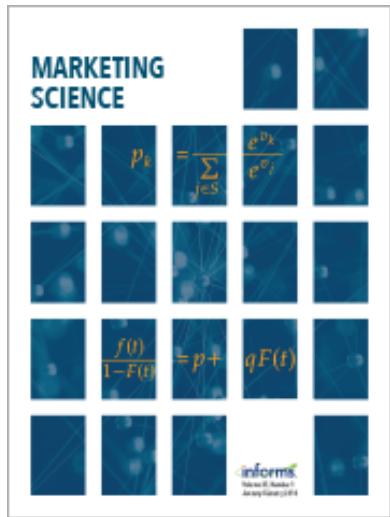


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A Dynamic Model of Optimal Retargeting

J. Miguel Villas-Boas,^a Yunfei (Jesse) Yao^a

^a Haas School of Business, University of California, Berkeley, California 94720

Contact: villas@haas.berkeley.edu,  <https://orcid.org/0000-0003-1299-4324> (JMV-B); jesseyao@berkeley.edu,  <https://orcid.org/0000-0001-9831-5083> (Y(J)Y)

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Abstract. A consumer searching for information on a product may be indicative that the consumer has some interest in that product but is still undecided about whether to purchase it. Some of this consumer search for information is not observable to firms, but some may be observable. Once a firm observes a consumer searching for information on its product, the firm may then want to try to provide further information about the product to that consumer, a phenomenon that has been known in electronic commerce as retargeting. Firms may not observe all activities by a consumer in searching for information, may not be able to observe the information gained by consumers, and may not be able to observe whether a consumer stopped searching for information. A consumer could stop searching either because he received information of poor fit with the product, because he bought the product (which may be unobservable to the firm), or because he exogenously lost interest in the product. This paper presents a dynamic model with these features characterizing the optimal advertising retargeting strategy by the firm. We find that a forward-looking firm can advertise more or less than a myopic firm to gain more information about whether the consumer is searching for information, advertising more if the effect of advertising is relatively high. We characterize how the optimal advertising retargeting strategy is affected by the ability of the firm to observe when the consumer purchases the product, when the firm is better able to observe the consumer search behavior, and by the informativeness of the signal received by the consumer. We find that better tracking of consumer search behavior could be beneficial for consumers, because it may reduce the length of time when a consumer receives retargeting, but that it also enlarges the region of firm's beliefs where retargeting is optimal. Finally, we also find that the value of retargeting is highest for an intermediate value of the likelihood of the consumer receiving an informative signal and that retargeting may allow the firm to charge higher prices if consumers are forward-looking.

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Keywords: retargeting • targeting • advertising • consumer search • information • dynamic strategy

1. Introduction

A consumer searching for information on a product may be indicative that the consumer has some interest in that product but is still undecided about whether to purchase it. Some of this consumer search for information is not observable to firms, but some may be observable. Once a firm observes a consumer searching for information on its product, the firm may then want to try to provide further information about the product to that consumer, a phenomenon that has been known in electronic commerce as retargeting. This practice of providing targeted information to consumers searching for information has been present with salesforce behavior, but, with the development of the information technologies, has become more prominent because of better tracking of consumers' information gathering behavior. In fact, in recent years, we have observed firms sending online advertising when they

see a consumer searching for information on a certain product. This is done through emails, display advertising of sites checked by that consumer, or with other forms of communication.

Obviously, firms may not observe all activities by a consumer in searching for information. For example, in the electronic world, a firm may not be able to know about the offline information gathering by consumers; even online, the consumer may be gathering information from sites where the firm does not track information. Even if a consumer is browsing in a site that has information on the product, the consumer may not be processing that information. A firm may also not know if a consumer is receiving favorable or unfavorable information, when it finds the consumer searching for information. Given the posterior search or purchase behavior by the consumer, the firm may infer to some degree whether the

information obtained by the consumer was favorable or unfavorable but does not know it firsthand.

Moreover, the firm may not know if a consumer stopped searching for information, as it cannot observe all search occasions, and may not be able to observe whether and when a consumer purchases the product. In fact, anecdotal evidence seems to suggest that consumers continue to receive purchase-oriented advertising after purchasing the product, or, more generally, after they stop searching for information. A firm may not be able to observe whether a consumer purchased the product because that is done offline, is done on a site that is not monitored, or for which the information collected is not cross-checked with the retargeting information. Obviously, one can consider firms getting better at connecting consumer purchases with consumer search behavior and that affecting the optimal retargeting behavior.

This paper considers a model of these effects, taking into account the firm's beliefs about the likelihood of search behavior by the consumer and the role of advertising. When the firm sees a signal that a consumer is searching for information, the firm learns that the consumer is searching for information, although it might not know whether the information received by the consumer is positive or negative or whether the consumer decided to purchase the product. When the firm does not see a signal that a consumer is searching for information, by Bayes' rule, it reduces its belief that the consumer is searching for information. Advertising is modeled as increasing the likelihood and frequency of the consumer learning information about the product and increasing the ability of the firms tracking that the consumer is searching for information. The optimal strategy calls for advertising when the firm has a sufficiently high belief that the consumer is considering the product. We can evaluate how the optimal strategy can be affected by different market forces and how the optimal strategy changes when the firm can also observe if and when the consumer buys the product. We also characterize the length of time that a product is advertised without further information about the consumer's search behavior. The model also replicates the real-world experiences by consumers of receiving advertised after searching for information on a product, and continuing to receive that information, even after becoming disinterested in the product.

We compare forward-looking with myopic firms and find that forward-looking can do less retargeting than myopic firms if the informational benefits of retargeting (more signals for the consumers, and greater ability by the firm to track that the consumer is searching for information) are not too large and if the likelihood of the consumer dropping out of the search process exogenously is low enough. A myopic policy

does not account for the fact that without advertising the consumer may still end up purchasing the product in the future and therefore can lead to greater urgency in advertising. This has important implications for firms about the importance of having a longer-term perspective in their retargeting decisions, and the biases that can occur from having too much of a short-term perspective. These implications can also be tested empirically by looking at retargeting behavior by firms depending on their planning horizon.

We find that better tracking of consumer search behavior could be beneficial for consumers, because it may reduce the length of time when a consumer receives retargeting. Better tracking of consumer search behavior allows the firm to update faster that the consumer is not searching for information when not observing the consumer searching for information, and therefore the firm stops doing retargeting sooner. This would suggest that with improvements in the tracking technology we could observe shorter retargeting periods. In fact, anecdotal evidence seems to suggest that the extremely long retargeting periods that occurred a few years ago seemed to have reduced over time. This has managerial implications for the optimal retargeting strategy when firms develop technological improvements in their tracking of consumer search, and also has public policy implications of making retargeting less problematic in terms of advertising annoyance.

Considering the value of retargeting, we find it is highest for an intermediate value of the informativeness of the signals received by consumers. If the informativeness of those signals is too high, consumers quickly get informed about the value of the product and having the ability to do retargeting is less valuable. If the informativeness of those signals is too low, then retargeting also does not help much as it takes too long for a consumer to learn the value of the product. This value of retargeting is also the highest for some intermediate value of the likelihood of the consumer exogenously dropping out of the search process. If the likelihood of the consumer exogenously dropping out of the search process is too low, there is not much benefit in retargeting as the consumer will likely find out about the value of the product without retargeting, and will be able to choose to purchase the product. On the other side, if the likelihood of the consumer exogenously dropping out of the search process is too high, there is not much benefit in retargeting as the consumer will likely drop out of the search process before finding out if the product is a good fit. As the informativeness of signals changes, this result has importance about the usefulness of firms doing retargeting and yields empirical predictions about the extent of firms' retargeting behavior.

We study also what happens if the information technology improves in such a way that firms are immediately able to recognize when purchases occur. In this case, firms stop retargeting when the consumer makes a purchase but may continue still going on doing retargeting after the consumer receives a negative informative signal. In this case, we find that the threshold belief for the firm to do retargeting is now lower because, when doing retargeting, the firm knows when the consumer made a purchase, and retargeting is no longer needed, and the maximum period of retargeting can now be longer. In addition to the managerial implications that the development of these technologies of recognizing purchases can bring, this result can potentially lead to an increase in advertising annoyance and therefore lead to potentially greater regulation on firms' retargeting behavior.

We consider the consumer search for information, and purchase behavior, finding that the optimal price can fall with lower search costs. If consumers are forward-looking and there is no disutility of receiving advertising, the possibility of retargeting allows the firm to charge a higher price, because of the anticipated benefit of the additional information from retargeting.

Existing research has focused on understanding how consumers past purchase behavior could affect the future behavior of the firm toward those consumers. This has been considered in the context of advertising (Shen and Villas-Boas, 2018), pricing (Villas-Boas 1999, 2004; Fudenberg and Tirole 2000; Fudenberg and Villas-Boas 2006; Shin and Sudhir 2010), and product design (Zhang 2011). However, in the real world, it seems that with the development of the information technologies, the most important practice is one of conditioning the behavior of firms on the search behavior of consumers rather than on the purchase behavior of consumers.¹ There is also some related recent work on the search behavior of consumers for information (Branco et al. 2012, Ke et al. 2016, Fudenberg et al. 2018, Gardete and Antill 2019, Ke and Villas-Boas 2019), but this research has not considered how that search behavior affects the firm strategy.² There has also been some research on the significant empirical effectiveness of retargeting advertising, such as Manchanda et al. (2006), Lambrecht and Tucker (2013), Li and Kannan (2014), and Hoban and Bucklin (2015).

The remainder of the paper is organized as follows. Section 2 presents the model. Section 3 considers the case in which the firm does not observe whether and when the consumer purchases the product. Section 4 studies the value of retargeting. Section 5 includes several model extensions, including the effects of a greater quality of the signals received by the

consumer when the firm does retargeting, the case in which the firm observes consumer purchases, and the effects of consumers being forward-looking. Section 6 concludes.

2. The Model

2.1. Consumer Search Behavior and Pricing

We start by presenting a model of consumer search behavior and optimal firm pricing that generates an expected profit v for the firm of a consumer receiving an informative signal that the product is a fit for the consumer. The only important element from this subsection for the remainder of the paper is the existence of this expected profit v , and the reader less interested on the consumer search problem, which is not the focus of this paper, can skip to the next section.

Suppose that the consumer can be in a state in which he knows that with equal probability he has either zero value for a product or some value w per period of using the product (Tables 1 and 2 present the notation used in the paper.). The product is a durable good with infinite life. By searching for information, with a process that is explained later, the consumer can determine, if he is in this state, whether the value is zero or w . The consumer also knows that with hazard rate ψ he will switch from this state to a state in which he has zero value of the product forever. Working in terms of present value of benefits, the consumer can then have an overall gross benefit of getting the product of either zero or $w = w/\psi$. Suppose that the firm chooses a price P that cannot be customized, and cannot vary with time, and w has an ex ante cumulative probability distribution function $F(w)$, with density $f(w)$, with positive density on, and only on, $[\underline{w}, \bar{w}]$ with $\underline{w} > 0$. One can obtain $F(w)$ directly from the cumulative probability distribution function on w . We consider the situation where the consumer only learns w when he finds that he has a strictly positive benefit for the product. The case in which the consumer knows the value of w , while he is still uncertain whether the benefit of the product is either zero or w , is discussed briefly at the end of Section 5.3. Finally, let m be the marginal cost of production of the product, and let $\tilde{P} = \arg \max_p (P - m)[1 - F(P)]$, the static monopoly price.³ If $(\underline{w} - m)f(\underline{w}) > 1$, the static monopoly price is $\tilde{P} = \underline{w}$, and all consumers who receive a positive fully informative signal purchase the product.

A consumer can search for information at a cost of εdt for a period of time of length dt , where ε is assumed small. If the firm is not advertising, the consumer, if searching for information, receives a signal about the product fit in the period dt with probability pdt . If the firm is advertising, the consumer, if searching for information, receives a signal about the product fit in the period dt with probability $\hat{p}dt$,

Table 1. Notation

Variable	Description
p	Hazard rate of consumer receiving product information if no retargeting
\hat{p}	Hazard rate of consumer information if firm is doing retargeting
c	Cost per unit of time of firm doing retargeting
q	Probability of consumer receiving fully informative signal given that he received
	Product information (with no retargeting if in Section 5.1)
\tilde{q}	Probability of consumer receiving fully informative signal given that he received
	Product information if firm is doing retargeting and this probability is different than the
ϕ	Case of no retargeting (it only appears in Section 5.1)
	Probability of firm observing that consumer is searching for information conditional on
	Consumer receiving product information if the firm is not doing retargeting
$\hat{\phi}$	Probability of firm observing that consumer is searching for information conditional on
	Consumer receiving product information if firm is doing retargeting
x	Firm belief that the consumer is in the state of searching for information
ψ	Hazard rate of consumer exogenously moving to the state of not searching for information
\tilde{x}	Endogenous belief threshold, when firm does not recognize when purchases occur such that firm does retargeting for $x \geq \tilde{x}$ and does not do retargeting for $x < \tilde{x}$
\tilde{x}	Endogenous belief threshold, when firm recognizes when purchases occur, such that firm does retargeting for $x \geq \tilde{x}$ and does not do retargeting for $x < \tilde{x}$
x_m	Endogenous belief threshold, when firm is myopic and does not recognize when purchases occur, such that firm does retargeting for $x \geq x_m$ and does not do retargeting for $x < x_m$
$V(x)$	Value function of firm in region of beliefs of no retargeting if firm does not recognize when purchases occur
$\hat{V}(x)$	Value function of firm in region of beliefs of retargeting if firm does not recognize when purchases occur
$\tilde{V}(x)$	Value function of firm in region of beliefs of no retargeting if firm recognizes when purchases occur
$\tilde{\hat{V}}(x)$	Value function of firm in region of beliefs of retargeting if firm firm recognizes when purchases occur
v	Payoff for firm if consumer purchases the product
\hat{T}	Maximum amount of time that a consumer could be retargeted when firm does not recognize when purchases occur
\tilde{T}	Maximum amount of time that a consumer could be retargeted when firm recognizes when purchases occur
B	$p\phi + \psi + p(1 - \phi)q$
\hat{B}	$\hat{p}\hat{\phi} + \psi + \hat{p}(1 - \hat{\phi})q$
A	$p(\phi + (1 - \phi)q/2)$
\hat{A}	$\hat{p}(\hat{\phi} + (1 - \hat{\phi})q/2)$
$C, \bar{C}, \tilde{C}, \tilde{\bar{C}}$	Constants in firm value functions

Table 2. Notation of Variables for Consumer Search Model

Variable	Description
ω	Utility per unit of time for consumer of product if product is of any value to consumer
w	Present value of product for consumer if product is of any value ($= \omega/\psi$; distributed with cumulative distribution function $F(w)$)
m	Marginal cost of production
P	Price charged by firm
$S(P)$	Expected consumer surplus given price P , conditional on consumer receiving a positive informative signal
\tilde{P}	Static monopoly price ($= \arg \max_P (P - m)[1 - F(P)]$)
ε	Search cost per unit of time for consumer
\bar{P}	Product price such that myopic consumer is indifferent between searching and not searching for information
P^*	Optimal price
$W(t)$	Expected present value of utility for consumer when searching for information and receiving retargeting for t time since firm observed the consumer search for information
W_n	Expected present value of utility for consumer when searching for information and not receiving retargeting
D	Constant in consumer value function
η	Disutility of receiving retargeting per unit of time

with $\hat{p} > p$. We further discuss the roles of p and \hat{p} later. If the consumer is not searching for information, the consumer does not get any signal, whether the firm is advertising.⁴ Given that the consumer receives a signal, the probability of it being informative is q .

Finally, let $S(P)$ be the expected consumer surplus conditional on the consumer receiving a positive informative signal of the product fit and the firm charging price P . That is, $S(P) = \int_p^{\bar{w}} (w - P) dF(w)$. Consumers are assumed to be risk neutral. Possible consumer discounting of the future is only considered through the hazard rate ψ at which time their benefit of having the product is extinguished. We restrict attention to the case of consumers being myopic with respect to any potential future advertising that results from the firm finding out that the consumer is searching for information. That is, consumers are unaware of the retargeting policy by the firm. We consider the case of forward-looking consumers in Section 5.3.

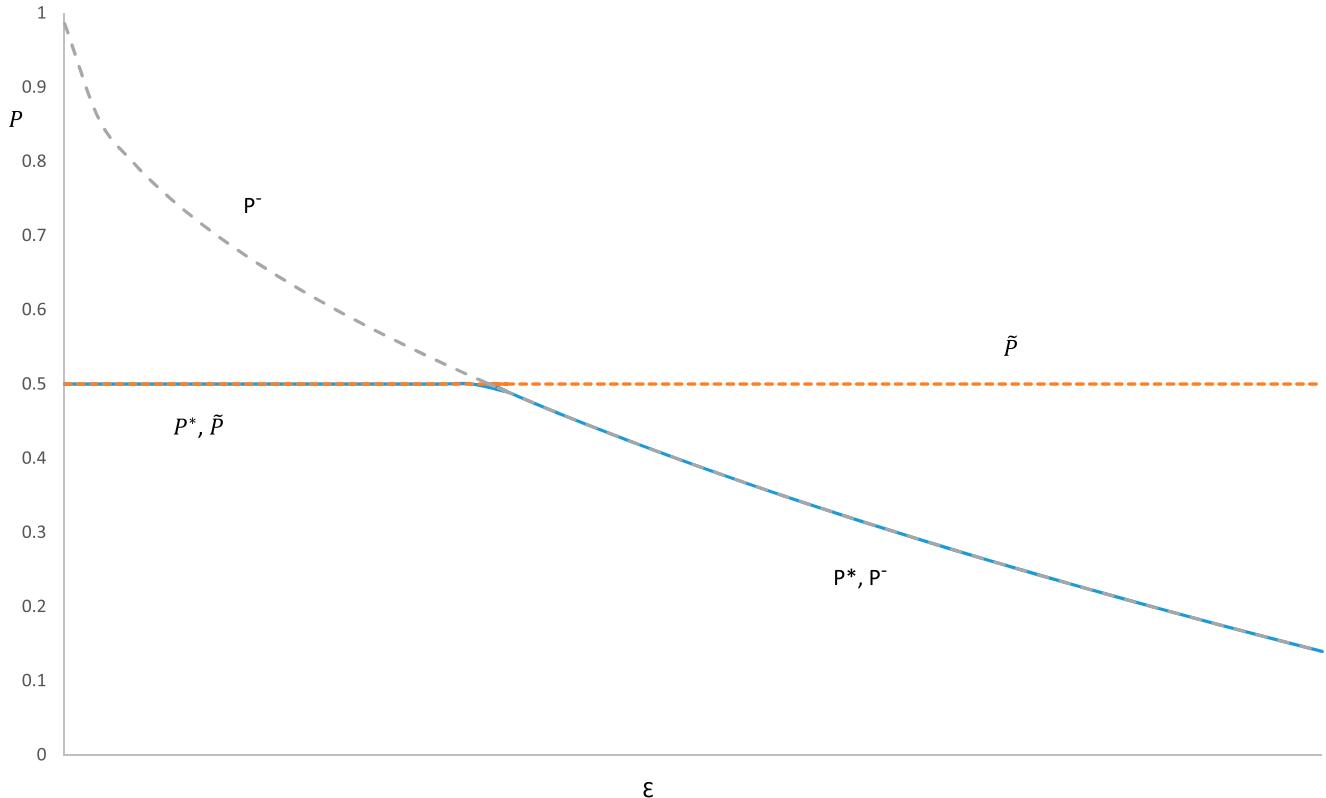
For a consumer to search for information, it must be that the expected benefit of searching for information is greater than the cost of searching for information. Consider the case in which the consumer is not receiving advertising. In that case, for the consumer to want to search for information, it must be the case that $\frac{1}{2}pS(P) \geq \varepsilon$. Define \bar{P} as the price that makes this inequality bind, $S(\bar{P}) = \frac{2\varepsilon}{pq}$.

If the price is only checked each time the consumer gets a signal, given that the search costs are sunk, the firm would choose to charge the static monopoly price \tilde{P} , and the consumer would only search for information if $\tilde{P} \geq \tilde{P}$, that is, $S(\tilde{P}) \geq \frac{2\varepsilon}{qp^2}$ and we obtain that the expected profit for the firm if the consumer receives a positive informative signal of product fit is $v = (\tilde{P} - m)[1 - F(\tilde{P})]$. In this setting, if $\tilde{P} < \tilde{P}$, no consumer would search for information, and the firm would not do any retargeting.

Potentially more interesting for the context being modeled, price could be seen as being freely checked (or fixed over time, and learned at the first search), and then the firm can use it to provide incentives for the consumer to search for information on product fit. The remainder of this section considers this case.

As the expected profit from a consumer receiving a positive informative signal is $(P - m)[1 - F(P)]$, if ε is small enough we have $\frac{q}{2}pS(\tilde{P}) > \varepsilon$, and the optimal price to charge is then $P^* = \tilde{P}$. If ε is not small enough, then that inequality does not hold for \tilde{P} , and we have then that the optimal price is $P^* = \tilde{P}$. That is, we have that the optimal price $P^* = \min[\tilde{P}, \tilde{P}]$, which is independent of the search costs ε for small ε , and decreasing in the search costs ε for large ε . We state this result in the following proposition.

