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# Estimating Demand in Search Markets: The Case of Online Hotel Bookings

Sergei Koulayev

**Abstract:**

In this paper, we emphasize that choice sets generated by a search process have two properties: first, they are limited; second, they are endogenous to preferences. Both factors lead to biased estimates in a static demand framework that takes choice sets as given. To correct for this bias, we estimate a structural model of search for differentiated products, using a unique dataset of consumer online search for hotels. Within a nested logit utility model, we show that the mean utility function and the search cost distribution of a representative consumer are non-parametrically identified, given our data. Using our model's estimates, we quantify both sources of bias: they lead to overestimation of price elasticity by a factor of five and four, respectively. The median search cost is about 38 dollars per 15 hotels; we also present some evidence on multi-modality of search cost distribution.

**JEL Classifications:** C14, D43, D83, L13

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# 1 Introduction

In markets with multiple sellers and frequently changing prices, consumers often have to engage in costly search in order to collect information necessary for making a purchase. A rational consumer in such a situation would make a sequence of search efforts, stopping at a point where the expected benefit from another attempt falls short of the search cost. When the search is over, the consumer makes a purchase from the set of goods discovered during the process,<sup>1</sup> that is, the choice set. Generated in this way,<sup>2</sup> choice sets have two distinct properties. First, since search is costly, they are usually small compared with the full set of available products: according to comScore data,<sup>3</sup> only a third of all consumers visit more than one store while shopping online. Second, choice sets are endogenous to preferences. This is because the decision to stop searching is dictated in part by the expected benefits of search, which itself is a function of preferences.

These properties complicate the inference about consumer demand for differentiated goods in search markets. The standard approach, made popular by Berry (1994) and Berry, Levinsohn, and Pakes (1995), is to recover preferences from the joint variation of market shares of goods and their attributes, including price. Implicitly, this method assumes that consumers possess full information about all goods available on the market. Therefore, the variation of choice sets across consumers comes from the availability of goods across markets, which is arguably exogenous to preferences. In search markets, where the variation of choice sets comes through individual search efforts, these assumptions do not hold and the application of this method leads to biased estimates of demand. The purpose of this paper is twofold. First, we propose an alternative estimation method that corrects for this bias. Second, using this method, we evaluate both the overall magnitude of the bias and the individual contributions of its two sources — the limited nature and the endogeneity of choice sets due to search. We find that both properties of choice sets have significant impact on estimates of the price elasticity of demand, an important input in many applications, including pricing decisions, welfare analysis of mergers, and benefits from the introduction of new products.

Our emphasis on separating the two sources of bias is motivated by the fact that their correction requires rather different approaches, both in nature and in the cost of implementation. Correcting for the limited nature of choice sets can be achieved either by using information on actual choice sets (as we do here), or by employing simulation methods developed in the

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<sup>1</sup>In the language of the search literature, we are assuming a search with recall: the consumer remembers all goods found during search and can costlessly return to them. On the internet, where our application belongs, such an assumption is reasonable, since it is easy to return to the results previously found. In the off-line world, this may not be the case.

<sup>2</sup>Although in our application we focus on the sequential nature of the search process, these properties of choice sets clearly hold also for non-sequential searches.

<sup>3</sup>As reported by de los Santos (2008), the number is 27 percent in 2002 and 33 percent in 2004. In our data, too, only a third of searchers look at more than one page of hotel options resulting from the search request. See also Johnson et al. (2004) for additional evidence on search intensity on the web.

literature, reviewed below. To correct for the endogeneity bias, we suggest estimating preferences within a model that includes both observed search decisions and purchases as outcome variables. Indeed, search decisions are precisely the channel through which preferences affect the distribution of choice sets, leading to the endogeneity problem. However, as pointed out by Sorensen (2001), and Hortacsu and Syverson (2004), explaining search decisions in the context of differentiated goods contains an identification problem. A person may stop searching either because she has a high idiosyncratic valuation for goods already found (her status quo), or because she has a high search cost. Therefore, an observed measure of search intensity (such as the distribution of search durations), can be explained either by variability in utilities across goods or by moments of the search cost distribution. To separate the effects of search costs and preferences on search decisions, one may use exogenous shifters of search costs. Alternatively, as we propose in this paper, one can use conditional search decisions: a search action together with the observable part of the search history preceding the action. In this way, we obtain a source of exogenous variation in the status quo across consumers, allowing us to separate the effects of search costs from the effects of preferences on search decisions.

We implement these ideas by estimating a structural model of sequential search, using a unique dataset of search histories by consumers who were looking for hotels in Chicago, on a popular website. Although this website offers a variety of search tools, we focus on a subset of consumers who employed a simple yet common strategy: start the search by sorting hotels by increasing price and then flip through pages.<sup>4</sup> The advantage of this dataset is that it offers detailed information on search histories: search actions, observed hotels, and clicks.<sup>5</sup> With these data, we show that consumer preferences, in the form of nested logit, and the search cost distribution are non-parametrically identified.

By comparing price elasticities from the search model with those from the nested logit model with full information, we find the latter overestimates it by as much as five times. One explanation is that choice sets of these searchers include mostly cheaper brands, located farther from the city center. As a result, consumers choose lower-quality hotels not only because they are price sensitive (as the full-information model predicts), but also because the higher-quality ones are often not observed. Although intuitive, this argument appeals only to the limited nature of choice sets, while both properties of choice sets are responsible for the bias. To correct for the limited choice sets, we drop the assumption of full information and re-estimate the logit model using data on actual choice sets. We find that the extent of overestimation of price elasticity remains large—about a factor of four. This is a consequence

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<sup>4</sup>Clearly, the choice of the search strategy itself contains a great deal of information about consumer preferences. Currently, we are working on such a model. By contrast, in this paper we focus on the information content of the sequential search decisions made within a given strategy.

<sup>5</sup>Since this website is a search aggregator, it does not sell hotel bookings itself. Rather, a click redirects the user to another website where the booking can be made. Therefore, we interpret a click as a revealed preference action (see below).

of the endogeneity of choice sets. For example, if we see someone willing to incur a cost in order to find more expensive, but potentially better-quality hotels, we ought to conclude that she is less price sensitive than the static model would predict. In our data, we observe sufficient search activity so that the search model predicts much lower price sensitivity than the static one.<sup>6</sup>

Essentially, the observed conditional search decisions themselves convey information about consumer preferences, which the static model cannot take into account. From our estimates, we conclude that the amount of such information can be significant. Therefore, both choice and search decisions may be required for a correct inference about consumer demand in a search environment similar to the one we study in this paper. To be sure, an exercise of this kind puts high requirements on the data, but since the technology necessary for its collection is already in place,<sup>7</sup> we believe such data will become increasingly available in the near future.

The median search cost is around 38 dollars for a collection of 15 hotels, or 2.5 dollars per hotel; there is also significant heterogeneity of search costs among the population. Although this estimate is generally in line with the findings of the existing empirical papers on search, its magnitude is still large. This suggests that there is room for improvement in our modeling of search decisions; we would account better for individual heterogeneity, were data on this available. Another potential explanation of large search costs is that, because of data limitations, we do not account for future searches by the same person, although these may serve as a substitute for current search actions. We also present some evidence suggesting that search costs have a bimodal distribution. There are two groups of consumers: those with almost zero search costs (about 20 percent of the population) and those with median cost of \$80 per 15 hotels (about 80 percent of the population).

This paper is organized as follows. In the next section, we situate our study in the existing literature. Section 3 describes the data; in section 4 we present our search model, and in section 5 we discuss its identification. Results are discussed in section 6 and in section 7 we compute and compare price elasticities of demand. Section 8 concludes. The appendix contains all the tables and figures.

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<sup>6</sup>A similar argument can be made when the sorting is by attributes other than price. For example, many users sort hotels by distance to the city center. Their choice sets are accordingly limited and skewed relative to the full set of hotels, and their search actions demonstrate their preference of being close to the city center versus other characteristics (such as price or access to parking). In fact, almost all search within a given platform is done by either sorting or filtering the search results by a particular attribute.

<sup>7</sup>Basically, what is required is a simple server script that records all actions and displays shown to the user. Although the data collection on a particular search platform is straightforward, linking the search activity across different platforms is a much harder task. Currently, the comScore web-behavior panel records such data using plug-ins installed on the browsers of respondents.

## 2 Related literature

In the growing literature on consumer search, we know of two other studies that estimate search for differentiated goods. Aside from differences in the modeling approach and data, our contributions relative to these papers are: first, a novel identification strategy, together with a formal result supporting it; second, a decomposition of the search-induced bias in demand estimates, both conceptual and empirical. Mehta, Rajiv, and Srinivasan (2003) estimate a non-sequential model of search for laundry detergents and find that the predicted price elasticities are higher than those in the model with full information. They explain this finding by the limited nature of choice sets, in an argument similar to the one above: contrary to the search model, the full information model assumes that consumers are aware of all price promotions and therefore must be price insensitive to show a low response. Although they discuss the relationship between price elasticity and length of search, they do not recognize the endogeneity of choice sets as a reason for the obtained discrepancy in price elasticities. In a concurrent study, Kim, Albuquerque, and Bronnenberg (2009) also exploit the identification power of search decisions, in a rather striking way: they estimate preferences and search costs using only view-rank data from Amazon, and no purchase data at all.

Existing papers on the identification of the search model consider either the case of homogeneous goods, for example, search for the best price (Hong and Shum (2003) for sequential search and de los Santos (2008) for non-sequential search) or the case of pure vertical differentiation (Hortacsu and Syverson (2004)). We add to these results by considering a nested logit utility model—a specification that allows for both horizontal and vertical differentiation. A limitation of our result is that we identify a common mean utility function, while the distribution of heterogeneity remains fixed. Extending this result to the model with random tastes remains a subject of future research.

This paper is also related to an emerging literature on consumer choice with limited availability, which, contrary to our case, is largely exogenous to preferences.<sup>8</sup> These papers study the impact of limited choice sets on estimates of demand and propose various methods to correct for the bias. For example, Conlon and Mortimer (2009) estimate the impact of understocking on the demand for snacks, using real-time data from vending machines, and propose an E-M algorithm to account for periods when the availability is unobserved. Bruno and Vilcassim (2008) propose a novel simulation method to account for store-level availability, based on aggregate data. Mariuzzo, Walsh, and Whelan (2009) use store-level data on availability of soft drinks in Ireland and estimate demand in an equilibrium framework. Similar to our study, these papers conclude that short-run variation in choice sets may have a significant impact on the estimates of consumer preferences.

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<sup>8</sup>The exogeneity assumption sets these papers apart from a large literature on consideration set formation, for example, Bronnenberg and Vanhonacker (1996) or Mehta et al. (2003), where choice sets are limited, but also endogenous to preferences.

### 3 Data

A consumer is searching for a hotel in Chicago on *kayak.com*. To begin the search, she submits a search request, which includes the city (Chicago), dates of stay, number of guests, and number of rooms. On average, a search request results in more than 140 available hotels, which makes it a non-trivial search problem. To navigate among search results, users can simply flip through pages or employ various sorting and filtering tools, such as sorting by price or filtering by neighborhood. Each search action (flipping, sorting, filtering) results in a display of at most 15 hotel options. As soon as the user finds a preferred hotel, she can click on it: this website does not sell hotel bookings itself, so the click redirects the user to another website<sup>9</sup> where a booking can be made. About half of the searchers who click do it only once, in which case this is the end of the search session. If more than one click is made, we take the last one for the analysis. Alternatively, the user can end the search just by leaving the website, without clicking. In total, there are 24,321 unique search histories, by consumers who searched on this website during May 2007.

