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TOPIC 19: PRICE DISCRIMINATION III

I. Why does popcorn costs so much at the movies?
   a. No, it's not because they are the only ones who provide popcorn. They are also the only ones who provide bathrooms but they don't charge for those, either. Napkins are free, too.
   b. When answering questions like these, it is often help to rethink what the vendor is selling into the broadest sense possible. The movie theater isn't merely selling movies; it's selling a movie-going experience.
      i. For some people to enjoy the experience, they just want to see the movie.
      ii. For others to enjoy the experience, they need a snack. Often this is popcorn but other food works just as well; note all snacks are expensive at movie theaters.
      iii. Movie tickets are relatively cheap (they barely cover the cost the theater has to pay for the right to show the movie). Tickets are cheap because theaters want as many people as possible to show up. The first group has an elastic demand for snacks; they walk away from such high prices.
      iv. But the rest of those people will want popcorn and such people will have a very inelastic demand curve for it (remember: to have an enjoyable experience, popcorn is *necessary*).
      v. By charging a lot for popcorn but a little for the ticket, the theater has two prices for "the movie-going experience," one for the elastic group and a higher one for the inelastic group.
   c. If your economic naturalist question involves an industry's strange pricing, it is often useful to rethink what the firm is actually selling. Selling an "experience" rather than simply a product is quite common.

II. Tying
   a. The price of popcorn is an example of *tying*—when the seller charges one price for a good that can only be used with another good charged at a lower price
      i. Crucially, the seller must be the only seller of the higher-priced good. The two goods must be tied together.

        ii. This is why video game consoles are so cheap compared to video games themselves. You can't use an X-Box game on a PlayStation.
    b. It's easy to see how this is price discrimination if you imagine the two goods—console and games, for example—as one good: ability to play video games.
        i. Those with an inelastic demand curve are probably video game nerds and will buy many different games.
        ii. Those with an elastic demand curve will only buy a few games and thus pay a much lower price for that ability.
    c. The "loss leader" strategy in retail is also an example of tying.

III. Bundling
    a. This is kind of the opposite of tying. Instead of two goods being separately (one good and many goods), *bundling* is selling a good which can <u>only</u> be bought in a bundle of other goods (one-to-one).
        i. You only need to buy one Nintendo Switch to play many games. But you want more copies of Microsoft Excel, you'll have to buy more copies of Word along with the Excel copies.
        ii. Bundling examples: streaming services, Office software, buffets, politicians
    b. Companies bundle when groups of people value parts of the bundle differently. If the bundle is assembled correctly, lots of people should value the result the same even if they vastly disagree on how they value the parts of the bundle.
        i. Wilf and David both use Microsoft Office. Wilf tends to use Excel, using other software for word processing. David prefers Word, using Excel only in rare cases. Suppose each is willing to pay $90 for what they use often and $10 for what they use rarely.
        ii. Even though they disagree on how much each component is worth, they agree on the bundle.
        iii. Unbundled, Microsoft could charge $90 for each or $10 for each part (getting $180 or $40 in total revenue, respectively). With bundling, they charge $100 for each bundle, getting $200 in revenue.
    c. Bundling is price discrimination. In practice, David is being charged $90 for Word and $10 for Excel while Wilf is being charged $10 for Word and $90 for Excel. The same good, examined as separate for the bundle, is being charged different prices.

i. In other words, the different prices functionally occur in the consumer's own head.