>1.127</td>
<td>0.096</td>
<td>0.052</td>
<td>0.132</td>
<td>0.511**</td>
</tr>
</tbody>
</table>

* p ≤ 0.05; ** p ≤ 0.01
Log = logarithmic transformation

Hypothesis testing

Each hypothesis was tested using PLS technique. The standardized path coefficients (b) and t-values obtained from the analysis were used to interpret their respective path coefficients and significance. The results are shown in Figure 2.

Figure 2: Partial least squares analysis results
Hypothesis 1a was supported. Positive online reviews had a significant positive impact on an online seller’s reputation \((b = 0.62, \ t = 9.29, \ p < 0.05)\). Hypothesis 1b was supported. Negative online reviews had a significant negative impact on an online seller’s reputation statistically significant \((b = 0.58, \ t = 8.79, \ p < 0.05)\). Surprisingly, hypothesis 2 was not supported \((b = 0.03, \ t = 0.31, \text{n.s.})\). Although the relationship was not significant, the positive direction of the relationship was as predicted. Hypothesis 3 was supported \((b = 0.36, \ t = 2.37, \ p < 0.05)\). In other words, an online intermediary’s reputation is positively affected by an online seller’s reputation.

In summarizing the hypotheses, both positive and negative online reviews were found to be significant predictors of an online seller’s reputation (H1a and H1b). However, an online seller’s reputation was not a statistically significant predictor of an online intermediary’s reputation (H2). Finally, an online intermediary’s reputation (H3) was found to be a significant predictor of consumer loyalty.

**Discussion**

The PLS results showed that both positive and negative online reviews were significant predictors of an online seller’s reputation. This result is not surprising as it is suggested that online reviews play important roles in determining business success (Resnick et al., 2000). Moreover, since the literature has demonstrated that online reviews are an effective form of word-of-mouth and could affect sales, reputation, customer expectation, trust, etc., the results of this study confirms the important impact of online reviews on an online seller’s reputation.

The results failed to support the hypothesis of the relationship between an online seller’s reputation and an online intermediary’s reputation. The lack of support for this relationship could be explained by two reasons. First, it is suggested that time plays a crucial impact on the reputation (e.g., Chun & Davies, 2010). Because this study used a cross-sectional survey approach, time effect on reputation may not be able to be captured. Second, because an online intermediary provides an online marketplace for various online sellers to sell products and/or services, an online intermediary’s reputation may be affected by all online sellers’ reputations. In other words, a single online seller’s positive or negative reputation alone may not have such a strong effect on an online seller’s reputation. Although the results showed that there was no
significant relationship between an online seller’s reputation and an online intermediary’s reputation, the positive direction of this relationship provides an important practical implication. Specifically, an online intermediary needs to proactively monitor its online sellers’ activities and take corrective actions when needed. By ensuring that its online sellers are honest, genuine, and competent, an online intermediary should be able to manage its reputation more effectively.

Finally, an online intermediary’s reputation was found to be related to consumer loyalty. Although this result is supported in traditional business environment (i.e., face-to-face transaction), this study extends this evidence to the virtual business environment. The practical implication of this relationship is that by managing its reputation more effectively, an online intermediary is able to prevent existing consumers from switching to other intermediaries and to increase consumer satisfaction. This, therefore, allows the online intermediary to attract more online sellers and generate more profits.

**Limitations and Future Research Directions**

Although this study intends to provide insight into individual perception of online reviews in the context of electronic commerce, it is not without limitations. A first limitation of this study is the possible misrepresentation of the truth results from the use of a self-report survey approach (Zikmund, 2003). Thus, future research may consider using other research approaches such as interviews. A third limitation is the use of undergraduate students as samples, which may not represent all Internet shoppers. Although college students are the major Internet shoppers (Lim et al., 2006), Future research that uses different types of Internet shoppers is needed to validate the results of this study.

A second limitation of this study is that because it attempts to identify the effect of online reviews using eBay sellers, an individual’s prior experience may play a crucial role on the perceived reputation of eBay. Thus, the generalizability may fluctuate across other online intermediaries. The results of this study, therefore, should be used with caution.

**Conclusion**

This study has sought to investigate and test the relationships among online reviews, an online seller’s reputation, an online intermediary’s reputation, and consumer loyalty. The results
provide support for online reviews (positive and negative) as statistically significant predictors of an online seller’s reputation. In addition, this study found that an online intermediary’s reputation was a significant predictor of consumer loyalty. Although this study is not without limitations, findings of this study may be used by online sellers and intermediaries to manage their reputations more effectively.

References


