

Price Discrimination MC & Essay Questions

GCE A-LEVEL ECONOMICS

5 Which of the following is the best example of price **discrimination**?

(1)

- A A bus company charges less than a train company for a single ticket from Oxford to London
- B An airline charges less for economy seats than for business seats
- C A café charges less for a cup of tea than a cup of coffee
- D A nightclub charges women less than men for admission
- E A university charges higher fees for Chemistry than for History undergraduate degrees

Answer

Explanation

(3)

Question Number	Answer	Mark
5	<p>D</p> <p>Definition/identification mark: The product is the same but the users are charged a different price. (1)</p> <p>Conditions for price discrimination (1). Rationale e.g. different elasticities of demand (1) and the women have more elastic/higher value PED than men (1)</p> <p>Diagram of price discrimination up to 2 marks: low price elasticity of demand for men, high price elasticity of demand for women (1) showing <i>high prices</i> in the low PED male sub-market and <i>low prices</i> in the high PED female sub-market (1)</p> <p>Application mark (1): women are charged less to attract them when they have more choices of entertainment, or other relevant application of the other keys</p> <p>Benefits to the firm (1): increased profit</p> <p>Further analysis mark (1+1): discussion of costs of keeping market separate, no resale between sub-market, discussion of product discrimination</p> <p>Example of elimination mark: Knock out of A, B, C or E as they are different products, with application (1)</p> <p>Knock out of A, B, C or E because there are different production costs (1)</p>	(4)

Jessops, the photography retailer, made a surprise return to the high street in March 2013 when Peter Jones, one of Britain's best-known entrepreneurs on the BBC programme *Dragons' Den*, relaunched the chain 11 weeks after it collapsed. Jessops, which was founded in Leicester in 1935, reached shut-down point in January 2013. Jessops suffered both from consumers' shift to buying cameras on the internet and their increased reliance on cameras built into mobile phones. Mr Jones became Chief Executive of Jessops after buying the firm from its administrators PricewaterhouseCoopers. Mr Jones made his money from the telecoms industry and operates some stores for Vodafone and has online retail investments. He has invested £4 million in Jessops and will reopen around 40 shops, far fewer than the 187 shops the retailer had before.

"Britain's high street is fighting back," Mr Jones said as he reopened a refurbished flagship Oxford Street store, adding that shops could compete with online traders if prices are competitive. "Who would *not* want to buy a camera from expert and enthusiastic staff?" he said. Stores will feature areas to try out products before buying. Customers will be able to create photo albums and take photography courses through the Jessops Academy. Staff will also turn photos into calendars and posters while you wait. Mr Jones said companies such as Apple had proved that customers would spend time and money in a welcoming environment with quality staff in busy locations. "It is very Apple-ish. We have learnt from other retailers, I believe Jessops is an iconic British brand which can lead the retail resurgence on Britain's high streets, powered by new innovations and world-leading, expert staff" he said. "Image is everything and, even in the mobile and tablet era, there's no substitute for a quality camera when it comes to taking the perfect picture."

Mr Jones has reduced fixed costs from £8 million to £1.5 million by cutting administration costs, closing stores and further rationalisation. Jessops will have outlets in centres such as London, Birmingham, Manchester and St Albans, with six opening immediately. Jessops will hire as many as 500 staff and many are drawn from the 1 400 who lost their jobs when it collapsed. "A lot contacted me on Twitter and asked for a job and it's great to have them," said Mr Jones.

Prices will be matched to those of Jessops.com and Mr Jones said it would be "competitive" with other online retailers such as Amazon. "We will make our profit margin on the accessories," he said. He said "click and collect" would be a powerful driver of sales and Jessops promised greater integration with its online presence, including an option to collect internet orders at store. "I think Amazon will start to lose their market share because they do not have a collect at store. Nobody likes waiting in for a delivery."

Mr Jones forecasts sales of more than £80 million in his first year and expects to take some 15% of the digital single lens reflex camera market in the UK. Revenue before Jessops shut was £304.6 million, but the firm is said to have made a loss of £12 million in the fifteen months up to its closure.

More than 10 000 jobs have been lost in retail this year as chains such as HMV and Republic have fallen into administration. However, Mr Jones is not the only person to see potential in the high street despite flat retail sales. Sports Direct bought fashion chain Republic while Gordon Brothers Europe, the private equity firm, this week bought Blockbuster UK, the entertainment group, out of administration and will keep half its 528 stores open, claiming it can "bring new life" to them.

