

Price and Marketing Strategy in Tourism Contexts: A preliminary study to mitigating seasonality

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ABSTRACT

Tourism, as an area of study, has expanded its scope, reflecting an increasing recognition in the academic community paralleled by the application of interdisciplinary concepts and methods. In this context, seasonality has long been viewed as one of the most unique and worrisome facets of the tourism industry. It can be defined as a cyclical pattern that more or less repeats itself each year. In this context, the element of marketing-mix that has been most impervious to sharing power with consumers is precisely the price. Participative pricing mechanisms have been used by for-profit entities for quite some time, and some of the most innovative participative pricing strategies have been applied in different industries throughout the past decades. The studies show the importance of investigating more about the price and phenomenon of seasonality in tourism contexts. Such is the case of Name Your Own Price and Pay What You Want. This preliminary research intends to provide evidence that identity and self-image concerns are potentially very important (in specific tourism contexts). Three field experiments will involve PWYW pricing demonstrate that companies can sustain profitability with payments that rely entirely on social preferences in Portuguese hospitality and tourism (i.e. Theme Park Experiment (Radical Tourism); Tour Boat Experiment (Douro River) and Religious Tourism (Fátima)). This study is an exploratory research based on a quantitative approach with the increasing competition among tourist and specific tourism contexts. At the end of the study, some limitations will be presented and lines of research will be outlined for the future.

Keywords: Competitiveness, Price Strategy, Seasonality, Tourism Marketing

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1. INTRODUCTION

The field of tourism marketing, in particular, has faced increasing challenges in capturing market dynamics, such as, market fragmentation and diversity (Sousa & Rocha, 2019). New habits, needs and trends in the global tourism arena create more sophisticated consumers who systematically look for different and specific experiences (Sousa & Rocha, 2019). Such context calls for new market approaches (Sousa & Simões, 2010). Therefore, and according to Butler (1994), seasonality has long been viewed as one of the most unique and worrisome facets of the tourism industry. It can be defined as a cyclical pattern that more or less repeats itself each year. It usually refers to a temporal imbalance in the demand, and may be expressed in terms of the number of tourists, their expenditure, and bed nights. Therefore, the majority of the extant literature on seasonality focuses on the examination of destination-specific demand patterns and the consequent problems and social responsibility (e.g. Li et al., 2018; Sousa & Simões, 2018; Casais & Sousa, 2019).

In parallel, participative pricing strategies can be divided into two groups: individual negotiation strategies and collective negotiation strategies (Kim *et al.*, 2009). Participative pricing mechanisms have been used by for-profit entities for quite some time, and some of the most innovative participative pricing strategies have been applied in different industries throughout the past decades. Such is the case of Name Your Own Price (NYOP) and Pay What You Want (PWYW). Therefore, in the present study we will address some specific features of the pricing strategy (in a tourism marketing perspective) and the problematic of tourism seasonality. In the following sections, we intend to present a model proposal to be tested empirically in the future, in an attempt to counteract the negative effect of seasonality.

2. LITERATURE REVIEW

Ask any manager you know and they will almost certainly tell you that one of the hardest tasks they face is defining the optimal pricing strategy to pursue and determining the right price to apply to a product or service. This is true for a vast majority of industries and for most of the companies that operate in the hospitality industry it is no different.

Referencing the works of Keane (1997) and Bertini and Koenisberg (2015), Adhikari (2016) acknowledges that the companies that operate in the hospitality industry spend an inefficient amount of time in the task of determining the right price to apply to their offer. The author believes that the hospitality sector is an environment conducive to these types of issues, as typically their cost structure is composed mainly of fixed costs and the variable costs account for a marginal slice of total costs incurred (Adhikari, 2016). More than ever, the competitive environment of the hospitality sector requires innovative managerial solutions, including innovative pricing solutions.

2.1 Pricing

Recently, in order to answer the question “what is pricing?”, Barros (2017) made reference to Mehadafi (2007), that defines pricing as a process through which the price of a product or service is set, using for that purpose, cost information both endogenous and exogenous to the company, as well as other market related information. Considering the perspective of a company’s performance, the level adequacy of a pricing strategy is positively correlated to its impact on that company’s revenue (Barros, 2017).

