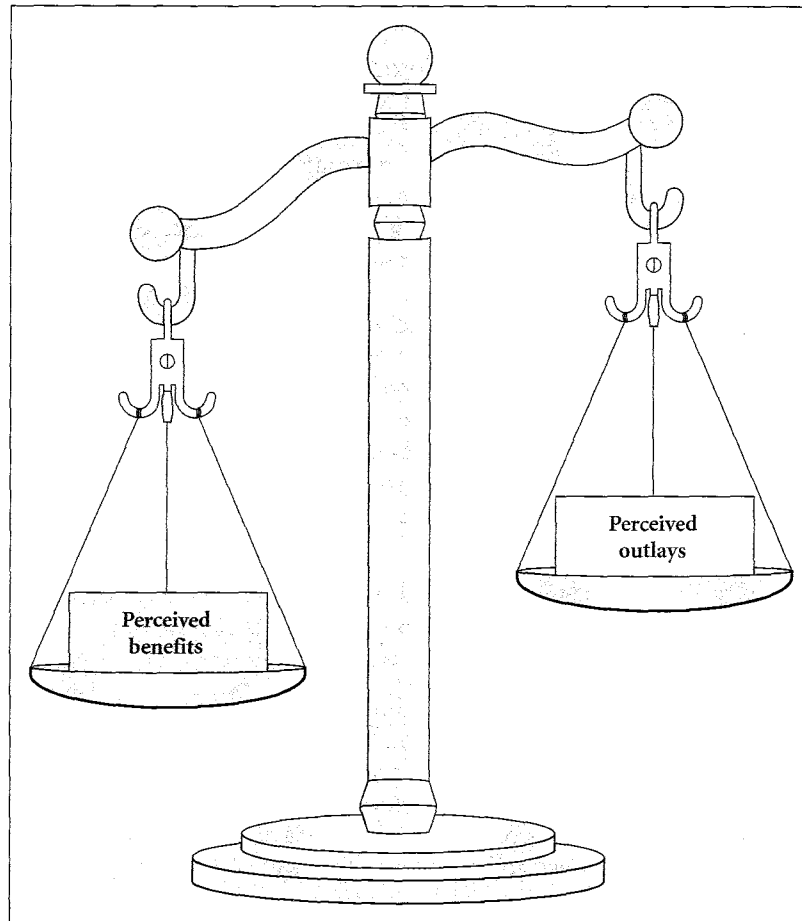


Figure 5.2 Net Value equals Benefits minus Costs



- *Flat-rate pricing* involves quoting a fixed price in advance of service delivery so as to avoid surprises for users. In essence, the risk is transferred from the customer to the supplier in the event that the service takes longer to deliver or costs were underestimated. Flat-rate pricing can be effective in situations where service prices are unpredictable, suppliers are poor at cost control, or competitors make low estimates to win business but subsequently claim that they were not making a firm pricing commitment.

Relationship Pricing

Discounting to win new business is not the best approach if a firm is seeking to attract customers who will remain loyal. Research indicates that those who are attracted by cut-price offers are easily enticed away by another offer from a competitor.¹⁰ More creative strategies focus on giving customers both price and nonprice incentives to consolidate their business with a single supplier. A strategy of discounting prices for large purchases can often be profitable for both parties, because the customer benefits from lower prices, while the supplier may enjoy lower variable costs resulting from economies of scale. An alternative to volume discounting on a single service is to offer discounts when two or more services are purchased together. The greater the number of different services a customer purchases from a single supplier, the closer the relationship is likely to be.

Cost Leadership

Low-priced services appeal to customers on tight financial budgets and may also stimulate larger purchases. One challenge when pricing low is to convince customers that they shouldn't equate price with quality but instead feel they're getting good value. A second challenge is to ensure that economic costs are kept low enough to enable profits. Some service businesses have built their entire strategy around being

Figure 5.3 Blondie Seeks Her Money's Worth from the Plumber



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the cost leader. A classic U.S. example of a cost leader in the airline business is Southwest Airlines, whose low fares often compete with the price of bus, train, or car travel. Southwest's low-cost operations strategy has been studied by airlines all over the world and now has many imitators, including Ryanair and easyJet in Europe, and WestJet in Canada, as well as JetBlue and others in the United States.

Managing the Perception of Value

Value is subjective, and not all customers have the expertise to assess the quality and value they receive. This is true in particular for credence services (discussed in Chapter 2), for which customers cannot assess the quality of a service even after consumption.¹¹ Marketers of services such as strategy consulting and specialized hospitals 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. Why? Because the invisibility of backstage facilities and labor makes it hard for customers to see what they're getting for their money.

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, soon locates the problem, replaces a defective circuit breaker, and presto! Everything works. A mere 20 minutes has elapsed. A few days later, the homeowner is horrified to receive a bill for \$90, most of it for labor charges. Just think what the couple could have bought for that amount of money—new clothes, several compact discs, a nice dinner. Not surprisingly, customers are often left feeling that they have been exploited—take a look at Blondie's reaction to the plumber in Figure 5.3.

Effective communications and even personal explanations are needed to help customers understand the value they receive. What they often fail to recognize are the fixed costs that business owners need to recoup: the 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 might be added 15 minutes of driving each way, plus 5 minutes each to unload and reload needed tools and supplies from the van, thus effectively tripling the labor time to a total of 60 minutes devoted to this call. And the firm still has to add a margin in order to make a profit.

More recently, auctions and dynamic pricing have become increasingly popular as a way to price according to value perceptions of customers—see Service Perspectives 5.1.

Reducing Related Monetary and Nonmonetary Costs

From a customer's standpoint, the price charged by a supplier is only part of the costs involved in purchasing and using a service. Users incur other outlays, comprising both *incremental financial outlays* and a variety of *nonmonetary costs*.

Incremental Financial Outlays

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

Dynamic pricing—also known as customized or personalized pricing—is a new version of the age-old practice of price discrimination and is popular with service suppliers because of its potential to increase profits. Retailing over the internet, or e-tailing, lends itself well to this strategy because changing prices electronically is a simple procedure. Dynamic pricing enables e-tailers to charge different customers different prices for the same product based on information collected about their purchase history, preferences, price sensitivity, and so on. Tickets.com gained up to 45% more revenue per event when pricing of concerts and events was adjusted to meet demand and supply.

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

Reverse Auctions

Travel e-tailers such as Priceline.com, Hotwire.com, and Lowestfare.com follow a customer-driven pricing strategy known as a *reverse auction*. Each firm acts as an intermediary between prospective buyers, who request quotations for a product or service, and multiple suppliers, who quote the best price they're willing to offer. Buyers can then review the offers and select the supplier that best meets their needs. Although the offer usually describes product attributes, it often doesn't provide brand information. Priceline has moved to correct this deficiency. Says a spokesperson, "Customers can now choose the exact brand name and product from a published list price, whereas before they could only use our name-your-own-price [service]. As a result, people were never sure what hotel they would get until they made their purchase, so if you were traveling with friends, you wouldn't know if you'd get the same hotel."

