

Information Economics, Spring 2014

Case Study 2

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1 Rules

Note 1. For this case study, each team can have *at most three* students. Your teammates should be those who work with you on lecture problems.

Note 2. The report is due *9:00 am, November 24, 2014*. Please submit a *hard copy* into the instructor's mail box at the first floor of the Management Building II. As each team only needs to submit one copy, please indicate the names and student IDs of all team members on the first page. Submissions between 9:00 am and 10:00 am on the due date will get 20% off as a penalty. Submissions later than 10:00 am of the due date are not accepted.

2 Article

David Robinson and Max Oltersdorf (2013), "Netflix: Pricing Decision 2011," *Berkeley-Haas Case Series*.¹

3 Tasks

Write a report with *at most ten* pages (i.e., three double-sided sheets) to address the following questions:

1. When Netflix was founded, why a subscription-based monthly membership fee was the only way for it to charge consumers? Why consumers cannot be charged based on the number of movies they rent? With this subscription-based pricing, may consumers enjoy unlimited consumption? Why or why not?
2. During the through-the-mail period, how did Netflix allocate DVDs among frequent and infrequent renters? If you are making the allocation, what mechanism will you use? In particular, if you mechanism favors one type of renters, how would you avoid complaints from another type?
3. For each of the three pricing plans for the through-the-mail model, estimate the monthly profit generated by each subscriber. Which plan is the most profitable? If you are making the pricing decision, would you do any adjustment?
4. Now the streaming service is introduced. Suppose the prices for through-the-mail (for 1 movie per delivery) and for streaming are both fixed at \$7.99 per month, how would you set the bundle price?
5. Suppose streaming is the only option and all costs are sunk, determine the pricing plan that maximize the total revenue. Note that you may combine consumption-based pricing, subscription-based pricing (with unlimited consumption), and an entry fee.²

If any of your ideas come from others, please remember to provide citations. For some of these problems, use appropriate economic models may help your go beyond intuitions and simple arithmetic.

¹The web page of this article: <https://cb.hbsp.harvard.edu/cbmp/product/B5766-PDF-ENG>.

²If you search for "information goods pricing" online, you will see really a lot of article discussing this issue. For example, the introductory article "Pricing Information Goods" by Hal Varian is a good reference. The *Management Science* paper "Nonlinear Pricing for Information Goods" by Arun Sundararajan gives more discussions in depth.