

## SERVICE PRICE STRATEGY

*UDC 65.03*

**Jelena Petrović**

Faculty of Science and Mathematics, Department of Geography and Tourism,  
University of Niš, 18000 Niš, Serbia  
jelena\_asistent@yahoo.com

**Abstract.** *Price differentiation is a practice of charging different prices for identical goods to different consumers or groups of consumers where price variations are not justified by variations in expenses. Their implementation enables a sales person to charge buyers with the prices that arise from their readiness to pay for the goods. In that way, not only can sales persons maximize their profit but buyers can also have benefit because more goods are offered to a greater number of people (goods production otherwise would not be profitable and people would not be able to afford them then). The author pays special attention to the analysis of the way air companies can apply price i.e. tariff differentiation for the purpose of surviving and developing in the circumstances where low-cost companies originate and develop.*

**Key Words:** *Price differentiation, tariff, low-cost air companies.*

### 1. INTRODUCTORY DISCUSSIONS

Product, distribution and promotion represent non-price instruments of marketing mix, which enable a company to form the value. The role of price in combination with the stated instruments is to transform the overall realised value into revenue. When making decisions about prices, the company tends to make prices acceptable to consumers on one hand, and to realise profit on the other.

Every product or service has its price. The concepts and approaches of price formation, which were developed for the products, are also used for services. The differences in price formation occur as a consequence of specific service characteristics. The influence of these characteristics on price formation depends on the type of service and market situation.

Does the formation and development of low-cost companies represent a permanent danger for traditional companies? Many managers believe that the existence of low-cost companies causes bankruptcy of traditional companies if they do not apply one of the

strategies such as: product differentiation, price differentiation, dual strategy application or transformation of high-cost models into low-cost ones.

The formation and development of low-cost air companies is a consequence of air-traffic deregulation, globalisation and information technology development and application. The growth of their business scope has been very fast and it is still significantly bigger than the business scope growth of traditional air companies. Price differentiation is a strategy that will enable a traditional air company to survive and further develop in the circumstances of low-cost air company competition.

## 2. PRICE STRATEGY

Strategic price formation becomes ever more important in marketing mix management. Until the seventies of the twentieth century, the majority of companies left the price formation to the financial department based on expenses and preferred profit. However, when market success started being measured by financial criteria, marketing managers started paying a more significant attention to price formation. The role of price in combination with marketing mix instruments is to keep a part of created value as a company profit.<sup>1</sup>

A company has to form a price when introducing a new product, when introducing an existing product into a new channel of distribution or marketing segment. Price formation represents a procedure which consists of six steps: 1) price goal choice; 2) demand establishment; 3) expenses evaluation; 4) analysis of competition expenses, prices and offers; 5) choice of price formation methods; 6) choice of the final price.<sup>2</sup>

The goals of price formation stem from and are in accordance with the goals on the level of company and marketing. A company often has more goals for price formation and tends to maintain balance among them. It is common, for example, for the company to have both goals – profit and sales scope; realised profit as a goal helps a company maintain its financial health, whereas sales scope as a goal helps it keep and increase market participation. If goals of a company are clearer, then price formation is simpler.

Demand curve shows the reactions of individuals or marketing segments when changing prices i.e. their price sensitivity. Companies need to be familiar with price sensitivity of existing and potential buyers. Moving towards price sensitive buyers can cause doing business with loss.

Whereas demand represents an upper limit when forming a product or service price, expenses represent the lower one. Although a company tends to cover total expenses with the price and to realise profit for risk and effort, it often happens that the profit is not the end result. Starting from the lower and upper limit of price formation, a company has to take competition offer characteristics and their price into consideration when forming a price. Competition prices and substitute prices determine approximate price.<sup>3</sup>

---

<sup>1</sup> Milosavljević M., *Strategijski marketing*, Ekonomski fakultet, Beograd, 2006., p. 167.

<sup>2</sup> Kotler Ph., Keller K., *Marketing management*, prevod sa engleskog jezika (Bogetić Z., Gligorijević M.), Ekonomski fakultet, Beograd, 2006., p. 437.

<sup>3</sup> Kotler Ph., Keller K., *cit. delo*, p. 444.

While price formation goals represent overall directions for action, price formation methods represent explicit steps or procedures that enable a company to reach a decision regarding a product or service price. Literature on price formation lists twelve price formation methods that can be divided into three big groups (price formation methods based on expenses, price formation methods based on demand and price formation methods based on competition).

