Economics Workshop

Topic 9: Pricing strategies

1. Explain why a business will find it difficult to set prices following the *MC* = *MR* rule of traditional economic theory.
   In practice, a firm is unlikely to know their exact costs or revenues.
   Also, the price a firm charges for a good may vary:
   - between customers (price discrimination)
   - over the life cycle of the product
   - between different aims of the firm, eg maximising sales or profits
   - between the level of competition faced
   - between the information held on demand and costs.

2. Could an existing firm implement a policy of limit pricing if it had the same cost schedule as potential new entrants?
   If the existing firm had the same cost schedule as potential new entrants, there will be no cost advantages for the existing firm when adopt limit pricing strategy. However, it is still possible to do via predatory pricing. Predatory pricing is where a firm sets its price below its average cost in order to drive other firms out of business. It may do this by cross-subsidizing losses in one market with profits elsewhere, ie by price discrimination.

3. What would be the reason a monopoly or oligopolists operate at a lower average cost and how could they do it without ruining their business?
   Monopoly or oligopolists are usually large companies who own majority of the market share in a particular economy. Therefore, they would benefit from economies of scale, making their long run average cost lower than what could have been.

4. Outline the main factors that might influence the size of the profit mark-up set by a business.
   Mark-up pricing involves adding a certain percentage (mark-up) for profit on top of the average costs; therefore, we need to know **average costs**. In order to determine "how much" of a mark-up is sensible, we must know the **market demand**, **customers price elasticity**, as well as **the level of competition.**

5. A salesperson often asks a customer the following question 'how much are you thinking of spending?' Why might the salesperson ask this question? Is it in the interests of the customer to tell him/her the truth?
   This could be an example of a **first-degree price discrimination (FDPD)**, where they aim to charge each consumer the maximum price that he/she is prepared to pay. Since they are usually unable to determine this maximum price, they outright ask for it. It may not be in the interests of customers to tell the truth, but rather do some research about the price yourself before going to the shop.

   This could also be an example of a **second-degree price discrimination (SDPD)**, where the salesperson might actually offer you a discount if you are going to buy many products from the shop and that your total spending is high enough for the discount.

6. There are websites that collect together information on the various discounts that are available at any given point in time. Some of them make statements like ‘Our staff spend several hours every day scouring the internet for great deals so that you don’t have to.’ Discuss the implications of these websites for retailers who want to use coupons as a means of implementing a policy of second-degree price discrimination.
   This is usually the case for big furniture or electronic appliances stores, where coupon discounts are offered at various points in time. When retailers find the ‘best’ or cheapest deal for a particular product from the stores, they will buy them in bulk for reselling purpose. Customers who buy from retailers will experience second-degree price discrimination, where their total expenditure usually depends on the quantity bought, and the products are usually sold in an as-is condition (with some depreciation in value or lower software version).

7. If a cinema could sell all its seats to adults in the evenings at the end of the week, but only a few on Mondays and Tuesdays, what price discrimination policy would you recommend to the cinema in order for it to maximise its weekly revenue?
   The cinema could adopt a **third-degree price discrimination**, where consumers in different groups are charged with different prices. Since they have low sales on a particular weekdays, they could offers a discount to seniors or pensioners, who are free during the time.

8. What is pricing strategy?
   a. A method to promote products through discounts
   b. A way to determine the production cost of goods
   c. An approach to set the prices of products or services
   d. A strategy to allocate budgets for marketing campaigns

9. Limit pricing is used primarily to:
   a. reduce (limit) the profits of all of the firms in the industry.
   b. discourage new firms from entering a market.
   c. drive other firms out of a market.
   d. establish a minimum price all of the firms in the market will charge.

10. Which pricing strategy sets prices based on production costs and desired profit margins?
    a. Peak-load Pricing
    b. Inter-temporal Pricing
    c. Cost-Based Pricing
    d. Two-part tariff

11. Which pricing strategy sets prices based on the demand?
    a. Peak-load Pricing
    b. Inter-temporal Pricing
    c. Cost-Based Pricing
    d. Two-part tariff

12. Which pricing strategy initially charges a fixed fee, then separate charge for usage?
    a. Peak-load Pricing
    b. Inter-temporal Pricing
    c. Cost-Based Pricing
    d. Two-part tariff