For every search history we observe: (1) parameters of the initial request (date of search, dates of stay, number of people, number of rooms), (2) sequence of search actions, (3) contents of the page following every action (hotel options with prices and other characteristics), and (4) identities and prices of clicked hotels. Thus, this dataset offers a very detailed picture of the search history, which sets it apart from other available datasets on consumer search behavior. At the same time, it has two main limitations. First, since the booking is made on other websites (usually, Expedia or the hotel’s own), we do not observe the actual bookings, only clicks, as a noisy measure of the bookings. See Section 4.5 for a discussion of this issue. Second, these data come from anonymous users. That is, as soon as the user leaves the website, the cookie that identifies the search session is destroyed and we cannot tell whether two sessions were made by the same person or not. Therefore, we are going to consider every search history as if made by a separate individual. Since this is the model of search without learning, the past searches are unlikely to affect the current behavior of a consumer. Instead, the possibility of future search can serve as a substitute for the current search effort, and, to that extent, our estimates of search costs are exaggerated.

Because of the availability of various sorting and filtering tools, the strategy space that this website offers to a searcher is extremely rich. Modeling the search process in a rational and comprehensive way in this environment seems unfeasible. Therefore, we focus on a subset of the population who employed a particular search strategy, both simple and popular: start the search by sorting by price, and then decide whether to see the next page of results, with more expensive but potentially better-quality hotels. In total, these criteria give us 1081 unique search histories that we use in the estimation. Of these 1081 searchers, 814 never turned a

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<sup>9</sup>We do observe the destination of the click, but we are not currently using this information in our estimation.

page, and 267 turned one page. This represents only 4.4 percent of the general population (that is, we observed 24,321 unique searches), and 79.5 percent of searchers who employed a “sort by price and flip” strategy (1360 in total). Despite its low share in the total number of searches, price sorting remains the most popular “active” search strategy: more than half of visitors do not search at all, or just flip through unsorted pages. An additional factor limiting the sample is that we do not include searches where the subjects continue searching using other strategies, such as sorting by distance or by filtering by neighborhood.

Our dataset is a selected sample, probably consisting of more price-sensitive consumers, since they have chosen price sorting as the best search strategy. Therefore, estimation results should be interpreted as being conditional on the choice of this search strategy. We would like to elaborate on a few rationales behind our choice. Although the computational cost is certainly one of them, there are others as well. First, price sorting is a ubiquitous method of search—not only on this particular website, but across the internet: most of the other search platforms offer price sorting as a navigational tool, and some focus exclusively on price comparison. Therefore, understanding how people behave within this particular environment is an empirically important issue. Second, because of the lack of consumer-level observables—demographics, income, education, etc.—we are limited in our ability to model heterogeneous preferences. For example, heterogeneity in income may affect both price elasticity and search costs. By focusing on a group of consumers who employed the same search strategy—essentially, those who decided to look at the same set of hotels—we expect to obtain a relatively homogeneous sample, in terms of their tastes, price sensitivity, and travel intent.

Next, we describe the available data fields in more detail, comparing the estimation sample with the general population along the way.

### 3.1 Chicago hotels

A search request for Chicago hotels typically returns 130–140 hotel options, depending on availability. During May 2007, the maximal number<sup>10</sup> of returned hotels was 148; these are Chicago hotels with online pricing. Figure 1 demonstrates a wide variation in the geographical position of hotels. These are hotels located in the city of Chicago itself, in satellite towns (Evanston, Skokie, etc.), as well as in close proximity to airports (O’Hare, Midway). For each hotel, we observe: name, including brand, if any, price, star rating, neighborhood, distance to the city center. In a separate dataset, we have more detailed data on these establishments; however, we use only the ones named above, as these are shown to the searcher and hence most likely to affect her decisions. Table 2 shows these variables. Hotels in neighborhoods labeled as “Gold Coast,” “Loop,” and “West side” are all within two miles of the city center, so we

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<sup>10</sup>If one includes hotels without online pricing (that is, those who advertise themselves on the internet but give price quotes only by phone), their number rises to around 220. However, by default the website shows only hotels with online pricing, and we use only these for estimation.



group them under a common category, "Center." Hotels in "SW" (Southwest) and "Midway" are relatively far from the center; we grouped them under the "South" category. Hotels to the north side are labeled "North," and there is a special category, "O'Hare," after the major airport in the area. On Figure 2 we have the distribution of hotels by their distance to the city center. There are two well-defined clusters: hotels located within five miles of the city center, and those far from the city, between 10 and 20 miles away. These clusters are largely accounted for by neighborhood groups.

Since we do not observe the total availability for each request, we assume that all  $N=148$  hotels are available at the time of request. This assumption is needed only for specification of the consumer's beliefs, and it affects our results only in this way. In May 2008, we checked the availability of various types of requests at random dates. Most of the time, most of hotels were shown as available; in other words, we found little variation in availability.

### 3.2 Request types

To start a search, the user has to enter a search request. Its parameters include: date of search, dates of stay, number of people, and number of rooms. From the dates of search and stay, we can derive advance purchase, length of stay, and whether Saturday night is included. Table 3 summarizes these parameters. On average, consumers in our sample search 16 days in advance (versus 19 days among the general population), and 56 percent of them stay over a weekend (versus 59 percent in the total sample). Another notable feature is that they often travel in groups: the average number of guests is 1.84. In our analysis, we aggregate various combinations of parameters of request into a number of "types" based on whether the search is made more than a week in advance, whether a weekend stay is included, and whether the person is traveling alone or in a group. We conjecture that these types may reflect underlying characteristics of the consumer, such as price sensitivity, or the value of the outside option. For example, one could argue that people who stay over the weekend are more likely to be leisure travelers; the same may be true of those who search well in advance.

### 3.3 Searching and clicking activity

In our sample, a searcher can turn at most one page, after sorting results by price. As a result, the average length of search in the estimation sample is relatively low, 1.25 pages. Among the general population, search intensity is much higher: 3.90 pages (with a standard deviation of 3.36). We find that most of the difference is not the result of our restriction on the number of flipped pages; rather, it is due to limitations of price sorting itself: people who search for three or more pages employ several strategies. If we consider only searchers who limited themselves to price sorting, the mean search length is 1.74 pages.

In terms of raw click rates, we do not find any statistical difference between the estimation

sample and the population: on average, the click rate is 0.36–0.38, with a standard deviation of 0.48. However, if we break click rates across different consumers with different parameter requests, then some differences appear, as shown in Table 4. Contrary to that of the general population, the click rate of people who use only price sorting is: (a) positively and significantly affected by length of stay, (b) not affected by weekend stay, and (c) not affected by advance purchase. In all groups an increase in the number of travelers has a strong effect on the click rate. This is preliminary evidence that the parameter of request may be relevant for consumer type; to test this idea more formally, we include request variables in the value of the outside option (see the next section).

Combining clicking and turning activity, one can distinguish between various types of demand. Demand for hotels on the first page may be "fresh" demand (from those people who did not go to the second page) or "returning" demand (from those who went to the second page and returned); demand for hotels on the second page is "residual" demand. The joint distribution of clicking and turning is:

**Table 1:** Searching and clicking activity

	no turn	turn	total
no click	525	190	715
click	289	77	366
total	814	267	1081

Most of the clicks for hotels on the first page belong to "fresh" demand, 289 out of 366, while "returning" demand (not shown) is negligible (only 19 of 77 clicks made by those who turned the page). The rest of the clicks belong to "residual" demand. Notice also that among page turners clicking activity is only 29 percent, which is much smaller than the sample average, 34 percent.

To compare this demand with the demand found in the overall population, Table 5 presents means of various characteristics of clicked hotels. As expected, consumers in the estimation sample are clicking on hotels that belong to the lower tail of the price distribution: on average, these hotels have a lower star rating and are located farther from the city center (most notably, close to O’Hare airport). Further, Table 6 gives more detail about the configuration of choice sets of consumers in the estimation sample, and about hotels that received most of the clicks. It seems that people who sort by price are mostly looking to stay closer to airports or places to the South of the city. The presence of airports as strong points of attraction suggests that there is probably a category of travelers who do not care about proximity to the city center—something we need to account for in the estimation. Table 7 shows observed and clicked hotels on the first and second page of results.

### 3.4 First-page variation

It is important for the identification of the model to have sufficient variation in the prices of hotels observed by searchers on the first page (that is, prior to making the search decision), as we will see in Section 5. Luckily for us, the hotel market is characterized by fluctuating demand and price-discrimination strategies (otherwise called *revenue management*) employed by hotels. This produces an ample variation of prices of hotels observed on the first page: they range from 32 to 567 dollars, with mean of 97 dollars. To offer some evidence of price variation at the hotel level, on Figure 3 we plot 10 percent and 90 percent quantiles of the price distribution (from the first page data), for each hotel separately. Although not all hotels (118 out of 148) were observed on the first page, most of the observed hotels displayed significant price variation.

An additional role is played by maximal prices on the first page. According to the search model, these prices serve as truncation points for the distribution of prices on the second page. This source of variation in posterior beliefs adds to variation in the expected benefit of search among consumers. As common intuition suggests, consumers who observed high maximal prices on the first page should turn less frequently, expecting even higher prices on the second page. Table 8 presents summary statistics of maximal prices, separately for turners and non-turners. The expected difference in behavior appears only for very high truncation prices—those in the 90 percent and 95 percent quantiles and for the four highest price observations.

Finally, looking beyond variation in prices, do people see first pages that are structurally different? On Figure 4, for every hotel we plot the share of first pages on which this hotel has appeared. Most hotels appear on the first page only from time to time (in fewer than 40 percent of cases), and only 15 hotels are displayed at least every second time. These are mainly two-star hotels and a couple of cheap one-star hotels. In other words, we do observe some diversity in the structure of the first pages, although it is not as substantial as the price variation.

## 4 Model

In this search environment, every consumer starts by observing a page of 15 hotel options, sorted by increasing price. At this point, she has three alternatives: (a) leave the website without clicking, (b) click on a hotel on the first page, or (c) go to the next page of results, which will reveal another 15 hotels, higher priced but of potentially better quality. We can merge options (a) and (b) by including the outside option as the "null" hotel, which is implicitly present on every page. Search is costly: every consumer is endowed with a non-zero search cost, which we interpret as a cognitive cost of processing information about 15 hotel options. Also, we assume search with recall: when on the second page, the consumer remembers the

best option found on the first page and can costlessly return to it if so desired. To summarize, the consumer in our model faces a two-step decision problem: first, decide whether or not to search, by comparing the expected benefit of search to the search cost; second, decide which hotel to click on, by comparing valuations of hotels in the choice set. To complete the model, we need to specify three basic ingredients: first, a utility model that determines the value of a hotel as a function of its observed and unobserved characteristics; second, a model of consumer beliefs about the benefits of turning the page; third, a distribution of search costs among the population. We start with the model of utility.

## 4.1 Utility

The information about every hotel that is displayed to the consumer includes the name of the hotel, brand, price, geographical location, star rating, and amenities. Since the consumer observes the hotel's identity, we assume that she can infer her idiosyncratic taste about this hotel, or "match value" in the parlance of the search literature.<sup>11</sup> The vector of observed hotel characteristics plus the match value determine the dimensionality of the space where the search is going on. A useful feature of the utility model, besides its ability to explain people's choices, is that it allows one to translate the search problem from the multi-dimensional space of characteristics into the single-dimensional space of utilities. Therefore, we can extend some of the intuition developed in theoretical models of search for the best price into the situation of search for differentiated products. Such notions as status quo, expected benefit of search, and reservation value continue to hold and be useful.

