Tourism Supply and Demand

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Abstract

The demand for tourism products may be affected by the marketing mix elements, including the nature of the product or service, its distribution, its promotional strategies and its price. Price is the only element in the marketing mix which actually produces revenue. However, the setting of a price is not an easy task, as there are a number of pricing strategies which any travel business may apply, including; prestige pricing, penetration pricing; cost-based pricing; differential pricing and uniform pricing. Moreover, there are a number of factors which will influence what type of pricing strategy could be employed. Such factors include; corporate objectives; the marketing objectives, and the organisations' cost levels, among other matters. This chapter explains the various approaches which may be utilised when setting prices. Ultimately, the customers themselves will decide whether the product that is being supplied to them will meet or exceed their expectations.

8.1 Introduction

The price one important element of the marketing mix, as it is the only one which adds value to the business. Price is very dependent on the customer demand for the service. Generally, as price goes down, the quantity demanded rises, and as price rises, the quantity demanded goes down. This may suggest that prices are inversely related to demand. However, at times, customers perceive that higher prices could be an indicator of high quality. The relative

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responsiveness in demand to changes in price is known as elasticity. An elastic demand is one where a change in price greatly changes demand. An inelastic demand is one where a change in price has a little effect on demand. Therefore, customers' demand for products is not always related to their price. There are other elements which could affect their purchase decision.

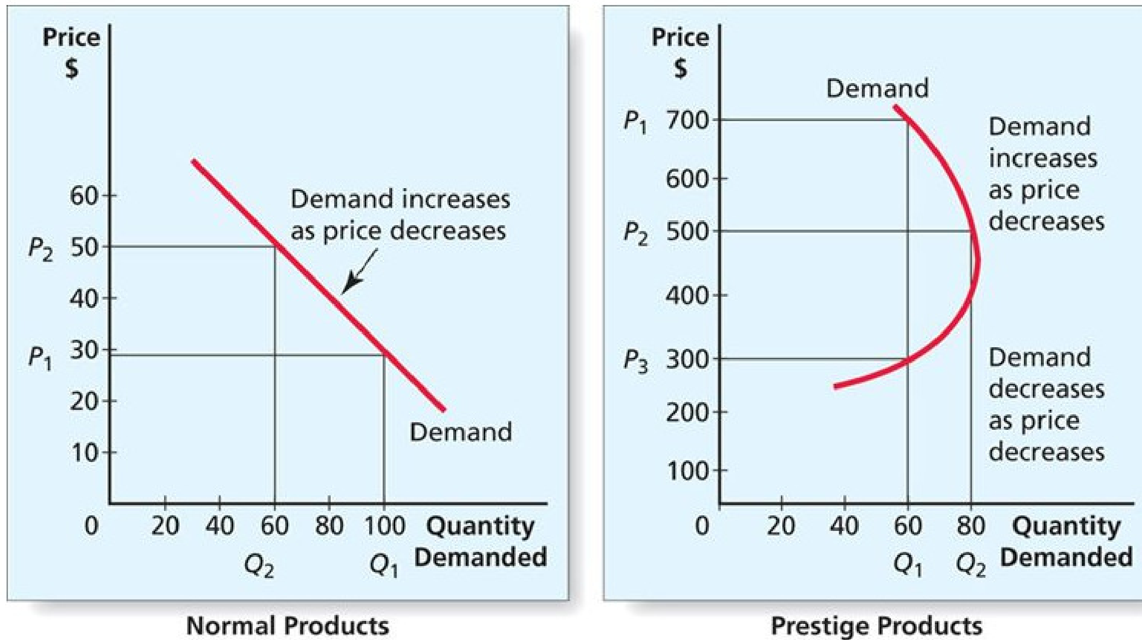
8.2 Determining Demand

It is the customers themselves, who will determine whether a price has been correctly set. The customers will decide whether the perceived value of the service reflects its asking price. If the product's price exceeds its value, customers will not purchase it. The price set is also dependent on the consumers' demand for the product or service. The general rule is that price is inversely related to demand. In other words, as prices go down, the quantity demanded rises. Alternatively, as the prices rise, the quantity demanded would usually go down. This may also be applicable to the tourism industry. As the air fare to a particular destination increases, the demand for that destination decreases.

To illustrate the effect price has on quantity, the economists use what is known as the classic demand curve. The classic demand curve is normally a line sloping downward to the right. It indicates to the marketing manager the number of units that the market will buy in a given period, at different prices, which might be charged. There is an inverse relationship between demand and price. That is, the higher the price, the lower the demand, and the lower price the higher the demand.

