Abstract

We model competition in a loss-leading environment by combining a model of sales (as in Varian 1980) with limited consumer attention: (i) Consumers only compare prices of a selected number of products and (ii) they may pay more attention either to price or quality, depending on the salience of the respective attributes. When consumers have standard preferences, which is our benchmark case, brand manufacturers benefit when their products are chosen as loss leaders, as this expands demand. Results are strikingly different when consumers are salient thinkers. When competition among retailers intensifies or when one-stop shopping increases the scope for loss leading, first, brand manufacturers' profits strictly decrease and, second, there will be an inefficient substitution to low-quality (private label) products.