Title
Expert Opinion and Price-Quality Dispersion. Evidence from the Wine Market

I want to submit an abstract for:
Conference Presentation

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Keywords
wine market, price-quality dispersion

Research Question
What is the effect of expert opinion on price-quality dispersion in the wine market

Methods
Heckman selection model

Results
(1) Price-quality dispersion grows with the level of past critical exposure. (2) Price-quality dispersion grows with the level of past maximum scores obtained.

Abstract
Expert Opinion and Price-Quality Dispersion. Evidence from the Wine Market

Stephanie Guo and Karl Storchmann
(both New York University)
In contrast to the classical Bertrand model of price competition, which assumes perfectly informed consumers and results in equilibrium prices at marginal cost, most markets exhibit considerable price dispersion. Price dispersion can arise from incomplete information about a product’s price and/or quality. When obtaining information is costly and a fraction of consumers chooses to remain uninformed, price dispersion can persist in equilibrium. It has long been assumed that lowering search costs may result in better-informed consumers and will thus lead to less price dispersion. Following this logic, many economists expected the expansion of the internet and e-commerce to cause significantly lower search cost resulting in prices to converge to the lowest possible level. (e.g., Bakos, 1997). Although this seems plausible, the empirical evidence of this effect appears to be equivocal. In fact, many analyses have shown that e-markets exhibit persistent price dispersion levels that are comparable with those observed in brick-and-mortar markets (e.g., Baylis and Perloff, 2002; Clemons et al., 2002; Pan et al., 2002).

Similarly, critical coverage and expert opinion may facilitate the search process and lower consumers’ cost of becoming informed. Many economists stress the positive role of experts in the price convergence process. When a new product enters the market, little is known about its quality and its price can substantially deviate from goods of similar quality. As the market matures, the good is increasingly reviewed (e.g., by Consumer Reports) and quality assessments diffuse into the market. As a result, the percentage of informed consumers increases and the price converges toward the full information equilibrium (e.g., Bagwell and Riordan, 1991). Theoretically, there would be no price dispersion in a fully informed market. This paper does not analyze price dispersion on homogenous goods markets but examines price deviations from the predicted quality-adjusted “full information” equilibrium for a differentiated product (wine). It studies the role of critical reviews in the price convergence process by analyzing approximately 90,000 U.S.-produced wines reviewed by Wine Spectator between 1984 and 2024. We examine whether a high level of past critical exposure results in a decline in the dispersion of quality-adjusted prices.

Since the sample inclusion of a certain wine from a specific winery in any given year is likely non-random, we employ the two-step Heckman correction for sample selection. The correction explicitly models the process of being selected into the sample, transforms the predicted probability of being in the sample, and adds a correction term (Inverse Mills Ratio) to the model.

At the first stage, we find that having received positive past reviews increase the likelihood of being included in the sample.

For each wine in the sample we predict its price based on various traits, particularly quality. We then calculate (squared) residuals between predicted and observed prices which serve as our measure of price-quality dispersion. This is the dependent variable for the second stage of the model.

After controlling for the number of past critical reviews and for past quality scores attained at the producer level, the following surprising results emerge from our analysis: (1) Price-quality dispersion grows with the level of past critical exposure. (2) Price-quality dispersion grows with the level of past maximum scores obtained. This is particularly pronounced if the difference between maximum and average points is high. (3) Both effects mentioned above exert their largest spillover in the low quality bracket resulting in significant overpricing of mediocre wines.

References


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