Companies do not usually determine one price but a structure of prices which shows variations in demand and expenses, demands of certain marketing segments, time and purchase quantity and the like. They most often use the following strategies of adjusting prices: geographic price formation, discounts and incentives, promotional prices and differentiated price formation.

### 3. THE INFLUENCE OF SERVICE CHARACTERISTICS ON PRICE STRATEGY

The difference between successful and unsuccessful companies is in the way they approach the process of price formation. A company tends to realise as big a profit as it is possible when reaching decisions about prices and also to form the price acceptable for a consumer. The stated goals of a company are mutually in conflict. Determining a real price is a crucial issue for company's profitability.<sup>4</sup>

Production companies produce tangible products that can be stored and transported to a buyer, whereas non-production companies provide services that are not tangible. Many concepts and approaches to price formation developed for products are also applied on services. However, service characteristics have influence on differences in price formation.

Price formation is a process that depends on expenses, competition, demand and state regulative. However, a more significant influence is made on the service market by specific service characteristics, rather than the product ones. The influence of these specific characteristics is changed by the type of service and market situation.

Companies do not form only one price, but a range of prices for the same service, which are adapted to different market situations and segments. The most common type of service price formation, which starts from demand, is differential price formation. It is defined as a sale of the same service at different prices to different buyers or groups of buyers at which time, differences between service prices do not correspond directly to their differences in expenses.<sup>5</sup>

For a successful application of price differentiation, the following conditions must be met:

1. Consumer heterogeneity: Consumers must have the same readiness to pay for goods or different readiness to pay for different quantity of goods. If everybody has the same readiness to pay, than the advantage of charging different prices cannot be made use of. Groups of consumers must react differently to prices i.e. they must value goods differently.

---

<sup>4</sup> Petrović J., Diskriminacija cenama kao faktor konkurentnosti, Regionalni razvoj i demografski tokovi balkanskih zemalja, Ekonomski fakultet, Niš, 2007., p. 400.

<sup>5</sup> Kotler, Ph., Bowen, J., Makens, J., cit. delo, p. 473.

2. Absence of arbitrage: Sales person must be capable of stopping repeated sale of goods, that is to say, if one person buys a good at a lower price, they cannot sell it again at a higher price. At first sight, the limitation seems to be strong and the existence of "grey" markets is a witness of that. Anyway, for many goods, such as travel tickets, transaction expenses of repeated sale can be too high.
3. Market power: Every attempt to sell the same goods at different prices must be such that at least one of the prices is not equal to marginal expenses. On competitive market, all the prices must be equal to marginal expenses so that units of the same goods must be sold at the same price.<sup>6</sup>

In order for differential price formation to function successfully, it is necessary to, alongside with the stated conditions, realise the following: Firstly, segments must be strong enough for the price discrimination application to be useful; secondly, consumers should not be confused by the application of different prices; thirdly, price discrimination application must not trigger bitterness and back-turning of consumers.<sup>7</sup>

Mitra and Capella divided all the factors that influence differential price formation into two groups in their work:

- core service factors – service critical point, demand fluctuation and service characteristics;
- side ambient factors – nature of market on which services are provided and degree of competition.<sup>8</sup>

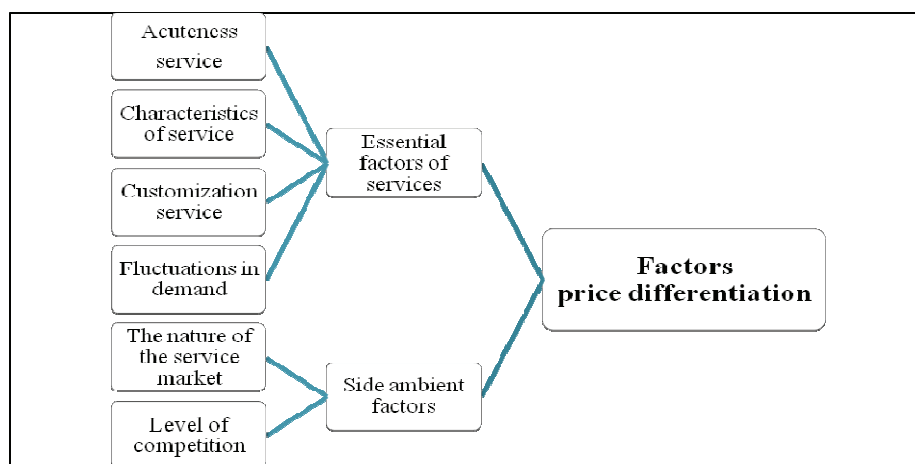


Fig. 1 Factors price differentiation

Source: Ljubojević Č., Marketing usluga, STYLOS, Novi Sad, 2002., p. 222.

