

## **PRICE IN THE FUNCTION OF COMPANY COMPETITION WITHIN THE TOURISM ECONOMY**

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**Abstract.** *The price in tourism is not a simple concept. It can be defined in many ways and it can have numerous forms. Deciding on the adequate price is the key to survival of every company within the tourism economy on the global market. When making decisions on the prices, a company should tend to set the price which is acceptable for tourists, but, on the other hand, it should enable the company to generate profit. In order to reach the stated goal, it is necessary, first of all, to determine a long-term level of the price within demand, expense and competition, and then to maximise revenue within this domain and make optimal use of the demand. The most common strategies used are price differentiation, tying prices, nonlinear formation of prices and yield management. In this written paper, the author pays special attention to the application and role of the yield management in creating competition advantage of a company within the tourism economy.*

**Key Words:** *price, price formation, tourism, yield management.*

### 1. INTRODUCTION

Company competition within the tourism economy represents the ability of reaching market success through constant adaptation to changes on the global tourism market. The notion "competition advantage" is mostly connected to the price and quality of goods.<sup>1</sup> Today, the basis for successful business operations of a company within the tourism economy is found in acceptable price, suitable goods quality, understanding and satisfying the needs of tourists and in the application of information technology.

The price is not the only factor of competition advantage of a company on the tourism market, but it also represents an unavoidable and crucial factor. The competition based on the price is becoming more and more present due to different elasticity of tourism demand of certain segments.

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<sup>1</sup> Čerović, S., *Strategijski menadžment turističke privrede Srbije*, Želnid, Beograd, 2002, p. 237

The price is one of the most significant phenomena of every economy.<sup>2</sup> It represents one of the marketing mix instruments which should enable the realization of business goals when combined with other marketing mix instruments. The price is an instrument (tool) and not the goal of marketing activity. In the marketing theory, prices are studied as a significant means of competition and unavoidable instrument of marketing activity.

## 2. PRICE COMPETITION ON TOURISM MARKET

The policy of forming prices chosen for a tourism product is often in direct connection with the future tourism demand. Determining the right price is also crucial for the profitability of a tourism economy company. Reaching decisions on price formation is considered to be the most difficult in relation to decisions dealing with the other marketing mix instruments. That is why, when forming prices of a tourism product, one should take into account the complexity created by the seasonal character of demand and the impossibility to stock a tourism product. Reducing tourism product prices has a greater influence on the consumption than average price reduction in the majority of other sectors. The study performed by the company Deloitte and Touche in 1995 for the Ministry of Tourism of Great Britain showed that the price elasticity in tourism can reach the amount of -2.5.<sup>3</sup> Also, there are significant differences among segments within tourism, such as between tourists who travel for business or personal reasons. The stated segments have different elasticity of demand and price sensitivity is conditioned by different factors.

Tourism product price is formed depending on the seasonal business, type and category of accommodation and additional elements such as atmosphere, location and the like. Hotels in tourism destination form prices so that they are the highest during the peak season and significantly low during the low season. This statement represents a kind of paradox because prices are the highest when demand is the greatest, whereas in low season when the intensity of using the capacities decreases, prices are significantly lower.<sup>4</sup>

The price in tourism economy is an extremely important element which determines consumer preferences and represents the means for competition on the tourism market. The focus of interest is how the increase or decrease of a price influences the intensity of tourism demand. The price increase in tourism service, primarily the basic tourism services of accommodation, catering and travel expenses, negatively reflects on the dynamics and intensity degree of tourism services demand. When defining the price policy, companies in the tourism economy should specifically and cautiously delve into the influence of the degree of demand elasticity for tourism services in relation to price movement, that is to say, delve into the influence of this elasticity on different groups of tourism service consumers and the time period in which these price changes are being done with extreme cautiousness. Also, when defining the price policy, one must not neglect a relevant fact that there is a possibility to substitute tourism services with other companies of the tourism economy which can have a negative influence on their business and competition

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<sup>2</sup> Zdravković D., *Uticaj cena na privredni razvoj*, Savremena administracija, Beograd, 1979, p. 3.