The mean utility from a particular hotel is a linear function of price, star rating, and geographical position of a hotel (distance to the city center, neighborhood). After trying various specifications, we settled on the following model of utility:

$$\begin{aligned}
 u(p_j, q_j, \varepsilon_{ij}) &= \alpha_{do} do_j I(n_j = \text{Ohare}) + \alpha_d d_j I(n_j \neq \text{Ohare}) & (1) \\
 &+ \alpha_s s_j + \vec{\alpha}_n \vec{n}_j + \vec{\alpha}_b \vec{b}_j + \alpha_p^i P_j + \varepsilon_{ij} \\
 \alpha_p^i &= \alpha_p + \alpha_{pwd} W_i
 \end{aligned}$$

where  $P_j$  is the displayed price of hotel  $j$  (in hundreds of dollars);  $q_j = (do_j, d_j, s_j, \vec{n}_j, \vec{b}_j)$  is a vector of non-price characteristics of hotel  $j$ : distance to O'Hare airport, distance to the city center, star rating, and a set of neighborhood and chain dummies. We take  $d_j = \log(1 + D_j)$ —the logarithm of distance (in miles)—in order to smooth the outliers (see Figure 2). Hotels in the neighborhood of O'Hare airport are located quite far from the city center, more than 10 miles. Therefore, we conjecture that searchers who want to stay close to the airport care

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<sup>11</sup>Learning the match value can be costly. This cost can be modeled explicitly, as in Kim, Albuquerque and Bronnenberg (2009), or implicitly, as in this paper, where it constitutes a part of the search cost, for example, the total cost of processing information about 15 hotel options.

only about distance to it, and searchers who want to stay closer to the city center care about distance to the center, not the airport. We attempted a specification where we included both distances independently and found that the coefficients were poorly identified (note that the O'Hare dummy is already present independently, among the  $\vec{n}_j$  variables). To capture possible heterogeneity between business and leisure travelers, we allow the price sensitivity to depend on  $W_i$ —a dummy variable that is equal to one if a person stays over a weekend, and zero if not.

There is also an additive term, a "taste shock" or "match value," that determines the idiosyncratic taste of a given consumer for a given hotel. It is observable to the consumer but not to the econometrician, and it follows a Type 1 extreme value distribution (EV). Importantly,

**Assumption 1** *Match values, or taste shocks, are distributed independently of a hotel's characteristics.*

This is a restrictive assumption, in particular because we rule out possible correlation between price and taste shock, which includes unobserved hotel quality. We adopt this assumption for two reasons. First, it is hard to find reasonable instruments for hotel price.<sup>12</sup> Second, in our model error terms enter non-linearly into the moments, which prevents the straightforward application of existing results on IV estimation (although the control function approach may be a solution). At the same time, we allow consumer tastes for hotels within the same neighborhood to be correlated, as the consumer may have a particular preference for the neighborhood as a whole. Parameter  $\lambda$  stands for the measure of correlation and is estimated together with other parameters. Taken together, these assumptions on the error term lead to a nested logit model.

To capture differences of quality standards among different hotel chains, we include a set of brand dummies. A large number of hotel brands are present in the Chicago market, but for most of them the estimation sample has very little or no data on clicks. Therefore, we include only the five most frequently occurring hotel brands: "Null," Rodeway Inns, Econo Lodge, Days Inn, and Best Western—together, they attract 28 percent of impressions and 56 percent of clicks. The "Null" brand stands for hotels that do not belong to any chain; all other hotels are grouped under a default category.

Leaving the website without any click constitutes a choice of the outside option, whose utility is:

$$u_{i0} = \mu_{out} + \vec{\mu}_o \vec{R}_i + \varepsilon_{i0} \quad (2)$$

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<sup>12</sup>Some popular choices, such as characteristics of other hotels (as in Berry, Levinsohn, and Pakes (1995)) do not work, because of lack of variation. Hausman-type instruments, such as prices of hotels in other markets, are probably not exogenous because of correlation of geographic demand shocks. Various shifters of marginal cost, such as wages in the area, can explain very little of price variation, which is mainly driven by demand fluctuations.

where  $\vec{R}_i$  is a vector of dummy variables, constructed from the request parameters by consumer  $i$ , indicating whether the search is made more than a week in advance, whether there is more than one traveler, and whether a weekend stay is included. By including these consumer-specific variables in the value of the outside option, we attempt to control for various reasons for leaving the website. For example, the user may decide to call the hotel directly, or to search later, or to give up on the idea. While we do not observe all these reasons, we may conjecture that users who search further in advance have more opportunities for searching later and hence are less likely to settle at the moment. Note that the utility specification (1) does not include a constant term. This exclusion restriction is necessary to identify  $\mu_{out}$ ; alternatively, we could identify a constant term in (1) and normalize  $\mu_{out}$  to zero.

## 4.2 Search decision

A model of rational search implies that when making a search decision, the consumer takes into account the information she has collected so far. In our case, the relevant information set consists of 15 hotel options observed on the first page of results. Since prices are sorted in increasing order, these are the 15 lowest priced hotels among those available. Let  $u_{ir} = u(p_{ir}, q_{ir}, \varepsilon_{ir})$ —the utility of a hotel ranked  $r$ , for consumer  $i$ ; also, let  $r = 0$  correspond to the outside option. From the first page of results, the consumer receives the current best utility,  $U_{1i}^* = \max\{u_{ir}\}_{r=0}^{15}$ , and the information set,  $\Omega_{1i} = \{p_{ir}, q_{ir}, \varepsilon_{ir}\}_{r=1}^{15}$ .

Going to the next page will reveal the next 15 hotels, which will be more expensive, but potentially of better quality. These hotels can be summarized by  $U_2^* = \max\{u(p_r, q_r, \varepsilon_r)\}_{r=16}^{30}$ —the best utility from the second page. At the point of decision making, the consumer faces uncertainty about the possible realization of results from the search. Let  $F_u(U_2^*|\Omega_{1i})$  be consumer  $i$ 's belief about the distribution of  $U_2^*$ , conditional on her information set,  $\Omega_{1i}$ . Then, a rational consumer will turn the page if and only if the expected benefit of doing so exceeds the search cost:

$$\int_{U_{1i}^*}^{+\infty} (U_2^* - U_{1i}^*(\Omega_{1i})) dF_u(U_2^*|\Omega_{1i}) > c_i \quad (3)$$

where  $c_i$  is a search cost of consumer  $i$ . A crucial assumption is the following.

**Assumption 2** *The distribution of search costs is independent of the distribution of the contents of the first page across consumers.*

With this assumption, we can analyze the search decision of every consumer as being conditional on her information set. In this way, we obtain exogenous variation in the expected benefit of search—the left side of the inequality—which can be used for identification (see below). In our basic specification, we assume a log-normal distribution of search costs, from which every consumer receives an i.i.d draw. Parameters of this distribution are estimated together with other unknowns. We also attempt a number of alternative specifications of the

search cost distribution, as reported later. Note that the lower limit of integration is  $U_{1i}^*$ , since we assume search with recall, that is, the consumer can costlessly go back to the first page. We now discuss the construction of the consumer’s beliefs in more detail.

### 4.3 Beliefs

To determine the expected benefit of a search, the consumer formulates a belief, denoted by  $F_u(U_2^*|\Omega_{1i})$ , about the distribution of  $U_2^*$ —the best utility on the second page of results—conditional on her information set,  $\Omega_{1i}$ . We adopt a structural approach to constructing this belief. First, we specify the consumer’s beliefs about the primitives that determine  $U_2^*$ : price, quality, and match values of hotels on the second page. Second, we use the utility model to translate this belief from the multi-dimensional space of product characteristics into the single dimension of utilities. While such an approach is computationally much more costly (relative to, say, imposing parametric assumptions on  $F_u$  itself), it has the benefit of explicitly accounting for the role of preferences in the search decision. Certain features of this search environment distinguish this search problem from the stylized models studied in theoretical papers and have to be taken into account: the search space is multi-dimensional, a search attempt reveals multiple hotels at a time, results are sorted by price so that the distribution of prices on the second page is truncated, and the consumer should not expect to see the same hotels again (memory).

We start with  $\vartheta(p_j, q_j, \varepsilon_{ij})$ , the consumer’s belief about the joint distribution of attributes of a random hotel, prior to search (before observing the first page of results). Together with other empirical studies on consumer search, we assume that  $\vartheta(p_j, q_j, \varepsilon_{ij})$  reflects the actual distribution of the data (in this case, prices and qualities of Chicago hotels), and crucially, that the consumer knows it prior to search. This is in contrast to the search from an unknown distribution, where consumers are uncertain about actual  $\vartheta(\cdot)$  and learn about it while searching (see Koulayev (2009), Koulayev and Wu (2009), de los Santos, Hortacsu, and Wildenbeest (2009) for estimation of such models).

Using the chain rule and Assumption (1) (independence of taste shocks), we can rewrite  $\vartheta(p_j, q_j, \varepsilon_{ij})$  as a product of conditionals:

$$\vartheta(p_j, q_j, \varepsilon_{ij}|a) = f_p(p_j|q_j)H(q_j)f_\varepsilon(\varepsilon_{ij}) \quad (4)$$

where the distribution of match values,  $f_\varepsilon(\varepsilon_{ij})$ , is Type 1 EV. Note that both the consumer and the econometrician are uncertain about the match values of hotels that may appear on the second page: the motivation is that consumer  $i$  learns about  $\varepsilon_{ij}$  only when she observes hotel  $j$ . In fact, the above equation does not follow immediately from Assumption (1), but rather is motivated by it: indeed, this is a statement about consumer beliefs, not preferences.

We also assume that consumer knows the empirical distribution of non-price characteristics

of existing hotels  $X = \{q_j\}_{j=1}^N$ :

$$H(q_j) = \frac{1}{N} \sum_{q_j \in X} I(q_j = q) \quad (5)$$

where the equality  $q_j = q$  is satisfied if all components of vector  $q_j$  are equal to the corresponding components of a vector  $q$ . Note that we do not assume that the consumer knows the identities of all Chicago hotels—otherwise she would know all  $\varepsilon_{ij}$ , contrary to the above. Instead, she knows  $H(q)$ , the distribution of observable qualities of Chicago hotels—those 148 hotels that had online pricing in May 2007—and perceives hotels on the second page as a random draw from it.

The belief about price distribution is log-normal:

$$\begin{aligned} f_p(p_j) &= \phi(\bar{p}_j, \sigma_j^2) \\ p_j &= \ln(P_j) \end{aligned} \quad (6)$$

where the hotel-specific mean and standard deviation  $(\bar{p}_j, \sigma_j^2)$  are estimated on a large dataset of hotel prices. Various tests of normality of residuals do not reject the null hypothesis of normality. After the consumer has seen the first page, she has to make two transformations to her belief  $\vartheta(p_j, q_j, \varepsilon_{ij})$ , to condition it on the observed information,  $\Omega_{1i}$ . First, she takes into account the fact that second-page prices are truncated from below by the maximal price on the first page:

$$f_p(p_j | p_j > p_{i15}) = \frac{\phi(\bar{p}_j, \sigma_j^2)}{1 - \Phi(p_{i15}, \sigma_j^2)} \quad (7)$$

Second, we allow for "memory" effects, in the sense that the consumer should not expect to see the same hotel as on the first page:

$$H(q | \Omega_{1i}) = \frac{1}{N - 15} \sum_{q_j \in X / \Omega_{1i}} I(q_j = q) \quad (8)$$

Both the price truncation and the exclusion of already observed hotels constitute the particular ways in which the consumer in our model updates her beliefs from the available information. This is why, even when there is no Bayesian learning, we have conditioning of posterior beliefs  $F_u(U_2^* | \Omega_{1i})$  in (3).

Finally, using the utility model (1), we transform the belief from the multi-dimensional space of hotel attributes into the space of scalar utilities, to obtain  $F_u(U_2^* | \Omega_{1i})$ . In practice, the integration in (3) is done by simulations, so we do not attempt derive analytical density here.