If it is quite straightforward that the main goal of a pricing strategy “is maximizing sellers’ profits by capturing consumers’ heterogeneous product valuations and accounting for competition and cannibalization” (Kim *et al.*, 2009; p. 44), the impact of price changes – and, consequently, of different pricing strategies – in a company’s profitability, on the other hand, is much more complex than what was prescribed by the classical economic theory (Webster, 1992).

Recently, the relationship between pricing strategy and a company’s performance was studied by Toni, Milan Saciloto and Larentis (2016). Price related decisions are amongst the most important that a management team can take, since these decisions

potentially have a great impact in a company's performance and competitiveness.

In addition, Kim *et al.* (2009) point out that “consumers’ reactions to different pricing strategies may not be purely rational but rather driven by behavioural aspects, such as perceptions and preferences” (Kim *et al.*, 2009). Indeed, being aware of consumers’ individual preferences towards a product or service and, specifically, of their willingness to pay (WTP) for that same product or service allows the managers to make better decisions related to price levels and pricing strategies (Barros, 2017).

For any manager, having insight on these aspects is essential to pursuit a pricing strategy that is adequate to the competitive environment and that takes into account “valuable sources for increasing profitability of the products offered” (Breidert, Hahsler, & Reutterer, 2006).

The application of pricing strategies to the hospitality industry, and their impact in the profitability of that industry was studied by Antunes (2018). The author makes reference to an idea articulated by Boz *et al.* (2017) that refers that pricing in the hospitality industry is complex and encompasses factors such as the product's characteristics and uniqueness, the competitive environment, the capital and cost structure of the hospitality industry and the consumer's individual preferences and price sensitivity. Hence, in light of this complexity Antunes (2018) – making reference to an idea by Kim *et al.* (2014) – underlines that managers need to be aware of consumers' WTP before setting prices.

The definition of WTP can be found in an article by the authors Chung, Kyle, Petrick and Absher (2011) that, referencing Kyle, Graefe, and Absher (2002) and Laarman and Gregersen (1996), state that the measure of WTP has “often been used to indicate the maximum amount that consumers intend to pay” (Chung *et al.*, 2011, p. 1039). This definition clearly differentiates WTP to ‘reference price’ which is “what consumers expect to pay”, according to the definition by McCarville and Crompton (1987). In a nutshell, it is important to generate value as much as possible, and this can only be done by capturing the individual preferences of each consumer (e.g. *brand or place attachment*) (Sousa & Vieira, 2018). Some pricing strategies can be a useful to help companies achieve that goal.

2.2 Participative pricing and PWYW

Lately, the quest for differentiation has guided the strategy of a large number of

companies around the world. However, this is not always easily internalized by companies which leads companies to share with their customers some power in defining the offer. However, the element of marketing-mix that has been most impervious to sharing power with consumers is precisely the price (Barros, 2017).

Referring to a study by Spann and Tellis (2006), Kim *et al.* (2009) state that participative pricing mechanisms “allow for differentiated prices accounting for consumer heterogeneity and enable consumers (buyers) to exert some control over the final price for the transaction” (Kim *et al.*, 2009, p. 44) taking into account the heterogenous characteristics of the consumers and increasing the efficiency.

Moreover, Kim *et al.* (2009) made reference to an article by Spann, Skiera and Schaefers (2004) that found that participative pricing mechanisms can allow companies to collect valuable information about their customers, specifically their WTP for a certain product.

Kim *et al.* (2009) argues that participative pricing mechanisms allow the seller can serve buyers who would otherwise be priced out of the market. Participative pricing leads to a greater intent to purchase, that experienced consumers prefer participative pricing mechanisms to predetermined prices and that these mechanisms “may increase a seller’s popularity by word of mouth” (Kim *et al.*, 2009). Participative pricing strategies can be divided into two groups: individual negotiation strategies and collective negotiation strategies.

