Submission is intended for the doctoral student sessions.

Abstract
We study the estimation of preference heterogeneity in markets where consumers engage in costly search to learn product characteristics. Costly search amplifies the way consumer preferences translate into purchase probabilities, generating a seemingly large degree of preference heterogeneity. To illustrate this effect, we develop a dynamic search model where consumers sequentially acquire information about different products. In this model, consumers rationally decide when to stop information search by weighing the gains from searching additional products and the search costs. We then develop a version of this model that allows for flexible heterogeneity in consumer preferences and estimate its parameters using a unique panel dataset on the search and purchase behavior of consumers. The estimation results reveal that ignoring search costs leads to an overestimation of standard deviations of product intercepts by 30%. We show that this bias leads to incorrect inference about price elasticities and markups of sellers and has important consequences for optimal targeted marketing.

Keywords

Authors
Xiaojing Dong (Santa Clara University), Ilya Morozov (Stanford University), Stephan Seiler (Stanford University), Liwen Hou (Shanghai Jiao Tong University).

Presenter (student)
Ilya Morozov (Stanford University).