17. Price Discrimination

Selling of a good (or service) to different consumers at different prices, where such prices aren't caused by **differences in cost**

Who does it? Monopolists (and near Monopolists)! **Why? To maximise profits!**

Selling SAME goods to DIFFERENT consumers at DIFFERENT prices

2 TYPES

Selling SAME goods at different QUANTITIES to SAME consumers at DIFFERENT prices

Example
Cinema tickets

How
Is it done?

All consumers have different **price elasticities of demand (PED)**

Cinema charges **different** prices for the **same** seat

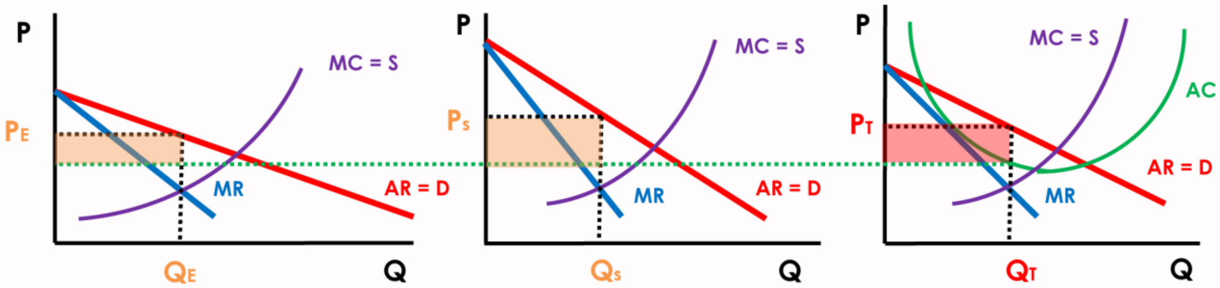
ELASTIC CUSTOMERS
Those on lower/fixed incomes: retired, students, elderly, unemployed
INELASTIC CUSTOMERS
Higher incomes: teenagers, employed (double income, no kids)

A price discriminating monopolist breaks down the overall market into sub-markets **(depending on these different PEDs)**

Why?
To maximise profits! (and revenue)
The monopolist will charge each market segment the **highest possible price**

2 Market Segments Elderly and Standard (Cinema Go-ers)

(A) Elderly (More Elastic) **+** **(B) Standard** (More Inelastic) **=** **Total Market**



The elderly are far more responsive to a change in price. P_E is **less** than the standard price P_S and **less** than the average price P_T

- **Costs** are the same for **all segments**
- Sets **MR**=**MC** to get **max profits**

The 'standard' person is less responsive to a change in price. P_S is **more** than the elderly price P_E and **more** than the average price P_T

- **Costs** are the same for **all segments**
- Set **MR**=**MC** to **max profits**

To maximise profits, the monopolist matches **MR**=**MC** in the total market and **THEN** in each submarket (**Costs equal**)

Cinema company maximises profits and revenue by adjusting prices so that **MR**=**MC** in **all segments**

Conditions Necessary for Price Discrimination

Element of Monopoly Power
Some **barriers to entry must exist** so new entrants can't undercut the price charged by the monopolist

Distinct and Separate Markets
Consumers must **not be able to resell** to each other (i.e. elderly selling cinema ticket to standard customers)

Differing Elasticities of Demand
Price discriminating monopolist will **KNOW** about different PEDs of its customers

Price Characteristics of Consumers

Consumer Ignorance
They must be unaware that a **substitute good is available** from another supplier at lower prices

Consumer Attitude
They must be willing to pay higher price for good supplied by one firm because of a **certain status attached**

Consumer Inertia
They must be reluctant to **change suppliers** should they exist (now or in the future)