



SERVICE MARKETING

CHAPTER 6: SETTING PRICE AND IMPLEMENTING REVENUE MANAGEMENT

OVERVIEW

6.1 Effective Pricing

6.2 Pricing Strategy

6.3 Revenue Management

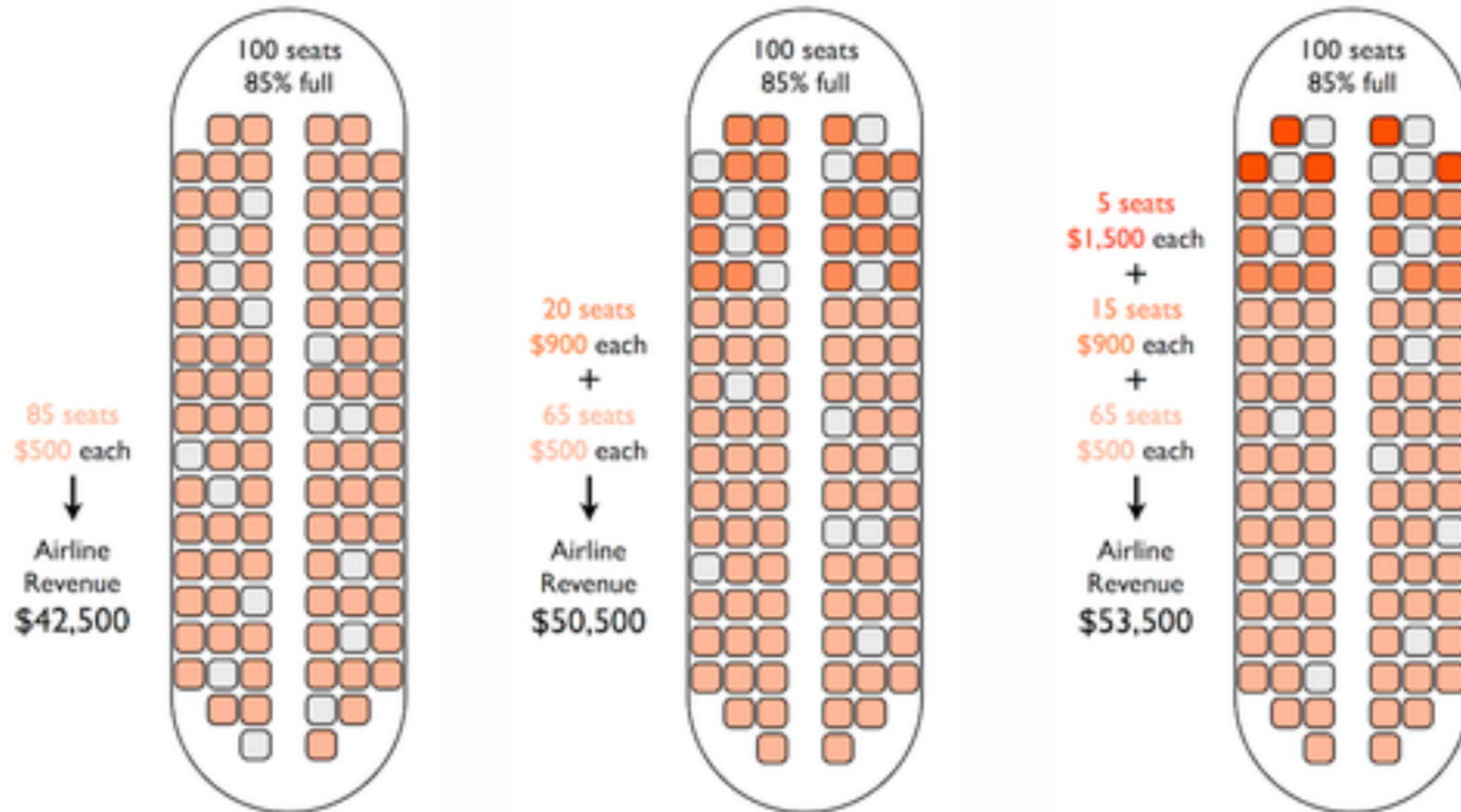
6.4 Ethical Concerns in Service Pricing

EFFECTIVE PRICING IS ESSENTIAL TO FINANCIAL SUCCESS



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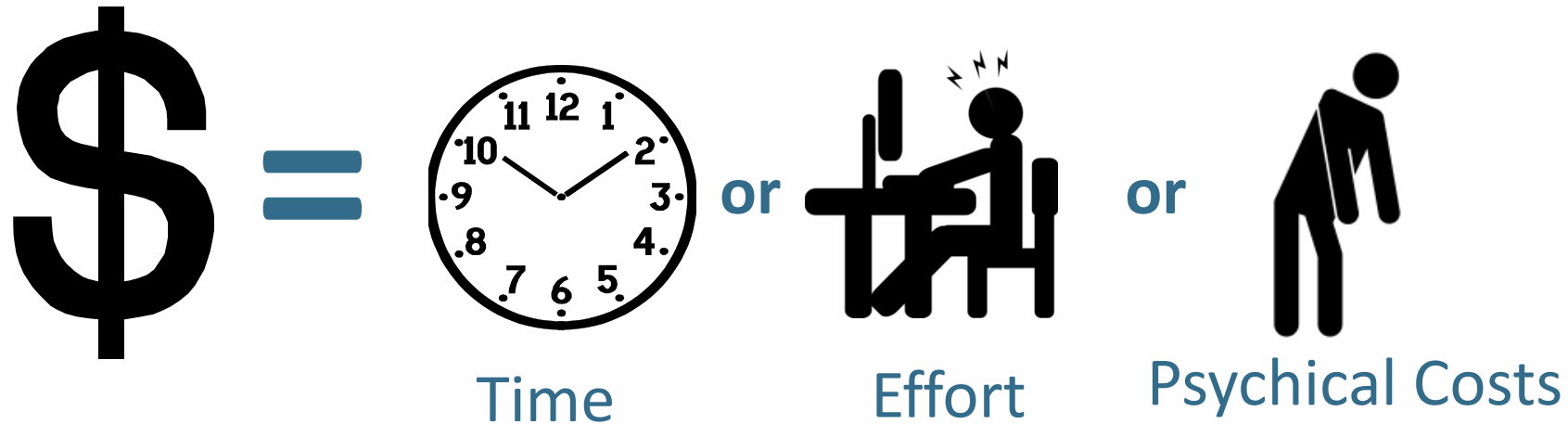
PRICING CONCEPT



WHAT MAKES SERVICE PRICING STRATEGY DIFFERENT AND DIFFICULT?

