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Search, Differentiated Products, and Obfuscation

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Search, Differentiated Products, and Obfuscation

Tobias Gamp*

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Abstract

Consumers buy products even if they find it too time-consuming to evaluate products carefully. I present a simple market model with sequential consumer search and differentiated products in which consumers may purchase products without evaluation. In a market with evaluation cost heterogeneity and endogenous consumer participation, market prices and profits may fall with increasing product diversity. Resulting concerns that the market may fail to provide the welfare optimal variety of products are gratuitous if product diversity is endogenized. Firms find it nonetheless individually rational to offer niche products. I endogenize evaluation costs and interpret this as the firms' opportunity to aggravate the acquisition of information by obfuscation. A firm's equilibrium strategy whether to obfuscate product information is monotonic in product diversity: while obfuscation is individually rational for high product diversity, firms simplify information acquisition if product diversity is low.

Keywords: sequential search, differentiated products, obfuscation, product design

JEL-Classifications: D43, D83, L13, L15

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1 Introduction

Tastes are different, and consumers search for products that satisfy theirs. A searching consumer faces a trade-off between the gains of finding a suitable product that fits his taste and the savings on time. At the very extreme end, the consumer forgoes the costly acquisition of any product information and purchases a product that he barely knows. In this study, I examine a market model with consumer search that considers a richer choice of consumer strategies than the search literature has typically considered before. In particular, I allow for consumers to purchase products without evaluation, and explore the consequences for market prices, product design and the information provision by firms.

This study interprets search as the time-consuming efforts devoted to acquiring and processing information about products. This could be the consumer's search for a suitable product in an online market, where he has to devote a considerable amount of time on reading descriptions and consumer reviews in order to determine whether a found product matches his taste. Alternatively, it could be the consumer's search in a traditional offline market, where the time spend walking is negligible in comparison to the time that is necessary to process information about complex products such as financial contracts or technical products. A key feature of these markets is that information acquisition is voluntary, and thus, time-consuming search is not a necessary condition for the purchase of a product. A consumers can buy a good in the internet instantly upon a click, he can sign a contract without reading the fine print, and purchase a product without reading the back of packaging, the consumer manual or available consumer reviews. And indeed, empirical evidence suggests that some consumers economize on fatiguing search efforts, and are consequently poorly informed when making their purchase.[1] In general, the consumer's lack of information could have several causes. Firms might not disclose all relevant information, or a consumer might be unable to process the information available. This study takes an approach that is based on the consumers' rational decision to remain uninformed.[2]

[1] For instance, Wilson and Price (2010, page 658) estimate that in the UK energy market 32 % of switching consumers lose surplus due to their choice of supplier.

[2] Given existing estimates of evaluation costs it seems reasonable that consumer exert the option

In section 2 I propose a monopolistic market model with consumer search and differentiated products, which extends the seminal model due to Wolinsky (1986), Bakos (1997), and Anderson and Renault (1999). Rational consumers search among the various products offered in the market in order to find products that fit their idiosyncratic tastes. The key departure is that consumers can purchase products without evaluation. This means that it is not a necessary condition to acquire information about the product's characteristics and price prior to purchase. Thus, a consumer can take the risk of bad buy and purchase an unknown product with the consequence that he potentially suffers from purchasing a product that neither fits his taste nor matches his expected price. Hence, the trade-off between costly evaluation and the risk of a bad buy constitutes the central theme of the consumer's strategic considerations. I enrich this environment further, and assume that consumers are heterogeneous with respect to their opportunity costs of time.[3] Intuitively, it is clear that in particular those consumers with high opportunity costs are apt to take the risk of a bad buy, and exert the introduced option to purchase without evaluation.

In section 3 I examine how market prices depend on product diversity and evaluation costs if consumers may purchase without evaluation. I derive the market equilibrium and explicitly consider how participation constraints determine the distribution of opportunity costs of those consumer that ultimately enter the market. I find that for low product diversity the market is not fully covered, and any effect of an increase in evaluation costs and product diversity on market prices is offset by an adjustment of consumer participation. If all consumers enter the market, I replicate the common finding that higher evaluation costs lead to higher market prices. Most interesting are the comparative statics with respect to product diversity, which challenge the prevailing view that greater product diversity leads to greater prices.[4] I find that market prices are u-shaped in product diversity. The decisive ingredient to obtain decreasing prices in product diversity is the consumer's option to purchases

to purchase unknown product. Hortascu and Syverson (2004, page 431) estimate that the median costs per evaluation for S&P 500 Index Fonds are 5$ with considerable heterogeneity.

[3] Alternatively, some consumers simply love shopping.

[4] See Chamberlain (1933) on monopolistic competition, Perloff and Salop (1985), or references in Thisse et al. (1992).

unknown products. The intuition is simple. As long as some consumers purchase products without evaluation, any increase in product diversity encourages more consumers to evaluate products, which enhances competition among firms sufficiently so that the market price is decreasing in product diversity. If all consumers actively search, the induced greater search intensity of an increase in product diversity alone cannot compensate the increased monopoly power of firms.

In section 4 I study the information provision of firms, more precisely, the obfuscation of product information.[5] I endogenize evaluation costs and interpret this as a firm's practice to aggravate or simplify the acquisition of product information. As pointed out by Ellison and Wolitzky (2012, page 417), obfuscation is collectively rational in any search model if equilibrium prices are increasing in evaluation costs. However, this does not provide a satisfying explanation for the observed obfuscation. If firms cooperate on obfuscation, it remains unclear why firms do not cooperate on prices in the first place, which is even more profitable. Hence, one is interested in whether obfuscation is individually rational, and thus, can arise in a non-cooperative market model.

The presented market model offers a channel through which obfuscation might be individually rational, since consumers may purchase products without evaluation. A firm obfuscates information in order to discourage consumers from evaluating her product. That might be profitable, as the demand from uninformed consumers is less elastic than the demand from informed consumers, because these consumers only find out after their purchase whether they like the variant they already bought. The study points out a mechanism that limits the obfuscation of information. Because firms have no commitment power to guarantee competitive prices, a consumer that purchases a product without evaluation relies on the active search of other consumers to reassure that the firm offers the expected price. If a firm obfuscates too much, the consumer correctly anticipates that the firm's incentive to set low prices relaxes, and avoids purchasing the firm's product. Thus, by simplifying and encouraging information acquisition, firms can signal low prices

[5]Ellison and Ellison (2009) provide anecdotal evidence how e-retailers aggravate search, and refer to such practices as obfuscation. Furthermore, e.g. Duarte and Hastings (2012) document how firms intentionally use complex fee structures in Mexico's security system.

to consumers. This creates a trade-off for firms that links obfuscation to product diversity.

In section 5 I endogenize product diversity in order to study the firms' choice of product design. The results of section 3 show that it is not necessarily profitable for firms to offer a rich variety of products. As product differentiation is desirable from a social planner's point of view, these results raise concerns that the market might fail to provide the desired variety. In this section I discuss an individual firm's incentive to offer a niche product. I find that the consumer's option to purchase without evaluation enhances product diversity in both setups, independent of whether evaluation costs are exogenous or not. In fact, all firms target niches such that no firm offers a plain vanilla product, and the market provides the desired rich variety.

1.1 Contribution to the literature

The issue of competition with search and differentiated products has been addressed before, starting with the seminal contributions by Wolinsky (1986), Bakos(1997) and Anderson and Renault (1999).[6] This study extends this analysis in several ways as it considers consumer heterogeneity, highlights the importance of participation constraints, and most importantly incorporates the consumer's choice to purchase products without evaluation. The only study that I am aware of and that examines consumer choice without evaluation in a search model with differentiated products is Kuksov and Villas-Boas (2010). However, they abstract from prices, and examine the consumer-optimal number of products if consumers can make inferences about the locations of offered products on a Hotelling line.[7]

Furthermore, the study is related to a growing literature on product design. Most related is Bar-Isaac et al. (2012) who examine the firm's choice of product design in a market model with consumer search.[8] Building on the same notion of product

[6]Recent contributions include Zhou (2011, 2014) on directed and multi-product search, Armstrong and Zhou (2011) on prominence, Bar-Isaac et al. (2012) on product design, Moraga-Gonzàles et al. (2014) on the competitive effects of higher search costs.

[7]Bar-Isaac et al. (2010) and Armstrong and Chen (2009) study consumer choice without evaluation in markets where products vertically differentiated.

[8]See Lewis and Sappington (1994) and Johnson and Myatt (2006) for an analysis of the choice

design, they find that firms choose extreme designs, and either produce plain vanilla products or target niches. In particular, they emphasize that a firm that has a competitive advantage tries to avoid competition by producing a plain vanilla product.[9] This study is different as consumers may purchase products without evaluation, which affects the firm's choice of product design.

Finally, the paper is related to a slim literature that interprets obfuscation as aggravating search. While most studies on consumer search share the view that firms profit from collectively aggravating search, these three studies put forward arguments why it might be individually rational to do so. Carlin (2009) assumes that the fraction of shoppers in a Varian-style clearinghouse model is endogenously determined by the overall complexity of the market. Via her obfuscation strategy an individual firm can affect the overall complexity of the market. In particular, firms that intend to set low prices seek to establish market transparency, while firms that seek to exploit the consumers' ignorance of prices try to create complexity. Ellison and Wolitzky (2012) argue that firms have incentives to raise evaluation costs in order to fatigue consumers. Formally, they assume that evaluation costs are convex, instead of linear, such that sunk evaluation costs affect the costs of continued search and discourage consumers from continuing their search. Wilson (2010) shows in a directed search model that firms differentiate in evaluation costs in order to relax competitive pressure and to split the market. This study complements this literature as it works out an explicit model of a competitive market in which firms obfuscate information in order to discourage the information acquisition of consumers. With respect to this aspect, this study is related to a literature in behavioral industrial organizations that examines how firms create complexity in order to keep consumers uninformed. Gabaix and Laibson (2006) study shrouded add-on prices; Piccione and Spiegler (2012) and Chioveanu and Zhou (2013) examine how firms use payoff-irrelevant frames in order to affect the consumer's ability to compare products. Carlin and Manso (2011) study a firm's incentive to frequently change its product portfolio in order to prevent that less sophisticated consumers can imitate

of product design by a monopolists.

[9] Anderson and Renault (2009) find similar results with respect to the disclosure of horizontal match information.

sophisticated consumers.

2 Model

There is a market that consists of a continuum of consumers with unit demand, and a continuum of single-product, profit-maximizing firms. Firms offer horizontally differentiated products of identical quality. Marginal costs of production are normalized to zero. If consumer i buys the product of firm j, his quasi-linear utility absent any evaluation costs is

$$u(\epsilon^{ij}, p^j) = v + \mu\epsilon^{ij} - p^j, \tag{1}$$

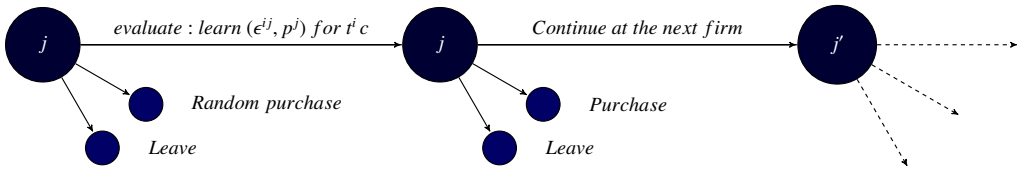
where $v > 0$ is the average valuation of the good, p^j is the price of the product, and $\mu > 0$ is an exogenous measure of product diversity. The benefit of the chosen representation of the consumer's utility is that it allows me to examine how market outcomes depend on the key parameter μ that captures product diversity.[10] Later on, I will endogenize μ which allows me to study product design. The idiosyncratic consumer-firm match-value ϵ^{ij} is a random draw from the continuously differentiable probability density function f. It indicates whether consumer i likes the particular variant that firm j offers. Let ϵ^{ij} be independent among consumers and firms. Its expectation is zero. The support of f is the interval $[\underline{\epsilon}, \overline{\epsilon}]$ on the real line. Let the cumulative density function F satisfy the usual increasing hazard rate condition.[11]

I consider a market where ex ante consumers are uninformed about the products' prices and characteristics. However, consumers can sequentially evaluate products in order to acquire this information. More precisely, consumer search begins randomly at some firm j. Upon arrival, a consumer i with type t^i who is uninformed about the firm j's product chooses among three actions: (*i*) leave, (*ii*) random purchase: purchase firm j's unknown product without knowledge of p^j and ϵ^{ij}, (*iii*)

[10] For a similar approach, see Anderson and Renault (1999) and Bar-Isaac et al. (2012).

[11] Equivalently, the corresponding reliability function $\tilde{F} := 1 - F$ is log-concave. A sufficient condition is log-concavity of f that indeed most distributions that have increasing hazard rates satisfy. For a list of log-concave p.d.f. see Bagnoli and Bergstrom (2005, p.12).

evaluate: spend the costs $t^i c$ in oder to become informed, and to learn p^j and the corresponding match-value ϵ^{ij}. If a consumer is knows the firm's product, he chooses among three actions: (a) leave, (b) purchase: purchase firm j's known product, (c) continue: continue search at a random next firm j'. If the consumer purchases a product or leaves, the consumer's search ends. If the consumer leaves, he obtains a utility of zero absent any evaluation costs.



Search is with without recall, without replacement, and uniformly random such that each firm is visited next with equal probability.[12] The key novel feature is that consumers take the risk of a bad buy and purchase products without evaluation. Evaluation costs $c > 0$ can be interpreted as an exogenous measure of the complexity of information acquisition that affect the amount of time that is necessary to evaluate a product. Later on, I will endogenize c which allows me to study obfuscation. There is heterogeneity among consumers with respect to their opportunity costs of time. That is, a consumer's type t^i determines the fraction of evaluation costs $t^i c$ that a consumer incurs if he evaluates a product. Let t^i be an independent draw from the uniform distribution H with an interval support $T = [\underline{t}, 1]$, where $\underline{t} > 0$. A consumer knows his realization t^i; while firms only know the cumulative distribution of consumers' types. In particular, firms can not target individual consumers and discriminate prices among consumers based on their opportunity costs of time.

