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The Influence of Loss Aversion on Purchase Behavior

Xiaojing Li

International School of Tianjin, Tianjin, China
Tiana_lie@outlook.com

Abstract. In recent years, psychological aspects of consumers' buying behavior have been under intense scrutiny in psychological research, and loss aversion has been shown to be an important concept for understanding consumers' assessment of gains, losses, and risks. This paper will show the impact of loss aversion on consumer purchasing behavior, how loss aversion effects the marketing strategies of companies, and consumers' own purchasing behavior. From the research results, it can be inferred that loss aversion can shift consumer psychological evaluation of the same consumption opportunity in different situations, such as one that may be interpreted as a potential gain and one that may be interpreted as a potential loss. The findings show that loss aversion has an impact on consumers and also on a continuous interaction between consumer psychology and corporate marketing. Thus, understanding of this psychological mechanism is valuable in the explanation of modern consumers' behavior and to suggest more responsible marketing behavior.

Keywords: Loss Aversion, Purchase Behavior, Consumer Psychology

1. Introduction

As behavioral economics and consumer psychology have evolved, the way consumer behavior is understood has been moving from the conventional "rational decision-making" to individuals' mental factors. The traditional economic theories state that individuals are likely to compare the costs and benefits of purchasing an item before they make a purchase and behave rationally. In recent years, however, psychological research has demonstrated that the rational decision-making process is not always followed by consumers when they think in many real-life shopping situations, such as their psychological biases and emotional responses. This has spurred interest among researchers to focus on this topic and undertake extensive research. These are significant in today's business world for a number of reasons; it is important to have some understanding of the rationale behind some of the marketing strategies being employed, as well as to be aware of the psychology involved in consumer buying behavior to make informed decisions.

One of the several psychological concepts that explain consumers' behavior will be highlighted in the paper, namely the concept of loss aversion. Loss aversion is a notion that has been incorporated in a theoretical model that tries to account for the special attention given to potential losses, called Prospect Theory [1]. There have been numerous studies in this area and loss aversion has been employed in the areas of consumer behavior and marketing. This paper will discuss the relationship

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of loss aversion and consumer purchase behaviors from two perspectives – the companies and the consumers – by incorporating existing research.

2. Overview of loss aversion

Loss Aversion is an important concept in behavioural economics and psychology, and can be used to explain consumer reactions to marketing strategies and their purchasing decisions for products. This is a theory of various psychological reactions in response to gains and losses. Instead, people are psychologically affected by a loss of equal magnitude as opposed to a gain – the 'losses loom larger than gains' effect. Sometimes, consumers do not make very rational decisions. Actually, with the incorporation of the psychological theories, the traditional economic notion of "rational decision-maker" was challenged, and an important theoretical foundation was provided to understand the irrational decision-making of the consumers [1].

The first important psychological trait of loss aversion is called reference dependence. Prospect theory, proposed by Kahneman and Tversky, states that people perceive the outcomes as gains or losses, and make their decisions not as a function of their final wealth or the actual price of the product, but as a function of the comparison with a subjective reference point [1, 2]. When the outcome is less than this reference, the individual experiences it as a loss, and when it is more than this, they experience it as a gain, and this can be influenced by previous price, expectations, or past experience.

Furthermore, another concept, risk preference, is also an important manifestation in which loss aversion appears in decision-making. It mainly affects decision making under risk because of the fact that people might prefer a safer choice or take a higher risk based on whether they see a risk as one to gain or one to lose. According to Prospect Theory, people are risk-averse with respect to gains, and risk-seeking with respect to losses [1]. Later studies have found that this risk preference is essentially a function of the reference point; that is, the extent to which an individual deems an outcome as a loss determines the level of risk he or she will accept [2].