Figure 1. (Color online) Optimal Price P^* for the Myopic Consumers' Case as a Function of the Search Costs ε for the Case in Which $F(w) = w$ with Support $[0, 1]$, and $m = 0, q = .2, p = 1$



Proposition 1. Suppose that consumers are not aware of future retargeting. Then, the optimal price is independent of search costs for low search costs and decreasing in search costs for high search costs.

Figure 1 illustrates how the optimal price P^* evolves with the search costs ε . In this case, we would have $v = (P^* - m)[1 - F(P^*)]$. If $(\underline{w} - m)f(\underline{w}) > 1$ and $\varepsilon < \frac{q}{2}pS(\underline{w})$, then $P^* = \underline{w}$ and $v = \underline{w} - m$.

As consumers that have some possible positive value for the product are ex ante equal (ω is only learned when the consumer receives a fully informative signal), the firm prices such that all consumers in that state search for information. If consumers have some information before searching for information on their potential value for the product, or if consumers are heterogeneous in their search costs, then the firm's pricing decision affects which consumers search for information, and the value of v would have to be adjusted by the margin obtained by the firm on each sale.

One possibility to also potentially consider is that the consumer search costs ε are lower when the consumer is being retargeted to than when the consumer is not being retargeted to. This could be, for example, because the firm could direct signals to the

consumer that are easier to process as information. In this case, if the search costs without retargeting are high, then the price is \bar{P} (assuming that the firm has to set the same price with and without retargeting), and the lower search costs during retargeting just means that the consumer has a strict positive surplus of searching for information during retargeting and does not affect the remainder of the analysis. As discussed in the next section, we can also interpret $\hat{p} > p$ as the consumer having some form of lower search costs during retargeting.

2.2. Firm's Information and Beliefs

From the point of view of the firm, consider a consumer potentially searching for information on the purchase of a product. A consumer can be in either of two states: (1) searching for information on the product or (2) not searching for information on the product. Given the optimal pricing determined in the previous section, the state of searching for information on the product is the state, in terms of the previous section, in which the consumer knows that with equal probability he has either zero value for the product or some value ω per period of using the product. The state of not searching for information is the state in which the consumer has zero value for the product forever. There could be several reasons that the consumer is not searching for information on the product: the consumer already bought the product, or the consumer received information that the product is a poor fit for his preferences, the consumer realized

that he no longer needs this type of product, or the consumer was never aware of this product.

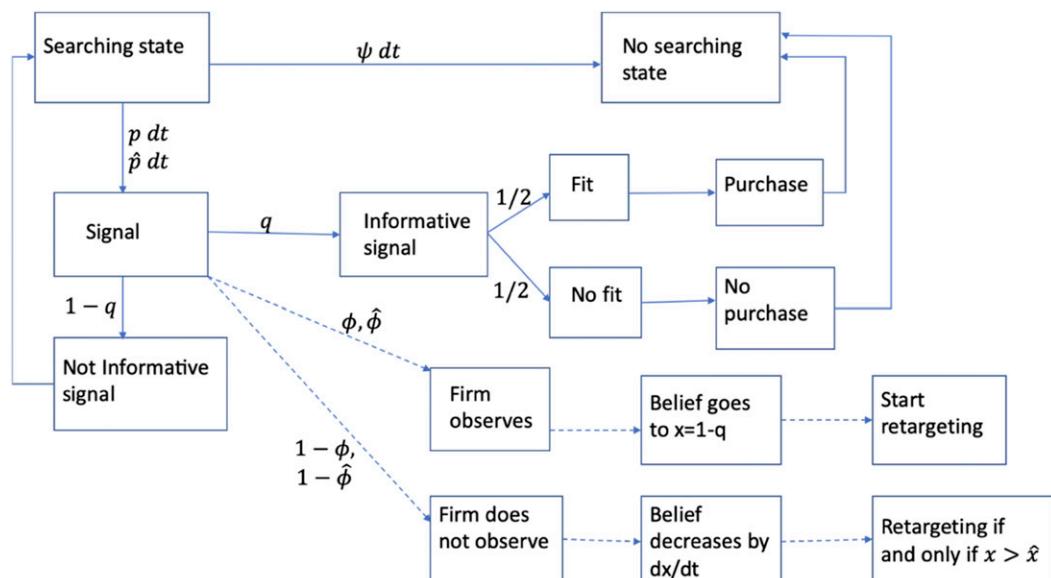
The firm does not know which state the consumer is in, but, occasionally, if the consumer is searching for information, the firm learns that, and at that moment the consumer is in the state of searching for information. For now, we will assume that the firm does not know whether the consumer bought the product, and in Section 5.2 we will allow for that possibility.

Time is continuous, and, to simplify, we assume no discounting, as the real-world phenomena considered typically last only a few weeks at most. We now present how the consumer evolves from the searching state to the no searching state at each moment in time and describe how the firm's beliefs about the consumer being in the searching state evolve over time. Figure 2 illustrates the different possibilities.

Consumers in the state of not searching for information are not useful for the firm, as going forward they will not purchase the product, and we assume that there is no activity that the firm can do that makes consumers switch from no search to search. Consider also that the probability of a consumer switching from the no searching state to the searching state is so low, that, if a firm knew that a consumer was in the no searching state, it would never be profitable to advertise to that consumer as long as the firm does not see that the consumer is searching for information.⁵

Consumers in the searching for information state can either remain there or move to the not searching for information state, by either purchasing the product,

Figure 2. (Color online) Illustration of How Consumers Can Evolve from the Searching State to the No Searching State Depending on the Signals Received



Notes. Retargeting signals are received at the hazard \hat{p} instead of p , and the probability of the firm observing the signal is $\hat{\phi}$ instead of ϕ . Dashed lines represent observations, beliefs, and actions by the firm.

receiving definitive information about the product and deciding that the product is a poor fit, or just losing interest in the product. The hazard rate of the consumer receiving a signal, given that he is searching, is $p > 0$, as noted in Section 2.1. In the period of time dt , the probability of the consumer receiving a signal is $p dt$. This probability is greater if the firm is advertising to the consumer, which can be done at a cost $c dt$, with $c > 0$. This is one of the two modeled main effects of retargeting. As noted in Section 2.1, \hat{p} is the hazard rate of the consumer receiving a signal if he is being advertised to, with $\hat{p} > p$.⁶ This allows for a clear distinction between retargeting and not retargeting. This greater probability of receiving signals during retargeting could also be seen as reducing some form of consumer search costs during retargeting⁷ and therefore increasing the rate at which the consumer receives information. We note that retargeting (and the advertising cost incurred) is done at the individual level—whether to send an advertising message at cost $c dt$, is done at the individual level, for an individual who was observed searching for information at some point in the past. We also consider that retargeting affects the likelihood with which the firm is able to observe the consumer searching for information and the likelihood of the consumer receiving a fully informative signal, whose role we now discuss.

If the consumer receives a signal, with probability $q \in (0, 1)$, that signal is fully informative about the fit of the product for the consumer, as noted previously.⁸ We can think of q as small. As we assumed, good or poor fit are equally likely; therefore, given that the consumer received a signal, with probability $q/2$ the consumer receives a positive fully informative signal, and delivers an expected profit for the firm of v , moves to the no searching for information state, and with probability $q/2$, the consumer receives a negative fully informative signal, delivers zero payoff for the firm, and also moves to the no searching for information state. For now, we assume that the firm does not observe whether the consumer buys the product.

When the consumer receives definitive information about the product fit, the firm does not necessarily see that the consumer received this signal. In fact, the firm only sees that the consumer has seen some form of information with probability $\phi \in (0, 1)$, given that it occurred. Given that the firm observes the consumer searching for information, the belief by the firm x_t that the consumer is in the searching for information state at time t is $1 - q$, as we know that with probability q the consumer receives a fully informative signal, and moves to the no searching for information state. As noted previously, this probability ϕ is greater if the firm is doing retargeting to the consumer, which we denote as $\hat{\phi} > \phi$. This is the second of the two modeled main effects of retargeting. A firm may have a better chance

at observing when the consumer receives a signal while doing retargeting. For example, this could be because the firm becomes more active in monitoring the consumer search behavior or because retargeting is more likely to increase the consumer clicking on the firm's advertisements, which are easier to track by the firm. We distinguish below the unique effects of p and ϕ on retargeting.

Finally, as noted previously, when in the searching for information state, the consumer can also move exogenously to the no searching for information state because of losing interest in the product or category, and this occurs with hazard rate $\psi > 0$. This captures the idea that a consumer can lose interest in a category for some factors exogenous to the problem. For example, a consumer could be in the market to purchase a new car, but then because loss of income, other activities that require the consumer's attention, or the consumer realizing that public transportation could be a better alternative, the consumer drops out of being in the market for a car.

Unconditional on any information, this structure yields a càdlàg process on beliefs (right continuous with left limits). Given this structure, we can use Bayes' rule to construct how the firm's belief about the consumer's search state evolves over time t when the firm does not receive any information that the consumer received a signal about product fit.

For example, consider that a firm observes a consumer searching for information and then does not observe that consumer searching for information for some period. During that period, and as time passes, the firm puts more weight on the possibility that the consumer either received a fully informative signal or decided to stop searching exogenously. That is, as time passes without observing the consumer searching for information, the firm has lower and lower beliefs that the consumer is still searching for information.

Formally, let x_t be the firm's beliefs that the consumer is in the searching state at time t . Letting $\tilde{x}_{t+dt} = x_t + \frac{dx_t}{dt} dt$ be the firm's beliefs that the consumer is in the searching state conditional on not receiving any information during the period dt , we want to express a relation between x_t and \tilde{x}_{t+dt} .¹⁰ The unconditional expected beliefs (unconditional on information obtained during period dt), which we denote by \tilde{x}_{t+dt} , have to fall in expected value by the probability of the consumer exogenously dropping out of the search process, $\psi x_t dt$, and the probability of the consumer receiving an informative signal, $p q x_t dt$. That is, $E(\tilde{x}_{t+dt}) = x_t - (\psi + pq)x_t dt$. In other words, the beliefs are a supermartingale falling in expected value, by $(\psi + pq)x_t dt$ in period dt . This yields a relation between the beliefs at time t , and what can occur and the beliefs at time $t + dt$.

Second, With likelihood $p\phi x_t dt$ the firm knows for sure that the consumer is in the *searching* state and the belief that the consumer is searching jumps to $1 - q$. Third, with probability $(1 - p\phi x_t dt)$ the firm does not receive any information, and the belief that the consumer is searching goes to $x_{t+dt} = x_t + \frac{dx_t}{dt} dt$. That is, $E(\tilde{x}_{t+dt}) = x_{t+dt}(1 - p\phi x_t dt) + (1 - q)p\phi x_t dt$. Putting this all together yields

$$x_t = \left(x_t + \frac{dx_t}{dt} dt \right) (1 - p\phi x_t dt) + (1 - q)p\phi x_t dt + (\psi + pq)x_t dt. \quad (1)$$

Dividing by dt and making dt go to zero, we can then obtain¹¹

$$\frac{dx_t}{dt} = -p\phi x_t(1 - x_t) - \psi x_t - p(1 - \phi)qx_t. \quad (2)$$

With this information on how the firm beliefs evolve over time, we can set up the dynamic programming problem of when the firm should and should not retarget. Once we have the optimal retargeting strategy, we can investigate how it is affected by the different market forces.

Before studying formally the optimal retargeting policy and setting up the dynamic programming problem, let us discuss the role of the different parameters.

The hazard rate of receiving a signal p (without advertising) and \hat{p} (with advertising) measure the extent to which the consumer receives a signal about the quality of the product. When these hazard rates get infinitely large, the consumer is receiving signals almost all the time. This then makes the firm's belief that the consumer in the searching state to decline very steeply without further information, but at the same time allows the firm to get more frequent information that the consumer is searching for information. These hazard rates being infinitely large also lead the consumer to make a decision about the product fit almost immediately. If, alternatively, these hazard rates are close to zero, then the beliefs of the firm regarding the consumer being in the searching state decline less steeply, but the consumer could be in the searching state for a long time and almost never get a signal, and the firm would rarely observe that the consumer is searching for information. The benefit of retargeting would be almost nonexistent if $\hat{p} \rightarrow p$. Obviously, when the difference $\hat{p} - p$ increases, the benefit of retargeting is greater.

An increase in the cost of advertising, c , also makes retargeting less appealing. On the other hand, when c goes to zero, it becomes optimal to do retargeting for almost all levels of the firm's belief regarding whether the consumer is in the searching state, and the threshold belief above which the firm chooses

to do retargeting, \hat{x} , goes to zero. Note that $c > 0$ throughout the paper (even when we consider the case of c approaching zero), such that there is a tradeoff of whether to do retargeting.¹²

Consider now the probability of a signal being informative given that it is received by the consumer, q . If this probability goes to one, almost every time that a consumer gets a signal, the consumer decides whether to buy the product, and there is therefore no incentive for a firm to do retargeting. If this probability is zero, then the consumer never gets true information about the value of the product, so the consumer would be in the searching state forever, and there would also be no incentive for a firm to do retargeting. In what follows, we can think of q as small, but nonzero, such that informative signals are not too frequent.

The role of ϕ (without retargeting) and $\hat{\phi}$ (with retargeting) is to measure the extent to which the firm is able to observe when the consumer is receiving a signal. When ϕ or $\hat{\phi}$ approaches one, the firm is able to observe almost all search occasions, and therefore each time the consumer searches, the firm's belief that the consumer is searching keeps going to $1 - q$. When $\phi = 0$, the firm never has information if the consumer is searching. As the information technology improves and the firm is better able to track the consumer search behavior, we would expect that ϕ and $\hat{\phi}$ would increase.

The role of ψ is to allow for the possibility of the consumer dropping out of the search process exogenously. Given no discounting, ψ creates an incentive for the firm to advertise to the consumer when the belief that the consumer is in the searching state is sufficiently high, in order not to lose the consumer, and to accelerate the possibility of the consumer learning about the product fit. In this sense, $\psi > 0$ plays the role of discounting in the model, such that there is an advantage in converting the consumer sooner rather than later. If $\psi = 0$, the firm does not gain by converting the consumer sooner and just chooses not to advertise, that is, not to do retargeting, for any beliefs. The greater is ψ , for some levels of ψ , the more important it may be to advertise now. Note also that ψ captures the effect that firms want to advertise to consumers when they are searching for information and in the market, because of the risk of the consumer exogenously losing interest in the product and not because of discounting the future payoffs. A firm may obtain an estimate about ψ from market research or historical data analysis, and that estimate may vary across product categories.

The current modeling of retargeting is one of providing informative advertising. Alternatively, we could consider the possibility of retargeting providing persuasive advertising. In that case, we could interpret q as the probability of the advertising being fully persuasive,

and we would never have the possibility of the consumer leaving the searching state when receiving a signal. The belief dynamics would be exactly as above, and, in the computation of the expected payoff, the firm would get v with probability q when the consumer receives a signal, whereas in the case of informative advertising, the expected payoff for the firm would be $v/2$ with probability q when the consumer receives a signal.

3. Optimal Retargeting

To compute the optimal retargeting strategy, we first study the form of the optimal policy.

Let $\pi(t)$ be the expected future payoff for the firm, conditional on the consumer being in the search state, if the firm chooses to do retargeting for a period of time t if the firm does not observe the consumer searching for information before t (in that contingency, the firm would go back to the optimal policy, after just observing that the consumer is searching for information). Note that $\pi(t)$ includes the possibility of the consumer dropping out of the search process before t (either because of the exogenous drop rate ψ or because the consumer receives a negative informative signal on the product fit), and the retargeting costs c that are incurred. The expected payoff for the firm under this strategy, given that the consumer is actually not in the search state, is $-ct$. Let $t^*(x)$ be the optimal t when the firm has a belief x that the consumer is in the search state.

Then, for it to be optimal for the firm to do retargeting when it has belief x , we must have that

$$x\pi(t^*(x)) + (1-x)(-ct^*(x)) \geq x\pi(0). \quad (3)$$

Consider now the belief $x' > x$, and suppose that the firm with that belief chooses the suboptimal strategy $t^*(x)$, as the maximum length of time that the firm does retargeting if the firm does not observe that the consumer is searching for information prior to $t^*(x)$. The expected future payoff for the firm would then be

$$\begin{aligned} x'\pi(t^*(x)) + (1-x')(-ct^*(x)) \\ > x\pi(t^*(x)) + (1-x)(-ct^*(x)) \geq x\pi(0). \end{aligned} \quad (4)$$

This yields that at state x' , it is optimal for the firm to do retargeting. As this was obtained for a general $x' > x$, we then have that there is a threshold \hat{x} such the firm does retargeting for $x \geq \hat{x}$ and does not do retargeting for $x < \hat{x}$. The following proposition states the result.

Proposition 2. *There is a belief threshold \hat{x} such that the firm advertises for $x \geq \hat{x}$ and does not advertise for $x < \hat{x}$.*

Given the evolution of the firm's beliefs (with and without retargeting) presented in the previous section, the format of this optimal retargeting strategy

determines $t^*(x)$ uniquely for $x > \hat{x}$, a one-to-one mapping between x and time to continue retargeting, and $t^*(x) = 0$ for $x \leq \hat{x}$.

From this property of the optimal retargeting strategy, we can then fully characterize the optimal retargeting strategy. Let $V(x)$ be the expected present value of the firm's profits if the firm has the belief $x < \hat{x}$; let $\widehat{V}(x)$ be the expected present value of profits of the firm if the firm has the belief $x > \hat{x}$; and we already have that v is the expected profit for the firm when the consumer receives a positive informative signal.¹³ We restrict attention to the case in which it is optimal to do retargeting if the firm observes the consumer searching for information, $\hat{x} < 1 - q$, which holds if the cost of retargeting c is low enough (presented in (A.3) in the appendix). To derive the optimal retargeting policy, let us first consider the present value of profits when the belief of the firm is sufficiently low, such that the firm does not advertise, $x < \hat{x}$. The Bellman equation of this problem can be written as

$$\begin{aligned} V(x) = p \frac{q}{2} vx dt + p\phi x dt \widehat{V}(1-q) + (1-p\phi x dt) \\ \times \left[V(x) + V'(x) \frac{dx}{dt} dt \right], \end{aligned} \quad (5)$$

as with probability $p\phi x dt$, the firm's beliefs jump to $(1-q)$ at which point the firm moves to a retargeting region, with an expected present value of profits equal to $\widehat{V}(1-q)$, with probability $p \frac{q}{2} x dt$ the consumer receives an informative signal that the product is a good fit, and in that case the firm gets a payoff of v , and with probability $(1-p\phi x dt)$, the firm does not receive any new information, and it then gets an expected payoff of $V(x_{t+dt})$, which can be approximated with a Taylor's expansion to $V(x_t) + V'(x_t) \frac{dx}{dt} dt$.¹⁴ Dividing by dt and substituting for $\frac{dx}{dt}$ from (2) one can obtain the differential equation

$$\begin{aligned} [p\phi(1-x) + \psi + pq(1-\phi)]V'(x) + p\phi V(x) \\ = p\phi \widehat{V}(1-q) + p \frac{q}{2} v, \end{aligned} \quad (6)$$

which can be solved to obtain

$$V(x) = \widehat{V}(1-q) + \frac{qv}{2\phi} + C[B - p\phi x], \quad (7)$$

where $B = p\phi + \psi + pq(1-\phi)$, C is a constant to be determined later, and $\widehat{V}(1-q)$ is the present value of profits when the belief that the consumer is searching is $(1-q)$, which is determined by $V(0) = 0$.

When the firm is advertising, the Bellman equation becomes

$$\begin{aligned} \widehat{V}(x) = -c dt + \widehat{p} \frac{q}{2} vx dt + \widehat{p}\phi x dt \widehat{V}(1-q) \\ + (1 - \widehat{p}\phi x dt) \left[\widehat{V}(x) + \widehat{V}'(x) \frac{dx}{dt} dt \right], \end{aligned} \quad (8)$$

from which one can obtain along the same lines as previously,

$$\begin{aligned}\widehat{V}(x) &= \widehat{V}(1-q) + \frac{qv}{2\phi} + \widehat{C}[\widehat{B} - \widehat{p}\widehat{\phi}x] - \frac{c}{\widehat{B}} \\ &\quad + c \frac{\widehat{B} - \widehat{p}\widehat{\phi}x}{\widehat{B}^2} \log \frac{\widehat{B} - \widehat{p}\widehat{\phi}x}{x},\end{aligned}\quad (9)$$

where $\widehat{B} = \widehat{p}\widehat{\phi} + \psi + \widehat{p}q(1 - \widehat{\phi})$, and \widehat{C} is a constant which is determined by (9) when $x = 1 - q$.¹⁵ To obtain C and \widehat{x} , one then makes $V(\widehat{x}) = \widehat{V}(\widehat{x})$, value matching at \widehat{x} , and $V'(\widehat{x}) = \widehat{V}'(\widehat{x})$, smooth pasting at \widehat{x} . Note that $C < 0$. We can obtain \widehat{x} implicitly by

$$\begin{aligned}&\left[2\widehat{\phi} - q\widehat{B} \frac{v}{c} + 2\widehat{\phi} \frac{\psi + \widehat{p}q}{\widehat{B}} \ln \frac{(\widehat{B} - \widehat{p}\widehat{\phi}\widehat{x})(1 - q)}{(\psi + \widehat{p}q)\widehat{x}} \right] \\ &\times (\widehat{p}\widehat{\phi} - p\phi)\psi\widehat{x} + 2\widehat{\phi}B(\psi + \widehat{p}q) + \frac{v}{c}pq\widehat{x}\widehat{B}(\psi + \widehat{p}q) \\ &\times (\widehat{\phi} - \phi) = 0.\end{aligned}\quad (10)$$

We wrote the value function as a function of the beliefs of the firm regarding whether the consumer is searching for information. As these beliefs are uniquely determined by the extent of time because the firm observed the consumer searching for information, we could alternatively have used time since observation of the consumer searching for information instead of x_t in the value function.