If an uninformed consumer forgoes a costly evaluation and purchases an unknown product, firms could exploit his ignorance of prices and sell arbitrarily expensive products. Therefore, an uninformed consumer only purchases randomly if there exists an upper bound on his potential losses. To resolve this matter, I assume

[12]The last assumption distinguishes this study from the work of Armstrong and Vickers (2009), Wilson (2010) and Zhou (2011) that consider the other extreme case when the consumer's search is directed and the order of search depends on the consumer's rational expectations or the prominence of firms. Market models with random consumer search can be interpreted as markets where consumers are ex ante uninformed such that firms are ex ante identical, and hence, search is per se non-directed.

that an uninformed consumer realizes when an unknown product's price exceeds his expectation by more than δ. Beyond that, this assumption plays no crucial role in the analysis.[13]

The timing of the model is as follows. First, firms set prices simultaneously and privately. Then, each consumer searches until he leaves or purchases a product. The equilibrium concept that I apply is perfect Bayesian equilibrium with passive consumer beliefs. This means that if a consumer observes a deviation by one firm, he does not change his beliefs about other firms' strategies. I focus on symmetric equilibria in pure, stationary strategies.

Comments on the model and its robustness

i) In this model, prices are ultimately markups or quality adjusted prices. Hence, the uninformed consumer's inability to observe a firm's price without evaluation can also be seen as a consumer's inability to effortless ascertain quality.[14] I dispense with a model of quality choice of firms, as such a stage does not alter the analysis if firms have access to identical production technologies.

ii) A consumer's type may reflect the difference in the consumers' opportunity costs of time. Interpreted differently, consumers with low opportunity costs are sophisticated consumers that have a greater ability to evaluate complex information. Less literally, one can interpret consumers with low opportunity costs as consumers that set great value upon buying a suitable product.

iii) Some assumptions and modeling choices only help to simplify the exposition and to avoid the obfuscation of the presented ideas. Let me be clear about which assumptions are superfluous. All results for exogenous evaluation costs carry over one-to-one to a model with perfect recall, since consumers do not exert the option to return to previously evaluated products; for endogenous evaluation costs this is the case if recall is costly. Further-

[13] In fact, in the main body of this paper only first order conditions for undetected deviations are examined. The interested reader is referred to the appendix B, where I examine undetected deviations and rigorously prove sufficiency of first order condition.

[14] This is the preferred interpretation of the author. However, let me mention that is per se not clear whether prices are observable for consumers in consideration of some empirical literature that documents that consumers fail to properly account for shipping costs (Della Vigna 2009 and Brown et al. 2010), for sales tax (Chetty et al. 2009), or display a left-digit bias (Lacetera et al 2011).

more, consumer-firm match-values do not have to be bounded from above and below as long as the corresponding tails of the distribution are thin. To be precise, the absolute first moment has to be finite. Finally, I assume that an informed consumer can perfectly tell whether the product fits his taste. Here, it suffices if the consumer receives a noisy signal upon evaluation, and ϵ^{ij} denotes the expected conditional match-value.

iv) Summing up, the model is in three aspects distinct to previous search models, as Wolinsky (1986), Bakos (1997), and Anderson and Renault (1999). It introduces heterogeneity on the consumer side, it considers the effects of participation constraints,[15] and it allows uninformed consumers to purchase products without evaluation.

3 Analysis for exogenous evaluation costs and product diversity

In this section I examine market outcomes if evaluation costs and product diversity are exogenous. The main results are the comparative static results of market prices with respect to product diversity. Later, in section 4 I endogenize evaluation costs which allows me to study obfuscation; in section 5 I endogenize product diversity and examine a firm's choice of product design.

3.1 Consumer behavior

In this section I will find that the consumer's behavior segments his type space. Intuitively, it is clear that consumers with low opportunity costs will prefer to invest

[15] In the realm of consumer search for homogeneous products already Diamond (1971) points out that participation constraints lead to the failure of market existence if evaluation costs are bounded away from zero. The subsequent literature typically assumes that the first search is for free in order to overcome this problem. For a discussion, see also Stiglitz (1989). Antecedents to this study with respect to this aspect are Janssen and Moraga-Gonzàles (2004) and Janssen et al. (2005) who point out that if the population is ex ante heterogeneous, then participation constraints endogenize the distribution of types that ultimately enters the market and affect market outcomes. This study and Moraga-Gonzàles (2014) are the first studies to consider the effect in market model with consumer search and differentiated products.

time in costly evaluations of products, and search until they find a satisficing product; while all other consumers will either take the risk of a bad buy and purchase a firm's unknown product or leave the market. I will find that if these consumers are indifferent between random purchase and leave, the consumer's best response is not unique, and a positive measure of consumers can mix between random purchase and leave.[16] Although this will only occur when the market price is equal to the average valuation, it will be an important case and the consumer's mixing is crucial. As I restrict myself to equilibria in pure strategies, the consumer's mixing corresponds to a consumers' behavior where some consumer types purchase randomly, while others leave. To simplify notation, I will assume that in that case consumers with lower opportunity costs purchase randomly and take the risk of a bad buy.

Formally, in order to determine the consumer's best response we have to examine two cases. On the one hand, we have to examine the consumer's behavior at a decision node when he is informed about the firm's product, and either purchases the firm's product, when it fits his taste and is not too costly, or continues search. On the other hand, we have to examine a consumer's decision when he is uninformed, and decides whether to evaluate the product or take the risk of bad buy. Recall that in either case he has the opportunity to leave. In the following I determine the consumer's best response if he expects a symmetric market equilibrium, in which each firm's price is p^*.

Begin with a consumer's decision when he is informed about a product's price and match-value. Then, his decision is fully characterized by a reservation utility $U_{res}(t, p^*)$. He purchases the firm's known product if the utility it supplies exceeds his reservation utility; otherwise, he continues his search.[17] This reservation utility is his expected utility of continued search, which depends on the consumer's future plans.

Continue with an analysis of the consumer's expected utility if he intends to

[16]Note that it is (almost) irrelevant how indifferences are resolved if a null-set of consumers is concerned, as the firms' profits remain unaffected.

[17]If the consumer prefers to leave, he can obtain the same utility if he continues, and leaves at the next firm. Hence, without loss of generality I assume that the consumer does not leave if he is informed. This is feasible, since each firm's demand remains unaffected by how the indifference is resolved.

evaluate products when he is uninformed. Then, a standard result in search theory[18] is that his type-dependent expected utility is $U_S(t, p^*) = v - p^* + \mu\tilde{x}(t)$, where the function $\tilde{x} : T \to (-\infty, \overline{\epsilon})$ is implicitly defined by the equation

$$\mu \int_{\tilde{x}(t)}^{\overline{\epsilon}} \Big(\epsilon - \tilde{x}(t)\Big) f(\epsilon) d\epsilon \stackrel{!}{=} c\, t. \tag{2}$$

The function $\tilde{x}$ is well-defined and decreasing in t.[19] The interpretation is that $\tilde{x}$ defines a type-dependent reservation match-value, since the consumer purchases a product at p^* if the consumer-firm match-value exceeds $\tilde{x}(t)$. Having this in mind, equation (2) states the familiar result that the reservation utility equates the expected benefits of a single additional evaluation (LHS) with its expected costs (RHS). Furthermore, $\tilde{x}$ decreasing means that if the consumer has low opportunity costs, his reservation match-values is greater. Hence, a consumer with low opportunity costs that evaluates products is choosier, and searches longer in expectation.

Next, I examine the consumer's expected utility if he intends to purchase randomly or to leave the market. In the first case, his type-independent expected utility is $U_R(p^*) = v - p^*$, as he expects each firm to charge p^*, and the expectation of the consumer-firm match-value is zero. If he intends to leave, his expected utility is $U_L = 0$.

Summing up, as the consumer seeks to maximize his expected utility, he will choose, at a decision where he is uninformed about the firm's product, that action for which the corresponding argument maximizes his expected utility $U_{res}(t, p^*) = max\Big\{U_S(t, p^*), U_R(p^*), U_L\Big\}$. At a decision where he is informed, he purchases the firm's product if the utility it supplies exceeds his reservation utility. Since only U_S is type-dependent and decreasing in t, any best response is characterized by a unique cut-off type $t_S(p^*)$ such that all consumers with lower opportunity costs evaluate products. All other consumers leave if $p^* > v$, and purchase randomly if $p^* < v$. If $p^* = v$, they are indifferent. In the latter case, assume that those consumer

[18] The proof is standard, and hence omitted – i.e. see McCall (1970) on the optimality of stopping rules in stationary i.i.d. environments.

[19] Let $g(x) := \int_x^{\overline{\epsilon}} (\epsilon - x) f(\epsilon) d\epsilon$ such that $g : (-\infty, \overline{\epsilon}) \to (0; \infty)$. Then, $\mu g(\tilde{x}(t)) = c\, t$. The function g is strictly decreasing, differentiable, and an inverse function g^{-1} is well-defined such that $\tilde{x}$ is well-defined. Furthermore, g decreasing implies $\tilde{x}$ decreasing.

that satisfy $t \in (t_S(p^*), t_R(p^*)]$ purchase without evaluation.[20] Interpreted differently, $\frac{t_R(p^*)-t_S(p^*)}{1-t_S(p^*)}$ denotes the probability that an indifferent consumer takes the risk of bad buy. I summarize previous findings in lemma 1. Let $\tilde{t}_{ind}(\mu, c) := \mu \int_0^{\bar{\epsilon}} \epsilon f(\epsilon) d\epsilon / c$ such that $\tilde{t}_{ind}(\mu, c)$ denotes the consumer that is indifferent between random purchase and evaluate.

Lemma 1 *The consumer's best response is characterized by two cut-off types $t_S(p^*) \in \mathcal{R}$ and $t_R(p^*) \in \mathcal{R}$.*

i) If the consumer has low opportunity costs, $t \leq t_S(p^*)$, he evaluate products and purchase the first product that supplies a utility that exceeds $U_{res}(t, p^*) = v - p^* + \mu\tilde{x}(t)$.

ii) If the consumer has intermediate opportunity costs, $t_S(p^*) < t \leq t_R(p^*)$, he purchases randomly and his expected utility is $U_{res}(t) = v - p^*$.

iii) If the consumer has high opportunity costs, $t > t_R(p^*)$, he leaves the market and his expected utility is zero.

Furthermore, if some consumer purchase randomly, then $t_S(p^*) = \tilde{t}_{ind}(\mu, c)$ if $t_S(p^*) \in T$, and hence, $t_S(p^*) = min\Big\{t_R(p^*), \tilde{t}_{ind}(\mu, c)\Big\}$.

Thus, the consumers' behavior is in line with intuition. Consumers with low opportunity cost are shoppers, and hence, evaluate products until they find a product that fits their taste; while all other consumers are either random-purchasers or non-participants.

3.2 Firm behavior

Each firm faces a trade-off between the profits generated by exploiting the incomplete information of uninformed random-purchasers and the gains in market share from price sensitive shoppers due to offering a low price. In this section, I derive a candidate market price that resolves this trade-off so that no firm has an incentives to deviate from the market price given her expectations.

[20] As mentioned before, I assume without loss of generality that in case of indifference consumers with lower opportunity costs purchase the firm's unknown product in order to simplify notation.

Suppose a firm expects a symmetric market equilibrium in which each firm's price is p^*. Furthermore, she expects the consumers' behavior to be given by $t_R^*, t_S^* > \underline{t}$, where $t_S^* = min\left\{t_R^*, \tilde{t}_{ind}(\mu, c)\right\}$. Suppose the firm deviates to a price p such that this deviation is not observed by an uninformed random-purchaser. Consequently, the demand that he generates is perfectly inelastic. In contrast, a shopper learns the firm's price, and buys her product if and only if it supplies a utility that exceeds his reservation utility $v + \mu\tilde{x}(t) - p^*$. Consequently, the conditional probability that an informed shopper purchases the firm's product is $\tilde{F}\left(\tilde{x}(t) + \frac{p-p^*}{\mu}\right)$, where $\tilde{F} := 1 - F$.

In order to determine the demand for her product, the firm has to take into account that shoppers visit more than one firm in expectation. Let $\xi(t)$ denote the density of consumer types that arrive at the firm. I find $\xi(t) = \frac{h(t)}{\tilde{F}(\tilde{x}(t))}$ for shoppers. The density of shoppers that arrive after n evaluations is $F\left(\tilde{x}(t)\right)^n h(t)$, where $F\left(\tilde{x}(t)\right)^n$ is the expected probability that a shopper has rejected n products. Thus, the resulting total density is $\xi(t) = \sum_{n=0}^{\infty} F\left(\tilde{x}(t)\right)^n h(t) = \frac{h(t)}{\tilde{F}(\tilde{x}(t))}$. All other consumers do not visit more than one firm such that $\xi(t) = h(t)$ for $t > t_S^*$.

Therefore, the firm's expected profits are

$$\pi(p, p^*) = \int_{\underline{t}}^{t_R^*} p\left\{1 - \mathbb{1}_{t \leq t_S^*} F\left(\tilde{x}(t) + \frac{p - p^*}{\mu}\right)\right\} \xi(t) dt. \tag{3}$$

By differentiating equation (3) with respect to p and imposing symmetry, one obtains the unique candidate equilibrium price that satisfies the first order condition. Let $\varphi := \frac{f}{1-F}$ denote the hazard rate of F.