Variability of **inputs** and **outputs**:

- How can firms define a “*unit of service*” and establish **basis** for pricing?



Importance of **time factor** – same service may have more value to customers when *delivered faster*

Customers find service pricing **difficult to understand, risky**, and sometimes even **unethical**

OBJECTIVES FOR PRICING OF SERVICES

Revenue and Profit Objectives

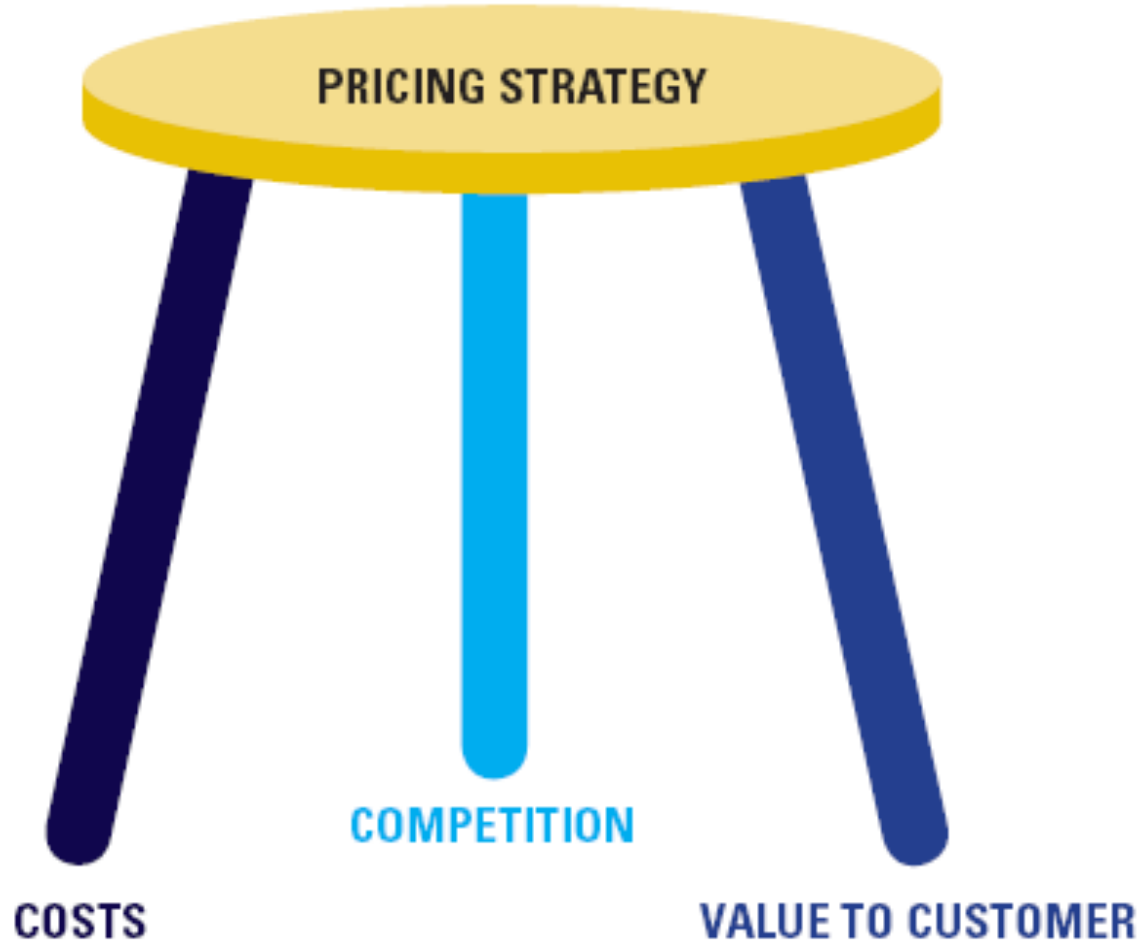
- Seek profit
- Cover costs

Patronage and User-Based Objectives

- Build demand
 - Demand maximization
 - Full capacity utilization
- Build a user base
 - Stimulate trial and adoption of new service
 - Build market share/large user base

