HOSPITALITY AND TOURISM MARKETING

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Lecture 10: Pricing strategies

Course outcomes

At the end of this lecture, you will be able to:

- Explain clearly **pricing strategies for new** hospitality and tourism products/services
- Describe **correctly pricing strategies for existing** hospitality and tourism products/services
- Interpret perfectly the impact of **price changes** for hospitality and tourism products/services

New-Product Pricing Strategies

- Pricing strategies usually change as a product passes through its **life cycle**.
- **The introductory** stage is especially challenging.
- Several options exist for pricing new products: **prestige pricing, market-skimming pricing, and market-penetration pricing**

1. Prestige Pricing

- Hotels or restaurants seeking to position themselves as **luxurious and elegant** enter the market with a high price to support this position.
- **Nightclubs** may charge a cover charge to attract a certain type of clientele and create an image of **exclusiveness**.
- In each of these cases, lowering the price would reposition the business, resulting in a failure to attract the target market.

2. Market-Skimming Pricing

- Price skimming is setting a **high price** when the market is **price-insensitive.**
- Price skimming can make sense when lowering the price will create less revenue.
- For example, the owner of the only motel in a small town in South Dakota during pheasant hunting season can set high prices if there is more demand than rooms.

- Price skimming can be an effective short-term policy.
- However, one danger is that **competition will notice the high prices that consumers are willing to pay and enter the market**, creating more supply and eventually reducing prices.
- The hospitality industry is particularly affected by this because market entry by competitors is relatively easy

3. Market-Penetration Pricing

- Rather than setting a high initial price to skim off small but profitable market segments, other companies set a low initial price to penetrate the market quickly and deeply, **attracting many buyers and winning a large market share.**

- Several conditions favor setting a low price:
- The market must be **highly price sensitive** so that a low price produces more market **growth**,
- there should be economics that reduce costs as sales volume increases, and the low price must help keep out competition

Existing-Product Pricing Strategies

- The strategies just described are used primarily when introducing a new product. However, they can also be useful with **existing products.**
- The following strategies are ones that can be used with existing products.

1. Product-Bundle Pricing

- Sellers who use product-bundle pricing **combine several of their products and offer the bundle at a reduced price.**
- For example, hotels sell specially priced weekend packages that include **room, meals, and entertainment** or offer commercial rates that **include breakfast and a newspaper**.

- Product bundling can promote the sales of products that **consumers might not otherwise buy, but the combined price must be low enough to convince them to buy the bundle**.
- The items added to the core service must hold more value to the customer than they cost to provide.
- Product-bundle pricing is a strategy that has been well developed by **cruise lines, tour wholesalers, and casinos**

- Price bundling has two major benefits to hospitality and travel organizations.
- First, customers have different maximum prices or reservation prices they will pay for a product.
- Thus, by **packaging products we can transfer the surplus reservation price on one component to another component of the package.**

- A second benefit of price bundling is that the price of the core product can **be hidden to avoid price wars or the perception of having a low-quality product.**

2. Price-Adjustment Strategies

- Companies usually adjust their basic prices to account for various customer differences and changing situations.
- We look at the following adjustment strategies: **discount pricing and allowances, and discriminatory pricing.**

Some example of Price-Adjustment

- **volume discounts**
- Most hotels have special rates to attract customers who are likely to purchase **a large quantity of hotel rooms**, either for a single period or throughout the year
- Hotels usually offer special prices or provide free goods for **association and corporate meeting planners.**

Some example of Price-Adjustment (cont')

- **Discounts based on time of Purchase**
- Seasonal discounts allow the hotel to keep demand steady during the year.
- Hotels, motels, and airlines offer **seasonal discount**s during selling periods that are traditionally slower
- Airlines often offer off-peak prices, based **on the time of day or the day of the week that the passenger flies.**

Some example of Price-Adjustment (cont')

- **Discriminatory Pricing**
- Sex-based price discrimination has historically served as **a promotional tactic in nightclubs and bars** that offer **a ladies night or ladies-only coupon** that heavily discounts prices of admission or drinks.
- Discriminatory pricing refers to segmentation of the market and pricing differences based on price **elasticity characteristics of these segments**.

Revenue Management

- One application of **discriminatory pricing is revenue management.**
- Revenue management involves **upselling, cross-selling, and analysis of profit margins and sales volume** for each product line
- Revenue management system is used to maximize a hospitality company's **yield or contribution margin.**

- An effective revenue management system establishes fences to prohibit customers from one segment receiving
- A typical fencing strategy for leisure travelers would be to **require a Friday and Saturday night stay with a 30-day advance reservation**.

