Space Tourism: Priced Out of This World

Since 2001, when American millionaire Dennis Tito became the first space tourist, paying around US$20 million for a week’s trip, space tourism is gradually becoming a viable commercial industry. Virgin’s Richard Branson is spearheading the private enterprise movement towards making space trips a reality via Virgin Galactic Airways, founded in 1991. A million would-be passengers are estimated to be ready and willing to pay for such cutting-edge tourism experiences.

Branson plans to start offering sub-orbital space flights as early as 2007 or 2008 and 40,000 people are already registered. Around 100 of them reputedly paid the full US$200,000 up front to become ‘astronauts’ during their three-hour flights, at 4,000 kilometres per hour, with a maximum of half an hour actually spent in space. ‘We priced the tickets to give us enough money to get off the ground, as well as to start looking into orbital flights, hotels in space, hopefully a hotel on the moon,’ said Branson. He first became interested in the project in the 1980s when he was outraged at a quote for US$25 million to accompany Russian astronauts on a space voyage. He and various family members planned to be aboard the first Virgin Galactic flight.

Branson is not the only contender in the race to make commercial space flights routine. In 2006 Space Adventures Ltd announced plans to build a US$265 million spaceport in the United Arab Emirates. Spacecraft for sub-orbital flights built by a Russian company were expected to be ready before 2008. Three telecommunications entrepreneurs (Hamid Ansari, his wife Anshousheh and brother Amir), from Texas, decided to back Space Adventures in this challenge to Branson’s plans. The United Arab Emirates government also invested in the project to the tune of US$30 million.

Branson and Virgin have the advantage of brand recognition, connections, resources and 20 years of airline experience. In 2005 Virgin Galactic announced an agreement with New Mexico for a state-built $225 million spaceport at Las Cruces near the White Sands Missile Range. Construction at Las Cruces was
hoped to start in 2007, depending on approval from environmental and aviation authorities. Virgin would have a 20-year lease on the facility with annual payments of $1 million for the first five years, rising to cover the cost of the project by the end of the lease. New Mexico’s steady climate, free airspace, low population density and high altitude were all factors in choosing the site; factors which would also significantly reduce the cost of the space flight programme.

Surveys by the space industry show that at least half of Americans would like to see the Earth from space – if they could afford it. In fact, demand for space travel is fairly elastic; in willingness-to-pay surveys, demand increases significantly when the price falls. By 2015, competition within the fledgling industry could cut prices to around $15,000 per head. And the Space Frontier Foundation, an industry group, is aiming even lower, at about $5,000. In 2006 Space Adventures was already offering various space-related experiences at cheaper rates. Simulated lunar gravity flights could take passengers on parabolic rides, climbing and diving, giving a few minutes of weightlessness, for about $4,000. Florida-based Zero Gravity offers similar experiences, marketed

Space adventures is just one company seeking to make commercial space flights routine
as the world’s largest rollercoaster rides, all available through travel agents. For those who would rather watch than experience such hair-raising rides, Planetspace was cashing in on voyeurism by providing paid public viewing of Canadian Arrow experiments at the Georgian Bay base in Ontario.

At the 55th Annual International Astronautical Congress in Vancouver in 2004, Prof. Haym Benaroya, a scientist from Rutgers University in New Jersey, presented a paper entitled ‘Doing Business On the Moon’, describing a lunar landscape dotted with resorts and amusement parks. Benaroya noted that Hilton Hospitality Inc., owner of the Hilton hotel chain, had also jumped on the space tourism bandwagon, commissioning an architectural study of a surface lunar hotel. It seems that space tourism will soon become a reality.


OBJECTIVES

On completion of this chapter, you should understand:

- the key factors determining pricing decisions;
- the contribution of economics to pricing;
- the specific characteristics of the tourism and hospitality industry that affect pricing policy;
- the key approaches that companies take toward pricing in tourism;
- how prices are calculated for new products;
- yield management as it applies to tourism; and
- the difference between strategic pricing and tactical pricing in tourism.

Introduction

The Opening Vignette looks at the pricing of space tourism, and in particular the willingness to pay and the elasticity of demand for this new tourism product. These concepts are two of many
Pricing theories discussed in this chapter, which begins by looking at the impact of various corporate objectives on pricing. These objectives may be profit maximization, target rate of return, market share, survival, or growth. Even if these objectives are not explicit, they can have a significant impact on pricing. The second section highlights the key factors determining pricing decisions. As well as marketing objectives, these include costs, other mix variables, channel member expectations, buyer perceptions, competition, and legal and regulatory restrictions.

The third part of the chapter focuses on the contribution of economics to pricing. This includes a discussion of the interaction between supply and demand, and the importance of elasticity of demand. Generally, companies position their product employing one of three basic approaches to pricing: premium pricing, value-for-money pricing, and undercut pricing. These are examined here, using hotels as examples. The next main section discusses the basic approaches to pricing itself, which fall into three general categories: cost-based methods, demand-based methods, and competition-oriented pricing. Pricing strategies for new products are the subject of the next part of the chapter, which discusses prestige pricing, market skimming, and penetration pricing. Other pricing techniques are then examined, followed by a discussion of yield management. The difference between strategic pricing and tactical pricing is then explained, and the final section of the chapter looks at the specific characteristics of the tourism and hospitality industry that affect pricing policy.

Pricing is crucial to the successful marketing of any product or service, but it is often the least understood of the marketing mix elements. The prices that an organization charges for its products must strike a balance between gaining acceptance with the target market and making profit for the organizations. Even in not-for-profit organizations, the pricing of products and services is the key to encouraging consumption. The pricing element of the marketing mix is unique in that it is the only one that directly affects an organization’s revenues, and hence its profits. The fields of finance and economics have much to contribute in setting prices, but on their own perhaps do not lead to the best pricing decisions. Other marketing mix decisions often interact with pricing decisions. Product quality (both real and perceived) needs to be considered in light of price. Knowledge of the price-quality trade-off compels decision-makers to recognize that consumers might accept a higher cost for a better quality of product. Similarly, with regard to brand image – often the consequence of marketing communications decisions – lesser-known brands might command lower prices. Finally, pricing decisions must take into account the needs of the distributor. Distributors will sell a product only if they will obtain a certain profit margin.

**PRICE–QUALITY TRADE-OFF**
acceptance of the higher cost of a better quality of product

As with other elements in the marketing mix, pricing should be treated as a tool to achieve corporate and marketing objectives. If the target market has been clearly identified, and a decision has been made about where a product is to be positioned, then pricing will become easier to determine. Companies choosing to position their products in the mass market and to enter a field with many competitors will need to adopt a very careful pricing policy. Those seeking to appeal to niche markets, like Space Adventures in the Opening Vignette, may have
slightly more price flexibility, since they have fewer competitors and perhaps more points of difference between their products and others in the niche.

**Factors Determining Pricing Decisions**

Whatever the strategy of the organization, clear pricing objectives should be established before price levels are set. The key factors determining pricing decisions are shown in Figure 6.1. They are as follows.

**PROFIT MAXIMIZATION**

Corporate objective that causes managers in organizations to make decisions in such a way as to maximize profits.
Organizational and Marketing Objectives

The most common objectives are profit maximization, target rate of return, market share, and survival. However, for some organizations, such as national parks or museums, objectives are not only commercial in their nature, and pricing decisions are made for societal reasons. This may involve raising entry fees to reduce the social and environmental impacts of increasing numbers of visitors, as in the case of Machu Picchu in Peru (see Global Spotlight in Chapter 13), or lowering fees to encourage more access. Other objectives may include being perceived as offering outstanding value for money, or being the brand leader in the marketplace. The first may be reflected in lower prices, whereas the second goal could lead to high prices in the long term.

**TARGET RATE OF RETURN**
corporate objective that aims to achieve a particular return on the assets employed in an organization

**MARKET SHARE**
the percentage relationship of an organization’s sales to total industry sales

Costs

The setting of prices should incorporate a calculation of how much it costs the organization to produce the product or service. If the company is profit-oriented, a margin will be added to the cost price to derive the selling price. An organization could also decide to sell below cost for a period of time, which is often referred to as a tactical price reduction, discussed later in this chapter. The snapshot ‘Low-Cost Airlines Take to the Air’ looks at the low-cost airlines that are springing up all over the world. These airlines are able to compete by offering low prices.