PRICING STRATEGY

THE PRICING TRIPOD

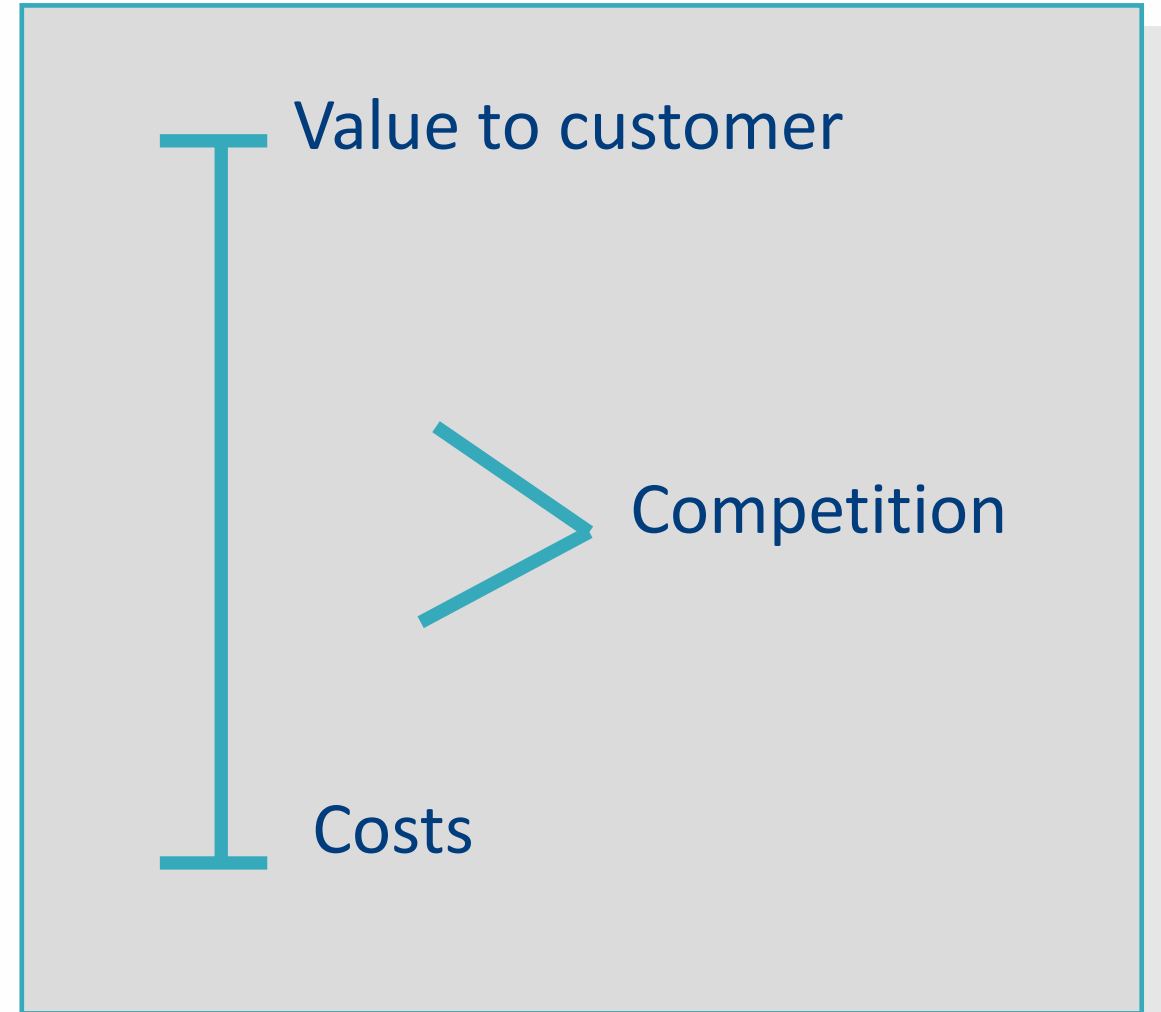


The foundations underlying **pricing strategy** can be described as a tripod, with **costs** to the provider, **competitors' pricing**, and **value** to the **customer** as the three legs.

FLOOR AND CEILING PRICE

In the pricing tripod, the costs a firm needs to recover usually sets a **minimum** price, or floor, for a specific service offering, and the customer's perceived value of the offering sets a **maximum**, or ceiling.

The price **charged** by competing services typically determines where, within the floor-to-ceiling range, the price can be set.



THREE MAIN APPROACHES TO PRICING

Cost-Based Pricing

- Set prices relative to financial costs
- Activity-Based Costing
- Pricing implications of cost analysis

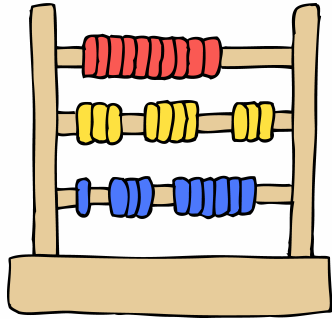
Value-Based Pricing

- Relate price to value perceived by customer

Competition-Based Pricing

- Monitor competitors' pricing strategy
- Dependent on the price leader

COST-BASED PRICING: TRADITIONAL VS ACTIVITY-BASED COSTING



Traditional costing approach

- Emphasizes expense categories (arbitrary overheads allocation)
- May result in reducing value generated for customers



ABC management systems

- Link resource expenses to variety and complexity of goods/services produced
- Yields accurate cost information

Customers only care about **value to themselves**, not what service production costs the firm

VALUE-BASED PRICING: UNDERSTANDING NET VALUE

Net Value = **Perceived Benefits to Customer** (Gross Value) minus
All Perceived Outlays (Money, Time, Mental/Physical Effort)

Consumer surplus: difference between *price paid* and amount *customer* would have been *willing to pay* in absence of other options

Competing services are then evaluated via comparison of net value

VALUE-BASED PRICING: STRATEGIES FOR ENHANCING NET VALUE

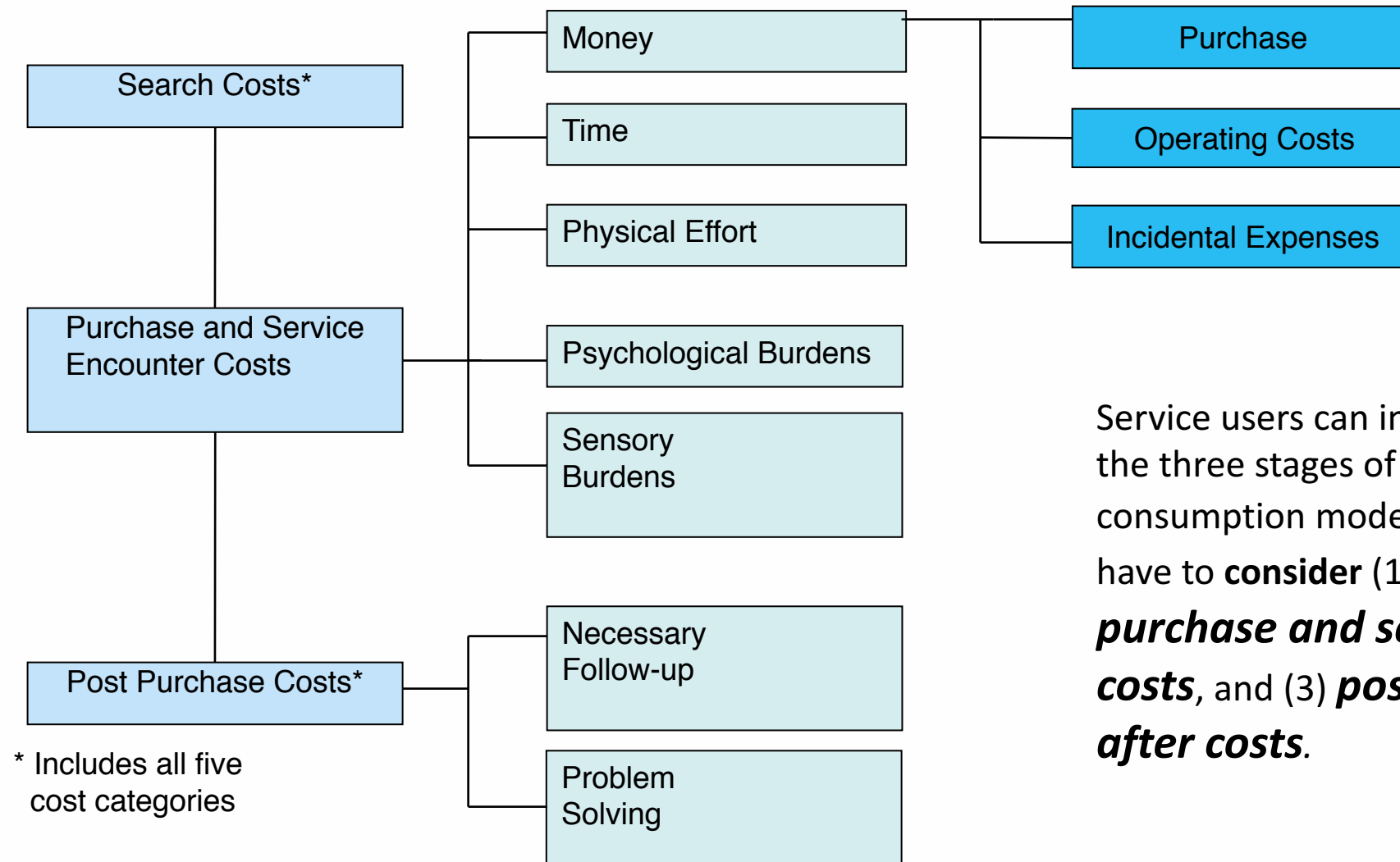
Enhance gross value – benefits delivered