(Source: adapted from By Andrew Bounds FT.com 28 March 2013, www.ft.com/cms/ and www.thisisleicestershire.co.uk)

***(c) To what extent is price discrimination possible for firms selling products both on the internet and in high street shops?**

(12)

Question Number	Answer	Mark
10c	<p>KAA 6 marks Allow up to (2x 3 marks) or (3x2 marks) or Diagram (2) plus (2+2) or (3+ 1)</p> <p>Answer may relate to price discrimination within Jessops or between firms within any retailing market.</p> <p>Allow 1 mark for clear explanation of price discrimination (selling the same product at different prices) (1)</p> <p>Diagram marks (up to 2 marks)</p> <ul style="list-style-type: none"> - Inelastic AR or D linked to high price and/or elastic linked to low price (1) (can be shown through gradient of AR or D) - Profit maximisation output and prices extrapolated from whole firm diagram (1) 	(12)

Reasons why price discrimination is possible:

Discussion of fulfilment of conditions for price discrimination:

- Different price elasticity of demand, e.g. higher PED online as more competition
- Monopoly power. Consideration of the branding within the market, and the ability to retain customers even when prices are raised. The appeal of Jones himself might be considered as a marketing tool.
- Separation of the market, e.g. people want to try the product and receive advice in a shop, and online there is a time delay before the goods are received
- Low costs of preventing arbitrage, or similar. For people shopping in store they may or may not be prepared to go home and buy the product online. Also can consider the risks or other costs of buying on the internet.

Award application: as part of these conditions (up to a maximum of 3 marks for each condition overall), e.g.

- Jessops sells accessories at higher prices in the high street stores but the cameras are very similar prices.
- Online prices are lower so people are transferring to the online market.
- High street stores are closing for this reason
- Jones's comments on trying the cameras in the shop, the Apple-ish model, etc.
- Jones does not intend to price discriminate on the major lines, but instead have very similar prices to online. He plans to make the money on accessories

Evaluation: 6 (2x3 marks or 3x2 marks)

- Discussion of whether price discrimination is in fact possible as a strategy, e.g. in the long term arbitrage will become easy
- It's product discrimination not price discrimination because costs in each market are different
- It's product discrimination not price discrimination because 'Try before you buy' and other advice in the shop means that the product in the shop is not the same as the one online (or similar application points)
- Changes in the economic cycle will affect PED, and other determinants of PED
- Jones is willing to stake £4million that discrimination is possible
- Depends on the season, e.g. Christmas, and the PED
- Depends on other factors, such as ability to park, availability of other retail outlets nearby, as to the willingness of face-to-face shoppers to spend.
- Depends on actions of competitors e.g. click and collect
- Other criticisms of price discrimination, e.g. it can be illegal in some cases, and might be investigated by the competition authorities

***(d) Discuss strategies, apart from price discrimination, that high street retailers might use to increase profit in the face of greater competition from online retailers.**

(16)

Question Number	Answer	Mark
10d	<p>Award up to 4 strategies (4x2 marks), or (3+3+2 marks) or (2x4 marks)</p> <p>Any comments regarding price discrimination are NOT permitted</p> <p>Strategies MUST be linked to profit. These might include:</p> <ul style="list-style-type: none"> • Pricing policies (may count as more than one strategy): predatory, limit pricing, cost-plus, BOGOF <i>if linked to profit</i> • Non-pricing strategies (may count as more than one strategy) e.g. heavy marketing, loyalty cards, good sales information, after sales service, friendly, photo albums, posters whilst you wait • Existing firms might cut own costs • New ideas might be developed to create barriers to entry • Other barriers to entry discussion • M&A activity is likely for new entrants being bought up • BOGOF (allowed if not used as a pricing strategy) <p>Award appropriate use of game theory to develop a point</p> <p>KAA CAP 6/8 if no reference to high street retailers</p>	(16)

Evaluation 8 marks (4x2 marks), or (3+3+2 marks) or (2x4 marks):

- it might not be possible to make profits – odds are stacked against high street stores as their costs are higher
- Magnitude issues, e.g. size of cuts in number of stores by Jones is a significant shift in fixed costs
- Depends on whether we are in recession or growth (camera is luxury, large part of income, YED issues etc)
- Discussion involving game theory can earn evaluation marks, e.g. the behaviour depends on the size of the payoffs
- Depends on the actions of other firms (game theory might be used)
- Some practices are illegal e.g. predatory pricing
- Cost of policies, e.g. advertising
- The high street retailer can adapt to also become an online retailer
- Critical judgement of strategies set out under KAA
- Prioritisation with justification