#### 4.4 Reservation property

Returning to decision rule (3), note that for a consumer, this inequality is a deterministic statement. For the econometrician, who observes neither taste shocks for hotels on the first page,  $\{\varepsilon_1, \dots, \varepsilon_{15}\}$  (and hence  $U_{1i}^*$ ), nor search cost, this is a probabilistic statement. For a given search cost, this inequality defines a set in the space of first-page taste shocks,  $\{\varepsilon_1, \dots, \varepsilon_{15}\}$ . Due to the nested logit specification of utility, the distribution of utilities on the second page will generally depend on the realization of best utility on the first page,  $U_{1i}^*$ . Therefore, to proceed<sup>13</sup> we need to adopt a simplifying assumption,

**Assumption 3** *Consumers believe that the utilities of hotels on the second page are independent from those on the first page.*

Note that formally this assumption does not contradict the nested logit specification, as it is a restriction on beliefs, not preferences (at the stage of click decision, we keep the nested logit specification unaltered—see the next section). Also, we continue to assume that hotel utilities on the second page may be correlated, on the neighborhood level. Then we have the following lemma.

**Lemma 1** *Suppose  $F_u(U_2^*|\Omega_{1i})$  is a continuous distribution function. Then, inequality (3) as a condition on unobservables  $\{\varepsilon_1, \dots, \varepsilon_{15}, c\}$  can be equivalently written as:*

$$\{\varepsilon_1, \dots, \varepsilon_{15}, c\} : U_1^*(\varepsilon_1, \dots, \varepsilon_{15}) < \bar{u}(c) \quad (9)$$

$$\text{where } \bar{u}(c) : \int_{\bar{u}}^{+\infty} (U_2^* - \bar{u}) dF_u(U_2^*|\Omega_{1i}) = c \quad (10)$$

**Proof.** *Consider the left side of inequality (3). From our assumption, it is a continuous function, and it can be re-written as:  $\int_{U_1^*}^{+\infty} (U_2^* - U_1^*) dF_u(U_2^*) = \int_{U_1^*}^{+\infty} U_2^* dF_u(U_2^*) - U_1^*(1 - F_u(U_1^*))$ . Taking the derivative with respect to  $U_1^*$ , we obtain:  $-U_1^* f_u(U_1^*) - 1 + F_u(U_1^*) + U_1^* f_u(U_1^*) = F_u(U_1^*) - 1$ , which is less than zero, provided  $U_1^* < +\infty$ . That is, the left side of (3) is a decreasing function of  $U_1^*$ . At  $U_1^* = -\infty$ , its limit is  $+\infty$ , and at  $U_1^* = +\infty$  it is equal to zero; hence, there exists a single crossing point where it is equal to the search cost (which is strictly positive). ■*

**Remark 1** *The reservation property established above is conditional: the content of information set  $\Omega_{1i}$  is fixed. This suffices for our purposes, because we take search decisions as being conditional on  $\Omega_{1i}$ . In a more general model, where information sets can vary endogenously, the monotonicity of the expected benefit of search with respect to  $U_{1i}^*$  will generally not hold.*

<sup>13</sup>Our conjecture is that this assumption can be overcome: with Type 1 EV errors, reservation utility should still hold. However, we have not yet been able to establish this fact formally.

## 4.5 Click as an indicator of preferences

Since the website that is the source of our data is a search aggregator, it does not sell hotels (or airline tickets) itself, but redirects the user to a website where such bookings can be made. For this reason, we observe clicks but not bookings, and in fact only a proportion of clicks result in a booking (about 20 percent, according to some estimates). Contrary to a booking, a click is a noisy indicator of consumer preferences; this potentially introduces the problem of measurement error in the dependent variable. In the discrete choice framework, such a problem is called "misclassification," and it is known that it makes MLE estimates inconsistent (see Abrevaya, Hausman, and Scott-Morton (1998)). In our model, when we observe that a consumer clicks on hotel A when hotel B is also available, we interpret it as a preference of A over B,  $u_A > u_B$ . A misclassification occurs when this relationship breaks, for example, when the click is made for reasons other than utility maximization (information gathering, for example). Explicit modeling of information gathering motives for clicking would take care of this, but it is outside scope of this paper. Therefore, we assume throughout that a click is a revealed preference action. The same assumption is made by Brynjolfsson and Smith (2002), who analyze data from a book comparison website: contrary to our case, they also have data on book sales and are therefore able to evaluate the quality of a click as a measure of preferences. They show that although the click-to-buy ratio is well below one, it is relatively even across merchants. Our estimation results also provide some support for this assumption: as seen from Table 9, the coefficients on price, star rating, and distance—both to O'Hare and to the city center—all have theoretically correct signs, as do the neighborhood dummies (not shown, but Center always dominates, holding other characteristics constant).

Note that the fact that a consumer may click but not book does not necessarily mean a misclassification. Consider an example. When the user clicks on a hotel, she is redirected to another website, where she can make a booking but she can also get more information about the hotel. It is possible that after learning more she changes her mind and does not book. To formalize this situation, suppose that in the utility model of the type  $u_{ij} = \alpha p_j + q_j + \varepsilon_{ij}$ , the error term has two components:  $\varepsilon_{ij} = \eta_{ij} + \zeta_{ij}$ . The first component is an idiosyncratic taste by consumer  $i$  for hotel  $j$ , known to the consumer but not to the econometrician. The second component is the consumer's residual uncertainty, due to lack of information or experience, about the pleasure she would experience from staying at that particular hotel. Ex-ante, the expected utility of hotel  $i$  is greater than that of hotel  $k$ :  $\alpha p_j + q_j + \eta_{ij} + E_i [\zeta_{ij}] > \alpha p_k + q_k + \eta_{ik} + E_i [\zeta_{ik}]$ , so she clicks. Ex-post, when she learns  $\zeta_{ij}$  from the booking website, this inequality may reverse, and she may not make a purchase. However, this does not represent a problem for estimation as long as a click remains a preference indicator and both  $\eta_{ij}$  and  $E_i [\zeta_{ij}]$  are uncorrelated with  $(p_j, q_j)$ . To summarize, we think it is plausible to assume that, even if no booking is eventually made, the desire to gather more information about a particular hotel is indicative of preference.

Further, the “no click” action also represents a certain ambiguity. Indeed, there may be a number of possibilities, some of which may be correlated with options observed before. For example, the consumer may decide to call the desired hotel directly, continue searching at another time, or abandon the idea about the trip. In an attempt to control for different reasons for "no click," we include the parameters of request in the mean value of the outside option. Otherwise, we assume that the unobserved component in the value of the outside option is independent of taste shocks in the hotel’s utility.

#### 4.6 Likelihood of clicking and turning decisions

For every consumer, we observe two kinds of decisions: first, whether or not she turned the page; second, which hotel was clicked on. As we discussed in the previous section, here we interpret a click as a revealed preference action, in other words, every click corresponds to a set of inequalities in utilities. For example, if we observe a consumer who has turned the page and clicked on a hotel  $r$ , then in terms of unobservables this implies two kinds of inequalities:

$$\begin{aligned} U_{1i}^* &< \bar{u}(c_i) \\ \mu_{ir} + \varepsilon_{ir} &\geq \mu_{ij} + \varepsilon_{ij}, \quad j = 0, \dots, 30 \end{aligned}$$

where  $\mu_{ij}$  is the mean utility of the  $j$ -th hotel among the 30 observed by consumer  $i$ , with  $j = 0$  corresponding to the outside option. Integrating these inequalities with respect to variables unobserved by the econometrician gives us the joint probability of clicking and searching decisions. These variables are match values (or taste shocks), associated with every observed hotel and the search cost parameter. At this point, our assumption about the Type 1 EV distribution of taste shocks becomes very helpful: for a given search cost, the integral over unobserved taste shocks can be computed analytically.

Before presenting the likelihood function, let us summarize what is observed on the consumer level. The exogenous variables are  $\Omega_{1,i} = \{p_{ir}, q_{ir}\}_{r=0}^{15}$ ; these are the characteristics of observed hotels on the first page. Here,  $r$  represents the position of a hotel on that page (where  $r = 0$  stands for the outside option, which is one of "hotels" on the first page). Also, define  $\Omega_{2,i} = \{p_{ir}, q_{ir}\}_{r=16}^{30}$ , the contents of the second page. Some of these data are missing, because we do not observe  $\Omega_{2,i}$  for consumers who did not turn the page; however, this information is irrelevant for explaining their joint decisions.<sup>14</sup> The choice set is defined as  $CS_i = \Omega_{1,i} \cup \Omega_{2,i}$  for turners, and  $CS_i = \Omega_{1,i}$  for non-turners. Finally, our consumer-level characteristics include  $R_i$ ; these are parameters of request, which include dates of search, dates of stay, number of people, and other variables derived from these data. The endogenous variables are  $(T_i, C_i)$ , where  $T_i = 0, 1$ , represents the page-turning decision and  $C_i = 0, 1, \dots, \#CS_i$  represents the

<sup>14</sup>This is not the case if we only had to explain the clicking decisions, where we have to integrate over page turning decisions.

position of the clicked option in the choice set  $CS_i$ , with  $C_i = 0$  for no click.

We also need some notation to properly define nests of hotels, which are on the neighborhood level, according to (1). Let  $n = 0, \dots, 4$  be indexes of nests (with  $n = 0$  corresponding to the outside option), and  $r(n, CS) = \{r : n_r = n, r \in CS\}$ —a (possibly empty) set of elements of the choice set  $CS$  that belong to the nest  $n$ . Conversely, for an element  $r$  of a set  $CS$ , let  $n(r, CS)$  be the index of the corresponding nest. With this notation, the nested logit probability that a consumer  $i$  chooses element  $r_0 \in CS_i$  is:

$$L(r_0, CS_i) = \frac{\exp(\mu_{ir_0}/\lambda)}{\sum_{r(n_0, CS_i)} \exp(\mu_{ir}/\lambda)} \frac{\left( \sum_{r(n_0, CS_i)} \exp(\mu_{ir}/\lambda) \right)^\lambda}{\sum_{n=0}^4 \left( \sum_{r(n, CS_i)} \exp(\mu_{ir}/\lambda) \right)^\lambda} \quad (11)$$

where  $n_0 = n(r_0, CS_i)$ . Further, a joint CDF of utilities of hotels in a set  $CS$ , evaluated at some common level  $t$  is:

$$F(t, CS) = \exp \left( - \sum_{n=0}^4 \left( \sum_{r(n, CS)} \exp \left( - \frac{(t - \mu_{ir})}{\lambda} \right) \right)^\lambda \right) \quad (12)$$

We are now ready to formulate the central result of this section.

**Proposition 1** *Conditional on exogenous variables  $X_i = (\Omega_{1,i}, \Omega_{2,i}, R_i)$  and search costs, the probabilities of individual choices are as follows:*

$$P(T_i = 0, C_i = r) = L(r, \Omega_{1,i}) (1 - F(\bar{u}_i, \Omega_{1,i})), \quad r \in \Omega_{1,i} \quad (13)$$

$$P(T_i = 1, C_i = r) = L(r, \Omega_{1,i} + \Omega_{2,i}) F(\bar{u}_i, \Omega_{1,i} + \Omega_{2,i}), \quad r \in \Omega_{1,i} \quad (14)$$

$$P(T_i = 1, C_i = r) = L(r, \Omega_{1,i} + \Omega_{2,i}) F(\bar{u}_i, \Omega_{1,i} + \Omega_{2,i}) \\ + L(h, \Omega_{2,i}) F(\bar{u}_i, \Omega_{1,i}) (1 - F(\bar{u}_i, \Omega_{2,i})), \quad r \in \Omega_{2,i} \quad (15)$$

**Proof.** *by integration.* ■

Every likelihood contribution has to be integrated with respect to the unobserved search cost. The method of estimation is by simulated maximum likelihood. However, before going to the estimation, we need to make sure that our model is identified.

