



On the Web and at the checkout counter, technology gives new twists to that old selling strategy: price discrimination.

I got it cheaper than you

By Scott Woolley

WHAT DO American Airlines, Glaxo Wellcome, Staples, Intuit, Stanford University, CDnow, AT&T, Simon & Schuster and Safeway have in common? They all engage in **price discrimination**. They charge some customers more than other customers for the same thing or almost the same thing.

Price discrimination is an old game, probably dating back 3,000 years or so. You cut a special deal for some customers but not for others, depending on how likely they are to take their business elsewhere. Now the game seems destined to get a lot bigger, both in frequency and in complexity. The reason? Technology.

If you are the kind of person who is ticked off about paying \$1,200 for an airline ticket while the fellow sitting next to you paid \$500, brace yourself. Computers are making it easier for vendors to play this game when you are shopping for just about anything—a CD, a piece of software, a dress, a book, a doctor's visit, a movie. A new wave of price discrimination is coming, says Hal R. Varian, dean of U.C. Berkeley's School of Information Management & Systems. Computers are going to discriminate not just between business travelers and leisure travelers but between Smith and Jones.

"There's going to be a massive expansion in price discrimination as the cost of MIPS [computing power] goes to zero," says Jay S. Walker, founder and vice chairman of Priceline.com. In Walker's world, you don't complain about the unfairness of it all. You just try to turn the discrimination game to your advantage. Priceline.com allows travelers to cut special deals for airline tickets booked at the last minute—\$400, for example, for a trip from Washington, D.C. to San Francisco, against the \$1,200 full fare. Using complex software that shops bids from travelers to 18 airlines, Priceline.com brokers around 1,000 tickets a day.

Now Walker is taking his style of E-commerce to cars, hotel rooms and home mortgages. Tsk, tsk—you're going to pay 65/8% on your mortgage? The same bank quoted me 61/2%.

Catalog retailers play this game. An old trick is to send out catalogs that sell identical goods except at different prices. The unlucky consumers who live in a more free-spending zip code may see only the higher prices. Victoria's Secret has used these tactics. Staples brazenly sends out different office supply catalogs with different prices to the same customers. The price-sensitive buyers know which to buy from. The inattentive ones pay extra.

That blunderbuss approach to mailing lists is now being replaced by discrimination of a finer sort. Computers collect and analyze highly detailed data on individual customers as they make their purchases over the Internet or at the cash register. New software coming from such outfits as Personify Inc. will sort out the skinflints from the spendthrifts and price accordingly.

Wait a minute. If the garden hose is plainly marked \$39, how does the store charge shoppers different prices? Simple. It invites some of them to become "preferred customers," who get a 10% discount at the cash register. With an electronic register tied to a central database, this sort of discrimination is a snap.

Wasn't the Web going to make price comparisons easier? So that everyone got the same low price? It won't necessarily happen. A shopping robot might be able to capture published prices, but it can't know what kinds of side deals may be offered in special circumstances. Personify, a San Francisco-based startup, has software that lets a Web-based merchant such as Amazon.com identify individual visitors to its Web site. Then the software studies a Web-surfer's "clickstream"—the way that person navigates through the Web site. Based on that behavior, the software can instantaneously target the shoppers for specific products and prices. If that visitor behaves like a price-sensitive shopper—perhaps by comparing many different products without buying—he may be offered a lower price.

"It's going to enable normal merchants to get much more sophisticated in their pricing, much like the airlines," says Eileen Gittins, Personify's chief executive. Using Personify's technology, Virtual Vineyards, the Web-based wineseller, offers different prices and deals to its customers depending on what they've done in the past.

CDnow, an on-line vendor of music albums, E-mails certain buyers a special Web site address with lower prices. Unless you know the secret address, you pay full price. Microsoft Office has a promotion with Village Software that offers people who enter Village's Web site via Microsoft's site a lower price on Village's add-ons to some Microsoft programs.

Cash registers can now print out customized coupons immediately, based on the contents of your grocery cart. For that matter, the entire supermarket coupon industry is just an elaborate price discrimination scheme in which busy people pay more than penny-pinchers for the same box of cereal.

Web-based wineseller Virtual Vineyards offers different deals depending on a customer's past behavior.

Microsoft has people investigating software similar to Personify's. Bill Gates predicts that Web sites will soon recognize individual consumers, remember what they paid for items in the past and charge them a customized price based on that history. "Sellers will use technology to extract the highest price they can from a particular shopper," Gates wrote recently. "This is an extension of pricing practices that are common today."

San Diego-based HNC Software is helping vendors discriminate. When you buy a shirt, the store can record your name—it's encoded onto the magnetic stripe on your credit card—along with the product you purchased and the price you paid. The store can then stuff the data into an HNC database that can be used to offer discounts or promotions to specific customers. "At the moment the retail space is one-size-fits-all," says John Buchanan, who oversees HNC's software for retailers. "Now we can understand you more as an individual."

The information age gives sellers not just the means to discriminate but the motive as well. It makes sense to discriminate wherever fixed costs are high and variable costs low. You need some high-ticket customers to cover your fixed costs; having done that, you take whatever you can get from the remaining customers. Such economics explain wacky airline fares, and they explain any amount of price discrimination in information goods and services like software, books, music, movies, fiber-optic lines and on-line databases. What are you buying in a Viagra tablet? A little bit of variable manufacturing cost and a lot of fixed research costs—information, that is.

Now the problem is getting customers to swallow the price discrepancies. They are used to them in the book and movie business: Early customers pay more for hardcovers and theater tickets than late customers pay for paperbacks and VCR rentals. Software is a natural for price discrimination. Professor Varian and coauthor Carl Shapiro devoted two chapters in their just-released book, *Information Rules*, to this subject. One of their examples: Intuit charges \$60 for its fancy version of Quicken, with more embellishments than its stripped-down basic version, which sells for about \$20.

Imposing price differences on, say, long distance customers is a little trickier. "If customers find out about the lower price, you can always tell them, 'Oh, you didn't get the lower price because you didn't have the coupon or the promotional offer, but tell you what—we'll make an exception and give you the lower price,'" says Ford Cavallari, who heads up Internet strategy for Renaissance Worldwide, a Boston-based management and information technology consultancy. "But once you start elevating from the standard price, you can never explain your way out of that with the customer."

It won't do for Glaxo Wellcome to say that it is levying a North American surcharge on its AIDS drug. It can, however, charge a high price for the treatment here, while selling it at a 75% discount in Africa as a humanitarian gesture. The common practice of soaking wealthy parents more for college tuition is described, euphemistically, as a scholarship plan for middle-class students.

If it's any consolation when you get hit up for a higher price, take note of the economic theory showing how price discrimination makes society better off (see sidebar). Like it or not, though, there's going to be more "yield management" (as the airlines call it), and you'll never know for sure if you are getting a good deal.

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Sidebar: Price discrimination is good for you

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