Why the Highest Price Isn't the Best Price Case Solution

PRICE DISCRIMINATION

"Taking a particular example of successful price discrimination, discuss the basis of the pricing policy and the conditions for successful price discrimination.Explain the impact of this policy on both the producer and consumers."

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What Producers Get Out Of This

The main aim of price discrimination is to increase the total revenue and/or profits of the supplier

It helps them to off-load excess capacity and can also be used as a technique to take market share away from rival firms.

Price discrimination seeks to extract consumer surplus and turn it into producer surplus (or profit).

All consumer surplus and deadweight loss that would have existed under uniform pricing is now part of the producers profits leaving consumers worse-off.

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What is Price Discrimination?

There is a one price law in perfectly competitive markets as all firms are price takers, but in reality firms charging different prices to different customers for the same product or service is common.

Price discrimination doesn’t always mean charging different prices, as customers may be charged the same price for a good but there may be cost differentials for the firm in providing the goods to different customers e.g. different transport costs incurred by royal mail in delivering to different regions but a uniform price is charged to all customers.

The different types of this pricing policy

First Degree (Perfect) Price Discrimination

First degree being the most extreme form of price discrimination entails setting different prices for each buyer at the maximum price they are willing to pay for each unit purchased.
E.g Negotiating prices with dealers for second hand cars, Haggling for the price of a hotel room, Dutch auctions, Antiques fairs and car boot sales!

May be deemed unrealistic-
Imagine the amount of information needed to this, I'll need to know all your demand curves.
Can businesses actually afford to do this?

This eventually leads to all consumer surplus being absorbed by the firm.

Second degree price discrimination

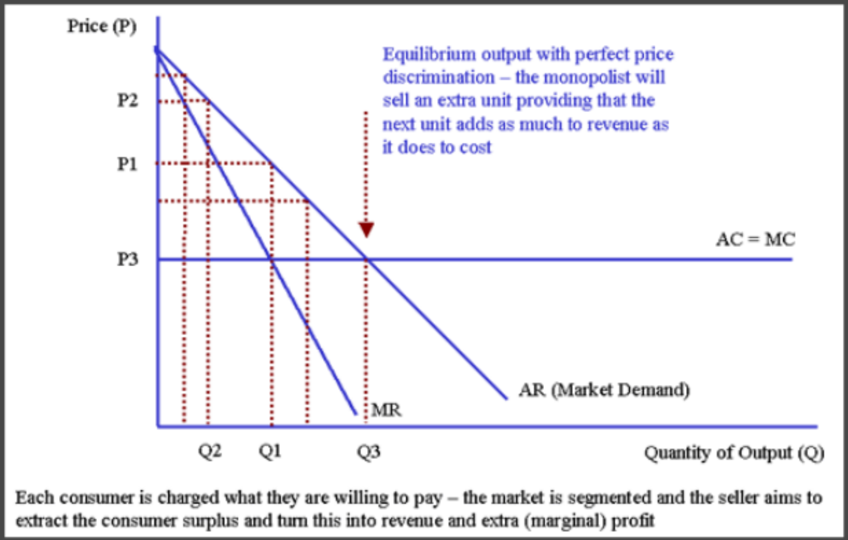
In the case of second degree price discrimination price differences depend on how much the customer purchases.

Usually, smaller levels of consumption are charged at higher rates and as level of consumption increases prices become relatively lower

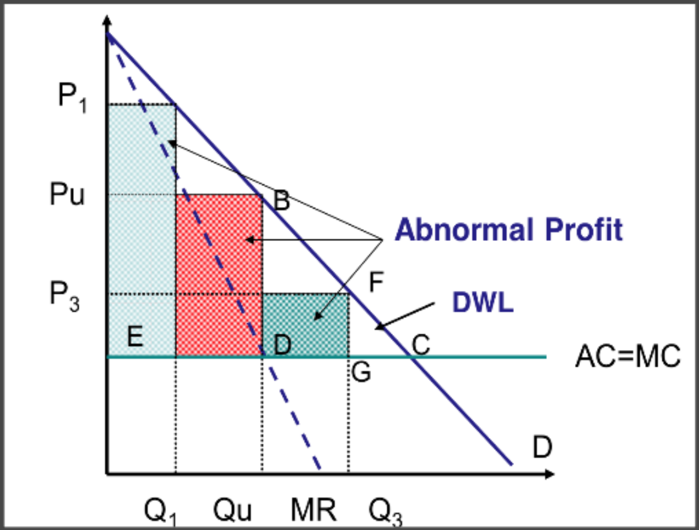
For example, after a certain number of units consumed, electricity tariffs tend to be lower.

What happens.