For prestige products, the demand curve slopes upwards. The higher price is perceived as being an indication of a high quality good. The prestige goods may be perceived as delivering more value. Demand in such circumstances can actually increase as the price goes up; although after a certain level, the curve resumes its traditional slope. An example of such a product in the airline industry might be the first and business class seats. Figure 8.1 illustrates the demand curve which indicates the relationship between price and quantity for normal and prestige products.

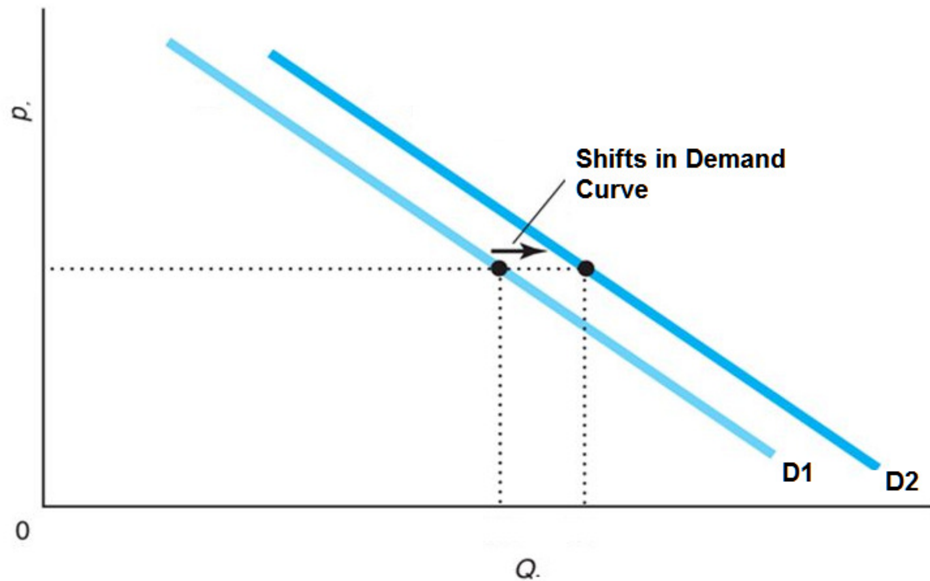
Figure 8.1 The Quantity Demanded per Period for Normal and Prestige Products



When setting prices, many companies try to measure their demand curve. When modelling the demand curve, one has to estimate demand at different prices. However, when carrying out this process, it is important to remember that other elements of the marketing mix must remain constant. Demand does not depend on price alone. A shift in the demand curve from D1 to D2 (i.e. an increase in demand) may occur for different reasons:

Customer tastes may be influenced by other marketing mix variables. Marketing mix variables such as promotion and distribution play an influential role. An improvement in these areas may cause a shift in the demand curve from D1 to D2, as featured in Figure 8.2. An increased quantity of products could be sold at an increased price. Alternatively, a shift from D2 to D1 (a fall in demand) could happen when there are substitute products. For example, leisure passengers may travel by different modes of transports which could be cheaper for them.

Figure 8.2 Quantity Demanded per Period



The marketing managers ought to ensure that other marketing factors do not vary when measuring demand. For example, an advertising campaign should not be launched if they are attempting to test various price levels. They will not really know whether it is the actual price change or the increased product promotion which is influencing the change in customer demand.