From (10) we can obtain that the threshold \widehat{x} is a decreasing function of v/c , which can be seen as expected as the firm wants to do more retargeting if there is a greater profit from a sale, greater v , or advertising is less costly, lower c . We may consider that v is large for higher priced products such as an automobile or a house, and therefore, for such products, we may expect that firms do retargeting for a longer period of time after a consumer makes a decision. Some anecdotal evidence seems to suggest that this is the case for consumers on the market for an automobile or for real estate. However, another factor to consider is that firms with such high v may bid up the cost of retargeting c , such that v/c may end up not being too large for such high priced items.

From (10) we can also obtain that for retargeting to be optimal, it requires a greater propensity for the consumer to receive signals, $\widehat{p} > p$, but it does not require that the firm better tracks that the consumer is searching for information, $\widehat{\phi} > \phi$. That is, when retargeting does not lead to a greater hazard rate of the consumer receiving signals, $\widehat{p} = p$, then it is optimal for the firm not to do retargeting with $\widehat{\phi} > \phi$. The ability to better track the consumer search does not lead by itself for retargeting to be optimal. In that case, by doing retargeting the firm would just incur the retargeting costs and not accelerate in

any way the possibility of the consumer purchasing the product.

To obtain some further insights, we concentrate on the case in which the cost of advertising, c , approaches zero, $c \rightarrow 0$. One may expect that these costs of advertising are relatively small per consumer in digital retargeting, a central motivation for this work. Furthermore, our numerical analyses, as discussed later, for the case when the costs of advertising are larger replicate the analytical results obtained for the case of advertising costs converging to zero.

When $c \rightarrow 0$, the firm wants to advertise for almost all beliefs, that is, $\widehat{x} \rightarrow 0$. We can then obtain a measure of \widehat{x} in comparison with c as

$$\lim_{c \rightarrow 0} \frac{\widehat{x}}{c} = 2\widehat{\phi} \frac{\widehat{p}q + \psi}{qv[\psi\widehat{\phi}(\widehat{p} - p) - \widehat{p}pq(\widehat{\phi} - \phi)]} \times \frac{p\phi + \psi + pq(1 - \phi)}{\widehat{p}\widehat{\phi} + \psi + \widehat{p}q(1 - \widehat{\phi})}.\quad (11)$$

From (11) we can obtain the following comparative statics, in addition to the comparative statics with respect to v and c discussed previously.

Proposition 3. Suppose that the firm does not detect when the consumer makes a purchase and that $c \rightarrow 0$. Then, the region of beliefs for optimal retargeting, $x > \widehat{x}$, is increasing in the propensity for the consumer to receive signals with retargeting, \widehat{p} , the likelihood of the firm observing during retargeting that the consumer is searching, $\widehat{\phi}$, the likelihood of the consumer receiving an informative signal given that he receives a signal, q , and the likelihood of the consumer deciding to stop searching exogenously, ψ , for small ψ , and decreasing in the propensity of the consumer to receive signals without retargeting, p , and in the likelihood of the firm observing that the consumer is searching without retargeting, ϕ .

Some of these results can be seen as one would expect: The firm wants to advertise more if advertising generates a higher chance of the consumer getting a signal (\widehat{p}), if there is a greater likelihood of signals being informative (q), and if the chance of a consumer receiving a signal without advertising is lower (p).

More interestingly, the firm wants to advertise more if it is better able to track that the consumer is searching for information when retargeting ($\widehat{\phi}$). As the firm is better able to track that the consumer is searching for information when retargeting, the firm advertises in a greater region of the belief space. On the other hand, if the ability for the firm to track consumer search without retargeting increases, the firm has less of a benefit from retargeting and therefore advertises in a smaller region of the belief space.

One could also consider the possibility of the ability to track consumers increasing equally for when the firm does retargeting and does not do retargeting (an increase in $\hat{\phi}$ and in ϕ in the same amount). In that case, one could potentially consider that with better overall tracking a firm would think that not observing the consumer searching for information might indicate that the consumer stopped being on the market. In fact, when the firm has better overall tracking, the firm realizes that when it advertises, it will be better able to discern whether the consumer is searching for information and therefore chooses to still advertise for lower beliefs of the consumer being in the searching for information state.

Also interestingly, when the likelihood of the consumer exogenously stopping the search process is greater (ψ), if ψ is small, the firm wants to advertise more. In this case, the firm realizes that in the future the consumer's interest may disappear and wants to advertise more. If $(\hat{p} - p)[(\hat{p}\hat{\phi} - p\phi)(1 - q) - pq] > \hat{p}pq(1 - \phi/\hat{\phi})$, we can have the firm wanting to advertise in a smaller region of the beliefs when ψ increases, if ψ is sufficiently large. In this case, which can occur, for example, if the probability of the consumer receiving an informative signal is sufficiently small, if ψ is sufficiently large, the firm realizes that the potential benefits of advertising leading to an informative signal are not too high, and the firm chooses to advertise in a smaller region of the belief space.

Given that we have \hat{x} , we can compute the maximum amount of time that a consumer could be retargeted after being identified as searching for information. This can be obtained to be (with derivation presented in the appendix):

$$\hat{T} = \frac{1}{\hat{B}} \log \left[\frac{1 - q}{\psi + \hat{p}q} \frac{\hat{B} - \hat{p}\hat{\phi}\hat{x}}{\hat{x}} \right]. \quad (12)$$

One interesting comparative statics on \hat{T} is that it can be decreasing in $\hat{\phi}$, which we state in the next proposition.

Proposition 4. Suppose that the cost of retargeting c is close to zero. Then, the maximum amount of time that a consumer could be retargeted after being identified as searching for information, \hat{T} , is decreasing in the firm's ability to track consumer search when retargeting, $\hat{\phi}$.

This proposition shows that the consumer could potentially benefit from the firm having a greater ability to track consumer search, considering the consumer has disutility in receiving retargeting. When the firm has a greater ability to track consumer search, it updates faster that the consumer may not be searching for information, when it does not observe the consumer searching for information. Then, the firm may prefer to stop doing retargeting sooner, as

its beliefs that the consumer is searching for information fall now more steeply.

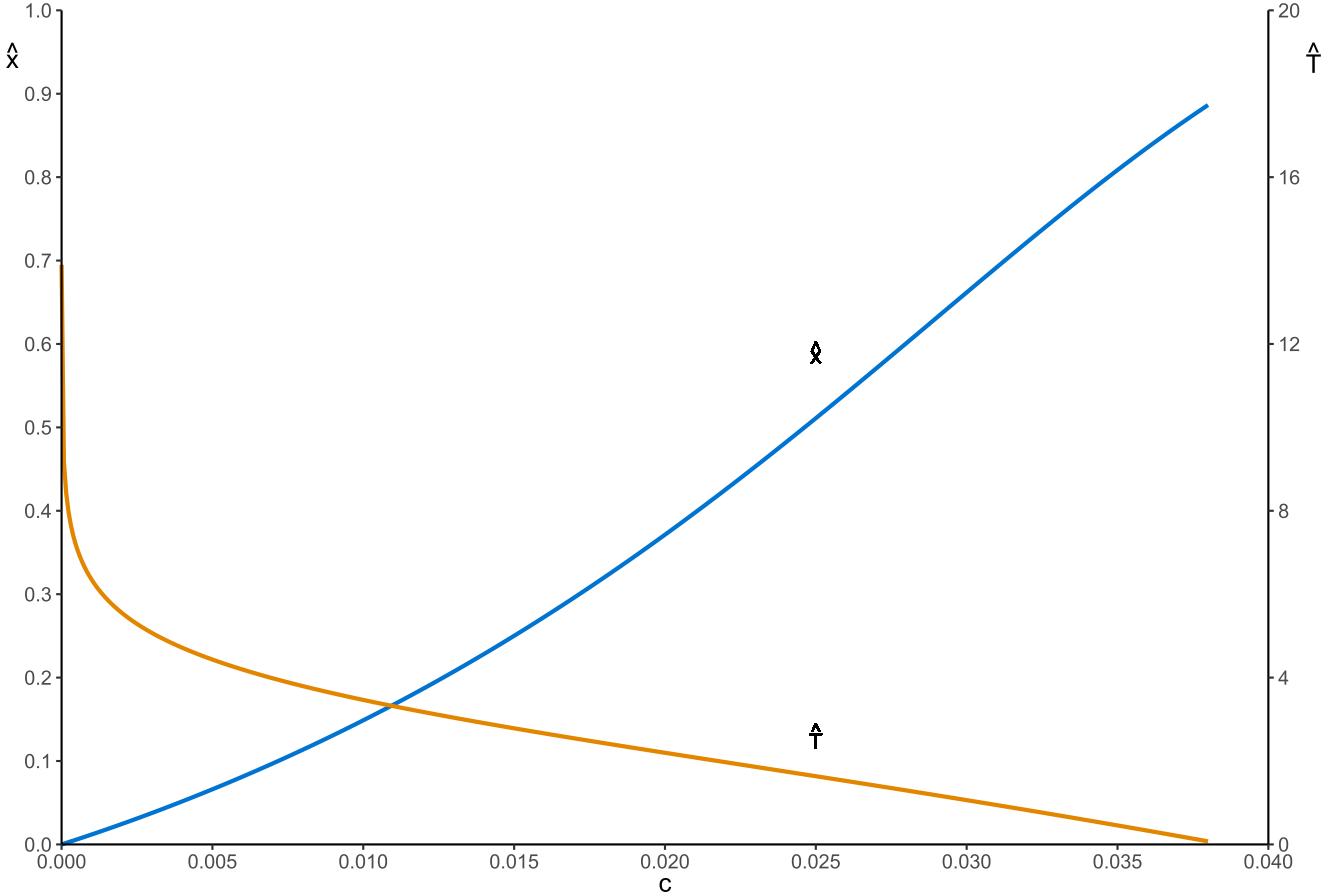
Figures 3–10 illustrate how the optimal threshold \hat{x} varies with the different parameters. As shown previously, as the cost of advertising c increases, the firm advertises less, and the maximum time of a consumer receiving advertising after having bought the product decreases. Figure 4 illustrates that the firm has a lower threshold \hat{x} to advertise when the consumer is more likely to get informative advertising, greater q , as shown in Proposition 3. More interestingly, the maximum time receiving advertising after purchases is not monotonic on q , increasing when q is small, as the firm is willing to advertise longer, and decreasing when q is large, as then the firm realizes that not observing the consumer search for a long time is more likely to mean that the consumer is not searching (the posterior beliefs that the consumer is searching for information decrease faster over time).

Figure 5 illustrates that the effect of the ability of the firm to track consumers when not retargeting (ϕ) has a monotonic effect on the optimal firm advertising strategy for $c > 0$. Increasing the ability to track if the consumer is searching for information when not retargeting makes the firm want to advertise less (higher \hat{x}), and naturally the time during which the consumer receives advertising after purchase decreases.

Figure 6 illustrates that the effect of the ability of the firm to track consumers when retargeting ($\hat{\phi}$) has also a monotonic effect on the optimal firm advertising strategy for $c > 0$. Increasing the ability to track if the consumer is searching for information when retargeting makes the firm want to advertise more (lower \hat{x}), and the time receiving advertising after purchase decreases. As shown in Proposition 4, a greater $\hat{\phi}$ has an effect on the firm's beliefs declining faster, and this has a bigger impact on \hat{T} than the lower threshold \hat{x} . As discussed previously, this illustrates that improvements in information technologies leading to an increase in the tracking ability by firms of consumer search could actually be beneficial to consumers in reducing the length of time that consumers receive advertising. This could also potentially provide an incentive for consumers to credibly disclose to what extent they are searching for information.

As shown previously, the firm advertises more, and the consumer ends up spending more time receiving advertising after purchase, if the profit for the firm of a sale, v , is greater (Figure 7). Also as expected, and as illustrated in Figure 8, as the rate of receiving information without advertising increases, the firm advertises less, and the consumer spends less time receiving advertising after purchase. As illustrated in Figure 9, and as expected, when the rate at which the consumer receives information when being advertised to (\hat{p}) increases, the firm is interested in advertising

Figure 3. (Color online) Evolution of \hat{x} and the Maximum Time Receiving Advertising Without Search, \hat{T} , as a Function of c for $v = 2, p = .4, \hat{p} = 1, q = .1, \phi = .5, \hat{\phi} = .8$, and $\psi = .1$



more for the same beliefs (\hat{x} is decreasing in \hat{p}). More interestingly, when \hat{p} increases, the length of time for which a consumer continues to receive advertising after a purchase (\hat{T}) first increases and then decreases. It increases for low \hat{p} because the firm now wants to advertise more. It decreases for high \hat{p} because in that case the firm updates more quickly that the consumer may not be in the searching for information state, and so it reaches the belief \hat{x} faster.

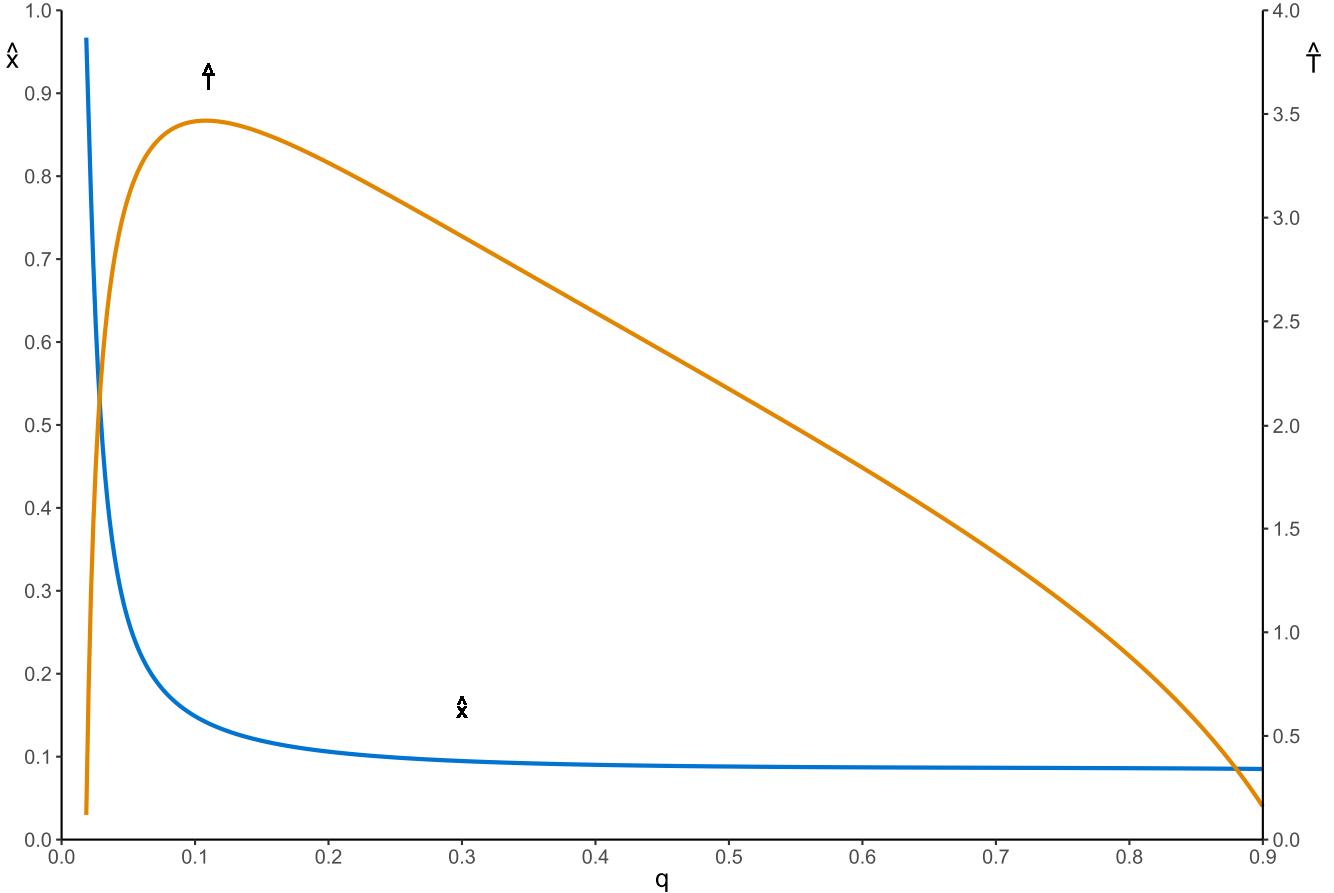
Finally, as illustrated in Figure 10, when the exogenous rate of the consumer dropping out of the search process, ψ , increases, and ψ is small, the firm wants to advertise more (\hat{x} is decreasing in ψ), as it wants to take advantage of the consumer searching for information. For some parameter values, as noted previously (e.g., if the signal informativeness q is low enough), we can have \hat{x} increasing in ψ for large ψ , as the potential benefits of advertising are now weaker (the case with solid lines in Figure 10). More interestingly, when ψ increases, the length of time for which a consumer continues to receive advertising after a purchase (\hat{T}) first increases and then decreases. It increases for low ψ because the firm now wants to advertise more. It decreases for high ψ because the

firm's beliefs that the consumer is searching now fall more steeply, which yields \hat{T} to fall.

The optimal policy accounts for the future effects of what the firm learns based on whether it advertises. It is interesting to compare this with the optimal policy if the firm were myopic. This myopic policy would be to advertise if the expected current benefit of advertising, $(\hat{p} - p)\frac{q}{2}v x_t dt$, is greater than the cost of advertising, $c dt$. This would give a threshold of belief on searching of $x_m = \frac{2c}{vq(\hat{p}-p)}$. Neither the ability of the firm to track whether consumers are searching for information, represented by $\hat{\phi}$ and ϕ , nor the exogenous rate of the consumer dropping out of the search process, ψ , affects the optimal myopic policy, as the benefits of the ability to track consumers and the loss of the consumer dropping out of the search process occur in the future.

Comparing the myopic policy with the optimal dynamic policy for the case of small c , one can get that it could be larger or smaller. In fact, the optimal dynamic policy is to advertise more than in the myopic policy if the product of the likelihood of tracking consumer search and the probability of the consumer receiving signals is high enough with retargeting,

Figure 4. (Color online) Evolution of \hat{x} and the Maximum Time Receiving Advertising Without Search, \hat{T} , as a Function of q for $v = 2, p = .4, \hat{p} = 1, c = .01, \phi = .5, \hat{\phi} = .8$, and $\psi = .1$



($\hat{p}\phi - p\phi$) high enough, and the probability of the consumer exogenously dropping out of the search process, ψ , is high enough.

The future benefits of retargeting are greater if the product of the likelihood of tracking consumer search and the probability of the consumer receiving signals is high enough, and therefore, that makes the optimal dynamic retargeting policy to be to advertise in a larger region of the belief space. This is possible even if the likelihood of tracking consumer search is the same with retargeting and without retargeting. Interestingly, the future effects of retargeting now are also not too large if the probability of the consumer exogenously dropping out of the search process is too low, because then the firm might as well wait for the consumer to find out about the product fit without retargeting. Therefore, the probability of the consumer exogenously dropping out of the search process needs to be high enough for the optimal dynamic retargeting policy to prescribe a greater region of the belief space for advertising than the myopic policy.

The myopic policy can prescribe a greater region of the belief space than the optimal dynamic policy,

because it does not account for the fact that even without advertising the consumer may find out in the future that the product is a good fit and purchase the product. Therefore, once the future potential payoffs are accounted for, it may be optimal for the dynamic policy to prescribe less advertising than the myopic policy.

