

Word-of-Mouth Communication: Implications for Pricing in a Market for an Experience Good

by Maria Rosa Battaglion | Alessandro Vaglio | Università di Bergamo | Università di Bergamo

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The paramount rise and spread of electronic word-of-mouth due to the emergence of Internet technologies and social networks make it crucial to understand the role of Word-of-Mouth (WOM) on the market equilibrium. In the present model, we analyze the such effect on the pricing strategy of a company producing an experience good with hidden quality. We assume a two-period model, in which the consumers can buy in the first or the second period. The consumers of the first generation communicate to the second generation of prospective consumers the perceived quality of the products through WOM. However, the delivered message depends upon the type of first-generation consumer, therefore it is biased. Then, second generation consumers decide whether to buy upgrading their posterior on quality with the new information. In this scenario, the firm set the prices of the two periods, taking into account the information flow on the product's quality through the WOM of the first generation. We show that the company would set a higher price in the first generation, independently of the quality level.