Lemma 2 *If $\underline{t} < t_S^*, t_R^*$, then the unique candidate equilibrium price is*

$$\tilde{p}(\mu, c, t_R^*) = \mu \frac{H(t_R^*)}{\int_{\underline{t}}^{min\{t_R^*, \tilde{t}_{ind}\}} \varphi(\tilde{x}(t)) h(t) dt}. \tag{4}$$

The comparative statics of $\tilde{p}$ are:

i) The effect of an increase in product diversity μ on $\tilde{p}$ is

- *negative if some consumer purchase randomly, $\tilde{t}_{ind} < t_R^*$.*

- *positive if no consumer purchases randomly, $\tilde{t}_{ind} \geq t_R^*$, if $f'(\epsilon) \leq 0$ for $\epsilon \geq 0$.*

ii) The effect of an increase in evaluation costs c on $\tilde{p}$ is positive.

iii) The effect of an increase in consumer participation t_R^* on $\tilde{p}$ is positive

The candidate equilibrium price is equal to the inverse of the elasticity of demand. Equation (4) captures that only shoppers create competition among firms, and that among shoppers those with low opportunity costs, that have greater reservation match-values, create more competition due to the assumption of increasing hazard rates. The comparative statics of $\tilde{p}$ are repeatedly used in the following. A discussion is postponed to the discussion of the comparative statics results of equilibrium market outcomes.

3.3 Market equilibrium

A market equilibrium is a triple $\left(t_R^*, t_S^*, p^*\right)$ such that firms' and consumers' strategies are mutual best responses. I focus on market equilibria in which trade occurs. Other equilibria, trivial equilibria, exist for all parameter values.[21] I impose some restrictions on the parameter space, and assume $v > \frac{\mu}{\varphi(0)}$, which guarantees that the market is in principle competitive enough to sustain prices below v if some consumers are shoppers. Otherwise, the introduced consumer's option to purchase without evaluation is irrelevant. I identify four equilibrium regimes in the (μ, c, v) – parameter-space, which are illustrated in the left panel of figure 1. In order to simplify notation fix c and v.[22]

Proposition 1 *There exists a unique market equilibrium in which trade occurs. There exist three cut-off values of product diversity that separate four regimes:*

i) ***Market Failure:*** *If $\mu \leq \mu_A$, all consumers leave the market such that no trade occurs. The market price exceeds the average valuation v.*

[21] In trivial equilibria, all consumers leave the market in expectation of excessively high prices such that firms are indifferent between all pricing strategies.

[22] Note that it is per se not clear that for each c and v four equilibrium regimes exists, which however is the case. Moreover, the cut-off values of product diversity depend on c and v, as can been seen in the left panel of figure 1. A definition of the cut-off values is delegated to the appendix.

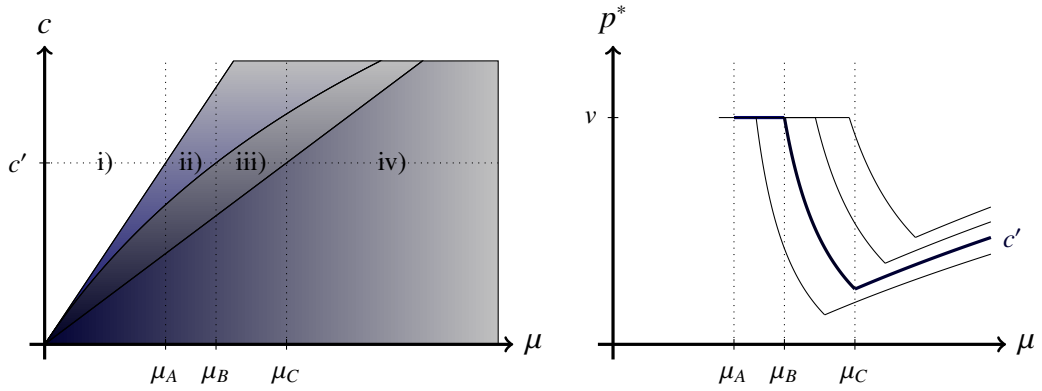


Figure 1: A market with uniformly distributed match-values. Fix the average valuation v. **(left)**: The four equilibrium regimes in the (μ, c) - plane: *i*) market failure, *ii*) partial participation, *iii*) full participation, *iv*) search. **(right)**: The market price as a u-shaped function of product diversity for distinct evaluation costs. Curves to the upper right correspond to greater evaluation costs.

ii) ***Partial Participation Regime:*** *If $\mu_A < \mu \leq \mu_B$, consumers with low opportunity costs evaluate products; while the participation of other consumers adjusts such that the market price is equal to v.*

iii) ***Full Participation Regime:*** *If $\mu_B < \mu \leq \mu_C$, all consumers purchase products but only consumers with low opportunity costs evaluate products. The market price is $p^* = \tilde{p}(\mu, c, 1)$.*

iv) ***Search Regime:*** *If $\mu_C < \mu$, all consumers evaluate products, and the market price is $p^* = \tilde{p}(\mu, c, 1)$.*

As is standard, for low product diversity a market fails to exist. The reason for this no trade result is that otherwise, if trade occurs, a firm's demand would be perfectly inelastic, since in the market failure regime all consumers prefer random purchase to evaluate. However, it is noteworthy that for some values of product diversity below μ_A, trade would occur if consumers could not purchase products without evaluation.[23] This means that the consumers' option to purchase without evaluation

[23]More precisely, the resulting lower bound in product diversity for market existence is greater than the one that is identified by Anderson and Renault (1999), although in both models market existence depends on whether demand is elastic. However, in the absence of the opportunity to purchase unknown products demand is elastic only if informed consumers refrain to buy a product,

has a deterring effect on market existence.

More interestingly, for intermediate intermediate product diversity trade occurs, but not the whole market is covered. The premise for the consumers' partial participation is that a firm's price is unobservable to uninformed consumers, as this results in a commitment problem for firms. A firm can not commit to low prices, and the consumers correctly anticipate that she chooses her price optimally given her expected elasticity of demand. Therefore, random-purchasers must rely on the competitive pressure that is generated by shoppers. In other words, the active search of choosy shoppers with low opportunity costs exerts an externality on other consumers, on which random-purchasers free-ride.[24] In the partial participation regime there are not enough shoppers to generate sufficient competition for the whole market to be covered. Consequently, consumer participation adjusts such that firms still can credibly commit to prices below the average valuation. Only in the full participation regime and the search regime, the market is sufficiently competitive to ensure prices below v even if all consumers participate. The consequences for the comparative statics of market prices are discussed next.

3.4 Are market prices increasing in product diversity?

Proposition 2 *The comparative statics results of market outcomes are as follows:*

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and thus, continue search and visit more than one firm. Multiple evaluations occur if products are sufficiently diverse so that those consumers with the lowest opportunity costs continue search if they find their most unliked variants. That is if $\tilde{x}(\underline{t}) > \underline{\epsilon}$. In contrast, in the presented model, elasticity is determined by whether these consumers prefer search to random purchase, and hence, by $\tilde{x}(\underline{t}) = 0$. Consequently, I obtain a lower bound for market existence that is greater.

[24] In fact, the failure to internalize this externality is one of the underlying reason why the consumer's option to purchase randomly has a deterring effect on market existence.

Regime:	Partial Participation			Full Participation		Search	
	p^*	t_R^*	π^*	p^*	π^*	p^*	π^*
Product diversity $\mu \uparrow$	-	$\uparrow$	$\uparrow$	$\downarrow$	$\downarrow$	$(\uparrow)$	$(\uparrow)$
Evaluation costs $c \uparrow$	-	$\downarrow$	$\downarrow$	$\uparrow$	$\uparrow$	$\uparrow$	$\uparrow$
Average valuation $v \uparrow$	$\uparrow$	$\uparrow$	$\uparrow$	-	-	-	-

Table 1: An upward (downward) arrow tells whether the up-sided variable is strictly increasing (decreasing) in the left-sided variable. '-' means that there is no effect. Brackets indicate that the result holds if $f'(\epsilon) \leq 0$ for $\epsilon \geq 0$.

Table 1: Comparative statics results

The most surprising result is the effect of an increase in product diversity on the market prices. More precisely, that the market price is a u-shaped function of product diversity, as is illustrated in the right panel of figure 1. This result challenges the common wisdom that firms benefit from greater product differentiation.[25] I find that the comparative statics results are the outcome of the interplay of four distinct effects of which the first two are known from Anderson and Renault (1999): a *niche-product-effect*, a *search-intensity-effect*, a *information-acquisition-effect*, and a *participation-effect*.

Let us briefly revisit the first two effects, which pin down the effect of an increase in product diversity in the search regime. In the search regime consumers neither exert the option to purchase without evaluation nor is a participation constraint binding such that the analysis coincides with AR.[26] If products are strongly differentiated, buying a suitable product is more valuable to consumers such that products are worse substitutes. This softens competition among firms, and allows firms to extract some of the additional surplus that is due to the provision of niche products. Therefore, the *niche-product-effect* raises prices and captures the common argument why firms profit from product differentiation. The *search-intensity-effect* is negative and is generated by greater search intensity of shoppers. An increase in product diversity increases reservation match-values. Then, consumers

[25] See Chamberlain (1933) on monopolistic competition or references in Thisse et al. (1992).

[26] The only remaining difference is the consumers' heterogeneity.

are choosier and compare more products, which enhances competition among firms due to the assumption of increasing hazard rates. Their overall effect is in general ambiguous; however, prices are strictly increasing if $f'(\epsilon) \leq 0$ for $\epsilon \geq 0$ holds. This condition is fulfilled for a rich set of widely used distribution functions, in particular for any symmetric log-concave pdf. f.

The novel effects that are presented in this paper are the *information-acquisition-effect* and the *participation-effect*. The *information-acquisition-effect* is negative and captures the effect of an increase in the number of shoppers, an increase of t_S^*. If product diversity increases, more consumers find it worthwhile to search for a suitable product, and evaluate products. Consequently, their demand becomes elastic, and enhances competition among firms. The first three effects determine the comparative statics in the full participation regime. In this regime prices are unambiguously decreasing as a result of higher product diversity. Let me emphasize this result again, as it highlights that firms do not necessarily profit from product differentiation.

The *participation-effect* is positive and is due to an increase in consumer participation, an increase of t_R^*, that results in an increase of inelastic demand from random-purchasers. In the partial participation regime the *participation-effect* prohibits that market price decrease. Not before all consumers participate market prices begin to fall with an increase in product diversity.

The effect of an increase in evaluation costs

With respect to evaluation costs I replicate the standard result that higher evaluation costs lead to higher prices. If all consumers participate the effect of an increase in evaluation costs on prices consists of the *search-intensity-effect* and the *information-acquisition-effect*. First, shoppers become less choosy and their reservation match-values decrease, which softens competition due to the assumption of increasing hazard rates. Second, less consumers are shoppers that search for suitable products. As both effects point to greater prices, the overall effect is unambiguously positive. If consumers participate partially, these two effects are completely compensated by a downward adjustment in consumer participation, which has a decreasing effect on prices due to the *participation-effect*.

Welfare

I conclude this section with a discussion of total welfare, which is the participating consumers' expected utility net prices $\int_{\underline{t}}^{t_R^*} \left[v + \mathbb{1}_{t \leq t_S^*} \mu \tilde{x}(t)\right] dt$. Total welfare is increasing in product diversity, since an increase in product diversity has a positive effect on consumer participation and on each participating consumer's utility net prices. This is the case, as $\mu\tilde{x}(t)$ increases, since the reservation match-value $\tilde{x}(t)$ is increasing in product diversity. By the opposite argument, an increase in evaluation costs has a negative effective on total welfare. Thus, from a social planner's point of view high product diversity is desirable, which does not necessarily benefit firms. This raises concerns that the market might fail to provide the desired variety of products. In section 5 I attend this issue, and discuss a single firm's incentive to offer a niche product.

4 Do firms obfuscate information about products?

4.1 An evaluation cost model of obfuscation

In this section evaluation costs are endogenized with the purpose to study obfuscation. Each firm may either simplify the information acquisition of consumers, a transparency policy, or try to deter consumers from evaluating her product by obfuscation. This means that obfuscation denotes a firm's strategy that aims to aggravate the acquisition of information. The general purpose of this section is to understand what are the motives of firms to obfuscate information and what are mechanisms that might protect consumers so that one learns when obfuscation is likely to occur.

A decisive and indispensable assumption will be that the firm's information strategy is observable to consumers upon arrival, since otherwise, a firm can not affect the consumer's decision whether to evaluate her product.[27] Technically, it

[27] If s was unobservable to consumers, then consumer behavior would remain unchanged, and only sunk evaluation costs would increase or decrease. This could affect the consumer's future behavior if evaluation costs are non-linear. Indeed, this is the main tenet of Ellison and Wolitzky (2012) that show that if evaluation costs are convex, firms have an incentive to obfuscate information in order to fatigue consumers.

suffices if a consumer receives an informative, noisy signal about his expected evaluation costs.

More precisely, add a first stage to the previously considered game in which each firm chooses her information strategy $s_j \in [\underline{s}, \overline{s}]$. The choice of s_j affects the consumer's costs $t(c + s_j)$ that he incurs if he evaluates her product. Therefore, a negative s_j corresponds to a transparency policy; a positive s_j corresponds to obfuscation. Assume that $c + \underline{s} > 0$ such that $t(c + s_j) > 0$ for any $s_j \in [\underline{s}, \overline{s}]$. The new timing is as follows. First, each firm privately chooses her s_j. Afterwards, time elapses as before with one slight difference; namely, a consumer observes s_j upon arrival at firm j.

Technically, the key task in this section is to determine the equilibrium information strategy s^*. Then, market outcomes follow directly from the previous analysis, as the continuation game coincides with the one analyzed in section 3. However, in order to determine s^* the behavior of firms and consumers off the equilibrium path, after a deviation $s \neq s^*$, has to be determined.

