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Fairness as a Constraint on Profit Seeking

Daniel Kahneman, Jack Knetsch and Richard Thaler, American Economic Review, 1986

Why some price rises make customers angry, and the snow shovel that showed where the line is.

The big idea

Kahneman, Knetsch and Thaler asked members of the public whether different pricing decisions were fair. People were happy for a business to pass on higher costs, but they saw it as unfair when a business put prices up just because demand had gone up. Customers feel entitled to a fair price, and businesses that break that rule pay for it in goodwill.

The famous example

A hardware store has been selling snow shovels for $15. The morning after a big snowstorm, it puts the price up to $20.

BEFORE THE SNOWSTORM

$15

THE MORNING AFTER

$20

Same shovel, same costs

SAID IT WAS UNFAIR

82%

The shovel hadn't cost the store any more. The store was just cashing in on demand, and most people saw it that way.

Why it matters for pricing

Customers remember when they feel taken advantage of. A business that charges what the market will bear might win today, but it risks losing the goodwill it needs tomorrow. Pricing on demand rather than value is exactly the trap a popular venue can fall into.

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Kahneman, D., Knetsch, J. L. & Thaler, R. (1986). Fairness as a Constraint on Profit Seeking: Entitlements in the Market. *American Economic Review*, 76(4), 728–741.

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