



Multiple Viable Domain Name Marketplaces Can Co-exist

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Examining current domain name activity without a model provides only a picture of current patterns of what stakeholders are looking for, what is currently in vogue, and what information is being discounted in current market prices. However, such analysis does not provide any insight into the structure, behavior, performance of firms and markets, or antitrust issues.

Below, I will outline the characteristics of the industrial organization model that is most appropriate for analyzing the domain name marketplaces. Although domain name markets exhibit characteristics that can lead to a dominant firm, I will use the model to: (a) highlight industry forces that make more than one viable marketplace possible; (b) highlight antitrust implications, and (c) shed some light on price dispersions across marketplaces.

Two-sided Markets and Concentration

The major domain name marketplaces are: AfterNIC, DomainMart, Moniker, and Sedo. These marketplaces can be characterized as two-sided markets, whereby: (1) the population consists of two (or more in general) distinct groups of customers, say, buyers and sellers; (2) a member of one group benefits from demand being coordinated with one or more members of another; and (3) a necessary, but not sufficient condition, is

that the marketplace (usually an intermediary) is more efficient in facilitating the exchange coordination than a bilateral relationship between buyers and sellers. Nevertheless, for the existence of an economically viable market, the marketplace must be able to derive economic profits from facilitating the coordination by appropriately charging each side of an exchange.

These markets face a “chicken or egg” problem that must be resolved. An example of a two-sided market is a club, whereby its success depends on the ability to attract enough of the two groups, men and women. Men would not go to clubs that women don’t frequent because they cannot get a date and vice-versa. To solve the chicken-egg problem, a club can, for example, require a cover charge for men, while women pay no cover and can buy cocktails for a dollar. Another example of a two-sided market is captured by the interaction between an Internet user and an online advertiser mediated by a search engine, such as Google, whereby currently only the advertiser is charged.

Cross-group interaction in two-sided markets is a source of increasing returns, which can result in concentration of exchange activity in a single

marketplace.¹ Other sources of increasing returns are technologies that reduce participants' transaction costs, provide efficient risk sharing,² and satisfy preferences of participants such as variety.³ Recent battles among online auction sites have resulted in eBay as the dominant player in the U.S., with Yahoo! at a distant second with 5 percent of the market.⁴ In the art market, Christy's and Sotheby's have dominated the market for over a century.

Current industrial organization research suggests that an industry that exhibits increasing returns does not necessarily tip the market toward a dominant monopolist. Rather, the source and the strength of the increasing returns affect the tipping point. If the sources of such

¹ Lieberman (2005), based on market value and revenues, finds that first-mover advantages have been concentrated in companies that can be classified as "market makers and "brokers," which are conducive to increasing returns.

² A single market allocates goods to high-value users more efficiently. Even if buyers are visiting multiple marketplaces – multihoming – sellers prefer to list domain names exclusively with one broker to take advantage of lower transaction costs: fees by the intermediary and management cost of user accounts with multiple marketplaces. See Ellison, Fudenberg, and Mobius (2004) for a theoretical discussion.

³ Even if prices are higher at larger markets, sellers are obviously happy to receive the extra premium, while buyers are willing to pay slightly higher prices in order to select among a variety of items that best match their preferences. For example, 40 percent of Amazon's sales appear to be obscure books not found on Barnes & Nobles. However, online job sites and B2B exchanges are examples of markets where variety does not seem to be an important success factor.

⁴ See Alex Tajirian, "[Auctions, Hagglng, and Mixed Prices: A Survey Of Recent Literature](#)," *DomainMart*, October 2004.

returns are weak or if product differentiation exists among the larger companies in the industry, concentration is less likely.

Thus, multiple marketplaces can co-exist in markets that exhibit increasing returns. Moreover, survival of the smaller markets depends on the relative magnitude of the increasing return forces.

Concentration and Profits

Concentration of an intermediary does not necessarily imply excess profits. The New York Stock Exchange, for example, generates high economic profits, while New York's Fulton fish market does not. Conversely, ownership concentration is not a necessary requirement for the attractiveness of an industry. Ellison and Ellison (2005) point out the U.S. real estate market as such an example.