The classic auction - where several buyers compete with each other to be able to buy the product from the selling counterpart -, the reverse auction - where multiple sellers compete with each other to be able to sell a product to a buying counterpart - and the exchange - where a multiplicity of buyers and sellers co-exist and the products are transacted whenever there is a match between a required value of a seller and a value offered by a buyer - are the most prominent collective negotiation pricing mechanisms presented by Kim *et al.* (2009). In the case of participative pricing mechanisms of individual negotiation, the most important are the PWYW and the Name Your Own Price (NYOP) mechanisms, where the buyer sets the final price of the transaction. However, these two pricing mechanisms are distinguished by the existence of a minimum price established by the seller and unknown to the buyer in the case of NYOP, which does not exist in the PWYW mechanism. (Kim *et al.*, 2009). In the case of the later, Kim *et al.* (2009) defines PWYW simply as a participative pricing strategy where

the seller delegates the price determination entirely to the buying counterpart.

According to Dekhili and Connan Ghesquire (2013), this means that the amount paid by the consumer will take into account not only the cost of the product or service, but most importantly what the consumer can and is willing to pay for it. From the consumer's perspective this opens the possibility of not only take advantage of a lower price, but also actively participate in the offer (Dekhili and Connan-Ghesquiere, 2013). From the seller's standpoint, Dekhili and Connan Ghesquire (2013) state that this strategy can constitute an element of differentiation that arises curiosity from the consumer and, consequently increase the seller's market share and the market's awareness towards the company that implements a PWYW strategy.

As we have mentioned before for the participative pricing strategies as a whole, the Pay What You Want strategy allows the seller to gather important information about the consumer, namely his WTP and, from this information the seller can adjust his cost structure (Dekhili and Connan-Ghesquiere, 2013).

Another benefit mentioned by Dekhili and Connan Ghesquire (2013) is the novelty effect that can generate word-of-mouth marketing and free publicity from the media.

Authors Chao, Fernandez and Nahata (2015), making reference to an article by Machado and Sinha (2013), say that behavioural factors such as fairness and reciprocity "could make PWYW a viable pricing option" (Chao *et al.*, 2015) and that this pricing strategy could increase the market size and, in some cases, lead to consumers paying amounts above their reference price.

Despite these potential advantages, this pricing strategy has an obvious drawback underlined by Kim *et al.* (2009) and Dekhili and Connan Ghesquiere (2013): an economically rational consumer can take advantage of this mechanism to pay an amount below the cost of production of a product, even zero. Notwithstanding the potential risk of free riders, Chao *et al.* (2015) consider that the PWYW strategy can take advantage of the inefficiencies of a fixed price strategy when the "marginal cost is low and the behavioural considerations are strong" (Chao *et al.*, 2015, p. 176).

The theory of transaction utility declares that each consumer is willing to purchase a product or service at a given price if that price is below his reference price (Thaler, 1983). Thaler (1983) states that the transaction utility function "represents the pleasure (or displeasure) associated with the financial terms of the deal per se" (Thaler, 1983).

According to Thaler (1983) the transaction utility "is a function of the difference

between the selling price and the reference price” (Thaler, 1983). Thaler (1983) explains that, from a consumer’s point of view, if the price of a product or service is lower than his reference price, the consumer evaluates the transaction as a good deal. On the other hand, if the price of a product or service is higher than the consumer’s reference price, he will consider the transaction to be a bad deal therefore, with a negative transaction utility (Thaler, 1983). Under a uniform price condition, the consumer’s utility function is given as (Chao *et al.*, 2015, p. 178):

$$U^u = v - p^u$$

Chao *et al.* (2015) follow Richard Thaler’s theory and assume that under PWYW conditions, consumer seek to “maximize the consumption utility; and to minimize the transaction utility which is a function of social preferences” (Chao *et al.*, 2015, p. 178). Chao *et al.* (2015) justify this with observed experiments in PWYW where consumers get disutility when they pay zero or a very small amount.