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. Others charge customers either a fixed fee or one based on a percentage of the savings.

Traditional Auctions

Other e-tailers, such as eBay and Yahoo! Auctions, 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 overstock items, collectibles, rare items, and second-hand merchandise. This form of retailing has become immensely successful since eBay first launched it in 1995.

Shopbots Help Consumers to Benefit from Dynamic Pricing

Consumers now have tools of their own to combat the potentially exploitive practices of dynamic pricing. One approach involves using shopbots to track competitive prices. *Shopbots*, or shopping robots, are basically intelligent agents that automatically collect price and product information from multiple online vendors. A customer has only to visit a shopbot site, such as Dealtime.com, and run a search for the desired item. The shopbot instantly queries all the associated retailers to check availability, features, and price, then presents the results in a comparison table.

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

Sources: Stephan Biller, Lap Mui Ann Chan, David Simchi-Levi, and Julie Swann, "Dynamic Pricing and Direct-to-Customer Model in the Automotive Industry," *Electronic Commerce Research*, 5, no. 2 (April 2005): 309-334; Melissa Campanelli, "Getting Personal: Will Engaging in Dynamic Pricing Help or Hurt Your Business?" *Entrepreneur*, 33, issue 10 (October 2005): 44-46; Mikhail I. Melnik, and James Alm, "Seller Reputation, Information Signals, and Prices for Heterogeneous Coins on eBay," *Southern Economic Journal*, 72, issue 2 (2005): 305-328.

far exceeds the price of the two tickets, because it can include such expenses as hiring a babysitter, travel, parking, food, and beverages.

Nonmonetary Costs

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

- *Time costs* are inherent in service delivery. Today's customers are often time-constrained and may use similar terms to define time usage as they do for money, speaking of budgeting, spending, investing, wasting, losing, and saving time. Time spent on one activity represents an opportunity cost because it could be spent more profitably in other ways. Internet users are often frustrated by the amount of time they spend to find information on a web site. Many people loathe visiting government offices to obtain passports, driving licenses, or permits, not because of the fees involved, but because of the time "wasted."
- *Physical costs* (such as fatigue and discomfort) may be incurred in obtaining services, especially if customers must go to the service factory, if queuing is involved, and if delivery entails self-service.
- *Psychological costs* such as mental effort, perceived risk, cognitive dissonance, feelings of inadequacy, or fear are sometimes attached to buying and using a particular service.
- *Sensory costs* relate to unpleasant sensations affecting any of the five senses. In a service environment, these costs may include putting up with noise, unpleasant smells, drafts, excessive heat or cold, uncomfortable seating, visually unappealing environments, and even nasty tastes.

As shown in Figure 5.4, service users can incur costs during any of the three stages of the service consumption model introduced in Chapter 2. Consequently, firms have to consider (1) *search costs*, (2) *purchase and service encounter costs*, and (3) *postconsumption or aftercosts*. When you were looking at colleges and universities, how much money, time, and effort did you spend before deciding where to apply? How much time and effort would you put into selecting a new mobile phone service provider or a bank, or planning a vacation?

A strategy of minimizing those nonmonetary and related monetary costs to increase consumer value can create competitive advantage for a firm. Possible approaches include:

- Working with operations experts to reduce the time required to complete service purchase, delivery, and consumption

Figure 5.4
Defining Total User
Costs

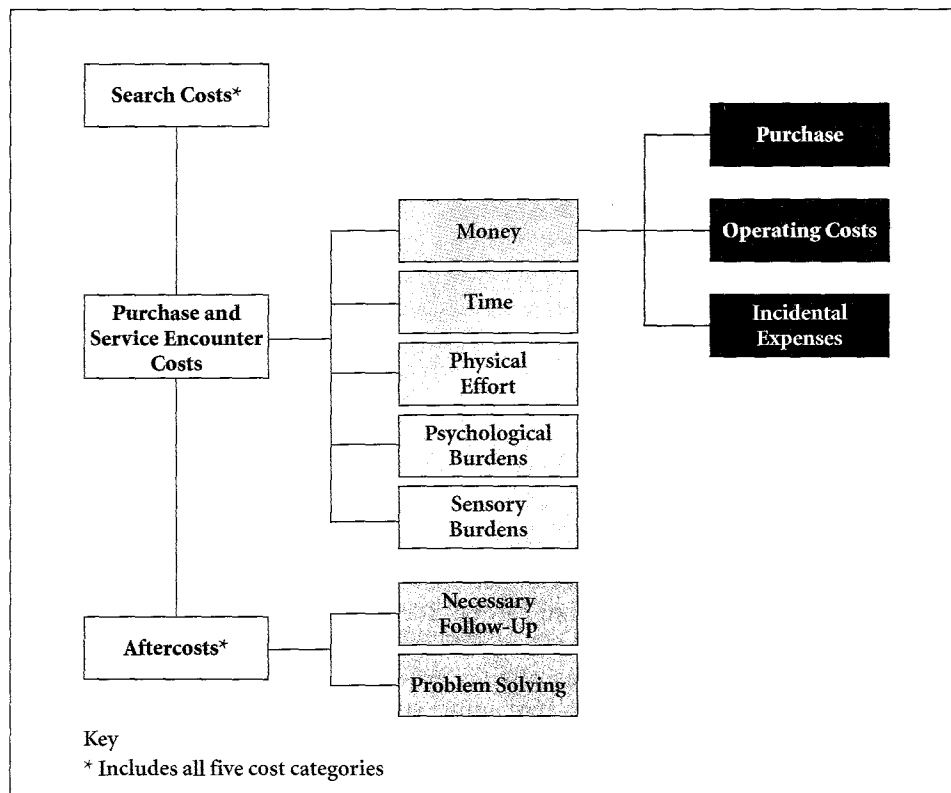


Figure 5.5
Trading Off Monetary
and Nonmonetary
Costs

Which clinic would you patronize if you needed a chest x-ray (assuming all three clinics offer good technical quality)?		
Clinic A	Clinic B	Clinic C
<ul style="list-style-type: none"> • Price \$45 • Located 1 hour away by car or transit • Next available appointment is in 3 weeks • Hours: Monday–Friday, 9 A.M.–5 P.M. • Estimated wait at clinic is about 2 hours 	<ul style="list-style-type: none"> • Price \$85 • Located 15 minutes away by car or transit • Next available appointment is in 1 week • Hours: Monday–Friday, 8 A.M.–10 P.M. • Estimated wait at clinic is about 30 to 45 minutes 	<ul style="list-style-type: none"> • Price \$125 • Located next to your office building (or college) • Next available appointment is in 1 day • Hours: Monday–Saturday, 8 A.M.–10 P.M. • By appointment; estimated wait at clinic is about 0 to 15 minutes

- 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, notably during search and delivery processes
- Decreasing unpleasant sensory costs of service by creating more attractive visual environments, reducing noise, installing more comfortable furniture and equipment, curtailing offensive smells, and the like
- 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. Service markets can often be segmented by sensitivity to time savings and convenience versus sensitivity to price savings.¹² Consider Figure 5.5, 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, there are different time and effort costs associated with using each service. Depending on the customer’s priorities, nonmonetary costs may be as important as, or even more important than, the price charged by the service providers.