## 5 Identification

We start our discussion with the *identification of mean utility functions*, one for hotels and one for the outside option. As usual, the argument will proceed conditionally on consumer level characteristics: the request parameters  $R$ . Therefore, in what follows we omit the consumer index  $i$ . Consider consumers who all observed the same first page  $\Omega_1$  and clicked on it; these could be either users who did not turn the page or consumers who turned but went back. For each nest  $n$  that is present in  $\Omega_1$ , and for each pair of its elements,  $r_1, r_2 \in r(n, \Omega_1)$ , that belong to the said nest, from our data we can compute a ratio of shares of consumers who clicked on these hotels,  $P_{r_1}/P_{r_2}$ . If a given nest contains only one hotel, then we can choose  $r_2 = 0$ . From the model, (13) and (14), this ratio is equal to:

$$\log(P_{r_1}/P_{r_2}) = \mu(p_{r_1}, q_{r_1})/\lambda - \mu(p_{r_2}, q_{r_2})/\lambda, \quad r_1, r_2 \in r(n, \Omega_1)$$

We see that the observed choices within nests only allow us to identify differences in mean utilities. To proceed, we need the following support condition.

**Assumption 4** *Let  $\mathbf{P}, \mathbf{Q}$  be the support of the distribution of  $(p, q)$ . Then, for each nest  $n$ , there exists a hotel<sup>15</sup>  $(p_{h(n)}, q_{h(n)})$  belonging to this nest, such that for any  $(p, q) \in (\mathbf{P}, \mathbf{Q})$  there exists a first page  $\Omega_1$  that contains both  $(p, q)$  and  $(p_{h(n)}, q_{h(n)})$ . Also, if a nest consists of only one hotel in every possible  $\Omega_1$ , the choice for  $h(n)$  is the outside option.*

In other words, if we consider all first pages that contain a given nest  $n$  and a hotel  $(p_{h(n)}, q_{h(n)})$  that belongs to that nest, the variation in characteristics of other hotels in that nest is rich enough to encompass the support of  $(p, q)$ . With that property, identification proceeds in two steps. First, we identify (up to a constant shift) five nest-specific constants,  $\mu_{h(n)} = \mu(p_{h(n)}, q_{h(n)})$ ,  $n = 0, \dots, 4$ , from shares of consumers who chose particular nests. Given  $\Omega_1$ , the ratio of shares of consumers who clicked on nest  $n_1$  versus  $n_2$  is:

$$P_{n_1}/P_{n_2} = \left( \frac{\sum_{r(n_1, \Omega_1)} \exp(\mu_r/\lambda)}{\sum_{r(n_2, \Omega_1)} \exp(\mu_r/\lambda)} \right)^\lambda \quad (16)$$

Substituting  $\mu_r/\lambda = \mu_{h(n)}/\lambda + \log(P_r/P_{h(n)})$  into the expression above and simplifying yields:

$$\log(P_{n_1}/P_{n_2}) = (\mu_{h(n_1)} - \mu_{h(n_2)}) + \lambda \log \left( \frac{\sum_{r(n_1, \Omega_1)} P_r/P_{h(n_1)}}{\sum_{r(n_2, \Omega_1)} P_r/P_{h(n_2)}} \right) \quad (17)$$

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<sup>15</sup>To clarify notation: a pair of hotel characteristics  $(p_r, q_r)$  refers to an element ranked  $r$  in some  $\Omega$ , while here,  $(p_{h(n)}, q_{h(n)})$  refers to characteristics of a hotel with absolute index  $h(n)$ . Even if  $(p_{h(n)}, q_{h(n)}) \in \Omega$ , the rank of this hotel does not necessarily equal  $h(n)$ .

Repeating this equation for pairs  $(n_1, n_2)$  we get a system of equations that identifies differences  $(\mu_{h(n_1)} - \mu_{h(n_2)})$  and a constant  $\lambda$ . Second, nest-specific mean utility functions are identified as  $\mu(p, q|n) = \mu_{h(n)} + \lambda \log(P_r/P_{h(n)})$ .

Note that we did not use observations for consumers who clicked on the second page, because their likelihood contributions, (15), do not have the necessary multiplicative forms. Only (13) and (14), which correspond to consumers who clicked on the first page, have this form. In fact, this property is a necessary and sufficient condition of the EV family of distributions, as shown by Costinot and Komunjer (2007).

The results of this proposition provide some insight as to why *static demand estimates are inconsistent* if choice sets are generated by search. Such estimation includes both types of consumers, those who clicked on the first page, and those who clicked on the second. As a result, the likelihood function is misspecified for part of the observations. The reason lies in the different modes of truncation of error terms in utility. In the case of (13), the utility of the chosen hotel is truncated from below by the reservation value:  $U_{1i}^* > \bar{u}(c_i)$ . Utilities of competing hotels also must exceed that threshold in order to have a positive chance of being the first best. Similarly, in the case of (14), all utilities in the choice set, including that of the chosen hotel, exceed the reservation utility. In contrast, in the case of (15), part of the choice set (first-page utilities) is truncated from above, while another part (second-page, together with the chosen hotel) is not truncated. This mixture leads to two components in (15): one that corresponds to the case when the second page exceeds  $\bar{u}(c_i)$ , in which case the first-page hotels offer no competition (do not enter the logit form), and another component where both first- and second-page utilities are below  $\bar{u}(c_i)$  and thus compete with each other.

Turning to the *identification of search cost distribution*, from our data we can compute the share of page turners among those who observed a given  $\Omega_1$ . The model predicts that:

$$P(T = 1|\Omega_1) = \int_0^{+\infty} F(\bar{u}(\Omega_1, c), \Omega_1) f(c) dc \quad (18)$$

Equation (10) defines the reservation utility  $\bar{u}(\Omega_1, c)$  as a function of exogenous variables and the search cost,  $c$ . With known mean utilities, this function is also known. As discussed in Section 4.3 above, the posterior belief  $F_u(U_2^*|\Omega_1)$ , and hence the reservation utility, depend on  $\Omega_1$  in two ways. First, it is the maximal price on the first page that truncates the distribution of second-page hotel prices from below. Second, these are identities of hotels (for example, all their non-price characteristics) that appeared on the first page and are not expected to appear on the second. In what follows, we analyze the identification of (18) conditional on these elements. In this way, what remains of  $\Omega_1$ , are the prices of the other 14 hotels on that

page:  $P_{14} = \{p_r\}_{r=1}^{14}$ . Equation (18) becomes:

$$P(T = 1|P_{14}) = \int_0^{+\infty} F(\bar{u}(c), P_{14}) f(c) dc \quad (19)$$

With respect to the unknown density function  $f(c)$ , the relationship of the type seen in (19) becomes a Fredholm type 1 integral equation. Existence and uniqueness of solutions to this equation is guaranteed only for a number of special cases, and below we aim to show that our model delivers one of them. Using the definition of extreme value distribution, and simplifying notation somewhat, this can be written as:

$$\begin{aligned} F(\bar{u}, P_{14}) &= \exp \left( - \sum_{n=0}^4 \left( \sum_{r(n, \Omega_1)} \exp \left( - \frac{(\bar{u} - \mu_r)}{\lambda} \right) \right)^\lambda \right) \\ &= \exp \left( - \exp(-\bar{u}) \sum_{n=0}^4 \left( \sum_{r(n, \Omega_1)} \exp(\mu_r/\lambda) \right)^\lambda \right) \end{aligned} \quad (20)$$

Now, let  $S(P_{14}) = \sum_{n=0}^4 \left( \sum_{r(n, \Omega_1)} \exp(\mu_r/\lambda) \right)^\lambda$  be the known function of the data and parameters. Equation (19) becomes:

$$P(T = 1|P_{14}) = \int_0^{+\infty} \exp(-\exp(-\bar{u}(c)) S(P_{14})) f(c) dc \quad (21)$$

Since  $\bar{u}(c)$  is a monotonic function, we can introduce a change of variables,  $t = \exp(-\bar{u}(c))$ . Note also, that according to the model,  $P(T = 1|P_{14})$  depends on its argument (which is multi-dimensional) only through a single-dimensional index  $S(P_{14})$ . Therefore, we can write,

$$P(S) = \int_0^{+\infty} \exp(-tS) g(t) dt \quad (22)$$

where  $g(t) = f(c^{-1}(t))/t'(c)$ . Assuming that  $g(t)$  belongs to a class of piece-wise continuous functions, exponentially restricted from above, it can be uniquely recovered from the above equation (inverse Laplace transform theorem). The density of the search cost distribution is then readily computed from  $g(t)$ .

## 6 Estimation results

In this section we report estimation results from a succession of models, adding more structural elements at each step.

We start with static logit demand models. Results are shown in Table 9. These are models of multinomial choice that try to explain observed clicking decisions, taking choice sets as given (see equation (11)). In D1, the choice set includes all available hotels, that is, as if the consumer possessed full information; these are estimates one would obtain in a more common situation when the actual choice set is unobserved,<sup>16</sup> or when the number of goods is not large. Model D2 brings in variation in the actual choice sets to help identify parameters of utility. For each model, we estimate versions with and without correlation of the error terms within nests (that is, nested and non-nested logits). For D2, we also try various specifications of the model, illustrating the importance of including such variables as brand, neighborhood dummies, consumer-specific variables (parameters of request), and distance to O’Hare airport.

The search model takes another step and tries to explain the formation of choice sets through a search process. In that model, consumers are assumed to know the true distribution of prices: hotel-specific means and standard deviations are estimated on a large dataset of prices. This approach follows the tradition of the preceding literature on product search, where the beliefs structure was fixed at some data-driven level. In this way, we ask a question: given that consumers are extremely rational (for example, they know the true equilibrium), what can we say about their preferences and search costs?

Table 10 presents estimation results for the search model, as given by Proposition (1), together with standard errors, computed numerically. We estimate various specifications of this model, both nested and non-nested, as well as various search cost distributions: S1, the log-normal; S2, the discrete support (from 0 to 1, with a step 0.05); S3, a mixture of two lognormals (with standard deviation fixed at 0.5). Model S1n is our default specification in the discussion below.

**Quality of fit.** To assess quality of fit, in particular with respect to predicting search decisions, we compute average deviances of page-turning decisions,  $-2 \log(p(T_i|X_i))$ , separately for page-turners and non-turners, for our main specification, S1n. For turners, we find the deviance (DEV)=2.8269; for non-turners DEV=0.5662. On the one hand, it seems that the search model does a much better job at explaining why people do not turn the page than at explaining why they do. This is quite expected, because non-turners represent about 75 percent of the sample. On the other hand, if we take a model-free estimate of the page-turning probability,  $p = 0.25$ , which is the average in our sample, then the average deviance for turners is DEV=2.7968, and for non-turners DEV=0.5674. Therefore, if we use the sample average

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<sup>16</sup>Since we observe only actual choice sets, prices of other hotels are imputed based on observations by other consumers, with similar dates of search and parameters of request.



as a benchmark, the model is only slightly useful for predicting non-turning ( $\Delta\text{DEV}=0.0012$ ), and, in a relative sense, does a better job at explaining turning decisions ( $\Delta\text{DEV}=0.0301$ ). Nevertheless, in both cases the absolute improvement over the model-free estimate is quite small, so the ability of the model to capture differential motives to search is rather poor. One reason might be that the search model is very restrictive about the mechanism through which existing information (the content of the first page) affects search decisions; it uses current best utility, a single scalar parameter. This finding raises a question: is it worth the effort? The answer depends on the goals of the modeler. If we already know consumer preferences from a separate study and our goal is only to predict search actions, then a sample average will do just as well. If, on the other hand, we would like to predict search generated demand—search actions and consequent purchase decisions—then, as we argue below, a fully specified search model is necessary to obtain consistent estimates of preferences, and, ultimately, to predict demand.