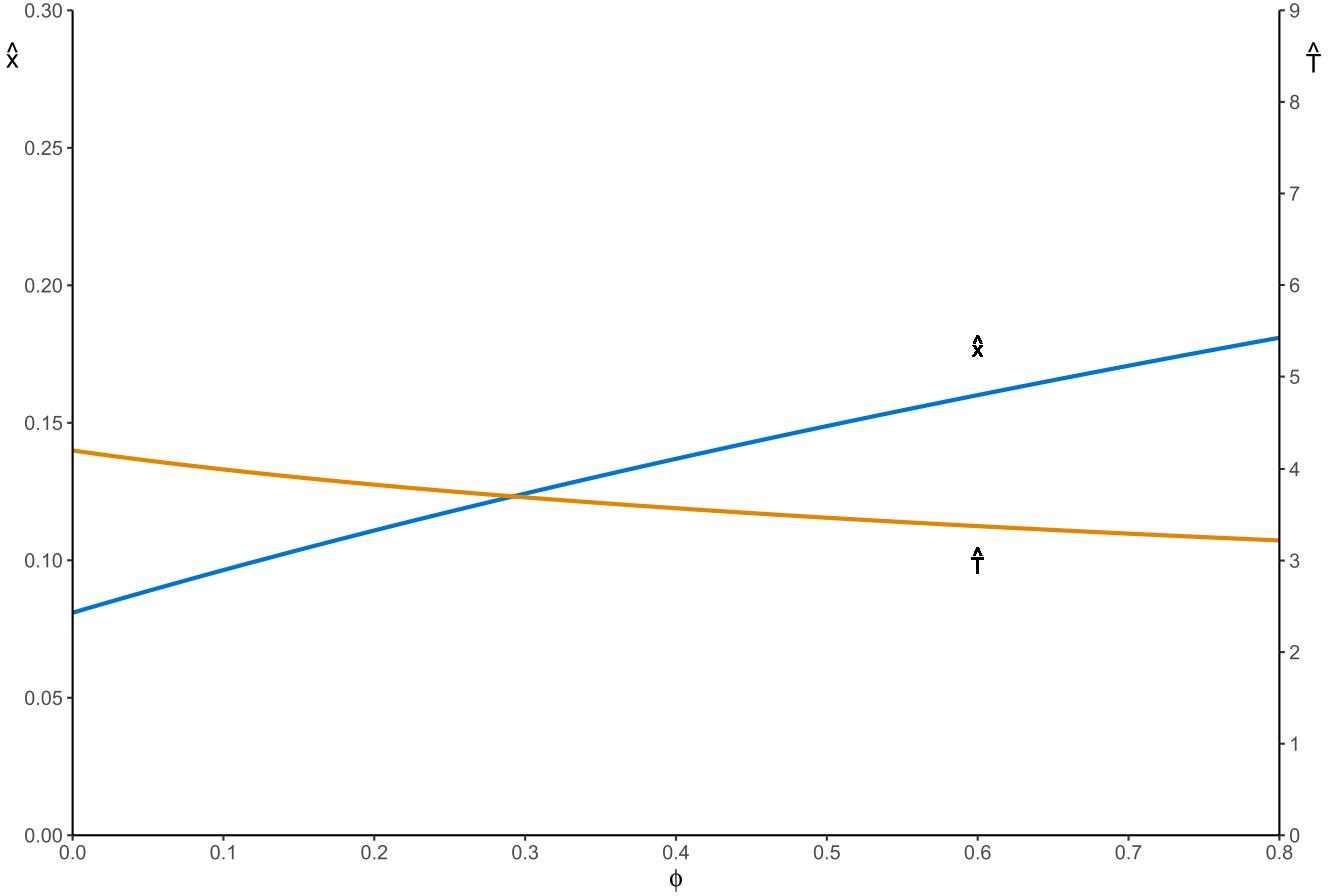
We summarize these results in the following proposition.

Proposition 5. *The optimal retargeting policy prescribes advertising for lower beliefs of consumer searching than the myopic policy if the effect of advertising is relatively high on the interaction of the likelihood of tracking consumer search and the probability of the consumer receiving signals (high $\hat{p}\phi - p\phi$) and the probability of the consumer exogenously dropping out of the search process is not too low (ψ not too low).¹⁶*

4. The Value of Retargeting

It is also interesting to evaluate the value for the firm of having the possibility of doing retargeting. This can be seen as the amount a firm is willing to invest to have the possibility of doing retargeting. In evaluating a policy

Figure 5. (Color online) Evolution of \hat{x} and the Maximum Time Receiving Advertising Without Search, \hat{T} , as a Function of ϕ for $v = 2, p = .4, \hat{p} = 1, c = .01, q = .1, \hat{\phi} = .8$, and $\psi = .1$



of making retargeting unlawful, this is the payoff for the firm that is lost. The payoff for the consumer is evaluated in Section 5.3.

Consider this value of retargeting evaluated at a time when the firm observes a consumer searching for information. The belief that the consumer is searching for information is then $(1 - q)$ at that time. The expected present value of profits with retargeting at that moment is then $\hat{V}(1 - q)$, which can be obtained from (7) as $\hat{V}(1 - q) = -\frac{qv}{\phi} - CB$, given that $V(0) = 0$.

The maximum expected present value of profits with the possibility of retargeting can be obtained with $c \rightarrow 0$, which can be obtained to be

$$\lim_{c \rightarrow 0} \frac{\hat{p}q(1-q)v}{2(\psi + \hat{p}q)}. \quad (13)$$

This limit is independent of ϕ and $\hat{\phi}$ as with $c \rightarrow 0$; the firm is retargeting forever in the limit, which means that the likelihood of the firm observing the consumer searching for information becomes irrelevant. This is not to mean that the expected present value of profits with the possibility of retargeting does not depend on

ϕ or $\hat{\phi}$ for $c > 0$. In fact, this expected present value of profits has a component that depends on ϕ and $\hat{\phi}$ for $c > 0$, but that component goes to zero as c approaches zero.

To obtain the value of retargeting, we have to still compute the expected present value of profits when there is no possibility of retargeting and the belief that the consumer is searching for information is $(1 - q)$, which can be obtained to be $\bar{V}(1 - q) = \frac{qv(1-q)v}{2(\psi + \hat{p}q)}$.

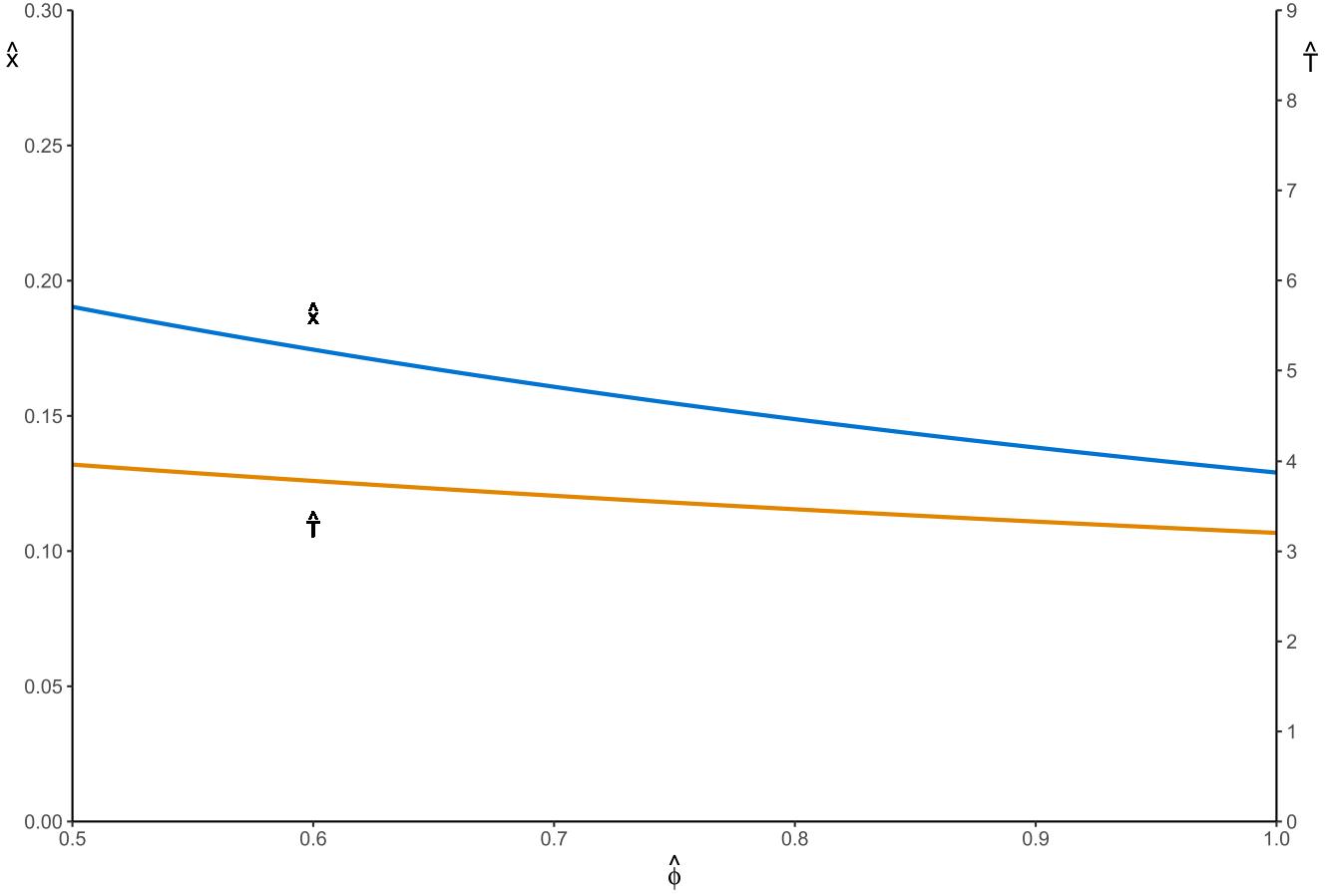
We can then obtain the value of retargeting when $c \rightarrow 0$ to be

$$\lim_{c \rightarrow 0} \hat{V}(1 - q) - \bar{V}(1 - q) = \frac{q(1-q)v\psi(\hat{p} - p)}{2(\psi + \hat{p}q)(\psi + pq)}. \quad (14)$$

This yields the following comparative statics.

Proposition 6. Suppose that the cost of retargeting is small. Then the value of retargeting is increasing in the propensity for the consumer to receive signals with retargeting, \hat{p} , the profit earned if the consumer purchases the product, v , the likelihood of the firm observing that the consumer is searching when retargeting, $\hat{\phi}$, decreasing in the propensity of the consumer to receive signals without retargeting, p , and the

Figure 6. (Color online) Evolution of \hat{x} and the Maximum Time Receiving Advertising Without Search, \hat{T} , as a Function of $\hat{\phi}$ for $v = 2, p = .4, \hat{p} = 1, c = .01, q = .1, \phi = .5$, and $\psi = .1$



likelihood of the firm observing that the consumer is searching when not retargeting, $\hat{\phi}$. When $\hat{\phi} = \phi$, the value of retargeting is increasing in ϕ . The value of retargeting is increasing (decreasing) in the likelihood of the consumer receiving an informative signal given that he receives a signal, q , for $q < (>) q^*$ for a $q^* \in (0, 1/2)$, and in the likelihood of the consumer deciding to stop searching exogenously, ψ , for small $\psi < (>) \hat{p}q$.

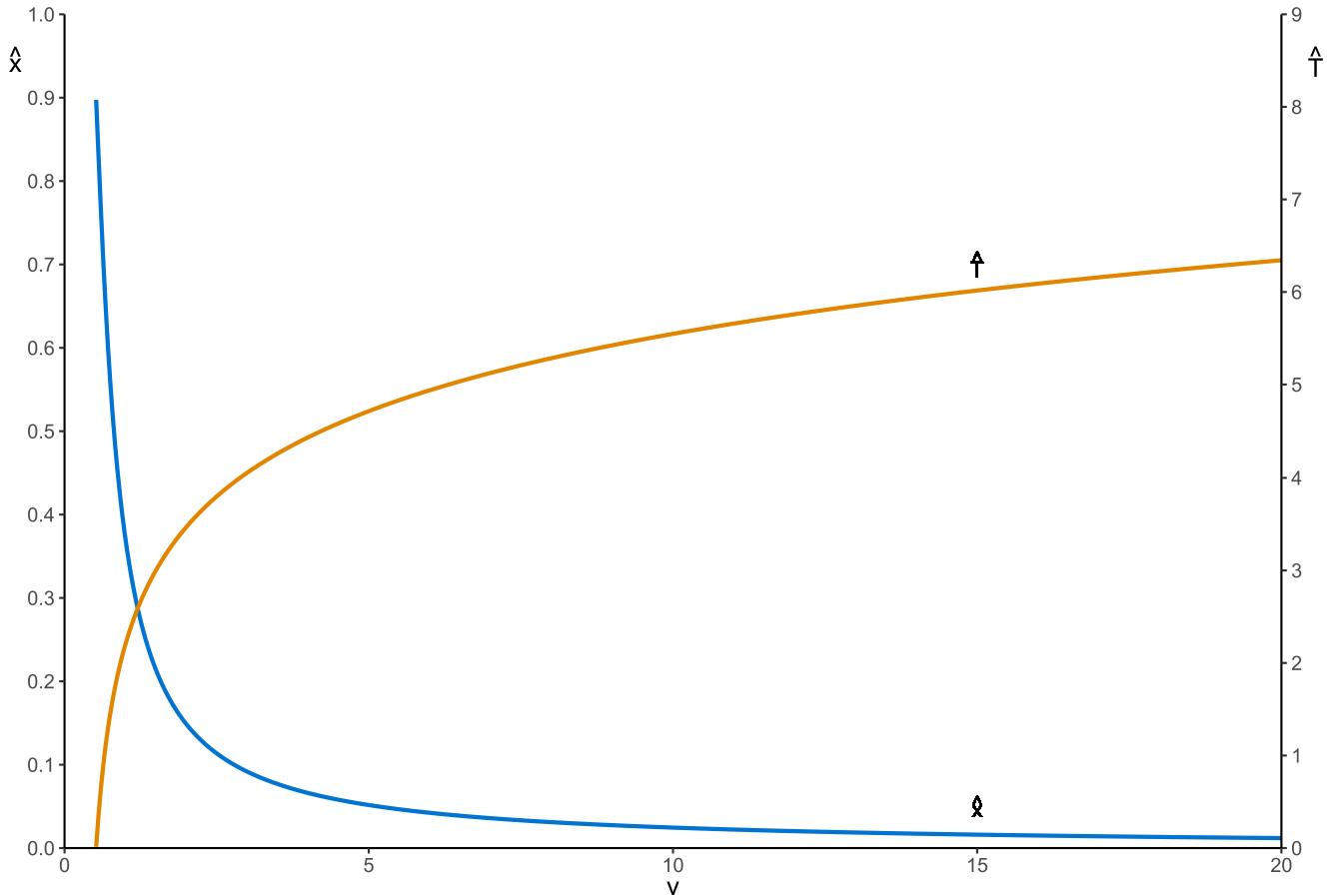
The more interesting comparative statics are the ones on the probability of the consumer receiving an informative signal given that he receives a signal, q , and on the likelihood of the consumer deciding to stop searching exogenously, ψ . As discussed previously, when the probability of receiving an informative signal is close to zero, there is not much gain in retargeting, as the consumer is not likely to receive an informative signal. At the same time, if the probability of receiving an informative signal is close to one, there is also not much of a benefit in retargeting, as when the firm observes the consumer searching for information, the consumer most likely also received a fully informative signal. The proposition shows that the value for retargeting is the highest for an intermediate value of q , which is less than $1/2$.

Also as discussed previously, if the likelihood of the consumer deciding to stop searching exogenously is close to zero, there is not much gain in retargeting, as the consumer will end up receiving a fully informative signal even if the consumer is not being retargeted to. At the same time, if the likelihood of the consumer deciding to stop searching exogenously is very high, there is not much gain in retargeting as the consumer is likely to stop searching before receiving a fully informative signal, even when being retargeted to. We find that the ψ that maximizes the value of retargeting is $\psi = \hat{p}q$.

This value of retargeting is not the cost of retargeting c such that the firm chooses not to do any retargeting. That threshold cost of retargeting is presented in (A.3) in the appendix. The greater the c , the less retargeting that the firms do, and the lower the value of retargeting.

One could also ask what is the value of information for the firm of learning for sure if a consumer is or is not searching for information. If a consumer is searching for information for sure, the expected presented value of profits is $\hat{V}(1)$. If a consumer is not searching for information for sure, the expected value of profits is $V(0) = 0$. The value of perfect information is then

Figure 7. (Color online) Evolution of \hat{x} and the Maximum Time Receiving Advertising Without Search, \hat{T} , as a Function of v for $\phi = .5, p = .4, \bar{p} = 1, c = .01, q = .1, \hat{\phi} = .8$, and $\psi = .1$



$x\hat{V}(1) - \hat{V}(x)$, which is positive as $\hat{V}(x)$ is strictly convex for $x > \hat{x}$.¹⁷ Given the convexity of the value function, we have $\hat{V}(1) - \hat{V}'(1) < 0$ and $\hat{V}(1) > V'(0) = \hat{V}'(\hat{x})$, which means that the value of perfect information is maximized at some $x^* \in (\hat{x}, 1)$. That is, as time passes since the firm knows for sure that the consumer is searching for information, the value of perfect information for the firm first increases, until the belief reaches x^* , and then decreases. We can also get that, for $c \rightarrow 0$, we have $V(1) < \hat{V}'(1 - q)$ such that $x^* \in (\hat{x}, 1 - q)$. That is, as time passes since the firm actually observes the consumer searching for information, the value of perfect information for the firm first increases and then decreases.

5. Model Extensions

This section considers several model extensions, including the possibility of the effect of retargeting on the quality of the signals, the possibility of the firm recognizing when purchases occur, and the possibility of the consumer being forward-looking with respect to the firm's retargeting strategy.

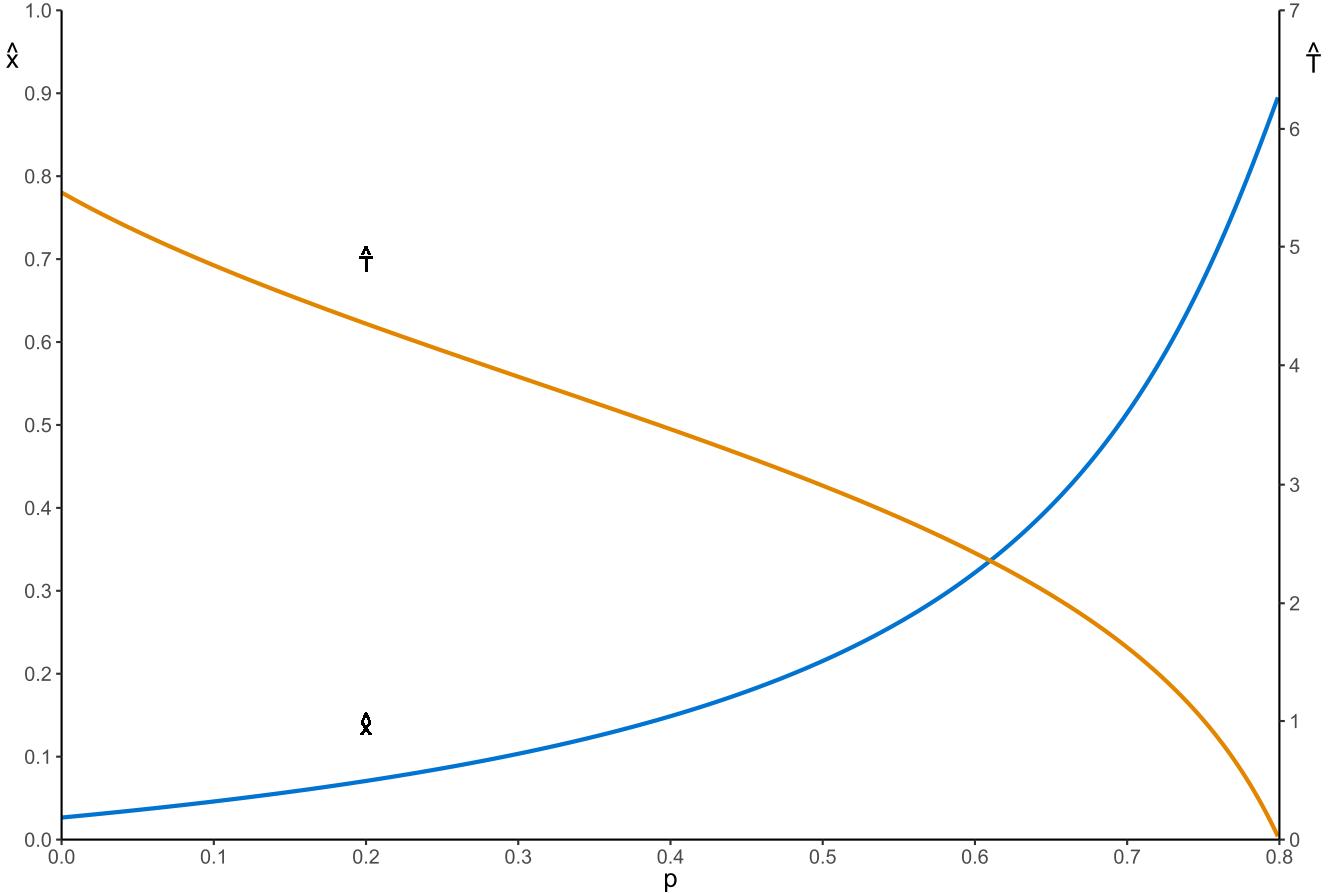
5.1. Retargeting and Quality of Signals

In this section we consider the possibility that retargeting may not only increase the hazard rate of information received by the consumers and the likelihood of the firm observing when the consumers receive a signal but can increase the likelihood of the consumers receiving a fully informative signal conditional on receiving a signal, q , as well. For example, this could be because the retargeting of the firm could be more informative than the usual consumer information sources. In terms of the previous model, this would mean that the parameter q would be greater when the firm is retargeting, $\hat{q} > q$.

In terms of the previous analysis, considering this case could be done by replacing q with \hat{q} in (9), with $\hat{B} = \hat{p}\hat{\phi} + \psi + \hat{p}\hat{q}(1 - \hat{\phi})$. The analysis would then lead to obtaining \hat{x} implicitly by (A.25), which is presented in the appendix.

