Differentiation

Hotelling Line

- Products are viewed as located on a line
- Same line represents preferences of consumers

![Customer Age vs Target Age of Audience Diagram]

Analysis of Hotelling Line

- Will tend to split the market
- Absent price competition, advantageous to move toward center
- Political parties
  - Buy from Disney
  - Buy from Dreamworks

Disney

Dreamworks
Price Competition

- Close proximity drives prices to marginal cost
- Strong price competition makes distance more valuable
- As we will see with Enterprise Rent-a-car, strong price competition is a deterrence to locating nearby

Determination of Prices

\[ P_1, P_2 \]

Delivered prices of F1 and F2

Gains from Price Increase

\[ P_1, P_2 \]

Gains from price increase for F1 and F2
Equilibrium Pricing
- Pricing equalizes gains and losses
- As products become less substitutable, margins increase
- If one firm increases its price, rivals should also increase price, but by a smaller amount
- Awareness of this reaction leads to higher equilibrium pricing

Examples
- Coors beer
- Delivered rental cars
- Internet purchases
  - Books
  - Brand name electronics
  - Desktop computer
  - Diamond ring

Synergies
- Disney exploits complementaries between theme parks and films
- Makes entry more difficult
Creating Synergies

- Sony memory stick
- DeWalt battery system
- Frequent flyer miles
- BMC Software: “1+1=3”
- Compaq ipaq devices
- MS Excel, Word, Outlook

Synergies

- Goal is to lock-in customers
- Create switching costs
  - Common peripherals, chargers, etc.
- Major role for complementary goods
- Often desirable to avoid low price offers to competitor’s customers
  - Get customers to choose a company and buy all their related products from that company

<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Price Effect</th>
<th>Price Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Price (VHS-C) B&amp;W viewfinder</td>
<td>$347.26</td>
<td>95.9%</td>
</tr>
<tr>
<td>On Sale</td>
<td>-7.5%</td>
<td>Sony Mini DV</td>
</tr>
<tr>
<td>Non-Sony 8mm</td>
<td>-15.3%</td>
<td>Monitor Size</td>
</tr>
<tr>
<td>VHS</td>
<td>-8.4%</td>
<td>Color Viewfinder</td>
</tr>
<tr>
<td>Non-Sony Hi 8mm</td>
<td>-8.9%</td>
<td>Image Stabilization</td>
</tr>
<tr>
<td>Sony Hi 8 mm</td>
<td>46.2%</td>
<td>Low weight</td>
</tr>
<tr>
<td>Sony Digital 8</td>
<td>79.8%</td>
<td>JPEG format</td>
</tr>
</tbody>
</table>

Table 7.3 Camcorder Hedonic Price Regression Results

- JVC mini-DV camcorder with a 3 inch monitor, color viewfinder, image stabilization, low weight, JPEG format and not on sale is worth:
  - Value = $347.26 \times 1.959 \times 1.129 \times 1.129 \times 1.098 \times 1.074 \times 1.337 \times 1.656 = $2,556.05.