The views expressed here are our own and not necessarily those of any institutions with which we are affiliated, nor of the National Bureau of Economic Research. Kashyap thanks the Chicago Booth Initiative on Global Markets for research support. We thank Cecilia Gamba, Aaron Jones, and Ashish Shenoy for outstanding research assistance. All mistakes are our own.

© 2011 by Judith A. Chevalier and Anil K Kashyap. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.
ABSTRACT

We explore the role of strategic price-discrimination by retailers for price determination and inflation dynamics. We model two types of customers, "loyals" who buy only one brand and do not strategically time purchases, and "shoppers" who seek out low-priced products both across brands and across time. Shoppers always pay the lowest price available, the "best price. Retailers in this setting optimally choose long periods of constant regular prices punctuated by frequent temporary sales. Supermarket scanner data confirm the model's predictions: the average price paid is closely approximated by a weighted average of the fixed weight average list price and the "best price". In contrast to standard menu cost models, our model implies that sales are an essential part of the price plan and the number and frequency of sales may be an important mechanism for adjustment to shocks. We conclude that our "best price" construct provides a tractable input for constructing price series.