4.2 Consumer behavior

I find again that the consumer's behavior segments his type space. The intuition remains the same; namely, that in particular those consumers with low opportunity costs evaluate the firm's product. However, the analysis is slightly more evolved, as the consumer's behavior depends on the one hand on the current firm's evaluation costs and the resulting belief about her price and on the other hand on his expectation about the strategies of all following firms.

Formally, a consumer's strategy consists of two parts: first, a reservation utility that specifies when an informed consumer purchases a product conditionally on knowing its price and match-value; second, a plan that specifies whether upon observing some s an uninformed consumers leaves, evaluates or purchases the firm's unknown product. In the following I determine the consumer's best response if he expects a symmetric market equilibrium (s^*, p^*), where $s^* \in [\underline{s}, \overline{s}]$ and $p^* : [\underline{s}, \overline{s}] \to \mathcal{R}$.

Begin with the first part of the consumer's strategy that is when he is informed.

Then, the consumer's reservation utility is his expected utility of continued search. This is still the case as previously, since evaluation costs are sunk and the consumer's beliefs are passive. Recall that the latter means that his expectations about future evaluation costs and prices remain unaffected if he observes a deviation. Since the consumer expects no deviations in the future, he expects all following firms to choose (s^*, p^*).

Thus, the consumer's expected utility is equal to his expected utility in a game with exogenous evaluation costs $c + s^*$ and market price $p^*(s^*)$, and therefore, follows directly from section 3. Hence, I find $U_{res}\Big(t, s^*, p^*(s^*)\Big) = max\Big\{0, v - p^*(s^*), v - p^*(s^*) + \mu\tilde{x}(t, s^*)\Big\}$, where $\tilde{x}(t, s^*)$ is implicitly defined by $\mu \int_{\tilde{x}(t,s^*)}^{\overline{\epsilon}} \Big(\epsilon - \tilde{x}(t, s^*)\Big) f(\epsilon) d\epsilon \stackrel{!}{=} \Big(c + s^*\Big) t$. This means that $\tilde{x}(t, s^*)$ denotes the consumer's reservation match-value if the exogenous evaluation costs are $c + s^*$.

Continue with the consumer's behavior if he is uninformed. Then, upon arrival at a firm he observes s and conditions his choice among his three actions upon s. Immediately, one obtains his expected utility if he leaves or purchase randomly. If he leaves the market, his utility is $U_L = 0$. If he purchases the firm's unknown product, his expected utility is $U_R\Big(p^*(s)\Big) = v - p^*(s)$. Notice that the consumer's expectation about the firm's price $p^*(s)$ depends on s.[28] Furthermore, if the consumer evaluates the firm's products, his expected utility is

$$
\begin{aligned}
&U_S\Big(t, s, p^*(s), s^*, p^*(s^*)\Big) \\
&= \int_{\left\{\epsilon \in [\underline{\epsilon}, \overline{\epsilon}]:\, u(\epsilon, p^*(s)) - U_{res}(t, s^*, p^*(s^*)) \geq 0\right\}} \Big\{u\big(\epsilon, p^*(s)\big) - U_{res}\Big(t, s^*, p^*(s^*)\Big)\Big\} f(\epsilon) d\epsilon \\
&- t(c + s) + U_{res}\Big(t, s^*, p^*(s^*)\Big).
\end{aligned}
$$

The first term is the expected gain if the consumer finds a product that supplies a utility that exceeds his expected utility of continued search; the second term captures the costs of evaluating the firm's product; the third term is his expected utility if he continues search after evaluation. Among these three actions the consumer's

[28] Firms choose first their information strategies and then their prices. This is key, as otherwise, if both choices happened simultaneously, the consumer's belief about the firm's price after a deviation $s \neq s^*$ would be undetermined.

best response is to choose one that maximizes his expected utility.

Again, the consumer's best response is monotonic such that it can be described by two cut-off types that depend on s. The reason is that only U_S is type-dependent and strictly decreasing in t due to two effects: a direct effect, as consumers with lower opportunity costs incur lower evaluation costs $t\,(c + s)$, an indirect effect, as U_S is strictly increasing in the consumer's expected utility $U_{res}\Big(t, s^*, p^*(s^*)\Big)$, which in turn is decreasing in his type t. Define $\hat{t}_{ind}\Big(s, p^*(s), s^*, p^*(s^*)\Big) \in R_0^+$ by $U_S\Big(\hat{t}_{ind}, s, p^*(s), s^*, p^*(s^*)\Big) \stackrel{!}{=} U_R\Big(s, p^*(s)\Big)$ such that it denotes the (hypothetical), indifferent consumer type for which the consumer is indifferent between random purchase and evaluate upon observing s given his expectations.[29]

Lemma 3 *If the consumer is uninformed about the firm's product, his best response upon observing s is characterized by two cut-off types $t_S\Big(s, p^*(s), s^*, p^*(s^*)\Big) \in \mathcal{R}$ and $t_R\Big(s, p^*(s), s^*, p^*(s^*)\Big) \in \mathcal{R}$.*

i) If the consumer has low opportunity costs, $t \leq t_S\Big(s, p^*(s), s^*, p^*(s^*)\Big)$, he evaluate the product.

ii) If the consumer has intermediate opportunity costs, $t_S\Big(s, p^*(s), s^*, p^*(s^*)\Big) < t \leq t_R\Big(s, p^*(s), s^*, p^*(s^*)\Big)$, he purchases the firm's product without evaluation.

iii) If the consumer has high opportunity costs, $t > t_R\Big(s, p^*(s), s^*, p^*(s^*)\Big)$, he leaves the market.

If the consumer is informed about the firm's product, he purchases the firm's product if the utility it supplies exceeds his reservation utility.

i) If the consumer has low opportunity costs, $t \leq t_S\Big(s^*, p^*(s), s^*, p^*(s^*)\Big)$, his reservation utility is $U_{res} = v - p^*(s^*) + \mu\tilde{x}(t, s^*)$.

ii) If the consumer has intermediate opportunity costs, $t_S\Big(s^*, p^*(s^*), s^*, p^*(s^*)\Big) < t \leq t_R\Big(s^*, p^*(s^*), s^*, p^*(s^*)\Big)$, his reservation utility is $U_{res} = v - p^*(s^*)$.

[29] A technical remark: in order for $\hat{t}_{ind}$ to be well-defined and unique, it is necessary to add a consumer that has no opportunity costs. However, note that U_{res} is only well defined for every $t > 0$. For $t = 0$ set $U_{res}\Big(t, s^*, p^*(s^*)\Big) = v - p^*(s^*) + \mu\overline{\epsilon}$. Then, $\hat{t}_{ind} \in R_0^+$ is well-defined. Note that on the equilibrium path $\hat{t}_{ind}$ and $\tilde{t}_{ind}$ coincide. That is $\hat{t}_{ind}\Big(s^*, p^*(s^*), s^*, p^*(s^*)\Big) = \tilde{t}_{ind}(\mu, c + s^*)$.

iii) If the consumer has high opportunity costs, $t > t_R\Big(s^*, p^*(s^*), s^*, p^*(s^*)\Big)$, his reservation utility is zero.

Furthermore, if some consumer purchase randomly upon observing s, then $t_S = \hat{t}_{ind}$ if $t_S \in T$, and hence, $t_S = min\Big\{\hat{t}_{ind}, t_R\Big\}$.

Thus, as before the consumer's behavior is in line with intuition in that sense that consumers with low opportunity costs evaluate the firm's product, while other consumers purchase without evaluation or leave. The key difference is that the consumer's behavior is now a more complex object, as it depends on his expectations about the currents firm's strategy and the expectation about all following firms' strategies.

I conclude with some remarks on the comparative statics. In particular, I argue first that an increase in the expected firm's price encourages consumers to evaluate her product. Consider $\hat{t}_{ind}$, the consumer type that determines the cut-off if some consumers evaluate the product and some purchase without evaluation.[30] Furthermore, consider some $s \neq s^*$, and an increase in the expected price $p^*(s)$. Then, the utility of random purchase $U_R\Big(s, p^*(s)\Big)$ decreases less than the utility $U_S\Big(t, s, p^*(s), s^*, p^*(s^*)\Big)$ that the consumer obtains if he evaluates the firm's product. This is the case as a consumer that purchases the firm's product without evaluation pays the greater price with probability one; while, to the contrary, a consumer that evaluates the firm's product only pays the greater price if he chooses to purchase the firm's product after evaluation, which the consumer expects to occur with a probability strictly lower than one. Hence, besides that $\hat{t}_{ind}$ is continuous, $\hat{t}_{ind}$ is strictly increasing in $p^*(s)$. This means that an increase in the consumer's expectation of the firm's price encourages evaluations.

Furthermore, and intuitively clear is that an increase in evaluation costs deters consumers from evaluating the firm's product. More precisely, consider an increase in s, holding $p^*(s)$ fix. Since only a consumer that evaluates the firm's product

[30]The following results are valid if $\hat{t}_{ind}(s, p^*(s), s^*, p^*(s^*)) \neq 0$. The excluded case occurs, when $p^*(s)$ is so low such that the consumer expects to purchase the product after evaluation for sure. Then, there is no expected gain of evaluating the product, and only the hypothetical consumer that satisfies $t = 0$, that can evaluate products for free, is indifferent between evaluate and random purchase.

incurs the higher costs, only $U_S\Big(t, s, p^*(s), s^*, p^*(s^*)\Big)$ decreases strictly, and thus, $\hat{t}_{ind}$ is continuously and strictly decreasing in s. Thus, firms can hinder the information acquisition of consumers by obfuscation.

4.3 Firm behavior

A firm has the opportunity to affect the consumer's search behavior by her information strategy s. Furthermore, she chooses a price that suits to the induced search behavior of consumers. In the following I derive the firm's profits and state sufficient conditions for a firm's strategy to be part of an equilibrium strategy profile.

Formally, a firm's strategy consist of an information strategy and a pricing strategy that specifies a price for every s. Suppose the firm expects a symmetric market equilibrium such that each firm's strategy is (s^*, p^*), and each consumer's strategy is (t_S^*, t_R^*), where $t_S^* : S \to T$ and $t_R^* : S \to T$. Let $\xi(t, s^*)$ denote the density of consumer types that arrive at the firm. As before, $\xi(t, s^*) = \sum_{n=0}^{\infty} F\Big(\tilde{x}(t, s^*)\Big)^n h(t) = \frac{h(t)}{\tilde{F}(\tilde{x}(t,s^*))}$ for $t \leq t_S(s^*)$, and $\xi(t, s^*) = h(t)$ otherwise. Equivalent to equation (3), the firm's strategy (s, p) generates the profits

$$\begin{aligned}&\pi\Big(s, p(s), s^*, p^*(s^*), t_S^*(s), t_R^*(s)\Big)\\ &= p(s) \int_{\underline{t}}^{t_R^*(s)} \left\{1 - \mathbb{1}_{t \leq t_S^*(s)} F\left(\tilde{x}(t, s^*) + \frac{p(s) - p^*(s^*)}{\mu}\right)\right\} \xi(t, s^*) dt,\end{aligned} \tag{5}$$

where the term in curly brackets denotes the probability that a consumer purchases the firm's product conditionally on visiting the firm. Notice that π is increasing in $t_R^*(s)$ and decreasing in $t_S^*(s)$, since an increase in $t_R^*(s)$ and a decrease in $t_S^*(s)$ cause an upward shift of the demand curve. This means that a firm profits if more consumer purchase the firm's product randomly either instead of leaving the market or instead of evaluating the firm's product.

A firm's optimal strategy must choose for every information strategy a price that maximizes her profits. Then, given the optimal pricing behavior, the information strategy maximizes profits. Thus, for (s^*, p^*) to be an equilibrium strategy it must hold that $p^*(s)$ maximizes $\pi\Big(s, p^*(s), s^*, p^*(s^*), t_S^*(s), t_R^*(s)\Big)$ for every $s \in [\underline{s}, \overline{s}]$, and second, that s^* maximizes $\pi\Big(s, p^*(s), s^*, p^*(s^*), t_S^*(s), t_R^*(s)\Big)$ among all $s \in [\underline{s}, \overline{s}]$.

4.4 Market equilibrium

Recall that market outcomes follow immediately from s^*. Hence, the main task in the constructive proof that establishes the existence of a market equilibrium with the market outcomes described in proposition 3 is to determine the pricing behavior of firms off the equilibrium path in order to verify that there exist no profitable deviation for firms.

Unfortunately, there exists a multiplicity of equilibria. This occurs for two reasons. First, if all consumers search, then a firm might not be able to affect the search behavior of any consumer by increasing or lowering evaluation costs such that firms are indifferent between all information strategies. The second reason is based on the self-fulfilling expectation that no trade occurs off the equilibrium path, and captures the same intuition that gives rise to trivial equilibria in section 3. In particular, if a consumer observes a deviation s, and expects $p^*(s)$ to be excessively high such that his best response is to leave the market. However, if all consumers leave the market upon observing s, an excessively high price $p^*(s)$ is a firm's best responses conditionally on s. As a consequence, such a consistent belief discourages firms from deviations, and creates a multiplicity of equilibria and market outcomes.