<sup>6</sup> Petrović J., cit. delo, p. 401.

<sup>7</sup> Kotler, Ph., Bowen, J., Makens, J., cit. delo, p. 475.

<sup>8</sup> Mitra K., Capella L., Differential pricing for services: a re-examination, The Journal of Service Marketing, Vol. 11 No. 5, p. 329-343.

Service critical point is its characteristic related to the importance of service to consumers and it determines the degree of price differentiation application. Another factor that influences the level of price differentiation application is the degree on which services are customised or standardised.

Service characteristics that have a dominant influence on price formation are:

1. non-tangible services,
2. service heterogeneity,
3. inseparability of services from an employee at a company providing a service
4. impossibility to store services.

As opposed to products, service cannot be seen, tasted, heard or smelled before the purchase. A passenger at an airport possesses only a plane ticket and a promise that they will safely reach a desired tourist destination. Robert Lewis considered that somebody who purchased a service went "empty-handed" not "empty-headed"<sup>9</sup>, because they possessed an experience which they could share with the others.

Non-tangible services have important implications on their price. This service characteristic enables changes in its quality and quantity which depend on the demand of a certain consumer or group of consumers. In that case, price is a result of negotiation between a buyer and a service provider.

Service heterogeneity provides a greater freedom to sales persons to charge consumers at different prices for the same service in accordance with how much they are ready to pay. In this case, service price is an indicator of its quality.

Inseparability of services from a service provider means that the contact between them and consumers is a part of service.<sup>10</sup> It makes such influences on service companies that they timely and spatially focus on market segments whose needs they can meet. The height of service price will depend on competition as well as on the place and time of service provision.

Fluctuations in demand, which cannot be amortised due to impossibility to store services, significantly influence the price policy of service sector. By reducing prices, a company can influence consumers with stimulations to use services during demand reduction. In view of a higher degree of capacity use, companies in air transport and hotel businesses use a differential price formation. It is considered that this would be a better way for companies to face competitions that make lower prices for the same type of service.<sup>11</sup>

Hotel companies in city centres, whose capacity use is levelled during the whole year, mostly form their prices independently from season. When it comes to a so-called season catering whose business is connected to winter or summer season, prices are formed depending on the period of season. Namely, prices are the highest in these seasons during the high season, exactly at the time when hotel-catering capacities are fully booked. Season in these destinations usually lasts six to eight months. By demand reduction, it comes to the decrease of degree of booking capacities and the reduction of service price.

It is necessary to perform segmentation of consumers according to their sensitivity to prices so as to better define price borders according to the readiness of consumers to

---

<sup>9</sup> Videti: Lewis Robert, Chambers Richard, *Marketing Leadership in Hospitality*, New York, Van Nostrand Reinhold, 1989.

<sup>10</sup> Kotler, Ph., Bowen, J., Makens, J., *Marketing for Hospitality and Tourism*, Prentice Hall, 2006., p. 43.

<sup>11</sup> Berman B., *Applying Yield Management Pricing to Your Service Business*, *Business Horizons*, No 48, p. 169.

pay. The analysis of consumer reaction to prices should take the following into consideration:

1. size of product-market in the sense of purchase potential,
2. used marketing segments and target markets,
3. sensitivity of demand at each segment to price change,
4. importance of non-price factors as attributes and performance,
5. evaluation of sale and different price levels.<sup>12</sup>

#### 4. CONTEMPORARY STRATEGIES OF TRADITIONAL AIR COMPANIES

It is easier to fight the enemy you know than the one you do not know. Competition attacks each industry as a forceful wind, so companies must invest a lot of money, personnel and time to face major competition.

However, being obsessed by traditional companies can make companies blind to the threat by low-cost competition. In the whole world, especially in Europe and North America, companies that apply different business models and technologies in relation to market leaders develop fast. Such companies offer products and services at prices that are drastically lower than the prices formed based on business expenses. They originated as a consequence of deregulation, globalisation and information technology development. Their origination and development changed the nature of competition in the twentieth century.

