Answer on Question #56786, Economics, Economics of Enterprise Completed

Question

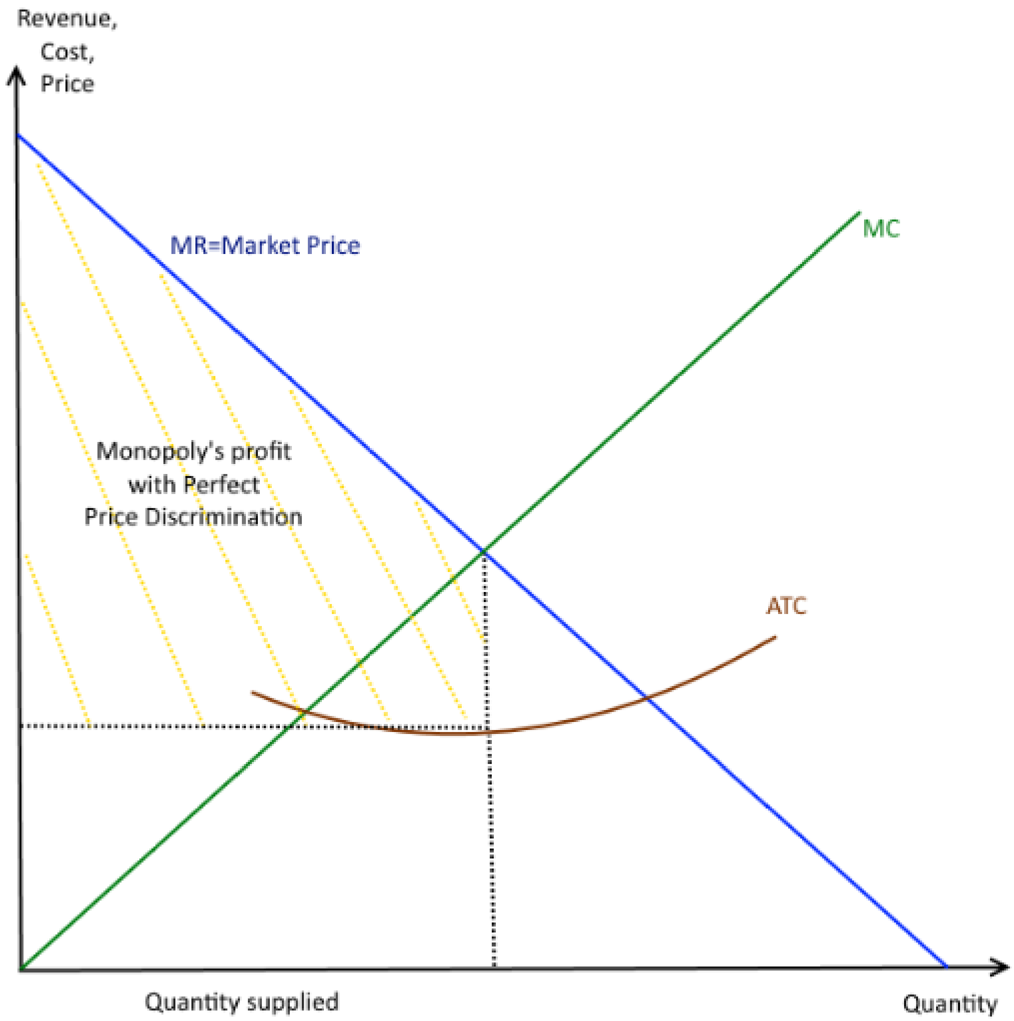
Many service industries such as restaurants, night clubs, movie theatres and hair dressers experience much higher demand during weekends compared to week days. Explain a pricing strategy which would increase profits compared to a single price profit maximizing strategy. Be sure to include a graph which explains your demand, marginal revenue, and marginal cost.

Answer

Many service industries markets are not perfect competition markets. Famous theatres, night clubs, etc are monopolists in their narrow segments. So here we speak about monopolies or monopolistic competition.

A monopoly maximizes profits by restricting its quantity of output so that marginal revenue equals marginal cost. This output is less than what would occur in a competitive market because the marginal revenue of a monopolist selling at a single price is less than what the output would be at the market price anywhere on the demand curve. A monopolist can only increase the sale of its product by reducing its price. But in doing so, it also earns less revenue on all previous units. However, if a monopolist can price its products according to who the buyers are, then it can significantly increase its profits by setting the profit-maximizing price for each market segment.

Price discrimination is selling a product at different prices for different classes of buyers based on their differing elasticity of demand for the product or service; whether the product or service actually differs among the price groups is secondary, but in most cases, the different prices charged are not related to the differences in the cost of providing the underlying item. Generally, the monopolist strives to charge the highest prices where demand is inelastic – i.e., where higher prices lead to higher revenue in spite of the decreasing quantities sold at the higher prices – and lower prices for more price sensitive buyers, where higher prices would decrease the quantity sold, leading to lower revenue in spite of the higher prices, because the drop in quantity more than offsets the rise in price. The products sold to different classes of buyers are sometimes different (films, personal haircuts, etc), but the differences have no significant relationship to the price differentials. The differences in prices are mostly motivated by a desire to earn greater profits – it does not reflect the cost-of-production differences among the products. See graph:


Revenue,
Cost,
Price
MR=Market Price
MC
Monopoly's profit
with Perfect
Price Discrimination
ATC
Quantity supplied
Quantity