Other Marketing Mix Variables

Pricing decisions always have an interaction with the other elements of the marketing mix. Consider the example of Canadian Mountain Holidays (CMH), which sells expensive heliskiing holidays (see the case study in Chapter 7). The high price of this product must be reflected in other elements of the marketing mix. A high level of personal service is included as part of the promotional package, and the quality of the lodges must meet the expectations that the high price has generated in the minds of the customers. Distribution of the holidays takes place via an exclusive channel system of overseas agents, reflecting the high-quality image and resulting high price.
Channel Member Expectations

A marketer must consider the intermediaries in the distribution channel when pricing a product or service. Travel agents, for example, will expect to earn commissions for their efforts. However, some stakeholders in the travel industry, such as airlines, car rental companies and international hotel chains, have been quick to grasp the potential of marketing and selling their services online. They have recognized an opportunity to bypass agents and sell their basic products and services directly to the customer. Increasingly, package holiday tour operators are also including direct sales via the internet in their sales strategy, thus bypassing the travel agent.

Buyer Perceptions

The prices set for travel products and services must reflect customers’ perceptions in the target market. The key is whether customers perceive that the price they have paid represents good value for money and matches their quality expectations. In tourism and hospitality, consumers expect a high level of service and special features if a high price is being charged. For example, after paying CDN$9,000, a CMH heli-skier can expect lodges to contain a fully stocked bar, a sauna and jacuzzi, and even a resident qualified massage therapist.

Competition

In competitive markets, organizations will be trying to win customers from competitors in two ways. Price competition involves offering the product or service at a lower price than that charged by competitors. In a very competitive marketplace, organizations are likely to resort to intense price competition to sell goods and services. Non-price competition, on the other hand, is concerned with trying to increase market share or sales by leaving the price unchanged, but persuading target customers that the product is superior to that offered by the competition. Such a strategy is more typical in oligopolistic markets, in which there are few competitors. It is important for tourism organizations, including destinations, to monitor the prices charged by competitors. A study of holiday costs in three different countries in 2006 found that the UK was considerably more expensive that Spain or the US for the same tourism services (ungoed-Thomas, 2006).

Legal and Regulatory Issues

There may be legal and regulatory restrictions that control the ways in which an organization fixes prices. For example, Robben Island in Cape Town (see opening vignette in Chapter 12), which is subsidized by the government, may be put under pressure to keep prices low to encourage people to visit. Legal restrictions are often placed on the practice of price fixing and collusion. Additionally, there are a number of organizations, quasi-governmental and industrial, that exercise some influence on pricing policies and strategies, a fact that marketing managers must bear in mind.
Economists contend that producers of a commodity are more likely to provide that commodity if the price for it in the marketplace is high. This is coupled with the suggestion that buyers are likely to purchase more of the commodity if prices are low. From this comes the idea that the quantity produced and consumed and the price acceptable to each party will be in equilibrium at some point. This is shown in Figure 6.2.

Unfortunately, this simplistic model is unlikely to be useful as a mathematical way of determining prices because it assumes that certain conditions need to be present for the process to occur. One of these is the assumption that consumers have perfect knowledge, and know all the prices from all the producers. Although the use of the internet is increasing, the likelihood of such wide consumer knowledge is small in the travel industry. However, although the model may not help pricing decisions in a mathematical or graphical way, the concept is not completely redundant. For instance, if a tourism organization has a feeling that the market is undersupplied, it may tend to increase prices. This happened in Las Vegas between 2003 and 2008, when hoteliers were able to charge premium room rates due to high demand. Similarly, if buyers sense that the market is oversupplied, they may try to negotiate lower prices – as happened in the hotel market after terrorist attacks, the war in Iraq, and the outbreak of severe acute respiratory syndrome (SARS).
Elasticity of Demand

The raising and lowering of prices generally has an effect on the level of sales. The analysis of buyers’ reactions to price change employs the concept of the *elasticity of demand*. This is represented by the formula:

\[
\text{Price elasticity of demand} = \frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}}
\]

If demand increases in line with price cuts then the product or service is said to be elastic. But if demand remains relatively unaltered by price changes, the product or service is said to be inelastic. In the tourism and hospitality industry, many products are elastic – as prices fall, demand increases. However, there are many occasions when this is not true. Business travel is often inelastic, and popularity or fashion may render a destination or restaurant inelastic. In the snapshot below, demand for the Burj Al Hotel in Dubai would seem to be inelastic. The hotel can charge very high prices, as business travellers are willing to pay for such luxury. Figure 6.3 shows two demand curves – for an elastic and an inelastic product. As with knowledge of the state of supply and demand, managers are not often in a position to know mathematically the value of elasticity for a product. They may not have access to all price and quantity data, or the service may be new and there may therefore be no historical data from which to derive the slope of the demand curve.
Price elasticity can be affected by a number of factors, including the customer's perception of the uniqueness of the product, the availability and awareness of substitutes, and how the consumer budgets. For example, a leisure traveller buying a holiday for personal use will have one perspective on price value; if the same person uses a company charge account, he or she may have another set of values. If consumers are purchasing something for someone else to use, they may be prepared to spend more – or less – than they would spend on themselves. Price elasticity of demand gives management a statistical method to measure whether or not the organization's prices are too high or low. In setting prices, a company will want to know what levels of demand it is likely to experience at different prices. This can be done in two ways.

**TEST MARKETING**

*a limited introduction of a product or service to test public reactions*

The first method is often called *willingness to pay (WTP) assessment*. The Opening Vignette suggested that demand for space travel is fairly elastic; in willingness-to-pay surveys, demand increases significantly when the price falls. The difficulty with this is that what people say they will do does not always translate into actual behaviour when the product is launched. A second way of assessing demand at different prices is test marketing, although it is difficult to control all the factors apart from price that will influence consumer decisions in different areas.

**WILLINGNESS TO PAY (WTP) ASSESSMENT**

*asking potential customers what they would be willing to pay for the product*

**Snapshot**

**Pricing for the Luxury Market: Burj Al Arab Hotel, Dubai**

The United Arab Emirates may not be the first destination on many travellers’ wish lists, but Dubai’s draw is undeniable. Described variously as the Gold City, the Artificial City and the billionaire’s playground, Dubai has been slowly shifting its attention away from energy over the years and into finance, commerce, transportation and tourism. In short, Dubai is cash rich and resource poor, interested in doing business with the world and with money to pay for it. Construction has been more or less non-stop in Dubai over the last few decades, with a number of high-class hotels built to cater for the growing number of tourists. The sail-shaped Burj Al Hotel is one such development.

Boasting seven stars, the Burj Al Hotel caters to the millionaires and billionaires of the world with its luxurious and spectacular facilities. It provides exclusivity, security and privacy—
celebrities in particular but also for international businessmen—for a high price tag: US$600 for a basic room per night and US$8,000 for the Royal Suite. Voyeurs can also nose around the hotel's decadent public areas for $25, refundable against any purchase in the lavish bars, restaurants or gift shops.

Working on the premise that people are willing to pay more for luxury, for the quality of service and for the setting, the hotel was opened in 1999 on a man-made island 280 metres offshore, reached by a causeway across which guests are shuttled in Rolls Royces. Each of the 202 rooms has a 42-inch plasma TV, Versace sheets on canopied beds, and is set on two floors connected by a spiral staircase. Every floor has its own check-in desk plus private elevators for the Royal Suites, ensuring both privacy and security. Butlers are available for guests’ every need and they enter suites via separate entrances to guarantee the least disruption to the visitor. The two-bedroom Royal Suites are decorated in marble and gold, have revolving beds, private cinema, and dressing rooms larger than average hotel rooms.

No expense was spared on the hotel’s design or its rococo furnishings fit for a sheik’s palace. It is shaped like a ship’s sail soaring over 341 metres high, making it the tallest hotel in the world. The lobby is a massive atrium, stretching several hundred feet up, making it one of the largest in the world. Gold pilasters and enormous aquariums surround the escalators. On the 17th floor, a British artist has an exhibition, sponsored by British Aerospace and Lockheed, where he sells his paintings of local flora and fauna for $30,000 apiece.

Restaurant facilities are equally luxurious, in particular the sealife-encircled Al Mahara Seafood Restaurant, reached by a short submarine from the lobby. The Skyview Restaurant, 200 metres above the Arabian Gulf, is reached by an express panoramic lift that travels at six metres per second. During the day, only hotel residents can use the facilities but the restaurants are open to outside diners by night. Bills can soar into thousands of dollars but the average cost is between US$200 and $500 for two people.


Pricing and Positioning

Generally, companies use pricing as part of their positioning of a product, employing one of three strategic approaches: premium pricing, value-for-money pricing, and undercut pricing (Dickman, 1999).²

Premium Pricing

In premium pricing, a decision is made to set prices above market price, to reflect either the image of quality or the unique status of the product. The product may be new, or it may have unique features not shared by competitors, such as the Burj Al Hotel in Dubai (see Snapshot). Also, the company itself may have such a strong reputation that the brand image alone is sufficient to merit a
premium price. The Four Seasons Hotel chain follows this strategy in setting prices. Promoted as upscale, full-service hotels, Four Seasons will, on occasion, raise prices to the highest level in the area. Others may use premium pricing in order to generate publicity. In 2005 the Hotel Jerome in Aspen started offering a ten-night holiday package that included unlimited ski tickets, private lessons, on-call masseuses, a chauffeur and a Maybach car that guests could get to keep. The price tag was US$1 million.3 Not to be outdone, The Marquis Los Cabos hotel in Baja California created a three-night stay with private jet and golf with Jack Nicklaus for US$7 million.

