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**Master of Business Administration**

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***MANAGERIAL ECONOMICS- WEEK 2 NOTES***

**CERTIFICATE OF AUTHORSHIP:**

I certify that I am the author of this paper and that any assistance I receive in its preparation is fully acknowledged and disclosed in this paper. I have also cited any sources from which I used data, ideas, or works, either quoted directly or paraphrased. I also certify that this paper was prepared by me specifically for this course/program.

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Professor Comments:

## Week III-I

### Chapter 12- More Realistic & Complex Pricing

The  $MR=MC$  pricing rule applies only to a single-product firm setting a single price on a single product. In more complex settings, the rule may not apply.

- Pricing Commonly owned products after acquiring a substitute good, raise price on both goods.
- After acquiring a substitute product, raise price on both goods, but raise price more on the more elastic (low-margin) product.
- After acquiring a complementary product, reduce the price on both products to increase profit.
- If fixed costs are large relative to marginal costs, capacity is fixed, and  $MR>MC$  at capacity, then set price to fill available capacity.
  
- If demand is hard to forecast and the costs of underpricing are smaller than the costs of overpricing, then underprice, on average, and vice versa.
  
- If promotional expenditures make demand more elastic, then reduce price when you promote the products, and vice versa.
  
- Psychological biases suggest being aware of price expectations and “framing” price changes as gains rather than as losses.
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If  $MR>MC$  at capacity, then price to fill available capacity

**Chapter 12.3** If promotional expenditures make demand more (less) price elastic, then you should reduce (increase) price when you promote the product.

**Cannibalism:** When you own two products and one product's price is really high and eating up all the profits. Basically, the sales of one product with increased sales of the other. To avoid price cannibalism, you **differentiate** them.

### Chapter 13. Direct Price Discrimination

**Price discrimination** is the practice of charging different prices to different buyers or groups of buyers based on differences in demand.

Direct price discrimination requires that you be able to identify members of the low-value group, charge them a lower price, and prevent them from reselling their lower-priced goods to the higher-value group.

**Arbitrage:** can defeat a price discrimination scheme if enough of those who purchase at low prices resell to high-value consumers. This can force a seller to go back to a uniform price.

If a seller can identify two groups of consumers with different demand elasticities, and can prevent arbitrage between the groups, it can increase profit by charging a higher price to the low-elasticity group.

You have to be able to prevent arbitrage. Ex. Senior citizen prices. Direct Price Discrimination: requires that you be able to identify the members of the low-value group, charge them at a lower price, and prevent them from reselling their lower-priced goods to the higher-value group. Indirect pricing scheme : When you can't differentiate between your customers?

**Chapter 14:** when a seller cannot identify low-and high-value consumers or cannot prevent arbitrage between two groups, it can still discriminate indirectly by designing products

**14.2** When bargaining with a customer, do not bargain over unit price; instead, bargain over the bundled price.

**Metering:** type of indirect discrimination that identifies high value consumers by how intensely they use a product.

**FOR CAPSTONE:** Justify pricing. Each service is directed to a different target market. Each subscription has a feature that is appealing to everyone. The profit margin for the biggest package should be higher. We recognize that there are high value customers and low value customers. This % customer is attracted to this, this % is attracted to that service, etc.

**FOR CAPSTONE:** Bundling different goods together can allow a seller to extract more consumer surplus if willingness to pay for the bundle is more homogeneous than willingness to pay for the separate items in the bundle. P. 176

The ideal profit margin:  $P - MC / P = 1 / |e|$

## **Chapter 15**

Strategic Games

A price matching announcement can end a price war.

**Nash equilibrium:** is a pair of strategies, one for each player, in which each strategy is a best response to the other.

*Basically, a law that no one would want to break, even in the absence of an effective police force.*

*Nash equilibrium (NE), in simple terms, can be understood as a solution to the non-cooperative (NCO) game. It describes a combination in which each player chooses an action that maximizes his/her self-interest or payoff, given the action of the other player.*

*A dominant strategy is that strategy in a game where a player gets the highest return, and the player has no tendency to switch from that strategy irrespective of what the other player's move will be. The dominant strategy equilibrium is achieved when both players employ their dominant strategy and attain equilibrium.*

**15.1** In **Sequential-move games**, players take turns, and each player observes what his or her rival did before having to move.

**15.2** In **Simultaneous- move games**, each player decides on her strategy before knowing the decisions of other players. To analyze these games, we use the *matrix or strategic form of a game*.

#### **15.4** Game of chicken

Dating game as the prisoners' dilemma, the idea is to find a way to change the rules of the game so both players can earn higher profits.

It gives a way to analyze the tension between divisions within a corporation.

Shirking Ex. a self- interested employee would prefer to work less (shirk), but shirking is profitable only if his manager is not monitoring what he does.

To get out of a prisoner's dilemma, work on developing on-run strategies that change the structure of the game to make your own payoffs less dependent on your rivals' actions. If possible, try to differentiate your product or figure out a way to lower your costs.

## **Chapter 16**

**16.1** Game of chicken: where the ability to commit to a position gives one player bargaining power over rivals.

**Strategic view of bargaining:** when the outcome depends on who moves first and who can commit to a position.

It also envisions bargaining as a game of chicken where the ability to commit to a position allows a player to capture the lion's share of the gains from trade.

*The first-mover advantage refers to **an advantage gained by a company that first introduces a product or service to the market**. The first-mover advantage enables a company to establish strong brand recognition and product/service loyalty before other entrants to the market*

*Second-mover advantage is **the competitive edge a company has when it enters the market later than other companies**. A second-mover*

*benefits from the first-mover by appealing to its existing customer base and using marketing strategies that have proof of success.*

**16.2 Non Strategic view of bargaining** does not depend on the rules of the bargaining game or whether players can commit to a position.

The nonstrategic view of bargaining tells you that if you can decrease your own gain to reach agreement by improving your outside option, you become a tougher bargainer because you have less to gain by reaching agreement.

It emphasizes the role of commitment and timing in affecting the outcome of a game.

It does not focus on the explicit rules of the game to understand the likely outcome of the bargaining. Rather, it is the alternatives to agreement that determine the terms of any agreement.

To improve your own bargaining position, improve your outside option, or decrease that of your opponent.

-----You can often increase profit by price discriminating, provided different consumers have different demand elasticities and you can prevent arbitrage.