According to (Egbert, Greiff, & Xhangolli, 2015), under PWYW conditions, a buyer “derives utility from three sources: First, from the consumption of a good of a specific quality, second, from the atmosphere in which purchase and consumption take place, and, third, from the image associated with buying the good at a specific price” (Egbert *et al.*, 2015). Translating into Thaler’s work, “the first and the second concept correspond to Thaler’s “acquisition utility””, and the third concept can be related to what Thaler calls “transaction utility” (Thaler, 1985, pp. 204-205)” (Egbert *et al.*, 2015). To account for social preferences and behavioural factors Chao *et al.* (2015) derive the utility function under PWYW conditions:

$$U^{pwYW} = v - p - \theta \cdot (R - p)^2$$

The additional second term in this PWYW utility function “represents the transaction utility that internalizes the disutility from not paying a “fair” price” (Chao *et al.*, 2015, p. 178).

Following the application of their model, Chao *et al.* (2015) have concluded that PWYW can more profitable than fixed pricing when the marginal costs are low and behavioural considerations are strong enough to encourage consumers to voluntarily

pay positive amounts.

This idea is shared by Kim *et al.* (2009) that believes that PWYW is ideal for products with high fixed costs and low variable costs, since the seller can still achieve profits when the prices paid are low, and for “capacity-constrained services if the capacity of the applying organisation is not fully used” (Kim *et al.*, 2009). One can find a number of examples of successful applications and experiments with PWYW in real businesses, as we will demonstrate next.

2.3 Real world applications of pay what you want pricing

Participative pricing mechanisms have been used by for-profit entities for quite some time, and some of the most innovative participative pricing strategies have been applied in different industries throughout the past decades. Such is the case of NYOP and PWYW. Considering the case of NYOP, one can find this strategy applied in a number of successful companies like Priceline, Expedia.com and Ashampoo (Hinz, Hann and Spann, 2011). As Hinz *et al.* (2011) mentions, the success of Priceline’s application of NYOP can be attested by \$1,885 million generated in revenue and gross profits of \$956 million attained in 2008 by this company. In the case of PWYW, the application of this pricing mechanism in the real world can be found in different industries like restaurants, cinemas, museums and digital music, among others.

Perhaps the most notorious application of PWYW pricing was made the English rock band Radiohead, at a time when the music industry faced many challenges. “In October 2007 the band announced that fans could download a new album from the band’s website and pay whatever they liked” (Egbert *et al.* 2015), including zero. Egbert *et al.* (2015), mention that, according to the statistics shared by Music Ally (2008) the band was able to generate “more revenue in the three months when the album was offered under PWYW than the total revenue generated by another album of the band” (Egbert *et al.*, 2015, p. 252).

Kim *et al.* (2009), in their article “Pay What You Want: A new participative pricing mechanism”, provided the readers with the example of a Pakistani restaurant in Vienna that, since its opening in 2005 has allowed their costumers to pay the amount they wanted for the food. The media reports show, according to Kim *et al.* (2009), that the application has been very successful, to the point that the restaurant has expanded to other location just “two months after opening” (Kim *et al.* 2009) and the business model

has been copied or adapted by other restaurants and fast food chains around the world. But the PWYW pricing strategy has also generated curiosity in the scientific community in recent years, to the point that several experiments have been made to study the effects of this strategy in the performance of businesses around the world.

Gneezy *et al.* (2012) have conducted a significant number of field experiments to study this relationship. In particular, Gneezy *et al.* (2012) have conducted a study at a very famous amusement park in the United States Of America. The participants “rode a rollercoaster-like attraction, were photographed during the ride, and later chose whether or not to purchase a print of the photo” (Gneezy *et al.*, 2012). The consumer behaviour of the participants was studied under four treatments: fixed price; fixed price with 50% of the proceedings going to charity; PWYW pricing; and PWYW with 50% of the revenue going to charity (Gneezy *et al.*, 2012). The usual price of a photograph in this ride, and the amount paid under fixed price conditions, was \$12.95. Gneezy *et al.* (2012) found with this experiment were that applying a PWYW strategy to this business greatly increased the number of people willing to buy a photograph (0.59% in fixed pricing vs 8.39% in PWYW) while the average amount paid per photograph was \$0.92. The authors also found that incorporating a charity feature to the PWYW resulted in fewer units sold (4.49% of the participants) but the average price per photograph was significantly higher at \$5.33. Gneezy *et al.* (2012) interpret these results as the participants thinking that “the “right” price for the PWYW + charity treatment was more than five times larger than that in the regular PWYW treatment” (Gneezy *et al.*, 2012, p. 7237). The authors refer that their “data support the proposition that people prefer to avoid buying in the PWYW + charity treatment because they would rather forego the opportunity than risk paying too little and harming their prosocial self-image” (Gneezy *et al.*, 2012, p. 7237).