- Add benefits to core product
- Enhance supplementary service
- Manage perceptions of benefits delivered

Reduce costs incurred by

- Reducing monetary costs of acquisition and usage
- Cutting amount of time required to evaluate, buy, use service
- Lowering effort associated with purchase and use

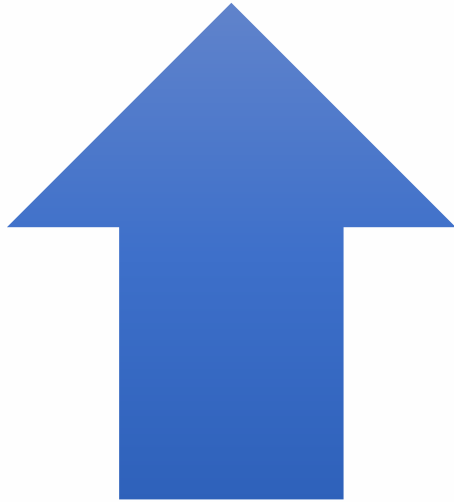
DEFINING TOTAL USER COST



* Includes all five cost categories

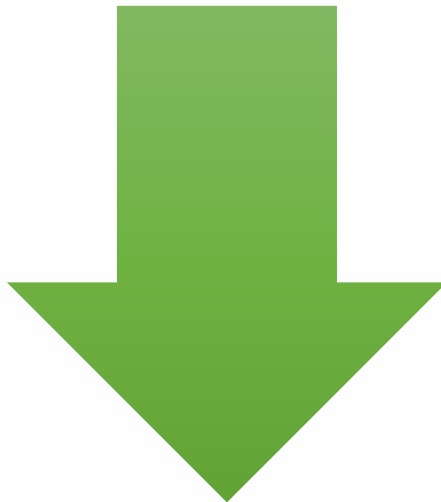
Service users can incur costs during any of the three stages of the service consumption model. Consequently, **firms** have to **consider** (1) ***search costs***, (2) ***purchase and service encounter costs***, and (3) ***postconsumption or after costs***.

COMPETITION-BASED PRICING



Price competition increases due to:

- Increasing competition
- Increase in substituting offers
- Wider distribution of competitor
- Increasing surplus capacity in the industry



However under these circumstances, price competition can decrease:

- High non-price-related costs of using alternatives
- Personal relationships matter
- Switching costs are high
- Time and location specificity reduces choice
- Managers should examine all related financial and non-monetary costs

COMPETITIVE-BASED PRICING

This table identifies a choice of **three clinics** available to an individual who needs to obtain a **routine chest X-ray**.

In addition to **varying dollar prices** for the service, different **time** and **effort costs** are associated with using each service.

Which clinic would you patronize if you needed a chest x-ray (assuming that all three clinics offer good technical quality)?		
Clinic A	Clinic B	Clinic C
<ul style="list-style-type: none">• Price \$65• Located 1 hour away by car or transit• Next available appointment is in 3 weeks• Hours: Monday – Friday, 9am – 5pm• Estimated wait at clinic is about 2 hours	<ul style="list-style-type: none">• Price \$125• Located 15 min away by car or transit• Next available appointment is in 1 week• Hours: Monday – Friday, 8am – 10pm• Estimated wait at clinic is about 30 to 45 minutes	<ul style="list-style-type: none">• Price \$185• Located next to your office building (or college)• Next available appointment is in 1 day• Hours: Monday – Saturday, 8am – 10pm• By appointment – estimated wait at clinic is about 0 to 15 minutes

