



Signaling Quality with Return Insurance: Theory and Empirical Evidence

by

Dr Man Yu

**Associate Professor
Operations Management
ISOM, HKUST**

Date : **10 September 2021 (Friday)**
Time : **10:30 - 11:45 AM**
Zoom ID : **998 2990 2117 (passcode 203368)**



Abstract: This paper examines an innovative return policy, return insurance, emerging on various shopping platforms such as Taobao.com and JD.com. Return insurance is underwritten by an insurer and can be purchased by either a retailer or a consumer. Under such insurance, the insurer partially compensates consumers for their hassle costs associated with product return. We analyze the informational roles of return insurance when product quality is the retailer's private information, consumers infer quality from the retailer's price and insurance adoption, and the insurer strategically chooses insurance premiums.

We show that return insurance can be an effective signal of high quality. When consumers have little confidence about high quality and expect a significant gap between high and low qualities, a high-quality retailer can be differentiated from a low-quality retailer solely through its adoption of return insurance. We confirm, both analytically and empirically with a data set consisting of over 10,000 sellers on JD.com, that return insurance is more likely adopted by higher-quality sellers under information asymmetry. Furthermore, we find that the presence of the third party (i.e., the insurer) leads to double marginalization in signaling, which strengthens a signal's differentiating power and sometimes renders return insurance a preferred signal, in comparison with free return, whereby retailers directly compensate for consumers' return hassles. As an effective and costly signal of quality, return insurance may also improve consumer surplus and reduce product returns. Its profit advantage to the insurer is most pronounced under significant quality uncertainty.

Bio: Dr Man Yu is an Associate Professor of Operations Management in Department of Information Systems, Business Statistics and Operations Management (ISOM) at the HKUST Business School. She received her PhD in Business Administration from Ross School of Business, University of Michigan and her B.S. and M.S. in Management Science from School of Economics and Management, Tsinghua University. Her research interests include pricing and revenue management, OM/marketing interface and operations analytics.