Essays in Behavioral Industrial Organization

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Product Advertising Through Influencers

(Job Market Paper)

Firms increasingly promote their products through social influencers. Followers that rely on product reviews by influencers do not directly observe the relationship between the influencers and the firms. As firms have an incentive to influence the reviewers through unobserved payments, it can be difficult to sustain market outcomes with informative independent reviews. Recent FTC regulations require mandatory disclosure of all paid advertising content so that buyers can differentiate between paid and independent product reviews. This paper investigates the impact of this disclosure policy on market outcomes when the influencer has the expertise to evaluate product quality and influence the beliefs of both potential buyers as well as the firm. The disclosure requirement is ineffective if the influencer has a high level of expertise, cares a lot about the economic value generated for followers or has a high probability of being honest. In markets where the influencers do not care much about their followers or lack sufficient expertise and in markets with high uncertainty about product quality, the disclosure regulation changes the outcome from hidden paid advertising to unbiased independent reviews; this not only improves consumer and social welfare but also the expected profit of the firm. Further, when the firm has private information about the distribution of its product quality, the disclosure policy facilitates signaling of this private information; paid (independent) review is posted when quality is more likely to be low (high).

Deceptive Advertising, Regulation and Naive Consumers

(Under Review)

In markets where buyers have incomplete information about product quality, consumer sophistication increases the case for strong regulation of deceptive advertising by firms. In a model where a fraction of buyers are naive (i.e., cannot update beliefs based on market signals and believe all advertising claims) and prior beliefs of the buyers about product quality are optimistic, I show that the socially optimal level of penalty is (a) higher than the penalty required to merely avoid deception by firms and (b) increasing in the proportion of sophisticated buyers. The optimal penalty for false advertising not only discourages deception but also reduces prices by eliminating the signaling distortion. Moreover, a low level of penalty is worse than no penalty from a social welfare standpoint.

Consumer Naivety and Price Signaling

Firms signal their quality through prices. But, naive consumers cannot interpret these signals because of cognitive limitations. In a static signaling model, I analyze the pricing behavior of a monopolist selling a product of uncertain quality in the presence of such naive consumers. In the high-quality state, the presence of a high proportion of naive consumers reduces the price of the product and hence improves overall welfare of the society. On the other hand, in the low-quality state, it increases the price of the product thereby reducing social surplus. Allowing for disclosure as an alternative to communicate quality, the high-quality monopolist has no incentive to disclose in the presence of a high proportion of naive consumers. This provides a partial explanation for the infrequent voluntary disclosure by some industries.