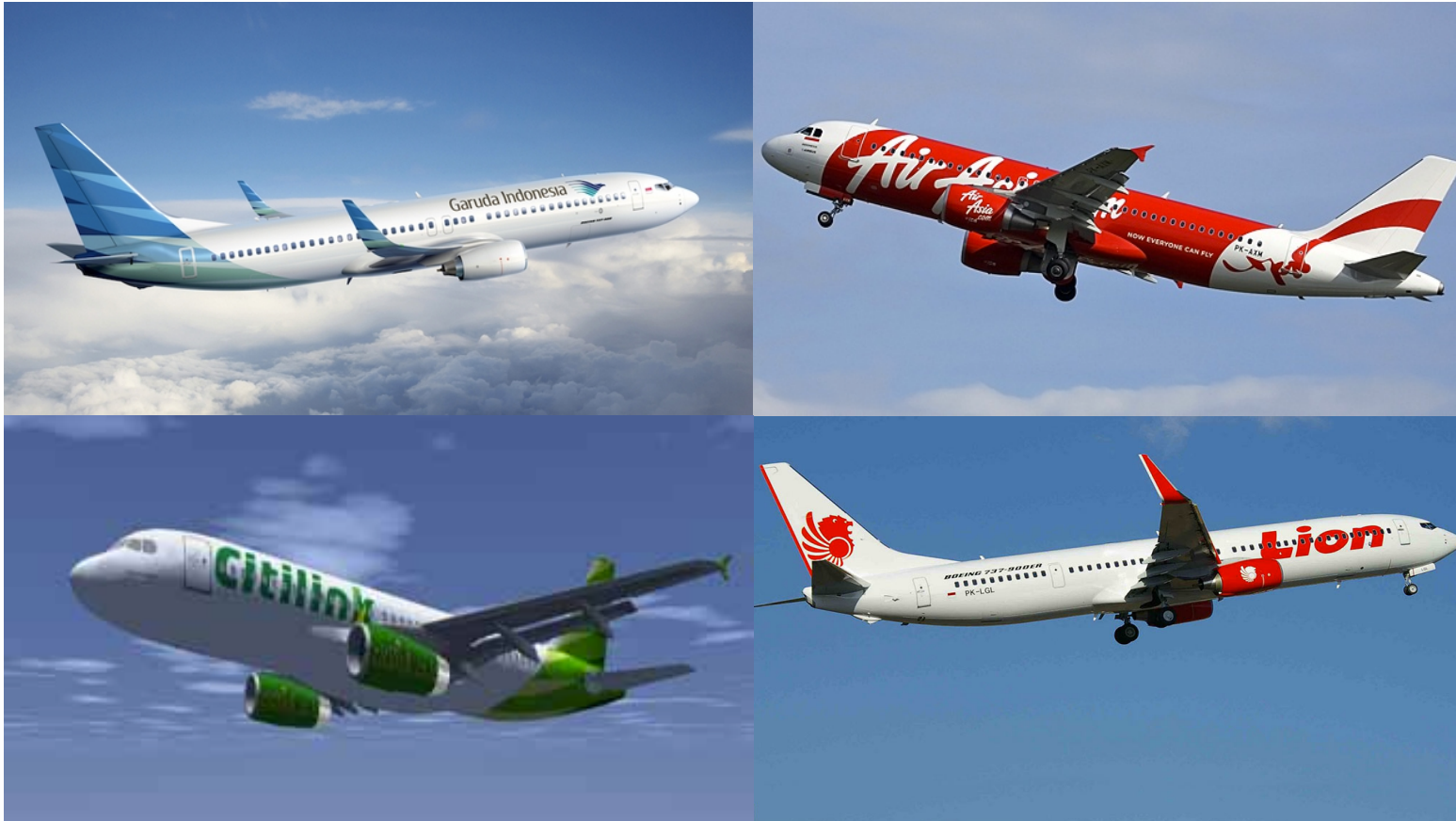
REVENUE MANAGEMENT

Revenue management (RM) is price customization

- Charge different value segments **different prices** for same product based on price sensitivity

- ➔ **Maximizes revenue** from a given capacity at a point in time
- ➔ **Manage demand** and **set prices** for each segment closer to perceived value
- ➔ **Use of rate fences**

PRICING IN AIRLINE INDUSTRIES



HOW DO AIRLINES SET PRICES?

The price of your ticket consists of a number of things (Schlick, 2003)



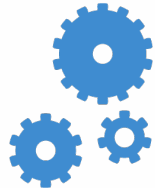
Base fare



Taxes and airport fees



Fuel surcharge



Service fee to issue



Food



Seat selection



Baggage

The last four are sometimes optional (especially for **low-cost airlines**) where you pay for them on top of the ticket price if you want them included. With the older, **more traditional airlines**, and for **long-haul flights**, these things are usually included in the ticket price.

EXAMPLE: PRICE COMPONENT

Citilink

DETIL HARGA	
	
Penerbangan berangkat Surabaya (SUB) to Jakarta (Soekarno Hatta) (CGK)	
1 Adult	Rp.417,000
Passenger Tax/Fees	
Passenger Service Charge / PSC	Rp.75,000
Insurance Surcharge	Rp.5,000
Value Added Tax	Rp.41,700
<hr/>	
Total harga	Rp.538,700
Semua jumlah yang ditampilkan adalah dalam IDR.	

Lion air

TOTAL TAXES & FEES

Base Fare	IDR	417,000
<u>Total Fuel Surcharge, Taxes & Fees</u>	IDR	121,700
Travel Insurance	IDR	18,500
TOTAL	IDR	557,200

Please ensure that you read the Fare Rules for terms & conditions, penalties, cancellation or change fees before purchasing your ticket.

[To view the fare rules in full click here](#)

TYPES OF PASSENGER

Business travelers

flexible on **price** (the company is paying) but not on dates

Leisure travelers

flexible on **dates** but are not on price (the cheaper the better)

The airline knows that as the departure date gets closer, *business travelers* who are still buying tickets really need to get where they're going on time.

People who buy far in advance are typically *leisure travelers* who just pick whatever's cheapest.

PRICING OF AIRLINE TICKETS

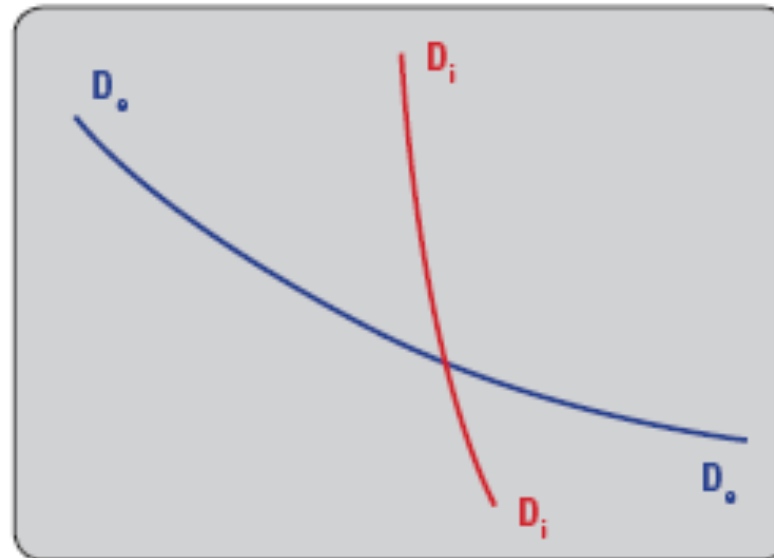
Airline ticket pricing is based on *demand supply dynamics*.

An airline is always trying to get maximum value for its seats, but it has to try to **sell** them all **before departure** or they will become worthless forever.

Just like a grocery store that puts stuff on sale to get food out the door before it spoils, an airline will **sell tickets** but not at one price but at a *range of prices* all this to run the airlines efficiently.