<sup>3</sup> <http://www.gom.cg.yu/files/1083072255.PDF>

<sup>4</sup> Štetić S., Šalov P., *Poslovanje turističkih agencija*, Savezni centar za unapređenje hotelijerstva – ugostiteljstva, Beograd, 2000, p. 106-107

position. What is specific about the tourism demand is its heterogeneity, with the needs of their bearers on one hand and the possibility to meet those needs on the other. This fact is extremely important for conducting and conceptualizing an adequate business policy especially when it comes to consumer i.e. tourist segmentation into smaller homogenous groups with the obligation to respect certain specific points and variables which serve as the basis for their segmentation according to different characteristics.

A system of managing price formation i.e. the yield management is being advocated for the companies which deal with tourism business and its application enables a greater profit generation with relatively stable capacity.<sup>5</sup> This is considered to be the best way to face competition which provides lower prices for that type of service. The purpose of the observed system is for a company to make better use of available capacities and to adapt its service price to a consumer or a group of consumers regardless of their price sensitivity.

### 3. KEY PROBLEMS IN THE YIELD MANAGEMENT APPLICATION

Companies dealing with tourism business face an ever-increasing competition on the tourism market. An adequate answer in the present conditions is seen in the efficient and effective application of the yield management which enables sustainability and development of a company on the overall turbulent global market.

Some companies apply a simple method expenses plus, whereas others develop a more complex method of price formation. The existence of difference in the elasticity of demanding certain segments and complementary goods as well as the impossibility to stock influence air-companies, hotels and other companies to apply and develop the yield management.

The yield management is an extremely important method (technique) applied by companies for the purpose of maximising profit in the conditions of increased competition on the tourism market. It enables efficient income and capacity management via price differentiation based on elasticity of selected segment demand by consumers.<sup>6</sup> The application of the yield management in air-company Delta enables the generation of additional annual income of 300 million dollars. Although air-companies are the oldest and most sophisticated users of the yield management, other companies dealing with tourism business also use the stated method. For example, owing to the application of the yield management, Marriot chain hotel generates additional annual income of 100 million dollars.<sup>7</sup> Additional income is generated by a relatively small increase of capacities and expenses.

The yield management is a procedure by means of which a real product is offered to a real buyer at a real price thus realizing maximal product.<sup>8</sup> Adequate application of the yield management is useful both for companies and tourists.<sup>9</sup> It is applicable in all economy businesses which have the following characteristics:

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<sup>5</sup> Milisavljević, M., *Strategijski marketing*, Ekonomski fakultet, Beograd, 2006, p. 174

<sup>6</sup> Kotler, Ph., Bowen, J., Makens, J., *Marketing for Hospitality and Tourism*, Prentice Hall, 2006, p. 478.

<sup>7</sup> [http://mba.tuck.dartmouth.edu/pages/faculty/robert.shumsky/Yield\\_management\\_note.PDF](http://mba.tuck.dartmouth.edu/pages/faculty/robert.shumsky/Yield_management_note.PDF)

<sup>8</sup> McMahan-Beattie Y., *Realism of Yield Management*, *Progress in Tourism and Hospitality Research*, No. 4, 1998, p. 187

<sup>9</sup> Kotler, Ph., Bowen, J., Makens, J., *Marketing for Hospitality and Tourism*, Prentice Hall, 2006, p. 479

- Products/services of a short-term character which cannot be stocked and/or seasonal characteristic of demand, due to which timing when the sale is being performed represents a crucially important factor for the business of one company;
- High fixed expenses and relatively low marginal expenses;
- Fixed capacities in a long or short term period;
- Sale, that is to say, product and service reservation is done beforehand.<sup>10</sup>

