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EE489: Sorensen (2000)

The paper examines the causation of price dispersion due to costly consumer search using the data from retail prices for prescription drugs. The evidence analysed suggests that dispersion arises at least in part from the nature of consumer search environment. Moreover, the pharmacies different can explain roughly one-third of price variation.

First of all, the paper establish the result that **price dispersion is not based strictly on pharmacy differentiation**. The data in table 1 shows that pharmacy's price ranking are far from perfectly correlated across drugs meaning that no one pharmacy has the lowest price across the board or if so, it would somewhat differ across drugs.

Second, the paper makes an important point that **the dispersion of prescription price decreases when the frequency of purchase is higher**. This result come from the estimated result in table 2. In column 2, the regression of explanatory variables on standard deviation, the coefficient of purchase frequency is negative and significant. So the purchase frequency can statistically explain the decrease in price dispersion.

Third, the result is strengthened by the including the pharmacy heterogeneity. The estimated result of PFREQ is still the same but different in magnitude as showed to column 3-4 in table 2. Moreover, column 1 in table 3 shows that coefficient of PFREQ is negative and significant meaning that margin are lower for prescriptions that are purchased frequently. The result from less margin is consistent with intuitive prediction of search theory because prescriptions that consumers likely to search for would have lower price-cost margin. Therefore, t**he dispersion in prescription prices can be explained by costly consumer search**.

Finally, the paper seeks for alternative explanation of service dimension in pharmacy and cost heterogeneity. However, service dimension yield weak result and cost heterogeneity effect is too small to explain price dispersion.