**Changes in the price coefficient across models.** In the linear utility model that we employ here, the price coefficient has two rather distinct interpretations. On the one hand, its magnitude determines the price sensitivity of demand: the larger it is, the stronger will be the consumer’s response to a given change in price. Thus, it also helps to determine the dollar equivalent of various hotels’ characteristics. For example, as the model D2n suggests, an additional star brings about 0.40 utils. The same increase in utility can be achieved through a price reduction of  $(0.40/1.29)*100=31$  dollars (see equation (1)). On the other hand, we can always divide the utility by the price coefficient, normalizing it to minus one. In this case, the price coefficient would be equal to the inverse of the standard deviation of taste shocks. In this interpretation, the price coefficient has an immediate impact on search behavior, as it determines the variation of the benefits of search. Below we return to this double role of the price coefficient (and, more generally, preferences) in explaining search-generated demand.

The difference between the estimated price coefficients in D1 and D2 (and their nested versions, D1n and D2n) is explained empirically by the availability of higher-quality hotels. In the actual choice sets from which consumers make their purchases we have only the left tail of the price distribution: hotels of low star rating, located far from the city center. In order to prefer the same hotels when better-quality ones are available (in model D1), consumers must demonstrate much higher price sensitivity, which is what we observe. More generally, the difference between the estimates of the two models suggests that we can make incorrect inferences about substitution patterns of demand if variation in actual choice sets is not taken into account. Conlon and Mortimer (2009) reach a similar conclusion in their recent paper, which uses availability data from vending machines. One difference between their study and ours lies in the distinction between incomplete information about available goods and the actual limited availability. From the perspective of consumer decisions, these notions are equivalent: they both lead to limited choice sets. From the perspective of estimation,

however, there is an important difference: while it may be argued that incomplete availability is exogenously given to a particular consumer, the incomplete information is not, as long as it is an outcome of decision making. Therefore, even though D2 performs better than D1 by incorporating information on actual choice sets, it ignores their endogeneity and therefore produces biased results.

Comparing nested and non-nested versions of D2 (and D1), from Table 9 we see significant differences in both the price coefficient and the model’s fit. The parameter of correlation within nests is  $\lambda = 0.44$  for D2 and  $\lambda = 0.59$  for D1; these are meaningful magnitudes (even though the standard errors are large). This suggests that allowing for correlation between the utilities of hotels in the same neighborhood is a desirable feature of the model. Estimates from search models S1–S3, from Table 10, also show that this feature has a significant impact on the parameters and model’s fit.

Comparing D2n (our benchmark static model) with S1n, we again observe a significant drop (in magnitude) of the price coefficient. In a search model, the role of the price coefficient becomes more involved, because together with search costs it serves to match page-turning decisions.<sup>17</sup> Holding everything else constant, a smaller (in magnitude) price coefficient produces two opposite effects on the probability of searching. For one, it increases utility from the best hotel on the first page, making the consumer more satisfied and thus less willing to search. At the same time, it makes second-page hotels more attractive, thus increasing the benefit of search. As mentioned above, the second effect can also be seen through the variance of taste shocks: the smaller is the price coefficient, the larger is the variance of outcome of search, which makes the effort more attractive. In an environment where prices are sorted in increasing order, one would expect the second effect to dominate: second-page prices are higher, which means changes in the price coefficient are applied to a larger base, which eventually leads to a relatively larger increase in utilities. And since the magnitude of the price coefficient in the search model is indeed smaller, we conclude that it must be the case that static model estimates fail to predict enough search activity.

To verify this conclusion, we substituted D2n’s estimates into S1n and, after converging with search cost parameters, re-computed the deviance measures: for turners,  $DEV=2.9801$ , and for non-turners,  $DEV = 0.564$ . As expected,  $DEV$  for turners in the S1n(D2n) model is larger than in the original S1n, and  $DEV$  for non-turners is smaller. Table 1 provides some evidence to explain this finding. First, 814 out of 1081 consumers do not turn the page, so D2n’s estimates are driven primarily by first-page choice sets. Despite the fact that these are mostly cheap hotels, only 289 of these 814 consumers actually chose them. Second, from 267 consumers who turned the page, only 77 did so successfully, that is, the search effort resulted in a click on the second page with higher-quality but more expensive hotels. From

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<sup>17</sup>Of course, all other coefficients of utility play a role. However, the role of the price coefficient is most pronounced, by a wide margin.

the perspective of a static demand model, these facts can be explained by concluding that consumers are quite price sensitive. From the point of view of the search model, clicking decisions should be explained conditionally on page turning: the mere fact that someone decided to go to the next page, which contains more expensive hotels, is an indicator that she must be relatively less price sensitive, and vice versa. Therefore, explanations of the fact that people rarely click on the second page have to put less weight on price sensitivity, and more on other factors, such as taste for quality. This additional information about consumer preference that is contained in search actions is completely overlooked by the static demand model and therefore its conclusions are biased. Can we predict the sign of the bias? Probably, not. For example, if it were the case that many consumers went to the second page and clicked there, we would see D2n delivering very low price sensitivity, which is not consistent with the low search activity we observe. In that case, we would expect a correction to go in the opposite direction.

**Search costs.** In the model with lognormal search costs, S1n, the median search cost is  $\text{cost\_med} = 37.58$  dollars; the mean value is even larger,  $\text{cost\_mean} = 42.70$  dollars. These quantities are obtained by first computing the median of the search cost distribution, measured in utils, and multiplying by  $100/\text{pcoef}$ , where  $\text{pcoef}$  is price coefficient in utility, and the 100 factor reflects our measuring of prices in hundreds of dollars. The result is the dollar value of search cost, which we interpret as a cost of processing information on a page of results. Alternatively, one may view this as the (maximum) amount of expected savings that the median search is willing to forgo in order to avoid studying one more page of results. Arguably, these are large numbers; while we believe the effort of comparing prices and characteristics of 15 hotels is hardly negligible, that alone cannot explain this magnitude. To that end, it is instructive to think of search cost as a reflection of benefits of search predicted by the model. A high search cost is only a way to reconcile low search activity (25 percent) in a model that predicts large benefits. In turn, the benefits of search are positively related to the variance of search results. Quantitatively, there are two main sources of variance of results: first, the sampling of multiple goods at the same time; second, our assumption regarding the distribution of the error term. A small example may help explain the last point. Suppose there is one hotel on the first page,  $u_1 = \mu + \sigma\varepsilon_1$ , and one on the second,  $u_2 = \mu + \sigma\varepsilon_2$ , where  $\varepsilon_i$  are independent, Type 1 EV. Now, if we want this consumer to turn the page with a 25 percent probability, what does it imply about her search cost? First, we find her reservation utility,  $\bar{u}$ , from the equation:  $F_{EV}(\frac{\bar{u}-\mu}{\sigma}) = 0.25$ , to be  $\bar{u} = \mu - 0.33\sigma$ ; second, we substitute it into (10) to find  $c = 1.02\sigma$ . This result is quite intuitive: the value of an option to turn the page is positively related to the variance of search results. In our model, where  $\sigma = \pi^2/6 = 1.65$ , this implies a cutoff value of search cost as  $c = 1.68$  utils, or  $1.68*100/0.8=275$  dollars. Although the dollar value of the search cost will depend on the price coefficient, this example shows

that high values of search cost are not surprising, given our assumption on the variance of the match value. This brings us back to our discussion of the price coefficient as the inverse of the variance of match value; biases in its estimates, besides their direct effect on estimated price sensitivity, also have an indirect influence, through estimated search costs, on the estimated price elasticity of search-generated demand. In our case, an inflated price coefficient given by D2n would lead to a smaller variance of match value and hence to smaller estimated search costs than those obtained in S1n.

Models S2 and S3 (along with their nested analogues S2n, S3n) take on the assumption of uni-modality of the search cost distribution, made in S1n. In S2n, we perform a "non-parametric" estimate of the search cost distribution, which is modeled as discrete random variable, with fixed support (a fine grid from 0 to 1 utils, with step 0.05). Figure 5 presents the results: 20 percent of consumers have zero search costs, and the rest have about 80 dollars. A model with a mixture of two lognormals, Figure 6, shows a similar picture: one mode is at 5 dollars, with 18 percent weight; another is at 45 dollars, with an 82 percent weight.

## 7 Price elasticity of search-induced demand

In the previous section, we discussed some implications of search frictions for the estimates of consumers' preferences. Even though preferences are important determinants of demand and its price elasticity, they are not sufficient: we also need to take into account the actual availability of hotels and the search environment where purchases are made. Here, we perform counterfactual experiments that take into account both factors and deliver price elasticities for the models we considered above. A correct idea about the price elasticity of demand is important from many perspectives, and in particular for the decision making of the firm. From a methodological perspective, focusing on price elasticity allows one to evaluate the importance of various structural differences between these models in an economically meaningful way.

In the market for hotel accommodation, the relevant definition of the good is a stay at a given hotel at a given date in the future. To set the price of this good optimally, a firm must compute the expected total demand realized between now and the future date. In our context, if a hotel sets its prices at the beginning of May, for its rooms on July 1, the proxy of demand will be the total number of clicks received during May from searchers whose dates of stay include July 1. For every searcher, the decision to click will depend on her preferences and her search experience. For the econometrician (and for the firm), neither of these components is perfectly observed: the expected demand (probability of a click) is obtained by integrating out unobserved heterogeneity in preferences and possible search histories. At every point in time, this probability is conditional on the existing availability of hotels, because that availability determines the set of possible search histories. For example, in our application there are only two possible search histories: one where the consumer turns the page, and the

other where she does not. The content of these pages is determined by the current availability of hotels on the future date and their relative prices: if the hotel price is too high, its choice probability is zero, even though it may be available.

To compute the price elasticity of search-induced demand in our sample, we perform a counterfactual experiment. For this purpose, we chose a "Super 8 motel," two stars, thirteen miles from the city center, six miles from O'Hare—an inexpensive hotel that often appears on the first page of results. We then make it available every day during May, for any future date requested by consumers in our sample, at a price of 90 dollars a night. At this price, it appears on the first page for 686 of 1081 consumers, and on the second page for the rest. By summing up click probabilities for all consumers in our sample, we obtain a measure of expected demand for this hotel, for all future dates requested by consumers in our sample. The price elasticity is obtained by increasing the price of this hotel by 1 percent and comparing the sum of choice probabilities before and after the disturbance. Note that whenever the hotel appears on the first page, the change in its price affects the decision to search, and, ultimately, the size of the choice set against which this hotel will be compared. This must be taken into account when computing price elasticity. Results for various search models are presented on the row "PE" in Table 10 and on the same row in Table 9 for logit models. We can see that, analogously to price coefficients, the differences are rather large.

Comparing non-nested logits D1 and D2, we can see that ignoring actual choice sets and assuming full information leads to overestimation of the price elasticity by more than 80 percent. Differences between nested logit variants D1n and D2n are much smaller, 30 percent. While most of the difference comes from the differences in the estimated price coefficient, another factor is the limited nature of choice sets in D2 relative to D1. It is straightforward to show that, with logit demand, more alternatives make consumers more price elastic, holding taste parameters constant. Indeed, the own price elasticity is found as (assuming  $\alpha_p = -1$ ):

$$\frac{dq_i}{dp_i} \frac{p_i}{q_i} = -p_i \frac{\sum_{j \neq i} \exp(\mu_j)}{\sum_{j=1}^n \exp(\mu_j)}$$

which is increasing in absolute value with  $n$ . As the number of firms increases, this has two effects on elasticity. On the one hand, there is a "price-sensitivity effect," when the demand curve  $q_i(p_i)$  becomes steeper because more alternatives are available; on the other hand, there is a "market share effect" due to a lower quantity of sales per firm. With a Type 1 EV distribution of error terms, the second effect dominates; however, this may not be true in other cases, as discussed in Chen and Riordan (2008).