I resolve this multiplicity using firm-optimality as a refinement, so that the equilibrium market outcome is unique. This seems to be appropriate, as it is plausible that firms coordinate on their preferred equilibrium.[31]

Proposition 3 *The firm-optimal market equilibrium has five regimes and is characterized by four cut-off values of product diversity.*

i) ***Market Failure:*** *If $\mu \leq \mu_A^S$, all consumers leave the market such that no*

[31] A reasonable alternative is a refinement that seizes the idea of forward induction. Then, consumers anticipate that a firm only deviates if she expects the deviation to be profitable, and consequently, off the equilibrium path those consistent beliefs are chosen that render deviation profitable to firms and encourage deviations. The constructive proof of proposition 3 establishes the existence of consistent beliefs for each deviation such that this deviation is not profitable. However, whenever there exist consistent beliefs for which trade occurs, then these beliefs are in fact unique and coincide with ones constructed in the proof. Therefore, the firm-optimal market equilibrium is stable with respect to any notion of forward induction. However, a refinement that seizes the idea of forward induction does not help to overcome the first reason for the multiplicity of equilibria, and does not yield a unique market outcome for all parameter values.

trade occurs. The market price exceeds the average valuation v. The firm's information strategy is arbitrary.

ii) ***Transparency Regime:*** *If $\mu_A^S < \mu \leq \mu_B^S$, firms choose a transparency policy and simplify information acquisition as much as possible. Consumers with low opportunity costs evaluate products; while the participation of other consumers adjusts such that the market price is equal to v.*

iii) ***Intermediate Regime:*** *If $\mu_B^S < \mu \leq \mu_C^S$, all consumers purchase products. The firms' information strategy adjusts such that the market price is equal to v.*

iv) ***Obfuscation Regime:*** *If $\mu_C^S < \mu \leq \mu_D^S$, firms obfuscate information and aggravate information acquisition. All consumers purchase products, but only consumers with low opportunity costs evaluate products. The market price is given by $p^* = \tilde{p}(\mu, c + \overline{s}, 1)$.*

v) ***Search Regime:*** *If $\mu_D^S < \mu$, firms obfuscate information and aggravate information acquisition. All consumers evaluate products, and the market price is given by $p^* = \tilde{p}(\mu, c + \overline{s}, 1)$.*

Beginning from low product diversity, I replicate the previously found no trade result with a slightly modified lower bound in product diversity. For $\mu \leq \mu_A^S$ there exists no consumer that evaluates a firm's product on the equilibrium path for any $s^* \in S$, and hence, there only exist equilibria in which no trade occurs.

More interesting is the transparency regime where firms simplify search as much as possible. Still, consumers only participate partially. If a firm deviates to higher evaluation costs, less consumers evaluate the firm's product, which seems to be desirable at first sight. However, consumers that consider to purchase the firm's product randomly anticipate that the firm's incentive to set low prices relaxes, and refrain from purchasing the firm's unknown product. As a consequence, the firm's gains of having less informed consumers is overcompensated by a loss in demand from random-purchasers. In other words, by encouraging information acquisition by consumers firms can signal to consumers, that consider to purchase her product without evaluation, that they can rely on the competitive pressure that is induced by informed consumers. Therefore, a transparency policy generates additional demand of consumers which purchase the firm's product without evaluation.

This argument prevails until all consumers participate. For greater product di-

versity, in the intermediate regime, firms gradually aggravate information acquisition. In particular, firms hinder the acquisition of information by that much such that still all consumers participate, and the participation constraint of the consumer with highest opportunity costs is binding. The intuition is that if lowering evaluation costs does not generate additional demand from otherwise leaving consumers, it is profitable for firms to obfuscate information. Otherwise, those consumers become informed and if they do not fancy the variant the firm offers, they continue search. This results in a monotonic relation between product diversity and evaluation costs, which is discussed later on.

In the obfuscation regime, all consumers participate although firms aggravate evaluation as much as possible. Lowering evaluation costs is not profitable, as it does not generate any additional demand. For even greater product diversity, in the search regime, all consumers evaluate products. In this regime firms are indifferent between all information strategies, as they can not hinder that the consumer evaluates her product. Nevertheless, firms profit if they collectively obfuscate information, since this increases each firm's monopoly power, because a consumer's option to continue search becomes less attractive. As a result, in the firm-optimal market equilibrium all firm's obfuscate information.

4.5 Comparative statics results for endogenous evaluation costs

Only in the intermediate regime the information strategy of firms varies with product diversity μ, evaluation costs c and the average evaluation v. Therefore, in all other regimes the comparative statics effects on market outcomes follow those for exogenous evaluation costs. Hence, I only discuss the intermediate regime.

4.5.1 Comparative statics results: intermediate regime

Proposition 4 *In the intermediate regime the equilibrium information strategy s^* is strictly increasing in product diversity μ and average valuation v, and strictly decreasing in evaluation costs c.*

Thus, the more variety there exist among the products offered in the market, the more firms obfuscate product information in order to discourage information acquisition. Furthermore, any decrease in exogenous evaluation costs c is offset by an increase in obfuscation. The intuition is that if the firm's information strategy remained unchanged the equilibrium price would decrease as a result of an increase in product diversity. Then, the participation constraint of no consumer would be binding anymore. Hence, the firm could marginally increase her evaluation costs, which would render demand slighty less elastic and increase her profits. However, if she increases her evaluation costs just slightly, she could still credibly commit to a price below the average valuation, so that she does not face any loss in demand.

A natural question that arises is whether the consumer's welfare is decreasing in product diversity, since any increase in product diversity comes along with further obfuscation of information. To answer this questions, I first show that the reservation match-value $\tilde{x}(t, s^*)$ is increasing in product diversity μ.

Lemma 4 *In the intermediate regime the reservation match-value $\tilde{x}(t, s^*)$ is strictly increasing in product diversity.*

Ergo, I find that despite more obfuscation, shoppers are choosier and search on average longer after an increase in product diversity. As the equilibrium prices is constant at v and a shopper's utility is $v - p^* + \mu\tilde{x}(t)$, each shopper's surplus is strictly increasing in product diversity, as reservation match-values increase. Furthermore, as before the increase in product diversity all non-participants and random-purchasers obtained a utility of zero, each consumer's welfare is weakly increasing.

Corollary 1 *In the intermediate regime each consumer's welfare is weakly increasing in product diversity, and total welfare is strictly increasing in product diversity.*

To conclude, in the intermediate regime an increase in product diversity is, despite further obfuscation of information, not only desirable form the social planner's point of view, but as well benefits each firm and each consumer. Obfuscation of product information allows firms to maintain their surplus at the dispense of shoppers' welfare and total welfare.

I conclude with an obvious remark on the effect of obfuscation on total welfare. As welfare is decreasing in evaluation costs by proposition 2, it immediately follows that obfuscation of product information reduces welfare. Hence, the welfare anlysis provides a rationale for policy intervention that aim to reduce the firm's opportunity to aggravate evaluation of product information.

5 Do firms offer niche or plain vanilla products?

In this section I examine product design. In particular, I endogenize product diversity such that each firm can choose whether to offer a plain vanilla product or a niche product. It is intuitively clear that it is irrelevant whether product differentiation is real or spurious. More broadly the question whether to offer a niche product is related to models of information disclosure if one considers undisclosed information about match-values to be equivalent to a plain vanilla design.[32]

Formally, let $\mu^j \in [\underline{\mu}, \overline{\mu}]$ denote the product design choice of firm j. Thus, by her choice of μ_j the firm can affect the variance of the valuations of consumers for her product. Figuratively speaking, a low μ^j represents a plain vanilla product, and a high μ^j a niche product. I include product design choice in the two previously presented models by adding a first stage to the game, in which all firms simultaneously and privately choose their product design. Then, time elapses as before. I assume that the product design choice is unobservable to consumers, but that consumers learn μ^j if they evaluate the product.

I find a strong result in favor of maximal product differentiation on the individual firm level. More precisely, each firm offers a niche product.

Proposition 5 *If product design is endogenous, and search cost are either exogenous or endogenous, then in any market equilibrium, in which trade occurs, each firm offers a niche product. That is* $\mu^* = \overline{\mu}$.

[32] The notion of product design builds on Johnson and Myatt (2006) and is related to their notion of demand rotations. A discussion of the equivalence of information disclosure and product design can also be found therein.

While this result is in line with the prevailing tenet in industrial organization that firms should seek to differentiate, recent studies suggest that individual firms might profit from offering plain vanilla products if they have a competitive advantage.[33] I obtain a very strong result in favor of product differentiation. The intuition is simple, and prevails in models of vertically differentiated products or information disclosure. The key insight is that only the demand of consumers is affected that evaluate the firm's product and learn about the firm's choice of product design. Hence, only the demand from shoppers changes. However, if consumers can purchase products without evaluation, all shoppers seek to find products that truly fit their taste. In particular, shoppers' reservation match-values exceed zero, $\tilde{x}(t) \geq 0$, and a shopper would never purchase a misfit at p^*, a product with a negative consumer-firm match-value. Thus, it becomes irrelevant for each firm whether a shopper just slightly dislikes her variant or hates it, as he has no intention to purchase her product in either case. On the other hand, it is decisive whether a consumer just slightly likes her product or loves it. Consequently, each firm would always offer a niche product, and by no means can commit to offering plain vanilla products in order to discourage the information acquisition of consumers. The general quintessence is that the option to purchase products with evaluation enhances product diversity.

6 Conclusion

This study seeks to close two gaps in the classical literature on sequential consumer search for differentiated products. First, it enlarges the consumer's strategy space and allows him to purchase products without evaluation. Second, it highlights the importance of participation constraints if the consumer population is heterogeneous with respect to opportunity costs. It turns out that both assumption alter market outcomes significantly. As long as participation constraints are binding for some consumers and not all consumers enter the market, any effect of an increase in evaluation costs and in product diversity on market prices vanishes, as market entrance

[33] In example, Bar-Isaac, Caruana, Cuñat (2012) demonstrate that in a consumer search model, if firms are vertically differentiated, those firms that have a competitive advantage choose plain vanilla designs, while the remaining firms focus on targeting niches. A similar argument is made in Anderson and Renault (2009).

of consumers with low opportunity costs offset any effect on market prices. Most interestingly, if all consumer enter the market, market prices are u-shaped in product diversity such that the firms' profits can be decreasing in the variety of products the market offers.

Moreover, the developed framework allows to examine obfuscation and product design in two distinct extensions. I demonstrate that the consumers' option to purchase products without evaluation provides incentives for firms to obfuscate information in order to hinder the information acquisition of consumers. However, the study illustrates that there are limits to these practices. As firms have no commitment power, they rely on the active search of shoppers in order to guarantee competitive prices to consumers that purchase without evaluation. In other words, a firm can signal low prices by encouraging consumers to evaluate her products. This mechanism creates a positive correlation between equilibrium obfuscation and product diversity. With regard to the firm's choice of product design, I find that a social planner's concerns that the market might fail to provide the desired variety of products is gratuitous. All firms find it individually rational to choose extreme product designs and target niches.

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A Appendix A

Proof of lemma 1: All arguments are given in the text, except a proof for the last claim.

Assume that some consumers search such that $t_S(p^*) \in T$. Then, $t_S(p^*)$ is the unique consumer type for which the consumer is indifferent between random purchase and evaluate if $t_R(p^*) > t_S(p^*)$. Otherwise, $t_S(p^*) = t_R(p^*)$. Let $\tilde{t}_{ind}(\mu, c) \in \mathcal{R}_+$ denote the unique, hypothetical consumer type for which the consumer is indifferent between random purchase and search. Therefore, $\tilde{t}_{ind}(\mu, c)$ is implicitly defined by $\tilde{x}\Big(\tilde{t}_{ind}(\mu, c)\Big) \stackrel{!}{=} 0$. I find $\tilde{t}_{ind}(\mu, c) = \mu g(0)/c$, where $g(x) := \int_x^{\overline{\epsilon}} (\epsilon - x) f(\epsilon) d\epsilon$. Then, the aforementioned implies $t_S(p^*) = min\Big\{t_R(p^*), \tilde{t}_{ind}(\mu, c)\Big\}$ if $t_S(p^*) \in T$. ■

Proof of lemma 2: Let me first provide the missing step in the derivation of the candidate equilibrium price. Differentiation of equation 3 with respect to p yields,

$$\frac{d}{dp}\pi(p, p^*) = H(t_R^*) - H(t_S^*) + \int_{\underline{t}}^{t_S^*} \frac{h(t)}{\tilde{F}(\tilde{x}(t))} \left\{ \tilde{F}\left(\tilde{x}(t) + \frac{p - p^*}{\mu}\right) - \frac{p}{\mu} f\left(\tilde{x}(t) + \frac{p - p^*}{\mu}\right) \right\} dt.$$

Imposing symmetry, one obtains the unique candidate equilibrium price that satisfies the first order condition.