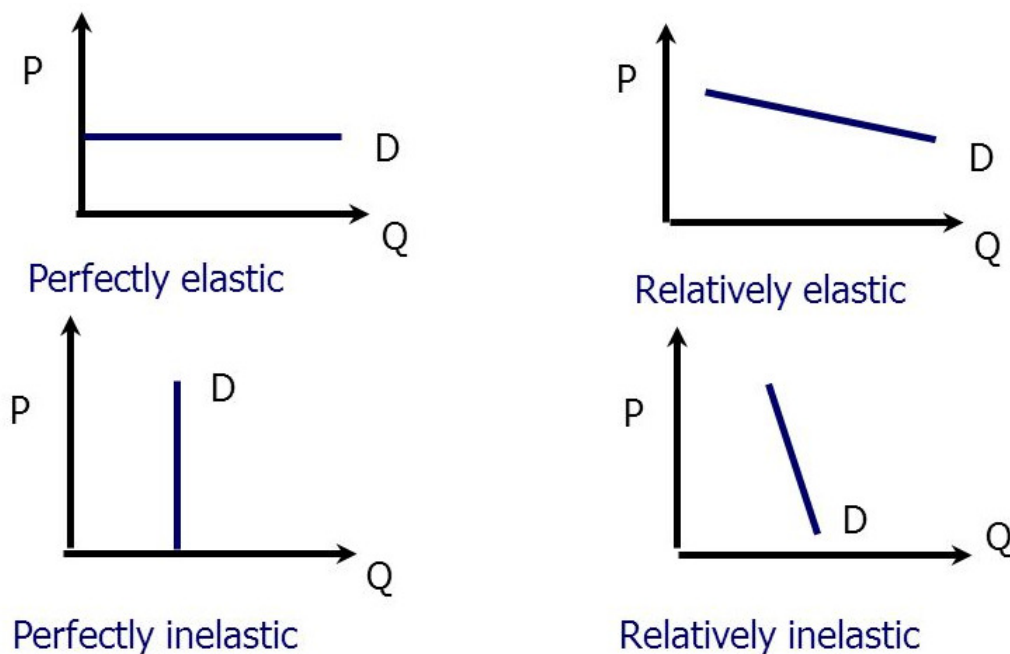
8.3 Elastic Demand

The relative responsiveness of changes in demand to the changes in price is known as elasticity (Brons et al., 2002; Arnott et al., 1993). A marketing manager who understands the concept of elasticity will find it easier to set prices to different products. An elastic demand is one where a change in price will alter the demand for a product. In other words, if a demand is elastic, a change in price causes an opposite change in total revenue. That is, a rise in price will decrease revenue, and a fall in price will increase total revenue. The demand curve for leisure travellers, the price sensitive segment of the market is an example of elastic demand. When an increase in price occurs, there is a decrease in the quantity demanded, and when there is a decrease in price, there is an increase in the quantity demanded.

8.4 Inelastic Demand

An inelastic demand has an opposite effect, as shown in Figure 8.3. An increase in price will increase total revenue, and a decrease in demand results in a decrease in revenue. In other words, price has a little effect on demand. For instance, the demand for the airline's seats in business or first class is a good example of a relatively inelastic demand (Brons et al., 2002). In such cases, the airfare is not really important to corporate passengers. A small change in price may bring little changes in demand.

Figure 8.3 Quantity Demanded per Period for Elastic and Inelastic Products



Generally, it could be said that the less elastic the demand, the more the business can consider raising its prices. If there is elastic demand, firms should consider lowering their prices as a means of producing more sales revenue.

8.5 Airline Demand

There are a number of ways in which an airline may consider estimating demand elasticity:

8.5.1 Direct Attitude Survey

The marketing managers will explore their customers' attitudes toward particular price changes. This information may be gathered through an inflight survey. However, great care must be taken when wording the questionnaire; so that the customers understand why an

increase in price may be required. For example, if the respondents are asked, “Would you be prepared to pay a higher price?”, most of them will say “No”.

8.5.2 A Historical Analysis of Passenger Yields

This analysis could take the form of a cross-sectional analysis of the relationship between price charged and demand. A historical analysis explores how prices may have affected the level of demand on particular services. A cross-sectional analysis involves a thorough investigation of the passenger mix. It determines how prices changes have affected the routes’ profitability.

8.5.3 Market Test

A market test is where an airline implements a price change for a fixed period of time, and studies its effect. However, this research method may have its disadvantages. Once a price change is introduced (especially if it is a price reduction); it may prove difficult to alter that decision without experiencing negative reactions from customers. Market testing also alerts competition of the airline’s intention, giving them the opportunity to follow such initiatives. If it is a price increase and the market is highly elastic, or if the market is very competitive, then such a test could turn out to be quite expensive.

8.5.4 Conjecture

Most marketing managers may rely on their past experience to charge prices for their products. However, it should be noted that accurate assessments of elasticity are extremely difficult to ascertain. This is because elasticity varies from each end of the route, by time of day, by day of week and month of year.

8.6 Pricing Methods and Strategies

In the past, international fares were agreed upon by the International Air Transport Association’s (IATA) member airlines. At the time, many governments put pressure on airlines to use cost-based pricing. Today, the majority of airlines operate in deregulated and liberalised markets. Therefore, they are in a position to offer what fares they wish. There are a number of

pricing strategies which may be applied. The following are the most common pricing methodologies that are employed by the marketing managers:

8.6.1 Prestige Pricing (or Price Skimming)

A marketing manager uses prestige pricing strategies when they set artificially high prices for their products or services, in order to to attract hedonic, high-value customers. Prestige products or services may be perceived as more valuable items by affluent customers, as their higher price may be associated with better quality and glamour. Such a skimming strategy may result in a rise in demand for the product. For example, First Class or Business Class fares possess a number of characteristics of prestige products. In the market place, such fares are considered to be the airlines' premium products. These products reflect status and high-quality lifestyles of passengers, mainly business travellers (Swarbrooke, & Horner, 2001).

