

Department of Decision Sciences

Occasional Seminar

Reference Prices, Double Comparisons, and Anomalies in Consumption-Payment Decisions

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Abstract

We propose a simple theoretical framework that evaluates the hedonic benefits of various consumption and payment streams. In any given period, mental accounting finds consumers engaged in a double comparison: one between the benefit of consumption and a reference price, and another between the reference price and the actual price. The reference price evolves over time, and it is influenced by the payment stream. Under standard assumptions, mainly loss aversion and adaptation, our model predicts various anomalies observed in consumer choice: sunk cost effects, the flat-rate bias, preference for advance payment, and payment depreciation. None of the existing model can explain all these biases.