Winning in Service Markets Series, Vol. 4: Pricing Services and Revenue Management

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Winning in Service Markets Series: Vol. 4

Pricing Services and Revenue Management

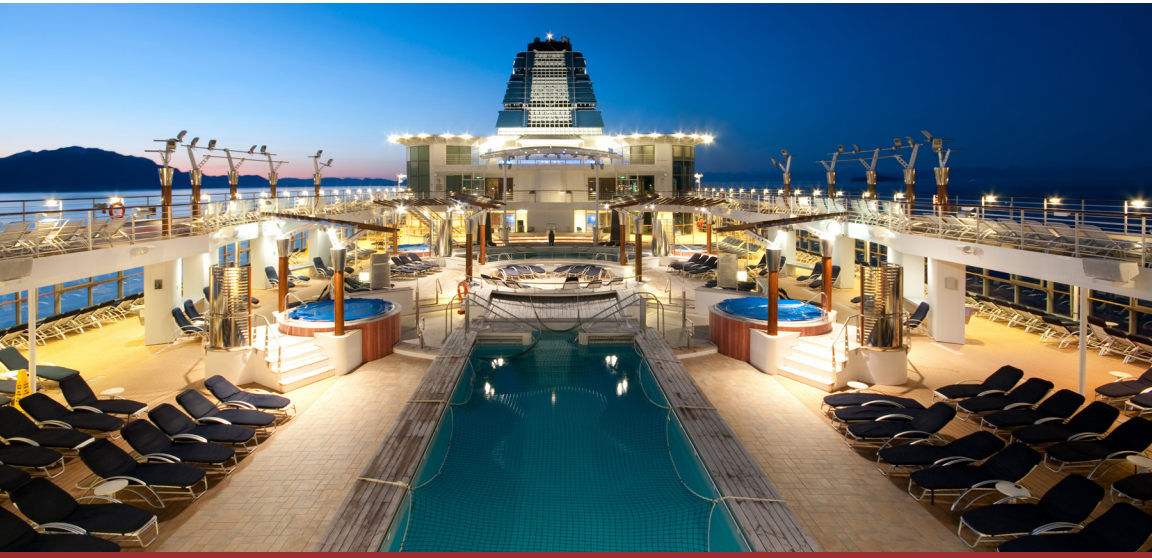
Jochen Wirtz

Winning in Service Markets is a highly practical book. I love the comprehensive coverage of services marketing and the rigor. Also, it is easy to read and full of interesting, best practice examples. I recommend this book to everyone working in a service organization.

Jan Swartz
President, Princess Cruises

Winning in Service Markets provides a set of useful frameworks and prescriptions rooted in both practice and research. As such, it represents a refreshing alternative to the prevailing literature available to managers who are looking for insights rooted in sound theory. A must read for any practicing manager in the service economy.

Leonard A. Schlesinger
Baker Foundation Professor, Harvard Business School



Creating a viable service requires a business model that allows for the costs of creating and delivering the service, in addition to a margin for profits, to be recovered through realistic pricing and revenue management strategies. However, the pricing of services is complicated. *Pricing Services and Revenue Management* explains how to set an effective pricing and revenue management strategy that fulfils the promise of the value proposition so that a value exchange takes place. This book is the fourth book in the Winning in Service Markets series by services marketing expert Jochen Wirtz to cover the key aspects of services marketing and management based on sound academic evidence and knowledge.

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Series Editor: Jochen Wirtz *(National University of Singapore, Singapore)*

The Winning in Service Markets Series covers the key aspects of services marketing and management based on sound academic evidence and knowledge. The books in this series is written by services marketing expert Jochen Wirtz, author of globally leading textbook for Services Marketing. Each book in the series covers different themes in the study of services marketing and management, is accessible, practical and presented in an easy-to-read format for busy practitioners and eMBA students.

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Winning in Service Markets Series: Vol. 4

Pricing Services and Revenue Management

Jochen Wirtz

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Dedication

To my past and future EMBA and Executive Program participants.

I have been teaching EMBA and Executive Programs for over 20 years. This Winning in Service Markets Series is dedicated to you, the participants from these programs. You brought so much knowledge and experience to the classroom, and this series synthesizes this learning for future EMBA candidates and managers who want to know how to bring their service organizations to the next level.

Preface

The main objective of this series is to cover the key aspects of services marketing and management, and that is based on sound academic research. Therefore, I used the globally leading text book I co-authored with Professor Christopher Lovelock (Title: *Services Marketing: People, Technology, Strategy*, 8th edition) as a base for this series, and adapted and rewrote it for managers. This is a unique approach.

This series aims to aims to bridge the all-too-frequent gap between cutting edge academic research and theory, and management practice. That is, it provides a strongly managerial perspective, yet is rooted in solid academic research, complemented by memorable frameworks.

In particular, creating and marketing value in today's increasingly service and knowledge-intensive economy requires an understanding of the powerful design and packaging of intangible benefits and products, high-quality service operations and customer information management processes, a pool of motivated and competent front-line employees, building and maintaining a loyal and profitable customer base, and the development and implementation of a coherent service strategy to transform these assets into improved business performance. This series aims to provide the knowledge required to deliver these.

Winning in Service Markets comprises of the following volume:

Vol 1: Understanding Service Consumers
Vol 2: Positioning Services in Competitive Markets
Vol 3: Developing Service Products and Brands
Vol 4: Pricing Services and Revenue Management
Vol 5: Service Marketing Communications
Vol 6: Designing Customer Service Processes
Vol 7: Balancing Capacity and Demand in Service Operations
Vol 8: Crafting the Service Environment
Vol 9: Managing People for Service Advantage
Vol 10: Managing Customer Relationships and Building Loyalty
Vol 11: Designing Complaint Handling and Service Recovery Strategies
Vol 12: Service Quality and Productivity Management
Vol 13: Building A World-Class Service Organization

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Introduction

Creating a viable service requires a business model that allows for the costs of creating and delivering the service, in addition to a margin for profits, to be recovered through realistic pricing and revenue management strategies. However, the pricing of services is complicated. *Pricing Services and Revenue Management* explains how to set an effective pricing and revenue management strategy that fulfils the promise of the value proposition so that a value exchange takes place. This book is the fourth book in the Winning in Service Markets series by services marketing expert Jochen Wirtz to cover the key aspects of services marketing and management based on sound academic evidence and knowledge.

VOLUME 4

Pricing Services and Revenue Management

What is a cynic? A man who knows the price of everything and the value of nothing.

Oscar Wilde
Irish author, playwright and poet, (1854–1900)

There are two fools in any market: One does not charge enough. The other charges too much.

Russian Proverb

EFFECTIVE PRICING IS CENTRAL TO FINANCIAL SUCCESS

Importantly, marketing is the only function that brings operating revenues into the organization. All other management functions incur costs. A *business model* is the mechanism whereby, through effective pricing, sales

are transformed into revenues, costs are recovered, and value is created for owners of the business. As noted by Joan Magretta:

> *A good business model answer [American management consultant] Peter Drucker's age-old questions: Who is the customer? And what does the customer value? It also answers the fundamental questions that every manager must ask: How do we make money in this business? What is the underlying economic logic that explains how we can deliver value to customers at an appropriate cost?*[1]

Creating a viable service requires a business model that allows for the costs of creating and delivering the service, in addition to a margin for profits, to be recovered through realistic pricing and revenue management strategies.

However, the pricing of services is complicated. Consider the bewildering fee schedules of many consumer banks or cellphone service providers, or the fluctuating fare structure of a full-service airline. Service organizations even use different terms to describe the prices they set. Universities talk about tuition fees, professional firms collect fees, banks impose interest and service charges, brokers charge commissions, some expressways impose tolls, utilities set tariffs, and insurance companies determine premiums; the list goes on. Consumers often find service pricing difficult to understand (e.g., insurance products or hospital bills), risky (when enquiring about an intercontinental flight on three different days, three different prices may be offered), and sometimes even unethical (e.g., many bank and credit card users complain about a variety of fees and charges they consider to be unfair).

This volume explains how to set an effective pricing and revenue management strategy that fulfills the promise of the value proposition so that a value exchange takes place (i.e., the consumer decides to buy the service). An overview of is provided in Figure 1.

Objectives for Establishing Prices

Any pricing strategy must be based on a clear understanding of a company's pricing objectives. The most common high-level pricing objectives are summarized in Table 1.

Figure 1: Organizing Framework for Pricing of Services

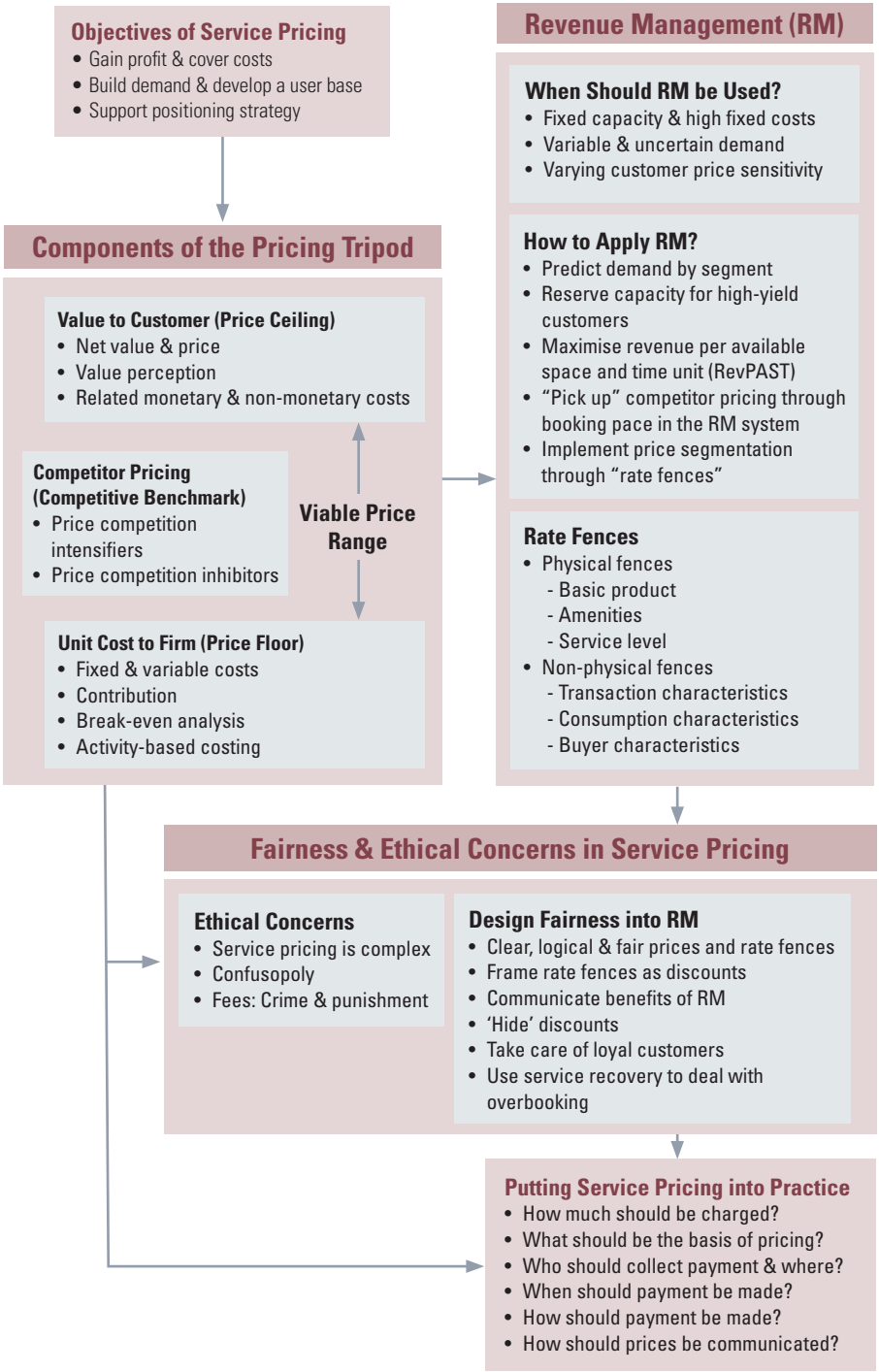


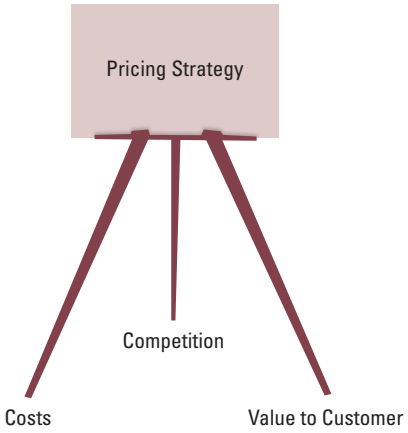
Table 1: Objectives for pricing of services