Many companies may apply this pricing method when they penetrate a new market, as a means of attracting high-end customers. In this case, the marketing managers will set a high price for their new products to skim maximum revenue from specific market segments, which may be willing to pay the high price. This way, the company will make fewer, but more profitable sales.

8.6.2 Penetration Pricing

Penetration pricing involves the setting of low prices for innovative products or services. The marketers' intention is to generate quick sales, and to win a large market share. If the target markets are elastic, penetration pricing will provide significant opportunities for market growth. Frequently, low-cost airlines have used penetration pricing when they first entered the market, in many countries. However, certain airlines who may have limited resources and lower capacities may find themselves having to compete with industry giants. The industry competitors, including the legacy carriers will rely on economies of scale (Caves, Christensen & Tretheway, 1984). They may decide to cross subsidise unprofitable routes where they are competing against low-cost airlines, and raise their prices on other destinations where they own

a monopoly. They often attempt to force new entrants out of their market. Such tactics are known as predatory pricing.

8.6.3 Cost-based Pricing

This approach uses three similar methods of cost-based pricing, including, cost-plus, break-even or target-profit pricing.

Cost-plus pricing is the easiest method. It entails adding of a standard mark-up to the cost of the product. When applying this to the travel industry, the cost per passenger / guest is calculated, and a mark-up is usually added to set the selling price of the lowest fare or hotel rate.

Break-even pricing is another cost-oriented, pricing approach. Here the company determines the price at which it could break-even. The marketing managers using this approach must calculate how many passenger seats should be filled, or how many rooms should be occupied, to break-even. In other words, the marketers' intentions are to cover the costs or to reach their target profit margins. When determining the break-even point, a break-even chart may be used.

A break-even chart indicates the relationship between sales, costs and profit, at different levels of sales activity. Marketing managers can quickly ascertain, by simply looking at the chart, the approximate profit or loss which is likely to be earned, at a specific level of activity. This chart will clearly illustrate a break-even point. In the chart, the horizontal axis represents the number of units sold, and the vertical axis indicates the costs and the sales.

The fixed cost line cuts the vertical line at the level of the fixed cost, and runs parallel to the horizontal axis. The fixed cost is the same for all levels of sales activity, and does not vary with increased sales levels, or with the quality of the service being offered.

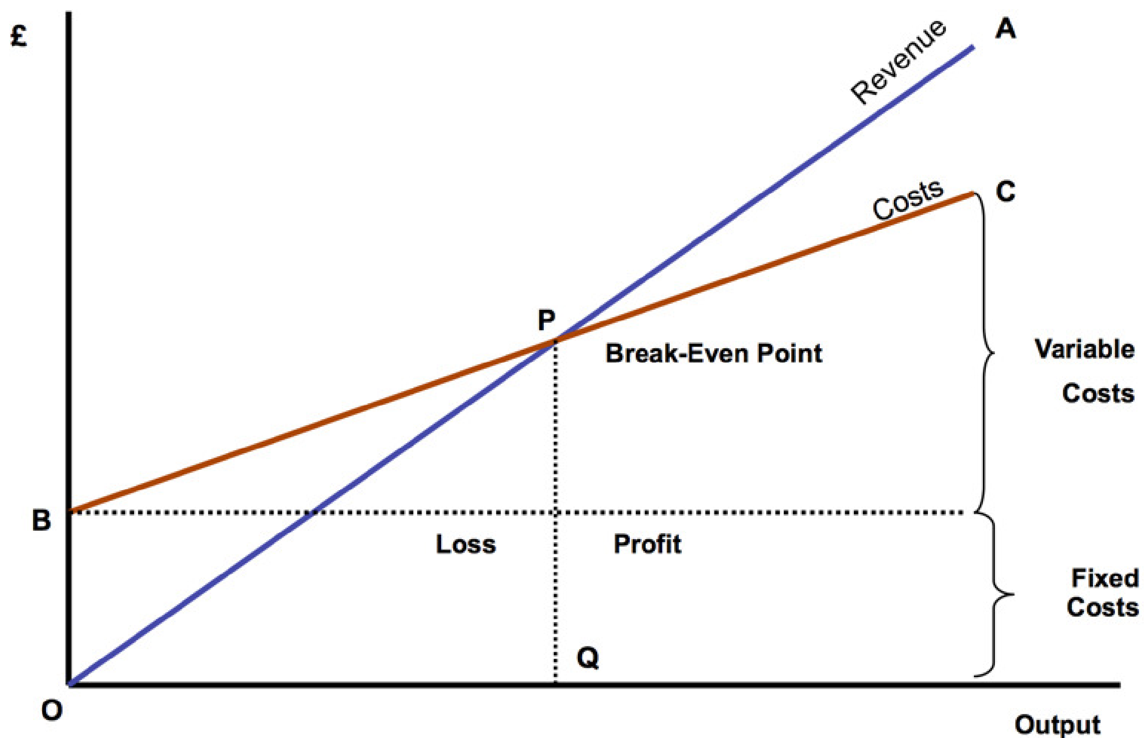
The total cost line meets the fixed cost line at the vertical axis. Total costs may be defined as fixed costs plus variable costs. The variable costs are costs which vary directly with the type of service being offered.