Do low-cost companies represent a permanent danger to traditional companies? Many managers are believed to be convinced that companies that sell their products at drastically lower prices must go bankrupt. They state the experience of companies in the USA, which succeeded to win low-cost companies such as People Express after the deregulation in 80s in 20<sup>th</sup> century. However, they forgot that low-cost companies later reintegrated. By reducing tariffs and additional services, air companies such as Southwest Airlines and JetBlue took part in American domestic air market.

Research showed that ignoring low-cost competition is a mistake because it forces traditional companies to desert the whole market segment at certain time. When market leaders respond, there comes "war of prices" when they hurt themselves more than competition. Companies that survive after the "war of prices" usually change direction in one of the two ways. Some companies apply defensive strategy and try to differentiate their products. Others undertake the offensive one by taking low-cost businesses as their own. This so-called dual strategy is successful if companies create synergy between the existing businesses and new dangerous venture. If they cannot realise that, companies rather try to transform themselves into suppliers that sell solutions instead of products, or into low-cost companies.

It is interesting that low-cost companies have advantage in relation to market leaders because of consumer behaviour. A company that coaxes a consumer into buying its products or services at basic price will lose a consumer only if a competition offers the same product or service at a lower price. Low-cost companies do not have to take care of traditional

---

<sup>12</sup> Cravens W.D., Piercy N.S., Strategic Marketing, McGraw-Hill, Boston, 2006., p. 322.

competition that always charges premiums. For example, until 2000, Southwest air company expenses were the lowest on air market in the USA. However, JetBlue, which was founded in 2000, does business with expenses that are 25% lower than expenses of Southwest. JetBlue represents a greater challenge to Southwest than traditional air companies.

Many low-cost companies influenced the behaviour of consumers. Since EasyCruise stopped offering lavish meals and expensive shows, it has provided services at lower prices. If passengers are common people and are 20 or 30 years old, many of them cannot afford the whole packet holiday offered by other cruising companies. Although Royal Caribbean and Cunard believe that EasyCruise passengers will use the services of traditional cruise lines when they become older and richer, many of them will never use cruise services at higher prices.

Although traditional companies copy critical elements of a low-cost company business model, they are not capable of adjusting their prices because individual model elements are not as important as interaction between them. Booking air tickets by Internet does not affect reduction of traditional company expenses in the same way as low-cost companies. Firstly, 98% of low-cost passengers book their tickets on the Internet. Low-cost companies and booking on the Internet are more attractive to passengers who travel on holiday. For the stated reasons, traditional companies have a limited influence on business expenses. Secondly, when there is one class, tickets are not return and passengers cannot book a seat, expenses of development and maintenance of booking system based on the Internet are not high. However, traditional companies have cabins for different classes and they make a reservation of seats, which significantly influences the height of their expenses. Thirdly, traditional air companies use services of tourist agencies and global booking systems such as Sabre. For the stated reasons, traditional companies cannot reduce their expenses and decrease prices down to the level of low-cost air companies.

In order to survive in contemporary conditions, traditional air companies must apply some of the strategies used by traditional companies in air traffic as well as in other sectors. Later on, the authors will pay special attention to analysing advantages and disadvantages of these strategies.

When companies realise that they cannot survive in conditions of low-cost company competition, they try to differentiate their products. In that case, companies should accept one of the following approaches:

- create an excellent product such as Apple and Bang&Olufsen,
- incessantly innovate tradition (Gillette and 3M),
- offer unique product mix such as Sharper Image and Whole Foods;
- form brand of union such as Harley Davidson and Red Bull;
- sell experience as was done by Four Seasons, Nordstrom and Starbucks.

In order for the stated approaches to be efficient, it is necessary to fulfil the following conditions:

- companies should convince consumers to pay a higher price due to additional value of a differentiated product,
- it is necessary to determine a limit of expenses and benefit before the implementation approach.

Although the air company British Airways initially ignored the origination and development of low-cost air companies, it later did a differentiation of its products by applying

different criteria with the aim to survive and further develop. BA is becoming more and more concentrated on longer flights which low-companies are not interested in. It keeps a minimal market share when it comes to short-distance flights influencing passengers to use electronic tickets. At each flight it offers a certain number of tickets for economic class at the price that is close to the price charged by low-cost companies.<sup>13</sup>

In order to survive in conditions of low-cost company competition and increase of segments of low-tariff consumers, traditional companies often get involved in low-cost adventure. Starting from a yearlong experience and vast resources, companies believe they can easily copy operations of price reduction because low-cost company business models are similar. Big air companies founded their affiliates that did businesses as low-cost companies in the 20s of the 20<sup>th</sup> century. However, a greater number of these affiliates has been closed or sold. This showed how strong companies should be in order to use a dual strategy. The success of this strategy application depends on the following conditions: the existence of unique brand, independence of affiliates, resource allocation.

