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# Pricing information

Jeff MacKie-Mason

SI 646

What factors affect price for a  
Tori Amos CD?

Who is the problem solver (who sets the price)?

What does seller's cost structure  
imply for price of a Tori CD?



What does competition imply for  
price of Tori CD?





“Find a way to send a credible signal that entry will be met with aggressive pricing.... One way to establish this reputation, painful though it may be in the short run, is to fight tooth and nail when faced with me-too entries for specific information products.”

(S&V p. 31)

What does consumer demand (WTP) imply for pricing of Tori CD?

**Review: What is profit-maximizing rule for pricing?**



$MR(p) = MC$ : What more do we need to know?

Why do S&V write: "You must price your information goods according to consumer value, not according to your production cost"?

**Digression: What does this have to do with non-profits?**

“Commentators marvel at the amount of free information on the Internet, but it’s not so surprising to an economist. The generic information on the Net – information commodities such as phone numbers, news stories, stock prices, maps and directories – are simply selling at marginal cost: zero.” (S&V p. 24)



Change demand

Segment demand

**Nagle: Don't think of consumer  
demand as fixed stone tablet**

Aggregate demand

# Change demand: How?

Segment demand

Aggregate demand

Increase it

Make it less price responsive

**Change demand: increase it.**

How?

Change demand: Make it less price responsive.

How?

**Both: Improve buyer information.**

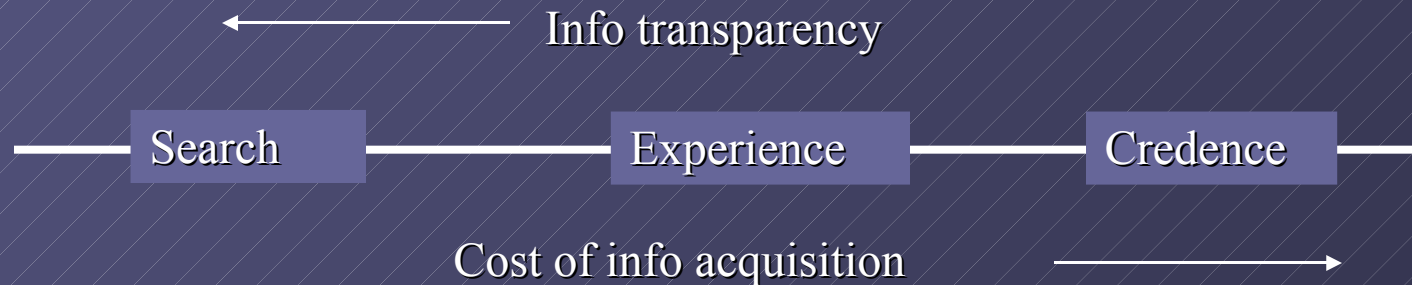
How?

Why?

**Change demand: Worsen buyer  
information!**

How?