**PREMIUM PRICING**

setting prices above market price, to reflect either the image of quality or the unique status of the product

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**Value-for-Money Pricing**

In **value-for-money pricing**, the intention is to charge medium prices and emphasize that the product represents excellent value for money at this price. Organizations with well-established reputations for service generally do well with such a pricing strategy. According to *Travel & Leisure* magazine, guests staying at properties in the Fairmont Hotels & Resorts collection are consistently maximizing the value of their dollar by receiving exceptional service, unique offerings, and renowned hospitality at an affordable price. For many ‘medical tourists’, having surgery in a foreign country represents excellent value for money, given the exorbitant costs of medical care in developed countries, and the comparative ease and affordability nowadays of international travel. The Case Study at the end of this chapter explores this phenomenon in more detail.

**VALUE-FOR-MONEY PRICING**

charging medium prices and emphasizing that the product represents excellent value for money at this price

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**Undercut Pricing**

Sometimes called ‘cheap value’ pricing, the objective in **undercut pricing** is to undercut the competition by setting lower prices, and the lower price is used as a trigger for immediate purchasing. Entrants into the low-cost airline segment use this tactic (see Snapshot below). Unit profits are low, but satisfactory overall profits are achieved through high turnover. This strategy is often used by organizations seeking a foot in or rapid expansion into a new market. EasyCruise, the cruise line owned by Stelios Haji-Ioannou, follows such a pricing strategy. Launched in 2005, EasyCruises (there are two of them now) sail around the hotspots of the French and Italian Rivieras. Instead of emphasizing the shipboard experience (his are
bare-bones cruise ships with just a bed, a shower unit and a toilet in the cabins) Stelios makes
the ports the main attraction. It is part of his strategy to attract a younger demographic –
tourists in their twenties or thirties who might usually avoid a week-long cruise. Sailing hap-
pens in the early morning for six hours or less, so that passengers can go on land, have a night
of fun, then sleep it off in their cabins. Nightly rates are around £20 per person; the earlier
one books, the lower the rate.

**UNDERCUT PRICING**

setting prices lower than the competition and using the
price as a trigger to purchase immediately

Any of these policies can be seen as ‘fair-pricing’ policies. A fair price can be defined as
one that the customer is happy to pay while the company achieves a satisfactory level of
profit. Thus a premium-pricing policy is acceptable, provided that the customer receives the
benefits appropriate to the price. Only when companies are able to force up prices against the
consumers’ will, such as in the case of monopolies, can it be said that fair pricing is inopera-
tive. A **monopoly** is a supply situation in which there is only one seller.

**MONOPOLY**

a supply situation in which there is only one seller

**Snapshot**

Low-cost Airlines Take to the Air

‘No frills’ is the latest term buzzing around the airline industry, and cut-price companies such as
Ryanair are taking it to the extreme. The Dublin-based airline, the second biggest international
carrier in the world, is spearheading the move towards very basic, cheap continental travel with
no complimentary food and beverage services, very low luggage allowances, tight cabin space,
high charges for excess baggage, and other surcharges for extras, such as wheelchair service.
Also, cut-price flights often use smaller, secondary airports, sometimes situated far from city
centres (Ryanair frequently uses Stansted instead of Heathrow). There are also compensation
limitations if flights are delayed: passengers may not be eligible for food and accommodation
since most cut-price airlines are not part of the EU’s Passenger Service Commitment.

Despite the disadvantages and potential discomforts of cheap travel, price is the bottom line
and passengers vie for seats sometimes offered as low as $25 for one-way European flights. This
only covers the flight taxes and service charges, so basically the seats are free. There are about 60
low-price airlines within Europe, including Geneva-based Flybaboo. Many have recently failed in
this volatile, cut-throat market – such as JetGreen, Duo, JetMagic, V Bird and Volareweb.com – leaving customers somewhat insecure, with no guarantees for advance reservations.

Similar price-cutting is also happening throughout India, Asia and the Middle East. SpiceJet, an Indian low-fare airline, competes with Kingfisher Airlines Ltd. and Air Deccan for the lucrative domestic market. Within India, with its increasingly prosperous emerging middle class, there has been a shift from train travel to the quicker and more efficient air travel. Air travel demand is expected to rise 25 per cent per year until 2010, with up to 100 million people choosing air over travel by land, thanks to low fares and also improved inflight amenities and service. This is partly due to government deregulation but also to the fierce competition between airlines, which has transformed the industry, with its original reputation for poor service, to an efficient and comfortable option. Low-cost air travel is mainly distributed via the internet in India. SpiceJet sells about 70 per cent of its seats on the internet and also reduces its overheads by utilizing its aircraft for a full 12 hours per day as well as aiming to fill up each flight with at least 80–90 per cent loads.

In Southeast Asia, likewise, a fierce price war erupted in the budget airline market during 2004, in sharp contrast to the high-price flights traditionally offered in the region. To gain market share and capture public attention, low-cost carriers offered one-way tickets from Singapore to popular destinations such as Bangkok for less than US$1 each. The lowest price was 59 cents, which Tiger Airways offered for one-way tickets to three different Thai destinations. In retaliation Thai Air Asia offered a 29-cent ticket to Bangkok, delighting consumers who would normally pay around US$250 return for Singapore to Bangkok. In the Middle East, the air transportation sector is becoming increasingly segmented, as new start-up airlines emerge to challenge the incumbent Middle Eastern carrier Emirates for a share of the global aviation pie. Low-cost carriers, like Air Arabia and Jazeera Airways, launched in 2003 and 2005 respectively, were prompted by the success of low-cost pioneers in North America and Europe, as well as the opportunity to offer a wide choice of prices and options on intra-regional flights compared to legacy rivals.

In 2006, Brazilian carrier Varig offered free tickets for domestic flights in an effort to win back flyers after financial problems resulted in cancellations and stranded clients. However, most of these media-hitting promotions are short lived. Ryanair’s Chief Executive, Michael O’Leary, is looking to push the boundaries in a bid to replace airfares with inflight gambling. He planned to introduce gambling services by 2007 via passengers’ mobile phones or Blackberries supplied by Ryanair, using a payment system that debits a passenger’s credit card before the plane lands. In 2005 subsidiary services such as car hire, hotels, travel insurance and in-flight sales accounted for around 20 per cent of Ryanair’s £950 million turnover, and O’Leary predicted that non-ticket revenues could rise dramatically with the introduction of more in-flight entertainment.


Basic Approaches to Pricing

Organizations involved in the marketing of tourism, leisure and hospitality products use different methods of calculation to set prices. Pricing methods fall into three main categories:
Cost-Based Methods

Cost-based pricing – the addition of a certain monetary amount or percentage to the actual or estimated costs of a service to arrive at a final price – draws heavily on the accounting discipline of costing. To use this method, it is necessary to understand the differences in the nature of costs. At the simplest level, costs can be split into two types. Fixed costs are costs that do not vary with the amount of the service provided. Hence, a hotelier has the fixed cost of owning the hotel to bear, whether or not rooms are occupied. Variable costs, on the other hand, are those that increase as more of a service is provided. For example, the energy and cleaning costs of a hotel will increase as more guests occupy the rooms. These two cost elements can be combined with revenue – which should increase as more of the service is sold – to give a picture of when an operation becomes profitable. Known as break-even analysis or cost/profit/volume (CPV) analysis, the interaction of these elements can be shown graphically. Figure 6.4 shows the break-even point for a hypothetical hotel that has high fixed costs.

**Figure 6.4** The break-even point for a hypothetical hotel

**COST-BASED PRICING**
adding a certain monetary amount or percentage to the actual or estimated costs of a service to arrive at a final price
Having established the cost of doing business, the simplest approach to pricing is to add a standard mark-up to the cost of the product, known as cost-plus pricing. A restaurant manager might decide that all wines will be marked up by 100 per cent and all food dishes will be marked up by 60 per cent. For example, a bottle of wine purchased at £12 will be sold for £24, and a steak dinner that costs £10 (including both fixed and variable costs) will be sold for £16. Clearly, this approach to pricing takes little account of market forces, and while costs do have to be covered in the long run, policies have to respond to changing market conditions and what the market will bear. However, the concept of marginal costing, which attempts to identify the cost of one or more unit of a product, is an important one in cost-plus pricing, since it offers the marketing manager a flexible tool for pricing. For example, in the case of an airline ticket for a flight across Europe, the additional cost of carrying one more passenger is extremely small: an added meal, a minute addition to fuel, etc. Therefore, once break-even is achieved, it becomes very attractive to price the ‘marginal seats’ (any remaining seats over the number that have to be sold to break even) at a price that will attract market demand from those unwilling to pay regular fares. This is the tactic used by many of the low-cost airlines (see snapshot above).