We can obtain that, even when retargeting does not lead to a greater hazard rate of the consumer receiving signals, $\hat{p} = p$, it is still optimal for the firm to do

Figure 8. (Color online) Evolution of \hat{x} and the Maximum Time Receiving Advertising Without Search, \hat{T} , as a Function of p for $\phi = .5, v = 2, \bar{p} = 1, c = .01, q = .1, \hat{\phi} = .8$, and $\psi = .1$



retargeting with $\hat{q} > q$. That is, the ability by itself to get the consumers to receive more informative signals with retargeting leads retargeting to be optimal. In that case, by doing retargeting, the firm accelerates the possibility of the consumer purchasing the product before the consumers drops exogenously out of the search process.

When the costs of retargeting approach zero we can obtain a measure of the ratio \hat{x}/c as

$$\lim_{c \rightarrow 0} \frac{\hat{x}}{c} = 2\hat{\phi} \frac{\hat{p}\hat{q} + \psi}{v \left\{ \psi\hat{\phi}(\hat{p}\hat{q} - pq) + p\hat{p}\hat{q} \left[\phi(1-\hat{\phi})\hat{q} - \hat{\phi}(1-\phi)q \right] \right\}} \times \frac{p\phi + \psi + pq(1-\phi)}{\hat{p}\hat{q} + \psi + \hat{p}\hat{q}(1-\hat{\phi})}. \quad (15)$$

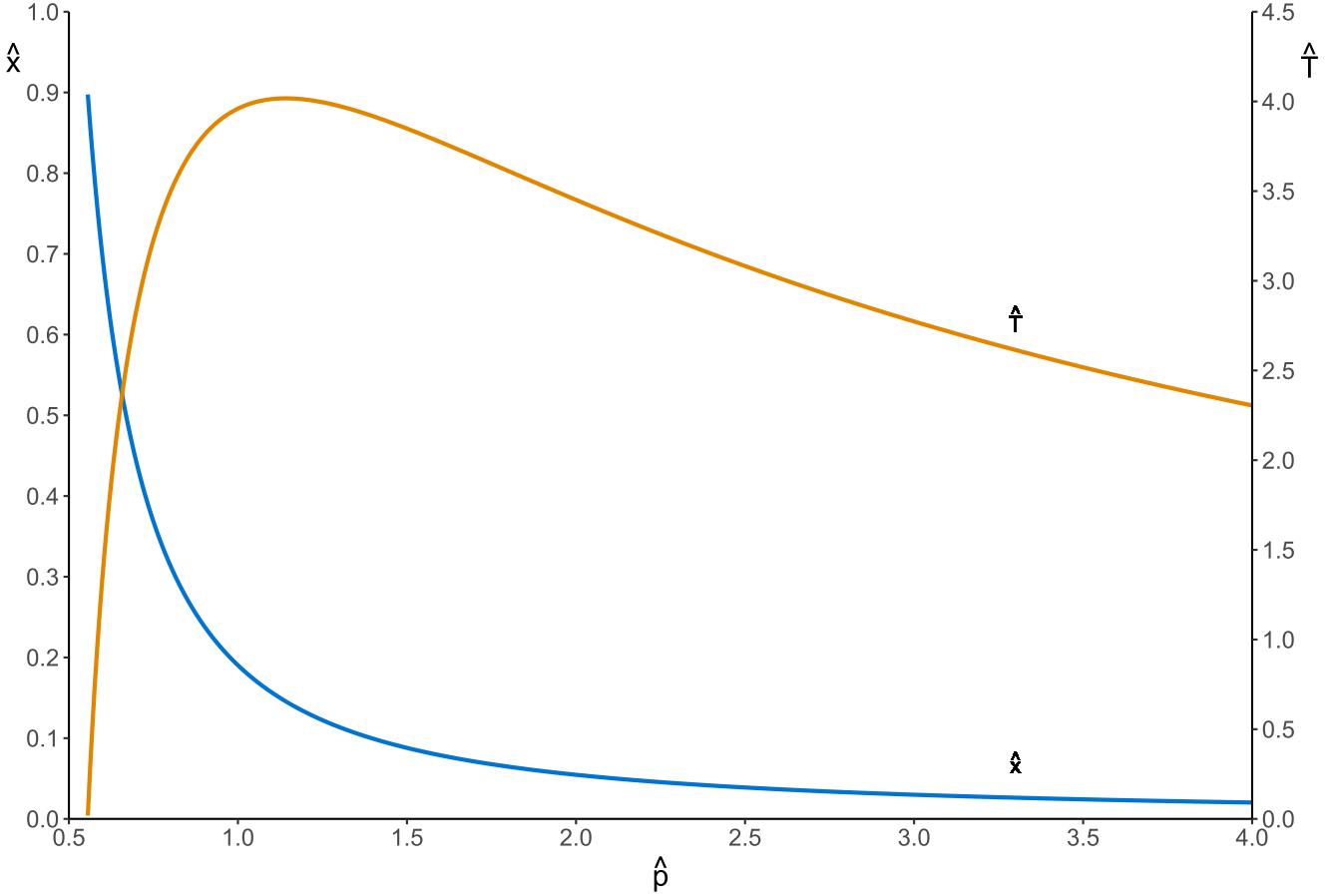
From this, we can obtain that a greater informativeness of signals during retargeting leads to greater retargeting. That is, the firm prefers to increase the region of beliefs where retargeting occurs if it leads to greater signal informativeness, because of the acceleration in consumers deciding whether to purchase the product.

5.2. Recognizing Purchases

In the previous sections, it was assumed that the seller does not know when the consumer makes the purchase, and therefore, we have that the firm may continue to advertise even after a purchase. With improvements in tracking technologies, firms might have the ability to detect when consumers purchase the product and therefore do not send further retargeting advertising. This section considers this case and compares the optimal strategy with the case in Section 3 in which the seller does not detect consumer purchases. We consider the case in which if the consumer receives a positive informative signal the consumer always purchases the product.¹⁸

In this case, if a firm observes a consumer search for information (which happens with probability $p\phi dt$ when not advertising given that the consumer is searching for information), with probability $q/2$ the firm sees the consumer purchase the product. After observing the consumer search for information and not observing any purchase, the posterior belief that the consumer is still searching for information is $(1 - \frac{q}{2-q})$, as the probability of no purchase given

Figure 9. (Color online) Evolution of \hat{x} and the Maximum Time Receiving Advertising Without Search, \hat{T} , as a Function of \hat{p} for $\phi = .5, v = 2, p = .4, c = .01, q = .1, \hat{\phi} = .8$, and $\psi = .1$



search is $(1 - q/2)$, and the probability of continuing to search for information given that a signal was received is $(1 - q)$.

The belief updating when the firm does not observe the consumer searching for information is also now different because the firm observes a product purchase which occurs with probability $p(1 - \phi)\frac{q}{2}x_t dt$, if the firm does not observe consumer search, and given that the consumer is searching for information. As in Section 3, the beliefs at time t have to be consistent with what can occur in the future. As in Section 3, the beliefs are again a supermartingale, falling in expected value by $(\psi + pq)x_t dt$ in period dt , and we can obtain

$$\begin{aligned} x_t &= \left(x_t + \frac{dx}{dt} dt \right) \left[1 - \phi p x_t dt - (1 - \phi) \frac{q}{2} p x_t dt \right] \\ &\quad + \phi \left(1 - \frac{q}{2} \right) \left(1 - \frac{q}{2 - q} \right) p x_t dt + \psi x_t dt \\ &\quad + q p x_t dt. \end{aligned} \quad (16)$$

We can then obtain that (2) changes in this case to

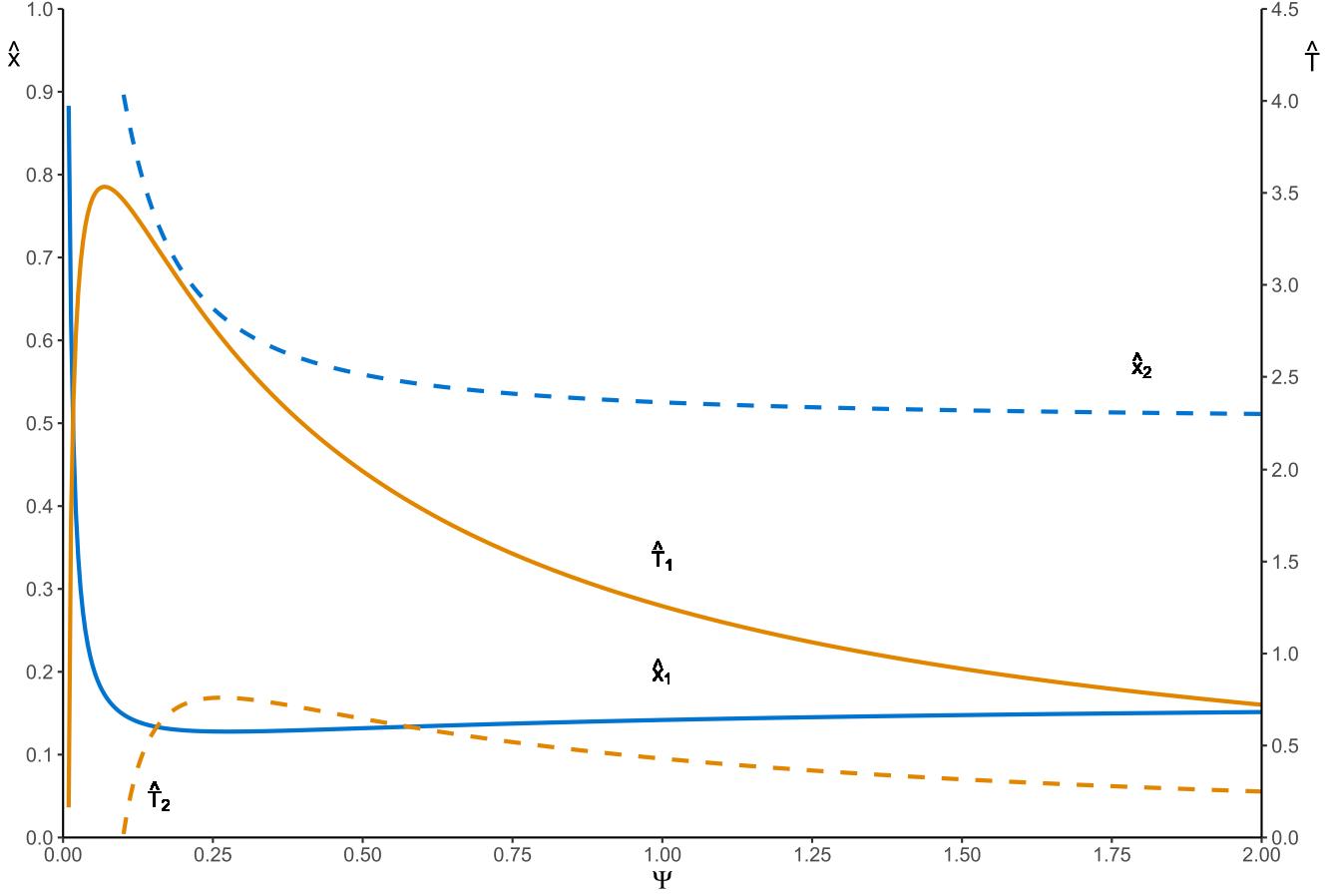
$$\begin{aligned} \frac{dx_t}{dt} &= -p \left[\phi + (1 - \phi) \frac{q}{2} \right] x_t (1 - x_t) - \psi x_t - p \\ &\quad \times (1 - \phi) \frac{q}{2} x_t. \end{aligned} \quad (17)$$

Let \tilde{x} be the threshold belief of the firm such that the firm only advertises for $x > \tilde{x}$. With similar analysis as in Section 3, we can obtain that, when the firm is not advertising, $x < \tilde{x}$, the present value of profits of the firm can be obtained as

$$\begin{aligned} \tilde{V}(x) &= \tilde{C}[B - Ax] \\ &\quad + \frac{qv/2 + \phi(1 - q/2)\tilde{V}\left(1 - \frac{q}{2-q}\right)}{\phi + (1 - \phi)q/2}, \end{aligned} \quad (18)$$

where $A = p(\phi + (1 - \phi)\frac{q}{2})$, \tilde{C} is a constant to be determined later, and B is, as defined previously, $B = p\phi + p(1 - \phi)q + \psi$.

Figure 10. (Color online) Evolution of \hat{x} and the Maximum Time Receiving Advertising Without Search, \hat{T} , as a Function of ψ for $\phi = .5$, $\hat{\phi} = .8$, $v = 2$, $\hat{p} = 1$, $c = .01$, and $q = .1$



Note. The solid lines have $p = .4$, and the dashed lines have $p = .8$.

For the region of beliefs where the firm advertises, $x > \tilde{x}$, we can obtain, along the same lines as in Section 3, the present value of profits as

$$\begin{aligned} \tilde{V}(x) &= \tilde{C}[\tilde{B} - \tilde{A}x] + c \frac{\tilde{B} - \tilde{A}x}{\tilde{B}^2} \log \frac{\tilde{B} - \tilde{A}x}{x} - \frac{c}{\tilde{B}} \\ &\quad + \frac{qv/2 + \hat{\phi}(1 - q/2)\tilde{V}\left(1 - \frac{q}{2-q}\right)}{\hat{\phi} + (1 - \hat{\phi})q/2}, \end{aligned} \quad (19)$$

where $\tilde{A} = \hat{p}[\hat{\phi} + (1 - \hat{\phi})q/2]$, \tilde{C} is a constant to be determined, and \tilde{B} is, as defined previously, $\tilde{B} = \hat{p}\hat{\phi} + \hat{p}(1 - \hat{\phi})q + \psi$. With the conditions $\tilde{V}(0) = 0$, $\tilde{V}(\tilde{x}) = \tilde{V}(\hat{x})$, and $\tilde{V}'(\tilde{x}) = \tilde{V}'(\hat{x})$, and evaluating (19) at $x = 1 - \frac{q}{2-q}$, one can obtain the value of \tilde{x} and of the constants \tilde{C} and \tilde{B} . The optimal \tilde{x} is determined implicitly by (A.35), presented in the appendix.

For $c \rightarrow 0$, we can obtain $\tilde{x} \rightarrow 0$, $\tilde{x} < \hat{x}$ and that $\frac{\tilde{x}}{c}$ converges to

$$\begin{aligned} \lim_{c \rightarrow 0} \frac{\tilde{x}}{c} &= 2 \frac{\hat{p}q + \psi p\phi + \psi + pq(1 - \phi)}{qv} \frac{\hat{p}\hat{\phi} + \psi + \hat{p}q(1 - \hat{\phi})}{\hat{\phi}(2 - q) + q} \\ &\quad \times \frac{\hat{\phi}(2 - q) + q}{\psi[(2 - q)(\hat{p}\hat{\phi} - p\phi) + q(\hat{p} - p)] + qp\hat{p}(\hat{\phi} - \phi)}. \end{aligned} \quad (20)$$

Proposition 7. When the firm is able to recognize purchases when they occur, and the costs of doing retargeting are small, the firm has a threshold of beliefs that the consumer is searching for information to do retargeting, which is lower than the threshold in the case in which the firm does not recognize purchases immediately.

In the case of recognizing purchases, the firm knows that if the firm waits longer without doing retargeting, the firm may learn that retargeting is not

needed because the consumer purchased the product. On the other hand, when doing retargeting, the firm knows when the consumer made a purchase, and retargeting is no longer needed. It turns out that, when the costs of doing retargeting are small, the latter effect dominates, and the threshold belief to do retargeting is lower when purchases are recognized. That is, the region of beliefs for which the firm does retargeting is greater when the firm recognizes purchases than when the firm does not recognize purchases. We could not find parameter values for which this result did not hold.

Figures 11–15 illustrate how \hat{x} and \tilde{x} evolve for the different parameters for the case of $c > 0$, showing that for the parameters considered we always have $\hat{x} > \tilde{x}$.

It is also interesting to evaluate how the beliefs evolve in this case where purchases are recognized and compare them with the case above when purchases are not recognized. In this case of purchases being recognized, we can obtain that the beliefs that the consumer is searching for information as a function of

time, because the time at which the firm recognizes that the consumer is actually searching for information, as

$$x_t = \frac{2(1-q)\widehat{B}}{\widehat{p}(1-q)[\widehat{\phi}(2-q) + q] + [\psi(2-q) + \widehat{p}q]e^{\widehat{B}t}}. \quad (21)$$

Comparing this with the previous case when purchases are not recognized, one can obtain that, without further information, the beliefs while the firm does retargeting without purchase recognition are always below the beliefs under purchase recognition. However, as in the case with purchase recognition the firm does retargeting for longer (as discussed later), we have that in the case with purchase recognition, the beliefs can at some point be lower in the retargeting phase than the lowest possible beliefs in the case without purchase recognition in the retargeting phase (\tilde{x}). Figure 16 illustrates how the beliefs evolve over time under the two different conditions.

As in Section 3, in this case when purchases are recognized, we can also compute the maximum amount of time that a consumer could be retargeted after being

Figure 11. (Color online) Evolution of \hat{x} and \tilde{x} as a Function of q for $c = .01, v = 2, p = .4, \widehat{p} = 1, \phi = .5, \widehat{\phi} = .8$, and $\psi = .1$

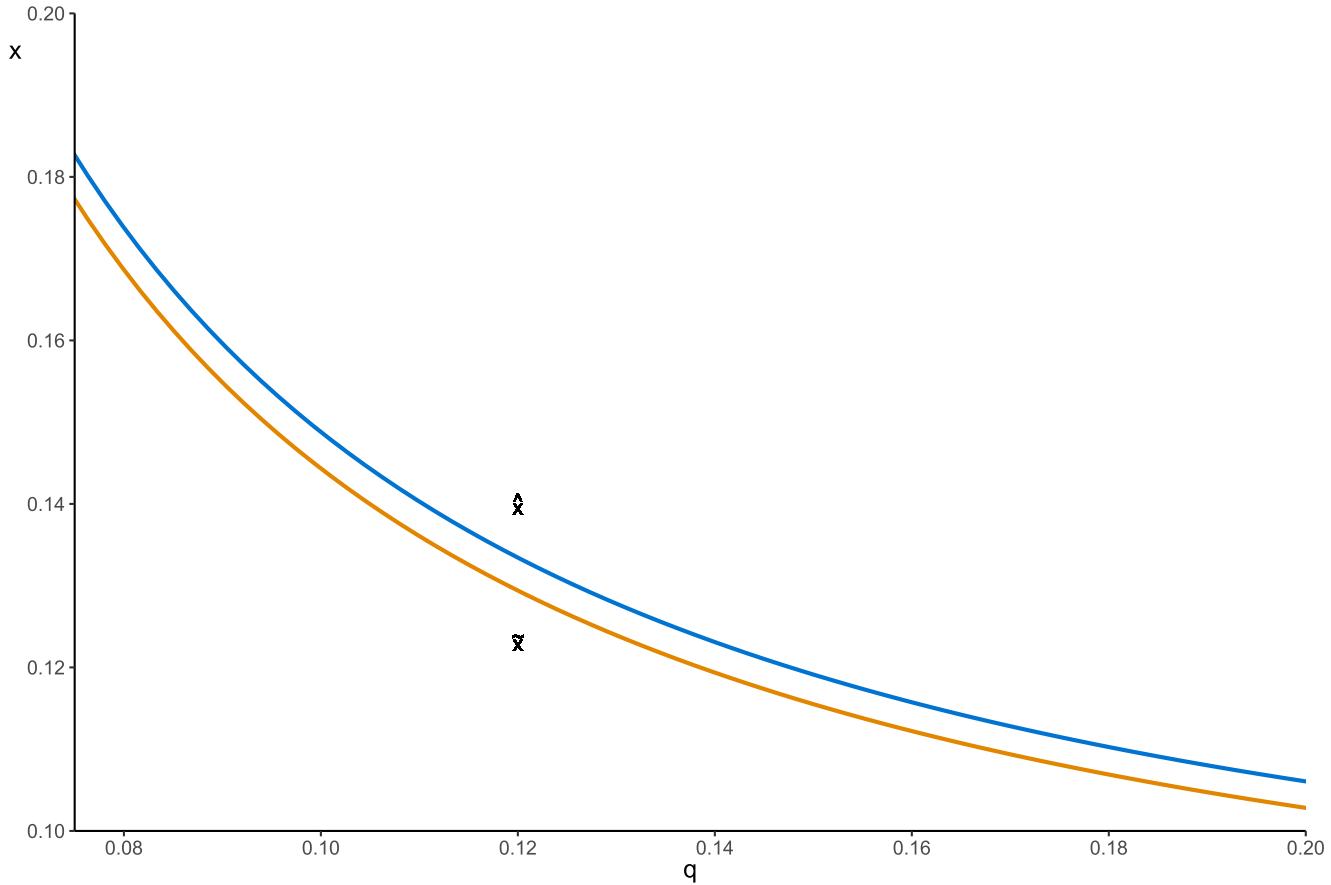
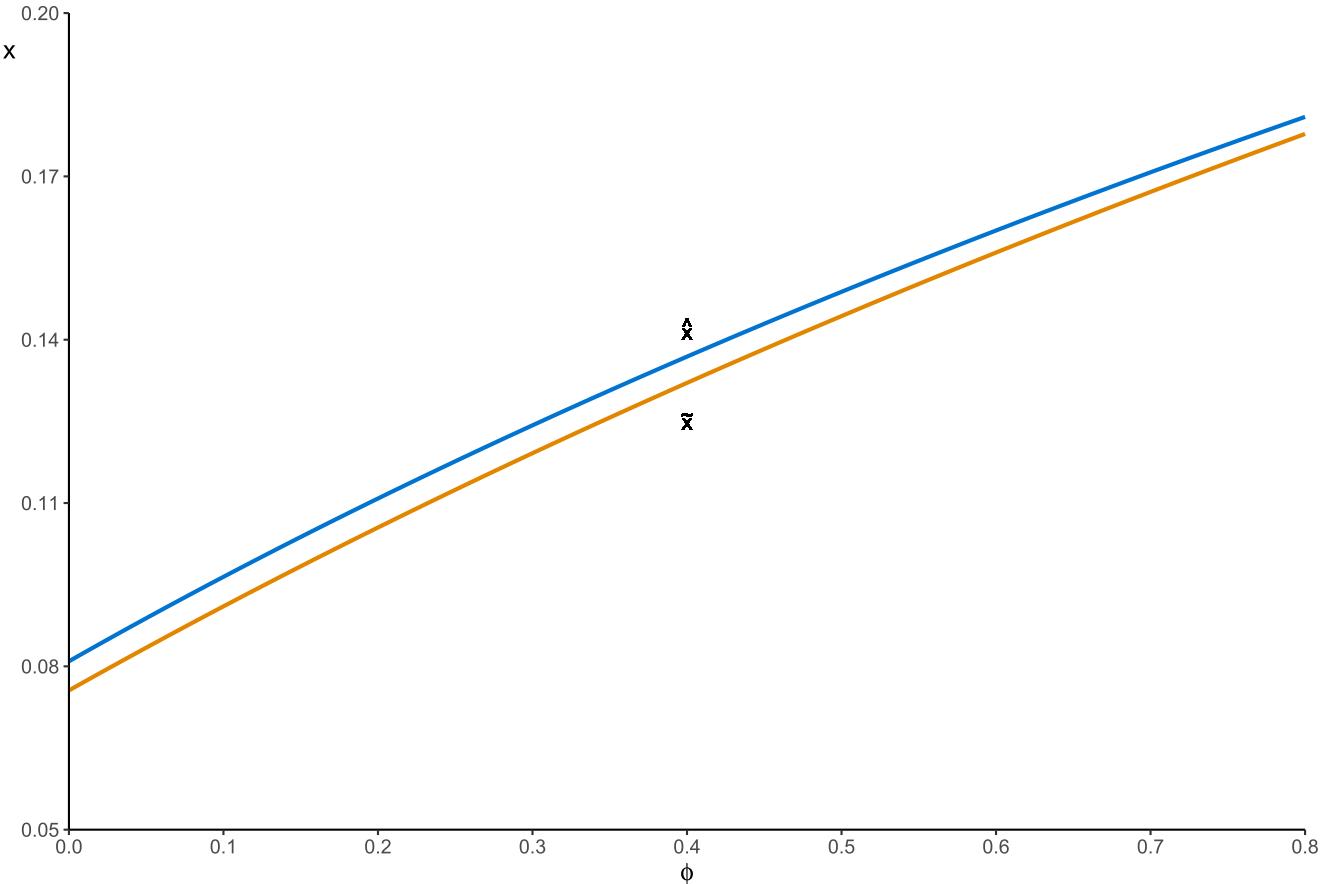