REVENUE MANAGEMENT: WHAT IT IS AND HOW IT WORKS

Many service businesses now focus on strategies to maximize the revenue (or contribution) that can be derived from available capacity at any given time. Revenue management is important in value creation, as it ensures better capacity utilization and reserves available capacity for higher-paying segments. It’s a sophisticated approach to managing 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.

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 allocated capacity, paying the highest price; other segments follow at progressively lower prices. Because 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 of a big event.

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.

In the case of airlines, these models integrate massive historical databases on past passenger travel and can forecast demand 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 there are significant deviations between actual and forecasted demand, the manager adjusts 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 from the lowest-paying segment. The objective is to maximize the revenues from the flight. Best Practice in Action 5.1 shows how revenue management has been implemented at American Airlines, long an industry leader in this field.

BEST PRACTICE IN ACTION 5.1

Pricing Seats on Flight AA 2015

Revenue management departments use sophisticated yield management software and powerful computers to forecast, track, and manage each flight on a given date separately. Let's look at American Airlines flight 2015, a popular flight from Chicago to Phoenix, Arizona, which departs daily at 5:30 p.m. on the 1,370-mi (2,200-km) journey.

The 125 seats in coach (economy class) are divided into seven fare categories, called "buckets" by yield management specialists. There is an enormous variation in ticket prices among these seats: Round-trip fares range from \$238 for a bargain excursion ticket (with various restrictions and a cancellation penalty) all the way to \$1,404 for an unrestricted fare. Seats are also available in the small first-class section, at an even higher price. Scott McCartney tells how ongoing analysis by the computer program changes the allocation of seats among the seven buckets in economy class:

In the weeks before each Chicago–Phoenix flight, American's yield management computers constantly adjust 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, American adds seats to low-fare buckets. If business customers buy unrestricted fares earlier than expected, the yield management computer takes seats out of the discount buckets and preserves them for last-minute bookings that the database predicts will still show up.

With 69 of 125 coach seats already sold four weeks before one recent departure of Flight 2015, American's computer began 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 125-seat flight, American still offered five seats at full fare because its computer database indicated 10 passengers were likely not to show up or take other flights. Flight 2015 departed full and no one was bumped.

Although AA 2015 for that date is now history, it has not been forgotten. The booking experience for this flight was saved in the memory of the yield management program to help the airline do an even better job of forecasting in the future.

Source: Adapted from Scott McCartney, "Ticket Shock: Business Fares Increase Even as Leisure Travel Keeps Getting Cheaper," *The Wall Street Journal*, (November 3, 1997): A1, A10.

(Q) What is your role as a revenue manager?

(A) When I started in 1993, 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. My role has also broadened to include revenue management of secondary income sources such as restaurants, golf courses and spa, as well as mainstream hotel rooms.

(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 the home market. By contrast, pricing practices in hotels can shift market share within a location but, as a rule, not overall market size. Although consumers see many pricing practices—such as advance purchase restrictions and discounts—as fair practice for the airline industry, they see them as less fair 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 more precise and statistical application of pricing and inventory control is thus the focus. In the hotel industry, revenue management is decentralized to every hotel, requiring daily interaction with reservations and sales. The human element is key for successful implementation in hotels, requiring acceptance of pricing and inventory decisions not only by consumers but also by internal departments such as reservations, sales and even front office.

(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 in order for their decisions to be accepted 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 have to be used to allow customers to self-segment so that they retain a feeling of choice.

(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. 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, Vice President Distribution Marketing & Revenue Management at Raffles International Limited, for this interview, conducted January 6, 2006. Jeannette has been responsible for spearheading and implementing the revenue management initiatives for the Group since February 2005. Her team drives the company's global distribution strategy and oversees its e-commerce channels and Central

Reservations System. Over the past 12 years, Jeannette has been working in revenue management with various international companies such as Singapore Airlines, Banyan Tree, and the Westin Stamford & Westin Plaza Hotels.

How Does Competitors' Pricing Affect Revenue Management?

Because revenue management systems monitor booking pace, they indirectly pick up the effect of competitors' pricing. If a firm prices too low, it will experience a higher booking pace, and its cheaper seats will fill up quickly. That is generally not good, as it means a higher share of late-booking but high-fare-paying customers will

not be able to get their seats confirmed, and will therefore fly on competing airlines. If the initial pricing is too high, the firm will get too low a share of early-booking segments (which still tend to offer a reasonable yield) and may later have to offer deeply discounted “last-minute” prices to sell excess capacity and thus obtain some contribution toward fixed costs. Some of these sales may take place through reverse auctions, using intermediaries such as Priceline.com.

Revenue management has been most effective when applied to operations characterized by relatively fixed capacity, a high fixed cost structure, perishable inventory, variable and uncertain demand, and varying customer price sensitivity. Industries that have implemented revenue management successfully include airlines, car rentals, hotels, and, more recently, hospitals, restaurants, golf courses, on-demand IT services, data processing centers, and even nonprofit organizations.¹³ Service Perspectives 5.2 gives insights to the work and thinking of a revenue manager.

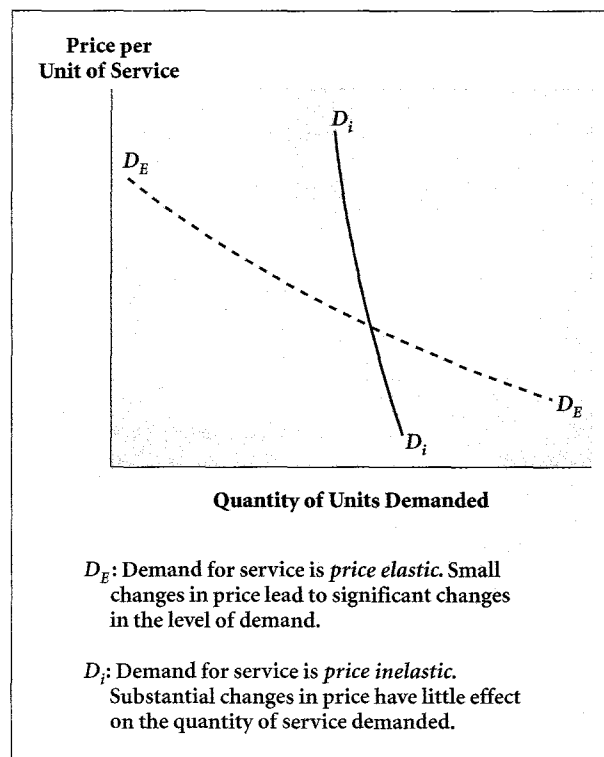
Price Elasticity

Revenue management requires two or more segments that attach different value to the service and have different price elasticities. To allocate and price capacity effectively, the revenue manager needs to determine how sensitive demand is to price and what net revenues will be generated at different prices for each target segment. 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 effect 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 5.6, 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

Figure 5.6
Illustration of Price Elasticity



the amount demanded), and the other with a highly inelastic demand (even big changes in price have little effect on the amount demanded).