Revenue and Profit Objectives
Gain Profit
• Make the largest possible long-term contribution or profit. • Achieve a specific target level, but do not seek to maximize profits. • Maximize revenue from a fixed capacity by varying prices and target segments over time. This is done typically using revenue management systems.
Cover Costs
• Cover fully allocated costs, including corporate overhead. • Cover costs of providing one particular service, excluding overhead. • Cover incremental costs of selling one extra unit or to serve one extra customer.
Patronage and User Base-Related Objectives
Build Demand
• Maximize demand (when capacity is not a restriction), provided a certain minimum level of revenue is achieved (e.g., many non-profit organizations are focused on encouraging usage rather than revenue, but they still have to cover costs). • Achieve full capacity utilization, especially when high capacity utilization adds to the value created for all customers (e.g., a "full house" adds excitement to a theater play or basketball game).
Develop a User Base
• Encourage trial and adoption of a service. This is especially important for new services with high infrastructure costs, and for membership-type services that generate a large amount of revenues from their continued usage after adoption (e.g., cell phone service subscriptions, or life insurance plans). • Build market share and/or a large user base, especially if there are large economies of scale that can lead to a competitive cost advantage (e.g., if development or fixed costs are high), or network effects where additional users enhance the value of the service to the existing user base (e.g., Facebook and LinkedIn).
Strategy-Related Objectives
Support Positioning Strategy
• Help and support the firm's overall positioning and differentiation strategy (e.g., as a price leader, or portrait a premium image with premium pricing). • Promote a "We-will-not-be-undersold" positioning, whereby a firm promises the best possible service at the best possible price. That is, the firm wants to communicate that the offered quality of service products cannot be bought at a lower cost elsewhere.
Support Competitive Strategy
• Discourage existing competitors to expand capacity. • Discourage potential new competitors to enter the market.

PRICING STRATEGY STANDS ON THREE FOUNDATIONS

The foundations of pricing strategy can be described as a tripod, with costs to the provider, competitors' pricing, and value to the customer as the three legs (Figure 2). In many service industries, pricing used to be viewed from a financial and accounting standpoint, and therefore cost-plus pricing was used. Today, however, most service firms have a good understanding of value-based and competitive pricing. In the pricing tripod, the costs a firm needs to recover usually set a minimum price, or price floor, for a specific service offering, and the customer's perceived value of the offering sets a maximum price, or price ceiling.

Figure 2: The pricing tripod



The price charged by competing services typically determines where the price can be set within the floor-to-ceiling range. The pricing objectives of the organization then determine where actual prices should be set, given the possible range provided by the pricing tripod analysis. Each leg of the pricing tripod will be examined in detail later.

Cost-Based Pricing

Pricing is typically more complex in services than it is in manufacturing. As there is no ownership of services, it is usually harder to determine the financial costs of creating a process or intangible real-time performance for a customer than it is to identify the labor, materials, machine time,

storage, and shipping costs associated with producing and distributing a physical good. In addition, due to the labor and infrastructure needed to create performances, many service organizations have a much higher ratio of fixed costs to variable costs than is typically found in manufacturing firms. Service businesses with high fixed costs include those with expensive physical facilities (such as hospitals or colleges), or a fleet of vehicles (such as airlines or trucking companies), or a network (such as railroad, telecommunications, and gas pipeline companies).

Establishing the Costs of Providing Service. It is helpful to review how service costs can be estimated, using fixed, semi-variable, and variable costs, as well as how the notions of contribution and breakeven analysis can help in pricing decisions (see *Marketing Review 6.1*). These traditional cost-accounting approaches work well for service firms with a large proportion of variable and/or semi-variable costs (e.g., many professional services).

MARKETING REVIEW 1

Understanding Costs, Contribution, and Break-Even Analysis

Fixed costs are economic costs a supplier would continue to incur (at least in the short run) even if no services were sold. These costs typically include rent, depreciation, utilities, taxes, insurance, salaries and wages for managers and long-term employees, security, and interest payments.

Variable costs refer to the economic costs associated with serving an additional customer, such as making an additional bank transaction, or selling an additional seat on a flight. In many services, such costs are very low. For instance, very little labor or fuel cost is involved in transporting an extra passenger on a flight. In a theater, the cost of seating an extra patron is close to zero. More significant variable costs are associated with activities such as serving food and beverages or installing new parts when undertaking repairs, as they often include providing costly physical products in addition to labor. Just because a firm has sold a service at a price that exceeds its variable cost does not mean the firm is

now profitable, since there are still fixed and semi-variable costs to be recouped.

Semi-variable costs fall in between fixed and variable costs. They represent expenses that rise or fall in a stepwise fashion as the volume of business increases or decreases. Examples include adding an extra flight to meet increased demand on a specific route, or hiring a part-time employee to work in a restaurant on busy weekends.

Contribution is the difference between the variable cost of selling an extra unit of service and the money received from the buyer of that service. It goes to cover fixed and semi-variable costs before creating profits.

Determining and allocating economic costs can be a challenging task in some service operations due to the difficulty of deciding how to assign fixed costs in a multi-service facility such as a hospital. For instance, certain fixed costs are associated with running the emergency department in a hospital. Beyond that, there are fixed costs of running the hospital. So, how much of the hospital's fixed costs should be allocated to the emergency department? A hospital manager might use one of several approaches to calculate the emergency department's share of overhead costs. These could include (1) the percentage of total floor space it occupies, (2) the percentage of employee hours or payroll it accounts for, or (3) the percentage of total patient contact hours involved. Each method is likely to yield a different fixed-cost allocation. One method might show the emergency department to be very profitable, while the other might flag it as a loss-making operation.

Breakeven analysis allows managers to know at what sales volume a service will become profitable. This is called the breakeven point. The necessary analysis involves dividing the total fixed and semi-variable costs by the contribution obtained on each unit of service. For example, if a 100-room hotel needs to cover fixed and semi-variable costs of $2 million a year, and the average contribution per room-night is $100, then the hotel will need to sell 20,000 room-nights per year out of a total annual capacity of

36,500. If prices are cut by an average of $20 per room-night (or if variable costs rise by $20), then the contribution will drop to $80, and the hotel's breakeven volume will rise to 25,000 room-nights.

Activity-based Costing.[2] For service firms with high fixed costs and complex product lines with shared infrastructure such as in retail banking, it may be worthwhile considering the more complex activity-based costing (also called ABC) approach. For such firms, the activity-based costing is a more accurate way to allocate indirect costs (i.e., overheads).

Activity-based costing links resources needed to perform an activity. A set of activities that comprises the processes needed to create and deliver a particular service is then combined. When determining the indirect cost of a service, a firm looks at the resources needed to perform each activity, and then allocates the indirect cost to a service based on the quantities and types of activities required to perform the service. Thus, resource expenses (or indirect costs) are linked to the variety and complexity of services produced and not just on physical volume.

If implemented well, firms will be in a better position to estimate the costs of its various services, activities, and processes — and about the costs of creating specific types of services, delivering services in different locations (even different countries), or serving specific customers. The net result is a management tool that can help companies to pinpoint the profitability of different services, channels, market segments, and even individual customers.

Pricing Implications of Cost Analysis. To make a profit, a firm must set its price high enough to recover the full costs of producing and marketing the service, and add a sufficient margin to yield the desired profit at the predicted sales volume.

Managers in businesses with high fixed and marginal variable costs may feel that they have tremendous pricing flexibility and be tempted to set low prices in order to boost sales. Some firms promote *loss leaders*, which are services sold at less than full cost to attract customers, who (it is hoped) will then be tempted to buy profitable service offerings from the same organization in the future. However, there will be no profit at the end of the year unless all relevant costs have been recovered. Many service

businesses have gone bankrupt because they ignored this fact. Hence, firms that compete on low prices need to have a very good understanding of their cost structure and the sales volumes needed to breakeven.

Value-Based Pricing

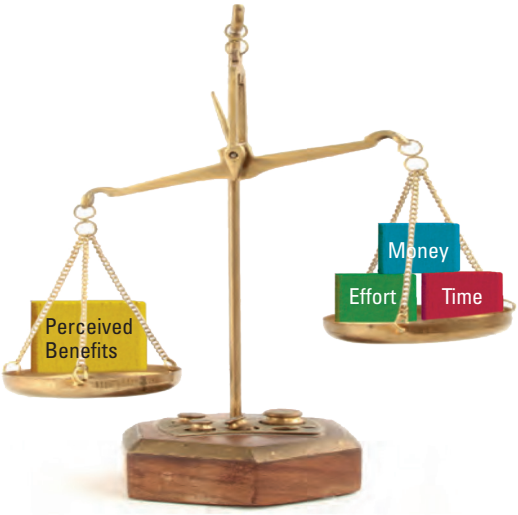
Another leg of the pricing tripod is value to the customer. No customer will pay more for a service than he or she thinks it is worth. Marketers need to understand how customers perceive service value in order to set an appropriate price.[3]

Understanding Net Value. When customers purchase a service, they are weighing the perceived benefits of the service against the perceived costs they will incur. This book uses the term *net value* — the sum of all perceived benefits (gross value) minus the sum of all the perceived costs of the service. The greater the positive difference between the two, the greater the net value.

Economists use the term *consumer surplus* to define the difference between the price customers pay and the amount they would have been willing to pay to obtain the desired benefits (or "utility") offered by a specific product. If the perceived costs of a service are greater than its perceived benefits, the service in question will possess negative net value, and the consumer will not buy it. Calculations that customers make in their minds are similar to weighing with a pair of old-fashioned scales, with product benefits in one tray and the costs associated with obtaining those benefits in the other tray (Figure 3). When customers evaluate competing services, they are comparing the relative net values (see also multi-attribute models in Volume 1). A a marketer can increase the value of a service by adding benefits to the core product and by improving supplementary services, which typically entails enhancing the benefits while reducing the burdens for customers.

