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BEST PRICES

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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.

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