Designing Rate Fences

Inherent in revenue management is the concept of *price customization*—charging different customers different prices for what is, in effect, 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.¹⁴

How can a firm ensure that customers for whom the service offers high value 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

Table 5.2
Key Categories of
Rate Fences

RATE FENCES	EXAMPLES
Physical (product-related) Fences	
Basic product	<ul style="list-style-type: none"> • Class of travel (business/economy class) • Size and furnishing of a hotel room • Seat location in a theater
Amenities	<ul style="list-style-type: none"> • Free breakfast at a hotel, airport pick up, etc. • Free golf cart at a golf course
Service level	<ul style="list-style-type: none"> • Priority wait listing, separate check-in counters with no or only short lines • Increase in baggage allowance • Dedicated service hotlines • Dedicated account management team
Nonphysical Fences	
<i>Transaction Characteristics</i>	
Time of booking or reservation	<ul style="list-style-type: none"> • Requirements for advance purchase • Must pay full fare 2 weeks before departure
Location of booking or reservation	<ul style="list-style-type: none"> • Passengers booking air tickets for same route in different countries charged different prices
Flexibility of ticket use	<ul style="list-style-type: none"> • Fees/penalties for canceling or changing a reservation (up to loss of entire ticket price) • Nonrefundable reservations fees
<i>Consumption Characteristics</i>	
Time or duration of use	<ul style="list-style-type: none"> • Early-bird special in a restaurant before 6:00 p.m. • Must stay over a Saturday night for an airline, hotel, or car rental booking. • Must stay at least for 5 nights
Location of consumption	<ul style="list-style-type: none"> • Price based on departure location, especially in international travel • Prices vary by location (between cities, city center versus edges of the city)
<i>Buyer Characteristics</i>	
Frequency or volume of consumption	<ul style="list-style-type: none"> • Member of certain loyalty tier with the firm (e.g., Platinum member) gets priority pricing, discounts, or loyalty benefits
Group membership	<ul style="list-style-type: none"> • Child, student, senior citizen discounts
Size of customer group	<ul style="list-style-type: none"> • Affiliation with certain groups (e.g., alumni) • Group discounts based on size of group

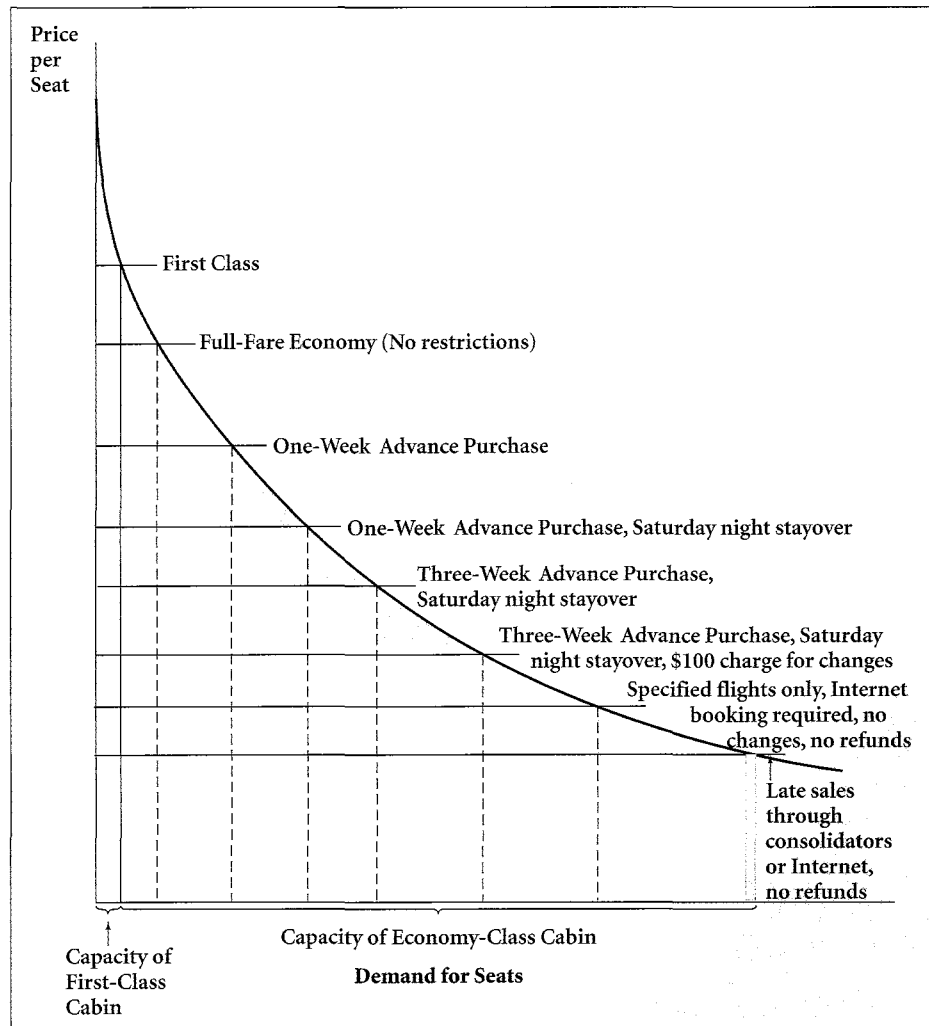
pay, and help companies to restrict lower prices to customers who are willing to accept certain restrictions on their purchase and consumption experiences.

Fences can be either physical or nonphysical. *Physical fences* refer to tangible product differences related to the different prices, such as the seat location in a theater, or the size and furnishing of a hotel room. *Nonphysical fences* refer to consumption, transaction, or buyer characteristics. For example, they include staying a certain length of time in a hotel, playing golf on a weekday afternoon, cancellation or change penalties, or booking a certain length of time ahead. Examples of common rate fences are shown in Table 5.2.