Managing the Perception of Value.[4] Since value is subjective, not all customers have the skills or knowledge to judge the quality and value they receive. This is true especially for credence services for which customers cannot assess the quality of a service even after consumption.[5] Marketers of services such as strategy consulting must find ways to communicate the time, research, professional expertise, and attention to detail that go into, for example, completing a best practice consulting project. The invisibility of back-stage facilities and labor makes it hard for customers to see what

Figure 3: Net value equals perceived benefits minus perceived costs

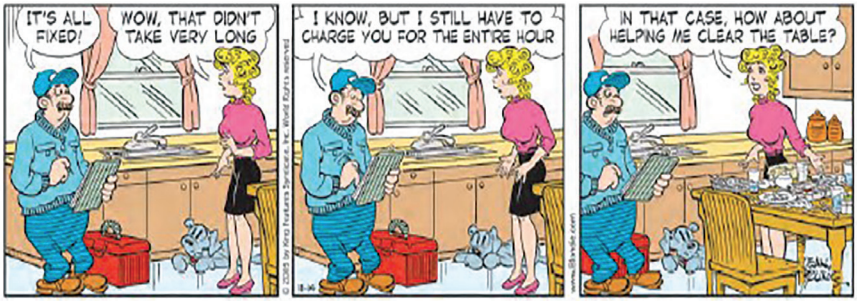


they are getting for their money. Therefore, the firm will have to manage the perception of value.

Consider a homeowner who calls an electrician to repair a defective circuit. The electrician arrives, carrying a small bag of tools. He disappears into the closet where the circuit board is located, locates the problem, replaces a defective circuit breaker, and presto! Everything works. A mere 20 minutes has lapsed. A few days later, the homeowner is horrified to receive a bill for $150, most of it for labor charges. Not surprisingly, customers are often left feeling they have been taken advantage of, as is illustrated in Blondie's reaction to the plumber in Figure 4.

To manage the perception of value, effective communications and even personal explanations are needed to help customers understand the value they receive. What customers often fail to recognize are the fixed costs business owners need to recoup. The electrician in the earlier example has to cover the costs for his office, telephone, insurance, vehicles, tools, fuel, and office support staff. The variable costs of a home visit are also higher than they appear. To the 20 minutes spent at the house, 15 minutes of driving each way might be added, an additional five minutes each spent to unload and reload needed tools and supplies from the van,

Figure 4: Blondie seeks her money's worth from the plumber



thus effectively tripling the labor time to a total of 60 minutes devoted to this call. The firm still has to add a margin in order to make a profit.

Reducing-Related Monetary and Non-monetary Costs

When considering customer net value, it is important to understand the customers' perceived costs. From a customer's point of view, the price charged by a supplier is only part of the costs involved in buying and using a service. There are other costs of service, which are made up of the related monetary and non-monetary costs.

Related Monetary Costs. Customers often incur significant financial costs in searching for, purchasing, and using the service, above and beyond the purchase price paid to the supplier. For instance, the cost of an evening at the theater for a couple with young children usually far exceeds the price of the two tickets, because it can include expenses such as hiring a babysitter, travel, parking, food and beverages.

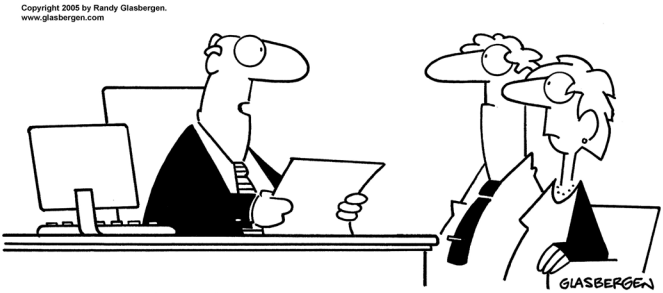
Non-monetary Costs. Non-monetary costs reflect the time, effort, and discomfort associated with the search, purchase, and use of a service and can be collectively referred to as "effort" or "hassle". Non-monetary costs tend to be higher when customers are involved in production (which is particularly important in people-processing services and self-service) and must travel to the service site. Services high on experience and credence attributes may also create psychological costs such as anxiety. There are four distinct categories of non-monetary costs: time, physical, psychological, and sensory costs.

- *Time costs* are part of the service delivery. Today's customers often complain that they do not have enough time and are therefore

reluctant to waste time on unenjoyable and non-value adding activities such as travelling to a government office and waiting in a queue. Customers may even use similar terms to define time usage as they do for money; for instance, consumers talk about budgeting, spending, investing, wasting, losing, and saving time. Time spent on one activity represents an opportunity cost because it could be spent more pleasurably or profitably in other ways. Internet users are often frustrated by the amount of time spent looking for information on a website. Many people loath visiting government offices to obtain passports, driving licenses, or permits, not because of the fees involved, but because of the time "wasted".[6]

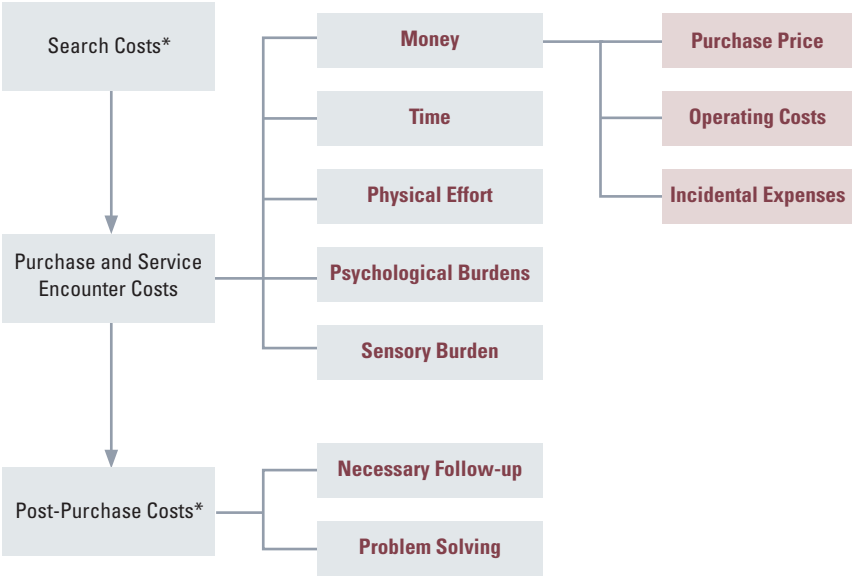
- *Physical costs* (e.g., effort, fatigue, discomfort) may be part of the costs of obtaining services, especially if customers must go to the service factory, if waiting and long queues are involved, if body treatments are involved such as for medical treatments, piercing or waxing, and if delivery is through self-service.
- *Psychological costs* such as mental effort (e.g., filling in account opening forms requesting for detailed information), perceived risk and anxiety ("Is this the best treatment?" or "Is this the best mortgage for me?", Figure 5), cognitive dissonance ("Was it good to sign up for this life insurance, this annual gym membership?"), feelings of inadequacy and fear ("Will I be smart enough to succeed in this MBA program?") are sometimes attached to buying and using a particular service.

Figure 5: Does adding options always create value or will it confuse the customer?



"As an alternative to the traditional 30-year mortgage, we also offer an interest-only mortgage, balloon mortgage, reverse mortgage, upside down mortgage, inside out mortgage, loop-de-loop mortgage, and the spinning double axel mortgage with a triple lutz."

Figure 6: Defining total user costs



* Includes all five cost categories

- *Sensory costs* relate to unpleasant sensations affecting any of the five senses. In a service environment, these costs may include putting up with crowding, noise, unpleasant smells, drafts, excessive heat or cold, uncomfortable seating, and visually unappealing environments.

As shown in Figure 6, service users can incur costs during any of the three stages of the service consumption model as introduced in Volume 1. Consequently, firms have to consider (1) search costs, (2) purchase and service encounter costs, and (3) post-purchase or after costs. Consider how much money, time, and effort is spent when deciding which college or university a potential student can apply to; or how much time and effort is put into selecting a new cellphone service provider or a bank, or when planning a vacation.

A firm can create competitive advantage by minimizing those non-monetary and related monetary costs, and thereby increase consumer value. Possible approaches include:

- Working with operations experts to reduce time required to complete service purchase, delivery, and consumption; become "easy-to-do-business-with"
- Minimizing unwanted psychological costs of service at each stage by eliminating or redesigning unpleasant or inconvenient procedures, educating customers on what to expect, and retraining staff to be friendlier and more helpful
- Eliminating or minimizing unwanted physical effort during search and delivery processes; improving signage and "road mapping" in facilities and on webpages can help customers to find their way and prevent them from getting lost and frustrated
- Decreasing unpleasant sensory costs of service by creating more attractive visual environments, reducing noise, installing more comfortable furniture and equipment, and curtailing offensive smells
- Suggesting ways in which customers can reduce associated monetary costs, including discounts with partner suppliers (e.g., parking) or offering mail or online delivery of activities that previously required a personal visit

Perceptions of net value may vary widely among customers and from one situation to another for the same customer. Most services have at least two segments; one that spends time to save money, and another that spends money to save time. Therefore, many service markets can be segmented according to the sensitivity to time savings and convenience versus price sensitivity.[7] Consider Figure 7, which identifies a choice of three clinics available to an individual who needs to obtain a routine chest x-ray. In addition to varying dollar prices for the service, different time and effort costs are associated with using each service. Depending on the customer's priorities, non-monetary costs may be as important, or even more, than the price charged by the service provider.

Competition-Based Pricing

The last leg of the pricing tripod is competition. Firms with relatively undifferentiated services need to monitor what competitors are charging and should to try to price accordingly.[8] When customers see little or no

Figure 7: Trading off monetary and non-monetary costs

Which clinic would you patronize if you needed a chest x-ray (assuming that all three clinics offer good technical quality)?		
Clinic A	**Clinic B**	**Clinic C**
• Price: $85 • Located 1 hour away by car or transit • Next available appointment is in 3 weeks • Hours: Monday to Friday, 9 am to 5 pm • Estimated waiting time is about 2 hours	• Price: $145 • Located 15 minutes away by car or transit • Next available appointment is in 1 week • Hours: Monday to Friday, 8 am to 10 pm • Estimated waiting is about 30 to 45 minutes	• Price: $225 • Located next to your office or college building • Next available appointment is in 1 day • Hours: Monday to Saturday, 8 am to 10 pm • By appointment; estimated waiting time is 0 to 15 minutes

difference between competing offerings, they may just choose what they perceive to be the cheapest. In such a situation, the firm with the lowest cost per unit of service enjoys an enviable market advantage and often assumes *price leadership*. Here, one firm acts as the price leader, with others take their cue from this company, e.g., when several gas stations compete within a short distance of one another, as soon as one station raises or lowers its prices, others follow suit.

