pay to acquire that same product initially. (Of course, other simpler explanations—such as reassuring the customer of the quality of the product—can also explain such guarantees.)

Another bias people exhibit is due to what is called *mental accounting,* in which customers tend to evaluate gains and losses for different categories of goods differently because they have "mental budgets" for each category of goods. For example, suppose you purchase a $1,000 watch and then immediately lose it. You might then be reluctant to replace it because in some sense your "budget" for purchasing watches has been exhausted. However, suppose you lost $1,000 in the stock market and you did not own a watch at the time. Then you might be willing to buy a new $1,000 watch because there is no direct association between the $1,000 dollar loss and the amount you might have "mentally allocated" to spend on a watch (for example, you might account for this as "an investment loss" not a "expensive-watch loss"). Such heuristic accounting again violates the rationality assumptions of classical consumer behavior.

Kahneman and Tversky [278] developed what they termed *prospect theory* to explain such effects. Prospect theory differs from expected-utility theory in several respects. For one, it handles the probabilities of outcomes differently, treating them as "decision weights" that may or may not correspond to actual probabilities. Indeed, prospect theory postulates that the subjective decision weights used by most customers tend to overweigh small probabilities and underweigh high probabilities. Prospect theory also uses the notion of "value" rather than "utility," where value is defined in terms of deviations from a reference point (the customer's status quo wealth). They postulate an S-shaped curve for the value function, which is convex for losses below the reference point and concave for gains above the reference point. Using this construct, Kahneman and Tversky [278] are able to model and explain many observed deviations from rational behavior.

Do such findings mean that expected utility theory is "dead"? Not really. In a gross sense, people do tend to behave in accordance with rationality assumptions. However, what this behavioral theory shows quite clearly is that the axioms of rational behavior, plausible as they are, do not apply uniformly and that there are situations in which deviations from rational behavior are systematic and substantial.

The main consequence of these findings for RM practice is that one should always understand the "environment" in which choices are made; the details of the buying situation matter in terms of customers' responses. How prices are presented, what "reference point" the customer perceives, the framing of the choice decision, their sense of "ownership" over the product—all can potentially influence their responses. While many of the tactics used to influence these factors lie in the domain of general marketing and are beyond the scope of this book, the general message that the choice environment matters is nevertheless an important one for RM practitioners and researchers to heed. Indeed, we expect these behavioral theories of demand to influence RM practice more directly in the years ahead.