Price Discrimination in Action

Three Examples

- Grocery Store Coupons
- Loss Leaders
- Tie-in Sales

Grocery Store Coupons

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- Manufacturers frequently give “cents off” coupons for their products. Why not simply cut the price?
- The benefits of coupons accrue to customers with a higher elasticity of demand (that is, their value of time is low and they will search for bargains) but not to customers with a low elasticity of demand.

Grocery Store Coupons

- If you don’t believe this point, spend an hour in a supermarket on Thursday afternoon and on Saturday afternoon and witness the different frequency of coupon use.

Eduardo’s Pasta

	Consumer Surplus per jar
Low Income Families	$4
Yuppies	$8

Eduardo's Pasta

Price at $8; run a $4 newspaper coupon

Price at $8 with a buy one get one free offer

	Consumer Surplus per jar
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Loss Leaders

- Stores often have "loss leaders" where they sell one item below marginal cost.
  - Milk is frequently sold that way, as are turkeys at Thanksgiving and Christmas.
  - I am told that most infant formula in this country is sold as a loss leader, below the wholesale price.

Loss Leaders

- The idea is to give a "rebate" to customers who have significant price elasticity because of their larger purchases (and who are thus more likely to search for good prices).
- Thus the posted prices are officially the same for all, but it works out differently in practice.

Tie-In Sales

Customer	***A***	***B***
Smith	500	1100
Jones	1300	700
Brown	300	1600

Tie-In Sales

Customer	***A***	***B***
Smith	500	1100
Jones	1300	700
Brown	300	1600

Price A at $1300; B at $1100; total sales of $3500

Tie-In Sales

Customer	***A***	***B***
Smith	500	1100
Jones	1300	700
Brown	300	1600

Sell at a package of $1600; make three sales

End