Pricing in Social Networks under Limited information

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Abstract

This paper models the strategy of a monopolist that offers rewards to current clients in order to induce them to activate their social network and convince peers to buy from the company. In presence of heterogeneous search costs and reservation prices, this network-activation reward program may serve to expand the client base through a flow of information from informed to uninformed consumers. The offer of the monopolist affects individual incentives of aware people to share information, determining a minimal degree condition for investment. The optimal unitary reward balances the information spread effect (i.e. more receivers) and the crowding effect (i.e. less individual incentives) of an increase in the number of speakers. The monopolist always finds it profitable to use the bonus. Nevertheless, its introduction has ambiguous effects on the price and profits, depending on the process of spread of information and, in turn, on the network structure.