

Non-reservation Price Equilibria and Consumer Search*

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Abstract

When consumers do not know the prices at which different firms sell, they often also do not know production costs. Consumer search models which take asymmetric information about production costs into account continue focusing on reservation price equilibria (RPE) and their properties. We argue that RPE assume specific out-of-equilibrium beliefs that are not consistent with the logic of the D1 refinement criterion. Moreover, RPE suffer from a non-existence problem as they typically do not exist when cost uncertainty is large. We characterize an alternative class of so-called non-RPE. We show these equilibria always exist and do not rely on specific out-of-equilibrium beliefs. Non-reservation equilibria are characterized by active consumer search among consumers. As cost uncertainty facilitates search, more consumers make price comparisons resulting in stronger price competition between firms and higher consumer surplus.

JEL Classification: D40; D83; L13

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