Abstract:

This paper analyzes the optimal pricing strategy of a monopoly firm in a subscription market when consumers have transaction costs. The firm has limited commitment power in the sense that it can commit to prices for only one period, which means that it cannot commit not to sell to potential customers in the second period. Once consumers subscribe, the firm can distinguish subscribers and nonsubscribers, and consequently, the firm price discriminates between the two; new customers receive discounts and current customers pay higher rates. Also, in at least one case, this price discrimination actually undermines efficiency because some consumers cancel their subscription in the second period after subscribing in the first period.

In this two-period model, there are two types of consumers – those with low transaction costs and those with high transaction costs. When consumer transaction costs remain constant throughout both periods of the subscription game, the monopolist’s optimal pricing scheme is to cave, which means selling to all consumers in the first period or, if there are enough consumers with low transaction costs, to dynamically screen them. Additionally, depending on the proportion of high cost types in the population in the caving outcome, the firm may charge a second period price high enough so that only high cost types remain; otherwise, the firm keeps all consumers in the second period. When consumer transaction costs are allowed to vary across the two periods, the results are nearly the same. These subgame-perfect equilibrium pricing strategies show that the profits the firm earns from exploiting consumers’ transaction costs in the second period outweigh the concessions made by the firm to entice consumers to subscribe in the first period.