Having these characteristics in mind, the question is how the yield management functions. Assuming a hotel has set prices for two classes: a full price and a discount price. The hotel will have 210 rooms which will be available on 29<sup>th</sup> March (suppose it is Monday). It is the end of February and the hotel is making reservations for the night of 29<sup>th</sup> March. The hotel can provide room accommodation to holiday tourists at a discount price, but they are also aware that many business people will also ask for rooms on 29<sup>th</sup> March and that they will be ready to pay a full price. In order to simplify the problem, let us assume that the demand is first made by people who travel for personal reasons and then by business people. However, the hotel manager must make a decision as to how many rooms he is going to reserve at a discount price, in other words, how many rooms he is going to keep so as to sell them at a full price. If they keep a greater number of rooms, there might be vacant rooms on 29<sup>th</sup> March. If they keep only a few, the hotel might be renouncing an additional income which would have been generated by providing accommodation services to tourists who travel for business reasons.

On the basis of what has been stated, a conclusion can be drawn that tourism demand evaluation is the only way for a company to reach an optimal decision and react adequately in a given situation by means of which a successful yield management is realized.

The problem of the yield management application can be best described as a non-linear, stochastic, mathematical programme which requires data on tourism demand, cancellation, group reservations, capacity use coefficient (percentage of used seats or portability) and the like. Resolving the observed problem would require approximately 250 million variables.<sup>11</sup> In order to save time and enable the possibility, resolving the problem can be based on the application of three variables: overbooking, allocation of discount prices and managing traffic.

One of the variables that an air-company should anticipate when applying the yield management is the use of overbooking when there is a chance for a guest not to appear. For example, a passenger may reserve a plane ticket and may not appear at the time of a plane take-off. If that is the case, the plane will fly with an unoccupied seat which will result in the company's income loss. As an answer to the problem of a passenger who does not use the reserved plane seat, air-companies usually overbook their flights: having in mind the rate of passengers who did not use a reserved plane seat in the previous period, the company books more seats than there are. If unexpectedly passengers appear in a larger number, the company will be forced to direct some of its passengers to another flight. Hotels and rent-a-car agencies also make overbooking. The optimal level of overbooking takes into account: a) loss income as a consequence of unoccupied seats and b) fine (fi-

<sup>10</sup> Jovičić, D., "Yield management" u turizmu i hotelijerstvu, HOTELlink, Viša ugostiteljska škola, Beograd, 2/2003, p. 202

<sup>11</sup> <http://www.ieor.berkeley.edu/~ieor166/Yield%20Management%20in%20airlines.pdf>.

nancial reimbursement for a passenger redirection to another flight) and the loss of goodwill when the company is faced with a demand which is greater than the available capacity. It is a common case in Europe to overbook planes and not to be able to use the transport services of a booked flight.<sup>12</sup>

The ratio between sold tickets at a discount price and full price is not fixed during the period of reservation. The observed ratio depends on the expected demand, realized sale in the previous period and special events.

After the deregulation of air-traffic, the majority of air-companies accepted the concept of hub-and-spoke in order to provide services to passengers on several markets. The application of this concept influenced the increase of the whole system complexity dramatically; the flights which provided services on one market now provide them on several. For example, let us consider the flight from Florida to California. Suppose there are four flights i.e. four cities in Florida which must be connected in Las Vegas where passengers continue their flight to one of the four cities in California. Thus, there are 16 lines for only 8 flights. Managing revenue is a real challenge in this case. What kind of a decision should a manager reach if there are only discount price seats available from Tallahassee to Las Vegas and only full price seats from Las Vegas to Sacramento?

In each of these cases, overall income generated from consumers may be included in the calculation of the yield management and not only the income generated by the flight on a part of a line. Additional problems arise when there are partners who function together on the same line. In that case each partner must have an initiative to take into account the income of the other partner.

A similar problem arises in group booking. How should a hotel manager consider the request for group booking of 210 persons at a discount price? It is clear that this differs from 210 bookings made by each individual since cancellation would bring a great loss for the hotel. Companies often limit group reservations during peak season; however, so far, there has not been a general rule when it comes to group reservations.

