Abstract
We provide a simple behavioral explanation of why manufacturers frequently announce non-binding suggested retail prices for their products. Our model is based on the assumption that once the actual price for a product exceeds its suggested retail price, the marginal propensity to consume suddenly jumps downward. This property of individual demand corresponds to Kahneman and Tversky's concept of loss aversion. We show that it may induce a monopolistic retailer to set the price equal to the suggested retail price in equilibrium, although the latter price is nonbinding. This, in turn, leads to a shift of profits from the retailer to the manufacturer.