# Nelson, Darby & Karni on goods attributes



# Change demand

## Segment demand: How?

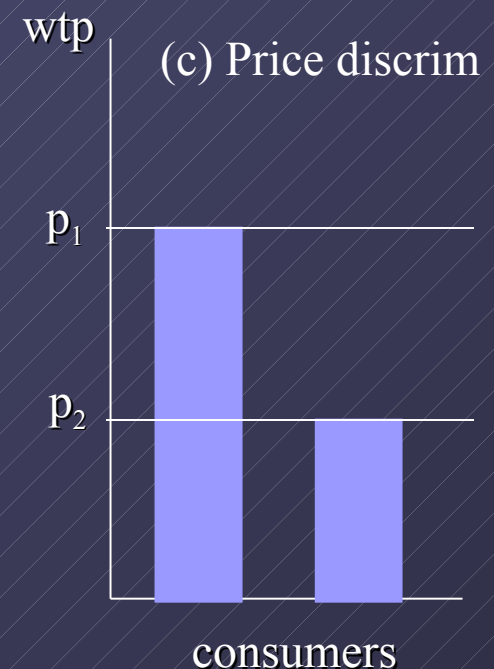
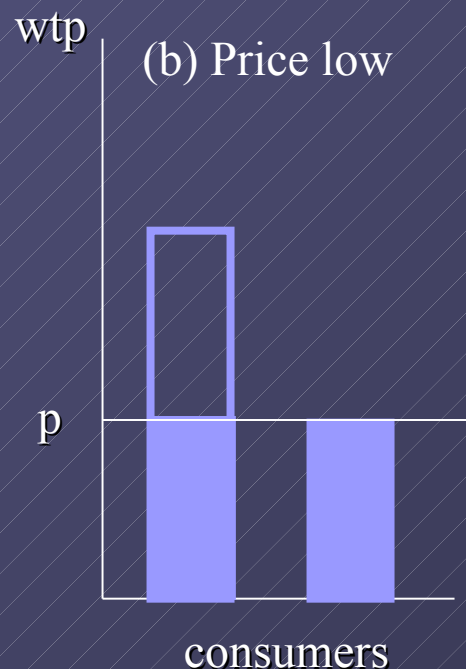
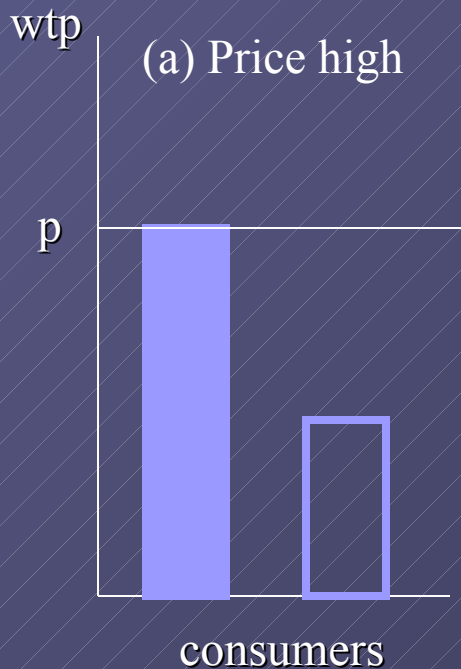
## Aggregate demand

Tailor pricing to  
distinguishable groups



# Simple illustration

- Suppose two customers each want one unit, different willingness to pay (blue bars)
- Can price high to one (a), or price low to both (b)
- If could price differentiate, could increase profit (c)



# Is segmenting easy?

Need segments distinguishable

and price distinctions enforceable

What three broad types of price differentiation do S&V discuss?

personal pricing: based on some indicator of individual WTP

What three broad types of price differentiation do S&V discuss?

versioning: product line  
or quantity variation

What three broad types of price differentiation do S&V discuss?

group pricing: based on observable  
group characteristics that predict  
average WTP

# How much to charge each group?

$$\text{Max } \pi = p(q)q - C(q)$$

$$\text{FOC: } \frac{\partial \pi}{\partial q} = p'(q)q + p(q) - C'(q) = 0$$

$$p'(q)q + p(q) = C'(q)$$

$$p(q) - C'(q) = -p'(q)q$$

$$\frac{p - MC}{p} = -p'(q) \frac{q}{p} = \frac{1}{|\epsilon_D|}$$

Inverse elasticity rule

What information is needed for each type of price differentiation?

Personalized: Identify individuals and their wtp

**What information is needed for each type of price differentiation?**

Versioning: Know predictable relationship between versions and distribution of wtp across consumers



**What information is needed for each type of price differentiation?**

Group: Know predictable relationship between observable groups and group demand elasticities

Why doesn't Apple charge lower iTunes price to senior citizens?

What are some examples of price differentiation by versioning?

What are some examples of price differentiation by group?

**Change demand**

Change demand

Aggregate demand: How?

