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Prices and Qualities in Markets With Imperfect Information: A Search Model

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DISCUSSION PAPER NO. 555

PRICES AND QUALITIES IN MARKETS WITH IMPERFECT INFORMATION:

A SEARCH MODEL

By

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Abstract

This paper considers a single market for a good where buyers are imperfectly informed; they know the distribution of quality levels and prices, but they do not know the location of individual sellers. Our model generalizes the extant work in two directions: (i) the sellers can select both the selling prices and quality levels of their good, and (ii) the buyers can acquire price/quality information about individual sellers through endogeneous optimal search strategies. We observe multiple price/quality combinations in equilibrium, which depends upon the distribution of search costs of consumers and upon whether quality, or price, or both are costly observable. Our model is used to compare equilibrium properties of various models. In particular, we find that some but not all the results of Salop and Stiglitz (1977) and Chan and Leland (1982) can be generalized in a search model.