Industrial Organization  
ECNS 406  
Fall 2015  

Homework #: 8  

Due by the beginning of class on: Tuesday November 24, 2015  

Name:  

Instructions:  
There are 1 questions worth a total of 100 points. Answer each question clearly and concisely. You must show your work to receive credit. You are allowed to work with others, but all work must be your own.  

Clearly print your name above and in the space provided on the next page. You must turn in both sides of this cover sheet along with your responses. You do not need to turn in the questions, only your responses with the cover sheet. All pages must be stapled to be graded.
Name: ________________________________

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<th>Question</th>
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Real World Application of Microeconomic Theory

1. A CEO of a software company sent me a cryptic email about how to determine a price for a product they’re developing. Rather than answering the message directly, I tell the CEO that I’ve got a bunch of bright and talented students in my IO course that can provide excellent answers. (I also mention that the consulting fee for my students is probably much less than mine.) The CEO then sends you an almost identical cryptic email which is as follows.

   I am curious about pricing frameworks for products without (or with trivially small) marginal costs and very large development costs (music, software, pharmaceuticals, etc) and Dr. Pearcy thought you might be able to help me out. Obviously attempting to derive a price from the supply and demand model where the supply curve is represented by marginal cost does not work well, or simply isn’t used in the real world (I am still waiting for my three cent copy of Microsoft Office). I am just curious if you might be able to suggest any resources explaining, or if there is a name for, a more complete pricing framework that encompasses these IP (Intellectual Property) style goods that I could research.

Answer the following questions using the email above:

(a) How does the pricing problem change if marginal costs are trivially small?
(b) Similar to the question above, when marginal costs are trivially small is there anything wrong with determining price from supply and demand where supply is represented by marginal costs?
(c) What does the CEO mean by “I am still waiting for my three cent copy of Microsoft Office.” and what’s wrong with this train of thought?
(d) How should this company figure out what price to set for the product and what factors should be considered?