

Product Differentiation

Econ 201/Haworth

Here is a summary of the two types of product differentiation

(1) **Horizontal Product Differentiation:** when products are differentiated in terms of consumer tastes or preferences.

Examples:

- Soft drink market – beverages vary on the basis of taste, diet vs non-diet drinks, etc.
- Movies – movies vary on the basis of genre. E.g. action, love story, documentary, etc.

How do we know that a market is horizontally differentiated?

If the price of each good in this differentiated market was the same, then each good would still enjoy positive demand.

(2) **Vertical Product Differentiation:** when products are differentiated in terms of agreed-upon differences in quality (high quality vs low quality).

Examples:

- Personal computer market – where computers have varying levels of processing speed (e.g. faster processors are better than slower processes)
- Automobile market – where cars have varying luxury features that can be included in the car (e.g. more luxury features is better than fewer features)
- Personal Warranties sold with a given good or service is also a means of vertically differentiating a good (e.g. a longer warranty provides a better service with the use of a good than a shorter warranty)

How do we know that a market is vertically differentiated?

If the price of each good in this differentiated market was the same, then only the highest quality good would enjoy positive demand.