Demand-Based Methods

Sometimes called buyer-based pricing (or sensitivity pricing), techniques in the demand-based category share the feature of giving major consideration to the consumer. These methods allow for high prices when the demand is high and for lower prices when the demand is
low, regardless of the cost of the product. Such pricing is common for accommodation in the popular holiday beach resorts of Europe, where hotels tend to be more expensive in summer than in winter due to higher demand. Demand-based pricing allows an organization to charge higher prices and therefore to make higher profits as long as the buyers value the products above the cost price. Segmentation is often used to price travel and tourism products, using time (see the global spotlight on Banff Mount Norquay) and age (children usually pay less for tourism services and attractions), for example, as the basis for segmenting the market.

**BUYER-BASED PRICING (SENSITIVITY PRICING)**

allows for high prices when the demand is high and for lower prices when the demand is low, regardless of the cost of the product.

Deeper understanding of the way consumers perceive prices can lead to **psychological pricing**. This usually manifests itself as prices that avoid barriers. For example, a £1,000 holiday may seem psychologically cheaper if offered at £999. Similarly, in order to present a simplified choice of product to the consumer, **price lining** – pre-establishing price lines (levels) that the company feels confident will attract customers – may be employed. For example, a whale-watching trip may be priced at £75 but may not include lunch. The same trip including lunch might be priced at £100 – even though lunch can be provided at a low cost, the £25 is added to make the offer clearly distinct. As long as consumers perceive the gap as representing a clear difference of price and quality, they should accept the distinction. The mistake to avoid is to price many products with marginal differences and prices, as this may lead to consumer confusion.

**PSYCHOLOGICAL PRICING**

using slightly lower prices to give consumers the perception of added value.

**PRICE LINING**

pre-establishing price lines (levels) that the company feels confident will attract customers.

One customer-driven pricing strategy that has increased in popularity due to the internet is the reverse auction. Travel e-tailers, such as Priceline.com (see Global Spotlight in Chapter 10), Hotwire.com, and Lowestfare.com, act as intermediaries between prospective buyers, who request quotations for a product or service, and multiple suppliers who quote the best price they are willing to offer. Buyers can then review the offers and select the supplier that
best meets their needs. Different business models underlie these services. While some are provided free to end users, most e-tailers either receive a commission from the supplier or do not pass on the whole savings. Others charge a fixed fee or one based on a percentage of the savings. Another important type of demand-based pricing, particularly in organizational buying, is **negotiating**, a technique used to establish prices when at least two parties are involved who have a conflict of interest with respect to the product. Hotel space, exhibition services and transport seats are all examples of tourism and hospitality products that are often block-booked by buyers, be they tour operators or specialist buyers.

**NEGOTIATING**

*a technique used to establish prices when at least two parties are involved who have a conflict of interest with respect to the product*

**Competition-Oriented**

In **competition-oriented** pricing, an organization fixes prices in relation to competitors’ prices; this is also called **going-rate pricing**. This method offers the advantage of giving the organization the opportunity to increase sales or market share, but it is a dangerous approach, as it does not focus on either costs or the consumer. The arguments in its favour are that the industry will have developed prices that are acceptable to the marketplace, and that there is little to be gained by offering different prices (so-called ‘industry wisdom’). The counter-argument is that there may be the opportunity to offer different prices (and therefore possibly to achieve better profits) that the majority of the industry has ignored.

**COMPETITION-ORIENTED PRICING (GOING-RATE PRICING)**

*technique in which an organization fixes prices in relation to competitors’ prices*

Some companies use competitors’ prices as a target to be undercut. Those adopting this approach will need to be sure of their cost structures compared to those of others. The danger is that competitors may have supply links that give them a cost advantage, or have some kind of ‘hold’ on customers, such as a strong loyalty scheme. In this case, prices charged may not be a true indication of either costs or price sensitivity. Generally, undercutting is a difficult position to sustain if the price cutter does not have lower costs in the long term. It may also lead to price wars. The snapshot on the low-cost airlines above described how in Southeast Asia, a fierce price war erupted in the budget airline market during 2004, in sharp contrast to the high-price flights traditionally an offer. Some airlines may be competition oriented to the extent that they use
prices to try to drive out competition, perhaps to give themselves a long-term monopoly. Airlines have also been accused of price-fixing in the past. For example, in 2006, several airlines including British Airways, American and United, were at the centre of a criminal investigation into alleged price-fixing on long-haul passenger flights across the Atlantic (Teather et al., 2006).

**Pricing Strategies for New Products**

At the core of pricing is the consumer's perception of price in relation to quality and value for money. This perception can be influenced by the way in which a company charges for its services. When a new product enters the market, it is vital to obtain market share and create the desired image for the product in the consumer's eyes. New products face unique problems. If the product is truly new – something never before available in the marketplace, like the BridgeClimb featured in Chapter 5 – it will be extremely difficult for consumers to develop a sense of what price is appropriate. If there are no similar products with which to compare it, they may either undervalue the innovation or perhaps overvalue it. Detailed research on price sensitivity, clearly outlining the unique features of the new product and researching the best way to communicate this information to consumers, will be important.

Three strategies commonly used for the introduction of new products are prestige pricing, market skimming and penetration pricing.

**Prestige pricing**

This method sets prices high to position a product at the upper or luxury end of the market. For example, tourism and hospitality operators that wish to be seen as top-end operators or establishments must enter the market with high prices to reflect this quality image. The product itself will need to deliver this quality level (in terms of décor, menu, locations, fittings, etc.) A coach company introducing a new luxury vehicle with airline-style seats, individual light and air-conditioning controls, panoramic windows, onboard catering, and amenities can price the transportation as a prestige product. If consumers value these attributes, they will pay the additional premium price. The Hotel Burj Al Arab in Dubai follows such a strategy (see Snapshot above).

**PRESTIGE PRICING**

setting prices high to position a product at the upper or luxury end of the market

**Market skimming**

This policy of ‘skimming the cream’ calls for setting high prices at the launch stage and progressively lowering them as the product becomes better established and progresses through its life cycle. The policy takes advantage of the fact that most products are in high demand in the early
stage of the life cycle, when they are novel or unique or when supplies are limited. Demand can be managed by setting very high prices initially to attract those prepared to meet them, and gradually reducing the price to meet different market segments’ price elasticities. The particular value of this policy is that it provides a high inflow of funds to the company when the marketing costs are highest. Operators in the space tourism market are currently following this strategy (see opening vignette). If the product anticipates a very short life cycle – as in the case of major events such as the World Cup football tournament – and organizing and marketing costs must be recovered quickly, market skimming is a sensible policy to pursue.

MARKET SKIMMING
a policy of ‘skimming the cream’ that calls for setting high prices at the launch stage and progressively lowering them as the product becomes better established

Penetration pricing

This strategy is the opposite of market skimming, as prices are set at a very low initial level. If an organization is trying to achieve maximum distribution for the product in the initial stages, it will probably price at a lower level to obtain maximum sales and market share. This method is commonly used in the marketing of fast-moving consumer goods, when rapid distribution-stocking is essential to the success of the product. If the market is price sensitive (such as in the fast-food sector), penetration pricing is an efficient way to gain a quick foothold. The intention is to set low prices only until this market share has been established and then to raise prices gradually to market levels. EasyCruise, mentioned earlier, penetrated the cruise market with very low prices for its first ship, and then with their second, EasyCruiseTwo, raised prices, justified by a more up-market restaurant and bar.

PENETRATION PRICING
setting prices at a lower level initially to get maximum sales and market share; used when an organization is trying to get maximum distribution for the product or service in the initial stages

Other Pricing Techniques

Promotional

Promotional pricing is used by companies when they temporarily sell products below their normal list price (or rack rate). This is often done to introduce new or revamped products.
Promotional pricing is used in the restaurant sector in these situations. The assumption is that consumers will buy other items at normal price levels along with the promotionally priced items. Promotional pricing is often used in conjunction with product-bundle pricing (see below).

