

# **Pricing to Heterogeneous Consumers and Firm Market Power: Evidence from the United States and China**

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## *Abstract :*

This paper investigates the impact of rising income inequality and consumer heterogeneity on firms' prices and markups. We develop a model where firms face distinct consumer segments, each with varying reservation prices—the maximum price they are willing to pay—and different demand elasticities. Firms cannot price discriminate across segments. Our model predicts two opposing effects on prices, contingent on whether heterogeneity influences reservation prices or demand elasticities. Greater dispersion in reservation prices leads to lower prices, whereas increased dispersion in demand elasticity results in higher prices. These effects manifest differently across the sales distribution, with heightened consumer heterogeneity resulting in relatively higher markups for large firms compared to smaller ones. We empirically test our model's predictions using a detailed dataset from NielsenIQ and Compustat for the United States, alongside transaction data from the Customs Trade Statistics for China. Our findings indicate that as income inequality rises, prices and markups decrease for smaller firms but increase for larger firms. We further validate our model through additional tests examining the reservation price and demand elasticity channels.