The sales line, otherwise known as the total revenue line must start at the point where the vertical and horizontal axes meet, because, at 0 activity, 0 sales are made.

Total revenue may be defined as the number of units sold multiplied by the price per unit.

The break-even point has been reached at the point where the total revenue curve meets the total cost curve. By drawing a line from this point to the sales in volume axis, it is possible to read off the number of units which must be sold in order to break-even, as shown in Figure 8.4.

Figure 8.4 The Break-Even Chart



The point where the total cost line intersects the sales line (i.e. total revenue line) is the break-even point. According to the chart, P is the break-even point.

The target profit pricing method uses the concept of the break-even chart. This method sets a target profit margin, and manipulates the break-even chart to calculate how many units must be sold before reaching the desired profit. Therefore, marketing managers must refer to a specific quantity of units along the horizontal axis, and from it, draw a vertical line parallel to the sales and costs axis. The profit or loss as the case may be, is represented by the gap between the total cost line and the sales line.

8.6.4 Volume Pricing

This is essentially a price reduction strategy that is usually dedicated to those who buy large volumes of a given product. For example, incentive and conference travel is normally organised for groups, so prices are usually reduced, to induce demand. Those intermediaries, including tour operators who will buying a large amount of airline seats or hotel rooms, may be offered lower prices from the service providers.

8.6.5 Differential Pricing

Differential pricing may be defined as a pricing method where prices vary amongst different customers; according to their willingness and ability to pay. For example, the airline market is a highly segmented one. Each segment has its own requirements, and price elasticity levels. Airline fares may be broken into the following categories; first, business, premium economy and economy class, among others. The economy class could be broken down into other sub-segments. Whilst the demand for the first and business class fares is relatively inelastic; the customers who purchase the economy or other promotional fares; will usually be price-sensitive. If an airline is only providing a low fare to cater for highly elastic demand, it can provide one large aircraft at an operationally convenient time (for example, outside peak landing fees periods). The airline revenue managers will know that in this case; if the fare level is right, the demand will accept the frequency and timings. This will give the airline the lowest seat kilmetre cost and probably a reasonable profit as well.

Hence, a differential pricing strategy caters to different segments in the market. Business class and first class fares are very expensive. However, the airlines will incur relevant costs (that are reflected in higher prices) to deliver superior services. For the asking price, passengers are provided with a premium product, a top quality service, which satisfies the needs and wants of the business travellers. The airlines' higher fares will usually refect the provision of frequent services to meet the demand of business travellers. A higher frequency will usually involve a smaller aircraft, and would translate to higher costs for the airline.

The marketing managers may set different prices for their economy class of service. Yet, very often, the economy fare passengers are entitled to the same inflight service, they may have similar seating arrangements (although they pay different prices for them). These passengers will also receive the same baggage services. These passengers may have purchased promotional or discounted fares which are subject to various conditions and restrictions. Moreover, they will usually experience lower seat access levels as the departure date approaches, as opposed to the business class passengers.

For the airline providing high seat access levels to profitable market segments means having seats available at the last minute. This may result in lower seat factors of around 60-70% in scheduled operations, as compared with the 90-95% for charter operations.

8.6.6 Uniform Pricing

A uniform pricing policy is one where there is a little difference in the price paid for a particular product from segment to segment. Previously, it has been argued that if the promotional fares are raised, the demand from price sensitive passengers will drop. In this case, the airline will find itself in difficulty as it will not be able to reduce its overhead costs. Consequently, the remaining passengers will have to bear a greater proportion of the overheads, if the airline is to remain profitable.

