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Two-sided Certification: The Market for Rating Agencies
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Discussion by Bruno Jullien

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Introduction

- What "business model" for certifiers?
- Preliminary paper, but clear results.

Other issue: Credibility (see Rochet-McAndrews-Mathis 2009)

The set-up:

- Two buyers with value q
- One seller with private information on q and value αq
  - If $\alpha > \frac{1}{2}$ then no trade
  - If $\alpha < \frac{1}{2}$ then trade at price $E(q) = \frac{1}{2}$
- One intermediary can produce a verifiable signal of q which can be transmitted publicly or secretly.

  Remark: The common value set-up may fit the financial market but not so well other industries, where consumption value is not given by resale value. Some discussion of this should be useful.

Game

1. *Seller observes q*
2. Intermediary sets prices
3. Seller pays and makes *q* public, or not
4. Buyers buy the information or not
5. *Identity of buyers is revealed*
6. First-price auction *with secret reserve price.*

Bidding game with one informed bidder

- Informed buyers: efficient trade, no rent to buyers
- $\alpha > \frac{1}{2}$:
  - Uninformed buyers: no trade
  - Asymmetric information: efficient trade, no rent to the uninformed buyer and to the seller.
- $\alpha < \frac{1}{2}$:
  - Uninformed buyers: efficient trade, no rent to buyers
  - Asymmetric information: inefficient trade, no rent to the uninformed buyer

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Main results:

- The seller reveals $q > \bar{q}$ if any
- The buyers buy the information with a probability less than 1
- The two-sided business model strictly dominates one-sided business models for the intermediary
  - With sellers-certification: $\bar{q} = \frac{1}{2}$
  - With buyers-certification: $\bar{q} = 1$
  - With both : $\frac{1}{2} < \bar{q} < 1$.

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Robustness?

- Suppose that intermediary wants sellers to reveal $q \geq \bar{q}$
  - it sets a price p^s for sellers certifcation q
  - commits to buyers-certification (BC) or no buyers-certification ($\varnothing$) if sellers doesn't pay

- But the profit of sellers $\bar{q}$ with buyers certification is higher than without!

- Selling to buyers entails conflicting effects
  - lower price p^s for sellers-certification
  - higher profit on buyers

- The latter dominates for $\bar{q} = \frac{1}{2}$ but not for $\bar{q}$ smaller

- Non uniform distribution?

Comments and questions

- The idea that the intermediary can "cash" on both sides is nice
- Policy implication?
    - In the lemon case: Two-sided better for total welfare than one sided!
- Should clarify the assumptions
    - When does seller choose to sell the good (ex-ante, interim, ex-post)
    - Identity of buyers

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Selling information to buyers

- Is it credible that the identity of buyers obtaining the information is observed?
- Is it optimal to reveal the identity of clients of the certifier?
- If identity is observable, then the certifier should sell exclusive information
  - sell to buyer 1 only at price V_{IB} yields more profit for the intermediary, implies an efficient allocation.
- What happens if identity not observed (then bidders are not sure of the other bidder's information)?
- Is it optimal to sell the exact information or to garble it?

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When and how to sell?

- The required assumption for the decision to sell are not clear to me
  - What happens if the seller decides to sell or not once he knows who has bought the information?
    - In the lemon, this may destroy the value of information (no sale if one informed)
- Why not put a public reserve price?
  - Jullien-Mariotti (GEB 2006) mix of common and private value: the reserve price signals the quality
- Certifier price to seller not observed by the buyers

Timing

- Why choosing this timing?
- Simultaneous offers on both sides should not change the results: buyers condition on $q < \bar{q}$.
- But reversing the order may make a difference
  - higher price for sellers ?
  - less sellers certification of high q ?
  - but sellers may certified if only one buyer has the information.