Comparative advantages of low-cost operations are not fully expressed with traditional companies due to the above stated reasons so that it is necessary for them to form independent affiliates. Newly founded independent affiliates can create operations with systems, personnel and values that are significantly different from the central company. However, practice showed that independence is necessary but not sufficient for successful application of dual strategy. For example, syndicate did not allow affiliates to disburse low salaries to their employees as is done by low-cost air companies Southwest and JetBlue.

Xiameter, created by Dow Corning, is an example of successful dual strategy application. Xiameter realised that it had to offer products at prices 20% lower than those of Dow Corning with the aim to provide for other low-cost participants. It used every tactics to realise that. Instead of fast deliveries, Xiameter promised delivery within 20 days starting from the day of contract and in this way it was in the position to predict the production of its products when Dow Corning factories were without work. It did not offer any technical services so it could not invest in services. In order to maintain its chain of offer as efficient, Xiameter sold only trucks, reservoirs and palettes for mounting products. Buyers either placed orders on web page or paid \$250 additionally for placing orders by e-mails or phone. Once determined, the date of delivery cannot be altered except if a buyer pays 5% tax, for delivery before the set date a premium of 10% must be paid as well as a tax of 5% for cancelation. Such rules make production planning simpler. Xiameter offered a credit for deferred payment of 30 days, which helped the reduction of needs for capital and its product prices were expressed in six currencies for the purpose of limiting currency risk. In 2001, Dow Corning announced sale of \$2.4 billion; in 2005, a combined sale of Dow Corning and Xiameter was \$3.9 billion. This increase helped a founding company to turn the loss of \$28 million in 2001 into profit of \$500 million in 2005. The strategy also helped consumers to better understand additional benefits offered by Dow Corning, thus enabling it to charge higher prices.

If there is no synergy between traditional and low-cost business, companies should take into consideration two other options: they can move from product sale to solution sale or they can make a drastic change and become low-cost companies.

---

<sup>13</sup> Holloway Ch., *The Business of Tourism*, Prentice Hall, London, 2006., p. 341-342.



Moving to solutions. When low-cost participants turn basic product or service into goods, the existing company can be successful at selling solutions. By offering products and services as an integrated package, companies can expand the marketing segment that is ready to pay more for additional benefits. Solutions provide several advantages: include a great number of services, so it is hard to value the quality of solutions provided by different companies. During the time, sales persons develop a deeper understanding for business processes of consumers, so consumers find it hard even to ask for expenses for supplier change. Apart from that, since low-cost participants have a limited range of products and possibilities to provide services, they cannot provide solutions.

Despite the popularity of this strategy, reorientation is hard. Many companies such as Boots, Compaq, Xerox and Unisys, did not succeed because they assumed that solution sale demands modification of their existing business model and not its transformation. Many companies see solution sale as a way to sell more products at higher prices. They find consumers with problems that fit their solutions. That never functions. A good supplier starts with a consumer problem analysis before creating a solution.

In theory, a company can consider transformation from high-cost to low-cost business model. In practice, such a transformation is different because it demands different abilities from those possessed by an existing company.

Ryanair represents a successfully transformed low-cost air company. Ryanair, the first European low-cost air company, which has had 229 regular flights in 20 countries since May 2005, is one of the air transporters which has the highest profit and growth rate in the world. Ryanair company started business as a company providing a complete service. Since it suffered serious financial losses, company finally made a recovery plan in 1991 according to the model first applied by air transporter Southwest from Texas and it was supported by Michael O'Leary and family Ryeane. Its goal was to transform Ryanair into a cheap air company providing a basic service.

A component part of low price strategy was the increase of revenue through additional activities which are more and more used for subvention of ticket prices in order to improve Ryanair company margin and compensate for the loss of revenue from the ticket sale. Among those activities there is sale in airplanes, charter flights, travel reservations and insurance, renting cars, television advertisements in airplanes and advertisements in airplanes when a company pays for its logo to be painted on the plane. Advertising on a popular Ryanair company website also generates revenue.

