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Coimbatore- 49



**DEPARTMENT OF COMMERCE WITH
INFORMATION TECHNOLOGY**

MANAGERIAL ECONOMICS
Differential Pricing

Dr. R.Arthi, M.Com (IB),M.Phil., MBA.,M.Com.,Ph.D.,

Assistant Professor,

Department of Commerce with Information Technology

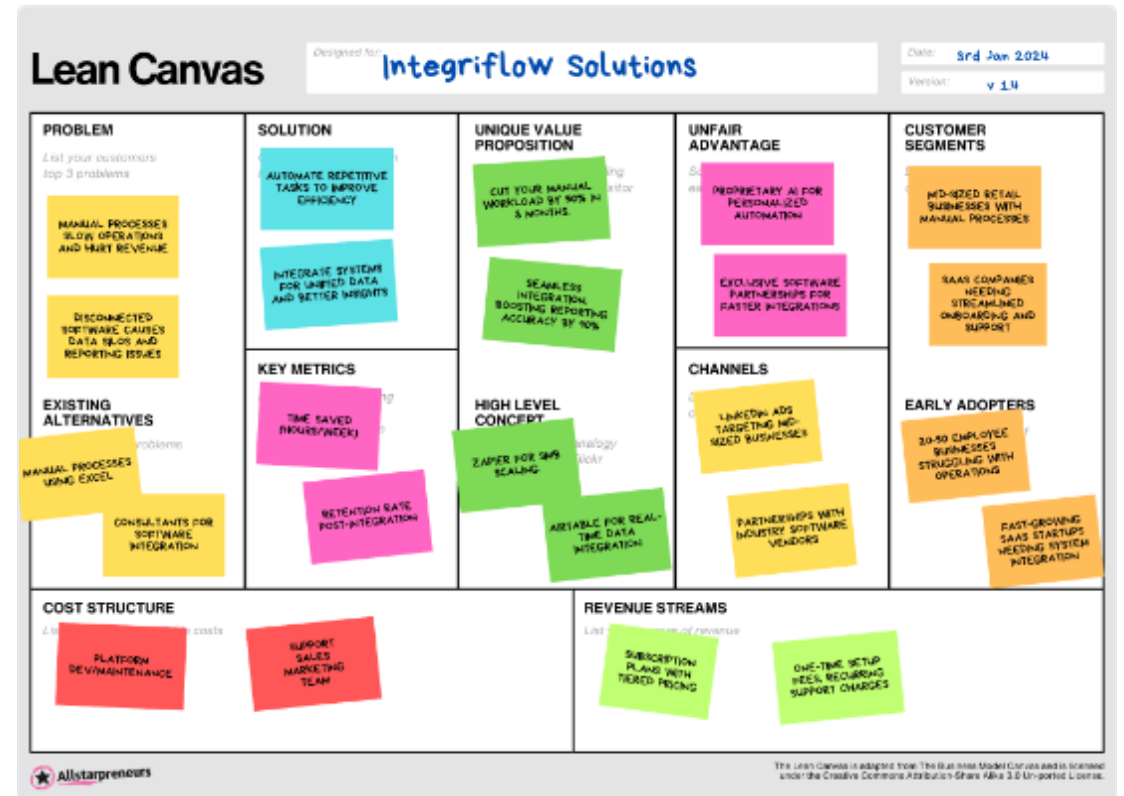
What is Differential Pricing?

The Core Concept

Differential pricing (or Price Discrimination) is the strategy of selling the same product or service to different customers at different prices.

The Goal: To capture consumer surplus—the difference between what a consumer is willing to pay and the market price—thereby maximizing total revenue.

It transforms the "one price fits all" model into a tailored approach based on willingness to pay.



Prerequisites for Success



Market Power

The firm must be a price maker, not a price taker.
Perfect competition prevents price discrimination.



Segmentation

The firm must be able to distinguish between different groups of consumers based on their elasticity of demand.



No Arbitrage

It must be impossible (or costly) for customers who buy at a low price to resell the product to those who pay a high price.

Personalized Pricing

"Perfect" Price Discrimination

The seller charges each customer the maximum price they are willing to pay.

Mechanism: Determining the exact reservation price for every individual.

Result: The firm captures 100% of the consumer surplus.

Examples: Auctions, car dealership negotiations, or complex B2B contracts where every deal is unique.



Product Versioning



Self-Selection

Prices vary according to the quantity sold or the version of the product.

The seller creates a menu of options, and customers *sort themselves* based on their preferences.

Examples:

- Bulk discounts (Buy 2, Get 1 Free).
- Software tiers (Basic vs. Pro vs. Enterprise).
- Airline classes (Economy vs. Business).