- Revenue management involves the development and use of different rate classes based on the projected demand for the service.
- These rates are used to maximize yield.
- This is the formula for yield:

$$\frac{\text{room} - \text{nights sold}}{\text{room} - \text{nights available}} \times \frac{\text{actual average room rate}}{\text{room rate potential}} = \text{yield}$$

- A hotel with sufficient history can project occupancy based on **current booking patterns**.
- If low occupancy is projected, the hotel keeps lower rate classes open to increase occupancy.
- The lower rates typically use price discrimination techniques that favor the leisure traveler.

- Two important concepts in revenue management are RevPAR and RevPASH.
- RevPAR is revenue per available room.
- It takes into consideration both **occupancy and average rate**, by determining the average rate per available room
- A one hundred–room hotel that sold sixty rooms at an average rate of \$200 would have a RevPAR of \$120 (60/100 × \$200).

- **RevPASH** is **the revenue per available seat hour.**
- It is tracked hourly because we do not sell a seat for a day, like we do hotel rooms. For example, it identifies **peak periods and periods of less demand.**
- It supplies data to track the effectiveness of the promotions to fill the low-demand periods.

3. Psychological Pricing

- Psychological pricing considers the psychology of prices, not simply the economics
- Another aspect of psychological pricing is reference prices; these are prices that buyers carry in **their minds** and refer to when they look at a given product.
- A buyer’s reference price might be formed by **noting current prices, remembering past prices, or assessing the buying situation.**

- For a given type of restaurant, most consumers have a preconceived idea about the price or price range of certain items, such as **a cup of coffee, a strip steak, or a hamburger**
- For example, a pizza chain may advertise its medium pizza for a price it knows is **$2 less than the competition to establish a reference price** for pizza eaters. But its price for **beverages and extra items will be the same as that of the competition.**

4. Promotional Pricing

- When companies use promotional pricing, they temporarily price their products below list price and sometimes even below cost. Promotional pricing takes several forms.
- Fast-food restaurants price a few products as **loss leaders** to attract customers to the store in the hope that they will buy other items at normal markups.

5. Value Pricing

- It could be argued that anytime a product/ service is purchased, at any price, the buyer must have **perceived value in that product.**
- Value pricing has become synonymous with the term **everyday low prices (EDLP).**
- “Value pricing can be extremely risky.
- Properly conceived and executed, it can earn **positive results.”**

Price Changes

- **Initiating Price Changes**
- After developing their price structures and strategies, companies may face occasions when they want to cut or raise prices

Initiating Price Cuts

- Several situations may lead a company to cut prices. One is **excess capacity**.
- Unable to increase business through **promotional efforts, product improvement, or other measures, a hotel may resort to price cutting.**
- As the airline, hotel, rental car, and restaurant industries have learned, cutting prices in an industry loaded with excess capacity generally leads to price wars as competitors try to regain market share.

Initiating Price Increases

- Inevitably many companies must eventually raise prices.
- They do this knowing that price **increases may be resented by customers, dealers, and their own sales force.**
- However, a successful price increase can greatly increase profits
- A major factor in price increases is cost **inflation**. Increased costs squeeze profit margins and lead companies to regular rounds of price increases

Buyer Reaction to Price Changes

- Whether the price is raised or lowered, the action **affects buyers, competitors, distributors, and suppliers.**
- Price changes may also interest the government.
- Customers do not always put a straightforward interpretation on price changes.

Competitor Reactions to Price Changes

- A firm considering a price change has to worry about competitors’ reactions.
- Competitors are most likely to react when the number of firms involved is small, when the product is uniform, and when buyers are well informed.

Responding to Price Changes

- Here we reverse the question and ask how a firm should respond to a price change by a competitor.
- The firm needs to consider several issues.
- Why did the competitor change the price?
- Was it to gain more market share, to use excess capacity, to meet changing cost conditions, or to lead an industry-wide program change?

…….Responding to Price Changes…..

- Does the competitor plan to make the price change temporary or permanent?
- What will happen to the company’s market share and profits if it does not respond?
- Are other companies going to respond?
- What are the competitors’ and other firms’ responses likely to be to each possible reaction?

References

1] Kotler ,.B (2014) Marketing for Hospitality and Tourism Industry, p 331-347, https://www.pdfdrive.com/marketing-for-hospitality-and-tourism-6th-edition-e178412795.html

2] Carlos, et al, (2021), Price Strategy, Market Orientation, and Business Performance in the Hotel Industry, https://www.researchgate.net/publication/348127604_Price_Strategy_Market_Orientation_and_Business_Performance_in_the_Hotel_Industry, DOI:10.4018/JGIM.2021010105

Thank you!

Next lecture: Promotion mix for tourism and hospitality products and services

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