Company Ryanair claims that it is necessary to dedicate more attention to things that are important for clients such as frequent flights, reservations, handling luggage and consistent and timely services. Simultaneously, all the surplus supplements, which impede the provision of reliable and cheap air transfer service, are eliminated. Eliminated supplements include assigning seats in advance, meals in planes, use of higher classes, special regime for regular passengers, complementary drinks and other. Since there is no need for mounting and dismounting of goods, the plane detention is limited to 30 to 25 minutes. Company considers that business passengers which are attracted to frequency and punctuality of their flights comprise 40% of the overall number of their passengers despite the fact that airports used by them are usually on less desired locations and there is no passenger pampering.

Apart from eliminating surplus supplements, organising business operations also helps this company to reduce its expenses to a minimum and the following factors have merit for that:

1. Levelled fleets (Boeing 737, as with the air company Southwest): that results in lower expenses of maintaining planes and personnel training. In 2005, the company reached an agreement on procuring new Boeing planes based on which its expenses per seat for all flights after January 2005 reached the lowest possible level. This agreement does not only represent the basis for growth; younger fleet also enables further decrease of expenses owing to petrol use and lower maintenance expenses.
2. Making a contract on the use of services such as maintenance of planes, ticket sale, managing luggage and the like, except on Dublin airport; this is the most economical and flexible approach and it also entails less worries regarding the relations with employees.
3. Airport expenses and policy: company Ryanair uses secondary airports on which there is less crowd and delay and which are motivated to offer a better price which results in flights being punctual and detention shorter.
4. Personnel expenses and productivity: salary payment is based on productivity and personnel is organised in syndicates.
5. Marketing expenses: Ryanair is the first air company that reduced and finally abolished provisions of travel agencies. In January 2000, company Ryanair launched the site [www.ryanair.com](http://www.ryanair.com). This contributed to saving on the personnel expenses, travel agencies provisions and computer reservation expenses whereas it significantly contributed to the company growth. In 2005, 97% of reservations were done over the Internet. Company Ryanair complements to its advertising by free publicity which emphasises its champion status among cheap air companies, attacking various factors which threaten to increase its expenses. Those are control bodies of European Union, Managing boards of airports, politicians and syndicates. It is considered that marketing expenses of companies of 60 cents per passenger are the lowest in sector of European air companies.

##### 5. DIFFERENTIATED TARIFF FORMATION IN AIR TRANSPORT

Differentiated price formation has an application in many industries. Air companies successfully apply differentiated price i.e. tariff formation. It entails charging different tariffs to different passengers on the same flight by the same air company. Researches show that the highest tariff for the same flight can be five times higher than the lowest.

In literature and economic practice it is possible to find more approaches in classifying basis according to which differentiation can be made. The most important one for practical purposes is a classification according to the technique which is then being used.<sup>14</sup> Mašlap states three groups of basis: personal, group and according to the product.

Personal price differentiation is realised when different price is charged to every consumer for identical product and each unit is offered to be sold. It follows from this fact that value is subjective. Producer has the possibility to charge a consumer for the exact amount they are ready to pay for the product. Sale is done according to different prices for every buyer. In order to implement personal price differentiation, sales person must

---

<sup>14</sup> Milisavljević, M., Marketing, Savremena administracija, Beograd, 2001. p. 319.

possess information about a consumer. It is based on sales person being perfectly informed about a consumer.

A greater practical importance is held by a group price differentiation in relation to personal. It is realised when different price is charged to different marketing segments that are homogenous within themselves and mutually different. Bigger buyers have a more favourable treatment when negotiating a price.<sup>15</sup>

With product discrimination, producer differentiates a product and enables consumers to classify themselves according to their own free will by buying different product models at different prices.<sup>16</sup> When forming a product, a company pays attention to have certain product models that would satisfy needs of certain marketing segments. The observed approach is especially developed with services, primarily in air transport.

Starting from Mašlap basis for price differentiation and air transport characteristics, the following types of price differentiations of air companies can be listed:

1. According to product characteristics i.e. services, there are "unlimited tariffs" (flexible tickets) and "limited tariffs" (limited tickets) as well as tariffs for economic and first class;
2. Quantity discount,
3. Frequent flyers programmes i.e. programme for increasing passenger loyalty.

Namely, there are two types of passengers: business people and tourists who generally have different readiness for payment. Air ticket sales agent can know that business people who travel are ready to pay a greater tariff than tourists, but it is often very hard to determine whether a passenger is a businessperson or a tourist.

