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Consumer feelings and equilibrium product quality

(Comments from Sridhar Balasubramanian)

- Interesting idea, elegantly executed
- Signaling model but different from "business as usual"
- Started off with a bunch of concerns – but most of these were systematically addressed by authors (often in the footnotes)
- Interesting results –
  - Low cost of quality firm overinvests in quality, but high cost of affect firm underinvests in affect

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Issues to consider: Issue 1: Some alternative formulations

$$U(p,q)=\gamma q-p;\quad \tilde{q}=f(q,\,a)\Rightarrow \tilde{q}=q+a$$

Here: $\tilde{q}=perceived\ \ quality;\ q=\text{"}real\text{"}\ quality;\ a=affect$

Possible reformulations (the authors do show that the model is generally robust to some reformulations)

$$\tilde{q}=q.a$$

$$U(q,p,a)=\gamma q+\delta a-p$$

$$U(q,p,a)=\lambda q(a)+\delta a-p$$

This last reformulation posits that real quality, as perceived by the consumer, is a function of affect as well.

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Issue 2: How plausible is it that consumers can solve the firm's cost minimization problem?

- Imagine walking up to the manager and asking him or her about the marginal cost of (a) quality and (b) affect. In all likelihood, the manager will not know the answer.
- But, despite that, managers may make approximately correct decisions about the level of quality and affect because they rely on tacit knowledge about these investments.
- However, the external customer who does not possess such tacit knowledge, may find it difficult to solve the cost minimization problem and deduce the "correct" quality.
- This issue can be made less acute by considering two levels each of quality and affect (High and Low) – this would call for less precise knowledge on the part of the consumer.

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Issue 3: How would a strategic manager decide on levels of investment in affect and quality?

- Assume for the moment that strategic consumers are indeed able to solve the firm's cost minimization problem. A strategic manager will recognize this.
- Would a strategic manager who is, in reality, delivering poor quality then not intentionally distort the investment in affect to elicit an assessment of quality from the consumer which is (a) incorrect but (b) nevertheless beneficial to the firm? And if the strategic customer realizes this is taking place, would not the game break down?
- It would be nice if the authors can work through this.

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Issue 4: What is the benchmark against which the results must be compared?

- In the model, high quality firms produce higher quality because they have lower cost of quality production
- Such a firm will also induce higher affect, even if it does not have a lower marginal cost of affect
- Authors' empirical observation: Firms which deliver higher quality also induce higher levels of affect
- Question: Is there a simpler segmentation-related argument? High income consumers prefer both quality and affect – if we are targeting them, let's give them both
- It would be nice to make the examples and arguments robust to this simpler explanation