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MASTER'S THESIS

Service Pricing Strategy in the Application of Hotel Industry

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The undersigned boards of examiners hereby, certify that
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Service Pricing Strategy in the Application of Hotel industry

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Abstract

Finch et al., (1998), Potter (2000) and O'Connor (2003), and Shipley and Jobber (2001) have suggested that pricing is the only element of the marketing mix that produces revenues for the firm, while all the others are related to expenses. Diamantopoulos (1991) has also argued that price is the most flexible element of marketing strategy in that pricing decisions can be implemented proportionately quickly in comparison with the other elements of marketing strategy.

Pricing decisions are not only important, they are also complicated. For example, hotel manager should achieve to these goals: maximise owner investment objectives, contribute to brand integrity, satisfy heterogeneous guests, minimise the effect of product perish ability and incur minimal administrative costs. Also to stakeholders' interests and the nature of the room product, there may be room-pricing issues related to timing, manager accountability and insufficient market and technical knowledge, administrative costs and a growing availability of pricing information all contribute to making room pricing decisions difficult.

None of the pricing approaches are an ideal pricing method that simultaneously meets the criteria of cost structure, profit margin, competition, elasticity of demand, and supply and demand. Due to the difficulty and complexity of pricing in the real business world, setting and managing prices is one of the most important elements of a marketing manager's duty (Campbell, 1999).

Another point is that pricing strategies in Iranian hotel is not certainly exist it means that most of the hotels try to sell their services with higher price that the governmental rules allowed them. They set their prices experimentally and it is not based on academic knowledge. So this thesis has an empirical contribution in the hotel and service market of Iran.

Hotel operators may be better off using various pricing approaches to set hotel room prices instead of using one single pricing approach. So we can see the complexly and difficulty of adopting a pricing strategy for hotel so I use a model that it named **Multi-Stage Synthetic Hotel Room Pricing Model** that is used to incorporate the complicated factors affecting hotel

room pricing such as cost structure, profit goal, market competition, demand and supply, and differentiation premium. The term *synthetic* is used because a combination of multiple pricing approaches rather than only one pricing approach is adopted in this study (Tung et al., 1997). That is expanded and added new factors by Woo Gon Kim et al, (2003).

This multi-stage synthetic pricing approach has seven stages that the final destination of this research is to calculating market premium price that is based on customers view, market and competitor.

I had to survey firs is hotel Esteghlal customers and the second is hotel Homa customers. I collected 308 questionnaires and analyze them. Based on these data, I calculated differentiation premium of hotel Esteghlal and hotel Homa.

I decide to work on the pricing Strategy of Hotel Esteghlal as my case. Also I need to study market situations to find main competitor of hotel Esteghlal. Hotel Esteghlal is the most famous five star hotels in Tehran that it has luxury customers. One of its competitors in this segmentation of market is hotel Azadi that it was in the reconstruction during my research, also both of Esteghlal and Azadi hotels are belong to a same chain that is Parsain hotels chain, so I didn't choose hotel Azadi as a competitor. In other hand hotel Homa (ex Shrayeton) is another five Star hotel in Tehran that I choose it as a competitor of hotel Esteghlal for my study. I calculate the average price of hotel Homa to use it as ACP (average competitor price).

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Moving each step forward, I achieved the understanding as to the sweetness of endeavor to gain knowledge.

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List of abbreviations

MPP: Market Premium Price

Pdp = differentiation premium price after SL adjustment;

DP = differentiation premium;

Ap = availability premium;

Rtp = reputation testability premium;

CIp = commitment incentive premium;

Psp = price sensitivity premium;

ACP = average competitor's price;

(SL) = governmental or industrial price standard limit.

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Chapter 1

Introduction and Preliminaries

1- Chapter 1-Introduction

1-1- Introduction

A number of different authors have underlined the importance of pricing decisions for every company's profitability and long-term survival. If effective product development, promotion and distribution sow the seeds of business success, effective pricing is the harvest. Although effective pricing can never compensate for poor execution of the first three elements, ineffective pricing can surely prevent those efforts form resulting in financial success (Nagle & Holden, 1995).

Similarly, Finch et al., (1998), Potter (2000) and O'Connor (2003) , and Shipley and Jobber (2001) have suggested that pricing is the only element of the marketing mix that produces revenues for the firm, while all the others are related to expenses. Diamantopoulos (1991) has also argued that price is the most flexible element of marketing strategy in that pricing decisions can be implemented relatively quickly in comparison with the other elements of marketing strategy. Despite this significance of pricing as an element of the company's marketing strategy, there seems to be a lack of interest among marketing academics on this issue, which has brought

Nagle and Holden (1995) to suggest that pricing is the most neglected element of the marketing mix. Within this context, the empirical research that has been conducted on the field of pricing is very limited, while this is even more evident in the case of services. However, the distinctive characteristics of services (intangibility, heterogeneity, perish ability and inseparability) necessitate a closer look at the way at which services are priced (Schlissel and Chasin, 1991; Zeithaml and Bitner, 1996; Kurtz and Clow, 1998; Langeard, 2000; Hoffman et al., 2002).