By comparing D2 (or D2n) to search models, we can evaluate the consequences of ignoring endogeneity of choice sets. These are even more striking: for the nested version, the degree of overestimation varies from 175 percent (D2n vs S3n) to 400 percent (D2n vs S1n), depending on the specification of the search model.

As pointed out by Armstrong et al. (2008), when demand is generated by search, every purchase can be classified under one of the three categories: First, "fresh" demand by people who observe a hotel on the first page and click on it without looking further; second, "returning" demand by those who go to the second page but then return to the hotel on the first page and click on it; finally, "residual" demand, received by hotels on the second page. Distinction between these types of demand is important for valuing the "prominent" position of a hotel in the search rankings. For S1n, we computed these demand types and their elasticities (again, aggregate demand over all consumers), and found that differences between price elasticities are very small, all close to -0.4. In terms of demand shares, fresh demand generates 61 percent; returning demand, 16 percent; and residual demand, 21 percent of total revenue. This implies that the value of being on the first rather than the second page of results comes mainly from the increased revenue, not from the greater ability to charge a higher price above the marginal cost.

## 8 Conclusions

In this paper, we estimate a structural model of sequential search for hotels online. The results show that accounting for search frictions matters for estimation of consumer demand. One implication of costly search is that it results in limited choice sets. If this is ignored and it is assumed that consumers have full information about available options when making a purchase, the estimates may be significantly biased. According to our model, the full information assumption leads to overestimation of price elasticity by 30 to 80 percent as compared with the case when actual choice sets are employed. This is in line with the general intuition that consumers are less price sensitive when choices are more limited. Further, the search process implies that the choice sets are not only limited, but also endogenous to preferences. Our results indicate that accounting for actual choice sets but ignoring their endogeneity leads to overestimation of price elasticity by 17 to 400 percent across specifications. However, contrary to the above case, the sign of the bias is specific to the dataset being used and cannot be determined a priori. These biases are of significant magnitude from the perspective of decision making by a firm. If we assume, for simplicity, that every hotel is a monopolist, the inverse elasticity rule implies that overestimation of elasticity by 50 percent leads to  $(1-1/1.5)*100=33$  percent loss of markup, because the charged price is sub-optimal.

The median search cost is around 38 dollars per 15 hotels, or 2.5 dollars per hotel. This is much smaller than what was found in some previous studies, such as Hong and Shum (2003) and Hortacsu and Syverson (2004), and is similar to findings by de los Santos (2008). We find that while the model does a good job at predicting average search intensity, it performs rather poorly at picking heterogeneous incentives to search among consumers. This points to some limitations of the model that suggest directions for future research. In particular,

it is desirable to relax the assumptions of common prior and search cost distributions by introducing consumer heterogeneity. Also, our estimates are obtained for a rather select group of the population, that is, consumers who search by price sorting. To generalize these results, it is important to increase the space of search strategies, by adding more pages and other sorting and filtering tools.

To summarize, this paper takes another step towards more realistic modeling of the search process, in terms of both the specifics of the actual search environment and the complexity of goods searched for. Clearly, greater realism comes at an increased cost of implementation and computation, which can limit the scope of search behavior that we can model in a fully structural way. Nevertheless, we believe this is a fruitful direction of research, for at least two reasons. First, we can look more closely at the implications of search frictions for demand for heterogeneous goods. Second, a comprehensive search model allows one to evaluate different ways of organizing the display, an important problem in online markets, such as those for hotel accommodations or airline tickets.

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## 9 Appendix. Tables and figures.

**Table 2:** Distribution of non-price characteristics of Chicago hotels, by the number of establishments (estimation sample)

c	n	nbhd	n	stars	n
null	34	Chinatown	3	1	9
best western	7	Gold Coast, Old Town	51	2	40
hampton inns	6	Loop	22	3	55
holiday inn hotels	6	SW	15	4	42
marriott (all)	6	midway	12	5	2
hilton (all)	5	north side	21		
super 8 motels	5	ohare	20		
comfort inns	4	west side	3		
hyatt (all)	4				

**Table 3:** Comparing samples by parameters of request. The right column is t-test for difference in means.

mean/sd	population	estimation	test
obs	24321	1081	
advance	18.86 (11.79)	16.02 (12.12)	7.64
weekend	0.59 (0.49)	0.56 (0.50)	1.94
N days	2.41 (1.61)	2.32 (1.61)	1.66
N rooms	1.07 (0.25)	1.07 (0.25)	0.06
N guests	1.84 (0.98)	1.82 (1.02)	0.70

**Table 4:** Logit estimates of click rates, depending on type of request.

coef / t	population	estimation
advance	0.0066	-0.0079
	4.73	-1.43
N days	-0.00	0.12
	-0.67	2.87
weekend	-0.08	-0.12
	-2.33	-0.90
N rooms	-0.08	-0.19
	-1.22	-0.67
N guests	0.12	0.15
	7.04	2.30
N pages	0.03	-0.11
	6.41	-0.89
const	-0.87	-0.63
	-11.17	-1.87

**Table 5:** Characteristics of clicked hotels in the population and in the estimation sample.

mean / sd	population	estimation
stars	3.07	2.45
	(0.88)	(0.80)
dist	5.00	10.95
	(6.12)	(5.29)
Chinatown	4.02	3.00
Gold Coast	35.58	8.25
Loop	22.99	8.25
SW	7.57	27.75
midway	5.28	3.25
north	6.02	7.75
ohare	17.21	41.75
west side	1.33	0.00

**Table 6:** Observed and clicked hotels in the choice sets, % of total.

stars	obs	click	nbhd	obs	click	dist	obs	click
0	0.00	0.00	Chinatown	2.02	3.00	0-5	10.09	20.25
1	10.85	4.50	Gold Coast	4.97	8.25	6-10	2.04	2.50
2	48.91	61.50	Loop	2.44	8.25	10-15	79.23	73.50
3	27.56	19.00	SW	20.59	27.75	16+	8.65	3.75
4	12.65	15.00	midway	10.56	3.25			
5	0.02	0.00	north side	16.10	7.75			
			ohare	43.16	41.75			
			west side	36.00	0.00			

**Table 7:** Observed and clicked hotels on the first and the second page of results.

	page1		page2	
stars	obs	click	obs	click
1	13.29	5.61	0.55	0.00
2	53.78	69.47	28.35	30.65
3	22.66	13.40	48.29	50.00
4	10.28	11.53	22.80	19.35
nbhd				
Chinatown	1.8	2.8	2.97	1.61
Gold Coast	3.41	4.67	11.55	19.35
Loop	1.51	2.18	6.38	27.42
SW	19.69	32.71	24.4	9.68
midway	9.05	1.87	16.94	11.29
north side	16.54	7.17	14.19	12.9
ohare	47.96	48.6	22.81	17.74
west side	0.04	0	0.76	0
dist				
0-5	6.95	9.66	23.32	56.46
6-10	0.77	0.62	7.43	9.68
11-20	92.27	89.72	69.24	33.87

**Table 8:** Summary statistics of maximal prices on the first page, observed by turners and non-turners.

	percentiles		max 4 prices	
	non-turn	turn	non-turn	turn
%				
1	90	90	469	396
5	92	92	479	419
10	95	95	529	421
25	98	98	567	429
50	103	104		
75	125	130		
90	199	179		
95	265	209		
99	409	419		
Mean	127.34	124.69		
Std. Dev.	62.7	50.82		
Skewness	3.24	3.41		
Kurtosis	15.31	17.75		
Obs	814	267		

**Table 9:** Logit models of demand for hotels

varname	D2(1)	D2(2)	D2(3)	D2	D2n	D1	D1n
dist	-1.52	-0.76	-0.82	-0.79	-0.69	-0.53	-0.35
	0.22	0.24	0.24	0.25	0.16	0.24	0.17
dohare				-0.60	-0.19	-0.21	-0.15
				0.35	0.16	0.35	0.21
price	-3.22	-1.75	-2.04	-2.04	-1.29	-3.63	-2.18
	0.19	0.22	0.25	0.25	0.24	0.24	0.64
price_wnd			0.40	0.39	0.21	0.27	0.08
			0.25	0.25	0.19	0.23	0.15
star	0.69	0.66	0.66	0.64	0.40	1.10	0.69
	0.10	0.11	0.11	0.11	0.08	0.10	0.21
out	-1.09	1.47	1.06	1.01	0.65	2.56	2.44
	0.37	0.54	0.54	0.55	0.36	0.54	0.39
out_np			-0.28	-0.29	-0.25	-0.25	-0.22
			0.13	0.13	0.13	0.13	0.13
out_wnd			0.31	0.31	0.16	0.30	0.14
			0.26	0.26	0.22	0.25	0.19
out_adv			0.33	0.33	0.30	0.21	0.22
			0.14	0.14	0.14	0.14	0.14
lambda					0.44		0.59
					0.57		0.69
fval	1611.03	1570.72	1564.79	1564.36	1547.66	1886.57	1883.69
PE	-2.84	-1.55	-1.60	-1.60	-2.18	-2.91	-2.87
	0.31	0.42	0.41	0.42	0.43	0.34	0.38

Estimation results from logit models: Dx is non-nested, Dxn is nested specification. D2 - estimates from actual choice sets, D1 - from full information. Dependent variable: a click on a particular hotel, conditional on the choice set.