Physical fences reflect tangible differences in the actual service (e.g., first class is better than economy class), whereas nonphysical services actually refer to the same basic service (e.g., there is no difference in economy class service whether a person bought a ticket really cheaply or paid full fare for it).

In summary, using a detailed understanding of customer needs, preferences, and willingness to pay, product and revenue managers can jointly design effective products comprising the core service, physical product features (physical fences), and non-physical product features (nonphysical fences). A good understanding of the demand curve 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 5.7. And lastly, the design of revenue management systems needs to incorporate safeguards for

Figure 5.7
Segmenting Price Buckets
on the Demand Curve



Note: Dark shaded areas denote amount of consumer surplus (goal of segmented pricing is to minimize this).

consumers. For additional insights into revenue management strategies, see the reading by Sheryl E. Kimes and Richard B. Chase, "The Strategic Levers of Yield Management," on pages 211–219.

ETHICAL CONCERNS IN SERVICE PRICING

Do you sometimes have difficulty understanding how much it's going to cost you to use a service? Do you believe that many prices are unfair? If so, you're not alone. The fact is, service users can't always be sure in advance what they will receive in return for their payments. There's an implicit assumption among many customers that a higher-priced service should offer more benefits and better quality than a lower-priced one. For example, a professional—say, a lawyer—who charges very high fees is assumed to be more skilled than one who is relatively inexpensive. Although price can serve as a surrogate for quality, it is sometimes hard to be sure whether the extra value is really there.

Are Service Pricing Schedules Too Complex?

Pricing schedules 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 don't want customers to be able to determine who offers the best value for the money. 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 comparison may be only the first of several charges they can be billed. As described in Service Perspectives 5.3, cellular phone service is particularly problematic in this respect.

Many people find it difficult to forecast their own usage, which makes it hard to compute comparative prices when evaluating competing suppliers whose fees are based on a variety of usage-related factors. It's no coincidence that humorist Scott Adams (creator of *Dilbert*), used exclusively service examples when he "branded" the future of pricing as "confusiology." Noting that firms such as telecommunications companies, banks, insurance firms, and other financial service providers offer nearly identical services within their respective industries, Adams remarked:

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 economic 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 evolve 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 United States, 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 (say) a high-mileage charge that is added once the car exceeds a very low threshold of free miles. The "hidden extras" phenomenon 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." A not uncommon practice when the car is returned is to charge a fee for refueling a partially empty tank that far exceeds what the driver would pay at the pump.¹⁷

Recent years have seen a rapid expansion in the availability of cellular (mobile) telephone services. Significant technological improvements have expanded the capability of these services, including the ability to transmit photos and download music. Not surprisingly, demand has exploded and competition has become intense.

In tailoring their services to the widely varying needs and calling patterns of different market segments, cell phone companies have developed a bewildering array of plans that defy easy comparison across suppliers. Plans can be national, regional, or purely local in scope. Monthly fees vary according to the number of minutes selected in advance, which typically include 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 allow free incoming calls. Some providers charge calls per second, per 6-second block, or even per-minute block, resulting in vastly different costs per call. Family plans let parents and children pool their monthly minutes for use on several phones as long as the total for everyone's calling doesn't exceed the monthly quota.

In addition, baffling new fees have started to appear on bills, ranging from a "paper bill fee" to pay for the bill itself to obscure-sounding fees such as "property tax allotment," "single bill fee," and "carrier cost recovery fee." Bundled plans that include mobile, landline, and Internet services compound the confusion further, in that the various surcharges can increase the total bill by up to 25 percent. 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 services, and the "carrier cost recovery fee" is a catch-all for all sorts of operating expenses.

Research by Consumers Union (CU) found high levels of customer dissatisfaction with cell phone service. In addition to poor-quality reception, dropped calls, and inaccessible service, many concerns related to billing and pricing, with complaints about overcharges, billing mistakes, and bills padded with extra charges. Compounding the problem is the fact that companies make it hard to switch. Typically, subscribers have to sign a one- or two-year contract that imposes significant penalties, often in the range \$100 to \$200, for early termination. In an editorial entitled "Cell Hell," Jim Guest, CU'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 carriers is nearly impossible.

CU advocates stronger regulation of the industry to protect consumers from confusing and abusive practices, including a government-mandated standard format for presenting calling plan features and charges. According to David Bergmann of the Office of the Ohio Consumers' Council and chairman of the telecommunications committee at the National Association of State Utility Consumer Advocates, all these extra and confusing charges should be included in the advertised prices of calling plans. He said, "I don't pay a health and safety fee to restaurants. If they want to raise the price of a

meal, that's fine. But customers shouldn't order something and not know what is going into the bill."

Source: Jim Guest, "Cell Hell" (p. 3) and "Complete Cell-Phone Guide," *Consumer Reports* (February 2003): 11-27; and Ken Belson, "A Monthly Mystery," *The New York Times* (August 27, 2005).

There has also been a trend toward 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 \$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

The importance of fees as a proportion of profits has increased dramatically—for some banks they now exceed earnings from mortgages, credit cards, and all other

lending combined. None of the fees is more controversial than “bounce protection” (i.e., allowing you to overdraw your account beyond an agreed credit line), which generates some \$8 billion in income for banks and making up almost 30 percent of all their service fees. Critics feel that some banks market bounce protection too aggressively. Regulators are particularly worried about bounce protection being offered via ATMs. For example, a customer with a balance of \$300 in his account, but a \$500 bounce protection, could be told at the ATM that he has \$800 available. If he withdrew \$400, the ATM would still show available funds of \$370 (after charging a fee of, for example, \$30 for using the bounce protection balance).

Some banks don’t 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. It’s just a way for banks to make money off customers.” Commerce and other banks offer services that cover overdrafts automatically from savings accounts, other accounts, or even the customer’s credit card, and don’t charge fees for doing so.¹⁹ (For further thoughts on this topic, see the reading by Emily Thornton, “Fees! Fees! Fees!” on pages 220–229.)

It’s possible to design penalties that do not seem unfair to customers. Research Insights 5.1 describes what drives customers’ fairness perceptions about service fees and penalties.

