

**SPRING 2015**  
**AEM 4160: Strategic Pricing**  
**Prof. Jura Liaukonyte**

**HW2**

**Ground rules for Homework 1-5:**

1. HW is due at the beginning of class on the due date designated for each homework (see course website for the list of dates).
2. You should turn in your homework 100% typed. I realize that for some students handwriting is more convenient or efficient, especially when it comes to writing out math equations. However, you should practice typing math formulas in MS Word or other word processing software of your choice.
3. Include a title page listing your name (or names if it is a group work) and homework number.
4. Please staple your sheets. Both your TA and I will look at each homework, so we don't want to lose any of your sheets.
5. If I have specific instructions or rules relating to any individual parts within homework assignments, I will list them there.

**Ground rules for HW2:**

1. HW 2 is due on Thursday **February 12<sup>th</sup>** at the beginning of class
2. HW 2 is group work. Please work in groups of 4.

**PART I**

**Price Discrimination**

1. When pricing automobiles, American car companies typically charge a much higher percentage mark-up over cost for "luxury operation" items such as leather trim, etc., than for the car itself or for more "basic" options such as power steering and automatic transmission. Explain why.
2. Sal's satellite company broadcasts TV to subscribers in Los Angeles and New York. The demand in each market is the following:

$$P_{NY} = 150 - 3Q_{NY} \qquad P_{LA} = 120 - 3/2Q_{LA}$$

The TC of providing Q units of service is given by  $TC = 1000 + 30Q$ .

- a) What are the profit maximizing prices and quantities for the New York and Los Angeles markets?
  - b) What would happen if people in LA were able to receive Sal's NY broadcasts and vice versa due to a new improved satellite?
3. Many retail video stores offer two alternative plans for renting films:
    - Two-Part Tariff: pay an annual membership fee (e.g. \$40) and then pay a small fee per film rented (e.g. \$2 per film per day)
    - Straight rental fee: pay no membership fee but pay a higher daily rental fee (e.g. \$4 per film).
    - a) Why do you think the store might offer the two-part tariff?
    - b) Why offer customers a choice rather than merely offering the two-part tariff?
    - c) Give examples of other businesses/industries that adopt similar pricing strategies.

## PART II

Answer the following questions about the HBS case "*Keurig at Home*" by Eric T. Anderson. Be concise and use your own wording for your analysis. When you can, use the numbers provided in the case (e.g. the size of the gourmet coffee market, price and cost information – there is considerable amount of data in the case!) to answer the questions. Qualitative, well reasoned answers will be accepted, but some quantitative answers are preferred.

- 1) Should Keurig use a single K-Cup for all markets or should it launch the Keurig Cup in the at-home market and continue to the K-cup in the commercial market?
- 2) What price for a brewer and for the portion pack (K-cup/Keurig-Cup) do you recommend? Under your pricing strategy, how profitable are coffee sales for Keurig? How do coffee profits affect the brewer price?

## PART III.

Write a blog post. Blog assignment guidelines:

<http://courses.cit.cornell.edu/jl2545/4160/blogguide4160.htm>

Also check the blog website [www.overtcollusion.com](http://www.overtcollusion.com) to see examples of good blog posts.

IMPORTANT: You have to submit your blog post in two ways:

- 1) as part of your typed and printed HW2 and
- 2) emailed to your TA [mfm88@cornell.edu](mailto:mfm88@cornell.edu). Please make sure that the emailed post contains the names of group members.

Please pay attention to the fact that every submitted blog post should entail some hyperlinks and most really good posts have pictures or embedded videos.

- Learn how to insert a hyperlink in MS Word [here](#).
- Learn how to insert a picture in MS Word [here](#).
- Since I will be posting the selected blog posts on [www.overtcollusion.com](http://www.overtcollusion.com) and there is no easy way to embed a video in MS Word, just provide a link to the video that you would like embedded, should your post be selected to be published.

Potential topics of choice for this HW assignment:

1. First Degree Price Discrimination
2. Reverse (Dutch) auction
3. All the varieties of Second degree price discrimination
4. Third degree price discrimination
5. Two-Part Tariff
6. Other topic that relates to issues we discussed in class.
7. In case you are unsure if your selected topic fits, email me and we will discuss!