



Department SEMINARS

Price competition and network
externality in a vertically
differentiated market

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A B S T R A C T

In this paper, we focus on interaction between distribution of the consumers WTP, quality differential, and strength of the externality effect linked to conspicuous consumption. In particular, we prove the existence and uniqueness of a Nash equilibrium in the price stage of a vertically differentiated duopoly game where the willingness to pay for high quality depends on the size of the market for high quality goods. Our setting can capture the situation in which high-quality goods are recognized as such and showcased by consumers that bought them, triggering the desire of other consumers. The effect does not need large differences in quality to lead to our results. In particular, we find that if the Esteban elasticity of the density of the distribution of income is higher than 1, then a high-quality good will be treated as a Veblen good in our setting, namely a good for which the demand increases with its price. The bandwagon effect per se is not enough to reach this result, and this suggests that the income distribution of the consumers acting in a certain market can change how a certain good is perceived and treated by the consumers themselves.

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