Group Pricing

Segmentation by Attribute

The most common form. Charging different prices to different groups based on observable characteristics that correlate with demand elasticity.

Key Segments:

Demographics: Student discounts, Senior citizen rates.

Geography: Regional pricing (e.g., Netflix subscription costs by country).

Time: Peak vs. Off-peak electricity rates.



Comparing

Feature	1st Degree (Perfect)	2nd Degree (Quantity)	3rd Degree (Group)
Basis of Price	Individual Willingness	Quantity/Choice	Group Identity
Information Need	Extremely High	Low (Self-selection)	Medium (Observable traits)
Surplus Capture	Complete (100%)	Partial	Partial
Common Example	Auctions	Wholesale Clubs	Student IDs

Modern Era: Dynamic Pricing

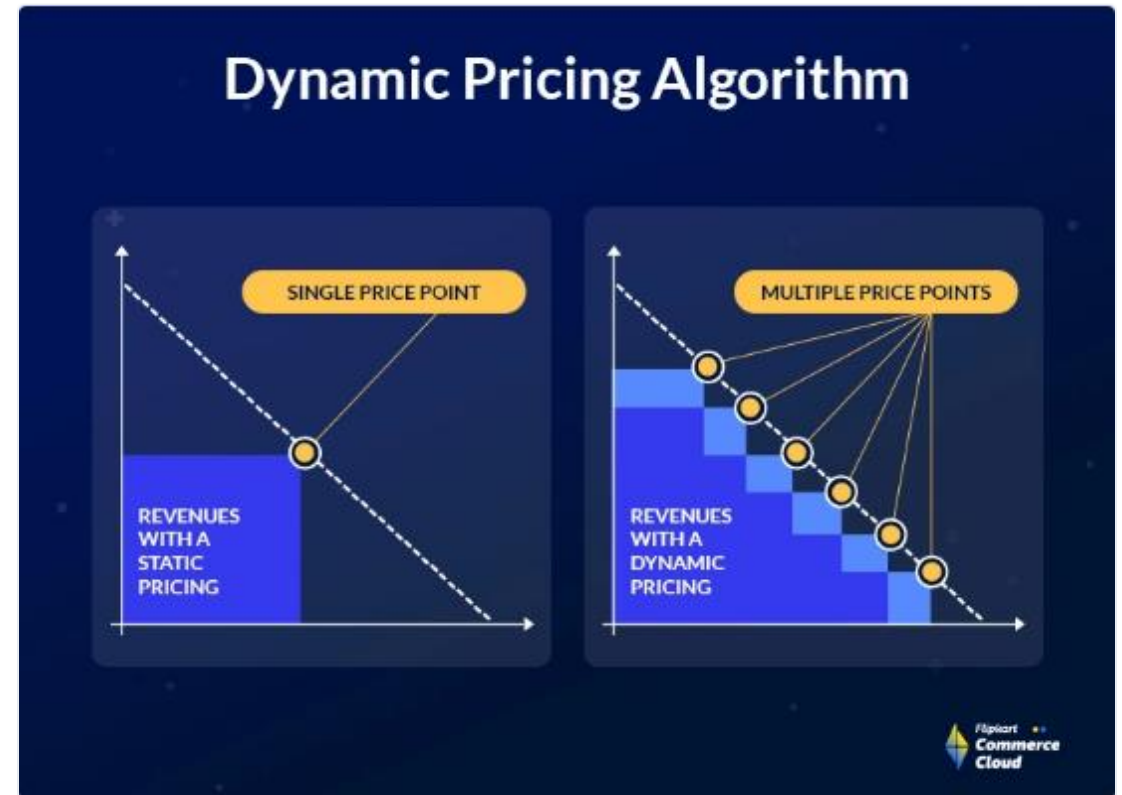
Technology has enabled a hyper-speed version of price discrimination known as dynamic pricing.

Prices fluctuate in real-time based on supply, demand, competitor pricing, and even user behavior history.

Uber/Lyft: "Surge pricing" during high demand.

Amazon: Prices change millions of times a day.

Airlines: Prices shift based on days until departure and cookies.



Strategic Benefits

- ✓ Increased Revenue: Captures surplus that would be lost under a single-price model.
- ✓ Market Expansion: Allows lower-income segments to access the product (e.g., students) who would otherwise be priced out.
- ✓ Inventory Management: Helps smooth demand via peak/off-peak pricing (e.g., Happy Hours).
- ✓ Economies of Scale: Increased sales volume from lower price tiers helps lower average production costs.

Real World Examples



Airlines

Classic dynamic pricing based on time of booking.



Cinemas

Matinee discounts and age-based tickets.



Hospitality

Happy Hours to shift demand to off-peak times.