**PROMOTIONAL PRICING**
temporarily selling products below their normal list price (or rack rate).

**Product-Bundle Pricing**

When a company groups several of its products together to promote them as a package, it is using **product-bundle pricing**. An example would be a hotel offering a weekend special that includes a room, dinner in a restaurant, valet parking, room-service breakfast, and late checkout for a set price. In some cases the package will include products that customers might not normally buy (such as the valet parking); this is often done to improve usage during slow periods. Package tours are a popular type of product bundling. Wholesalers package airfare, ground transport, accommodation, sightseeing tours and admission to attractions, and because of their bulk purchases they can negotiate significant discounts. These companies can then offer packages to customers that work out to be considerably cheaper than buying the individual components separately. Bundling therefore offers cost advantages to the company as well as convenience to the consumer. Banff Mount Norquay, featured in the Global Spotlight below, often bundles together a lift ticket with accommodation in a nearby hotel.

**PRODUCT-BUNDLE PRICING**
grouping together a company’s products to promote them as a package

**PRICE SPREAD**
a range of products and prices that will suit the budget of all target markets

**Price Spread and Price Points**

Organizations in tourism and hospitality try to offer a **price spread** – a range of products that will suit the budget of all target markets. A holiday park, for example, may offer campsites with tents, standard cabins, en suite cabins and family units, each different from the other in
terms of size, location, types of fittings and furnishings. Table 6.1 shows the range of prices offered by Banff Mount Norquay, the ski resort profiled in the Global Spotlight below. The range of prices that an organization can set is virtually unlimited. However, research in the restaurant sector has suggested that if the price spread is too wide, consumers will tend to order from among the lower-priced items (Carmin and Norku 1990).5

**Price points** are the number of ‘stops’ along the way between the lowest-priced item and the highest-priced item. Price points vary among industry sectors and types of business. In a restaurant, it is possible to create a menu with a wide range of dishes and to allot a different price to each dish. Restaurants will generally pick several price points and group dishes around those prices. There may be several dishes priced at £10–£13, then several priced around £19–£20, then others at £23–£28. The idea here is to simplify costing and menu planning, and to create points of comparison for the consumer.

**Table 6.1** Banff Mount Norquay Lift Ticket Prices, 2006–2007*

<table>
<thead>
<tr>
<th>Categories</th>
<th>Adult 18+</th>
<th>Youth/Student</th>
<th>Child 6–12</th>
<th>Senior 55+</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full-day</td>
<td>49.00</td>
<td>39.00</td>
<td>17.00</td>
<td>39.00</td>
</tr>
<tr>
<td>Afternoon</td>
<td>41.00</td>
<td>32.00</td>
<td>14.00</td>
<td>32.00</td>
</tr>
<tr>
<td>Night skiing</td>
<td>24.00</td>
<td>22.00</td>
<td>12.00</td>
<td>22.00</td>
</tr>
<tr>
<td>Last hour</td>
<td>15.00</td>
<td>15.00</td>
<td>10.00</td>
<td>15.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Categories</th>
<th>Adult 18+</th>
<th>Youth/Student</th>
<th>Child 6–12</th>
<th>Senior 55+</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 hours</td>
<td>29.00</td>
<td>25.00</td>
<td>11.00</td>
<td>25.00</td>
</tr>
<tr>
<td>2.5 hours</td>
<td>32.00</td>
<td>27.00</td>
<td>12.00</td>
<td>27.00</td>
</tr>
<tr>
<td>3 hours</td>
<td>35.00</td>
<td>30.00</td>
<td>13.00</td>
<td>30.00</td>
</tr>
<tr>
<td>3.5 hours</td>
<td>38.50</td>
<td>33.00</td>
<td>14.00</td>
<td>33.00</td>
</tr>
<tr>
<td>4 hours</td>
<td>41.00</td>
<td>35.00</td>
<td>15.00</td>
<td>35.00</td>
</tr>
<tr>
<td>4.5 hours</td>
<td>44.00</td>
<td>38.00</td>
<td>16.00</td>
<td>38.00</td>
</tr>
<tr>
<td>5 hours</td>
<td>47.00</td>
<td>40.00</td>
<td>17.00</td>
<td>40.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Categories</th>
<th>Adult 18+</th>
<th>Youth/Student</th>
<th>Child 6–12</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 days</td>
<td>98.00</td>
<td>76.00</td>
<td>31.00</td>
</tr>
<tr>
<td>3 days</td>
<td>138.00</td>
<td>108.00</td>
<td>44.00</td>
</tr>
<tr>
<td>4 days</td>
<td>184.00</td>
<td>144.00</td>
<td>58.00</td>
</tr>
<tr>
<td>5 days</td>
<td>230.00</td>
<td>180.00</td>
<td>73.00</td>
</tr>
</tbody>
</table>

Some tourism organizations, notably from the transportation sector, have been accused of having convoluted systems of fare categories, termed ‘confusiology’ by one author (Adams, 1997). The rail companies in the UK, for example, have come under fire for confusing passengers with their fare systems in order to charge more. In 2006, travellers had the option of 34 different fares for the same route between London and Manchester, from a £6 advance fare to a £317 business return (Macfarlane, 2006). In response, a report by the all-party Transportation Select Committee suggested that the railways should develop a simple, user-friendly and affordable structure of train fares that apply across the network to give passengers a fair deal. First Great Western reacted to the report by withdrawing SuperSaver, Advance, Super-Advance, Apex and First Apex fares and replacing them with ‘leisure’ and ‘business’ class tickets.

Global Spotlight

‘Save Time, Save Money’: Ski by the Hour at Banff Mount Norquay

‘Save time, save money’. This is the slogan used by Alberta ski area Banff Mount Norquay to promote its skiing-by-the-hour concept. In 1995, the resort introduced the concept of hourly skiing, which has ultimately proved to be an extremely successful long-term pricing strategy. The resort decided to test the waters in 1995 by selling a mid-week-only, two-hour ticket called a ‘flex-time’ ticket, targeted at the local market. Reaction to the flex-time ticket was extremely positive – skiers who had never been to Norquay were turning up for a couple of hours of skiing and then going back to work. Hourly skiing opened up a new market, so after two seasons Norquay decided to expand the idea by introducing two-, three-, four-, and five-hour tickets, seven days a week. ‘We found it was not abused, and it did not cannibalize existing business,’ says Robert Coté, Norquay’s director of marketing. ‘People bought a two-hour ticket because they only wanted to ski for two hours – they wouldn’t normally have bought a day ticket, and they wouldn’t have bought a season’s pass because they didn’t ski enough to make it worthwhile.’

According to Coté, hourly skiing takes down all the barriers to skiing that would normally prevent people from coming. ‘We knew everyone liked Norquay, but it wasn’t accessible from a customer’s point of view. If someone wanted to ski for the morning they had to buy a whole day’s lift ticket, and if they wanted a half day, they had to wait until midday. This meant Norquay was imposing its timetable on customers. Now we have put customers in control of their own day.’

Competitors have not followed Norquay’s lead on hourly tickets, mainly because they are not as close to Banff or Calgary, and also because the layout of their resorts is not conducive to hourly skiing. For hourly skiing to succeed, a close proximity to the client base is necessary. Norquay’s proximity to Banff allows visitors to the city to snatch a few hours of skiing on arrival or departure day, or to put in a half-day of skiing before an afternoon at the hot springs or shopping. Locals can also come up just for a short period. ‘The way
the lifts are laid out here, you can do a lot of skiing in two hours,' explains Coté. 'At other resorts it may not work because they are bigger and more spread out.'

For Coté, the most significant advantage to skiing by the hour is that skiers now feel they are getting value for money. ‘There is a general perception that the sport of skiing is expensive. I don’t think it is the actual money spent – I think it is a whole-value equation. Normally, if you don’t make it by 9 am for the first lift, you are not going to get full value for your lift ticket. You are going to leave with an unused portion and leave with the feeling of being ripped off. Our slogan is ‘save time, save money.’ Coté adds, ‘The biggest thing here is saving time. In today’s society with all the time demands placed on people, time is the most valuable commodity out there. People want to ski, but they don’t necessarily want to commit so much time to it. Unfortunately, the full-day/half-day scenario of purchasing lift tickets just doesn’t allow for that. It all of a sudden puts a high demand on people’s time.’ The hourly tickets have also led to fewer queues, as skier numbers are spread throughout the day, and this puts less stress on the customers. Yield is also higher as it is proportionately more expensive to ski by the hour than by the day.

In 2002–2003, in response to customer demand for even more flexibility, Norquay decided to offer half-hourly increments as well as hourly ones. The resort’s ski-by-the-hour ticket options are shown in Table 6.1. The 2001–2002 season was the first winter in which gross sales from the different hourly tickets exceeded sales from full-day tickets – the three-hour ticket being the most popular, followed by two-hour and four-hour tickets. But full-day sales have remained steady, so hourly tickets have not adversely affected sales of full-day tickets. And skiing by the hour has become so popular at Norquay that Coté tags the skiing-by-the-hour concept onto many of its resort promotions. ‘After six years of it, people are really catching on to it, and it is becoming associated with us,’ he says.