PRICE ELASTICITY

PRICE PER UNIT
OF SERVICE



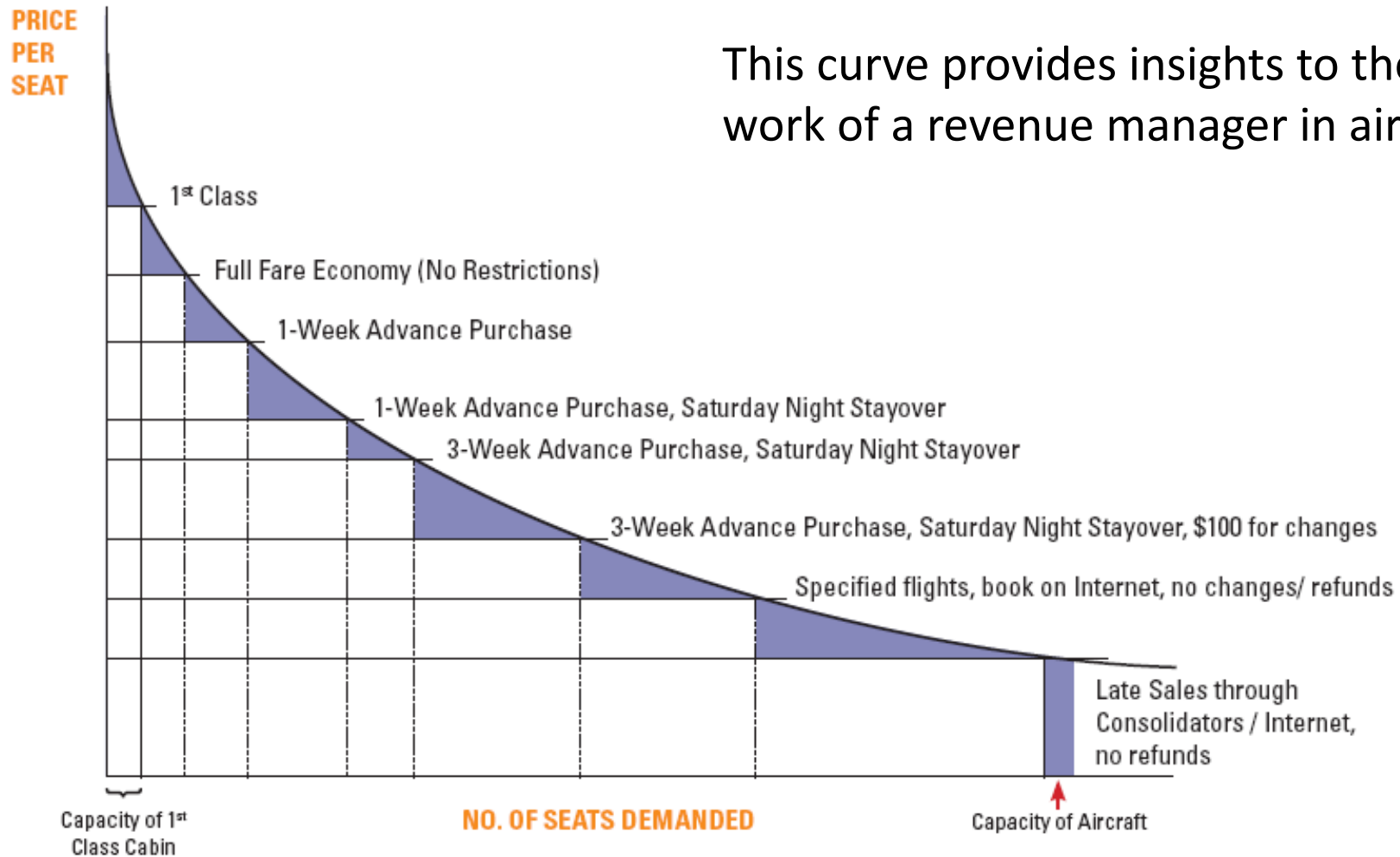
QUANTITY OF UNITS DEMANDED

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

D_e : Demand is *price elastic*. Small changes in price lead to big changes in demand

D_i : Demand for service is *price inelastic*. Big changes have little impact on demand

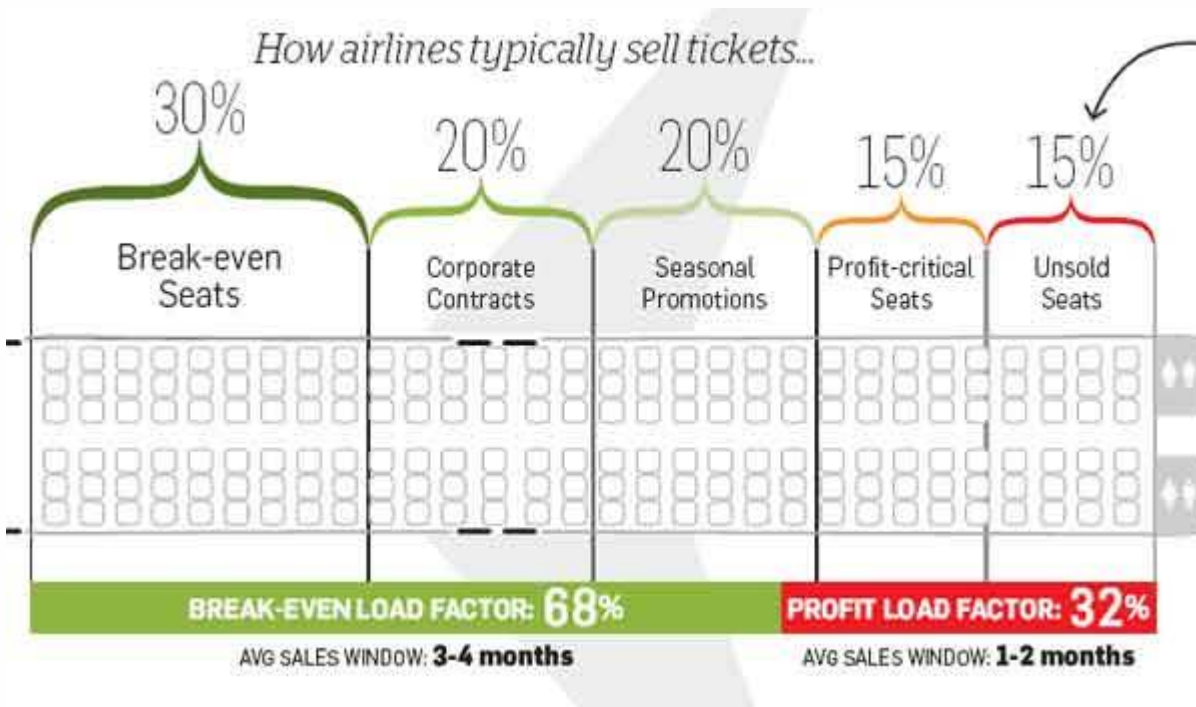
RELATING PRICE BUCKETS AND FENCES TO DEMAND CURVE: AIRLINES



This curve provides insights to the thinking and work of a revenue manager in airline industry

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

LOAD FACTOR IN AIRLINE SERVICE



Passenger load factor, or load factor, measures the **capacity utilization** of **public transport services** like airlines, passenger railways, and intercity bus services.