Bundling

Tying

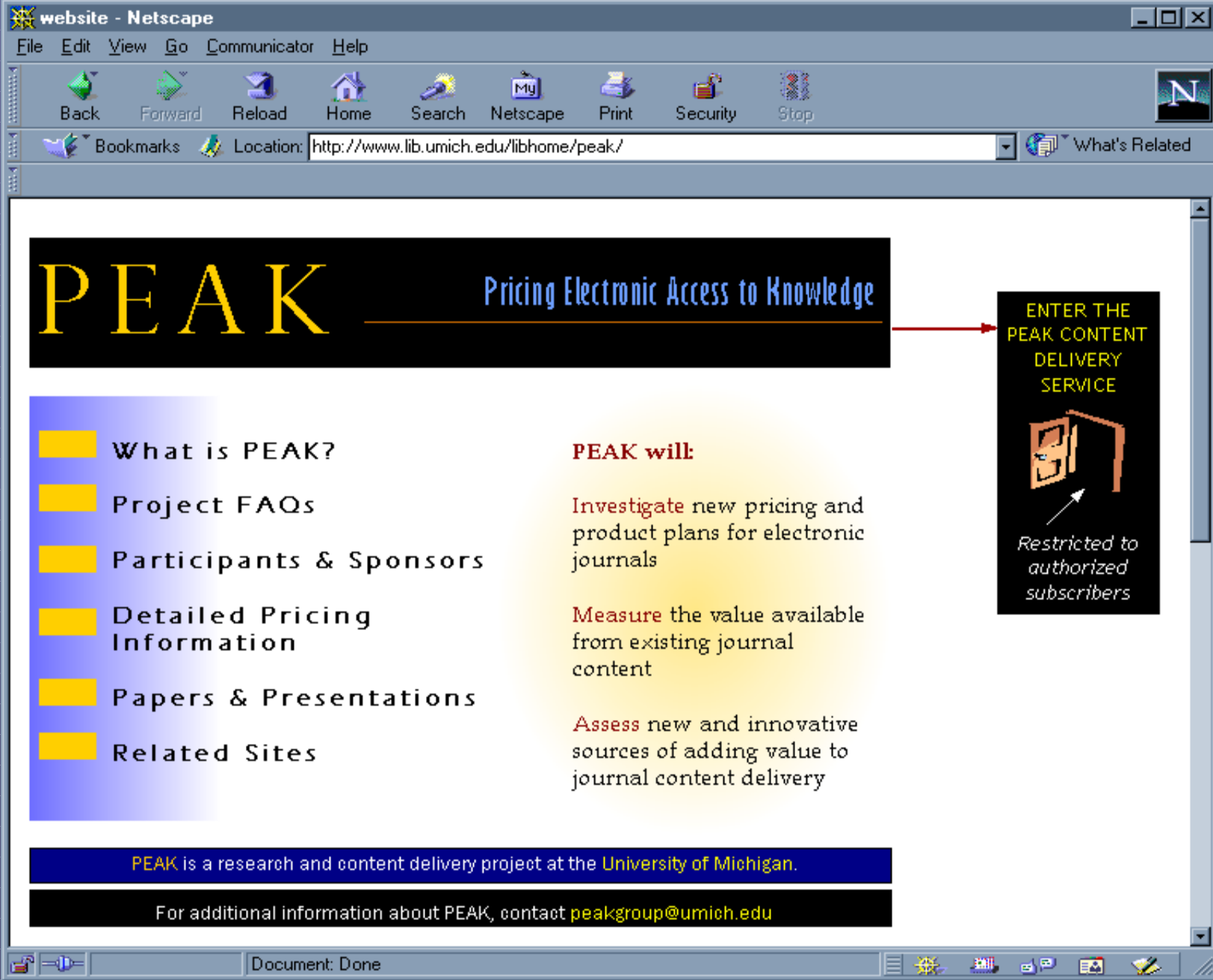
**What is bundling?**

What is tying?

How does tying affect demand?



How does bundling affect demand?



# PEAK


Pricing Electronic Access to Knowledge

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- Assess** new and innovative sources of adding value to journal content delivery

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**What are the fixed and variable costs of publishing?**

What implications do these costs have for journal pricing?

What are some price configurations to consider for scholarly publishing?

**What implications for competition?**

Really? Low prices?