

Abstract of a paper to be presented at the
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Contractual Structures and Consumer Misperceptions – The Case of Product Warranties

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This paper analyzes contract choices and the effectiveness of consumer protection policies in a model where firms can offer warranties for their products. When product quality is observable, a single firm can profitably sell exploitative extended warranty contracts to naive consumers who underestimate their costs of claiming a warranty payment. Under retail competition, sophisticated consumers' utility is increasing in the fraction of naive consumers, while firms can still incur positive profits. Inducing competition in the extended warranties market weakly increases aggregate consumer welfare. When product quality is unobservable to consumers, return cost misperceptions can furthermore lead to an endogenous overestimation of product qualities by naive consumers. In this case imposing an additional minimum warranty standard is sometimes needed to prevent consumer exploitation.