Advertising Content when Consumers are Loss Averse*

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Abstract

In this paper, we examine the product match and price advertising strategies of a single–product monopolist when consumers are expectation–based loss averse à la Koszegi and Rabin (2006) and Heidhues and Koszegi (2010). Consumers are initially uncertain about their individual match values and the price set by the monopolist but receive the monopolist’s advertising signal before forming their reference point distribution in the match value and the price dimension. The advertising signal contains match value and/or price information or no information at all. Before undertaking their purchase decision, consumers become fully informed (independently of the content of the advertising signal). So, with standard consumers, the advertising signal is fully redundant, whereas, with loss–averse consumers, it is not since consumers’ purchase decision depends on their expectations at the stage when their reference point is formed. We show that the monopolist can increase loss–averse consumers’ willingness to pay ex post above their true valuation (attachment effect) by either engaging in low–price advertising or partial match value disclosure. For

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varying levels of product complexity, we characterize the monopolist’s optimal advertising strategies in this paper.

**Keywords:** Advertising, Loss Aversion, Reference-Dependent Utility, Information Disclosure, Behavioral Industrial Organization

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