APPLIED ECONOMICS FOR MANAGERS SESSION 8—

I. BASIC DISCRIMINATION STRATEGIES

A. PRICE TACTICS

1. TWO-PART TARIFFS
2. BLOCK-PRICING OR QUANTITY DISCOUNTS
3. MARKET SEGMENTATION

B. PRODUCT DESIGN ISSUES

1. BUNDLING/TYING
   a. THE SHOW MUST GO ON
   b. MAGICAM
2. VERSIONING
3. LOCATION ISSUES

C. PROFIT = CREATION AND CAPTURE OF VALUE

II. TYING AND PRICE DISCRIMINATION

A. IMAGINARY FIRM—ROWLING CORP.

1. MAKES A UNIQUE CAMERA CALLED THE MAGICAM.
2. PEOPLE IN PHOTO CAN WAVE AND TALK TO VIEWER.
3. HEAVY DESIGN COSTS SUNK IN DEVELOPING THE MAGICAM, BUT VARIABLE PRODUCTION COSTS = ZERO.
4. CAMERA REQUIRES SPECIAL FILM COSTING €2/PHOTO TO MAKE—SUPPLIED BY COMPETITIVE FILM INDUSTRY

B. TWO TYPES OF MAGICAM CONSUMERS—

1. HIGH DEMAND $P = 16 – Q$ (Q = SHOTS PER MONTH)
2. LOW DEMAND $P = 12 – Q$
3. THERE ARE 10 MILLION OF EACH TYPE

C. STRATEGY 1:

1. SELL CAMERA FOR €50.
2. RESULT: BOTH TYPES BUY CAMERA, ROWLING EARNS €50 FROM EACH TYPE OR €100 MILLION PER PAIR

D. STRATEGY 2:

1. DESIGN CAMERA SO THAT IT ONLY USES *ROWLING'S SPECIAL MAGIFILM* (WHICH COSTS €2 PER SHOT TO MAKE)
2. CHARGE €4 PER SHOT FOR FILM
   a. LOW DEMAND TAKE 8 SHOTS (€32 SURPLUS)
   b. HIGH DEMAND TAKE 12 SHOTS (€72 SURPLUS)
3. CHARGE €32 FOR CAMERA (LOW DEMAND SURPLUS)
4. RESULT: EARN €32 FROM BOTH IN CAMERA SALES PLUS €16 FROM LOW DEMAND AND €24 FROM HIGH DEMAND ON FILM EARN €104 PER PAIR

E. STRATEGY 3:

1. INTEGRATE FILM AND CAMERA SELLS TWO TYPES
   a. 10 SHOT FOR €70 (LOW DEMAND VALUE OF 10 SHOTS)
   b. 14 SHOT FOR €86 RESULT (HIGH DEMAND VALUE OF 14 SHOTS *LESS* €40):
2. RESULT: EARN €50 FROM LOW DEMAND AND €58 FROM HIGH DEMAND--€108 PER PAIR

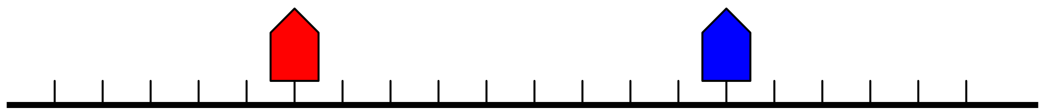
F. ***NOTE*** QUANTITY DISCOUNT IN ALL STRATEGIES

1. PRICE PAID PER SHOT UNDER STRATEGY 2:
   a. LOW DEMAND: (€32 + €32)/8 = €8
   b. HIGH DEMAND: (€32 + €48)/12 = €6.667
2. PRICE PAID PER SHOT UNDER STRATEGY 3:
   a. LOW DEMAND: €70/10 = €7
   b. HIGH DEMAND: €86/14 = €6.14

III. COMPETITION WITH PRICE DISCRIMINATION & VERSIONING

A. MONOPOLY POWER vs LARGE PROFIT

B. INTENSITY OF PRICE COMPETITION WITH DISCRIMINATORY PRICES



C. MONOPOLISTIC COMPETITION

1. CLOSE (NOT PERFECT) SUBSTITUTES $\Rightarrow$ LOW PROFIT
2. INEFFICIENT—AVERAGE COST NOT MINIMIZED
3. LINEVILLE’S FIRE DEPARTMENT

NICHE MARKETS AND MONOPOLISTIC COMPETITION