3. Loss aversion in marketing strategies

Loss aversion is a crucial psychological concept for sellers when creating marketing strategies, including loss framing, time-limited promotions, and scarcity marketing. In recent years, many applications have been made of this theory, and it has affected consumer buying. Understanding loss aversion, companies have come to realize that consumers are much more sensitive to losses than to gains. In creating marketing messages, today's businesses do not just communicate the value that consumers can get from the products – they have been coached to communicate the benefits or opportunities that consumers might miss out on if they do not purchase right now. This exploitation of consumer psychology has led companies to rethink ways to communicate product information from "what you can gain" to "what you could lose," and adopt new "loss" marketing strategies.

This 'loss' strategy of influencing consumer perceptions can be called 'loss framing'. Kern & Chugh did experimental studies to investigate the effects of various information frames on individuals' judgments and decisions. They found that the presentation of information influences the evaluation of the various options, and individuals are more motivated to take action when the decision is presented in the context of avoiding losses [3]. So, companies are more likely to resort to loss framing when formulating their promotion strategies, such as limited-time offers, coupon expiration, and membership expiration [4]. Unlike conventional price reductions, these marketing

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tactics highlight the scarcity of an opportunity, and consequently, may make consumers feel that they might not be able to obtain the benefit if they wait to buy it.

A popular method in which businesses utilize the loss aversion is time-limited promotions, which can help spur people to make quicker purchasing choices. Unlike discounts, time-limited promotions also include a time element that ensures that consumers will feel they are receiving a discount now but not later. For instance, businesses can come up with texts like "only 24 hours remaining" or "last chance to buy" to generate a sense of urgency. Khetarpal and Singh did a research study to gain insights into how time pressures in promotion affect the psychological responses and consumer buying behavior. Their study finally concluded that the time pressure and less choice in marketing can make the consumers more aware of the potential losses [5]. Thus, by establishing a time frame for decision making, companies can minimize consumers' inclination to keep comparing alternatives or postponing purchases and maximize the effectiveness of promotion. This helps to boost sales, but it could also result in less thoughtful buying.

Another way that companies use consumers' sensitivity to giving up existing benefits is by offering coupons, membership benefits, and loyalty programs. For many consumers, they have encountered a time when sellers or brands have let them know that they are on the verge of losing some of the perks, whether it is expired coupons, unused points, or a downgraded membership. Those reminders may give rise to a feeling of possession, so that consumers feel like these benefits belong to them even before they are used. In such cases, the consumer's initial reaction is often to defend what they feel is rightfully theirs. Gu et al. examined the impact of companies on the engagement of consumers through promotional strategies and psychological influences. The study revealed that where there is a perception that benefits are diminishing or are going to be lost, consumers may emphasize the importance of preserving their existing benefits and feel more motivated to act to prevent the loss of benefits [6]. By changing potential gains to perceived potential losses, companies can make consumers more involved with brand activities and bring consumer relationships closer to brands.

Aside from the change in the information presented, another common way in which firms use the loss aversion effect is by using 'scarcity marketing'. With this strategy, there is an impression that consumers might miss out on important opportunities. Traditional scarcity is due to supply difficulty, whereas scarcity marketing may be created by the seller's limited supply and/or marketing it as such. For instance, businesses can release limited edition items, unique releases, or even provide information that certain products are in stock or are running out of stock, which makes people feel like the products are soon going to be unavailable. If consumers feel that they could miss out on owning the product if they do not buy it soon, they may feel more positive about the product and more inclined to buy it. Hamilton and Hosany examined the implications for consumer value perception and buying opportunities, in particular, determining if the scarcity marketing affects the consumers' evaluation of value and purchase tendencies. Their study revealed that there was a positive correlation between the scarcity of information and the consumer responses [7]. This implies that sellers can create opportunities to be irreplaceable that can be used in marketing strategies based on loss aversion psychology. It also informs that product scarcity does not necessarily have to be a natural phenomenon of the interaction between supply and demand in a market, but a marketing strategy by companies as they design it [7].