Figure 12. (Color online) Evolution of \hat{x} and \tilde{x} as a Function of ϕ for $c = .01, v = 2, p = .4, \hat{p} = 1, q = .1, \hat{\phi} = .8$, and $\psi = .1$



identified as searching for information, which we can denote as \tilde{T} , and is presented in the appendix. For c close to zero, one can obtain that this length of time is greater than the maximum amount of time of retargeting in the case when purchases are not recognized. Recognizing purchases makes the extent of time that a consumer can receive retargeting without being in the state of search for information to be greater. This is because the firm now has a greater belief that the consumer is still searching for information because the firm would observe whether a purchase had occurred.

5.3. Forward-Looking Consumers

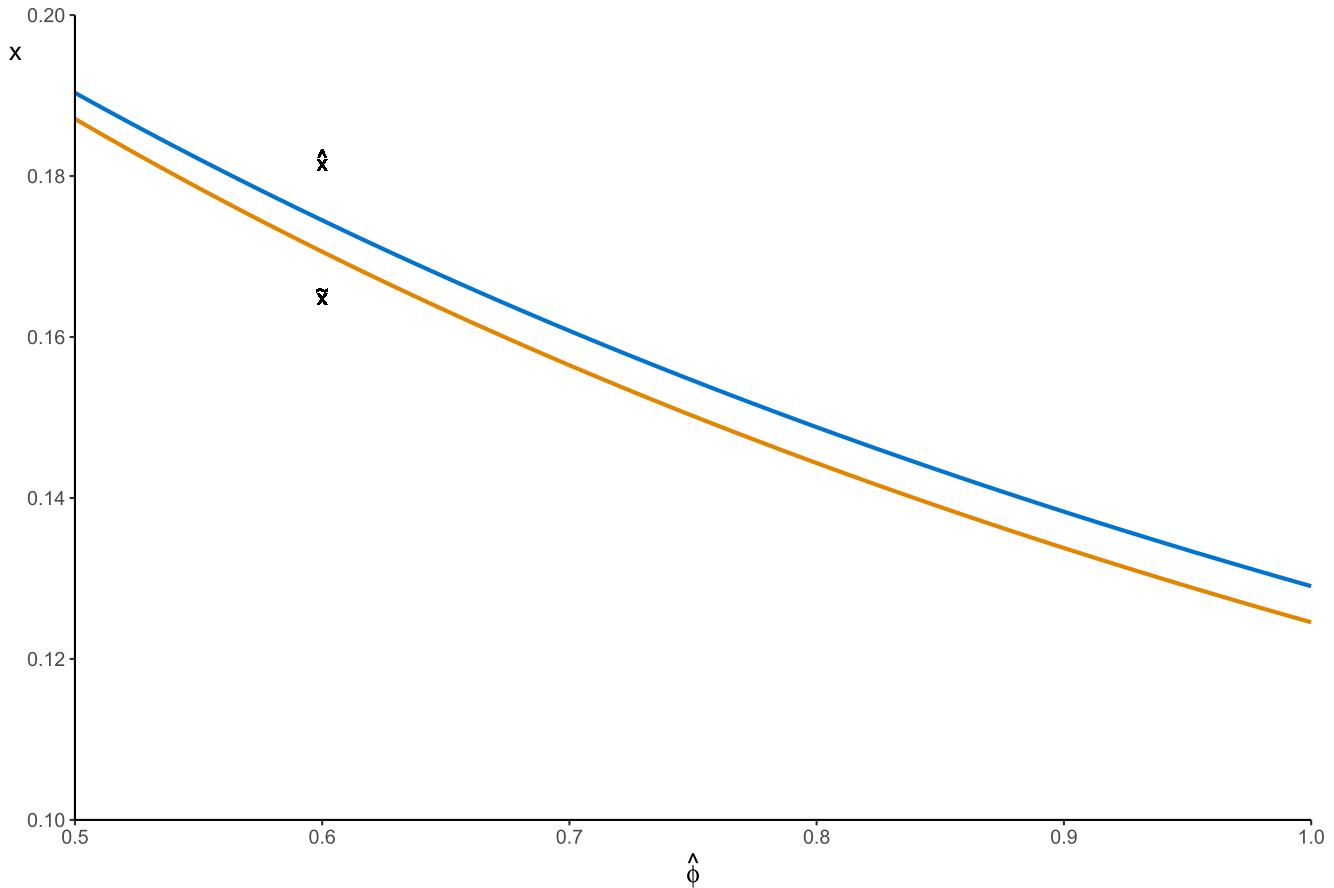
The analysis in the previous sections considered that the consumers were not aware that, if they were observed searching for information, they would receive advertising later. Consider now the case of forward-looking consumers, where consumers are now aware that if they are observed searching for information, they will receive retargeting advertising that will provide more information about the product fit. Suppose that consumers are infinitely patient, but given that the consumer also knows that with hazard rate ψ , he will switch from a state of having a potential positive benefit for the product to a state in which he

has zero benefit of the product forever, the consumer has bounded benefit of having the product. The existence of hazard rate ψ works as discounting on the consumer benefits. This possibility of retargeting, given the assumed no hassle costs of receiving advertising, makes then the consumer more willing to search for information than in the case of myopic consumers, potentially allowing the firm to increase its price. To focus on the critical market forces, and simplify the analysis, let us also assume that the consumer knows when retargeting is occurring.

To analyze this situation, let W_n be the expected present value of benefits for the consumer when the firm is not retargeting, and let $W(t)$ be the expected present value of benefits for the consumer when the firm has been retargeting for a t period of time. From Section 3, we also have the maximum extent of time that a consumer is retargeted to without purchase as a function of v as \tilde{T} . The expected payoff for the consumer when searching for information without being retargeted to can be derived as

$$W_n = \frac{q}{2} S(P) p dt - \varepsilon dt + (1 - B dt) W_n + \phi (1 - q) \times W(0) p dt. \quad (22)$$

Figure 13. (Color online) Evolution of \hat{x} and \tilde{x} as a Function of $\hat{\phi}$ for $c = .01, v = 2, p = .4, \hat{p} = 1, q = .1, \phi = .5$, and $\psi = .1$



To obtain (22), with probability $\frac{q}{2} p dt$, the consumer gets an expected consumer surplus $S(P)$, and during the period dt , the consumer pays search costs εdt . Furthermore, with probability $(1 - B dt)$ the consumer does not get any full informative signal or drop exogenously out of the search process, nor does the firm observe the consumer searching for information; in this case, the consumer gets the expected present value of benefits when the firm is not retargeting, W_n .¹⁹ Finally, with probability $\phi(1 - q)p dt$, the firm observes the consumer searching for information, but the consumer does not receive a fully informative signal, and in that case, the consumer gets the expected present value of benefits when the firm is just starting the retargeting phase, $W(0)$.

From (22) one can obtain

$$BW_n = \frac{q}{2} p S(P) - \varepsilon + \phi(1 - q)p W(0). \quad (23)$$

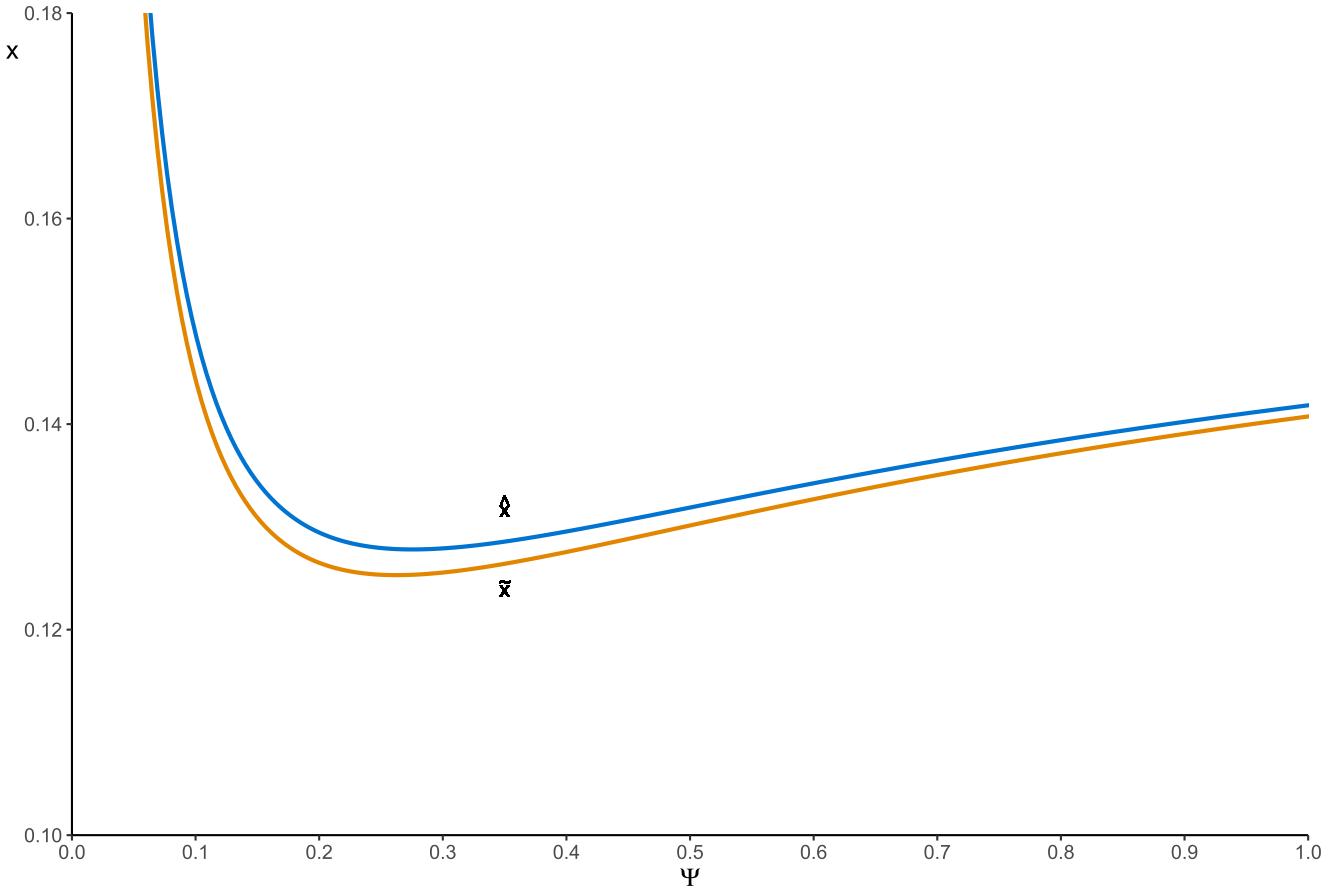
Similarly, if the consumer is searching for information and is being retargeted to for a t period of time,

we can now derive his expected present value of payoffs as

$$\begin{aligned} W(t) = & \frac{q}{2} S(P) \hat{p} dt - \varepsilon dt + [1 - \hat{B} dt] [W(t) \\ & + W'(t) dt] + \hat{\phi}(1 - q) W(0) \hat{p} dt. \end{aligned} \quad (24)$$

To obtain (24), with probability $\frac{q}{2} \hat{p} dt$, the consumer gets an expected consumer surplus $S(P)$, and during the period dt , the consumer pays search costs εdt . Furthermore, with probability $(1 - \hat{B} dt)$, the consumer neither gets any full informative signal nor drops exogenously out of the search process, and the firm does not observe the consumer searching for information; in this case, the consumer gets the expected present value of benefits when the firm is retargeting for an additional period dt , $W(t + dt)$. Finally, with probability $\hat{\phi}(1 - q)\hat{p} dt$, the firm observes the consumer searching for information, but the consumer does not receive a fully informative signal, and in that case, the consumer gets the expected present value of

Figure 14. (Color online) Evolution of \hat{x} and \tilde{x} as a Function of ψ for $c = .01, v = 2, p = .4, \hat{p} = 1, q = .1, \phi = .5$, and $\hat{\phi} = .8$



benefits when the firm is just starting the retargeting phase, $W(0)$.

From (24) we can obtain

$$W(t) = De^{\hat{B}t} + \frac{1}{\hat{B}} \left[\frac{q}{2} \hat{p} S(P) - \varepsilon + \phi(1-q) \hat{p} W(0) \right], \quad (25)$$

where D is a constant to be determined, and from which we can obtain

$$W(0) = \frac{D\hat{B} + \frac{q}{2}\hat{p}S(P) - \varepsilon}{q\hat{p} + \psi}. \quad (26)$$

As the consumer's expected value of payoffs is continuous when the firm switches to stopping advertising, we have $W_n = W(\hat{T})$, from which we can obtain, using (23), (25), and (26), the value of D , which is presented in the appendix. We can obtain that $D < 0$, which yields that $W(t)$ is decreasing in t at an increasing rate. That is, the consumer is better off the longer he is likely to be receiving retargeting, and this benefit falls quickly when the maximum future time is reduced.

For search costs that are not too small, the optimal policy of the firm is to price such that a consumer not

receiving retargeting is indifferent between searching and not searching for information, $W_n = 0$. As $W(t)$ is decreasing in t and $W(\hat{T}) = W_n$, we then have that $W(t) > 0$ for $t \in [0, \hat{T}]$. From this we can obtain from (26) that $\frac{q}{2}\hat{p}S(P) - \varepsilon > 0$; that is, when the period of retargeting starts, the consumer has a strictly positive current expected benefit of searching for information. This confirms that during the period of retargeting the consumer continues to want to search for information.

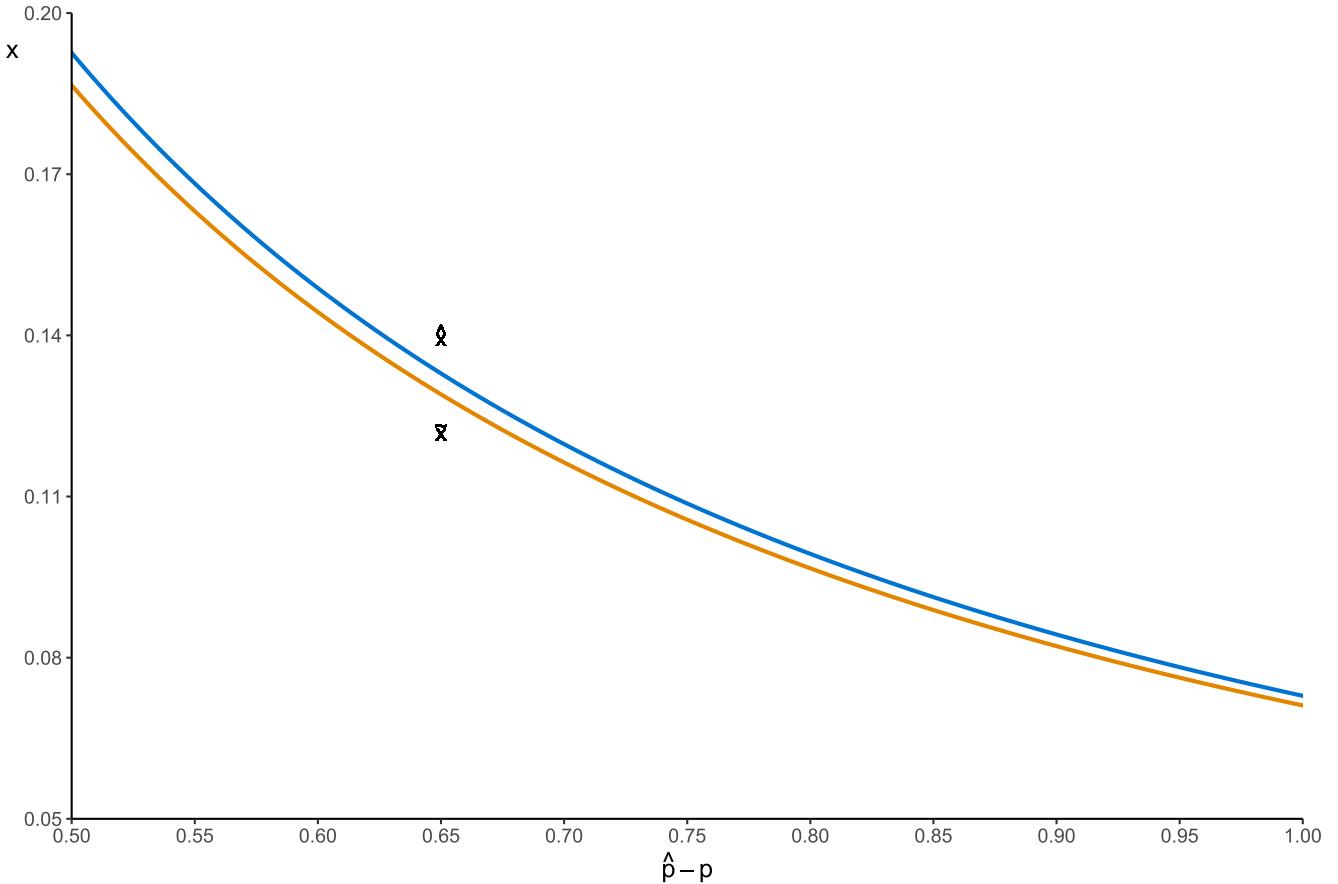
From (23) and $W(0) > 0$, we can also obtain that $\frac{q}{2}pS(P) - \varepsilon < 0$; that is, when the consumer is not receiving retargeting, the consumer has a strictly negative current expected benefit of searching for information. This is the positive effect of the consumer's search for information because the consumer is forward-looking.