One of the ways to overcome the existing problem is for the air companies to offer two different combinations which differ in price and quality, where one combination would be directed to passengers with greater readiness for payment, and the other to a passenger with smaller readiness for payment.

Air companies apply this in the following way: they offer "unlimited tariffs" for business trips and "limited tariffs" for non-business trips. Unlimited tariff enables a passenger to change the flight or even to cancel it without additional expenses. Limited tariff presupposes that a passenger must buy a ticket in advance or some other taxes.

The amount of tariff paid by a passenger depends on the moment of booking a ticket when those who "make early reservations" are rewarded by a lower tariff. Passengers who book their seat in the plane a month before the flight will pay less than passengers who do the same seven days before the flight. A passenger thus enables an air company to do timely planning of its capacities.

Another way in which an air company does tariff differentiation is its division according to the class of transport in tariff for economic and first class. Passengers of the first class pay a significantly higher tariff but they get a higher level of service: greater comfort, more lavish service in the plane as well as possibilities of free transfer of greater weight of personal luggage.<sup>17</sup>

---

<sup>15</sup> Milisavljević, M., cit. delo, p. 319-320.

<sup>16</sup> Milisavljević, M., cit. delo, p. 320.

<sup>17</sup> Štetić, S., Šalov, P. Poslovanje turističkih agencija, Savezni centar za unapredjenje hotelijerstva, Beograd, 2000., p. 231.

Differentiating prices according to the quality has represented a characteristic of traffic transport for hundreds of years. Emil Dipuij, a French economist of 20<sup>th</sup> century, commented on prices and the quality of railway transport in the following way:

*„this or that company has wagons with open roof and wooden benches not due to several thousands of francs it would need to spend on setting the roof on the third class wagon or upholstering seats of the third class... What a company is trying to do is to restrain passengers who can pay for the second class ticket to take a ride in the third one; that concerns the poor, but not because a company wishes to harm them, but because it is trying to scare the rich... For that reason, having behaved almost cruelly towards the passengers of third class and meanly towards the passengers of second class, companies become very open handed to passengers of first class. Having taken the necessary from the poor, they give the excessive to the rich.”<sup>18</sup>*

Quantity discount is a discount in price which is systematically being given according to the purchased amount at once or within a given time period.<sup>19</sup> This form of price differentiation played an important role in air transport of Norway in the period from 1998 to 2001.

After the air transport deregulation in 1999, air companies SAS and Braathens were the only ones to provide services in Norway. Deregulation did not affect the changes of flexible ticket tariffs for business people. However, air companies started competing by prices for a marketing segment of business people. Companies that bought a greater number of tickets started using their purchasing power. Every one of them asked from air companies to provide an offer with a discount and thus make an agreement on purchase with one of them. Certain companies received significant discounts even up to 50% for certain lines, which had such an effect that a tariff that they paid for a flexible ticket was lower than the average tariff of a limited ticket.

The observed company demand is typically price inelastic. Big discounts are a consequence of competition between two air companies caused by companies, since the air company with the best offer signs a contract. The stated implies that each air company has high personal demand elasticity for each of these companies.

Frequent flyers programmes represent a specific kind of quantity discount approved by air companies with the aim to increase passenger loyalty. With the aim to increase overall income, many air companies introduce a concept of frequent flyer programme, which enables a passenger to get a free plane ticket after passing a certain number of miles. This marketing campaign is a victim of its own success; over 90 members around the world gained these benefits.

The USA air companies were the first to apply frequent flyer program in 1981 with advantage scheme. It is now the biggest scheme with over 45 million members. Other companies followed swiftly: Executive club British Airways, USA Miles Plus, Atlantic

---

<sup>18</sup> R.B: Ekelunda, Price Discrimination and Product Differentiation in Economic Theory: An Early Analysis, Quarterly Journal of Economics, 84, 1970., p. 268-278.

<sup>19</sup> Milisavljević, M., cit. delo, p. 321.

Club of Flying.<sup>20</sup> Programmes were later amplified. Passengers collected points expressed in miles not only by ticket purchase for a specific destination but with a product purchase by using specific hotels and petrol stations which are business partners with air companies within strategic alliances. The popularity of such schemes increased the number of free tickets, which made air companies increase limitations for their use. Frequent passengers can use seats that would otherwise be empty during the flight and create expenses for food and drinks that influence the increase of overall air company expenses.