**Table 10:** Search models

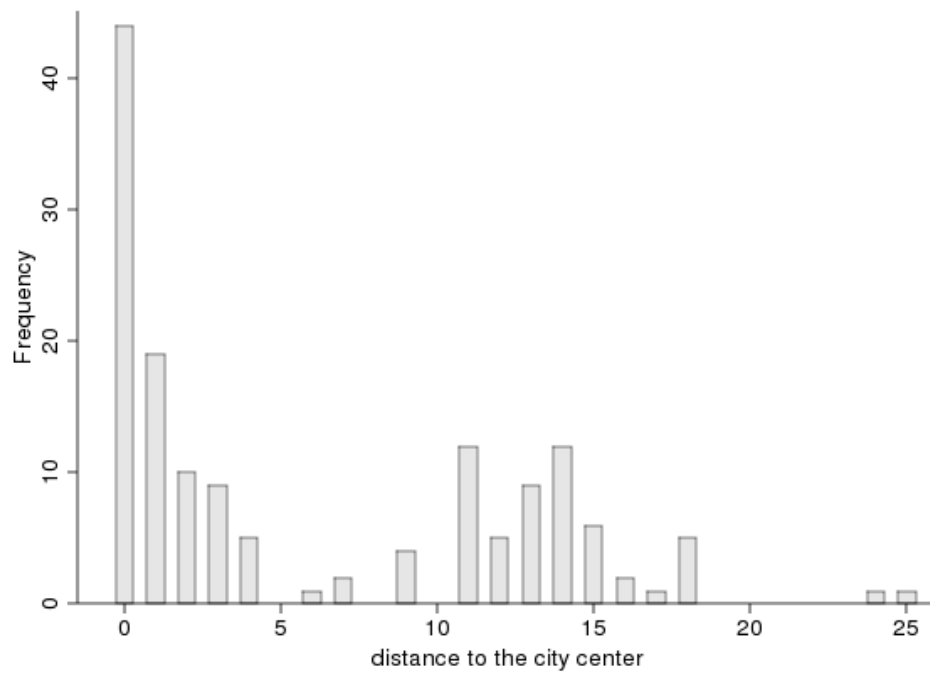
varname	S1	S1n	S2	S2n	S3	S3n
dist	-0.40 0.06	-0.55 0.07	-0.47 0.03	-0.63 0.07	-0.50 0.10	-0.75 0.07
dohare	-0.43 0.21	-0.50 0.23	-0.38 0.09	-0.50 0.07	-0.61 0.14	-0.53 0.08
price	-0.80 0.10	-0.61 0.11	-0.83 0.15	-0.59 0.18	-0.59 0.11	-0.79 0.15
price_wnd	0.13 0.12	0.29 0.14	0.17 0.15	0.24 0.17	0.29 0.14	0.04 0.17
star	0.29 0.05	0.34 0.06	0.27 0.03	0.26 0.06	-0.04 0.06	0.26 0.06
out	2.75 0.23	2.75 0.25	2.76 0.22	2.68 0.27	1.86 0.28	1.91 0.27
out_np	-0.08 0.11	-0.02 0.11	-0.08 0.09	-0.26 0.10	0.14 0.11	-0.09 0.12
out_wnd	0.37 0.19	0.32 0.20	0.42 0.19	0.32 0.22	0.27 0.21	0.04 0.23
out_adv	0.15 0.11	0.14 0.11	0.16 0.12	0.00 0.10	0.24 0.12	0.13 0.12
lambda		0.88 0.58		0.88 0.59		0.84 0.60
fval	2230.11	2210.49	2204.96	2192.20	2215.73	2185.19
cost_med	30.04	37.58	35.96	76.34	55.96	30.89
PE	-0.65 0.10	-0.44 0.12	-0.66 0.21	-0.45 0.22	-0.37 0.28	-0.79 0.27

Estimation results from search models: Sx is a model with non-nested utilities, Sxn is the same specification with nested logit. S1 - lognormal search costs, S2 - discrete support, S3 - mixture of two lognormals

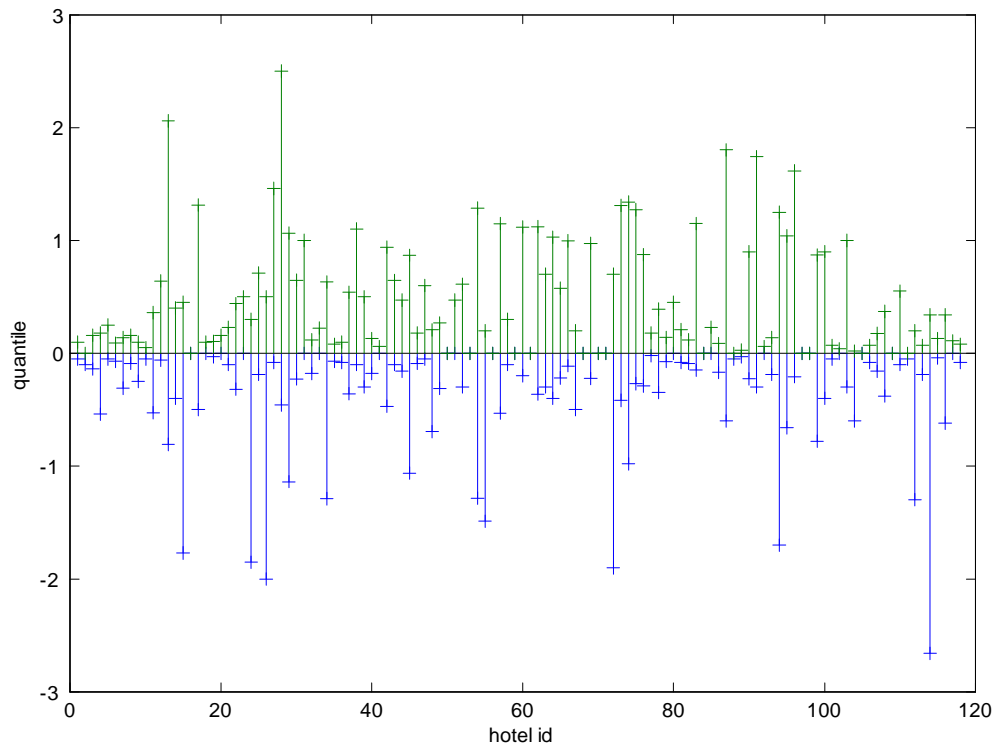


Figure 1: Geographical position of Chicago hotels

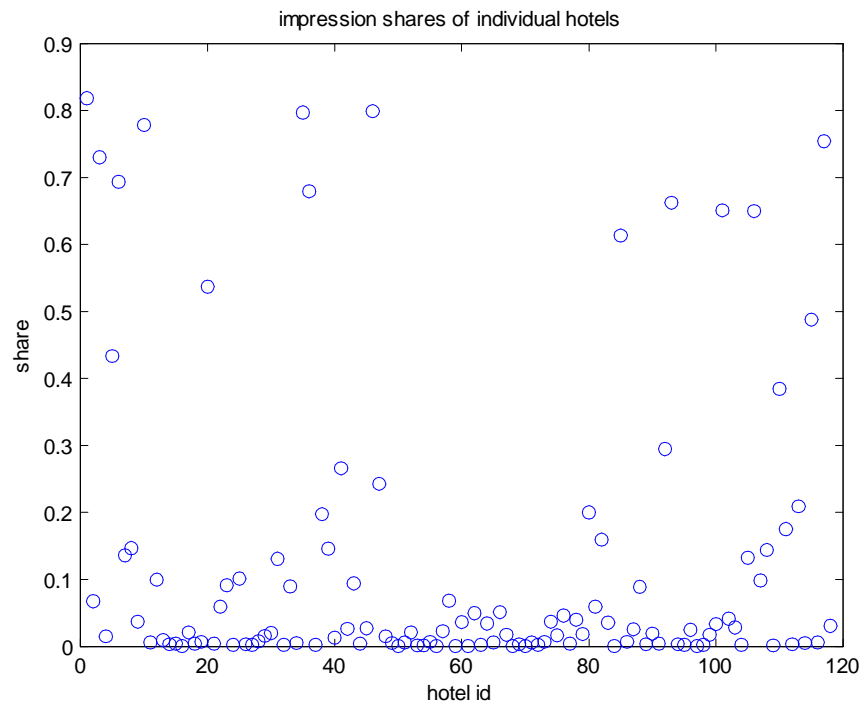




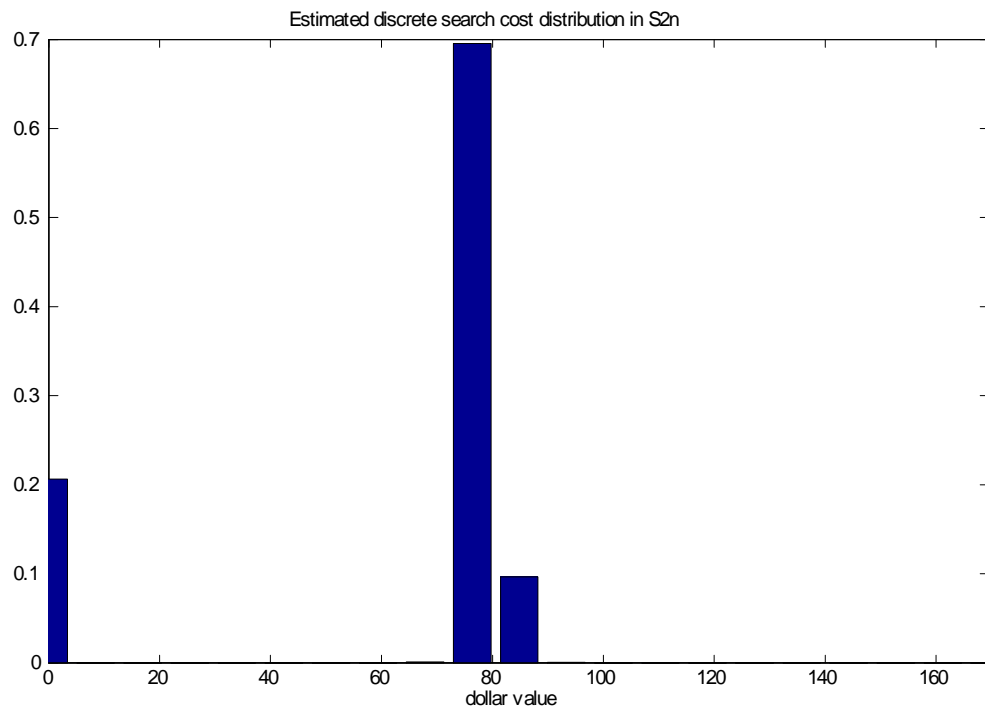
**Figure 2:** Distribution of distances to the city center (in miles) of Chicago hotels (estimation sample)



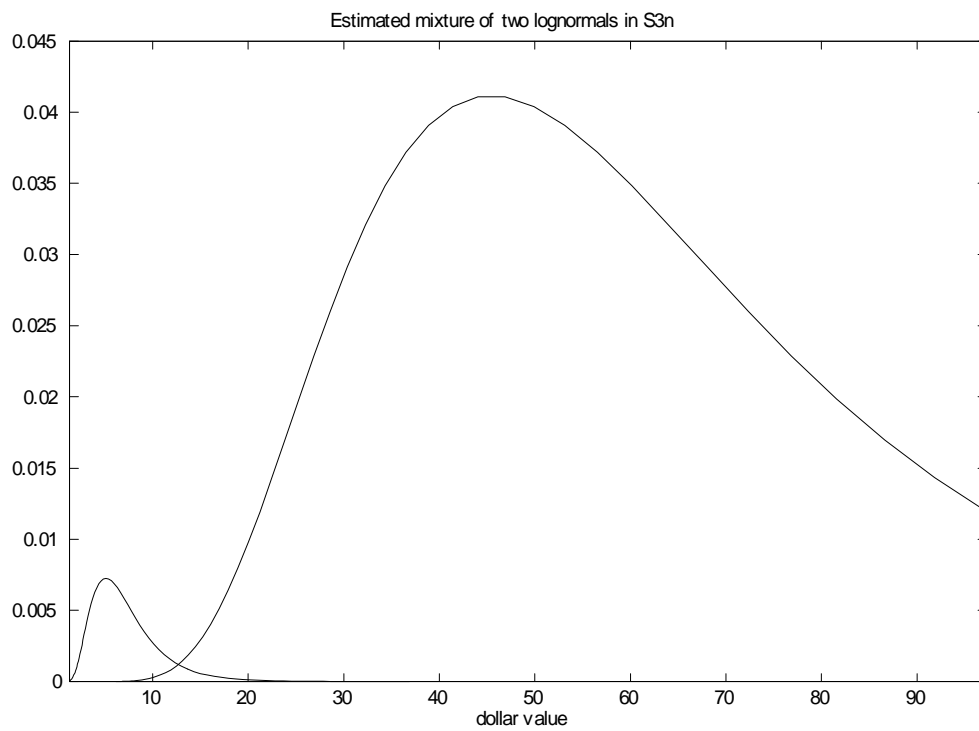
**Figure 3:** Quantiles (10%, 90%) of hotel prices, observed on the first page (for each hotel separately). The y-axis is measured in hundreds of dollars. Centered around median.



**Figure 4:** Proportions of first pages at which individual hotels were displayed, estimation sample. In total, 118 hotels on 1081 observed first pages.



**Figure 5:** Estimates of discrete search cost distribution in S2n.



**Figure 6:** Estimation results from a mixture of two lognormals, model S3n.