Another field study performed by these authors was applied in a boat tour company, where the authors “manipulated the price of the photos” (Gneezy *et al.*, 2012) taken at the end of each tour. Adding to the usual fixed price of \$15 charged per photo, the authors included a PWYW scenario and a reduced fixed price scenario (\$5 per photo). Concomitantly to their expectations, the PWYW scenario resulted in more transactions than the usual \$15 price setting and the average amount paid was lower than the usual price but still significantly higher than zero (\$6.43 per photo) (Gneezy *et al.*, 2012). In this experiment Gneezy *et al.* (2012) also found that, in terms of profitability, the

PWYW scenario produced the best results. (Gneezy *et al.*, 2012).

2.4 Seasonality in tourism

In the past few decades, tourism has clearly become one of the most prominent economic trends for many countries. For many destinations, this trend will continue to rise and tourism will become the most dynamic and fastest growing sector of the economy (Goh & Law, 2002). Over the years there has been an increase in competition among tourism destinations (Becken & Simmons, 2002), leading to the need for a deeper understanding about the tourism realm, impact and management (Ferreira *et al.*, 2018), sustainability (Machado & Sousa, 2018) and also digital marketing in hospitality (Dinis *et al.*, 2016; Oliveira & Remondes, 2018). Tourism, as an area of study, has expanded its scope, reflecting an increasing recognition in the academic community paralleled by the application of interdisciplinary concepts and methods (Sousa & Simões, 2010). Indeed, research in tourism has been studying its various implications from a multitude of perspectives and with interdisciplinary insights (Echtner & Jamal, 1997). Areas in tourism research entail, for example, planning of tourism destinations, local development, environmental impact, territorial brand management and tourist loyalty (Getz, 1986; Embacher & Buttle, 1989; Backman & Crompton, 1991). In this context, seasonality is one of the most problematic but least understood aspects of tourism. Many destinations are suffering from this phenomenon every year, yet limited efforts have been made to overcome the troublesome issue. According to Jang (2004), it is generally agreed that seasonality is due to two main factors: natural and institutional (Baron 1975; Hartman 1986). The former is usually caused by regular climatic changes throughout the year, such as temperature, rainfall, snowfall, and sunlight (Butler 1994). According to McEniff (1992), the literature examines the demand aspects of seasonality mostly from tourism management's standpoint and views it as a problem of considerable magnitude. In the tourism industry, seasonality has a notable impact on many aspects of tourism economy. Witt & Moutinho (1994) presented many studies on seasonal variability in tourism that basically stressed the problems and disadvantages caused by seasonality. (Witt & Moutinho, 1994, p. 88) also stressed the importance of extending these studies further (Goh & Law, 2002). Many economic time series exhibit strong seasonal fluctuations. Seasonality is caused basically by three reasons: weather effect, festival effect, calendar effect (Hyllebert, 1992). The tourism industry is affected predominantly by all these three factors in both the origin country and destination

country (Lim, 2001). Climate and climate variables, which affect the choice of destination and the distribution pattern of tourists in different seasons, are greatly relevant to tourism stakeholders in both the private and public sectors. These variables affect not only the profitability of day-to-day operations but also the planning and design of tourism facilities to maintain destination competitiveness in the future (Zhang & Kulendran, 2017). Also word-of-mouth communications have received extensive attention from both academics and practitioners for decades (De Bruyn & Lilien, 2008). The use of social media has increased the relevance of WOM. According to Brown (2007), WOM is a consumer dominated channel of marketing communication where the sender is independent of the market (Silva, Machado & Cruz, 2017).

