

Referee Report on "Reexamining the Schmalensee effect"

This paper shows that a high-quality product can be signaled by a lower price. The intuition is quite clear. If firms can make cost-reducing R&D investment in the initial stage, provided that the quality of the product is exogenously given, then the firm with high-quality products (leading to larger sales) would have stronger incentives to make such an investment than the ones with low-quality products do. As a result, the high-quality firms may charge lower prices (due to a lower cost) than the low-quality firms in a separating equilibrium.

The paper is well written, and clearly presents interesting ideas using a simple model. Thus, I only have some minor comments as follows.

Comments

1. The main results shown in this paper – a lower price may be used as a signal of higher quality – are more likely to be observed in a situation where it is relatively easy for firms to lower their production costs by R&D investment but not about the quality of products, as assumed in the model. I expect it would greatly improve the relevancy of the model if the author could provide such examples.
2. On p.4, the paper says that the profit of each period is defined net of investment cost, but it is not – the total profit is defined so. Also the total profit expression contains quite a few typos.
3. On p.10, the inequality of costs on the last sentence of the first paragraph seems to be reversed.