First degree



Second degree



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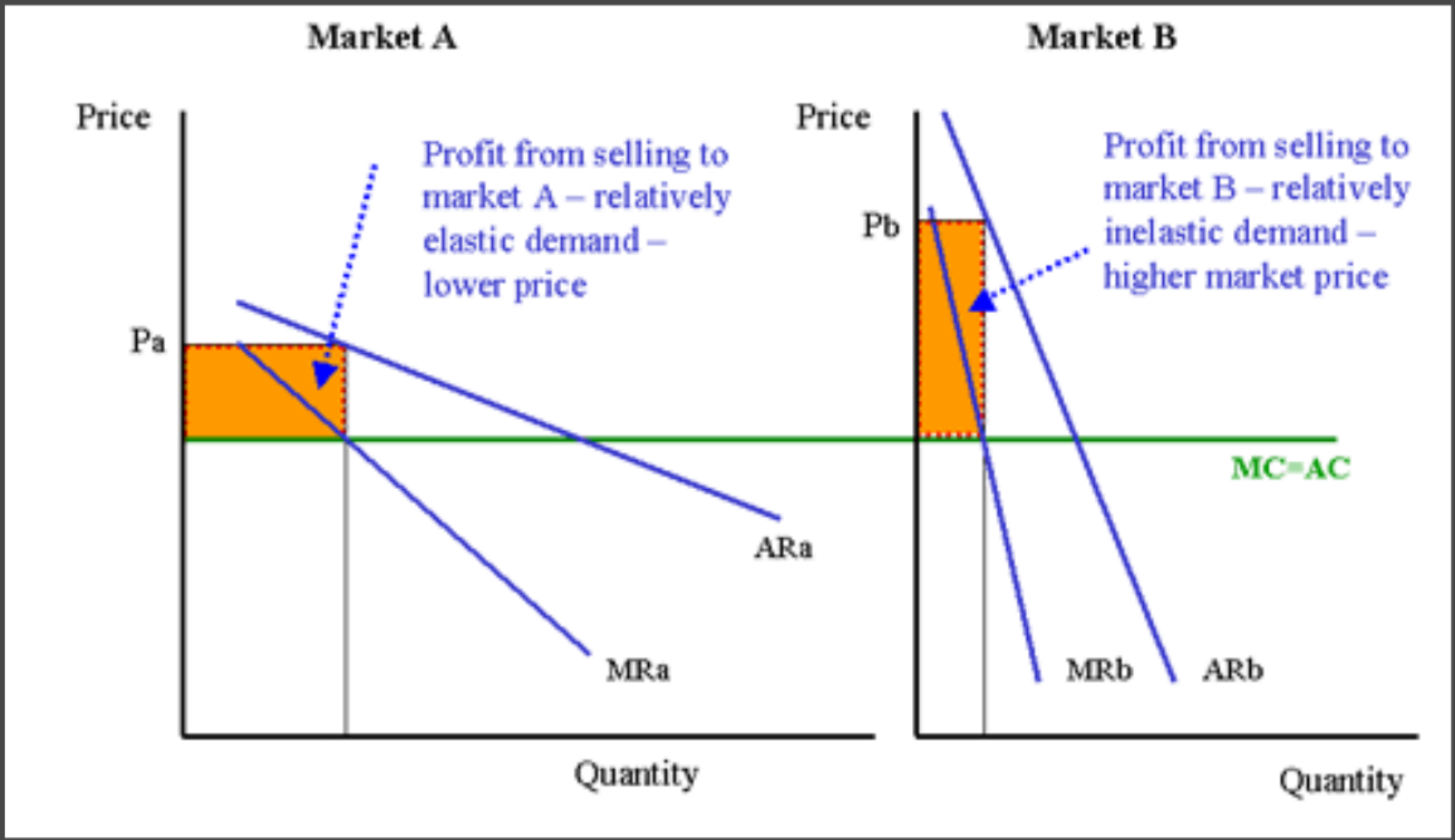
Third degree Price Discrimination

The most common form of this pricing policy. Here consumers are divided into groups(sub-markets) and different prices are set for each group.

There is no discrimination between individuals in the groups as there isn't enough information for firms to do this.



what is the firms profit as a result of these two graphs?

And what is the profit like compared to an instance of uniform pricing?

Train companies

Discrimination is done in different ways

- by time of day- off peak vs peak travel.
- buying ticket's in advance.
- by age group.

The conditions necessary for them to do this

Some degree of market power that is “the ability to set prices above marginal costs profitably”.

Train companies can be said to be natural monopolies

Although the UK government has actively tried to introduce competition by franchising the right to run trains in different regions to different private firms for a period of about 15years

But at the end of the day the private operators for the specified contract period have the monopoly on collecting money from passengers