Sandro Shelegia

“Consumer Search with Observational Learning”, joint with Daniel Garcia, 2014.

Abstract

This paper studies social learning in a search environment. We model consumers who observe other consumers' purchasing decisions before embarking on their own search for the best-fitting product. This form of social learning has two distinct effects on consumer search and firm pricing. First, consumers *emulate* others in the sense that they always make the first visit to the firm where their predecessor has purchased. Second, consumers *free-ride* on their predecessor's information and search less intensively than in the standard search model. Emulation encourages price competition because firms fight for consumer visits, while free-riding has the opposite effect due to reduced search. Both effects increase in the search cost, but emulation is shown to dominate for most commonly used distributions of consumer preferences, therefore prices (eventually) fall as search cost increases, and may even go down to the marginal cost. We show that the results derived in a static duopoly model remain valid with a large number of firms and can be extended to a dynamic framework.