If the airline is to retain a high frequency of service with less passengers; it will have to use smaller aircraft. The small aircraft are not as economical as the larger ones. Hence, the airline will have to raise its fares. If the airline decides to keep the large aircraft, it will have to reduce its frequencies and to withdraw its services from thinner markets. The bottom line is that uniform pricing is not satisfactory as it results in a reduction in product quality, and an increase in fares.

Very often, many airlines are using differential pricing strategies as they offer different prices to diverse customer bases, according to their needs and wants. The prices vary according to their willingness and ability to pay. The full-service carriers may usually charge very high prices to the business travellers, and provide cheaper fares to the price-sensitive leisure passengers. Nevertheless, the differential pricing may have its disadvantages. A differential pricing strategy may result in revenue dilution.

8.7 Revenue Dilution

Revenue dilution occurs when a passenger who is prepared to pay high fares will choose a lower one. The differential pricing may result in excessive dilution, which is unprofitable for the business. As a means of avoiding revenue dilution and ensuring that differential pricing works successfully, the airlines must ensure that those who are willing to pay a higher fare, will do so. This is easier said than done. Airlines should have high-yield seats available whenever they are requested. This may be achieved by:

1. Utilising a sophisticated revenue and capacity management system which will enable the airline to control when and where seats are sold. A yield management system will ensure that high revenue passengers will not find difficulties in obtaining a seat, when required.

2. The cheaper fares will include certain conditions, including advance purchase rules. They may not allow cancellations or refundable itineraries, and so on.

8.8 Price Determinants

The type of pricing strategy which the marketing manager will decide to use is determined by a number of factors, including: organisational and marketing objectives; types of pricing objectives; cost levels; other marketing mix variables; market demand; competition and legal and regulatory issues, among other matters.

8.8.1 Organisational and Marketing Objectives

Company policy and image, target profit margins, staff and fleet size could influence the type of pricing policy which the marketing managers will apply. Company policy and image will play an important role when determining a pricing strategy. The price set must be consistent with the general corporate objectives and strategic direction of the company. For example, a full-service airline may want to be associated with the top-end of the market by providing a high-quality service to the business travel segment. To price below the average rate for such a service may imply an inferior and poor-quality service.

Any airline which would like to target the business market should provide an extensive schedule and a high-quality service. Therefore, it will require considerable resources and capabilities to do so.

8.8.2 Pricing Objectives

The most fundamental pricing objective is that of survival pricing. When experiencing severe competition, businesses may be forced to offer lower prices than their rivals. This way they will generate revenue, and improve their chances of survival. If a tourism service or sub product does not generate revenue as it is not used over a given period of time (for example, an empty seat on a particular flight), it will perished. While the service or sub-products may be available for sale at some later point in time, the revenue that was originally lost, can never be regained. For example, a hotel had thirty empty rooms on a specific date. These empty rooms cannot be sold at a later date because the service has been completed, and perished. Similarly, an airline could depart with empty seats which cannot be sold at a later date.

Moreover, the demand for tourism products is usually seasonal. For example, many north Americans flee south to Hawaii and to the Caribbean, during the winter months; whilst Australasians travel to Europe during the summer months of June, July and August. Of course, seasonality may be due to other factors, other than climate, including; vacation and holiday periods. For example, families may habitually travel at the same time of the year, usually over Christmas, Easter or summer periods. This is the usual close-down time period for schools, industry and commerce, in many countries. Since tourism is highly seasonal, suppliers may reduce their prices during off-peak times. A low price strategy assists in creating demand particularly among price-sensitive customers. Conversely, operators may charge higher prices when there are peaks in demand, due to major attractions and special events.

Profit maximisation is another pricing objective. However, it may prove difficult to measure, as businesses could not be in a position to determine when they have reached maximum profit. As a result, profit maximisation may be evaluated according to a certain ‘level of satisfaction’. A change in profit relative to previous periods may be considered as satisfactory or unsatisfactory for the businesses. The setting of prices to obtain a fixed rate of return on a company’s investment is a profit-related objective. Hence, many businesses could be aiming to achieve a specific profit.

Another possible pricing objective is that of increasing market share. Many companies may design pricing policies which will enable them to improve their market share. However, at times, they may be satisfied with their current status in the market. In this case, their objective would be to retain their status quo. Companies with such an objective may not use pricing as a competitive tool. They will probably maintain a steady market share by nurturing their brand equity.

8.8.3 Cost Levels

The marketing managers should be careful to analyse all costs so that they will be included in the total cost. Therefore, the pricing of products should be based on the company’s direct and indirect costs (and may consider overhead expenses) if they are projecting a certain profitability margin.