Price Competition Intensifiers. Price competition intensifies with:

- Increasing number of competitors
- Increasing number of substituting offers
- Wider distribution of competitor and/or substitution offers
- Increasing surplus capacity in the industry

Price Competition Inhibitors. Although some service industries can be fiercely competitive (e.g., airlines and online banking), not all are, especially when one or more of the following circumstances reduce price competition:

- *Non-price-related costs of using competing alternatives are high.* When saving time and effort are of equal or greater importance to customers than price in selecting a supplier, the intensity of price competition is reduced. Competitor services have their own set of related monetary and non-monetary costs. In such cases, the actual prices charged sometimes become secondary for competitive comparisons .
- *Personal relationships matter.* For highly personalized and customized services such as hairstyling or family medical care, relationships with individual providers are often very important to customers, thus discouraging them from responding to competitive offers. For example, many global banks prefer to focus on wealthy customers in order to form long-term personal relationships with them.
- *Switching costs are high.* When it takes effort, time, and money to switch providers, customers are less likely to take advantage of competing offers.[9] Cellphone service providers often require one- or two-year contracts from their subscribers and charge significant financial penalties for early cancellation of service. Likewise, life insurance firms charge administrative fees or cancellation charges when policy holders want to cancel their policy within a certain time period.
- *Services are often time and location specific.* When people want to use a service at a specific location or at a particular time or perhaps both simultaneously, they usually find they have fewer options, which reduces price competition.[10]

Firms that always react to competitors' price changes run the risk of pricing *lower* than what might be necessary. Managers should be aware of falling into the trap of comparing competitors' prices dollar-for-dollar, and then seeking to match them. A better strategy is to take into account the entire cost to customers of each competitive offering, including all related monetary and non-monetary costs, plus potential switching costs. Managers should also assess the impact of distribution, time, and location factors, as well as estimating competitors' available capacity before deciding what response is appropriate.

REVENUE MANAGEMENT: WHAT IT IS AND HOW IT WORKS[11]

Many service businesses now focus on strategies to maximize the revenue (or contribution) that can be obtained from available capacity at any given point in time. Revenue management is important in value creation as it ensures better capacity utilization and reserves capacity for higher-paying segments. It is a sophisticated approach to manage supply and demand under varying degrees of constraint.

Airlines, hotels, and car rental firms in particular have become adept at varying their prices in response to the price sensitivity and needs of different market segments at different times of the day, week or season. More recently, hospitals, restaurants, golf courses, on-demand IT services, data-processing centers, concert organizers, and even nonprofit organizations increasingly use revenue management.[12] It is most effective when applied to service businesses characterized by:

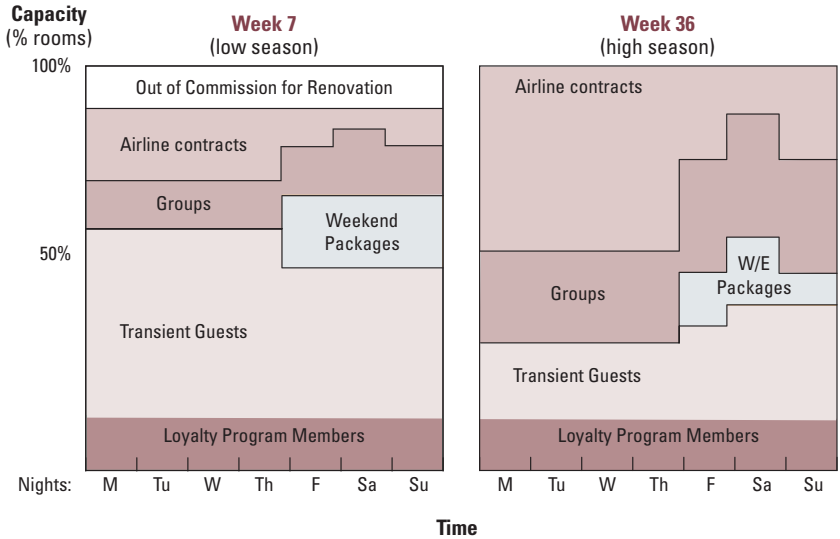
- High fixed-cost structure and relatively fixed capacity resulting in perishable inventory
- Variable and uncertain demand
- Varying customer price sensitivity

Reserving Capacity for High-Yield Customers

In practice, revenue management (also known as yield management) involves setting prices according to predicted demand levels among different market segments. The least price sensitive segment is the first to be provided capacity, paying the highest price; other segments follow at increasingly lower prices. As higher-paying segments often book closer to the time of actual consumption, firms need a disciplined approach to save capacity for them instead of simply selling on a first-come, first-served basis. For example, business travelers often reserve airline seats, hotel rooms, and rental cars at short notice, but vacationers may book leisure travel months in advance, and convention organizers often block hotel space years in advance for big events.

Figure 8 illustrates the capacity allocation in a hotel setting, where demand from different types of customers varies not only by day of the week but also by season. These allocation decisions by segment, captured in reservation databases accessible worldwide, tell reservations personnel when to stop accepting reservations at certain prices, even though many

Figure 8: Setting capacity allocation targets by segment for a hotel



rooms may still remain available. Loyalty program members, who are mainly business travelers paying high corporate rates, are obviously a very desirable segment, followed by transient guests, and weekend packages. Airline contracts typically offer the lowest rates per room, as airlines book large volumes far in advance and can therefore negotiate attractive rates.

Similar charts can be constructed for most capacity-constrained businesses. In some instances, capacity is measured in terms of seats for a given performance, seat-miles, or rooms-nights; in others, it may be in terms of machine time, labor time, billable professional hours, vehicle miles, or storage volume, whichever is the scarce resource.

A well-designed revenue management system can predict with reasonable accuracy how many customers will use a given service at a specific time at each of several different price levels and then block the relevant amount of capacity at each level (known as a *price bucket*). Sophisticated firms use complex mathematical models for this purpose and employ revenue managers to make decisions about inventory allocation. This information can also be used to predict periods of excess capacity with the aim to increase usage through promotions and incentives. The objective is to maximize revenues on a day-to-day basis.

In the case of airlines, these models integrate massive historical databases on past passenger travel, and can forecast demand of up to one year in advance for each individual departure. At fixed intervals, the revenue manager — who may be assigned specific routes at a large airline — checks the actual pace of bookings (i.e., sales at a given time before departure) and compares it with the forecasted pace. If significant deviations exist between actual and forecasted demand, the manager will adjust the size of the inventory buckets. For example, if the booking pace for a higher paying segment is stronger than expected, additional capacity is allocated to this segment and taken away from the lowest-paying segment. The objective is to maximize the revenues from the flight. *Service Insights 6.1* shows how revenue management has been implemented at American Airlines, an industry leader in this field.

SERVICE INSIGHTS 1

Pricing Seats on Flight AA 333

Revenue management departments use sophisticated revenue management software and powerful computers to forecast, track and manage each flight on a given date separately. Look at American Airlines (AA) Flight 333, a popular flight from Chicago to Phoenix, Arizona, which departs daily at 4.50 p.m. on the 1,440 mile (2,317 kilometer) journey.

The 124 seats in coach (economy class) are divided into different fare categories, referred to by revenue management specialists as "buckets". There is enormous variation in ticket prices among these seats: round-trip fares range from $298 for a bargain excursion ticket (with various restrictions and a cancellation penalty attached) all the way up to an unrestricted fare of $1,065. Seats are also available at an even higher price in the small first-class section at $1,530. Scott McCartney tells how ongoing analysis by the computer program changes the allocation of seats between each of the seven buckets in economy class.

In the weeks before each Chicago–Phoenix flight, AA's revenue management system constantly adjusts the number of seats in each bucket, taking into account tickets sold, historical ridership

patterns, and connecting passengers likely to use the route as one leg of a longer trip.

If advance bookings are slim, AA adds seats to low-fare buckets. If business customers buy unrestricted fares earlier than expected, the revenue management system takes seats out of the discount buckets and preserves them for last-minute bookings that the system predicts will still show up.

With 69 of 124 coach seats already sold four weeks before one recent departure of Flight AA333, American's revenue management system begins to limit the number of seats in lower-priced buckets. A week later, it totally shut off sales for the bottom three buckets, priced $300 or less. To a Chicago customer looking for a cheap seat, the flight was 'sold out'.

One day before departure, with 130 passengers booked for the 124-seat flight, AA still offered four seats at full fare because its revenue management system indicated that 10 passengers were likely to not show up or take other flights. Flight AA333 departed full and no one was bumped.

Although Flight AA333 for that date is now history, it has not been forgotten. The booking experience for this flight was saved in the memory of the revenue management system to help the airline do an even better job of forecasting in the future.

Source: Scott McCartney, "Ticket Shock: Business Fares Increase Even as Leisure Travel Keeps Getting Cheaper", *The Wall Street Journal,* 3 November 1997, pp. A1, A10. http://www.aa.com, accessed 2 March 2016. Note that flight details and prices are illustrative only.

How Can We Measure the Effectiveness of a Firm's Revenue Management?

Many capacity-constrained service organizations use percentage of capacity sold as a basic indicator of success. For instance, airlines talk of 'load factor' achieved, hotels of 'occupancy rate' and hospitals of 'census'. Similarly, professional firms monitor the proportion of their partners' and associates' time that is 'billable hours'. However, these percentages by themselves tell little of the relative profitability of the business attracted, since high usage rates may simply be a reflection of heavy discounting.

Therefore, success in revenue management is generally defined as maximizing the revenue per available capacity for a given space and time unit (RevPAST). For example, airlines seek to maximize revenue per available seat kilometer (RevPASK); hotels try to maximize their revenue per available room night (RevPAR); and performing arts centers try to maximize their revenue per available seat performance. These indices show the interplay between capacity utilization and average rate or price achieved, and can be tracked over time and benchmarked across operating units within a service firm (e.g., across hotel properties in a larger chain) and across firms. Success in revenue management means increasing RevPAST.

How Does Competitors' Pricing Affect Revenue Management?

As revenue management systems monitor booking pace, they indirectly pick up the effects of competitors' pricing. For example, if an airline prices a flight too low, it will experience a higher booking pace, and its cheaper seats fill up quickly. That is generally not desirable, as it means a higher share of late-booking as well as high fare-paying customers are not able to get their seats confirmed, and therefore will choose to fly on competing airlines. If the initial pricing is too high, the firm will get too low a share of early booking segments (although this still tends to offer a reasonable yield) and may later have to offer deeply discounted "last-minute" tickets to sell excess capacity. Some of the sales of distressed inventory, as it is called in industry, may take place through reverse auctions, using intermediaries such as Priceline.com.

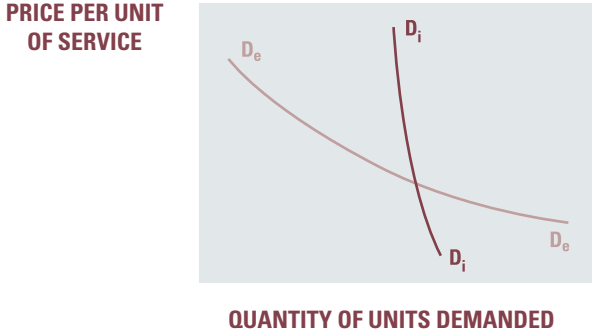
Price Elasticity

For revenue management to work effectively, there needs to be two or more segments that attach different values to the service and have different price elasticities. The concept of elasticity describes how sensitive demand is to changes in price and is computed as follows:

$$\text{Price elasticity} = \frac{\text{Percentage change in demand}}{\text{Percentage change in price}}$$

When price elasticity is at unity, sales of a service rise (or fall) by the same percentage that price falls (or rises). If a small change in price has a big impact on sales, demand for that product is said to be price elastic. If a change in price has little effect on sales, demand is described as price inelastic. The concept is illustrated in the simple chart presented in Figure 9, which shows the price elasticity for two segments, one with a highly elastic demand (a small change in price results in a big change in the amount demanded), and the other with a highly inelastic demand (even big changes in price have little impact on the amount demanded). To allocate the price capacity effectively, revenue manager needs to find out how sensitive demand is to price and what net revenues will be generated at different price points for each target segment.