To obtain further insights, for $c \rightarrow 0$, we have $\hat{T} \rightarrow \infty$, from which we can obtain

$$W(0) \rightarrow \frac{\frac{q}{2}\hat{p}S(P) - \varepsilon}{q\hat{p} + \psi}, \quad (27)$$

$$W_n \rightarrow \frac{1}{B} \left\{ \frac{q}{2}pS(P) - \varepsilon + \frac{\phi(1-q)p}{q\hat{p} + \psi} \left[\frac{q}{2}\hat{p}S(P) - \varepsilon \right] \right\}. \quad (28)$$

Figure 15. (Color online) Evolution of \hat{x} and \tilde{x} as a Function of $\hat{p} - p$ for $c = .01, v = 2, p = .4, q = .1, \psi = .1, \phi = .5$, and $\hat{\phi} = .8$



Setting $W_n = 0$ to obtain the optimal price P^* , we get that when $c \rightarrow 0$, the optimal price when ε is small is obtained by

$$S(P^*) = \frac{2\varepsilon B}{qp\bar{B}}, \quad (29)$$

which leads to a higher price P^* than in the myopic consumers case. From this, one can also obtain that, as the search costs ε increase, P^* has to decrease, reducing then $v = (P^* - m)[1 - F(P^*)]$. That is, as search costs increase, the firm reduces the price to induce search, and earns a lower expected profit per consumer who receives a positive informative signal.

For general costs of retargeting c , P^* is increasing in \hat{T} . For large \hat{T} this effect on P^* is small, as in that case P^* is close to (29). On the firm side, per the analysis in Section 3, we can obtain that for small c , the effect of v on \hat{T} is bounded, and bounded away from zero. As an increase in c makes the firm increase \hat{T} for a fixed v , we have that, in equilibrium, for c small, an increase in c leads to a decrease in \hat{T} and a small decrease in v (small decrease in P^*).²⁰ Similarly, an increase in the consumer search costs leads to lower prices and a decrease in \hat{T} . We formalize these results in the following proposition.

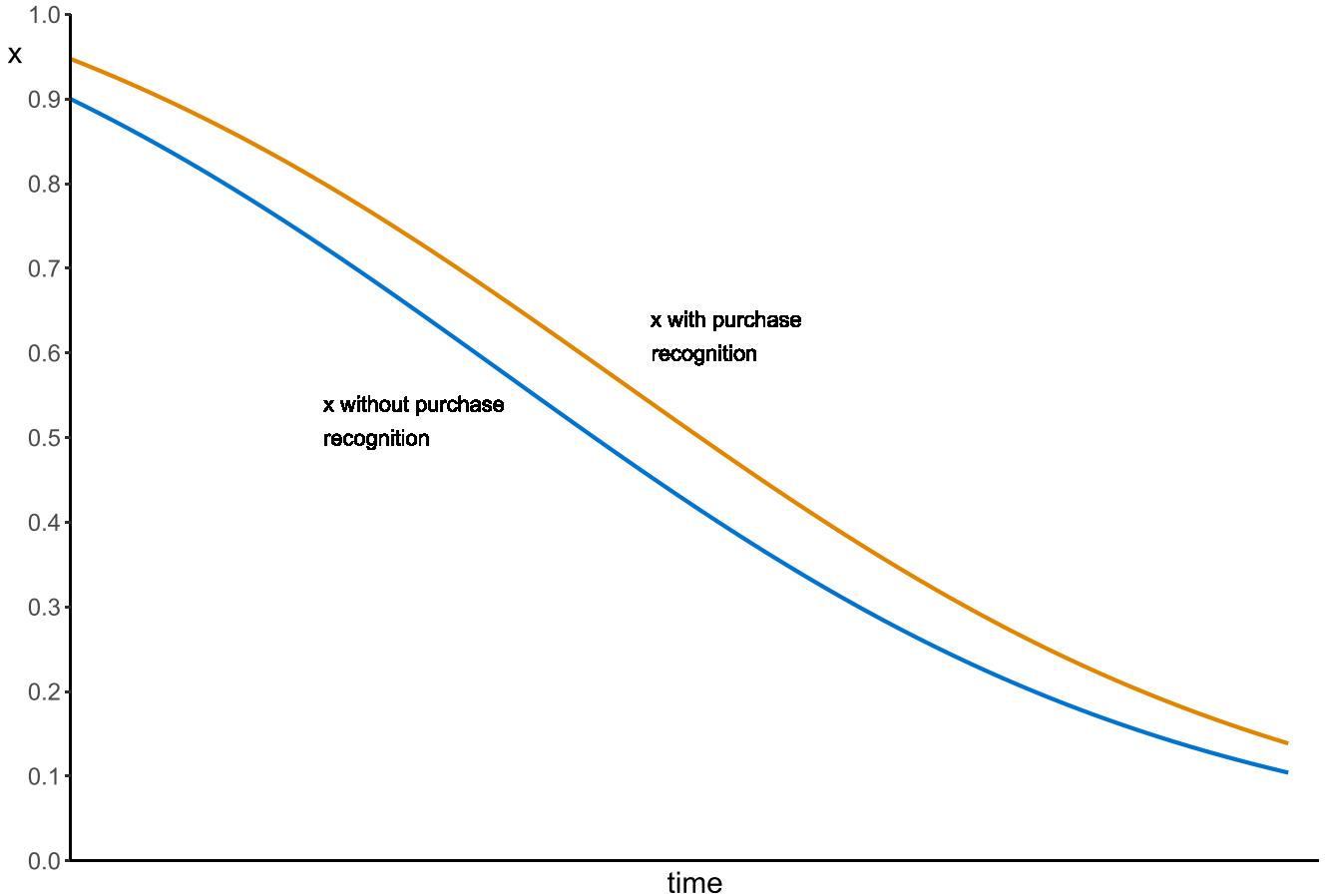
Proposition 8. Suppose that the costs of retargeting c are small. Then a decrease of the costs of retargeting or a decrease of the consumer search costs leads to higher prices and to a higher maximum length of time of receiving advertising after purchase. Without disutility costs of receiving advertising, the consumer is more willing to search when he is aware of potential future retargeting than when he is not aware of the future retargeting.

Figure 17 illustrates the change in the equilibrium for an increase in c for this case of small c .

The result that the consumer is willing to accept a higher price when being forward-looking depends on our assumption that there was no disutility of receiving advertising. If receiving advertising creates disutility (ad annoyance), that can be introduced in (22) and (24), which would lead to a lower price for the consumer to be willing to search for information. Letting η be the disutility per unit of time of receiving retargeting, (22) and (24) would change to

$$\begin{aligned} W_n = & \frac{q}{2} S(P) p dt - \varepsilon dt + (1 - B dt) W_n + \phi (1 - q) \\ & \times W(0) p dt - \eta \hat{T} \phi q p dt, \end{aligned} \quad (30)$$

Figure 16. (Color online) Evolution of the Beliefs x over Time, for the Cases with and Without Purchase Recognition, and if the Firm Does Not Get New Information



Note. This is presented for $v = 2, p = .4, \hat{p} = 1, q = .1, \psi = .1, \phi = .5$, and $\hat{\phi} = .8$.

and

$$\begin{aligned} W(t) &= \frac{q}{2} S(P) \hat{p} dt - (\varepsilon + \eta) dt + [1 - \hat{B} dt] \\ &\quad \times [W(t) + W'(t) dt] + \hat{\phi} (1 - q) W(0) \hat{p} dt \\ &\quad - \eta (\hat{T} - t) [\hat{p} q (1 - \hat{\phi}) + \psi] dt - \eta \hat{T} \hat{\phi} q \hat{p} dt, \quad (31) \end{aligned}$$

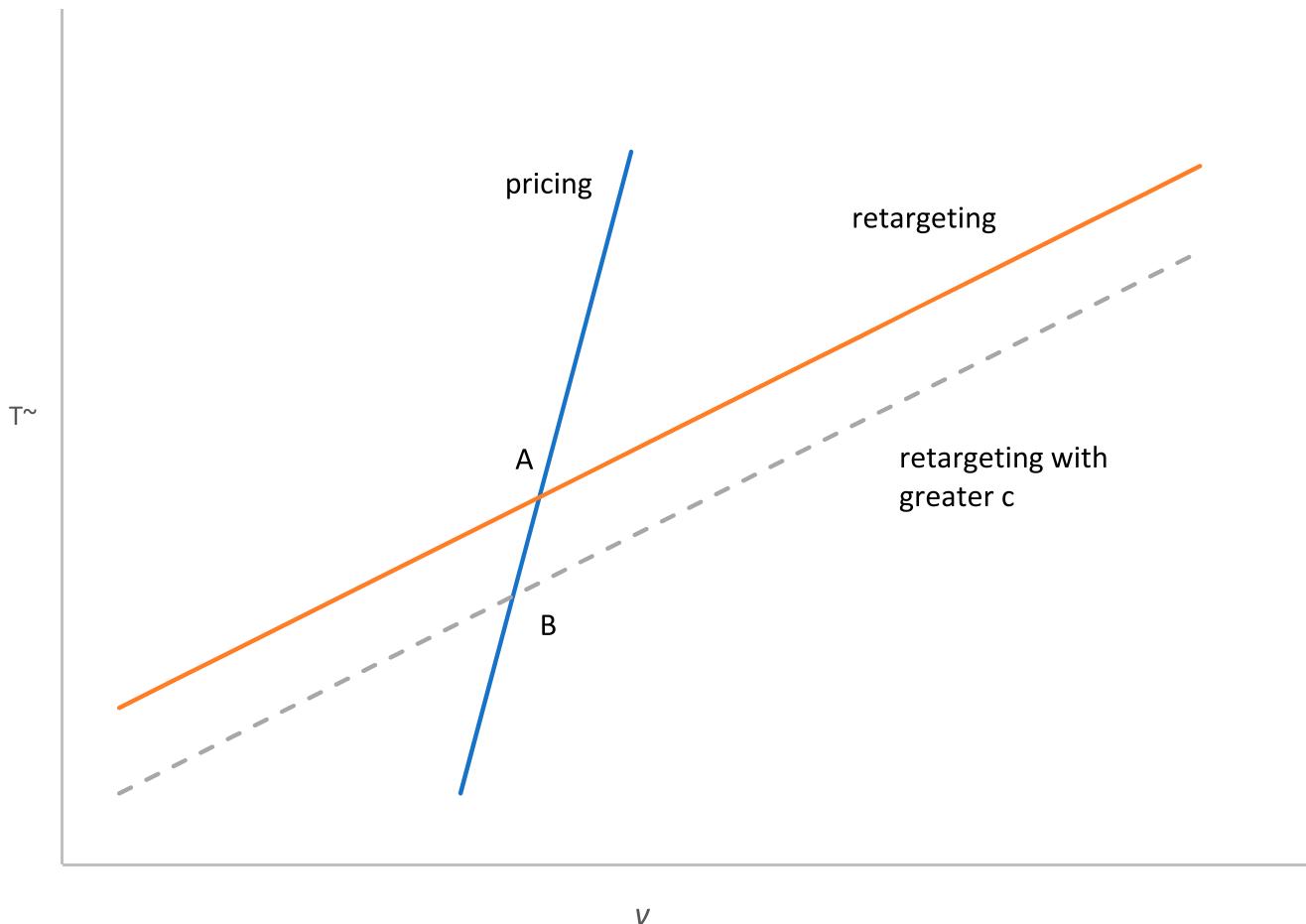
respectively, and the analysis would then proceed as before. This includes the fact that the disutility of retargeting will continue after the consumer drops out of the search process (either by getting a fully informative signal or by exogenously dropping out of the search process), and the possibility that when the consumer gets a fully informative signal, the firm may also observe the consumers searching for information which would lead to an additional period \hat{T} of retargeting. If this disutility of receiving advertising, η , is sufficiently large, the price to induce consumer search for information may be lower than the price under myopic consumers, which would be translated to a reduction in v and therefore a reduction in the value of retargeting.

Another interesting possibility not considered previously is that the consumer, before engaging in search for information, may have a sense of his valuation for the product w in case of product fit. This could be because the valuation in case of product fit is related to some consumer characteristic that is common across all products. One such characteristic could be, for example, consumer income. In such a case, only consumers with a sufficiently large w will search for information with the intent of purchasing the product if they find a product fit. The choice of the price would then determine the threshold w for the consumer to search for information. The construction of v in this case would then just involve the margin obtained on the product.

6. Concluding Remarks

This paper considers the optimal retargeting strategy of a firm when the firm does not fully know whether the consumer is searching for information but receives occasional signals when the consumer is searching for information. The consumer searches for information and at some point finds out whether the product is a good fit. The model captures the possibility of the consumer

Figure 17. (Color online) Equilibrium Change in \hat{T} and v for an Increase in the Costs of Retargeting c for Small c : Retargeting Best Response Moves Down, and Equilibrium Moves from Point A to Point B



continuing to receive retargeting even after purchasing the product or after deciding that the product is not a good fit. The paper characterizes how the optimal policy is affected by the different parameters and compares the optimal strategy with the case in which purchases are immediately recognized.

We also illustrate how consumers looking for information can be endogenized in the model and illustrate how forward-looking consumers may potentially allow the firm to increase its price. This possibility allows for both the choices of price and retargeting to be endogenized and illustrates how these two decisions interact, with a higher price leading to more retargeting and more retargeting allowing for higher prices if consumers do not have a strong disutility for the advertising that is received.

The paper models retargeting as a discrete action that can either occur or not. Alternatively, one could think of retargeting as a continuous variable, such that a greater retargeting intensity is more costly but

leads to more information to be provided to the consumers. This alternative model could potentially generate that the retargeting intensity is greater closer to the time that the firm receives information that the consumer is searching for information and then slowly decreases over time. The analysis of such an alternative model is rather complex, but the main messages of the model considered here should carry over in that smoother case.

The model considered that the probability of a firm receiving information that the consumer is searching for information is exogenous. More generally, we could imagine the firm endogenously deciding on the intensity of monitoring whether the consumer is searching more information. This would be an interesting issue for future research.

Another interesting question to investigate is what happens when the consumer is searching for information to choose one of several products, and the retargeting decision is made by several firms.

That problem would require considering how the different firms gain information on whether a consumer is searching for information, how retargeting by any set of firms affects how consumers receive information, and the threshold decisions for any number of firms to decide to do, or stop doing, retargeting. The surplus extracted by a firm after a product fit may also depend on the opportunity for the consumer of continuing to search for information. Such a model may also endogenize the probability of a consumer stopping the search process, because of the consumer purchasing the product of one of the competitors.

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Appendix

A.1. Derivation of Equation (1)

We can obtain x_{t+dt} by Bayes' rule. Let $\Pr(\text{search} \cap \text{no observation} | x_t)$ be the probability of the consumer being in the search state at time $t + dt$ and the firm not observing the consumer searching for information during time period dt , given that the probability that the consumer is in the search state at time t is x_t . We have $\Pr(\text{search} \cap \text{no observation} | x_t) = x_t - (1-q)p\phi x_t dt - (\psi + pq)x_t dt$. Let $\Pr(\text{no observation} | x_t)$ be the probability of firm not observing the consumer search for information during the time period dt given given that the probability that the consumer is in the search state at time t is x_t . We have $\Pr(\text{no observation} | x_t) = 1 - p\phi x_t dt$. By Bayes's rule we have $x_{t+dt} = \Pr(\text{search} \cap \text{no observation} | x_t) / \Pr(\text{no observation} | x_t)$. Multiplying by $(1 - p\phi x_t dt)$ we can then obtain (1).

A.2. Presentation of \widehat{C} in (9)

By making $x = 1 - q$ in (9), one obtains

$$\widehat{C} = \frac{c}{(\psi + \widehat{p}\widehat{q})\widehat{B}} - \frac{qv}{2\widehat{\phi}(\psi + \widehat{p}\widehat{q})} - \frac{c}{\widehat{B}^2} \log \frac{\psi + \widehat{p}\widehat{q}}{1 - q}. \quad (\text{A.1})$$

A.3. Derivation of Optimal Policy for $c \rightarrow 0$ and the Firm Not Detecting Consumer Purchases

From (7), we can obtain $V'(x) = -Cp\phi$ and

$$\widehat{V}'(x) = -\widehat{C}\widehat{p}\phi - \frac{\widehat{p}\phi c}{\widehat{B}^2} \log \frac{\widehat{B} - \widehat{p}\phi x}{x} - \frac{c}{x} \frac{1}{\widehat{B}}. \quad (\text{A.2})$$

Using $V(\widehat{x}) = \widehat{V}(\widehat{x})$ and evaluating $\widehat{V}(x)$ at $x = 1 - q$ yields condition (10), which determines the value of \widehat{x} .

When $c \rightarrow 0$ in (10) we can then obtain (11).

To check the condition on c such that we have $\widehat{x} < 1 - q$, using $\widehat{x} = 1 - q$ in (10), we can obtain an upper bound on c , which is

$$\begin{aligned} c &< \frac{1}{2} \frac{vq(1-q)\widehat{B}}{\widehat{\phi}B(\widehat{p}\widehat{q} + \psi)} \left[(\widehat{p} - p)\psi\widehat{\phi} - p\widehat{p}\widehat{q}(\widehat{\phi} - \phi) \right] \\ &\leq \frac{1}{2} vq(1-q)(\widehat{p} - p). \end{aligned} \quad (\text{A.3})$$

Proof of Proposition 3. Differentiating (11) with respect to $\widehat{p}, p, \psi, \widehat{\phi}, \phi$, and q , one obtains the results in the proposition.

Derivation of \widehat{T} : Solving for the differential Equation (2) when the firm is retargeting, one obtains

$$t + C_m = \frac{1}{\widehat{B}} \log \frac{\widehat{B} - \widehat{p}\widehat{\phi}x_t}{x_t}, \quad (\text{A.4})$$

where the constant C_m can be obtained by using $x_0 = 1 - q$ in (A.4), which yields $C_m = \frac{1}{\widehat{B}} \log \frac{\widehat{p}\widehat{q} + \psi}{1 - q}$. Using this value for C_m and $x_t = \widehat{x}$ in (A.4), we can obtain (12).

Proof of Proposition 6. Direct differentiation of (14) gets the comparative statics with respect to p, \widehat{p}, v, q , and ψ . The comparative statics with respect to ϕ and $\widehat{\phi}$ require more work, but are relatively intuitive. We show the comparative statics with respect to ϕ under the constraint $\widehat{\phi} = \phi$, which is less obvious. From $V(0) = 0$ one can obtain $\widehat{V}(1 - q) = -\frac{qv}{2\widehat{\phi}} - CB$ where

$$C = \widehat{C} \frac{\widehat{p}\widehat{\phi}}{p\phi} + c \frac{\widehat{p}\widehat{\phi}}{p\phi\widehat{B}^2} \log \frac{\widehat{B} - \widehat{p}\widehat{\phi}\widehat{x}}{\widehat{x}} + \frac{c}{\widehat{B}p\phi\widehat{x}} \quad (\text{A.5})$$

from $V'(\widehat{x}) = \widehat{V}'(\widehat{x})$, and

$$\widehat{C} = \frac{1}{\psi + \widehat{p}\widehat{q}} \left(\frac{c}{\widehat{B}} - \frac{qv}{2\widehat{\phi}} \right) - \frac{c}{\widehat{B}^2} \log \frac{\psi + \widehat{p}\widehat{q}}{1 - q} \quad (\text{A.6})$$

from the evaluation of $\widehat{V}(x)$ and $x = 1 - q$.

We can then obtain

$$\begin{aligned} \widehat{V}(1 - q) &= \frac{qv\widehat{p}(1 - q)}{2(\psi + \widehat{p}\widehat{q})} + \frac{qv\psi(\widehat{p} - p)}{2\phi p(\psi + \widehat{p}\widehat{q})} \\ &\quad - \frac{cB\widehat{p}\widehat{\phi}\widehat{x} + \psi + \widehat{p}\widehat{q}}{p\widehat{B}} \\ &\quad + \frac{cB\widehat{p}}{p\widehat{B}^2} \log \frac{\widehat{x}(\psi + \widehat{p}\widehat{q})}{(1 - q)(\widehat{B} - \widehat{p}\widehat{\phi}\widehat{x})}. \end{aligned} \quad (\text{A.7})$$

From (10) we can write $\widehat{x} = c(D_1 + D_2)$ with

$$D_1 = 2 \frac{\psi + \widehat{p}\widehat{q}}{qv\psi(\widehat{p} - p)} \frac{B}{\widehat{B}} \quad (\text{A.8})$$

and

$$D_2 = \frac{2\phi\widehat{x}}{qv\widehat{B}} \left[1 + \frac{\psi + \widehat{p}\widehat{q}}{\widehat{B}} \log \frac{(1 - q)(\widehat{B} - \widehat{p}\widehat{\phi}\widehat{x})}{\widehat{x}(\psi + \widehat{p}\widehat{q})} \right]. \quad (\text{A.9})$$

The term D_1 is the term that does not go to zero when $c \rightarrow 0$, and is independent of \widehat{x} , and $D_2 \rightarrow 0$ when $c \rightarrow 0$.