In the following I proof the comparative statics of $\tilde{p}$. Denote $\tilde{\varphi}(t) = \varphi(\tilde{x}(t))$.

i) The effect on an increase in product diversity μ:
a) $\tilde{t}_{ind}(\mu, c) < t_R$***:***

$$\frac{d}{d\mu}\frac{1}{\tilde{p}(\mu, c, t_R)}$$
$$= \frac{1}{\mu\, H(t_R)} \left\{ \frac{-1}{\mu} \int_{\underline{t}}^{\tilde{t}_{ind}(\mu,c)} h(t)\, \tilde{\varphi}(t)\, dt + \frac{d\tilde{t}_{ind}(\mu, c)}{d\mu}\, h\Big(\tilde{t}_{ind}(\mu, c)\Big)\, \tilde{\varphi}\Big(\tilde{t}_{ind}(\mu, c)\Big) + \int_{\underline{t}}^{\tilde{t}_{ind}(\mu,c)} h(t)\, \frac{d}{d\mu}\varphi\Big(\tilde{x}(t)\Big)\, dt \right\}.$$

Rewriting the derivative of the hazard rate with respect to product diversity yields[34]

$$= \frac{1}{\mu^2\, H(t_R)} \left\{ - \int_{\underline{t}}^{\tilde{t}_{ind}(\mu,c)} h(t)\, \tilde{\varphi}(t)\, dt + \tilde{t}_{ind}(\mu, c)\, h\Big(\tilde{t}_{ind}(\mu, c)\Big)\, \tilde{\varphi}\Big(\tilde{t}_{ind}(\mu, c)\Big) - \int_{\underline{t}}^{\tilde{t}_{ind}(\mu,c)} t\, h(t) \frac{d}{dt}\tilde{\varphi}(t)\, dt \right\}.$$

After partial integration of the last summand, the first and second summand cancel with the third, and one obtains

$$= \frac{1}{\mu^2 H(t_R)} \left\{ \underline{t}\, h(\underline{t})\, \tilde{\varphi}(\underline{t}) + \int_{\underline{t}}^{\tilde{t}_{ind}(\mu,c)} t\, h'(t)\, \tilde{\varphi}(t)\, dt \right\}.$$

The first summand is strictly positive. The second is zero for the uniform distribution. □

b) $\tilde{t}_{ind}(\mu, c) \geq t_R$**:**
Following the same steps as in *a)*, one obtains

$$\frac{d}{d\mu} \frac{1}{\tilde{p}(\mu, c, t_R)} = -\frac{1}{\mu^2 H(t_R)}\, t\, h(t)\, \tilde{\varphi}(t)\Big|_{\underline{t}}^{t_R}.$$

Thus, a sufficient condition for $d/d\mu \tilde{p}(\mu, c, t_R) > 0$ is $d/dt\{t\, \tilde{\varphi}(t)\} \geq 0$ for every $t \leq \tilde{t}_{ind}(\mu, c)$. One obtains

$$\frac{d}{dt} t\tilde{\varphi}(t) = \frac{\partial \tilde{x}(t)}{\partial t} \frac{\partial}{\partial \tilde{x}(t)} \left\{ \frac{\mu}{c}\, g\Big(\tilde{x}(t)\Big)\, \varphi\Big(\tilde{x}(t)\Big) \right\}.$$

Simple analysis shows that $\tilde{F} = -g'$. This implies

$$= \frac{\mu}{c} \frac{\partial \tilde{x}(t)}{\partial t} \frac{\partial}{\partial \tilde{x}(t)} \left\{ \frac{-g\Big(\tilde{x}(t)\Big)}{g'\Big(\tilde{x}(t)\Big)}\, f(\tilde{x}(t)) \right\}.$$

Non-shoppers have lower reservation values, and hence, $\partial \tilde{x}(t)/\partial t$ is strictly negative. Thus, $\frac{d}{d\tilde{x}(t)} \left\{ \frac{-g(\tilde{x}(t))}{g'(\tilde{x}(t))} f(\tilde{x}(t)) \right\} \leq 0$ completes the proof. The first term of the derivative is negative since $f(\tilde{x}(t))$ is strictly positive, and the function g is log-concave which follows from simple analysis. The second term of the derivate is negative if $f'(\tilde{x}(t)) \leq 0$ since $-g(\tilde{x}(t))/g'(\tilde{x}(t)) > 0$ is positive. A sufficient condition for $f'(\tilde{x}(t)) \leq 0$ is $f'(x) \leq 0$ for $x \geq 0$ since $\tilde{x}(t) \geq 0$ holds for every $t \leq \tilde{t}_{ind}(\mu, c)$. □

ii) The effect on an increase in evaluation costs c: Assume $\tilde{t}_{ind}(\mu, c) < t_R$. For $\tilde{t}_{ind}(\mu, c) \geq t_R$ the first term in the derivative vanishes and the comparative statics

[34] $\frac{d}{d\mu}\varphi(\tilde{x}(t)) = -\frac{t}{\mu}\frac{d}{dt}\tilde{\varphi}(t)$

remain unaffected.

$$\frac{d}{dc}\frac{1}{\tilde{p}(\mu,c,t_R)} = \frac{1}{\mu\, H(t_R)}\left\{\frac{d\tilde{t}(\mu,c)}{dc}\, h\Big(\tilde{t}_{ind}(\mu,c)\Big)\,\tilde{\varphi}\Big(\tilde{t}_{ind}(\mu,c)\Big) + \int_{\underline{t}}^{\tilde{t}_{ind}(\mu,c)} \frac{d}{dc}\,\tilde{\varphi}(t)\, h(t)\, dt\right\}$$
$$= \frac{1}{\mu\, H(t_R)}\left\{-\frac{\mu}{c^2}\, g(0)\, h\Big(\tilde{t}_{ind}(\mu,c)\Big)\,\tilde{\varphi}\Big(\tilde{t}_{ind}(\mu,c)\Big) + \int_{\underline{t}}^{\tilde{t}_{ind}(\mu,c)} \frac{d\varphi\Big(\tilde{x}(t)\Big)}{d\tilde{x}(t)}\,\frac{d\tilde{x}(t)}{dc}\, h(t)\, dt\right\}$$

Obviously, the first summand is strictly negative. The second summand is strictly negative since the hazard rate φ is strictly increasing, and the reservation value $\tilde{x}(t)$ is strictly decreasing in evaluation costs by equation (3). □

iii) The effect on an increase in t_R^*: For $\tilde{t}_{ind}(\mu,c) \leq t_R^*$ the price is obviously increasing in t_R^* as more consumers purchase randomly. For $\tilde{t}_{ind}(\mu,c) > t_R^*$ the equilibrium price is the inverse of the weighted average hazard rate evaluated at the consumer's reservation match-value $\tilde{x}(t)$. As consumers with greater evaluation costs have lower reservation values, $\tilde{p}(\mu,c,t_R^*)$ is strictly increasing in t_R^* due to the assumption of strictly increasing hazard rates. ■

***Proof of proposition 1*:** Let $\mu_A = \underline{t}c/g(0)$, $\mu_C = c/g(0)$, and define μ_B as the unique solution to $\tilde{p}\Big(\mu_B, c, 1\Big) \overset{!}{=} v$ that satisfies $\mu_B < \mu_C$. Uniqueness and existence is shown in the proof.

***i) Market Failure*:** If $\mu < \mu_A$, then $\tilde{t}_{ind}(\mu,c) < \underline{t}$, and no consumer prefers evaluate to random purchase. Then, there does not exist a non-trivial equilibrium, as otherwise, if trade occurs, the firms' demand is perfectly inelastic.[35] Thus, only trivial equilibria exist, in which all consumers leave, and $p^* \geq v$ holds. □

***ii) Partial Participation Regime*:** Define $q(\mu,c,t) = \mu/\varphi(\tilde{x}(t))$. That is $q(\mu,c,t)$ is the symmetric equilibrium price if only consumers of type t participated and searched.[36]

Existence: The proof proceeds in four steps.

[35] For $\mu = \mu_A$ there does not exist a non-trivial symmetric equilibrium in pure strategies, but in mixed strategies in which only consumer $\underline{t}$ participates and randomizes between search and random purchase.

[36] Note that the imposed assumption $v > \mu/\varphi(0)$ is equivalent to $q(\mu,c,\tilde{t}_{ind}(\mu,c)) < v$.

Step 1: If $\mu_A < \mu \leq \mu_C$, then $\tilde{p}(\mu, c, \tilde{t}_{ind}(\mu, c)) < v$ holds. This means that some consumers will purchase randomly.

Proof: For $\mu_A < \mu \leq \mu_C$ the indifferent consumer satisfies $\underline{t} < \tilde{t}_{ind}(\mu, c) \leq 1$ by definition. Then, $\tilde{p}(\mu, c, \tilde{t}_{ind}(\mu, c)) < q(\mu, c, \tilde{t}_{ind}(\mu, c))$ holds for any such μ, since consumers with high opportunity costs have lower reservation match-values which softens competition. Furthermore, $q(\mu, c, \tilde{t}_{ind}(\mu, c)) = \mu/\varphi(0) < v$, since first, the reservation match-value of the indifferent consumer is zero, $\tilde{x}(\tilde{t}_{ind}(\mu, c)) = 0$, and second, $v > \mu/\varphi(0)$ by assumption. □

Step 2: There exists μ_B and $v = \tilde{p}(\mu_B, c, 1)$ such that $\mu_A < \mu_B < \mu_C$. Furthermore, if $\mu_A < \mu < \mu_B$, then $\tilde{p}(\mu, c, 1) > v$.

Proof: Proof by intermediate value theorem. First, consider $\tilde{p}(\mu_C, c, 1)$, the symmetric equilibrium price if all consumers participate. By definition of μ_C, $\tilde{t}_{ind}(\mu_C, c) = 1$ holds. Thus, $\tilde{p}(\mu_C, c, 1) = \tilde{p}(\mu_C, c, \tilde{t}_{ind}(\mu, c)) < v$ holds by step 1. Second, $\lim_{\mu \to \mu_A^+} \tilde{p}(\mu, c, 1) = \infty$, since the mass of shoppers vanishes and $\varphi(0)$ is bounded. Since, $\tilde{p}$ is continuous, the intermediate value theorem applies, and the existence of some μ_B that satisfies $v = \tilde{p}(\mu_B, c, 1)$ and $\mu_A < \mu_B < \mu_C$ follows.
Furthermore, as $\tilde{p}(\mu, c, 1)$ is strictly decreasing in μ for $\mu < \mu_C(c)$ by lemma 2, μ_B is unique and $\tilde{p}(\mu, c, 1) > v$ holds if $\mu_A < \mu < \mu_B$. □

Step 3: For $\mu_A < \mu < \mu_B$ there exists $t_R^*(\mu, c, v)$ that solves $\tilde{p}(\mu, c, t_R^*(\mu, c, v)) = v$.

Proof: Proof by the intermediate value theorem. For $\mu_A < \mu < \mu_B$ it holds that $\tilde{p}(\mu, c, \tilde{t}_{ind}(\mu, c)) < v$ by step 1, and $\tilde{p}(\mu, c, 1) > v$ by step 2. By continuity and monotonicity of $\tilde{p}$ in t_R there exists an unique $t_R^*(\mu, c, v)$ that solves $v = \tilde{p}(\mu, c, t_R^*(\mu, c, v))$.
□

Step 4: For $\mu_A < \mu < \mu_B$ it holds that $\tilde{t}_{ind}(\mu, c) < t_R^*(\mu, c, v)$.

Proof: For $\mu_A < \mu < \mu_B$ step 1 implies $\tilde{p}(\mu, c, \tilde{t}_{ind}(\mu, c)) < v = \tilde{p}(\mu, c, t_R^*(\mu, c, v))$ which implies $\tilde{t}_{ind}(\mu, c) < t_R^*(\mu, c, v)$ by lemma 2. This completes the existence proof since first, all participating consumers prefer participation to non-participation, and second, all non-participating consumers weakly prefer non-participation to random purchase, and random purchase to search by step 4. □

Uniqueness: Proof by contradiction. First, assume that there exists an equilibrium with $p^* < v$, then all consumers strictly prefer to participate in the market. A con-

tradiction to $\tilde{p}(\mu, c, 1) > v$ in step 2. Second, assume that there exists an equilibrium with $p^* > v$, then no consumer buys randomly. Hence, $t_R^* \leq t^{ind}(\mu, c)$ holds, which implies $p^* = \tilde{p}(\mu, c, t_R^*) \leq \tilde{p}(\mu, c, t^{ind}(\mu, c)) < v$ by lemma 2 and step 1. A contradiction to $p^* > v$. □

***iii) Full Participation Regime*:** By definition of μ_B, $\tilde{p}(\mu_B, c, 1) = v$. Furthermore, the definition of $\mu_C = \frac{c}{g(0)}$ implies $\tilde{t}_{ind}(\mu, c) < 1$ for $\mu < \mu_C$. Then, by lemma 2, $\tilde{p}(\mu, c, 1)$ is decreasing in μ on $\left(\mu_B, \mu_C\right)$. Jointly with $\tilde{p}$ increasing in t_R this implies $\tilde{p}(\mu, c, t_R) < v$ for any $t_R \in T$ and $\mu \in \left(\mu_B, \mu_C\right]$. Consequently, full participation is the unique non-trivial equilibrium, and all consumers with $t \leq \tilde{t}_{ind}(\mu, c)$ evaluate. □

***iv) Search Regime*:** If $\mu > \mu_C$, then $\tilde{t}_{ind}(\mu, c) > 1$. This means that all consumers that purchase a product strictly prefer to evaluate. Then, full consumer participation is the unique equilibrium, since for any $t_R \in T$ and any $\mu > \mu_C$, $\tilde{p}(\mu, c, t_R) \leq \tilde{p}(\mu, c, 1) \leq \frac{\mu}{\varphi(0)} < v$, where the last inequality holds by assumption. ■

***Proof of proposition 2*:** In the partial participation regime the equilibrium price is v by proposition 1, and consumer participation adjusts such that $v = \tilde{p}\left(\mu, c, t_R^*(\mu, c, v)\right)$ holds. The comparative statics of $t_R^*(\mu, c, v)$, and those of $\pi^*(\mu, c, v) = H\left(t_R^*(\mu, c, v)\right) p^*(\mu, c, v)$, follow directly from the comparative statics of $\tilde{p}$ in lemma 2. In the full participation and search regime $t_R^*(\mu, c, v) = 1$ holds, and the comparative statics follow directly from $p^*(\mu, c, v) = \tilde{p}(\mu, c, 1)$ and lemma 2. ■

Proof of lemma 3: All arguments are given in the text. A proof of the last claim of the lemma is omitted, as it follows along the same lines as the proof of the corresponding claim in lemma 1. ■

Proof of proposition 3: Let $\mu_A^S = \underline{t}(c + \underline{s}/g(0)$, $\mu_D^S = (c + \overline{s})/g(0)$, define μ_B^S as the unique solution to $\tilde{p}\left(\mu_B^S, (c + \underline{s}, 1\right) \overset{!}{=} v$ and define μ_C^S as the unique solution to $\tilde{p}\left(\mu_B^S, (c + \overline{s}, 1\right) \overset{!}{=} v$. Existence and uniqueness follows from the analysis in proposition 1.