While these marketing techniques can boost the sales performance of companies, they would be counterproductive if they are used in excess, as this could raise ethical issues such as the accuracy of information, consumer autonomy, and trust in the long-term brand. Some companies may inflate potential losses or give an artificial sense of urgency to coerce customers, such as artificially low

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levels of stock or bogus discount dates, or misleading promotions. This artificial loss can easily lead to impulse buying and thus cause consumers to make hasty decisions. Thus, if the companies take too much advantage of the consumers' weakness in their psychological aspect, they may be damaging the consumers' rights and decreasing their trust in the brand.

4. Loss aversion and consumer purchase behavior

Loss aversion is a psychological phenomenon that affects consumers' assessment of potential gains and losses, making it relevant to them. It is important to note that the act of the consumer purchasing a product is not a one-off decision, but rather a psychological process which consists of pre-purchase evaluation, purchase decision making, and post-purchase reflection [1, 8].

In terms of purchase intentions, loss aversion can affect the consumers' value and need for purchasing by making them more aware of problems that they may encounter if they do not buy the product, for example, missing out on discounts, benefits, and limited-time opportunities. This may be due to many internal and external factors. Some of the most common factors are the nature of the product and the occasion of its use. Peña-García et al. have done this by considering the various factors that affect consumers' online purchase intention and how perceived value, perceived risk, and psychological factors interact to impact consumer behavior. The study revealed that subjective assessment of purchase outcomes impacts the consumers' final purchase intention and that paying attention to the potential negative outcomes can alter consumers' perceptions of product value [8]. But the effect of loss aversion is not equal in all circumstances; consumer attitudes and risk perceptions, purchase objectives, and loss perceptions can vary. Kim also explored how loss aversion relates to consumer responses and discovered that the impact of loss aversion can vary across specific consumption situations and consumers' psychological traits. Hence, consumers' loss sensitivity is not a constant but varies with a number of factors related to the situation and the consumer's assessment of the potential losses [9, 10].

Loss aversion can also impact consumers' choice process. Consumers are often presented with several options when making a purchase, comparing products, and evaluating factors like price, purchase risks, and product value. But, because of the power of loss aversion, consumers might focus more on avoiding a monetary loss, a quality disappointment, or missing the opportunity rather than maximizing the potential gain. To examine the effect of loss aversion on consumer judgment process, Nagaya explored the consumer judgment and decision-making process, focusing on how consumers make a choice in an uncertain situation. The report emphasized that consumers' attention to the loss potential might affect their evaluation of the different options. Especially, customers that think of a possible monetary loss will pay more attention to risk and thus will be more likely to experience risk perception and anticipated regret (APR) which, in turn will affect their purchasing decision [10].

Finally, loss aversion also impacts consumers' post-purchase behaviours like purchase regret, return intention, repurchase intention and brand loyalty. After the consumer has purchased it he/she is more inclined to second guess himself or herself and make comparisons between purchase outcomes and other possible options. For example if a customer purchases a relatively expensive product, he or she may discover later that the same product is being sold in an additional store for a reduced price which becomes a brand new benchmark for the customer to assess the first purchase. In such cases the consumer may feel that he or she could have done better. Therefore, consumers are likely to highlight the benefits they have forgone by taking their current action and, as a result, feel regretful, disappointed, and discontent, which could consequently lower their future purchasing of the brand. This unpleasant feeling following the purchase is called "Purchase Regret. This has been

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supported by Davvetas and Diamantopoulos, who examined the psychological responses the consumers have after purchase, and also investigated how regret affects the consumer's brand and future behaviors, such as their relationship with the brand. The study revealed that there is a relationship between purchase regret (consumer's perception of loss) and consumer satisfaction, which has a significant impact on the long-term relationship between consumers and brands, and consequently on brand loyalty [11]. In another study, Sarwar et al. investigated the nature of subsequent behavioral responses from the negative consumption experiences from a perspective of future behavioral intentions. This study examined whether consumers would continue to purchase the same product or look at other alternatives, or act as if they were not satisfied and purchase the product again after their dissatisfaction. The results indicated that negative experiences have a negative impact on the evaluations of products and brands, as well as an increase in the likelihood that consumers would change their choices if they perceived that the actual purchase outcome was less than what they expected. This means that people can have an increased intention to return, decreased intention to rebuy, and even alterations in future brand preferences [12]. As this study can prove, consumers' assessments of purchase results are highly sensitive to consumers' perception of whether they have suffered a loss as a consequence of the purchase. This loss may have additional effects on future consumption behavior of consumers after the purchase, when they feel that their purchase decision has led to an undesirable outcome, which demonstrates that loss aversion can impact beyond purchase intention and on the customers' satisfaction, loyalty, and brand choice.

