

The Incentive Properties of Collective Reputation

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Abstract: We build a model of collective reputation under moral hazard and analyze the incentive effects of different collective reputation structures. Heterogeneous producers need to exert effort to produce high quality. The demand side a priori does not observe the true quality, however high quality is detected as such by the market with some probability, reflecting e.g. expert inspections and awards. Products not detected as of high quality are pooled together according to the collective reputation structure, i.e. grouping of producers. In the unique equilibrium, each group is subject to internal free-riding by their higher-cost members. We find that full collective reputation can yield higher quality and welfare than individual reputation, since inter-producer free-riding under full collective reputation might be less severe than intra-producer free-riding under individual reputations. However, full collective reputation is never optimal: A cut-off collective reputation structure with a small elite improves upon full collective reputation. Despite potentially higher producers' surplus (and welfare) under some collective reputation, any group with collective reputation unravels in absence of transfers. Nevertheless, we show that simple non-type-dependent internal contracts under collective reputation implement the First Best.