Figure 9: Illustration of price elasticity



D_e: Demand is *price elastic*. Small changes in price lead to big changes in demand.
D_i: Demand for service is *price inelastic*. Big changes in price have little impact on demand.

$$\textbf{Price elasticity} = \frac{\text{Percentage change in demand}}{\text{Percentage change in price}}$$

Designing Rate Fences

Inherent in revenue management is the concept of *price customization;* that is, charging different customers different prices for what is actually the same product. As noted by Hermann Simon and Robert Dolan,

> The basic idea of price customization is simple: Have people pay prices based on the value they put on the product. Obviously you can't just hang out a sign saying "Pay me what it's worth to you", or "It's $80 if you value it that much but only $40 if you don't". You have to find a way to segment customers by their valuations. In a sense, you have to "build a fence" between high-value customers and low-value customers so the "high" buyers can't take advantage of the low price.[13]

How can a firm make sure that customers who are willing to pay higher prices are unable to take advantage of lower price buckets? Properly designed rate fences allow customers to self-segment on the basis of service characteristics and willingness to pay. Rate fences help companies to restrict lower prices to customers willing to accept certain restrictions on their purchase and consumption experiences.

Fences can be either physical or non-physical. Physical fences refer to tangible product differences related to the different prices, such as the seat location in a theater, the size and furnishing of a hotel room, or the product bundle (e.g., first class is better than economy). In contrast, non-physical fences refer to differences in consumption, transaction, or buyer characteristics, but the service is basically the same (e.g., there is no difference in an economy class seat or service whether a person bought a heavily discounted ticket or paid the full fare for it). Examples of non-physical fences include having to book a certain length of time ahead, not being able to cancel or change a booking (or having to pay cancellation or change penalties), or having to stay over a weekend night. Examples of common rate fences are shown in Table 2.

In summary, based on a detailed understanding of customer needs, preferences, and willingness to pay, product and revenue managers can design effective products comprising the core service, physical product features (physical fences), and non-physical product features (non-physical fences). In addition, a good understanding of the demand curve

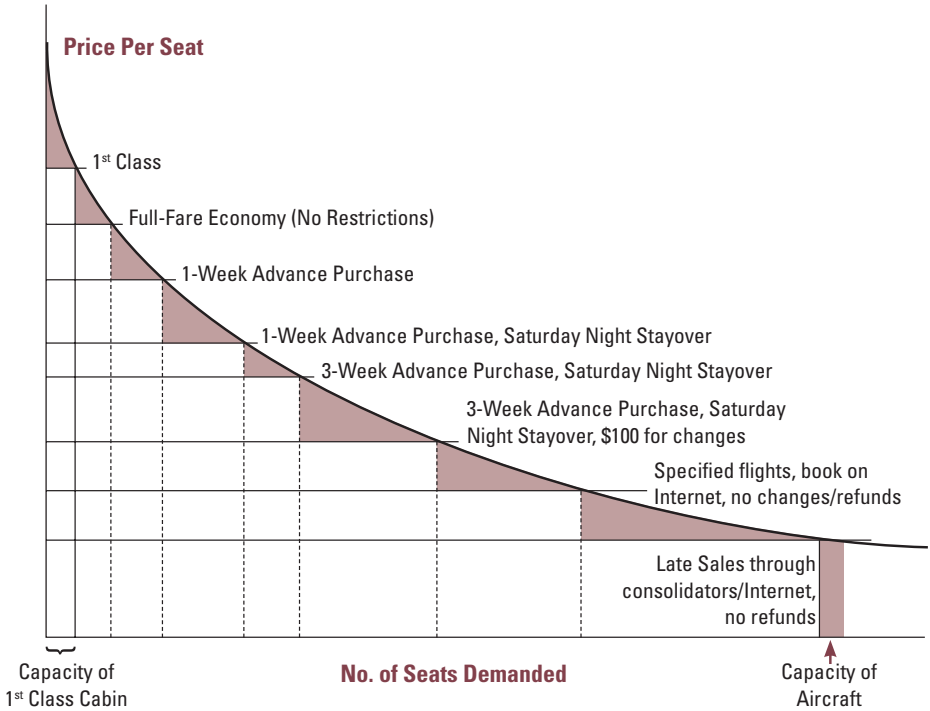
Table 2: Key Categories of Rate Fences

Rate Fences	Examples
Physical (product-related) Fences	
Basic product	• Class of travel (business/economy class) • Size of rental car • Size and furnishing of a hotel room • Seat location in a theater or stadium
Amenities	• Free breakfast at a hotel, airport pick up, etc. • Free golf cart at a golf course • Valet parking
Service level	• Priority wait-listing, separate check-in counters with no or only short queues • Improved food and beverage selection • Dedicated service hotlines • Personal butler • Dedicated account management team
Other physical characteristics	• Table location pricing (e.g., restaurant table with view in a high rise building), seat location pricing (e.g., a window or aisle seat in an aircraft cabin) • Extra legroom on an airline
Non-Physical Fences	
Transaction Characteristics	
Time of booking or reservation	• Discounts for advance purchase
Location of booking or reservation	• Passengers booking air tickets for an identical route in different countries are charged different prices (e.g., prices tend to be higher at an airline's hub because of higher frequency flights and more direct flights) • Customers making reservations online are charged a lower price than those making reservations by phone
Flexibility of ticket usage	• Fees/penalties for canceling or changing a reservation (up to loss of entire ticket price) • Non-refundable reservation fees
Consumption Characteristics	
Time or duration of use	• Happy hour offer in a bar, early-bird special in a restaurant before 6 pm, and minimum required spending during peak periods • Must stay over a Saturday night for a hotel booking • Must stay at least for five nights
Location of consumption	• Price depends on departure location, especially in international travel • Prices vary by location (between cities, city center versus edges of the city)

Buyer Characteristics	
Frequency or volume of consumption	• Members of certain loyalty tier with the firm (e.g., platinum member) get priority pricing, discounts or loyalty benefits • Season tickets
Group membership	• Child, student, senior citizen discounts • Affiliation with certain groups (e.g., alumni) • Membership with the firm's loyalty program • Corporate rates
Size of customer group	• Group discounts based on size of group
Geographic location	• Local customers are charged lower rates than tourists • Customers from certain countries are charged higher prices

is needed so that "buckets" of inventory can be assigned to the various products and price categories. An example from the airline industry is shown in Figure 10, and an interview with a senior executive with a career in revenue management is featured in *Service Insights 6.2*.

Figure 10: Relating price buckets to the demand curve



*Dark areas denote amount of consumer surplus (goal of segmented pricing is to reduce this).

SERVICE INSIGHTS 2
Interview with a Vice President of Revenue Management and Analytics

Q: What is the role of a revenue manager?
A: When I started my career, the primary focus was on forecasting, inventory control, pricing, market segment and geographic mix, and allotment control. The Internet changed the scene significantly and several global giants, like Expedia and Travelocity, emerged after 9/11 when travel bookings plummeted and the industry realized the power of the Internet to help them sell distressed inventory. But airlines and hotels want to control their own inventory and pricing to cut costs and reduce reliance on intermediaries, so there's increasing focus on driving bookings via direct channels such as their own branded websites, building online brands, and implementing CRM programs to build loyalty and encourage repeat purchase. Responsibilities have also broadened beyond mainstream hotel rooms to include revenue management of secondary income sources such as function space, restaurants, golf courses and spa.

Q: What differences do you see between revenue management for airlines and hotels?
A: Fundamentally, the techniques of forecasting and optimizing pricing and inventory controls are the same. However, some key differences exist. Airlines have a larger ability to use pricing to expand travel demand from their key markets. By contrast, pricing practices in hotels can shift market share within a location but, as a rule, not overall market size. Consumers are also more likely to view many pricing practices, such as advance purchase restrictions and discounts, as fair practice for the airline industry, but less so when applied by the hotel industry.

Organizational structure also tends to be different. The airlines adopt central revenue management control for all flights, and revenue managers have little interaction with the reservations

and sales teams in the field. A precise and statistical application of pricing and inventory control is thus the focus. In the hotel industry, revenue management is still often decentralized to every hotel, requiring daily interaction with reservations and sales. The human element is key for successful implementation in hotels, requiring a more cohesive culture of revenue management across multiple hotel departments such as reservations, sales, catering and even front office, to gain the biggest impact on hotel performance.

Q: What skills do you need to succeed as a revenue manager?
A: Strong statistical and analytical skills are essential, but to be really successful, revenue managers need to have equally strong interpersonal and influencing skills for their decisions and analyses to be embraced by other departments. Traditional ways of segmenting customers via their transactional characteristics such as booking lead time, channel of reservation and type of promotion are insufficient. Both behavioral characteristics (such as motive for travel, products sought, spending pattern and degree of autonomy) and emotional characteristics (such as self-image, conspicuous consumer or reluctant traveler, impulse or planned) need to be incorporated into revenue management considerations.

Q: How are revenue management practices perceived by customers?
A: The art of implementation is not to let the customers feel that your pricing and inventory control practices are unfair and meant primarily to increase the top and bottom line of the company. Intelligent and meaningful rate fences and product packaging have to be used to allow customers to self-segment so that they retain a feeling of choice. Now with the importance of Big Data application, intelligent integration of individual customer needs and wants to create personalized pricing and product offer is key to not only maximizing the revenue for a given period, but maximizing the share of wallet from a loyal customer over their lifecycle.

Q: What is the daily nature of the job?
A: The market presents a lot of demand changes and you need to monitor your competitors' price as it fluctuates daily across the various distribution changes. The customer needs and willingness to pay are also changing over time. It's definitely a pre-requisite to be quick in analysis and decisive. One needs to feel comfortable taking calculated risks and choose from a plethora of revenue management and pricing tools to decide on the best fit for the situation.

We thank Jeannette Ho, who was Vice President Revenue Management and Distribution at Fairmont Raffles Hotels International when this interview was conducted on 25 June 2013. Jeannette was responsible for spearheading and implementing the revenue management initiatives for the Group. Her team drove the company's global distribution strategy, oversaw its E-commerce channels and Central Reservations System, and developed its performance intelligence capabilities. Prior to her current role, Jeannette has been working in revenue management, distribution and CRM with various international companies such as Singapore Airlines, Banyan Tree, and Starwood Hotels & Resorts.

FAIRNESS AND ETHICAL CONCERNS IN SERVICE PRICING

Do you sometimes have difficulty understanding how much it is going to cost you to use a service? Do you believe that many prices are unfair? If so, you are not alone.[14] Service users cannot always be sure in advance what they will receive in return for their money. There is an implicit assumption among many customers that a higher priced service should offer more benefits and greater quality than a lower priced one. For example, a professional lawyer who charges very high fees is assumed to be more skilled than one who is relatively inexpensive. Although price can serve as an indication of quality, it is difficult to be sure if the extra value is really there.

Service Pricing Is Complex

Pricing for services tend to be complex and hard to understand. Comparison across providers may even require complex spreadsheets or even mathematical formulas. Consumer advocates sometimes charge that this complexity represents a deliberate choice on the part of service

suppliers who do not want customers to be able to determine who offers the best value for money, and therefore reduce price competition. In fact, complexity makes it easy (and perhaps more tempting) for firms to engage in unethical behavior. The quoted prices typically used by consumers for price comparisons may be only the first of several charges that can be billed.