Designing Fairness into Revenue Management

A well-implemented revenue management strategy does not mean blind pursuit of short-term yield maximization. The following specific approaches can help to reconcile yield management practices with customer satisfaction, trust, and goodwill.²⁰

- *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 that customers can more easily understand the financial implications of a specific usage situation. For a rate fence to be perceived as fair, customers must be easily able to understand them (i.e., fences have to be transparent and upfront), see the logic in them, and be convinced that they are difficult to circumvent and therefore fair.
- *Use high published prices and frame fences as discounts.* Rate fences framed as customer gains (i.e., discounts) are generally perceived as more fair 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 also helps to increase the reference price and potentially 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 balances allows a broader spectrum of customers to self-segment and enjoy the service. It allows each customer to find the price and benefits (value) balance 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.
- *Use bundling to “hide” discounts.* 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

Crime and Punishment: How Customers Respond to Fines and Penalties

Various types of “penalties” are part and parcel of many pricing schedules, 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 very 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 drastically 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 suddenly charged to them and they had not been aware of the fee or the magnitude of the fee. 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 occurs (e.g., in a banking context, through a clearly explained fee schedule, and through front-line staff that explain at the time of opening an account or purchase of a bank service 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—it must have been delayed in the mail”), rather than when they felt it was within their control and really their fault (“I forgot to mail the check”). To increase the perception of fairness, firms may want to identify common penalty causes that are typically out of the control

of the customer, 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 and waived the fee.” Service firms should take into account customers’ penalties history in dealing with penalties, and offer differential treatments based on past behavior—perhaps waiving the fine for a first incident while at the same time communicating that the next time the fee will be charged.

3. *Focus on Fairness and Manage Emotions During Penalty Situations.* Consumers’ responses are heavily driven by their perception of fairness. 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 created by the incident. 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 too long should not exceed the potentially lost rental fees during that period.

Service companies can also make penalties seem more fair 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, though we could have given it to a guest on our waiting list”) or the community, but not as a means for generating significant profit. Finally, the front line should be trained in how handle customers who have become angry or distressed and who complain about penalties. (See Chapter 13 for some recommendations on how to deal with such situations.)

In sum, this study shows how firms can reduce customer unhappiness related to penalties.

Source: Adapted from 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): 162–180.

thereby sidesteps potential perceptions of unfairness and reductions in reference 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. Yield 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, too, 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. So it’s important to back up overbooking programs with well-designed service recovery procedures, such as:
 1. Give customers a choice between retaining their reservation and receiving compensation.
 2. Provide sufficient advance notice that customers are able to make alternative arrangements.
 3. If possible, offer a substitute service that will delight customers.

A Westin beach resort has found that it can free up capacity by offering guests who are departing the next day the option 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 securing 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

Although the main decision in pricing is usually seen as how much to charge, there are also other decisions to be made. Table 5.3 summarizes the questions that service marketers need to ask themselves as they prepare to create and implement a well-thought-out pricing strategy. Let’s look at each in turn.

How Much to Charge?

Realistic decisions on pricing are critical for financial solvency. The pricing tripod model, discussed earlier (Figure 5.2), provides a useful departure point. The three elements involve determining the relevant economic costs to be recovered at different sales volumes and setting the relevant floor price; assessing the elasticity of demand of the service from both the providers’ and customers’ perspectives, as it helps to set a “ceiling” price for any given market segment; and analyzing the intensity of price competition among the providers.

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.

What Should Be the Specified Basis for Pricing?

It’s not always easy to define a unit of service as the specified basis for pricing. 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, or occupying a hotel room for a night? Alternatively, should it be related to a monetary value associated with service delivery, as when an insurance company scales its premiums to reflect the amount of coverage provided, or a realtor 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. In the hospitality industry, rather than charging customers an hourly rate for occupying a table and chairs, restaurants put a sizable markup on the food and drink items consumed. Recognizing the fixed cost of table service—such as a clean tablecloth for each party—restaurants in some countries impose a fixed cover

Table 5.3
Some Pricing Issues

- 1. How much should be charged for this service?**
 - What costs are 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?
- 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
 - Should each service element be billed independently?
 - Should a single price be charged for a bundled package?
- 3. Who should collect payment?**
 - The organization that provides the service
 - A specialist intermediary (travel or ticket agent, bank, retailer, etc.)
 - How should the intermediary be compensated for this work—flat fee or percentage commission?
- 4. Where should payment be made?**
 - The location at which the service is delivered
 - A convenient retail outlet or financial intermediary (e.g., bank)
 - The purchaser's home (by mail or phone)
- 5. When should payment be made?**
 - Before or after delivery of the service
 - At which times of day
 - On which days of the week
- 6. How should payment be made?**
 - Cash (exact change or not?)
 - Token (where can these be purchased?)
 - 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)?
- 7. 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?)

charge that is added to the cost of the meal. Others may establish a minimum meal charge per person. Transport firms have traditionally charged by distance, with freight companies using a combination of weight or cubic volume and distance to set their rates. Such a policy has the virtue of consistency and reflects calculation of an average cost per mile (or kilometer). However, it ignores relative market strength on different routes, which should be included when a yield management system is used. Simplicity may suggest a flat rate, as with postal charges for domestic letters below a certain weight, or a rate for packages that groups geographic distances into broad zones.

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.²¹

Price Bundling

As we emphasize throughout this book, many services unite a core product with a variety of supplementary services. Meals and bar service on a cruise ship offer one example, baggage service on a train or aircraft another. Should such service packages be priced as a whole (referred to as a “bundle”), or should each element be priced separately? To the extent that people prefer to avoid making many small payments, bundled pricing may be preferable, and it is certainly simpler to administer. But if customers dislike feeling that they have been charged for product elements they did not use, itemized pricing may be preferable.

Bundled prices offer firms a certain guaranteed revenue from each customer, while giving the latter a clear idea in advance how much the bill will be. Unbundled pricing provides customers with flexibility in what they choose to acquire and pay for.²² However, they 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.

Discounting

Selective price discounting targeted at specific market segments can offer important opportunities to attract new customers and fill capacity that would otherwise go unused. However, unless it is used with effective rate fences that allow a clean targeting of specific segments, a strategy of discounting should be approached cautiously. 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.

Who Should Collect Payment?

As discussed in Chapter 3, supplementary services include information, order taking, billing, and payment. Customers appreciate it when a firm makes it easy to obtain price information and make reservations. They also expect well-presented billing and convenient procedures for making payment. Sometimes, firms delegate these tasks to intermediaries, such as travel agents who make hotel and transport bookings and collect payment from customers, and 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 a net savings in administrative costs. Nowadays, however, many service firms are promoting their web sites as direct channels for customer self-service, thus bypassing traditional intermediaries and avoiding payment of commissions.

Where Should Payment Be Made?

Service delivery sites are not always conveniently located. Airports, theaters, and stadiums, for instance, are often situated some distance from where potential patrons live or work. When consumers have to purchase a service before using it, there are obvious benefits to using intermediaries that are more conveniently located, or allowing payment by mail or bank transfer. A growing number of organizations now accept Internet, telephone, and fax bookings with payment by credit card.

When Should Payment Be Made?

Two basic options 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 in advance of service delivery, with the balance being due later. This approach is quite common for expensive repair and maintenance jobs, when the firm—often a small business with limited working capital—must buy materials up front.

