

# Consumer Information Asymmetry in Online Product Reviews

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## **Abstract**

Firms often know the distribution of tastes across the consumer population. Individual consumers are likely to be unaware of this distribution. This constitutes an information asymmetry. The paper shows that when an individual makes a purchase decision using online product reviews as her source of information about the product quality, the lack of information about consumer heterogeneity does not allow her to correctly infer the true product quality. The inferred product quality is systematically biased, and the bias depends on the consumer's characteristics. In the market with such information asymmetry, a strategic forward-looking firm is able to maximize its profits by setting the price to attract consumers who would give the product a high rating. This paper shows that the firm earns higher profits if consumers are informed about the consumer heterogeneity distribution, i.e. in the market with no information asymmetry. The findings are in line with the empirical evidence that firms selling their products online try to reduce the information asymmetry, e.g. by disclosing the average product ratings by consumer types to their prospective customers.

**Subject Areas:** *Consumer Behaviour, Electronic Commerce and Internet Marketing, Pricing, Recommendation Systems*

**Track:** Digital Marketing & Social Media