We can then obtain

$$\begin{aligned} \frac{\partial \widehat{V}(1-q)}{\partial \phi} &= \frac{B}{p\phi^2\widehat{B}} \left[\frac{1}{D_1+D_2} - \frac{1}{D_1} \right] + c \\ &\quad \times \frac{\widehat{p}\psi(\widehat{p}-p)(1-q)}{\widehat{B}^2 p(\psi+\widehat{p}q)} + \frac{B}{\widehat{B}p\phi(D_1+D_2)} \\ &\quad \times \left[\frac{\psi(\widehat{p}-p)(1-q)}{B\widehat{B}} + \frac{D'_1+D'_2}{D_1+D_2} \right] \\ &\quad - c(1-q)\widehat{p} \frac{\widehat{p}p(\phi+q-\phi q) + \psi(2\widehat{p}-p)}{p\widehat{B}^3} \\ &\quad \times \log \frac{\widehat{x}(\psi+\widehat{q}q)}{(1-q)(\widehat{B}-\widehat{p}\phi\widehat{x})} + c \frac{B\widehat{p}}{p\widehat{B}^2} \\ &\quad \times \left[\frac{\widehat{B}(D'_1+D'_2)}{(\widehat{B}-\widehat{p}\phi\widehat{x})(D_1+D_2)} + \frac{\widehat{p}\widehat{x}}{\widehat{B}-\widehat{p}\phi\widehat{x}} \right] , \quad (\text{A.10}) \end{aligned}$$

which reduces to

$$\begin{aligned} \frac{\partial \widehat{V}(1-q)}{\partial \phi} &= \frac{B}{p\phi^2\widehat{B}} \frac{-D_2}{D_1(D_1+D_2)} + c \\ &\quad \times \frac{\widehat{p}\psi(\widehat{p}-p)(1-q)}{\widehat{B}^2 p(\psi+\widehat{p}q)} + \frac{B}{\widehat{B}p\phi} \times \frac{D_1D'_2-D'_1D_2}{D_1(D_1+D_2)^2} \\ &\quad - c(1-q)\widehat{p} \frac{\widehat{p}p(\phi+q-\phi q) + \psi(2\widehat{p}-p)}{p\widehat{B}^3} \\ &\quad \times \log \frac{\widehat{x}(\psi+\widehat{q}q)}{(1-q)(\widehat{B}-\widehat{p}\phi\widehat{x})} \\ &\quad + c \frac{B\widehat{p}}{p\widehat{B}^2} \left[\frac{\widehat{B}(D'_1+D'_2)}{(\widehat{B}-\widehat{p}\phi\widehat{x})(D_1+D_2)} + \frac{\widehat{p}\widehat{x}}{\widehat{B}-\widehat{p}\phi\widehat{x}} \right]. \quad (\text{A.11}) \end{aligned}$$

Note now that

$$D'_2 = \frac{2\widehat{x}}{qv\widehat{B}} \left[1 + \frac{\psi+\widehat{p}q}{\widehat{B}} \log \frac{(1-q)(\widehat{B}-\widehat{p}\phi\widehat{x})}{\widehat{x}(\psi+\widehat{p}q)} \right] + G, \quad (\text{A.12})$$

where

$$G = \frac{2\phi\widehat{x}'}{qv\widehat{B}} \left[1 + \frac{\psi+\widehat{p}q}{\widehat{B}} \log \frac{(1-q)(\widehat{B}-\widehat{p}\phi\widehat{x})}{\widehat{x}(\psi+\widehat{p}q)} \right] - \frac{2\phi\widehat{x}'}{qv(\widehat{B}-\widehat{p}\phi\widehat{x})}. \quad (\text{A.13})$$

When $c \rightarrow 0$, the biggest terms in $\frac{\partial \widehat{V}(1-q)}{\partial \phi}$ are of the order $\widehat{x} \log \frac{1}{x}$. Dividing by this expression we obtain

$$\lim_{c \rightarrow 0} \frac{1}{\widehat{x} \log \frac{1}{x}} G = -2 \frac{(1-q)(\widehat{p}-p)\psi\phi(\psi+\widehat{p}q)}{B\widehat{B}^3qv} \quad (\text{A.14})$$

and we can also obtain that

$$\lim_{c \rightarrow 0} \frac{1}{\widehat{x} \log \frac{1}{x}} (D_1G - D'_1D_2) = 0. \quad (\text{A.15})$$

This then yields

$$\lim_{c \rightarrow 0} \frac{1}{\widehat{x} \log \frac{1}{x}} \frac{\partial \widehat{V}(1-q)}{\partial \phi} = \widehat{p}(1-q) \frac{\widehat{p}p(\phi+q-\phi q) + \psi(2\widehat{p}-p)}{pD_1\widehat{B}^3} > 0. \quad (\text{A.16})$$

A.4. Optimal Policy for Variation in Quality of Signals

Consider the case of optimal retargeting when purchases are not recognized and $\widehat{q} > q$.

By making $V(\widehat{x}) = \widehat{V}(\widehat{x})$, we get

$$\begin{aligned} \widehat{V}(1-q) - \widehat{V}(1-\widehat{q}) &+ \frac{v}{2} \left(\frac{q}{\phi} - \frac{\widehat{q}}{\widehat{\phi}} \right) + C[B - p\phi\widehat{x}] \\ &= \widehat{C} \left[\widehat{B} - \widehat{p}\phi\widehat{x} \right] - \frac{c}{\widehat{B}} + c \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{\widehat{B}^2} \log \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{\widehat{x}}, \quad (\text{A.17}) \end{aligned}$$

where $\widehat{B} = \widehat{p}[\widehat{\phi} + (1-\widehat{\phi})\widehat{q}] + \psi$, and from which we can obtain, solving for C ,

$$\begin{aligned} C &= \widehat{C} \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{B - p\phi\widehat{x}} - \frac{c}{\widehat{B}(B - p\phi\widehat{x})} + c \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{\widehat{B}^2(B - p\phi\widehat{x})} \\ &\quad \times \log \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{\widehat{x}} - \\ &\quad \times \frac{v}{2(B - p\phi\widehat{x})} \left(\frac{q}{\phi} - \frac{\widehat{q}}{\widehat{\phi}} \right) - \frac{\widehat{V}(1-q) - \widehat{V}(1-\widehat{q})}{B - p\phi\widehat{x}}. \quad (\text{A.18}) \end{aligned}$$

By making $V'(\widehat{x}) = \widehat{V}'(\widehat{x})$, we get

$$Cp\phi = \widehat{C}\widehat{p}\widehat{\phi} + c \frac{\widehat{p}\widehat{\phi}}{\widehat{B}^2} \log \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{\widehat{x}} + \frac{c}{\widehat{B}\widehat{x}}, \quad (\text{A.19})$$

from which, solving for C , we can get

$$C = \widehat{C} \frac{\widehat{p}\widehat{\phi}}{p\phi} + c \frac{\widehat{p}\widehat{\phi}}{p\phi\widehat{B}^2} \log \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{\widehat{x}} + \frac{c}{\widehat{B}p\phi\widehat{x}}. \quad (\text{A.20})$$

By making the left-hand side of (A.18) equal to the left-hand side of (A.20), we can obtain

$$\begin{aligned} &\left[\widehat{C} + \frac{c}{\widehat{B}^2} \log \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{\widehat{x}} \right] \left[\frac{\widehat{p}\widehat{\phi}}{p\phi} - \frac{\widehat{B} - \widehat{p}\phi\widehat{x}}{B - p\phi\widehat{x}} \right] + \frac{c}{\widehat{B}} \\ &\quad \times \left[\frac{1}{p\phi\widehat{x}} + \frac{1}{B - p\phi\widehat{x}} \right] + \\ &\quad \frac{v}{2(B - p\phi\widehat{x})} \left(\frac{q}{\phi} - \frac{\widehat{q}}{\widehat{\phi}} \right) + \frac{\widehat{V}(1-q) - \widehat{V}(1-\widehat{q})}{B - p\phi\widehat{x}} = 0. \quad (\text{A.21}) \end{aligned}$$

Now, to obtain \widehat{C} , we can evaluate $\widehat{V}(x)$ at $x = 1 - \widehat{q}$ to obtain

$$\widehat{C} = \frac{1}{\psi + \widehat{p}\widehat{q}} \left(\frac{c}{\widehat{B}} - \frac{\widehat{q}v}{2\widehat{\phi}} \right) - \frac{c}{\widehat{B}^2} \log \frac{\psi + \widehat{p}\widehat{q}}{1 - \widehat{q}}, \quad (\text{A.22})$$

which we will use in (A.21). Now, from the evaluation $\widehat{V}(x)$ at $x = 1 - q$, one can obtain

$$\begin{aligned} & \widehat{V}(1 - q) - \widehat{V}(1 - \bar{q}) \\ &= \frac{\widehat{qv}}{2\phi} + \widehat{C}[\psi + \widehat{p}\bar{q} - \widehat{p}\phi(\bar{q} - q)] - \frac{c}{\bar{B}} + c \\ &\quad \times \frac{\psi + \widehat{p}\bar{q} - \widehat{p}\phi(\bar{q} - q)}{\bar{B}^2} \log \frac{\psi + \widehat{p}\bar{q} - \widehat{p}\phi(\bar{q} - q)}{1 - q}. \end{aligned} \quad (\text{A.23})$$

Substituting for \widehat{C} from (A.22) we can obtain

$$\begin{aligned} & \widehat{V}(1 - q) - \widehat{V}(1 - \bar{q}) \\ &= -\frac{\widehat{p}\phi(\bar{q} - q)}{\psi + \widehat{p}\bar{q}} \left(\frac{c}{\bar{B}} - \frac{\widehat{qv}}{2\phi} \right) + c \frac{\psi + \widehat{p}\bar{q} - \widehat{p}\phi(\bar{q} - q)}{\bar{B}^2} \\ &\quad \times \log \left[\frac{\psi + \widehat{p}\bar{q} - \widehat{p}\phi(\bar{q} - q)}{\psi + \widehat{p}\bar{q}} \frac{1 - \bar{q}}{1 - q} \right]. \end{aligned} \quad (\text{A.24})$$

Using (A.22) and (A.24) in (A.21) and multiplying by $2\phi\widehat{p}\widehat{x}\bar{B}(\psi + \widehat{p}\bar{q})(B - p\phi\widehat{x})/c$, one obtains that \widehat{x} it is determined by

$$\begin{aligned} & \left[2\widehat{\phi} - \widehat{q}\widehat{B}\frac{v}{c} + 2\widehat{\phi}\frac{\psi + \widehat{p}\bar{q}}{\bar{B}} \ln \frac{(\bar{B} - \widehat{p}\phi\widehat{x})(1 - \bar{q})}{(\psi + \widehat{p}\bar{q})\widehat{x}} \right] \\ &\quad \times (\widehat{p}\phi - p\phi)\widehat{x} + 2\widehat{\phi}B(\psi + \widehat{p}\bar{q}) + \\ &\quad \frac{v}{c} p\widehat{x}\bar{B}(\psi + \widehat{p}\bar{q})(\phi q - \phi\bar{q}) - \widehat{p}\phi(\bar{q} - q) \\ &\quad \times \left(2\widehat{\phi} - \frac{\widehat{qv}\widehat{B}}{c} \right) p\phi\widehat{x} + \\ &\quad + 2\phi\widehat{p}\widehat{x} \frac{(\psi + \widehat{p}\bar{q})(\psi + \widehat{p}\bar{q} - \widehat{p}\phi(\bar{q} - q))}{\bar{B}} \\ &\quad \times \log \left[\frac{\psi + \widehat{p}\bar{q} - \widehat{p}\phi(\bar{q} - q)}{\psi + \widehat{p}\bar{q}} \frac{1 - \bar{q}}{1 - q} \right] = 0. \end{aligned} \quad (\text{A.25})$$

Proof of Proposition 7. By making $\widetilde{V}(\bar{x}) = \widehat{V}(\bar{x})$, one obtains

$$\begin{aligned} -\widetilde{CA}\bar{x} &= \widehat{\widetilde{C}}(\bar{B} - \widehat{A}\bar{x}) - \frac{c}{\bar{B}} + c \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{B}^2} \log \\ &\quad \times \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{x}} + \bar{V}, \end{aligned} \quad (\text{A.26})$$

where we use $\widetilde{V}(0) = 0$, and where $\bar{V} = \frac{qv/2 + \widehat{\phi}(1-q/2)\widehat{V}(1-q/(2-q))}{q/2 + \widehat{\phi}(1-q/2)}$.

By making $\widetilde{V}'(\bar{x}) = \widehat{V}'(\bar{x})$, and multiplying throughout by \bar{x} , one obtains

$$-\widetilde{CA}\bar{x} = -\widehat{\widetilde{C}}\widehat{A}\bar{x} - c \frac{\widehat{A}\bar{x}}{\bar{B}^2} \log \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{x}} - \frac{c}{\bar{B}}. \quad (\text{A.27})$$

Subtracting (A.27) from (A.26), one obtains

$$\bar{V} + \widehat{\widetilde{C}}\bar{B} + \frac{c}{\bar{B}} \log \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{x}} = 0, \quad (\text{A.28})$$

which will be used later.

Now from (A.27), one can obtain

$$\widetilde{C} = \widehat{\widetilde{C}} \frac{\widehat{A}}{A} + c \frac{\widehat{A}}{AB^2} \log \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{x}} + \frac{c}{AB\bar{x}}. \quad (\text{A.29})$$

Because we can write $\widetilde{V}(x) = \widetilde{C}(B - Ax) + \bar{V}$, the condition $\widetilde{V}(\bar{x}) = \widehat{V}(\bar{x})$ can be reduced to

$$\begin{aligned} \widetilde{C} &= \widehat{\widetilde{C}} \frac{\bar{B} - \widehat{A}\bar{x}}{B - A\bar{x}} - \frac{c}{\bar{B}(B - A\bar{x})} + c \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{B}^2(B - A\bar{x})} \\ &\quad \times \log \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{x}}. \end{aligned} \quad (\text{A.30})$$

Equalizing the left-hand sides of (A.29) and (A.30), one obtains

$$\begin{aligned} & \left[\widehat{\widetilde{C}} + \frac{c}{\bar{B}^2} \log \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{x}} \right] \left[\frac{\widehat{A}}{A} - \frac{\bar{B} - \widehat{A}\bar{x}}{B - A\bar{x}} \right] + \frac{c}{\bar{B}} \\ &\quad \times \left[\frac{1}{A\bar{x}} + \frac{1}{B - A\bar{x}} \right] = 0. \end{aligned} \quad (\text{A.31})$$

Multiplying (A.31) by $A(B - A\bar{x})\bar{x}\bar{B}$, one obtains

$$\left[\widehat{\widetilde{C}} + \frac{c}{\bar{B}^2} \log \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{x}} \right] \bar{B}(\bar{A}B - A\bar{B})\bar{x} + cB = 0, \quad (\text{A.32})$$

Now, to obtain $\widehat{\widetilde{C}}$, note by evaluating $\widehat{V}(x)$ at $x = 1 - \frac{q}{2-q}$, we can obtain

$$\begin{aligned} \frac{q}{2} \left(\widehat{V} \left(1 - \frac{q}{2-q} \right) - v \right) &= \frac{\widehat{A}}{\widehat{p}} \left[\widehat{\widetilde{C}} \left(\psi + \frac{\widehat{p}q}{2-q} \right) + c \frac{\psi + \widehat{p}q/(2-q)}{\bar{B}^2} \right. \\ &\quad \left. \times \log \frac{\psi(2-q) + \widehat{p}q}{2(1-q)} - \frac{c}{\bar{B}} \right]. \end{aligned} \quad (\text{A.33})$$

Using (A.28), one can obtain

$$\begin{aligned} \widehat{\widetilde{V}} \left(1 - \frac{q}{2-q} \right) - v &= -\frac{q + \widehat{\phi}(2-q)}{\widehat{\phi}(2-q)} \left[\widehat{\widetilde{C}}\bar{B} + \frac{c}{\bar{B}} \log \frac{\bar{B} - \widehat{A}\bar{x}}{\bar{x}} + v \right]. \end{aligned} \quad (\text{A.34})$$

Using this in (A.33), solving for $\widehat{\widetilde{C}}$, and using it in (A.32), one obtains that \bar{x} can be implicitly determined by

$$\begin{aligned} 2B(\widehat{p}q + \psi)\widehat{A} + \widehat{p} \left(\bar{A}B - A\bar{B} \right) \bar{x} \left[-\frac{qv\bar{B}}{c} + \widehat{\phi}(2-q) \right. \\ \left. + \widehat{\phi} \frac{\psi(2-q) + \widehat{p}q}{\bar{B}} \log \frac{2(\bar{B} - \widehat{A}\bar{x})(1-q)}{\bar{x}[\psi(2-q) + \widehat{p}q]} \right] = 0. \end{aligned} \quad (\text{A.35})$$

Making $c \rightarrow 0$, one can obtain that $\frac{\bar{x}}{c}$ converges to

$$\frac{\bar{x}}{c} = \frac{2B\widehat{A}(\psi + \widehat{p}q)}{qv\widehat{p}\bar{B}(\bar{A}B - A\bar{B})}, \quad (\text{A.36})$$

which results in (20), from which we can obtain that $\lim_{c \rightarrow 0} \frac{\bar{x}}{c} - \frac{\bar{x}}{c} < 0$.

A.5. Analysis of the Maximum Time of Retargeting When Purchases Are Recognized, \tilde{T}

Along the lines of Section 3, we can obtain \tilde{T} as a function of \tilde{x} as

$$\tilde{T} = \frac{1}{\tilde{B}} \log \frac{2(1-q)}{\psi(2-q) + \tilde{p}\tilde{q}} \frac{\tilde{B} - \tilde{A}\tilde{x}}{\tilde{x}}. \quad (\text{A.37})$$

To compare \hat{T} and \tilde{T} , when $c \rightarrow 0$, we have

$$e^{\hat{B}(\hat{T}-\tilde{T})} \rightarrow \frac{\psi(2-q) + \tilde{p}\tilde{q}}{2(\psi + \tilde{p}\tilde{q})}, \quad (\text{A.38})$$

from which we can get $\tilde{T} > \hat{T}$.

A.6. Presentation of D in (25)

Using $W_n = W(\hat{T})$, (23), (25), and (26), we can obtain

$$\begin{aligned} D = & -(\tilde{p} - p)q \left[\tilde{q}\hat{p} + \tilde{\phi}\hat{p}(1-q) + \psi \right] \times [\psi S(P)/2 + \varepsilon] / [(\tilde{q}\hat{p} + \psi)\tilde{B}\hat{B}e^{\hat{B}\hat{T}} + \left[\psi(\tilde{p}\hat{\phi} - p\phi) + p\tilde{p}\tilde{q}(\hat{\phi} - \phi) \right] \times (1-q)\tilde{B}] \\ & \quad (\text{A.39}) \end{aligned}$$

Endnotes

¹ There is also some work exploring the possibility of firms offering exploding offers to deter consumers from searching further for alternatives (Armstrong and Zhou 2016), work on tracking consumers to practice intertemporal price discrimination (Öry 2016), and work on the design and price of information (Bergemann et al. 2018). See also, for example, Kuksov (2004) on the effects of search costs on firm strategies.

² In related research, Ning (2021) considers the possibility of a seller knowing the information that the buyer is receiving and making price offers conditional on that information. See also Iyer et al. (2005) for the static case of the targeting of advertising. For other examples of greater information about customers by the seller affecting its strategy, see Chen et al. (2017) and Xu and Dukes (2019).

³ Suppose also that m is large enough such that the consumer's expected value ex ante is below m . That is, it is not profitable to price such that the consumer purchases the product without searching for information.

⁴ We could also consider that when the firm is advertising the consumer gets a signal in period dt with probability between zero and $(\tilde{p} - p)dt$, and the main messages of the results below would still follow.

⁵ A consumer that switches from the no searching to searching state is assumed to have no information about the product fit independent of any prior experience with the product. This could explain, for example, by a change of preferences, when this change of state occurs.

⁶ In Section 6, we briefly discuss the case in which the extent of retargeting is a continuous variable, where p and c are increasing functions of the extent of retargeting.

⁷ To see how $\tilde{p} > p$ could be related to consumer search costs, suppose that there is a hazard rate at which the additional search costs (in addition to ε) of getting a signal are zero (and otherwise, are very large), and this hazard rate is greater when the firm is doing retargeting.

⁸ This setup is similar to Bergemann and Välimäki (2006), in which a consumer fully learns the product fit at some constant hazard rate.

⁹ We will say that in this case, the consumer purchased the product.

¹⁰ See the appendix for a Bayes' rule derivation.

¹¹ When there is advertising, the evolution of beliefs follows a similar expression to (1) with p replaced with \tilde{p} and ϕ replaced by $\tilde{\phi}$.

¹² If $c = 0$, then the firms would always be advertising.

¹³ Note that $V(x) = x\pi(0)$ and $\hat{V}(x) = x\pi(t^*(x)) - (1-x)ct^*(x)$.

¹⁴ The Bellman equation is a contraction mapping as the value function of the future state is multiplied by a number which is less than one, $1 - p\phi x dt < 1$. In fact, this number approaches the discount factor coefficient $e^{-p\phi x dt}$ when $dt \rightarrow 0$.

¹⁵ The constant \hat{C} is presented in the appendix.

¹⁶ The exact condition for the optimal policy to prescribe more advertising than the myopic policy is $\psi[(\tilde{p}\tilde{\phi} - p\phi)(1-q) - pq] > \tilde{p}q[p\phi(1-q) + pq]$.

¹⁷ The same holds for $x < \hat{x}$, and in that case, the value of perfect information would be $x\hat{V}(1) - V(x)$.

¹⁸ As noted previously, this occurs if $(w - m)f(w) > 1$.

¹⁹ We remind the reader that $B = p\phi + p(1-\phi)q + \psi$.

²⁰ The effects on v and P^* converge to zero as $c \rightarrow 0$.

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