Asking customers to pay in advance means that the buyer is paying before the benefits are received. However, prepayments may be advantageous to the customer as well as to 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 up-front financing requirements 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 members' usage patterns were closely related to their payment schedules. When members made payments annually, their use of the club was highest during the months immediately following payment and then declined 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.

Gourville and Soman conclude that the timing of payment can be used more strategically to manage capacity utilization. For instance, if a golf club wants to reduce 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, and thereby reduce the need to get his or her "money's worth." A reduction in demand during the peak period would then allow the club to increase its membership.²³

How Should Payment Be Made?

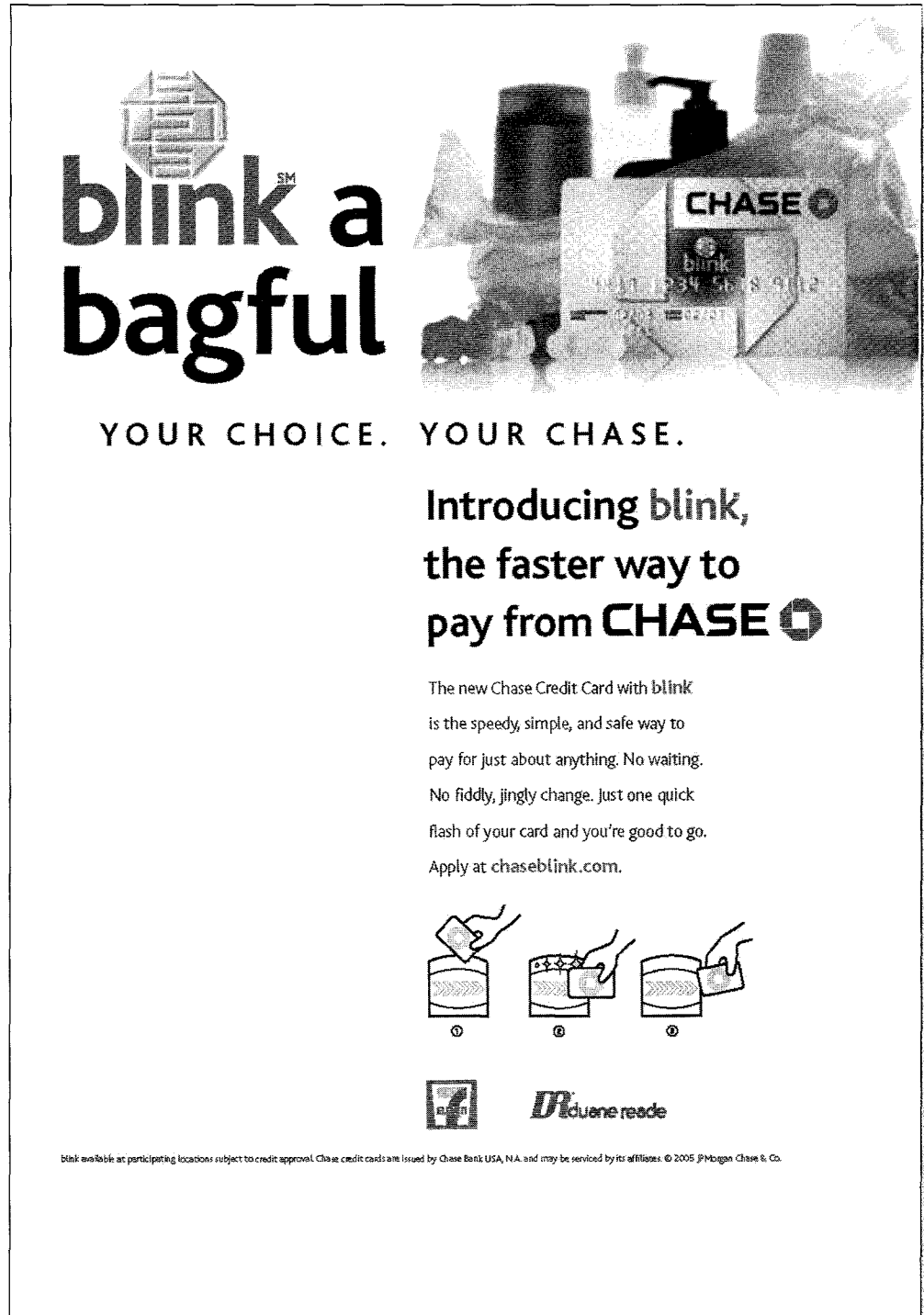
As shown earlier in Table 5.3, there are many different forms of payment. Cash may appear to be the simplest method, but it raises security problems and is inconvenient when exact change is required (e.g., to operate machines). Accepting payment by check for all but the smallest purchases is now fairly widespread and offers customer benefits, although it may require controls to discourage bad checks, such as a hefty charge for returned checks (\$15 to \$20 on top of any bank charges is not uncommon at retail stores).

Credit and debit cards can be used around the world. As their acceptance has become almost universal, businesses that refuse to accept them increasingly find themselves at a competitive disadvantage. Many companies also offer customers the convenience of a credit account, which generates a membership relationship between the customer and the firm. Other payment procedures include tokens or vouchers as supplements to (or instead of) cash. Tokens with a predefined value can simplify the process of paying road and bridge tolls, or public transit fares. Vouchers are sometimes provided by social service agencies to elderly or low-income people. Such a policy achieves the same benefits as discounting, but avoids the need to publicize different prices and to require cashiers to check eligibility.

Now 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. Service firms that want to accept payment in this form, however, must first install card readers. Service marketers should remember that the simplicity and speed with which payment is made may influence the customer's perception of overall service quality. To save its customers time and effort, Chase bank has introduced credit cards with what it calls "blink," an embedded technology that can be read by a point-of-sale terminal without physically touching it (Figure 5.8).

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.²⁴ The less tangible or immediate the payment mechanism, the more consumers tend to spend. Cash is the most tangible (i.e., consumers will be


Figure 5.8 Chase Advertisises Its Fast New Credit Card Scanning Service, "blink"



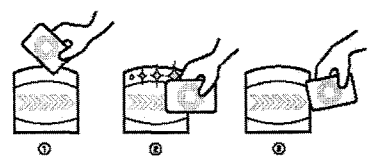
The advertisement features a large, bold headline "blink a bagful" with a small "SM" trademark symbol. Above the word "blink" is a small icon of a credit card scanner. To the right of the headline is a photograph of a Chase credit card with the "blink" logo and a shopping bag filled with various items like bottles and containers. Below the headline is the tagline "YOUR CHOICE. YOUR CHASE." followed by the text "Introducing blink, the faster way to pay from CHASE" with the Chase octagon logo. A paragraph of text describes the service as a speedy, simple, and safe way to pay without waiting for change. Below this is a three-step diagram showing a hand holding a card over a scanner, the card being scanned, and the scanner displaying a receipt. At the bottom are the logos for "blink" and "Duane Reade". A small disclaimer at the very bottom states that the service is available at participating locations subject to credit approval and is issued by Chase Bank USA, N.A.


blink a bagfulSM

YOUR CHOICE. YOUR CHASE.

