Price Discrimination with Self-Identification

The Basic Problem

• Suppose the firm cannot tell one customer from another, but knows that there are demand differences to exploit.
• It must post a single price schedule.

An Illustration

• Eduardo’s Fine Foods makes gourmet peanut butter. It has two typical clients
  – The yuppie market, composed of swinging singles
  – The married market, where families purchase peanut butter for their kids.

Two Demand Functions

Two Demand Functions

The single price solution

The Block price solution
Two Demand Functions

The Block price solution

One customer pays a high price

And the other pays a low price

Implementation 101

• Eduardo’s Gourmet Peanut Butter comes in two sizes:
  – The regular one pound size costs $2
  – The three pound family size costs $4

Implementation 102

• Office Max has two types of customers for plain paper: households and businesses.
Office Max has two types of customers for plain paper: households and businesses. They sell it:
- By the ream (500 sheets)
- By the case
- By even bigger lots

Two Examples:
- At one time, Xerox leased machines at $25 per month and 3.5 cents per page.
- This effectively charged high volume users one price and low volume users another price.

Two Examples:
- IBM went at it a different way. It required that users purchase their computer punch cards from IBM.
- They effectively charged high volume users more.

Why did IBM go one way and Xerox another?
- Xerox could monitor usage, through an internal monitor.
- IBM could not, and so used punch cards as a proxy.
End

©2006 Charles W. Upton