1-2- Pricing objectives

According to Oxenfeldt (1983), pricing objectives provide directions for action. "To have them is to know what is expected and how the efficiency of the operations is to be measured" (Tzokas et al., 2000a). Table 1 summarizes the fundamental pricing objectives that have been derived from the services pricing literature (Channon, 1986; Cannon and Morgan, 1990; Bonnici, 1991; Payne, 1993; Palmer, 1994; Bateson, 1995; Drake and Llewellyn, 1995; Woodruff, 1995; Ansari et al., 1996; Lovelock, 1996; Meidan, 1996; Zeithaml and Bitner, 1996; Hoffman and Bateson, 1997; Langeard, 2000). Diamantopoulos (1991) suggests that pricing objectives can "fall under three main headings relating to their content (i.e. nature), the desired level of attainment and the associated time horizon".

Table 1: pricing objectives of firms

Table I Pricing objectives of service firms

Profit maximization	Achievement of satisfactory profits
Sales maximization	Achievement of satisfactory sales
Market share maximization	Achievement of a satisfactory market share
Market share increase	Cost coverage
Return on investment (ROI)	Return on assets (ROA)
Coverage of the existing capacity	Liquidity maintenance and achievement
Price differentiation	Service quality leadership
Distributors' needs satisfaction	Creation of prestige image for the company
Price stability in the market	Price wars avoidance
Sales stability in the market	Market development
Discouragement of new competitors' entering into the market	Price similarity with competitors
Maintenance of the existing customers	Customers' needs satisfaction
Determination of "fair" prices for customers	Attraction of new customers
Long-term survival	Achievement of social goals

Source: (langeard, 2000)

As far as their content is concerned, both quantitative and qualitative objectives can enter the objective functions of firms. The quantitative objectives can be measured easily and include those objectives that are related to the firm's profits, sales, market share and cost coverage. On the other hand, the qualitative ones are associated with less quantifiable goals such as the relationship with customers, competitors, distributors, the long-term survival of the firm and the achievement of social goals.

1-3- Service Pricing

According to Smith (1995), the fundamental pricing information may be classified into three large categories, namely:

1. Information related to cost, profits, production and sales;

2. Information associated with competitors; and

3. Information related to customers.

What is clear from the above classification is that both inward- and outward-looking information may be collected. However, the complexity of pricing decisions necessitates gathering multiple types of information with an emphasis being given to both the internal and external environment of the company.

1-3-1- Product Differentiation

- ***Product Differentiation***

Differentiated products are those which are in the same product group, yet are not identical. The various brands of breakfast cereal are an example of product differentiation. Microsoft Word and WordPerfect are differentiated products in the product group of word processing programs. While Word and WordPerfect are "differentiated" products, WordPerfect and a breakfast cereal are "different" products (different product group).

Historical battles show that a competition based on price often leads to zero profits for all competitors as prices are lowered in each round of struggle for market share well aware of this, sellers are constantly seeking out non-price forms of competition.

The primary incentive for sellers to differentiate is the reduced substitutability between products as differentiated products become imperfect substitutes for each other. For example, suppose that there are two spread-sheet programs with the same look and feel as well as similar qualitative capabilities in macro operations, limitations on observation numbers, or calculation speed. In other words, the two products are perfectly substitutable. When one of the two companies changes the look and feel of its program, the two products are differentiated and some consumers may choose on the basis of the look and feel of each program. The two products are no longer perfect substitutes.

With reduced substitutability between products, retaliatory price-cutting will not result in a complete loss of one's market share. Product differentiation thus gives a firm a certain power within its own market.

In many services, consumers choose a service plan according to their expected consumption. In such situations, consumers experience two forms of uncertainty. First, they may be uncertain about the quality of their service provider and can learn about it after repeated use of the service. Second, they may be uncertain about their own usage of minutes and learn about it after observing their actual consumption (Raghuram Iyengar, 2007). So here we can see the importance of customer perception from service quality and it uncertainty it means best differentiation and better image can caused more value and higher price for the business.

- ***Horizontal Differentiation***

Products are said to be differentiated horizontally if the difference is based on appearance or consumer tastes, such as colour. If consumers are different in their tastes—for example, some prefer the colour blue while others prefer red—each differentiated product will have a market share even when horizontally differentiated products are priced the same.

- *Vertical Differentiation*

In contrast, products are said to be vertically differentiated if all consumers agree on which product is better if their prices are the same. For example, products are differentiated vertically if the qualities of two products are different. Suppose that a firm sells personal computers with two types of microprocessor—one with 100 MHz clock speed and the other with 133 MHz—at the same price.

1-3-2- Price Discrimination

price discrimination states that price discrimination occurs when two units of the same physical good are sold at different prices, practitioners have found this definition unsatisfactory.1 Instead, they have defined price discrimination as selling similar goods at different prices in order to extract consumer surplus. (Whinston et al., 2003) a firm price discriminates when the ratio of prices is different from the ratio of marginal costs for two goods offered by a firm. More recently, Stole (2003) has advanced a broader definition that “price discrimination exists when prices vary across customer segments [in a way] that cannot be entirely explained by variations in marginal cost.”

While the monopolistic competition model was originally developed for single-product firms, a firm may decide to differentiate its own product. A run-of-the-mill reason is the desire to cover the market by introducing different brands—e.g. different cereal brands or soft drinks with different flavour or caloric content. Still, the firm's incentive to differentiate is the same—to reduce substitutability between its products and their markets. Under product differentiation, discriminatory prices are possible since the firm can sell differentiated products at different net prices.

Prices are discriminatory if they do not reflect the difference in costs including production as well as transaction costs. By 'discriminatory prices' we also mean that different some consumers are charged different prices for the same product. An efficient and competitive market supports one uniform price for all consumers regardless of their private valuations for the