8.8.4 Other Marketing Mix Variables

The marketing mix elements, including; promotions (the integrated marketing communication mix) and place (distribution channels), could determine the target customers' perceptions of the firms' products (or services), in a given competitive context.

The extent to which a product is promoted can have a huge effect on consumer demand. The products' price will usually determine their target market. Low-priced products may attract price-sensitive markets. Such products will be promoted through different marketing communications channels other than high-priced, high-quality, premium services. The more expensive the products; the higher the customers' expectations. Considerable thought and action must go into product development so as to provide the customer with a valuable service which reflects its price. One of the most significant promotional tools is word-of-mouth publicity. For instance, online reviews and ratings are increasingly playing a major role in tourism marketing.

When making a pricing decision, the businesses should consider their distribution costs. The companies' intermediaries, including; tour operators, online travel agents, and the like, will expect financial compensation for selling travel products. Alternatively, they will expect discounts and special incentives to push the businesses' products to consumers. For example, they may book large seat orders and place substantial mark-ups on seats which they have bought from the airline (these products may be demanded for inclusive tours). These factors must always be taken into consideration by the airline marketing managers, as they have to add mark-ups to the cost price of seats, when selling them to intermediaries.

8.8.5 Market Demand

There is a highly segmented market for tourism products. Each of the market segments vary in terms of elasticity, and service requirements. These variables will influence the way in which prices a set.

The business travel segment is generally more inelastic in demand. Fluctuations in prices will not affect demand to any great extent. However, the business travel segment expects a high-quality service. Generally, business travellers are prepared to pay a higher price for such services (Swarbrooke, & Horner, 2001). The higher fares will not only cover the costs of the superior service, but will also convey an image of a premium, prestige product.

The passengers from the leisure travel segment are usually price-sensitive. Their expectations are somewhat lower than those of the business travellers. Demand is extremely elastic in this segment; and an increase in price may result in lower demand.

The socio-political factors may affect market demand. If a destination is politically or socially unstable, tourists may not want to go there. Most people like to feel safe and comfortable. For instance, many destinations have experienced dramatic reductions in the number of tourist arrivals, following the terrorist activities in certain countries.

Economic factors, including the individuals' income and well-being, will affect their propensity to travel. However, this may not necessarily translate to an increased demand for all tourism products. For instance, if leisure travellers receive an increase in income, they may decide to travel to long-haul destinations rather than short-haul itineraries. Alternatively, these clients may increase the quality and standard rather than to increase their frequency of travel. Such customers may decide to upgrade their hotel accommodation, or to travel in higher classes. Income may affect demand according to the purpose of travel. For business travellers it may not make much difference, whilst for leisure travellers it can make quite a substantial difference. Their demand may also be influenced by the availability of substitute products. If there are no substitutes for the product, then consumers will be forced to buy regardless of price.

In addition, customers may develop perceptions about tourism products. Whether they are accurate or not, they could influence their purchase behaviours. Therefore the travellers' perceptions, the online ratings and reviews should be carefully considered, as tourism products must always be purchased in advance.

8.8.6 Competition

The businesses should be aware of their competitors' prices. They may decide to respond to their rivals' pricing strategies, or to be proactive by taking the pricing initiative, themselves.

8.8.6.1 Responding to the Competitors' Pricing Initiatives

There is no rigid method of responding to a price initiative taken by competitors. Every situation is unique. However, businesses are capable of making confident decisions if they examine the situation from different viewpoints:

At times, competitors may decide to lower their prices: It is not wise for other businesses to follow suit, unless they establish why their competitors are pursuing such a pricing strategy. It may be the case that the competitors have made a bad decision. It must be determined whether the competitors' pricing initiative was a long term or a short term one. For instance, an airline's poor fleet planning may result in the company changing its prices on a long-term basis. In such situations, rivals will have to respond or risk losing their market share. Price reductions will eventually lead to lower yields for the airline. As a result, this will have a negative impact on the airline and its long-term sustainability prospects. If the pricing initiative appears to be a short-term action, it is advisable to ignore it, and to avoid de-stabilising the market.

The price reductions on certain products may be questioned by the airline's customers. As discussed above, the airlines may usually charge higher prices for their business and first class as these services are considered as prestige products. The airlines can differentiate themselves from competitors when they provide superior services; that are perceived as an index of quality and corporate image.

On the other hand, the airlines' should continuously monitor those competitors who are resorting to price-cutting policies. Certain leisure markets may be more price-sensitive than others, as they may exhibit higher price-elasticity levels. The lower prices could result in an increase in demand for the economy class of service.

