Summary

In a search market, consumers cannot directly observe important features of the products, which creates market power for individual firms. In recent years, there is a rising interest in the area of quality provision under search frictions. On one hand, the fact that quality is not directly observable may create perverse incentives for the firms to invest in quality; therefore the provision of quality may be insufficient. On the other hand, firms may further derive market power from market frictions and this may push firms to pursue the right investments. This thesis is devoted to the question of whether in a frictional market firms have the right incentive to price and provide quality and how the degree of frictions affect welfare.

Product Quality and Consumer Search. The first chapter studies the provision of quality in a consumer search market for differentiated products. A raise in quality improves the distribution of match utilities offered by a firm in the sense of first-order stochastic dominance. We show that higher search costs may lead to less investment in quality and, correspondingly, the equilibrium price may decrease in search costs. We provide conditions under which the market may under- or over-supply quality. When the market provides an insufficient (excessive) amount of quality, consumers search too little (much).

Quality Provision and Welfare in a Search Market for Services. The second chapter studies the market provision of service quality and welfare in a
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consumer search market. Services can be of high- or of low-quality. Service providers that pay an investment cost are more likely to offer high-quality services. With higher search costs, the gains from investing in high-quality increase and the market equilibrium has more high-quality services. In spite of this beneficial aspect of higher search costs, consumer surplus decreases as search costs rise. From the collective point of view of the firms, an individual firm invests too much in quality; from the standpoint of consumers, firms invest too little. It turns out that the market over-provides service quality on welfare grounds when the search cost is low, while it under-provides service quality when the search cost is high.

Product Upgrading in Repeated Search Market. The third chapter studies a search market in which the quality of the product is improved over time. Consumers and firms care about their total discounted utility/profit of the two periods. We characterise the optimal consumers search rule and firms pricing. Depending on the scale of the upgrade, consumers may search only in the first period or in both periods. In the first case, consumers search more in the first period to save the trouble to search again later. In the second case, consumers also search more in the first period compared to a single-period game to lower the probability they have to search again in the second period. Firms' pricing strategy depends on consumers' search behaviour. If there is no search in the second period, firms set a relatively low first-period price to attract more consumers in that period and set a higher price in the second period. If there is search in the second period, firms must compete for consumers in both periods. Since the consumers they get in the first period may leave in the second period, firms compete less fiercely in the first period and more aggressively in the second period. The level of the upgrade in the second period has an impact on search and profits. The higher the quality improvement, the more consumers search on average, since higher quality also implies that the
products are more differentiated. The impact of quality on price is two-fold: on one hand, firms offer a better product, which allows them to charge a higher price; on the other hand, consumers use a higher reservation value when they search, which induces a drop in price. We show that if the density of match values is decreasing, total profit increases in quality as well.