I proof an equivalent statement; namely, that there exists a market equilibrium that has the following structure:

i) **Market Failure:** If $\mu \leq \mu_A^S$, no trade occurs, $p^* \geq v$ and $s^* \in S$.

ii) **Transparency:** If $\mu_A^S < \mu \leq \mu_B^S$, $t_S^* = \tilde{t}_{ind}(\mu, c + \underline{s})$, t_R^* solves $\tilde{p}(\mu, c + \underline{s}, t_R^*) = v$, $p^* = v$ and $s^* = \underline{s}$.

iii) **Intermediate Regime:** If $\mu_B^S < \mu \leq \mu_C^S$, $t_S^* = \tilde{t}_{ind}(\mu, c + s^*)$, $t_R^* = 1$, $p^* = v$, s^* solves $\tilde{p}(\mu, c + s^*, 1) = v$.

iv) **Obfuscation Regime:** If $\mu_C^S < \mu \leq \mu_D^S$, $t_S^* = \tilde{t}_{ind}(\mu, c + \overline{s})$, $t_R^* = 1$, $p^* = \tilde{p}(\mu, c + \overline{s}, 1)$ and $s^* = \overline{s}$.

v) **Search Regime:** If $\mu_D^S < \mu$, $t_S^* = t_R^* = 1$, $p^* = \tilde{p}(\mu, c + \overline{s}, 1)$ and $s^* = \overline{s}$.

The market outcomes as described above follow immediately from s^* and proposition 1. Thus, what remains to be shown is that there does not exist a profitable deviation $s \neq s^*$, and furthermore, in order to ensure the existence of an equilibrium, that for each $s \neq s^*$ there exist $p^*(s)$ and $\left(t_S^*(s), t_R^*(s)\right)$ that are mutual best responses after s. The proof proceeds in 6 steps. Step 1 and 2 are auxillary results. The main part of the proof are the steps 3 and 4. Then, the main result, which is established in step 5, follows directly from step 3 and 4. Firm-optimality is shown in step 6.

The proof proceeds in 6 steps. Step 1 and 2 are auxillary results. The main part of the proof are the steps 3 and 4. Then, the main result, which is established in step 5, follows directly from step 3 and 4. Firm-optimality is shown in step 6.

Step 1: If π, as defined in equation (5), is differentiable with respect to $p(s)$, and $\underline{t} < t_S^*(s) < t_R^*(s) < \overline{t}$, then π is strictly submodular with respect to $p(s)$ and $t_S^*(s)$, and strictly supermodular with respect to $p(s)$ and $t_R^*(s)$.

Proof: The first derivative of profits with respect to prices is

$$\begin{aligned}
&\pi_2\Big(s, p(s), s^*, p^*(s^*), t_S^*(s), t_R^*(s)\Big) \\
&= \int_{\underline{t}}^{t_S^*(s)} \tilde{F}\left(\tilde{x}(t, s^*) + \frac{p(s) - p^*(s^*)}{\mu}\right)\left\{1 - \frac{p(s)}{\mu}\varphi\left(\tilde{x}(t, s^*) + \frac{p(s) - p^*(s^*)}{\mu}\right)\right\}\xi(t, s^*)dt \\
&+ \int_{t_S^*(s)}^{t_R^*(s)} \xi(t, s^*)dt.
\end{aligned} \tag{6}$$

First, π_2 is strictly increasing in $t_R^*(s)$. Second, π_2 is strictly decreasing in $t_S^*(s)$, since $\tilde{F}(x) < 1$ for every x and $\varphi(x) > 0$ for every x. □

Step 2: If $\underline{t} < t_S^*(s) = t_R^*(s)$, then $\pi_2\left(s, v, s^*, v, t_S^*(s), t_R^*(s)\right) < 0$.

Proof: Note that π is differentiable with respect to $p(s)$ in an open interval around $p^*(s^*)$. Then, if one substitutes $t_S^*(s) = t_R^*(s)$, $p^*(s^*) = v$ and $p(s) = v$ in equation (6), one obtains

$$\pi_2\Big(s, v, s^*, v, t_S^*(s), t_R^*(s)\Big) = \int_{\underline{t}}^{t_S^*(s)} \tilde{F}\Big(\tilde{x}(t, s^*)\Big)\left\{1 - \frac{v}{\mu}\varphi\Big(\tilde{x}(t, s^*)\Big)\right\}\xi(t, s^*)dt < 0,$$

where the last inequality holds due to the assumption of increasing hazard rates, $\tilde{x}(t, s^*) \geq 0$, and $v > \frac{\mu}{\varphi(0)}$. □

Step 3: Suppose there exist $\left(s^*, p^*(s^*)\right)$, where $p^*(s^*) = v$, and $\left(t_S^*(s^*), t_R^*(s^*)\right) > \left(\underline{t}, \underline{t}\right)$ such that $p^*(s^*)$ and $\left(t_S^*(s^*), t_R^*(s^*)\right)$ are mutual best responses after s^*. Then, for any $s > s^*$ there exist $\left(t_S^*(s), t_R^*(s)\right)$ such that $p^*(s) = v$ and $\left(t_S^*(s), t_R^*(s)\right)$ are mutual best responses after s. Furthermore, the firm's profits are lower after s than after s^*.

Proof: Set $p^*(s) = v$. Then, $\hat{t}_{ind}(s, v, s^*, v)$ is uniquely determined.

First, suppose $\hat{t}_{ind}(s, v, s^*, v) \leq \underline{t}$ such that no consumer strictly prefers to evaluate the firm's product. Then, $t_S^*(s) = t_R^*(s) = 0$ and $p^*(s) = v$ are mutual best responses after s. Furthermore, the firms profits are zero.

Second, suppose $\hat{t}_{ind}(s, v, s^*, v) > \underline{t}$ such that some consumers strictly prefer to evaluate the firm's product. Set $t_S^*(s) = \hat{t}_{ind}(s, v, s^*, v)$. Note that $t_S^*(s)$ does not exceed 1, because $t_S^*(s) = \hat{t}_{ind}(s, v, s^*, v) < \hat{t}_{ind}(s^*, v, s^*, v) = t_S^*(s^*) \leq 1$, where the last two inequality hold, since otherwise, $p^*(s^*) = v$ is not a best response after s^* by step 2. By step 2, if $t_R^*(s) = t_S^*(s)$, then $\pi_2\left(s, v, s^*, v, t_S^*(s), t_R^*(s)\right) < 0$. On the other hand, if $t_R^*(s) = t_R^*(s^*)$, then from step 1 it follows that $\pi_2\left(s, v, s^*, v, t_S^*(s), t_R^*(s)\right) > 0$, since $t_S^*(s) < t_S^*(s^*)$, $t_R^*(s) \geq t_R^*(s^*)$ and $\pi_2\left(s^*, v, s^*, v, t_S^*(s^*), t_R^*(s^*)\right) = 0$. Then, the intermediate value theorem implies that there exists $t_R^*(s) \in \left(t_S^*(s), t_R^*(s^*)\right)$ such that $\pi_2\left(s, v, s^*, v, t_S^*(s), t_R^*(s)\right) = 0$. This implies that $p^*(s) = v$ and $\left(t_S^*(s), t_R^*(s)\right)$ are mutual best responses after s.

Let us examine the firm's profits next. Note that less consumer evaluate the firm's product upon observing s, as $t_S^*(s^*) > t_S^*(s)$. Thus, the firm's demand from shopper's is strictly lower after s. Furthermore, the firm as well generates lower

profits from consumers that purchase the firm's product randomly after s if

$$\int_{t_S^*(s)}^{t_R^*(s)} \xi(t, s^*)dt \leq \int_{t_S^*(s^*)}^{t_R^*(s^*)} \xi(t, s^*)dt. \tag{7}$$

The inequality (7) holds, since the first order conditions of the firm's profits after s and s^*, that one obtains if one sets equation (6) equal to zero, imply

$$\int_{t_S^*(s)}^{t_R^*(s)} \xi(t, s^*)dt = -\int_{\underline{t}}^{t_S^*(s)} \tilde{F}\Big(\tilde{x}(t, s^*)\Big)\left\{1 - \frac{v}{\mu}\varphi\Big(\tilde{x}(t, s^*)\Big)\right\}\xi(t, s^*)dt,$$

and

$$\int_{t_S^*(s^*)}^{t_R^*(s^*)} \xi(t, s^*)dt = -\int_{\underline{t}}^{t_S^*(s^*)} \tilde{F}\Big(\tilde{x}(t, s^*)\Big)\left\{1 - \frac{v}{\mu}\varphi\Big(\tilde{x}(t, s^*)\Big)\right\}\xi(t, s^*)dt,$$

Then, the inequality (7) follows from $\tilde{F}\left(\tilde{x}(t, s^*)\right)\left\{1 - \frac{v}{\mu}\varphi\left(\tilde{x}(t, s^*)\right)\right\}\xi(t, s^*) < 0$, which holds, since $1 - \frac{v}{\mu}\varphi\left(\tilde{x}(t, s^*)\right) \leq 1 - \frac{v}{\mu}\varphi(0) < 0$. □

Step 4: Suppose there exist $\Big(s^*, p^*(s^*)\Big)$ and $\Big(t_S^*(s^*), t_R^*(s^*)\Big) > \Big(\underline{t}, \underline{t}\Big)$, where $t_R^*(s^*) = 1$, such that $p^*(s^*)$ and $\Big(t_S^*(s^*), t_R^*(s^*)\Big)$ are mutual best responses after s^*. Then, for any $s < s^*$ there exist $p^*(s) < p^*(s^*)$ and $\Big(t_S^*(s), t_R^*(s)\Big)$ such that $p^*(s)$ and $\Big(t_S^*(s), t_R^*(s)\Big)$ are mutual best responses after s. Furthermore, the firm's profits are lower after s than after s^*.

Proof: Consider some arbitrary $p(s)$. Set $t_S^*(s) = \hat{t}_{ind}\Big(s, p(s), s^*, p^*(s^*)\Big)$ and $t_R^*(s) = 1$. Consider

$$\begin{aligned}
&\pi_2\Big(s, p(s), s^*, p^*(s^*), \hat{t}_{ind}(s, p(s), s^*, p^*(s^*)), 1\Big) \\
&= \int_{\underline{t}}^{\hat{t}_{ind}(s,p(s),s^*,p^*(s^*))} \tilde{F}\left(\tilde{x}(t, s^*) + \frac{p(s) - p^*(s^*)}{\mu}\right)\left\{1 - \frac{p(s)}{\mu}\varphi\left(\tilde{x}(t, s^*) + \frac{p(s) - p^*(s^*)}{\mu}\right)\right\}\xi(t, s^*)dt \\
&+ \int_{\hat{t}_{ind}(s,p(s),s^*,p^*(s^*))}^{1} \xi(t, s^*)dt.
\end{aligned}$$

Then, $\pi_2\Big(s, p^*(s^*), s^*, p^*(s^*), \hat{t}_{ind}(s, p^*(s^*), s^*, p^*(s^*)), 1\Big) < 0$. This holds by step 1, since $\hat{t}_{ind}\Big(s, p^*(s^*), s^*, p^*(s^*)\Big) > \hat{t}_{ind}\Big(s^*, p^*(s^*), s^*, p^*(s^*)\Big) \geq t_S^*(s^*)$ and $\pi_2\Big(s, p^*(s^*), s^*, p^*(s^*), \hat{t}_{ind}(s^*, p^*(s^*), s$

0. Recall that $\hat{t}_{ind}\Big(s, p(s), s^*, p^*(s^*)\Big)$ is strictly increasing in $p(s)$, and there exists $p'(s)$ that satisfies $\hat{t}_{ind}\Big(s, p'(s), s^*, p^*(s^*)\Big) = \underline{t}$. Then, $\pi_2\Big(s, p'(s), s^*, p^*(s^*), \hat{t}_{ind}(s, p'(s), s^*, p^*(s^*)), 1\Big) > 0$. Since π_2 is continuous in $p(s)$, there exists $p^*(s) \in \Big(p'(s), p^*(s^*)\Big)$ that satisfies $\pi_2\Big(s, p^*(s), s^*, p^*(s^*), \hat{t}_{ind}(s, p^*(s), s^*, p^*(s^*)), 1\Big) = 0$ by the intermediate value theorem. Furthermore, if $t_R^*(s^*) = 1$, then $s < s^*$ and $p^*(s) < p^*(s^*)$ imply that $t_R^*(s) = 1$ is a best response of the consumer after s.

Let us examine the firm's profits after s. Due to the weak concavity of π with respect to $p(s)$, which is formally proven in the appendix B, and due to the submodularity of π with respect to $p(s)$ and $t_S^*(s)$, which is proven in step 1, $p^*(s) < p^*(s^*)$ and $t_R^*(s^*) = t_R^*(s)$ imply $t_S^*(s^*) < t_S^*(s)$. Then, the firm's profits are lower after s than after s^*, since $t_R^*(s^*) = t_R^*(s)$ and $t_S^*(s^*) < t_S^*(s)$. □

Step 5: There exists a market equilibrium that satisfies the properties outlined at the beginning.

Proof: All regimes except the market failure regime: For a given s^*, the consumers' and firms' behavior on the equilibrium path, as outlined in proposition 3, follows immediately from proposition 1. Thus, what remains to be verified is that there does not exist a profitable deviation s for firms. Note however that either $p^*(s^*) = v$ or $t_R^*(s^*) = 1$ or both hold such that either step 3 or step 4 or both are applicable. Then, there does not exist a profitable deviation, and the existence of an equilibrium is guaranteed, since there as well exist fix-points off the equilibrium path.

Market failure regime: For $\mu \leq \mu_A$ in any symmetric equilibrium with s^* no positive measure of consumers evaluates the firm product irrespective of prices. Then, no equilibrium with trade exists as a firm's demand is otherwise perfectly inelastic.

Step 6: A market equilibrium that satisfies the properties outlined in proposition 3 is firm-optimal. That is, there exist no other market equilibrium that generates greater profits for firms.