8.8.6.2 Taking the Price Initiative

Generally, businesses may avoid lowering their fares, as this will affect their bottom lines. Price wars have destroyed the profitability of many businesses. However, there may be a tendency toward price competition: when firms have low variable costs; when there is little differentiation among the competitors' products; when industry growth rate is low, and; when the economies of scale are important (Caves et al., 1984). The businesses need to consider their cost levels before taking the initiative to lower their prices. The lean businesses who may have less costs, will usually be in a much stronger position to lower their prices than other competitors with high costs. However, more established high-cost businesses may have stable

financial backing, which will enable them to meet, if not undercut, the new companies' prices. They could eventually push their competitors out of the market.

An increase in price may be required if the business is facing controllable or uncontrollable costs. For example, if the airlines' uncontrollable costs, include; increased airport landing fees and air traffic control charges; they may either decide to absorb these costs or alternatively, they may increase their fares as a means of covering these added costs. Of course, rival airlines will also face the same pressure. In such cases, the airlines could inform their customers about their uncontrollable costs, which have forced them to increase their fares. Ongoing corporate communications and public relations will help them to maintain their customers' goodwill. On the other hand, the airlines' controllable costs, including the employees' salaries and wages, are under their direct responsibility. Such costs may not justify taking pricing initiatives to improve the organisation's financial performance. They may even aggravate the airline's profitability, in the long-term.

8.8.7 Legal and Regulatory Issues

Legal and regulatory issues may have an impact on a company's pricing structure. Although, the airline industry has experienced deregulation and liberalisation in the past decades, there is still some government intervention, in certain areas. In international markets, air service agreements between governments necessitate that national airlines should meet and agree on the fares and rates to be charged to passengers. The agreed fare is brought back to both the airline's governments who have the right to veto the fare. Should this happen, the airline concerned must seek to re-open negotiation.

Deregulation and liberalisation have affected the airlines' pricing policies in many contexts. For example, liberalisation has changed the fares regime in the United States of America, in the European Union and in many other places. Today, several airlines have introduced lower fares which have contributed to increased travel. Moreover, the rise of the low-cost carriers has often resulted in lower air fares within pre-agreed zones. Evidently, pricing is increasingly being used as a competitive tool, in many contexts.

8.9 Questions

- *Define the price elasticity of demand.*

- *What is the difference between elastic and an inelastic demand? Give an example of their presence in the airline industry.*
- *Explain how differential pricing can be employed in the airline industry.*
- *How has a change in pricing policy affected a particular airline's sales in the past?*

8.10 Summary

The price is an extremely important element of the marketing mix. It is very dependent on the customer demand for the service. The general rule is that as the price goes down, the quantity demanded rises; and as price rises, the quantity demanded falls. However, there are exceptions. In some cases; the higher the price, the greater the demand. Therefore, higher prices could be an indicator of high quality.

The relative responsiveness of changes in demand to changes in price is known as elasticity. An elastic demand is one where a change in price greatly changes demand. An inelastic demand is one where a change in price has a little effect on demand. There are a number of pricing strategies, including; prestige pricing, penetration pricing; cost-based pricing; differential pricing and uniform pricing.

Prestige pricing involves charging high prices for superior services. These services may be perceived of a higher quality. For example, prestige pricing may be used in first class and business class fares. Penetration pricing involves the setting of a low price on a new product, with the intention to attract a large number of customers, to increase market share. This strategy is frequently used by new airlines to penetrate into a new market. Volume pricing often translates to price reductions to those who buy large volumes of a given product. Fare discounts could be given to travel intermediaries and distributors in the value chain, including online travel agents, and tour operators who buy in bulk. Cost-based pricing uses three methods of cost oriented pricing, including; cost-plus pricing; break-even pricing and target profit pricing. Differential pricing may be defined as a pricing method where prices are varied amongst different customers, according to their willingness and ability to pay. A uniform policy is one where there is little difference in the price paid for a particular product among different segments. However, applying such a pricing policy in the economy service would result in a poor quality service, and high fares.

It may appear that the differentiated pricing policy is the best policy to apply in the economy class as it enables the airline to increase its revenues, and to lower operating costs. However, differential pricing may also lead to revenue dilution. This occurs when a passenger who is prepared to pay a high fare (rate) makes use of a lower one. This may result in considerable losses to the airline (or hotel).

There are a number of factors which will affect the type of pricing strategy to be employed. Such factors include; organisational and marketing objectives; the pricing objectives of the company, and the cost levels, among other issues. As already stated, pricing is not an independent variable; it is affected by other variables of the marketing mix, namely, distribution, product development and promotion.