3. RESEARCH PROPOSITIONS

Gneezy *et al.* (2012) state in their article that under PWYW conditions, a consumer pays a price that feels right rather than simply the lowest price possible (Gneezy *et al.*, 2012). The results of the experiments made by Gneezy *et al.* (2012) led the authors to conclude that, “in different market contexts”, PWYW can be a sustainable and profitable pricing strategy in the long run. A pricing scheme known as “pay-what-you-want” (PWYW) can help answer both of these questions. To address the first question, nonselfish behaviour in the form of PWYW definitely exists in markets. As a future research, we suggest putting to test Gneezy *et al.* (2012) statement and testing the hypothesis that a PWYW pricing strategy can be economically viable and sustainable in the long run in the specific context of the hospitality industry. According Liang *et al.* (2018), perceived authenticity was found to have a significant effect in reducing Airbnb consumers’ perceived risk and positively influencing their perceived value. Electronic word-of-mouth has a positive effect on repurchase intention as well as perceived value whereas it negatively affects perceived risk.

Participative pricing mechanisms have been used by for-profit entities for quite some time, and some of the most innovative participative pricing strategies have been applied in different industries throughout the past decades. Such is the case of NYOP and PWYW. What motivates prosocial behaviour in markets? This preliminary study intends to provide evidence that identity and self-image concerns are potentially very important (in specific tourism contexts). Three field experiments will involve PWYW pricing demonstrate that companies can sustain profitability with payments that rely

entirely on social preferences in Portuguese hospitality and tourism (i.e. Theme Park Experiment (Radical Tourism); Tour Boat Experiment (Douro River) and Religious Tourism (Fátima)).

4. CONCLUSION AND FUTURE RESEARCH

Accordingly, great efforts should be made to mitigate the troublesome seasonality in destinations through a variety of approaches. However, although many suggestions have been made for measuring the problems of seasonality, it seems that only limited efforts have been devoted to methods of overcoming them. For instance, and according to Jang (2004), financial portfolio theory is extensively used in the stock market to assist investors' choice of the proportion of their total investment budgets to allocate to different securities. The majority of the extant literature on seasonality focuses on the examination of destination-specific demand patterns and the consequent problems. Although the several studies provided useful information for destination marketers, the existing literature of the seasonality reduction has concentrated on qualitative solutions (Jang, 2004). Thus, more effort and attention is needed to overcome the problematic aspects of tourism seasonality. In that respect, this preliminary research is expected to contribute to the literature by expanding the horizon of tackling seasonality through a quantitative approach. In specific, we intend this preliminary study intends to provide evidence that identity and self-image concerns are potentially very important (in specific tourism contexts).

Gneezy *et al.* (2012) investigate the role of identity and self-image consideration under “pay-what-you-want” pricing. Results from different field experiments show that the application of this pricing strategy has generally allowed sellers to increase their sales volume (Barros, 2017). Nonetheless, Gneezy *et al.* (2012) also found evidence that, when granted the opportunity to name the price of a product, fewer consumers choose to buy it than when the price is fixed and low. Gneezy *et al.* (2012) show that this opt-out behaviour is driven largely by individuals' identity and self-image concerns; individuals feel bad when they pay less than the “appropriate” price, causing them to pass on the opportunity to purchase the product altogether. Therefore, we intend that three Portuguese field experiments will involve PWYW pricing demonstrate that companies can sustain profitability with payments that rely entirely on social preferences in Portuguese hospitality and tourism (i.e. Theme Park Experiment (Radical Tourism);

Tour Boat Experiment (Douro River) and Religious Tourism (Fátima)). Future research and next results should provide strong support for the PWYW mechanism in different tourism contexts, by suggesting that this profitability can often be sustained in the long run. This study is an exploratory research based on a quantitative approach with the increasing competition among tourist and specific tourism contexts, managers should also to develop an emotional brand connected to the service and product tourism. Based on the underlying idea of seasonality in tourism, this study addresses the specific needs of the tourist market in a specific tourism contexts with an interdisciplinary perspective (marketing, price strategy and tourism).

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