Proof: I proof a stronger claim. Let π^* denote the firm's equilibrium profits for exogenous search costs. Then, $\pi^*(\mu, c + s^*, v) \geq \pi^*(\mu, c + s', v)$ for any $s' \in S$. The inequality holds, since from proposition 2 it follows that each firm's profits are increasing in evaluation costs if all consumers enter the market and purchase some

product, and that profits are decreasing in evaluation costs if consumers participate only partially.

Proof of proposition 4: In the intermediate regime s^* satisfies $\tilde{p}(\mu, c + s^*, 1) = v$. From the comparative statics of $\tilde{p}$, that are given by lemma 2, it immediately follows that s^* is strictly increasing in product diversity μ and average valuation v, and strictly decreasing in evaluation costs c. ■

Proof of lemma 4: By equation (2), the reservation match-value $\tilde{x}(t, s^*)$ is strictly increasing in $\frac{\mu}{c+s^*}$. Therefore, it suffices to show that $\frac{\mu}{c+s^*}$ is strictly increasing in μ. Now, consider an increase in μ, holding $\frac{\mu}{c+s^*}$ fixed. Then, $\tilde{x}(t, s^*)$ and $\tilde{t}_{ind}(\mu, c + s^*)$ remain constant. Hence, $p^* = \tilde{p}(\mu, c + s^*, 1)$ is proportional to μ for $\frac{\mu}{c+s^*}$ fixed, since the nominator of $\tilde{p}(\mu, c + s^*, 1)$ in equation (4) remains constant. Thus, if $\frac{\mu}{c+s^*}$ was fixed, the equilibrium price would be strictly increasing in μ. However, in the intermediate regime the equilibrium price is constant. Then, $\tilde{p}$ increasing in $c + s^*$ implies that $\frac{\mu}{c+s^*}$ has to be increasing in μ. ■

Proof of proposition 5: Without loss of generality assume that evaluation costs are exogenous. Assume the contrary, namely that there exists a market equilibrium that satisfies $\mu^* < \overline{\mu}$. Denote p^* the firm's price on the equilibrium path. Consider a deviation of a firm to (p^*, μ). Then first, the demand from randomly purchasing consumers remains unaffected as they do not observe the deviation. Second, the demand from leaving consumers remains unaffected, as they do not observe the deviation and still leave. Third, the demand of shoppers is strictly increasing in μ. Consider a consumer that prefers to evaluate products. Then, his reservation utility is $U^*(t) = v - p^* + \mu^* \tilde{x}(t)$. Hence, the consumer purchases the firm's product if and only if the match-value ε satisfies $\mu\varepsilon \geq \mu^* \tilde{x}(t)$. Therefore, $\tilde{F}(\frac{\mu^*}{\mu}\tilde{x}(t))$ is the conditional probability that the consumer purchases the firm's product after evaluation. Note that the first derivate of the conditional probability is strictly positive, since $\tilde{x}(t)$ is weakly positive and strictly positive for some consumers if there exists a positive measure of consumers that evaluate products. Hence, a deviation to $\mu = \overline{\mu}$ is always profitable if $\mu^* < \overline{\mu}$ and trade occurs in equilibrium. ■

B Appendix B

The purpose of the appendix B is twofold. First, I provide sufficient conditions to ensure that the firm's profits are maximized whenever the first order condition holds. Second, I show that a firm's deviations that are detected by consumers that do not evaluate the firm's products are never profitable. The notation follows the one from section 3, and hence, the proof covers the case for exogenous evaluation costs. The proof directly implies that for endogenous evaluation costs, sufficiency of first order conditions on the equilibrium path is guaranteed. A proof of sufficiency of first order conditions off the equilibrium path, that is after a deviation $s \neq s^*$, follows along the same lines, and hence, is omitted.

Let me briefly point out why sufficiency is an issue here beyond the necessary distinction between detected and undetected deviations. The natural approach, that is adopted by Anderson and Renault (1999), is to show quasi-concavity of the firm's profit function. The problem is that due to the consumers' search cost heterogeneity it does not suffice to show quasi-concavity of the profits from a particular consumer t, since the sum of quasi-concave functions is per se not quasi-concave. Hence, I proof weak concavity of the profits from any consumer t for undetected deviations.

The purpose of this first paragraph is to examine the firm's profits after a detected deviation, when a firm chooses a price that exceeds the consumer's belief p^* by more than δ. Then, each consumer notices that p exceeds $p^* + \delta$, even if he does not evaluate the firm's product. Consequently, no consumer purchases the firm's product randomly. In the firm's best case, those consumers that intended to purchase the firm's product randomly and those consumers that intended to evaluate the firm's product, evaluate the firm's product. This is the case, since a consumer that intended to leave, strictly prefers to leave upon detecting a deviation. Hence, as a preliminary result we find that the firm's profits for undetected deviations are bounded from above by

$$\bar{\pi}^D(p) = \int_{\underline{t}}^{t_S^*} p\tilde{F}\left(\tilde{x}(t) + \frac{p - p^*}{\mu}\right)\xi(t)dt + \int_{t_S^*}^{t_R^*} p\tilde{F}\left(\frac{p - p^*}{\mu}\right)\xi(t)dt, \tag{8}$$

where the second term corresponds to the profits generated by the demand from

those consumers that intended to purchase the firm's product randomly, but evaluate the firm's product upon detecting the firm's deviation. Note that their reservation utility is $v - p^*$, and thus, such a consumer purchases the firms product if the consumer-firm match-value exceeds $\frac{p-p^*}{\mu}$.

In the following I show that first order conditions are sufficient if consumers are sufficiently cautious and the search cost heterogeniety among consumers is not too great. The main idea, as outlined in step 4, is to show weak concavity of the firm's profits for undetected deviations, and to derive an upper bound on profits after detected deviations. Let π^U denote the firm's profit for undetected deviations.

Lemma 5 *There exists $\delta, \underline{t} < 1$ such that, if $\frac{f_1}{f}$ is bounded from below by $\frac{f_1}{f} \geq -2\frac{\mu}{v+\mu\bar{\epsilon}}$ and f is log-convave, then $\pi_1^U(p^*) = 0$ implies that p^* is a global maximum.*

Proof. The proof proceeds in four steps.

Step 1: For any δ there exists $\underline{t} < 1$ such $\tilde{x}(\underline{t}) - \tilde{x}(t) < \frac{\delta}{\mu}$ for every $t \in [\underline{t}, 1]$.
Proof: The claim is equivalent to left-sided continuity of g^{-1} at $\frac{c}{\mu}$, and thus follows from continuity of g^{-1}. □

Set $\delta = \frac{\bar{\epsilon}-\tilde{x}(\underline{t})}{2}$, and set $\underline{t} < 1$ such that $\tilde{x}(\underline{t}) - \tilde{x}(t) < \frac{\delta}{\mu}$ for every $t \in [\underline{t}, 1]$.

Step 2: The profit function is weakly concave for $p \leq p^* + \delta$, and strictly concave at $p = p^*$.
Proof: A deviation $p \leq p^* + \delta$ is only detected by consumers that evaluate the firm's product. The firm's profits for undetected deviations are given by equation (3)

$$\pi^U(p) = \int_{\underline{t}}^{t_R^*} \underbrace{p\left\{1 - \mathbb{1}_{t\leq t_S^*} F\left(\tilde{x}(t) + \frac{p-p^*}{\mu}\right)\right\}}_{\pi^{U,t}(p)} \xi(t)dt. \tag{9}$$

Then, the profit function is weakly concave if $\pi^{U,t}$ is weakly concave for every $t \leq t_R^*$, which I show in the following.

First, for $t > t_S^*$, for those agents that purchase the firm's product randomly, $\pi^{U,t}$ is linear, and thus weakly concave.

Second, consider $t \leq t_S^*$. Then, $\pi^{U,t}$ is linear for $p \leq \mu\left(\underline{\epsilon} - \tilde{x}(t)\right) + p^*$, since then $F\left(\tilde{x}(t) + \frac{p-p^*}{\mu}\right) = 0$ and the consumer purchases the product after evaluation. At

$p = \mu\Big(\underline{\epsilon} - \tilde{x}(t)\Big) + p^*$ it holds that $\pi^{U,t}$ is continuous, but has a kink. However, $\pi^{U,t}$ is steeper on the left side of the kink,

$$1 = \lim_{p \to \{\mu(\underline{\epsilon} - \tilde{x}(t)) + p^*\}^-} \pi_1^{U,t}(p) \geq \lim_{p \to \{\mu(\underline{\epsilon} - \tilde{x}(t)) + p^*\}^+} \pi_1^{U,t}(p) = 1 - \frac{p}{\mu} f(\underline{\epsilon}),$$

such that weak concavity is not vioated. Finally, what remains to be shown is that $\pi^{U,t}(p)$ is weakly concave on $\Big(\mu(\underline{\epsilon} - \tilde{x}(t)\Big) + p^*, p^* + \delta)$. In this regime $\pi^U(p,t)$ is twice continuously differentiable as $\tilde{x}(t) + \frac{p-p^*}{\mu} \in (\underline{\epsilon}, \overline{\epsilon})$. The second derivate of $\pi^{U,t}$ with respect to prices is

$$\pi_{11}^{U,t}(p) = \frac{f\left(\tilde{x}(t) + \frac{p-p^*}{\mu}\right)}{\mu} \left\{ -2 - \frac{p}{\mu} \frac{f_1\left(\tilde{x}(t) + \frac{p-p^*}{\mu}\right)}{f\left(\tilde{x}(t) + \frac{p-p^*}{\mu}\right)} \right\}.$$

If f is weakly increasing, then the second derive of $\pi^{U,t}$ is strictly negative which completes the proof. Thus, suppose that f is not weakly increasing in some regime such that for some p' it holds that $f_1\left(\tilde{x}(t) + \frac{p-p^*}{\mu}\right) < 0$. Consider an arbitrary p'. Then,

$$\pi_{11}^{U,t}(p') \leq \frac{f\left(\tilde{x}(t) + \frac{p'-p^*}{\mu}\right)}{\mu} \left\{ -2 - \frac{v + \mu\overline{\epsilon}}{\mu} \lim_{\epsilon \to \overline{\epsilon}} \frac{f_1(\epsilon)}{f(\epsilon)} \right\} < 0.$$

The first inequality holds, since $p' < v + \mu\overline{\epsilon}$, and since f_1/f is weakly decreasing, which holds as f is log-concave. The last inequality holds by assumption.

Step 3: For $p > p^* + \delta$ the firm's profits are bounded from above by $\pi^U(p^* + \delta)$.
Proof: The firm's profits for a detected deviations $p > p^* + \delta$ are bounded from above by $\bar{\pi}^D(p)$ as defined in equation (9). Then, first, $\bar{\pi}^D(p^* + \delta) \leq \pi^U(p^* + \delta)$, and second, $\bar{\pi}^D(p)$ weakly decreasing for $p \geq p^* + \delta$ complete the proof.

The first claim follows immediately from the definition of π^U in equation (9) and $\bar{\pi}^D$ in equation (8).

For the second claim it suffices to show that $\bar{\pi}^{D,t}$ is weakly decreasing for every t on $p \geq p^* + \delta$. First, note that $\bar{\pi}^{D,t}$ is continuous and bounded from below by zero. Furthermore, $\bar{\pi}^{D,t}$ is differentiable whenever $\bar{\pi}^{D,t}(p) \neq 0$. Thus, it suffices to show

that $\bar{\pi}_1^{D,t}(p) \leq 0$ whenever $\bar{\pi}^{D,t}$ is differentiable at p. I find

$$\frac{\bar{\pi}_1^{D,t}(p)}{\tilde{F}\left(\tilde{x}(t)+\frac{p-p^*}{\mu}\right)} = 1 - \frac{p}{\mu}\varphi\left(\tilde{x}(t)+\frac{p-p^*}{\mu}\right) < 1 - \frac{p^*}{\mu}\varphi\left(\tilde{x}(\underline{t})+\frac{p-p^*}{\mu}+\left[\tilde{x}(t)-\tilde{x}(\underline{t})+\frac{p-p^*}{\mu}\right]\right),$$

where the inequality follows from $p > p^*$. Furthermore, since φ is weakly increasing, and $\left[\tilde{x}(t)-\tilde{x}(\underline{t})+\frac{p-p^*}{\mu}\right] \geq \left[\tilde{x}(t)-\tilde{x}(\underline{t})+\frac{\delta}{\mu}\right] > 0$ by step 1. Hence,

$$\frac{\bar{\pi}_1^{D,t}(p)}{\tilde{F}\left(\tilde{x}(t)+\frac{p-p^*}{\mu}\right)} < 1 - \frac{p^*}{\mu}\varphi\left(\tilde{x}(\underline{t})+\frac{p^*-p^*}{\mu}\right) \leq 0.$$

The last inequality holds as $1 - \frac{p^*}{\mu}\varphi\left(\tilde{x}(\underline{t})+\frac{p^*-p^*}{\mu}\right) = \pi_1^{U,\underline{t}}(p^*)$. Then, $\pi_1^{U,t}(p^*) \leq 0$ holds, since $\pi_1^U(p^*) = 0$ implies $\pi_1^{U,t}(p^*) \leq 0$ for some t, which implies $\pi_1^{U,\underline{t}}(p^*) \leq 0$, since the demand generated by shoppers is more elastic due to the assumption of increasing hazard rates. □

Step 4: $\pi_1^U(p^*) = 0$ imlies that p^* is a global maximum

Proof: By step 2, the profit function is weakly concave for $p \leq p^* + \delta$, and strictly concave at p^*. By step 3, the firm's profits for $p > p^* + \delta$ are bounded from above by $\pi^U(p^* + \delta)$, and thus strictly lower than $\pi^U(p^*)$, by step 2. ■