Load Factor is generally used to assess how **efficiently** a **transport provider fills seats** and **generates fare revenue**. It is passenger-kilometres flown as a percentage of seat-kilometres available.

CASE STUDY I: GARUDA INDONESIA



Garuda Indonesia
The Airline of Indonesia



About Garuda Indonesia



The Pride of Indonesia

Garuda Indonesia is the flag-carrier of Indonesia, the largest archipelago national. Garuda Indonesia flies to over 40 domestic and 36 international destinations and was named as World's Best Regional Airline by Skytrax.

Flew for the first time in 1949, today Garuda Indonesia carries more than 25 million passengers annually.

GARUDA INDONESIA – ECONOMY CLASS



	ECO SPECIAL PROMO	ECO PROMO	ECO AFFORDABLE	ECO FLEXIBLE	BUSINESS PROMO
Priority Check In	GarudaMiles Gold & Above	GarudaMiles Gold & Above	GarudaMiles Gold & Above	GarudaMiles Gold & Above	Yes
Priority Baggage	GarudaMiles Gold & Above	GarudaMiles Gold & Above	GarudaMiles Gold & Above	GarudaMiles Gold & Above	Yes
Lounge Access	GarudaMiles Gold & Above	GarudaMiles Gold & Above	GarudaMiles Gold & Above	GarudaMiles Gold & Above	Yes
Comfortable Seat Request	with fee	with fee	with fee	Yes	Comfortable Business Seat
Seat Request	with fee	with fee	Yes	Yes	Yes
Baggage Allowance (GA operated flight only)	20 kg	20 kg	20 kg	20 kg	30 kg
Miles	N/A	0 up to 25% Miles	75% up to 100%	100%	125%
Refund	From 90% Penalty Fee	From 75% Penalty Fee	From 15% Penalty Fee	From 10% Penalty Fee	From 15% Penalty Fee
Changes	Not allowed	Fee Applies	Fee Applies	No Fee (2 hour before departure)	Fee Applies
Child Discount	N/A	N/A	Up to 25%	25%	25%
Infant Discount	90%	90%	90%	90%	90%
BidUpgrade eligibility	N/A	N/A	Yes	Yes	N/A



SURABAYA
Juanda (SUB)



JAKARTA
Soekarno Hatta International (CGK)



FRI 27 OCT

OCTOBER 2017

-7 Previous 7 days	TUE 24 from IDR 823,200	WED 25 from IDR 823,200	THU 26 from IDR 823,200	FRI 27 from IDR 823,200	SAT 28 from IDR 687,900	SUN 29 from IDR 823,200	MON 30 from IDR 687,900	+7 Next 7 days
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Order by ▼ Filter flights ▼

Lowest Fares Selected fare

[Show fare comparison](#)

ECO SPECIAL PROMO 	ECO PROMO 	ECO AFFORDABLE 	ECO FLEXIBLE 	BUSINESS PROMO
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05:25 Juanda (SUB)

07:00 Soekarno Hatta International (CGK)

Total duration **01h35m**, Direct flight
Garuda Indonesia (GA303)

[Show flight details](#)

IDR 836,200 823,200	IDR 1,057,500	IDR 1,299,500	IDR 1,604,200	not available
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GARUDA INDONESIA – BUSINESS CLASS

Fly in Luxury for Less
with our Business Class Sale

▶ *Look Forward*



THE NEW DEFINITION OF TRAVELING IN STYLE



Privacy and comfort

- 38 staggered seats, each guest has direct aisle access
- 43" pitch & 21.2" width seat that reclines into flat bed makes travelling more comfortable
- Ottoman
- Personal storage
- USB & power outlet
- 15" touchscreen LCD with innovative eX2 Panasonic inflight entertainment system



Dynamic & Authentic Dining Experience

- Indulge in world's favorite menus served by the energetic cabin crew.
- When opting for lighter menu, in between fuel and galley snacks are also available.
- All prepared by our Manager Cuisine -qualified chef from 5 star establishments.

	BUSINESS PROMO	BUSINESS FLEXIBLE
Priority Check In	Yes	Yes
Priority Baggage	Yes	Yes
Lounge Access	Yes	Yes
Comfortable Seat Request	Comfortable Business Seat	Comfortable Business Seat
Seat Request	Yes	Yes
Baggage Allowance (GA operated flight only)	30 kg	30 kg
Miles	125%	150%
Refund	From 15% Penalty Fee	From 10% Penalty Fee
Changes	Fee Applies	No Fee (2 hour before departure)
Child Discount	25%	25%
Infant Discount	90%	90%
BidUpgrade eligibility	N/A	N/A



SURABAYA
Juanda (SUB)



JAKARTA
Soekarno Hatta International (CGK)



FRI 27 OCT

OCTOBER 2017

-7 Previous 7 days	TUE 24 from IDR 2,424,800	WED 25 from IDR 2,424,800	THU 26 from IDR 2,424,800	FRI 27 from IDR 2,424,800	SAT 28 from IDR 2,309,300	SUN 29 from IDR 2,309,300	MON 30 from IDR 2,309,300	+7 Next 7 days
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Order by

Filter flights

Lowest Fares Selected fare

Show fare comparison

BUSINESS PROMO



BUSINESS FLEXIBLE



05:25 Juanda (SUB)

07:00 Soekarno Hatta International (CGK)

Total duration **01h35m**, **Direct flight**
Garuda Indonesia (GA303)