For example, cellphone companies have a confusing variety of plans to meet the distinct needs and usage patterns of different market segments. Plans can be national, regional, or purely local in scope. Monthly fees vary according to the number of minutes and mobile data capacity selected in advance. There can be separate allowances for peak and off-peak minutes. Overtime minutes and "roaming minutes" on other carriers are charged at higher rates. Some plans allow unlimited off-peak calling, others have free incoming calls. Some providers charge calls per second, per six-second block or even per-minute block, resulting in vastly different costs per month. Data plans (including features such as being allowed to roll over unused mobile data to the next month), handset subsidies for new phones, roaming fees, family and bundled plans that can include several cellphones and other mobile devices, landline, and Internet services add to this complexity. On top of complex pricing plans, many find it difficult to forecast their own usage, which makes it even harder to compute comparative prices when evaluating competing suppliers whose fees are based on a variety of usage-related factors.

In addition, puzzling new fees have started to appear on bills. Phone bills of course include real taxes (e.g., sales tax), but on many bills, the majority of surcharges, which users often misread as taxes, go directly to the phone company. For instance, the "property tax allotment" is nothing more than a factor for the property taxes the carrier pays, the "single bill fee" charges for consolidated billing of the mobile and landline service, and the "carrier cost recovery fee" is a catch-all for all sorts of operating expenses. In an editorial entitled "Cell Hell," Jim Guest, Consumer Union's president, observed:

> *In the 10 years since Consumer Reports started rating cell phones and calling plans, we've never found an easy way to compare actual costs. From what our readers tell us, they haven't either. Each carrier presents*

> *its rates, extra charges, and calling areas differently. Deciphering one company's plan is hard enough, but comparing plans from various carries is nearly impossible.*[15]

It seems no coincidence that humorist Scott Adams (the creator of Dilbert) used exclusively service examples when he "branded" the future of pricing as "confusopoly". Noting that firms such as telecommunication companies, banks, insurance firms, and other financial service providers, offer nearly identical services, Adams remarks:

> *You would think this would create a price war and drive prices down to the cost of providing it (that's what I learned between naps in my economics classes), but it isn't happening. The companies are forming efficient confusopolies so customers can't tell who has the lowest prices. Companies have learned to use the complexities of life as an economic tool.*[16]

One of the roles of effective government regulation, says Adams, should be to discourage this tendency for certain service industries to develop into "confusopolies".

Piling on the Fees

Not all business models are based on generating income from sales. There is a growing trend today to impose fees that sometimes have little to do with usage. In the US, the car rental industry has attracted some notoriety for advertising bargain rental prices and then telling customers on arrival that other fees such as collision insurance and personal insurance are compulsory. Also, staff sometimes fail to clarify certain "small print" contract terms such as a high mileage charge that is added once the car exceeds a very low limit of free miles. The "hidden extras" for car rentals in some Florida resort towns got so bad at one point that people were joking: "The car is free, the keys are extra!"[17]

There has also been a trend to adding (or increasing) fines and penalties. Banks have been heavily criticized for using penalties as an important revenue-generating tool as opposed to using them merely to educate customers and achieve compliance with payment deadlines.

Chris Keeley, a New York University student, used his debit card to buy $230 worth of Christmas gifts. His holiday mood soured when he received a notice from his bank that he had overdrawn his checking account. Although his bank authorized each of his seven transactions, it charged him a fee of $31 per payment, totaling $217 for only $230 in purchases. Keeley maintained that he had never requested the so-called overdraft protection on his account and wished his bank had rejected the transactions, because he would then simply have paid by credit card. He fumed, "I can't help but think they wanted me to keep spending money so that they could collect these fees".[18] In fact, for some banks, such fees and penalties now exceed earnings from mortgages, credit cards, and all other lending combined.

The Consumer Financial Protection Bureau (CFPB) has repeatedly raised concerns about overdraft protections and its study found that the majority of debit card overdraft fees are incurred on transactions of $24 or less and the majority of overdrafts are repaid within three days.[19] Put in lending terms, if a consumer borrowed $24 for three days and paid the median overdraft fee of $34, such a loan would carry a 17,000% annual percentage rate (APR). Richard Cordray, CFPB Director, said "Consumers who opt in to overdraft coverage put themselves at serious risk when they use their debit card… Despite recent regulatory and industry changes, overdrafts continue to impose heavy costs on consumers who have low account balances and no cushion for error. Overdraft fees should not be 'gotchas' when people use their debit cards".

Some banks do not charge for overdraft protection. Said Dennis DiFlorio, President for Retail Banking at Commerce Bancorp Inc. in Cherry Hill, New Jersey: "It's outrageous. It's not about customer convenience. Its just a way for banks to make money off customers". Some banks now offer services that cover overdrafts automatically from savings accounts, other accounts, or even the customer's credit card, and do not charge fees for doing so.[20]

It is possible to design fees and even penalties that do not seem unfair to customers. *Service Insights 6.3* describes what drives customers' fairness perceptions with service fees and penalties.[21]

SERVICE INSIGHTS 3
Crime and Punishment: How Customers Respond to Fines and Penalties

Various types of "penalties" are part and parcel of many pricing schedules to discourage undesirable consumer behaviors, ranging from late fees for DVD rentals to cancellation charges for hotel bookings, and charges for late credit card payments. Customer responses to penalties can be highly negative, and can lead to switching providers and poor word-of-mouth. Young Kim and Amy Smith conducted an online survey using the Critical Incident Technique (CIT) in which the 201 respondents were asked to recall a recent penalty incident, describe the situation, and then complete a set of structured questions based on how the respondents felt and how they responded to that incident. Their findings showed that negative consumer responses can be reduced significantly by following these three guidelines:

1. **Make Penalties Relative to the Crime Committed.** The survey showed that customers' negative reaction to a penalty increased greatly when they perceived that the penalty was out of proportion to the 'crime' committed. Customers' negative feelings were further aggravated if they were "surprised" by the penalty being charged to them suddenly and they had not been aware of the fee or the magnitude of it. These findings suggest that firms can reduce negative customer responses significantly by exploring which amounts are seen as reasonable or fair for a given "customer lapse", and the fines/fees are communicated effectively even before a chargeable incident happens (e.g., in a banking context through a clearly explained fee schedule, and through frontline staff that explain at the point of opening an account or selling additional services the potential fines or fees associated with various "violations", such as overdrawing beyond the authorized limits, bounced checks, or late payments).

2. **Consider Causal Factors and Customize Penalties.** The study showed that customers' perceptions of fairness were lower and negative responses were higher when they perceived the causes that led to the penalty to be out of their control ("I mailed the check on time — there must have been a delay in the postal system"), rather than when they felt it was within their control and really their fault (e.g., "I forgot to mail the check"). To increase the perception of fairness, firms may want to identify common penalty cases that typically are out of the customer's control and allow the frontline to waive or reduce such fees.

   In addition, it was found that customers who generally observe all the rules, and therefore have not paid fines in the past, react particularly negatively, if they are fined. One respondent said, "I have always made timely payments and have never been late with a payment — they should have considered this fact and waived the fee". Service firms can improve fairness perceptions by taking into account customers' penalties history in dealing with penalties, and offer different treatments based on past behavior; perhaps waiving the fine for the first incident, while at the same time communicating that the fee will be charged for future incidents.

3. **Focus on Fairness and Manage Emotions during Penalty Situations.** Consumers' responses are heavily driven by their fairness perceptions. Customers are likely to perceive penalties as excessive and respond negatively, if they find that a penalty is out of proportion compared to the damage or extra work caused by the penalized incident to the service firm. One consumer complained, "I thought this particular penalty (credit card late payment) was excessive. You are already paying high interest; the penalty should have been more in line with the payment. The penalty was more than the payment!" Considering customers' perceptions of fairness might mean, for example, that the late fee for keeping a DVD or library book should not exceed the potentially lost rental fees during that period.

Service companies can also make penalties seem fairer by providing adequate explanations and justifications for the penalty. Ideally, penalties should be imposed for the good of other customers (e.g., "We kept the room for you which we could have given to another guest on our wait list") or community (e.g., "others are already waiting for this book to be returned"), but not as a means for generating significant profit. Finally, frontline employees should be trained to handle customers who are angry or distressed and complain about penalties (see Volume 11 for recommendations on how to deal with such situations).

Source: Young "Sally" K. Kim and Amy K. Smith, "Crime and Punishment: Examining Customers' Responses to Service Organizations' Penalties", *Journal of Service Research*, 8, No. 2, 2005, pp. 162–180.

Designing Fairness into Revenue Management

Similar to pricing plans and fees, revenue management practices can be perceived as highly unfair, and customer perceptions have to be carefully managed. Therefore, a well-implemented revenue management strategy cannot mean a blind pursuit of short-term yield maximization. Rather, the following approaches can help firms to reconcile revenue management practices with customers' fairness perceptions, satisfaction, trust, and goodwill[22]:

- *Design price schedules and fences that are clear, logical, and fair.* Firms should proactively spell out all fees and expenses (e.g., no-show or cancellation charges) clearly in advance so that there are no surprises. A related approach is to develop a simple fee structure so customers can more easily understand the financial implications of a specific usage situation. For a rate fence to be perceived as fair, customers must understand them easily (i.e., fences have to be transparent and upfront) and see the logic in them.
- *Use high published prices and frame fences as discounts.* Rate fences framed as customer gains (i.e., discounts) are generally perceived as fairer than those framed as customer losses (i.e., surcharges), even if the situations are economically equivalent. For example, a customer

who patronizes her hair salon on Saturdays may perceive the salon as profiteering if she finds herself facing a weekend surcharge. However, she is likely to find the higher weekend price more acceptable if the hair salon advertises its peak weekend price as the published price and offers a $5 discount for weekday haircuts. Furthermore, having a high published price helps to increase the reference price and related quality perceptions in addition to the feeling of being rewarded for the weekday patronage.

- *Communicate consumer benefits of revenue management.* Marketing communications should position revenue management as a win-win practice. Providing different price and value enables a broader spectrum of customers to self-segment and enjoy the service. It allows each customer to find the price and benefits (value) that best satisfies his or her needs. For example, charging a higher price for the best seats in the theater recognizes that some people are willing and able to pay more for a better location and makes it possible to sell other seats at a lower price. Furthermore, perceived fairness is affected by what customers perceive as normal. Hence, when communication makes customers more familiar with particular revenue management practices, unfairness perceptions are likely to decrease over time.[23]
- *"Hide" discounts through bundling, product design, and targeting.* Bundling a service into a package effectively obscures the discounted price. When a cruise line includes the price of air travel or ground transportation in the cruise package, the customer knows only the total price, not the cost of the individual components. Bundling usually makes price comparisons between the bundles and its components impossible, and thereby sidesteps potential unfairness perceptions and reductions in reference prices. This reduces unfairness perceptions.[24]

  Service products can be designed to hide discounts. Instead of varying the prices of food, which makes it difficult to increase once it has been lowered, restaurants can vary the product. For example, restaurants can offer smaller portions for lower cost set-lunches, and they can impose a minimum spending level during peak periods. Diners having a set-lunch feel they are getting a good deal. When demand is high, a minimum spending per diner can be set at a high

level. That is, menu prices will not be changed and price perceptions of diners are unaffected. These two tactics give restaurants flexibility in adjusting effective revenue per seat according to demand levels.[25]

Finally, instead of widely advertising low prices and thereby reducing the reference price and potential quality perceptions, special deals can be offered only to members of a firm's loyalty program and be positioned as a benefit of the program. Members are likely to feel appreciated and the firm can generate incremental demand without reducing its published prices.