Services

Domain name marketplaces,⁵ in addition to providing an exchange mechanism, provide services that include bringing in the other side of a transaction to the negotiation table, qualifying buyers and sellers, and mitigating cost of negotiation, escrow, title transfer, and appraisals. These additional services might be one of the important reasons as to why a multi-marketplace listing aggregating service, such as that offered by [AboutDomains.com](#), has not gathered momentum. The other plausible explanation for the failure of AboutDomains aggregation service is its lack of visibility.

⁵ See Alex Tajirian, "[Domain Name Markets](#)," *DomainMart*, Revised March 2005.

Pricing

One of the main characteristics of two-sided markets is that there are different ways to break up the prices across buyers and sellers to attract both groups simultaneously. Obviously a marketplace can attract buyers and sellers with low fees, but that would negatively impact profits. Nevertheless, besides charging a sales commission, domain name marketplaces use performance-commission based services such as traffic monetization to attract sellers to list their domain names.

Ellison, Fudenberg, and Markus (2004) speculate that a major reason that Amazon and Yahoo! auction sites struggled is that they tried to compete by not charging listing fees. Their pricing structure encouraged listing of products by nonserious sellers with high reserve prices. On the other hand, buyers prefer to visit sites with reputable sellers, high quality goods, and reasonable prices. Thus, markets with the wrong menu of prices are unable to create a critical mass and may survive only with their existing captive audience, if any.

Antitrust

Understanding the structure of an industry is also important for regulators. Online marketplaces have raised two antitrust issues. The antitrust division of the U.S. Department of Justice is concerned that websites facilitate price fixing collusions, as competitors are able to exchange price information. Their second concern is market concentration. However, when markets are not inclined to tip over to a single dominant player,⁶

⁶ The existence of a dominant player does not necessarily imply that the government should

the government is more likely to take a hands off approach.

Price Dispersion & Differentiation

With the Internet making price comparisons readily available to consumers, one may expect the Law of One Price across competing vendors to hold. However, there is strong empirical, experimental, and theoretical evidence to the contrary.

Vendors' websites, in general, can make it hard for consumers to make meaningful price comparisons by convoluting information on specific product features. Price comparison sites can also present a challenge to users when features other than price are important. Inter- and intra-domain-name marketplace price comparisons are harder due to the lack of publicly available sales data. Moreover, there is no agreement on the factors⁷ – let alone the contribution of various factors - that drive domain name value, making price dispersion tests based on factor models indeterministic, as they would involve a joint test of dispersion and the underlying value generating factor model being correct. Thus, to analyze price dispersions, I will provide indirect evidence of relevant insights from studies of online vendors in other markets.

intervene to dampen monopoly power, especially in markets where the incumbents are innovative.

⁷ For example, DomainMart is the only domain name valuation service provider that finds that the number of characters in a domain name is practically irrelevant. See Alex Tajirian, "[Length of A Domain Name Is Irrelevant!](#)," *DomainMart*, July 2003.

Ellison and Ellison (2005) relevant empirical results are summarized below:

1. The standard deviation in book and CD prices across e-retailers is typically about 10 percent of the mean price and the difference between the highest and lowest price is typically between 25 and 40 percent of the mean.
2. Price dispersion varies even in situations where consumers find retailers via price comparison search sites such as pricewatch.com. For example, the twelfth-lowest price is typically about 10 percent above the lowest price. Data from Shopper.com is comparable, where the gap between the lowest and second-lowest price is less than 1 percent for almost half of the products, but has an average of about 5 percent overall.
3. Even people who use a price search engine to compare book offers seem to be willing to pay between \$1.50 to \$2 more to buy from a well-known Internet retailer rather than from an unknown retailer. Thus, branding is still an important online success factor.

2. Masterpieces provide the lowest cumulative return across American, impressionist, and old master samples.

Baye and Morgan (2004) find consistency of the price dispersion with a theoretical competitive model.⁸

Thus, there is no a priori reason to believe that there isn't price dispersion across domain name marketplaces.

Ashenfelter and Graddy (2003) report results from a number of art auction studies that find:

1. Significant differences between Sotheby's NY and Christine's NY, as well as mixed evidence differences on differences between NY and London.

⁸ They use a Bertrand model with bounded rationality.

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