Show flight details



not available

IDR

3,233,300

4 seats left

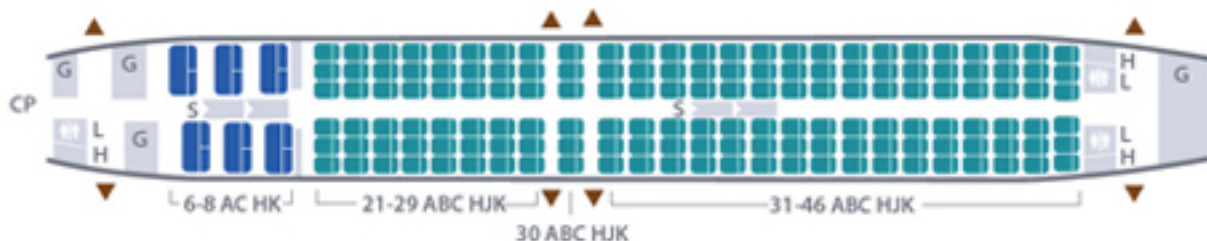
GARUDA INDONESIA SEAT MAP



GA303 (SUB - CGK)

27 OCT 2017 (05.25-07.00)

Aircraft type:



Boeing 737-800NG

SEAT CAPACITY	12/150
CREW	Cockpit 2, Cabin 5
OPERATED IN	2009 - Present

ECO SPECIAL PROMO 	ECO PROMO 	ECO AFFORDABLE 	ECO FLEXIBLE
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BUSINESS PROMO 	BUSINESS FLEXIBLE
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IDR 836,200 823,200	IDR 1,057,500	IDR 1,299,500	IDR 1,604,200
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<p>not available</p>	IDR 3,233,300 4 seats left
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CASE (1): GA 303 – SUB-CGK (27 OCT 2017; 05.25-07.00)

Boeing 737-800NG

SEAT CAPACITY	12/150
CREW	Cockpit 2, Cabin 5
OPERATED IN	2009 - Present

Calculating GA 303 revenue based on given assumption:

SEAT COMPOSITION

100 %

ECO SPECIAL PROMO 	ECO PROMO 	ECO AFFORDABLE   	ECO FLEXIBLE    
---	---	--	--

IDR
~~836,200~~
823,200

IDR
1,057,500

IDR
1,299,500

IDR
1,604,200

100%

BUSINESS PROMO      	BUSINESS FLEXIBLE      
--	---


not available

IDR
3,233,300

4 seats left

CASE (2):

GA 303 – SUB-CGK (27 OCT 2017; 05.25-07.00)

Boeing 737-800NG

SEAT CAPACITY	12/150
CREW	Cockpit 2, Cabin 5
OPERATED IN	2009 - Present

Calculating GA 303 revenue based on given assumption:

SEAT COMPOSITION



CASE STUDY II: LION AIR – ALL ECONOMY CLASS



! You have not selected a departing flight. Please correct your selection and try again

Departure SUB - Fri, 27 Oct 2017 Guest Adult x 1, Child x 0, Infant x 0 [Modify Search](#)

Select Your Departing Flight SURABAYA (SUB) → JAKARTA (CGK) *Prices includes taxes and fees*

[Tue, 24 Oct 2017](#)
[Wed, 25 Oct 2017](#)
[Thu, 26 Oct 2017](#)
[Fri, 27 Oct 2017](#)
[Sat, 28 Oct 2017](#)
[Sun, 29 Oct 2017](#)
[Mon, 30 Oct 2017](#)

Depart	Arrive	Promo	Economy	Business
SUB 05:30 ID 6401 Batik Air	CGK 07:00 Duration: 1h 30min	○ IDR 656,000	○ IDR 777,000	○ IDR 1,503,000
SUB 05:30 ID 6896 Batik Air	CGK 07:00 Duration: 1h 30min	Sold Out	Sold Out	Sold Out
SUB 06:15 ID 6597 Batik Air	CGK 07:45 Duration: 1h 30min	○ IDR 656,000	○ IDR 777,000	○ IDR 1,503,000
SUB 06:15 ID 6852 Batik Air	CGK 07:45 Duration: 1h 30min	Sold Out	Sold Out	Sold Out
SUB 06:45 JT 571 Lion Air	CGK 08:15 Duration: 1h 30min	○ IDR 579,000	○ IDR 623,000	N/A

CASE (3): JT 571 – SUB-CGK (27 OCT 2017; 06.45-08.15)

BOEING 737-800NG

Seat capacity: 189 passengers in an all-economy layout

Calculating JT 751 revenue based on given assumption:

SEAT COMPOSITION

60% 35% 5%

Depart	Arrive	Promo	Economy	Business
SUB 05:30 ID 6401 Batik Air	CGK 07:00 Duration: 1h 30min	○ IDR 656,000	○ IDR 777,000	○ IDR 1,503,000
SUB 05:30 ID 6896 Batik Air	CGK 07:00 Duration: 1h 30min	Sold Out	Sold Out	Sold Out
SUB 06:15 ID 6597 Batik Air	CGK 07:45 Duration: 1h 30min	○ IDR 656,000	○ IDR 777,000	○ IDR 1,503,000
SUB 06:15 ID 6852 Batik Air	CGK 07:45 Duration: 1h 30min	Sold Out	Sold Out	Sold Out
SUB 06:45 JT 571 Lion Air	CGK 08:15 Duration: 1h 30min	○ IDR 579,000	○ IDR 623,000	N/A

REVENUE COMPARISON

REVENUE SIMULATION (LION AIR VS. GARUDA) MORNING FLIGHT, 27 OCT 2017				
AIRLINES	CLASS	NUMBER OF SEAT	TICKET PRICE	REVENUE
LION AIR	PROMO (60%)	113	IDR 579,900	IDR 65,528,700
	ECONOMY (40%)	76	IDR 623,000	IDR 47,348,000
				IDR 112,876,700
GARUDA (CASE 1)	ECONOMY (100%)	150	IDR 823,200	IDR 123,480,000
	BUSINESS (100%)	12	IDR 3,233,300	IDR 38,799,600
				IDR 162,279,600
GARUDA (CASE 2)	ECO SPECIAL PROMO (20%)	30	IDR 823,200	IDR 24,696,000
	ECO PROMO (40%)	60	IDR 1,057,500	IDR 63,450,000
	ECO AFFORDABLE (25%)	37	IDR 1,299,500	IDR 48,081,500
	ECO FLEXIBLE (15%)	23	IDR 1,604,200	IDR 36,896,600
	BUSINESS FLEXIBLE (100%)	12	IDR 3,233,300	IDR 36,799,600
				IDR 209,923,700

ETHICAL ISSUES IN PRICING

Complex pricing schedules

Unfairness and misrepresentation in advertising

Hidden charges

Too many rules and regulations

ORGANIZED BY:

Department of Business Management

Faculty of Business & Management of Technology

Institut Teknologi Sepuluh Nopember

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