- *Take care of loyal customers.* Firms should build in strategies for retaining valued customers, even to the extent of not charging the maximum feasible amount on a given transaction. After all, customer perceptions of price gouging do not build trust. Revenue management systems can be programmed to incorporate "loyalty multipliers" for regular customers, so that reservations systems can give them "special treatment" status at peak times, even when they are not paying premium rates.
- *Use service recovery to compensate for overbooking.* Many service firms overbook to compensate for anticipated cancellations and no-shows. Profits increase but so does the incidence of being unable to honor reservations. Being "bumped" by an airline or "walked" by a hotel can lead to a loss of customer loyalty and adversely affect a firm's reputation.[26] It is important to back up overbooking programs with well-designed service recovery procedures, such as:

  1. Giving customers a choice between retaining their reservation or receiving compensation (e.g., many airlines practice voluntary offloading at check-in against cash compensation and a later flight).

  2. Providing sufficient advance notice for customers to make alternative arrangements (e.g., pre-emptive offloading and rescheduling to another flight the day before departure, often in combination with cash compensation).

  3. Offering a substitute service that delights customers if possible (e.g., upgrading a passenger to business or first class on the next available flight, often in combination with options 1 and 2 above).

A Westin beach resort found that it can free up capacity by offering guests who are departing the next day the choice of spending their last night in a luxury hotel near the airport or in the city at no cost. Guest feedback on the free room, upgraded service, and a night in the city after a beach holiday has been very positive. From the hotel's perspective, this practice trades the cost of getting a one-night stay in another hotel against that of turning away a multiple-night guest arriving that same day.

PUTTING SERVICE PRICING INTO PRACTICE

The first thing a manager has to realize is that service pricing is multifaceted. It is not just about "How much do I charge?" There are other important decisions to be made that can have a major impact on the behavior and value perceptions of customers. Table 3 summarizes the questions service marketers need to ask themselves to develop a well-thought out pricing strategy.

How Much to Charge?

Realistic decisions on pricing are critical for financial solvency. The pricing tripod model discussed earlier (Figure 2) provides a useful starting point. First, all the relevant economic costs need to be recovered at different sales volumes and these set the relevant floor price. Next, the elasticity of demand of the service from both the providers' and customers' perspectives will help to set a "ceiling" price for any given market segment. Finally, firms need to analyze the intensity of price competition among the providers, before they come to a final price.

A specific figure must be set for the price itself. This task involves several considerations, including the need to consider the pros and cons of setting a rounded price, and the ethical issues involved in setting a price exclusive of taxes, service charges, and other extras.

More recently, auctions and dynamic pricing have become increasingly popular as a way to price according to demand and the value perceptions of customers, as seen in the examples of dynamic pricing in the Internet environment in *Service Insights 6.4*.

Table 3: Issues to Consider When Developing a Service Pricing Schedule

1.	**How much should be charged for this service?** • What costs is the organization attempting to recover? Is the organization trying to achieve a specific profit margin or return on investment by selling this service? • How sensitive are customers to various prices? • What prices are charged by competitors? • What discount(s) should be offered from basic prices? • Are psychological pricing points (e.g., $4.95 versus $5.00) customarily used? • Should auctions and dynamic pricing be used?
2.	**What should be the basis of pricing?** • Execution of a specific task • Admission to a service facility • Units of time (hour, week, month, year) • Percentage commission on the value of the transaction • Physical resources consumed • Geographic distance covered, weight or size of object serviced • Outcome of service or cost-saving generated for the client • Should each service element be billed independently? • Should a single price be charged for a bundled package? • Should discounting be used for selective segments? • Is a freemium pricing strategy beneficial?
3.	**Who should collect payment and where?** • The organization that provides the service collects payment at the location of service delivery or at arm's length (e.g., by mail, phone or online). • A specialist intermediary (travel or ticket agent, bank, retail, etc.) with a convenient retail outlet location. • How should the intermediary be compensated for this work — flat fee or percentage commission?
4.	**When should payment be made?** • In advance or after service delivery? • In a lump sum or by installments over time?
5.	**How should payment be made?** • Cash (exact change or not?) • Token (where can these be purchase?) • Stored value card • Check (how to verify?) • Electronic funds transfer • Charge card (credit or debit) • Credit account with service provider • Vouchers • Third-party payment (e.g., insurance company or government agency)?
6.	**How should prices be communicated to the target market?** • Through what communication medium? (advertising, signage, electronic display, salespeople, customer service personnel) • What message content (how much emphasis should be placed on price?) • Can the psychology of pricing presentation and communications be used?

SERVICE INSIGHTS 4

Dynamic Pricing on the Internet

Dynamic pricing, also known as customized or personalized pricing, is a version of the age-old practice of price discrimination. It is popular with service providers because of its potential to increase profits and at the same time provides customers with what they value. E-tailing, or retailing over the Internet, lends itself well to this strategy because changing prices electronically is a simple procedure. Dynamic pricing enables service firms to charge different customers different prices for the same product based on information collected about their purchase history, preferences, price sensitivity, and so on. However, customers may not be happy.

E-tailers are often uncomfortable about admitting the use of dynamic pricing due to ethical and legal issues associated with price discrimination. Customers of Amazon.com were upset when they learned the online megastore, in its early days of e-commerce, was not charging everyone the same price for DVDs of the same movie. A study of online consumers by the University of Pennsylvania's Annenberg Public Policy Center found that 87% of respondents did not think dynamic pricing was acceptable.

Reverse Auctions

Travel e-tailers such as Priceline.com and Hotwire.com follow a customer-driven pricing strategy known as a reverse auction. Each firm acts as an intermediary between potential buyers who ask for quotations for a product or service, and multiple suppliers who quote the best price they're willing to offer. Buyers can then compare the offers and choose the supplier that best meets their needs. For example, if a buyer is looking for a flight and accommodation package, search results often show a variety of combinations of packages one can choose from. All the different airlines and hotels are listed by brand, and the price of each package is listed clearly.

Different business models underlie these services. Although 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

to their customers. Others charge customers either a fixed fee or a percentage of the savings.

Traditional Auctions

Other e-tailers, such as eBay, uBid or OnlineAuction, follow the traditional online auction model in which bidders place bids for an item and compete with each other to determine who buys it. Marketers of both consumer and industrial products use such auctions to sell obsolete or overstocked items, collectibles, rare items, and secondhand merchandise. This form of retailing has become very successful since eBay first launched it in 1995.

Shopbots and Metasearch Engines Help Consumers to Benefit from Dynamic Pricing

Consumers now have tools of their own to prevent them from being taken advantage of by practices of dynamic pricing. One approach involves using shopbots and metasearch engines to do a comparison of prices and find the cheapest prices available. Shopbots, or shopping robots, basically are intelligent agents that automatically collect price and product information from multiple vendors. A customer has only to visit a shopbot site, such as Dealtime.com, and run a search for what they are looking for. In the travel industry, Kayak is a leading metasearch engine. These shopbots instantly query all the associated service providers to check availability, features, and price, and then present the results in a comparison table. Different shopbots have links to different retailers. There is even a shopbot site called MegaShopBot.com, which searches for deals within the best shopbots!

There's little doubt that dynamic pricing is here to stay. With further advances in technology and wider application, its reach will extend to more and more service categories.

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What Should Be the Specified Basis for Pricing?

It is not always easy to define a unit of service as the specified basis for pricing as there may be many options. For instance, should price be based on completing a promised service task, such as repairing a piece of equipment or cleaning a jacket? Should it be based on admission to a service performance, such as an educational program, a concert, or a sports event? Should it be time-based, for instance, using an hour of a lawyer's time? Alternatively, should it be related to a monetary value linked to the service delivery, such as when an insurance company scales its premiums to reflect the amount of coverage provided, or a real estate company takes a commission that is a percentage of the selling price of a house?

Some service prices are tied to the consumption of physical resources such as food, drinks, water, or natural gas. Transport firms have traditionally charged by distance, with freight companies using a combination of weight or cubic volume and distance to set their rates. For some services, prices may include separate charges for access and for usage. Recent research suggests that access or subscription fees are an important driver of adoption and customer retention, whereas usage fees are much more important drivers of actual usage.[27] Consumers of hedonic services such as amusement parks tend to prefer flat rates for access rather than by individual usage as they do not like to be reminded of the pain of paying while enjoying the service. This is also called the taximeter effect, as customers do not want to "hear" the price ticking upward; it lowers their consumption of enjoyment![28]

In B2B markets in particular, innovative business models charge based on outcomes rather than services provided. For example, Rolls-Royce's 'Power-by-the-Hour' service does not charge for services such as maintenance, repairs, and materials, but based on the outcome of these activities, that is, the number of flying hours.[29] Some supply chain service providers, such as DHL Supply Chain, charge a base price and then add a variable component that depends on the cost-saving generated for the client. In effect, generated cost savings are shared between the provider and their client.

Price Bundling. An important question for service marketers is whether to charge an inclusive price for all elements (referred to as a "bundle") or to price each element separately. If customers prefer to avoid

making many small payments, then bundled pricing may be preferable. However, if they dislike being charged for product elements they do not use, itemized pricing is preferable. Bundled prices offer firms a certain level of guaranteed revenue from each customer, while providing customers a clear idea in advance of how much they can expect to pay. Unbundled pricing provides customers with the freedom to choose what to buy and pay for.[30] For instance, many US airlines now charge economy class passengers for meals, drinks, check-in baggage, seat selection, and surcharges for credit card payment on their domestic flights. However, customers may be angered if they discover that the actual price of what they consume, inflated by all the "extras", is substantially higher than the advertised base price that attracted them in the first place.[31]

Discounting. Selective price discounting targeted at specific market segments can offer important opportunities to attract new customers and fill the capacity that would otherwise go unused. However, unless it is used with effective rate fences that allow specific segments to be targeted cleanly, a strategy of discounting should be approached with caution. It reduces the average price and contribution received, and may attract customers whose only loyalty is to the firm that can offer the lowest price on the next transaction. Volume discounts are sometimes used to cement the loyalty of large corporate customers who might otherwise spread their purchases among several different suppliers.

Freemium. Over the past decade, "freemium", a combination of "free" and "premium", has become a popular pricing strategy for online and mobile services. Users get the basic service at no cost (typically funded by advertising) and can upgrade to a richer functionality for a subscription fee. If you have shared files on Dropbox, networked on LinkedIn or streamed music from Spotify, you have experienced this business model first-hand. As marginal costs for technology and bandwidth are dropping, "freemium" models are likely to become more attractive.[32]

Who Should Collect Payment and Where Should Payment be Made?

Supplementary services include information, order taking, billing, and payment. However, service delivery sites are not always conveniently located. Airports, theaters, and stadiums, for instance, are often situated some distance from where potential customers may live or work. When consumers need such services and/or have to purchase a service before

using it, and there is no convenient online channel available, there are benefits to using intermediaries that are more conveniently located. Therefore, firms sometimes delegate these services to intermediaries, such as travel agents who make hotel and transport bookings, and collect payment from customers, or ticket agents who sell seats for theaters, concert halls, and sports stadiums.

Although the original supplier pays a commission, the intermediary is usually able to offer customers greater convenience in terms of where, when, and how payment can be made. Using intermediaries may also result in savings in administrative costs. However, many service firms nowadays are promoting their websites and apps with best rate guarantees as direct channels for customer self-service, thus bypassing the traditional intermediaries and avoiding the payment of commissions. Tickets are then simply delivered to an email account or a smart phone.

When Should Payment be Made?