#### 4. THE DEVELOPMENT AND APPLICATION OF THE YIELD MANAGEMENT TO DATE

The origin of the yield management is connected to the deregulation of the air-traffic on the USA market by the end of the 70s of the previous century. People Express forced the majority of the USA companies, such as American and the United, to offer the tickets for certain seats at lower prices while keeping the same high price for the remaining seats. Those were the first days of the yield management application.

Attracted by the lower ticket prices, the passengers of the air-company People Express started using the services of the other air-companies which resulted in its bankruptcy. The bankruptcy of the observed company was partially a consequence of the lack of the yield management application.

In the beginning, the yield management was successfully applied in air-industry by grand international transport companies and, during the last decades, it has been success-

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<sup>12</sup> Štetić, S., Šalov, P. Poslovanje turističkih agencija, Savezni centar za unapređenje hotelijerstva, Beograd, 2000, p. 199

fully applied by the low-price air-companies which successfully operate on the USA, west European and Australian market.

Through the use of specialized software, air-companies control the number of the seats that are going to be reserved and they react by applying price differentiation. Hotels use the yield management in great extent in the same way to calculate prices, rooms and limitations in sale so as to maximise wealth return in the best way possible. In the areas such as ski-lifts, golf courses, theatres, museums, attractions and amusement parks, however, potential use of the YM is present but is not researched enough.

The Yield management is greatly used by hotel chains, tour operators and round trip organizers whereas small and medium sized companies in the tourism industry rely on the intuition by applying the yield management in an unofficial form.

Forming prices is the key problem for many tourism economy companies and also an important factor of the yield management not only for big but also for small and medium-sized companies. Awareness of the yield management as an official discipline is low among small and medium-sized companies, although many of them apply the concept of the yield management in an unofficial form relying on their own intuition.<sup>13</sup>

The expansion of tourism movement during the last decades has been followed by a significant growth of volume and type of tourism services as well as by a large competition on the ever-fastidious tourism market. In the observed conditions it is necessary for the small and medium-sized companies of the tourism economy to realize tasks and activities which would contribute to the wider application of the yield management since its application and development represent the only way of its existence on the ever-competitive global tourism market.

#### CONCLUSION

Specifying an adequate price is the key for each tourism economy company existence on the global market. Forming prices is an important factor of applying and developing the yield management by not only big, but also small and medium-sized companies.

According to world-wide scope and all the relevant indicators, tourism occupied one of the leading positions in the world economy by the end of the 20<sup>th</sup> and beginning of the 21<sup>st</sup> century. The competition on the contemporary tourism market is becoming more and more merciless, and the success of a business operation mostly depends on the application and development of the yield management.

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<sup>13</sup> Jovičić, D., "Yield management" u turizmu i hotelijerstvu, HOTELink, Viša ugostiteljska škola, Beograd, 2/2003, p. 208

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## **CENA U FUNKCIJI KONKURENTNOSTI PREDUZEĆA TURISTIČKE PRIVREDE**

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*Cena u turizmu nije jednostavan koncept. Može biti definisana na mnogo načina i može imati mnoštvo formi. Određivanje adekvatne cene je ključ za opstanak svakog preduzeća turističke privrede na globalnom tržištu. Pri donošenju odluka o cenama preduzeće treba da nastoji da cena bude prihvatljiva za turiste, a sa druge strane da omogući da preduzeće ostvari dobit. Da bi se navedeni cilj ostvario neophodno je najpre utvrditi dugoročni nivo cene u okvirima tražnje, troškova i konkurencije, a da se onda u okviru ovog domena maksimizira dobit, da se optimalno iskoristi tražnja. Najčešće se koriste strategije diferenciranja cena, vezivanja cena, nelinearnog formiranja cena i yield menadžment. Autor u radu posebnu pažnju posvećuje primeni i ulozi yield menadžmenta u stvaranju konkurentne prednosti preduzeća turističke privrede.*

**Ključne reči:** *cena, formiranje cena, turizam, yield menadžment.*