Source: R. Coté, director of marketing, Mount Norquay, personal communication 15 February 2003 and 5 January 2006.

Discriminatory Pricing

Organizations often alter prices to suit different customers, products, locations, and times. This **discriminatory pricing** allows the organization to sell a product or service at two or more prices, despite the fact that the product costs are the same. For example, many restaurants charge higher prices in the evening than they do at lunchtime, even if the food is identical, because of demand differences. Ski resorts may charge more for a weekend ski pass than a week-day one if the majority of their customers drive up on a Saturday or Sunday.

**DISCRIMINATORY PRICING**

selling a product at two or more prices, despite the fact that the product costs are the same
These are examples of ‘time-based’ discriminatory pricing, but a market may also be segmented to encourage increased participation from special groups, such as senior citizens or students. In this case, the groups are offered special concessions, as seen in Banff Mount Norquay’s cheaper prices for children, students and seniors (see Table 6.1). The market must be capable of being segmented if discriminatory pricing is going to be an effective strategy. Segments will have highly distinct sensitivities, and being able to price differently to each is key to success in maximizing profits (Hiemstra, 1998). Care should also be taken to ensure that the strategy is legal and that it does not lead to customer resentment.

Discounting

From time to time, most businesses need to consider discounting their standard prices. Many tourism organizations engage in volume discounting – offering special rates to attract customers who agree to major purchases. Hotels and airlines for example, offer special prices (or upgrades) to corporate clients to encourage volume business, and loyalty programmes frequently offer discounts to ensure that travellers use a particular brand. The discount will often reflect the level of overall demand. Airlines and hotels traditionally discount during slow periods and low seasons. A discounted price is only a wise move if it increases demand, brings new users, or increases consumption by regular users. Organizations that discount key products but don’t lower costs to offset the discount are taking an economic risk unless the discount is only for a very short period, or is designed to overcome a very specific problem. There is also the risk that discounting may not lead to increased demand.

Yield Management

Yield is the profit that is made on the sales of goods and services; the calculation is based on the number of customers, how much they spend, and the number of products they buy. Yield management is the practice of developing strategies to maximize sales of an organization’s perishable products, such as airline seats, hotel rooms and tour seats, and therefore improving its long-term viability. More simply, it has been defined as ‘lowering the price… according to expected demand, and relying heavily on computers and modelling techniques’ (Lundberg et al., 1995). It was initiated by the airline industry in the 1980s as a way to increase revenue from existing routes and aircraft. Computer technology made it possible for airlines to predict the number of seats that would be sold on a given flight, called the load factor. By analyzing costs, and also determining the price sensitivity of various types of airfares, airlines discovered that by offering seats at a variety of special fares they could boost load and revenues.
YIELD
the profit that is made on the sales of goods and services; calculation is based on the number of customers, how much they spend, and the number of products they buy

YIELD MANAGEMENT
developing strategies to maximize sales of an organization’s perishable products, such as airline seats, hotel rooms and tour seats, and therefore improving its long-term viability

Many have argued in favour of yield-management techniques, using price to balance the market conditions of supply and demand. Duadel and Vialle (1994), for example, distinguished between ‘spoilage’, the under-utilization of resources, and ‘spill’, selling too cheaply early, with the result that later, higher-yielding demand has to be denied. The practice of yield management is now common in other sectors of tourism, from hotels to ski resorts. Different rates are offered for certain groups of customers, and restrictions are placed on the use of these rates by other groups. Even theatres use yield management techniques to maximize revenue. The Snapshot below shows how the Cherry Blossom Festival in Kyoto uses a simple three-tier approach to pricing tickets.

Snapshot
Pricing at a Cherry Blossom Festival in Japan

The recent Hollywood blockbuster, Memoirs of a Geisha, may have attracted an increased number of tourists to the Gion area of Kyoto, Japan’s historic ‘flower town’. But for many years, Japanese tourists have been flocking to the Miyako Odori Festival, held each April in the Koubu Kaburenjo theatre.

The Miyako Odori, or Cherry Blossom Festival, takes place over the whole of April, with four afternoon hour-long performances each day. Busloads of tourists arrive from all over Japan, as well as from international destinations, for the chance to see geishas and maiko perform. Visitors anxious for photos tour the narrow, winding streets hoping to bump into a fully dressed and made-up geisha on her way to the festival or the many tea shops. Also, hundreds of Japanese spectators take the opportunity to wear traditional kimonos; the audience for the dancing show can often be half full of authentically-clad women.

The Miyako Odori dates back to an exposition held in 1872 when Kyoto was reinforcing its 1,000-year-old dignity as the former capital of Japan. The capital had just been transferred to Tokyo and the city introduced the Cherry Blossom Dance as a classic Kyoto stage
production, with its geisha and maiko troupes and musicians specializing in the shamisen, an ancient Japanese string instrument. Every year, the Gion area is inundated with tourists anxious to see the dance as well as tour the religious and historical icons of the city with the famous cherry trees in full bloom. Nowadays you can even rent a geisha outfit, complete with wooden sandals, wig, kimono and make-up, by the hour.

The theatre uses a simple three-tier approach to pricing tickets for the festival. Creating pricing tiers is a traditional aspect of theatre attendance world over. The premium-priced tickets, at ¥4,300 in 2006 (around £20) enable viewers to sit on reserved seats on the first floor or the front of the second floor. They are also invited to attend a geisha tea ceremony 40 minutes before the performance. This includes green tea in exquisite cups with Japanese cake, and guests can keep a souvenir dish. They also have the opportunity to walk around the authentic Japanese-style garden.

First-class tickets, at ¥3,800, give patrons reserved seats – either on the second floor or on the designated seating area without chairs at the sides of this floor. They get a close-up appreciation of the dancers and musicians and a clear view for photos. The cheapest, second-class tickets, at ¥1,900, are for the free seating area without chairs on the third floor. Here viewers either kneel barefoot on cushions on raised deck areas or perch on narrow wooden benches.


**Strategic and Tactical Pricing**

Organizations in the tourism and hospitality industries operate pricing policies at strategic and tactical levels. In **strategic pricing**, prices are determined early on in the planning of the marketing strategy; the nature of the business means that they have to be set a long way in advance so that brochures and guides can be published. These pricing decisions are based on the long-term view of corporate strategy, product positioning, and value for money in the marketplace.

**STRATEGIC PRICING**

setting prices early, in accordance with the long-term view of corporate strategy, product positioning, and value for money in the marketplace

While strategic pricing is concerned with the overall plans for the implementation of pricing policy, **tactical pricing** relates to day-to-day techniques in pricing, which can be rapidly altered to suit changing conditions in the marketplace. Thus, a strategy of discriminatory pricing that involves the setting of different prices for different market groups...
(e.g., business travellers and leisure travellers) may be introduced, but the actual prices to be charged and the ways in which these fares will be adjusted require tactical decisions. The fact that organizations cannot stock services means that if the planned supply exceeds demand in the marketplace for whatever reason, the organization must sell excess capacity. This often means resorting to tactical strategies, in the form of promotional pricing or discounting, for example. Hotels have become skilled at using last-minute tactical pricing methods to fill unoccupied rooms. Customers can often negotiate a substantial reduction on the rack rate if they phone the hotel during the evening on which they want a room.

### TACTICAL PRICING

Making short-term pricing decisions in response to changes in the marketing environment.

One of the strategic decisions that must be taken is whether to price differently in different geographic areas. Should the price set be common to all customers, or should it vary to reflect different market demand in various countries? It may be more costly to sell a package tour to the Japanese than to Americans, because of higher costs in Japan; elsewhere it may be necessary to boost agents’ commission levels to secure their support. According to the 2007 Cost of Living Survey from Mercer Human Resource Consulting, Moscow London and Seoul are the most expensive cities in the world (see Table 6.2). Tourism players who operate in an international market have to be aware of such statistics when setting prices.