Introducing blink,
the faster way to
pay from **CHASE** 

The new Chase Credit Card with blink is the speedy, simple, and safe way to pay for just about anything. No waiting. No fiddly, jingly change. Just one quick flash of your card and you're good to go. Apply at chaseblink.com.



 **Duane Reade**

blink available at participating locations subject to credit approval. Chase credit cards are issued by Chase Bank USA, N.A. and may be serviced by its affiliates. © 2005 JPMorgan Chase & Co.

Courtesy JP Morgan Chase & Company.

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 mobile phone 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). People need to know the price for some product offerings well in advance of purchase. They

may also need to know how, where, and when that price is payable. This information must be presented in ways that are intelligible and unambiguous, so that customers will not be misled and question the ethical standards of the firm. Dismayed by the complexity of cell-phone calling plans in the United States, Consumers Union has called for a simple, standardized summary of the features of each calling plan that would simplify the process for consumers to compare competing offers. This would be similar in style to the government-mandated box printed on all credit card solicitations that lays out, in standard format and readable type, the offer's essential rates and terms.²⁵

Managers must decide whether to include information on pricing in advertising for the service. It may be appropriate to relate the price to the costs of competing products. Certainly, salespeople and customer service representatives should be able to give prompt, 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 about prices.

Finally, when the price is presented in the form of an itemized bill, marketers should ensure that it is both accurate and intelligible. Hospital bills, which may run to multiple 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 United States may be overpaying for their hotel rooms by half-a-billion dollars a year, with 11.6 percent of all bills incorrect, resulting in an average overpayment of \$11.36.²⁶

CONCLUSION

To determine an effective pricing strategy, a firm has to have a good understanding of its costs, the value created for customers, and competitor pricing. Defining costs tends to be more difficult in a service business than in a manufacturing operation. Without a good understanding of costs, managers cannot be sure that the prices set are, in fact, sufficient to recover all costs.

Another challenge is to relate the value that customers perceive in a service to the price they are willing to pay for it. This step requires an understanding of other costs that the customer may be incurring in purchase and use, including outlays of a nonfinancial nature, such as time and effort. Managers also need to recognize that the same service may not be valued in the same way by all customers, offering the potential to set different prices for different market segments.

Competitor pricing cannot be compared dollar for dollar. Services tend to be location- and time-specific, and competitor services have their own set of related monetary and nonmonetary costs, sometimes to the extent that the actual prices charged become secondary for competitive

comparisons. Competitive pricing needs to take all those factors into account.

Revenue management is a powerful tool that helps to manage demand and price different segments closer to their perceived values. Well-designed physical and nonphysical rate fences help to define "products" for each target segment. However, great care has to be taken in the way revenue management is implemented, to ensure that customer satisfaction and perceived fairness are not compromised.

A pricing strategy must address the central issue of what price to charge for selling a given unit of service at a particular point in time (however that unit may be defined). Because services often combine multiple elements, pricing strategies need to be highly creative.

Finally, firms need to be careful lest pricing schedules become so complex and hard to compare that they simply confuse customers. A policy of deliberately creating confusing price schedules, including hiding certain costs that only become apparent to customers after usage, is likely to lead to accusations of unethical behavior, loss of trust, and customer dissatisfaction.

REVIEW QUESTIONS

1. What is the role of service pricing and revenue management in a business model?
2. How can the three main approaches to service pricing be integrated to arrive at a good pricing point for a particular service?
3. How can a service firm compute its unit costs for pricing purposes? How does predicted and actual capacity utilization affect unit costs and profitability?
4. Why can't we compare competitor prices dollar for dollar in a service context?
5. Why is the price charged by the firm only one, and often not the most important, component of the total cost to the consumer? When should we cut non-price-related costs to the bone, even if that incurs higher costs and a higher price to be charged?
6. What is the role of nonmonetary costs in a business model, and how do they relate to the consumer's perception of the offered value exchange?
7. What is revenue management, how does it work, and what type of service operations benefit most

from good revenue management systems and why?

8. Why are ethical concerns and fairness perception important issues when designing service fee schedules and revenue management strategies? What are potential consumer responses to service pricing schedules or policies that are perceived as being unfair?
9. How can we improve the perceived fairness of pricing schedules, and what are the implications of these rec-

ommendations? How can perceptions of unfairness be mitigated and perceptions of fairness created?

10. How can we charge different prices to different segments without customers feeling cheated? How can we even charge the same customer different prices at different times, contexts, and/or occasions, and at the same time be seen as fair?
11. What are the seven key decisions managers need to make when designing an effective pricing schedule?

APPLICATION EXERCISES

1. Select a service organization of your choice and find out what its pricing policies and methods are. In what respects are they similar to or different from what has been discussed in this chapter?
2. From a customer perspective, what serves to define value in the following services: (a) a hairdressing salon; (b) a legal firm specializing in business and taxation law; and (c) a nightclub?
3. Explore two highly successful business models that are based on innovative service pricing and/or revenue management strategies, and identify two business models that failed because of major issues in their pricing or revenue management strategy. What lessons can you learn from your analysis of these successful and unsuccessful pricing and revenue management strategies?
4. Review recent bills that you have received from service businesses, such as those for telephone, car repair, cable TV, and credit cards. Evaluate each one against the following criteria: (a) general appearance and clarity of presentation; (b) easily understood terms of payment; (c) avoidance of confusing terms and definitions; (d) appropriate level of detail; (e) unanticipated ("hidden") charges; (f) accuracy; (g) ease of access to customer service in case of problems or disputes.
5. How might revenue management be applied to (a) a professional firm (e.g., consulting); (b) a restaurant; and (c) a golf course? What rate fences would you use and why?
6. Collect the pricing schedules of three leading mobile phone service providers. Identify all the pricing dimensions (e.g., airtime, subscription fees, free minutes, per-second/6-seconds/per-minute billing, airtime rollover, etc.) and pricing levels for each dimension (i.e., the range that is offered by the players in the market). Determine the usage profile for a particular target segment (e.g., a young executive who uses the phone mostly for personal calls, or a full-time student). Based on the usage profile, determine the lowest-cost provider. Next, measure the pricing schedule preferences of your target segment (e.g., via conjoint analysis). Finally, advise the smallest of the three providers how to redesign its pricing schedule to make it more attractive to your target segment.
7. Consider a service of your choice, and develop a comprehensive pricing schedule. Apply the seven questions marketers need to answer to design an effective pricing schedule.

ENDNOTES

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