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**ASYMMETRIC INFORMATION, WORD-OF-MOUTH
AND SOCIAL NETWORKS: FROM THE MARKET
FOR LEMONS TO EFFICIENCY**

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Abstract

I analyze a market where there is a homogeneous good, which quality is chosen, and therefore known, by a single producer. Consumers do not know the quality of the good but they use their acquaintances in order to obtain information about it. Information transmission exhibits decay and consumers assign a common initial willingness-to-pay before information transmission takes place. I define an equilibrium concept for this type of situation and characterize the set of resulting equilibria for any possible social network. The main conclusion from this characterization is that, if there is a maximal level of quality (given by technological knowledge) that can be chosen, then, the producer may choose lower levels of quality as the population of consumers is getting more internally connected, due to free-riding on information by consumers when quality levels are low. This “adverse-selection” effect vanishes if consumers are expected to coordinate on the most favorable equilibria for the producer, if there is zero initial willingness-to-pay or if there are no technological constraints.

Keywords: networks, word-of-mouth communication, asymmetric information.

JEL Classification: D4, D8, L1.

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