### Table 6.2 The Most Expensive Cities in the World

<table>
<thead>
<tr>
<th>Rankings</th>
<th>City</th>
<th>Country</th>
<th>Cost of Living Index March 2007</th>
<th>Cost of Living Index March 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Moscow</td>
<td>Russia</td>
<td>134.4</td>
<td>123.9</td>
</tr>
<tr>
<td>2</td>
<td>London</td>
<td>United Kingdom</td>
<td>126.3</td>
<td>110.6</td>
</tr>
<tr>
<td>3</td>
<td>Seoul</td>
<td>South Korea</td>
<td>122.4</td>
<td>121.7</td>
</tr>
<tr>
<td>4</td>
<td>Tokyo</td>
<td>Japan</td>
<td>122.1</td>
<td>119.1</td>
</tr>
<tr>
<td>5</td>
<td>Hong Kong</td>
<td>Hong Kong</td>
<td>119.4</td>
<td>116.3</td>
</tr>
<tr>
<td>6</td>
<td>Copenhagen</td>
<td>Denmark</td>
<td>110.2</td>
<td>101.1</td>
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<td>7</td>
<td>Geneva</td>
<td>Switzerland</td>
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<td>103</td>
</tr>
<tr>
<td>8</td>
<td>Osaka</td>
<td>Japan</td>
<td>108.4</td>
<td>108.3</td>
</tr>
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<td>9</td>
<td>Zurich</td>
<td>Switzerland</td>
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<td>100.8</td>
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<tr>
<td>10</td>
<td>Oslo</td>
<td>Norway</td>
<td>105.8</td>
<td>100</td>
</tr>
</tbody>
</table>

Other popular strategies include all-in pricing or all-inclusive pricing. This type of pricing was used originally in holiday camps in the UK, where customers were provided access to every entertainment facility in the camp for a single price. The strategy proved highly successful, and Club Med built on this model for its chain of holiday resorts around the world. Club Med now advertises ‘total all-inclusive’ holidays, so that consumers pay for no extras whatsoever (see Figure 6.5). Today, tourists are very familiar with booking all-inclusive holidays in resorts like the Caribbean and Mexico. Theme parks also normally adopt the all-inclusive strategy by charging just one fee for the use of all their attractions.
ALL-IN PRICING (ALL-INCLUSIVE PRICING)
charging consumers a single price for the various products or services on offer

A contrasting strategy involves charging a low basic entrance fee and recouping profits through add-ons, which require that customers pay for each individual attraction. Organizers at the Calgary Stampede (see Global Spotlight in Chapter 12) have used this strategy for the funfair set in the middle of the Stampede grounds. Guests pay a small entrance fee but then have to pay for all of the rides. This is similar to off-set pricing or bait pricing, in which an operator such as an attraction will set a very low entry charge, possibly even a ‘loss leader’ at below cost, in order to attract visitors who then find themselves facing extra charges for every event. Casino hotels provide an example of bait pricing. Prices are often extremely reasonable for rooms, food and drink because profits are reaped through gambling on the premises.

OFF-SET PRICING (BAIT PRICING)
charging a low basic price and charging for extra services

Tourism and Hospitality Characteristics That Affect Pricing Policy

Although some of the following points have already been referred to in this chapter, a separate discussion of the particular features of the tourism and hospitality industry that affect pricing is warranted here.

High Level of Segmentation in the Industry

The tourism industry is highly segmented, with varying elasticities of demand in the segments. These demand segments may be associated with different income levels, age groupings, seasonality, and types of pleasure or business. Groups are also not homogeneous in their demands. Some may be business travellers with expense accounts and others may be pleasure travellers spending their own funds.

Variability of Demand

Different products also face much variability in level of demand depending on the day of the week, holidays, different seasons of the year, and fluctuations in local personal or business situations. For hotels, this variability makes it difficult to forecast average room demands for an individual property, so each day of the year has to be projected and priced differently.
Perishable Nature of the Product

The tourism product is perishable, i.e., it cannot be stored and sold at a later date. In addition, suppliers may not wish the surplus to be sold through the same channel as the standard product, as this may affect future demand and pricing. This is why outlets exist that allow the supplier to remain anonymous. For example, the internet provides an outlet for tour operators and airlines to offload surplus holidays or flights at reduced margins without changing their main brochures.

High Fixed Costs

High fixed costs in major tourism sectors exacerbate the perishable nature of selling holidays, seats or hotel rooms. This means that an organization saves little by not filling to capacity. In the hospitality sector, for example, variable costs associated with the rooms department account for only a quarter of total room department income, while fixed costs associated primarily with paying for the building and overhead expenses account for a large share of the remaining revenue. This feature gives strong incentive to rent rooms at relatively low rates rather than leaving them vacant.

Cost Fluctuations

For many operators in the tourism industry, there is a high probability of unpredictable but major short-term fluctuations in cost elements, such as oil prices and currency exchange rates. A tour operator running packages to various European and South American destinations may, according to exchange rates and the general climate of tourism in each country, have to vary its prices. High oil prices in 2006 forced many airlines to cut costs. One Chinese airline, China Southern, calculated that it takes a litre of fuel to flush a toilet at 30,000 feet, so urged passengers to go to the toilet before they boarded.11

Vulnerability to Demand Changes

The industry is vulnerable to demand changes resulting from unforeseen economic and political events. Tourism worldwide suffered a downtrend between 2001 and 2004 due to terrorism, the Iraq war, low economies and the SARS outbreaks. Since 11 September 2001 there have been more than 3,000 major terrorism attacks worldwide, most of which have impacted the tourism industry.

High Level of Customers’ Psychological Involvement

Customers display a particularly high level of psychological involvement in choosing vacation products, in which price may be a symbol of status as well as value (Laws, 1998).12 They are therefore likely to invest considerable care in their choice. In the packaged holiday
market, where the tour operators or travel agents emphasize prices rather than destination attributes in their promotions, the customers’ attention is likely to be focused on comparing prices rather than on what each destination offers, potentially resulting in a reduced commitment to the resort visited. Under these conditions, there is more likely to be a mismatch between the tourists’ holiday expectations and their destination experiences, resulting in dissatisfaction and complaint.

Seasonal Demand

One of the most common ways of setting holiday price differentials is the seasonal banding that is typical of tour operators’ brochures – and familiar to all who purchase inclusive holidays – in the form of price and departure date matrices. Seasonality of demand leads to differing price expectations. Commercial business demand for some hotels often declines in high summer. This leads to domestic consumers anticipating lower rates and higher availability mid-week. Conversely, many tour operators and airlines are able to increase prices in high summer when demand is at its peak. An interesting pricing strategy was set by the Eden Roc Resort & Spa in Miami in the 1990s. The resort charged guests the same figure in dollars as the day’s highest temperature. The idea was to give guests no cause for complaint even in the event of a cold snap!

Tactical Price Cutting and Price Wars

If supply exceeds demand, there is near certainty of price-cutting by major competitors. This leads to the high possibility of price wars being provoked in sectors such as transport, accommodation, tour operating and travel agencies, in which short-term profitability may disappear.

Low Prices

Price competition in many sectors has led to an industry characterized by low prices. Low prices have not only stimulated demand for holidays currently on offer, but have also altered the timing of demand – for example, by extending the holiday season – and have changed the demographic profile of holidaymakers to include all age groups and most socioeconomic groups of society. A lower price provides increased access to the product, bringing it to a new group of potential purchasers that have different behavioural characteristics. One example of this is that cruise holidays are now promoted to a broader market on the basis of reduced prices.

Fixed Capacity

Even though demand may be highly variable and unpredictable, in many sectors of the industry supply tends to be relatively fixed. For a hotel, for example, it takes a long time to
expand a building or to build a new one. Adding part-time or seasonal labour may be useful in better serving guests during periods of peak occupancy, but it can add little to available room inventory. As a result, pricing policies are largely restricted to allocating existing supplies among competing demands. This restriction adds importance to effective no-show policies.

The Customer’s Total Purchases

Some sectors of the industry have to consider the customer’s total purchases when considering prices and profits. Hotels should not consider room rates and restaurant prices separately. Selling a room cheaply to a guest who will use the restaurant and bars extensively may be more profitable than selling it to someone who pays full rate for the room but purchases nothing else. For example, mixed-offering destinations like those owned by Intrawest (see Case Study in Chapter 5) do not have to concern themselves too much with visitors not skiing, as they can earn huge profits from selling other on-snow activities, as well as earn revenue from the restaurants and retail units. Destinations are keen to attract medical tourists (see Case Study below) because of the total purchases such a tourist will make both before and after surgery.

Increased Use of the Internet

Many travel consumers are ‘empowering’ themselves by learning the routines of internet research and transacting for airfares. They are also increasingly aware of their ability to exercise more control over their purchases, and a large percentage of hotel customers attempt to negotiate lower prices for their rooms. In general, consumers have become more self-reliant; and the most adventurous are building their own holidays, many of them encouraged to make online purchases with internet-only discount rates (Davis, 2002).13

Late Booking

Price reductions for late booking are a widespread holiday industry response to its unsold capacity, and are typically promoted by travel agents and tour operators shortly before departure. However, operators are increasingly using website pricing options to accommodate late bookers. It wasn’t long ago that most businesses made only non-discounted rates available through the web. Today, pricing is more complex, and many travel websites now have a whole menu of pricing options online. It is now typical to see last-minute discounts; web-only offers; discounted pricing for groups; incentive rates for travel agents, tour operators and reservation agents; and a variety of packages at different price points, including such add-ons as meals, activities and transportation (Hudson and Larg, 2002).14
Chapter Summary

The key factors determining pricing decisions are marketing objectives, costs, other mix variables, channel member expectations, buyer perceptions, competition, and legal and regulatory restrictions.