Two basic ways are to ask customers to pay in advance (as with an admission charge, airline ticket, or postage stamps), or to bill them once service delivery has been completed (as with restaurant bills and repair charges). Occasionally, a service provider may ask for an initial payment

Figure 11: Some firms do not leave their customers with much flexibility in dealing with late payment

"Unless we receive the outstanding balance within ten days, we will have no choice but to destroy your credit rating, ruin your reputation, and make you wish you were never born. If you have already sent the seven cents, please disregard this notice."

in advance of service delivery, with the balance due later (Figure 11). This approach is quite common for expensive repair and maintenance jobs, when the firm — often a small business with limited working capital — must buy and pay for materials.

Asking customers to pay in advance means the buyer is paying before the benefits are received. However, prepayments may offer advantages to the customer and the provider. Sometimes it is inconvenient to pay each time a regularly patronized service — such as the postal service or public transport — is used. To save time and effort, customers may prefer the convenience of buying a book of stamps or a monthly travel pass. Performing arts organizations with heavy upfront financing requirements can also offer discounted subscription tickets in order to bring in money before the season begins.

Finally, the timing of payment can determine usage patterns. From an analysis of the payment and attendance records of a Colorado-based health club, John Gourville and Dilip Soman found that its members' usage patterns were closely related to their payment schedules. When members made payments, their use of the club was highest during the months immediately following payment and then slowed down steadily until the next payment; members with monthly payment plans used the health club much more consistently and were more likely to renew, perhaps because each month's payment encouraged them to use what they were paying for.[33]

Gourville and Soman concluded that the timing of payment can be used more strategically to manage capacity utilization. For instance, if a golf club wants to reduce the demand during its busiest time, it can bill its fees long before the season begins (e.g., in January rather than in May or June), as the member's pain of payment will have faded by the time the peak summer months come, thereby reducing the need to get his or her "money's worth". A reduction in peak demand during the peak period would then allow the club to increase its overall membership.

Conversely, the timing of payment can also be used to boost consumption. Consider the Boston Red Sox (i.e., the famous American professional baseball team) season ticket holders, who are billed five months before the season starts. To build attendance and strong fan support throughout the season, Red Sox could spread out this large annual payment to four installments that coincide with their games. The

team would garner a high game attendance and fan support, and their fans might prefer the lower and financially more manageable installments.

How Should Payment be Made?

There are many different forms of payment. Cash may appear to be the simplest method, but it raises security problems and is inconvenient when exact change is required to operate machines. Credit and debit cards can be used around the world as their acceptance has become almost universal. Other payment procedures include tokens or vouchers as supplements to, or instead of, cash. Vouchers are sometimes provided by social service agencies to the elderly or individuals in the low-income bracket. Such a policy achieves the same benefits as discounting, but avoids the need to publicize different prices, and to require cashiers to check eligibility.

Service marketers should remember that the simplicity and speed with which payment is made may influence the customer's perception of overall service quality. Coming into broader usage are prepayment systems based on cards that store value on a magnetic strip or in a microchip embedded within the card. Contactless payments systems based on credit and debit cards with radio-frequency identification (RFID) technology are increasingly used. Starbucks launched a smartphone app-based payment system integrated with its "My Starbucks Reward Program", which allows its customers to earn special discounts and freebies. Soon, order-taking will be integrated to cut wait time at the counter. Apple users can pay by holding their device to the point of sale system and authenticating the transaction by holding their fingerprint to the phone's Touch ID sensor. Suppliers of these systems claim transactions can be up to twice as fast as conventional cash, credit, or debit card purchases.

Interestingly, a recent study found that the payment mechanism has an effect on the total spending of customers, especially for discretionary consumption items such as spending in cafes.[34] The less tangible or immediate the payment mechanism, the more consumers tend to spend. Cash is the most tangible (i.e., consumers will be more careful and spend less), followed by credit cards, prepayment cards, and finally more sophisticated and even less tangible and immediate mechanisms such as payment via one's cell phone service bill.

How Should Prices be Communicated to the Target Markets?

The final task, once each of the other issues has been addressed, is to decide how the organization's pricing policies can best be communicated to its target market(s). Consumers need to know the price they are expected to pay before purchase. They may also need to know how, where, and when that price is payable. This information must be presented in intelligible and unambiguous ways so that customers will not be misled and question the ethical standards of the firm. Managers must decide whether or not to include information on pricing in advertising for the service. It may be suitable to relate the price to the costs of competing products. Salespeople and customer service representatives should be able to give immediate, accurate responses to customer queries about pricing, payment, and credit. Good signage at retail points of sale will save staff members from having to answer basic questions on prices.

How to communicate prices is important and shapes buying behavior. For example, in a restaurant context, menu psychology looks at how diners respond to pricing information on a menu (*Service Insights 6.5*).

Finally, when the price is presented in the form of an itemized bill, marketers should make sure that it is both accurate and easy to understand. Hospital bills, which may run up to several pages and contain dozens or even hundreds of items, have been much criticized for inaccuracy. Hotel bills, despite containing fewer entries, are also notoriously inaccurate. One study estimated that business travelers in the US may be overpaying for their hotel rooms by half-a-billion dollars a year, with 11.6% of all bills incorrect, resulting in an average overpayment of $11.36.[35]

SERVICE INSIGHTS 5

The Psychology of Menu Pricing in Restaurants

Have you ever wondered why you choose certain dishes on the menu and not others? It could be due to the way the dish is displayed. Menu psychology is a growing field of research. Menu engineers and consultants research on the most effective ways to design a menu, including layout and pricing information, in the

hope that the diner will spend more money. What can we do to get people to spend more money, and to order items with high profit margins?

When showing prices on the menu, avoid using a dollar sign. Prices that come with dollar signs will result in customers spending less, compared to when there are no dollar signs on the menu.

Prices that end with "9", e.g., $9.99, make diners feel that they are getting value for money. This is good for a low price and for good value positioning, but should not be used by high-end restaurants.

The best position to place prices should be at the end of the description of an item and it should not be highlighted in any way.

In terms of the order of items, place the most expensive item at the top of the menu so the price of the other items looks lower in comparison.

For layout, the most profitable item on the menu should be placed at the top right hand corner of the page because people tend to look there first.

A longer description of a dish tends to encourage people to order it. Therefore, menus can be designed to have more detailed and more appetizing descriptions of dishes that are more profitable, and have less description for the less profitable dishes.

What kind of names should be given to dishes? Using names of mothers, grandmothers and other relatives (e.g., Aunty May's beef stew) has been shown to encourage people to order that item.

The next time you have selected a dish from the menu, you may want to stop and see how it was displayed, and whether that potentially swayed you towards a dish the restaurant wanted you to order.

Sources: Sarah Kershaw, "In Search of a Formula to Entice Mind, Stomach and Wallet", *The New York Times*, 23 December 2009.

SUMMARY

1. Effective Pricing is Central to Financial Success

The key objectives for establishing prices can be to:

- gain profits and cover costs,
- build demand and develop a user base, and
- support the firm's positioning strategy.

Once a firm sets its pricing objectives, it needs to decide on its pricing strategy.

2. The Pricing Tripod

The foundations of a pricing strategy are the three legs of *the pricing tripod*:

- The costs the firm needs to recover set the minimum or floor price.
- The customer's perceived value of the offering sets a maximum or ceiling price.
- The price charged for competing services determines where, within the floor-to-ceiling range, the price can be set.

3. The Cost to the Firm

The first leg of the pricing tripod is the cost to the firm.

- Costing services often is often complex. Services frequently have high fixed costs, varying capacity utilization, and large shared infrastructures that make it difficult to establish unit costs.
- If services have a large proportion of variable and/or semi-variable costs, cost-accounting approaches work well (e.g., using contribution and breakeven analysis).
- However, for complex services with shared infrastructure, activity-based costing (ABC) is often more appropriate.

4. The Value to the Customer

The second leg of the pricing tripod is the value to the customer.

- Net value is the sum of all perceived benefits (gross value) minus the sum of all the perceived costs of a service. Customers will only buy

if the net value is positive. The net value can be enhanced by either increasing value or reducing costs.

- Since value is perceived and subjective, it can be enhanced through communication and education to help customers better understand the value they receive.
- In addition to the price customers pay for the service, costs include related monetary costs (e.g., the taxi fare to the service location) and non-monetary costs (e.g., time, physical, psychological, and sensory costs) during the search, purchase and service encounter, and post-purchase stages. Firms can enhance net value by reducing these related monetary and non-monetary costs.

5. Competition

The third leg of the pricing tripod is competition.

- Price competition can be fierce in markets with relatively similar services. Here, firms need to closely observe what competitors charge and then price accordingly.
- Price competition intensifies with
  - Number of competitors
  - Number of substituting offers
  - Distribution density of competitor and substitution offers
  - Amount of surplus capacity in the industry
- Price competition is reduced if one or more of the following applies:
  - Non-price related costs of using competing alternatives are high
  - Personal relationships are important
  - Switching costs are high
  - Service consumption is time and location specific

6. The Importance of Revenue Management

Revenue management increases revenue for the firm through better use of capacity and reservation of capacity for higher paying segments, through:

- Designing products using physical and non-physical rate fences, and prices them for different segments according to their specific reservation prices.

- Setting prices according to predicted demand levels of different customer segments.
- Measuring success by revenue per available capacity for a given space and time unit (RevPAST). For example, airlines seek to maximize revenue per available seat kilometer (RevPASK) and hotels try to maximize their revenue per available room-night (RevPAR).

Revenue management works best in service businesses characterized by

– high fixed costs and perishable inventory,

– several customer segments with different price elasticities, and

– variable and uncertain demand.

7. Physical and Non-Physical Rate Fences

Well-designed rate fences are needed to define "products" for each target segment so that customers with high value for a service offer are unable to take advantage of lower price buckets. *Rate fences* can be physical and non-physical:

- *Physical fences* refer to tangible product differences related to different prices (e.g., seat location in a theater, size of a hotel room, or service level).
- *Non-physical fences* refer to consumption (e.g., a hotel stay must be over a weekend), transaction (e.g., weeks' advance booking with cancellation and change penalties), or buyer characteristics (e.g., student and group discounts). The service experience is identical across fence conditions although different prices are charged.

8. Perceiving Service Pricing as Ethical and Fair

Customers often have difficulties understanding service pricing (e.g., revenue management practices with their many fences and fee schedules). Service firms need to be careful that their pricing does not become so complex and so riddled with hidden fees that customers perceive them as unethical and unfair.

9. Ways to Improve Customers' Fairness Perceptions

- Design price schedules and fences that are clear, logical, and fair.
- Use published prices and frame fences as discounts.

- Communicate consumer benefits of revenue management.
- "Hide" discounts through bundling, product design, and targeting.
- Take care of loyal customers.
- Use service recovery or deal with overbooking.

10. Formulating a Pricing Strategy

To put service pricing into practice, service marketers need to consider six questions to have a well-thought-out pricing strategy.

- How much to charge?
- What should be the specified basis for pricing?
- Who should collect payment, and where should payment be made?
- When should payment be made?
- How should payment be made?
- How should prices be communicated to the target markets?

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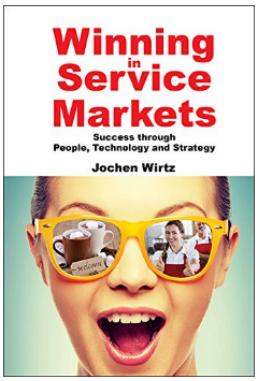

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