#### 4. CONCLUSION

Strategic price formation becomes ever important in marketing mix management. A company must form a price when introducing a new product, when introducing an existing product into a new channel of distribution or marketing segment. Forming prices represents a procedure which consists of six steps: 1) price goal choice; 2) demand establishment; 3) expenses evaluation; 4) analysis of competition expenses, prices and offers; 5) choice of price formation methods; 6) the choice of final price.

Companies do not mostly determine one price but a certain structure of price which represents variations in demand and expenses, requests of certain marketing segments, time and purchase quantity and the like. The most commonly used strategies for adjusting prices are the following: geographic price formation, discounts and benefits, promotional prices and differential price formation.

Service characteristics that have a dominant influence on price formation are:

1. non-tangible services,
2. service heterogeneity,
3. inseparability of services from an employee at a company providing a service
4. impossibility to store services.

The formation and development of low-cost air companies is a consequence of air-traffic deregulation, globalisation and information technology development and application. The application aggravated the survival and development of traditional air companies. In order to survive in contemporary conditions, they have to apply one of the strategies: product differentiation, price differentiation, dual strategy application or high cost model transformation into a low-cost one.

Price differentiation is a practice of charging different prices for identical goods to different consumers of groups of consumers where differences in prices are not justified by differences in expenses. Air companies successfully apply differentiated price i.e. tariff formation. Starting from Mašlap basis for price differentiation and air transport characteristics, three types of price differentiations applied by air companies can be stated. Forming tariffs in such a way, tickets become available even to passengers with lower readiness for payment, i.e. traditional air companies can satisfy the needs of passengers who use low-cost air company services.

---

<sup>20</sup> Holloway Ch., cit. delo, p. 342.

## REFERENCES

1. Berman B., Applying Yield Management Pricing to Your Service Business, Business Horizons, No 48.
2. Cravens W.D., Piercy N.S., Strategic Marketing, McGraw-Hill, Boston, 2006.
3. Holloway Ch., The Business of Tourism, Prentice Hall, London, 2006.
4. Kotler, Ph., Bowen, J., Makens, J., Marketing for Hospitality and Tourism, Prentice Hall, 2006.
5. Kotler Ph., Keller K., Marketing management, prevod sa engleskog jezika (Bogetić Z., Gligorijević M.), Ekonomski fakultet, Beograd, 2006.
6. Lewis Robert, Chambers Richard, Marketing Leadership in Hospitality, New York, Van Norstrand Reinhold, 1989.
7. Ljubojević Č., Marketing usluga, STYLOS, Novi Sad, 2002.
8. Milisavljević, M., Marketing, Savremena administracija, Beograd, 2001.
9. Milosavljević M., Strategijski marketing, Ekonomski fakultet, Beograd, 2006.
10. Mitra K., Capella L., Differential pricing for services: a re-examination, The Journal of Service Marketing, Vol. 11 No. 5.
11. Petrović J., Diskriminacija cenama kao faktor konkurentnosti, Regionalni razvoj i demografski tokovi balkanskih zemalja, Ekonomski fakultet, Niš, 2007.
12. R.B:Ekelunda, Price Discrimination and Product Differentiation in Economic Theory: An Early Analysis, Quarterly Journal of Economics, 84, 1970.
13. Štetić, S., Šalov, P. Poslovanje turističkih agencija, Savezni centar za unapredjenje hotelijerstva, Beograd, 2000.
14. Varijan, H., Mikroekonomija, Ekonomski fakultet, Beograd, 2003.

**STRATEGIJA CENA USLUGA****Jelena Petrović**

*Diferenciranje cena je praksa naplate različitih cena za identična dobra različitim potrošačima ili grupama potrošača, gde razlike u ceni nisu opravdane razlikama u troškovima. Njihova primena omogućava prodavcu da naplati kupcima cene koje proizilaze iz njihove spremnosti da plate za robu. Na taj način prodavci mogu da maksimiziraju svoj profite, ali i kupci da ostvare korist jer se nudi više robe većem broju ljudi (proizvodnja dobara drugačije ne bi bila profitabilna i ljudi tada ne bi mogli da ih priušte sebi). Autor posebnu pažnju posvećuje analizi primene diferenciranja cena odnosno tarifa od strane tradicionalnih avio-kompanija radi njihovog opstanka i razvoja u uslovima nastanka i razvoja low-cost kompanija.*

Ključne reči: *diferenciranje cena, tarifa, low-cost avio-kompanije*