5. Discussion and suggestion

In sum, it can be said that this paper has examined the issue of loss aversion in two distinct ways: first, from the company's perspective on how they design their marketing strategies to accommodate loss aversion and, second, from the consumer's perspective on how they are influenced by loss aversion before, during, and after purchase. However, loss aversion can be present throughout the whole purchase process: before purchasing, in the assessment of the value of the products; during the purchase, in the risk assessment; and after purchasing, in the regret experienced and the future usage of these products. From these, the interaction between consumer behavior and corporate marketing can also be observed: The sensitivity of the consumers towards the losses gives them a psychological foundation to companies for implementing various marketing strategies, and vice versa, the marketing strategies will affect the perception of consumers regarding the "losses." That is, consumers' loss aversion is a psychological underpinning for business strategies like loss framing, time-limited promotions, and scarcity marketing. At the same time, these strategies shift the originally perceived "potential gain" to a perceived "loss." Thus, consumers, through the influence of these strategies, further reinforce the consideration of potential losses.

This can bring both benefits and negative effects for both parties. Thus, the proper use of the concept of loss aversion is a topic to consider by both companies and consumers. Loss aversion, for the companies, is not enough to ensure successful marketing. They should also help to make product information accurate and credible, and give consideration to the effectiveness of businesses and consumer interests. While it is possible to make a marketing message more appealing by offering a real-time-limited promotion, a reasonable degree of product scarcity, and a clear expiration date, it is not ethical to attempt to create artificial urgency with bogus product availability, false product expiration, or misleading loss-related information. Companies can leverage loss aversion for marketing success, but it is important to be transparent and accurate regarding any information that is relevant, while not making it too manipulative for consumers. Loss aversion and other marketing concepts should be important for consumers. So, for a message like "only one left" or "offer is valid

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only while supplies last," consumers can actually reflect on whether they really need the item or whether fear of missing out (FOMO) is driving the purchase. The "fear of loss" does not necessarily imply that the product is of higher value; consumers should remind themselves of this consciously. If consumers are able to understand the psychological impact that loss framing, scarcity marketing, and time-limited promotions can have, they may be more aware that their buying habits are driven by psychological biases, and thus be able to make more rational decisions before buying.

6. Conclusion

To conclude, loss aversion and consumers' purchase decision has been discussed. Businesses can capitalise on their consumers' loss sensitivities through strategies such as time-limited promotions, consumer membership benefit expiry and scarcity marketing, which can shape consumer purchasing behaviour. Loss aversion, on the other hand, offers an important lens to view consumer decision-making and consumer reactions to uncertainty. It is also found in the course of this paper that business environment and psychology of the consumer is not independent from each other. Consumer's psychological characteristics can influence company's decision making and the psychological perception and behavior of consumers can be influenced by the consumption environment created by the companies. In order to avoid any kind of ethics issues, companies must maintain a balance between the consumers' interests and the effectiveness of the business. The consumer awareness of some of their psychological biases will be useful for consumers to make rational decisions in a complex consumption environment.

Hence, it is crucial to grasp loss aversion for understanding consumers' choices and realizing the constant interplay between consumer psychology and marketing. The ideas suggested in this paper can be used to incentivize businesses to become more responsible in the marketing process, while incentivizing consumers to be more rational in consumer decision-making. This paper discusses loss aversion, from a consumer psychology point of view, and gives insight about how to connect it with business practices. The conversation is a reference to further studies on psychological biases, marketing strategies and customer decision making processes, which might be useful in the study of psychological factors in the current consumption context.

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