The analysis of buyers’ reactions to price change uses the concept of ‘elasticity of demand’. If demand increases in line with price cuts, the product is said to be elastic. But if demand remains relatively unaltered by price changes, the product is said to be inelastic.

Generally, companies use pricing as part of their positioning of a product, employing one of three strategic approaches: premium pricing, value-for-money pricing and undercut pricing.

Basic approaches to pricing fall into three main categories: cost-based methods, demand-based methods and competition-oriented pricing.

Three strategies commonly used for the introduction of new products are prestige pricing, market skimming and penetration pricing. Other pricing techniques include promotional pricing, product-bundle pricing, price spread and price points, discriminatory pricing, discounting, and yield management.

Particular features of the tourism and hospitality industry that affect pricing include the high level of segmentation within the industry; variability of demand; the perishable nature of the product; high fixed costs; cost fluctuations; vulnerability to demand changes; the high level of customers’ psychological involvement; seasonal demand; tactical price-cutting and price wars; low prices; fixed capacity; the customer’s total purchases; increased use of the internet; and late booking.

Key Terms

all-in pricing (all-inclusive pricing), p. 205
break-even analysis, p. 191
buyer-based pricing (sensitivity pricing), p. 192
competition-oriented pricing (going-rate pricing), p. 193
cost-based pricing, p. 190
cost-plus pricing, p. 191
discriminatory pricing, p. 199
elasticity of demand, p. 184
fixed costs, p. 191
market share, p. 181
market skimming, p. 195
monopoly, p. 188
negotiating, p. 193
offset pricing (bait pricing), p. 205
Discussion Questions and Exercises

1. What are the benefits and costs to a tourism operator in providing discounts?
2. When would a new restaurant introduce a new product with premium pricing? When might it use undercut pricing?
3. What pricing strategy is Space Adventure using for space tourists? How could the company find out about price sensitivity for its proposed new package?
4. Collect advertisements for hotels in your area and find examples of product-bundle pricing. Explain how they work. Try to calculate the savings that the bundle offers.
5. Explain the differences between prestige pricing, market skimming and penetration pricing, using examples from a sector of tourism and hospitality other than hotels.
6. What type of pricing strategy is Banff Mount Norquay following? Can you see any disadvantages to this strategy?
Safari and a Facelift: The Rise of Medical Tourism

Medical tourism, whereby patients travel a different country for either urgent or elective surgery, is fast becoming a worldwide, multi-billion-dollar industry. Time, money and anonymity are three reasons driving international medical queue-jumping. The rapid rise in this new industry is attributable to the exorbitant costs of medical care in developed countries, in conjunction with the comparative ease and affordability nowadays of international travel, rapidly improving technology and standards of care worldwide, and the proven safety records of medical care in many developing countries around the world.

Surgery wait times, in particular, can lead patients to seek alternative venues. North Americans are finding that trips abroad combined with surgery can cost between four and ten times less than medical procedures at home. Also, by mixing surgery with pleasure, less time away from work is required. And, for everyone, foreign travel can disguise the primary purpose of the vacation so that friends and colleagues attribute their newly refreshed, youthful appearance to the benign effects of the holiday rather than the cosmetic surgeon’s scalpel.
As far back as the times of ancient Greece, pilgrims and patients travelled throughout the Mediterranean to the sanctuary of the healing god, Asklepios, at Epidaurus. The healing waters at Bath, first established in Roman Britain, have been a shrine for more than 2,000 years. Baden Baden in Germany was another traditional watering-hole for rich European patients seeking alleviation of arthritis and other debilitating ailments. Now, in the 21st century, cheap airfares and increasingly high standards of medical facilities and expertise worldwide have opened up ‘medical tourism’ to a growing middle class market.

Countries that actively promote medical tourism include Cuba, Costa Rica, Hungary, India, Israel, Jordan, Lithuania, Malaysia and Thailand. India is currently considered the leading country to promote this phenomenon, and has been encouraging its expatriates from all over the world to return for cheaper and quicker access to medical attention for the past decade. Government and private sector studies there estimate that medical tourism, with a growth rate of 30 per cent annually, could bring between US$1 billion and $2 billion into the country by 2012. Apollo Hospital Enterprises is the largest of the outsourcing medical corporations in India, having treated about 60,000 patients between 2001 and spring 2004.

Even South Africa, where medical advertising is still illegal, is joining in with medical safaris, dubbed ‘beauty and beast tours’. South Africa is particularly attractive to cosmetic surgery patients because of its high-quality surgeons and its prices, which are cheap as a result of the ailing currency rate rather than any deficiency in facilities or expertise. Surgeon and Safari is one Johannesburg-based company capitalizing on this growing demand, and has consultants located online and in South Africa, Britain and the United States. Set up in 1999 by Lorraine Melvill, it circumvents advertising restrictions by providing a middleman-type service between patients and doctors. Melvill, a marketing executive, saw that she could exploit the unusual synergy between the demand for tourism on one hand and for cosmetic surgery that is affordable, high quality and offers the client anonymity on the other.

Clients are informed via the website about the medical and tourism aspects of their trip. Melvill makes all the arrangements for transportation, surgery, recuperation, hotels and safari plans, meeting all her clients right off the plane. She attributes her success to this personal, hands-on, reassuring business approach. She even sits by her clients’ side during the lead-up to surgery. On offer are a range of cosmetic and reconstructive surgeries including plastic, ophthalmic, orthopedic; dentistry, hair transplants and sports medicine are also offered, as well as non-surgical Botox and restalyne treatments. Almost half of the clients are from the UK and they opt mainly for reconstructive procedures. The other half, from the US, arrive with a shopping list of mainly cosmetic requests.

Costs vary according to the type of operation and the length of recuperation required. A seven-day package, including two surgical procedures (e.g. liposuction and tummy tuck), accommodation in a luxury resort as well as some meals would cost approximately US$3,800. If you tack a safari onto that package, the overall cost equals the price of having the surgery alone done back in the US. A facelift in the States costs around $9,000 compared to $4,400 in South Africa. And Melvill
assures her customers that the cost differential is purely due to the country’s weak currency and represents value for money rather than low standards.

As with any surgery, there are risks associated with surgery abroad. The American Society for Aesthetic Plastic Surgery warns about the risks of sitting in the sun post-surgery, inconsistent follow-up care, drinking alcohol when on strong medications, flying too soon after surgery with the potential for deep vein thrombosis, and the possibility of insufficient credentials among foreign surgeons. Melvill counters all these criticisms, claiming that the South African surgeons are of the highest quality and expertly trained. The hospital’s blood supply is screened for HIV, patients are tested for blood clots in their legs, and surgeons refuse to operate on the mentally unstable, anorexic or obese.

The future of medical tourism seems strong in light of the potential baby boomer market of over 220 million people throughout the US, Canada, Western Europe, Australia and New Zealand. It capitalizes upon the fascination with vanity, agelessness and beauty at any cost among an increasingly older population, as well as the globalization of tourism and medicine. ‘Come for the surgery, stay for the scenery’ is a website advertising slogan attracting many people to South Africa to combine their elective surgeries with safaris, sightseeing and even a round of golf. The following table shows the price of medical tourism for one American customer who travelled to South Africa to have excess skin removed, followed by a safari and a whale-watching trip.


### Questions

1. Is demand for medical tourism price-elastic or inelastic? Explain your answer.
2. How would a developed country, such as the UK or the US, argue that medical tourism in a developing country like India, involves a price–quality trade-off?
3. What kind of pricing strategy is Lorraine Melvill following?
4. Account for the increase in demand for medical tourism. Where will the growth come from in the future for this particular sector of tourism?
5. What other tourism products could be ‘bundled’ into the package detailed in Table 6.3?

<table>
<thead>
<tr>
<th>Table 6.3 Plastic Surgery and Safari Tally (in US dollars)</th>
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<tbody>
<tr>
<td><strong>Round-trip flight to South Africa</strong></td>
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<tr>
<td><strong>Safari/whale-watching</strong></td>
</tr>
<tr>
<td><strong>Room and meals</strong></td>
</tr>
<tr>
<td><strong>Tummy tuck and lipo</strong></td>
</tr>
<tr>
<td><strong>Private nurse and driver</strong></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
</tr>
<tr>
<td><strong>Average price of just surgery in the US.</strong></td>
</tr>
</tbody>
</table>

*Source: People Magazine, 2006*
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