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MBA 504 – Managerial Economics (W. Troost) *Case studyabout the iPad Mini by Justin Sellers Kimberly Gadsden Krista Pauly Marjorie Venus Baliog Paulus Mirtschink Rob Hicks I have read the StudentAcademicCode of Conduct and this Assignment complies with the Code. 8th November 2012 * Table of Contents * List of Figures

 * INTRODUCTION Apple has clearly established itself as a market leader in the competitive market of consumer electronic products. Recently, the company released a smaller sized version of its highly successful tablet: the iPad. The launch has come under widespread criticism as many industry pundits believe the pricing strategy may be incorrect and there are fears that the new product will cannibalize sales of other merchandise.

Even the late Steve Jobs was strong in his view that Apple would never offer a smaller tablet product to the market as he felt it would provide less benefit to consumers. To properly assess whether or not Apple did in fact make the correct decision, the rationale behind the decision must be analyzed. As part of the analysis: the market structure, cost factors, competitive position, nature of product demand, and strategic vision will be scrutinized. FIRM, BRAND, LIFESTYLE

Under the direction of one of the most visionary CEOs of the modern era, Steve Jobs, Apple was able to completely revolutionize the way that consumer electronics are perceived, purchased, and manufactured. It started with a completely different concept of consumer preferences and has ultimately ended with the most valuable company in the world. Apple has a long history within the computer industry with a focus on building units for sale to the consumer marketplace. After success during the early 1980s with the launch of the Macintosh line of computers, the company failed to gain significant market share until the launch of the iMac in 1998.

From the late 1990s Apple began a prolific campaign of acquiring other companies with specific technological expertise, which it began combining in both software and hardware components included in its subsequent line of products. Apple released the first of many important revolutionary products, the iPod, in 2001. The iPod became the ‘ quantum leap’ the company had long been striving for and allowed the branding of Apple as a company with the Apple logo to become an industry heavyweight. The advertising that Apple used helped to produce an emotional response that resonated with consumers.

Being seen with the iconic “ white headphones” became as much about fashion and image as it was about the actual enjoyment of listening to mp3s on a personal device. Due to the vertical integration between devices, software and design based on a platform of “ ease of use,” the company began to create immense brandloyalty. “ Once you go Mac, you never go back,” is a phrase used to describe that once someone made the decision to purchase an Apple product (phone, computer, etc.) the cost of switching becomes high.

Apple intuitively created an opportunity cost for not purchasing newer Apple products because of the way their devices communicate with one another. Apple has gained such a significant brand following that demand for their products is much more inelastic than comparable firms. Demand for competitor’s products Demand for Apple products INDUSTRY There are significant numbers of manufacturers of tablet devices, but it can be argued that there are only several key players. The tablet marketplace is very interesting because of the dominant effect that Apple, Samsung, Google, and Amazon have on consumer behaviour.

There is a significant split, both from a consumer and producer standpoint, between the ‘ premium’ tablet devices and the ‘ generic’ devices. In effect, there are two different marketplaces in operation simultaneously. In the generic market it is a competitive market, firms are essentially price takers as what they are offering is a standard tablet with limited features. In the premium market however, there is an oligopolistic situation where the major firms dominate both, market share and brand recognition. Please see Appendix A and B for Price comparisons of generic and premium brand tablets.

The pricing strategy for the premium products is therefore very different than for generics. In the premium market, the products are seen as more inelastic based on their brand power, and thus a higher price can be charged in order to generate a higher economic profit. Apple uses the concept of “ Prestige Pricing” for its product line. Prestige pricing happens when a firm charges a higher price for its products in an attempt to be seen as a ‘ status’ item. Apple separates itself even from the other premium tablets by charging a price that is actually 2-5 times higher than some of its closest ivals. The reason that Apple has decided to launch at such a high price dates back to their theory of brand image and loyalty. Withrespectto the technology adoption lifecycle developed by Joe Bohlen et al. , Apple seeks to “ reward” loyal customers by charging a high price so that only technologically conscious innovators and early adopters will have the product for a period. It is valuable to the innovators and early adopters to have the newest Apple product ahead of the vast majority of people and price point is a way to discriminate between groups.

Once a product has been on the market for a sufficient amount of time, Apple will then drop the price to gain a larger amount of consumers that are willing to pay for the product at the given price. Graph Rob Directly related to the high price point that Apple charge is its monopolistic position within the industry. It is strategically beneficial from a firm standpoint to charge a price that causes the intersection of the marginal cost and marginal revenues when represented graphically. Figure 1: Monopolistical pricing For Apple, they experience higher economic profits when they charge a higher price initially.

Only when they are about to release an updated version of the product will they drop the price to gain the additional consumer demand. When considering the product lifecycle, Apple seeks to have a different product in each section of the cycle. Rather than having different versions of the same model, the company simply relies on releasing a newer product, but still offering the old product for a period. When considering their new tablet the strategy will be as follows: 1) New tablet is released: iPad mini 2) After a designated amount of time, (typically 3-5 quarters) a new version will be released.

Likely, it will be called the iPad mini S. 3) Following the same release schedule a bigger redesign will occur and the product will come out as the iPad mini 2. Figure 2: Technology life cycle Apple prices the tablet in #1 high in order to experience profits from the innovators and early adopters. By the time the newer version is announced, the company will drop the price in order to gain access to the early majority. When the new product is actually released #2 it will have a premium price point to again gain access to the innovators and early adopters.

Product #1 is moving from early majority to late majority as the price drop has opened up a wealth of consumers willing to buy. When product #3 is announced the price of both product #1 and product #2 will be dropped. By this time product #1 will be 2 editions old and is likely to be purchased by the tail end of late majority and laggards. Product #2 will take its place in the early majority and innovators will desire product #3. When considering Apple's brand loyalty it is also likely that by the time product #3 comes out some people that purchased product #1 will deem that it is time to upgrade.

COST

Another major consideration in the pricing of Apple's products is the associated cost of producing them. Each item has a large array of inputs ranging from: hardware, software, development, advertising, testing, management, transport, and legal issues. Apple has sought out areas of the world where it is cheaper to assemble their units because the relationship between manufacturing and transportation costs results in higher profit.

Figure 3: VMP and MC in the US compared with China Apple has formed acoalitionof manufacturers that it uses to outsource many of the components that it uses within its products.

In some cases the firms that manufacture parts for Apple are actually direct competitors within the same market. If you look at the decision to manufacture internally or outsource to another company it is very similar to the trade theories of competitive and comparative advantage. When considering the iPad mini, Apple had to decide whether to make the computing hardware themselves or have someone else make it for them. Apple deemed that they have a competitive advantage in software development and that Samsung and Intel have comparative advantages in production of hardware, thus they made the decision to have the parts made for them.

Each iPad that Apple sells generates a large amount of profit for the firm because their total cost is significantly less than the price point at which it is sold. Generally, Apple sells their products for at least 3 times as much as their total cost, resulting in a huge amount of revenue. You guessed it… a graph What the fuck Justin?!? CONCLUSION * APPENDICES Price Comparison of Generic Android Tablets Price Comparison of Premium Brand Tablets * BIBLIOGRAPHY *