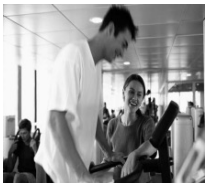


# Services Marketing

## Chapter 6: Setting **Prices** and Implementing **Revenue Management**



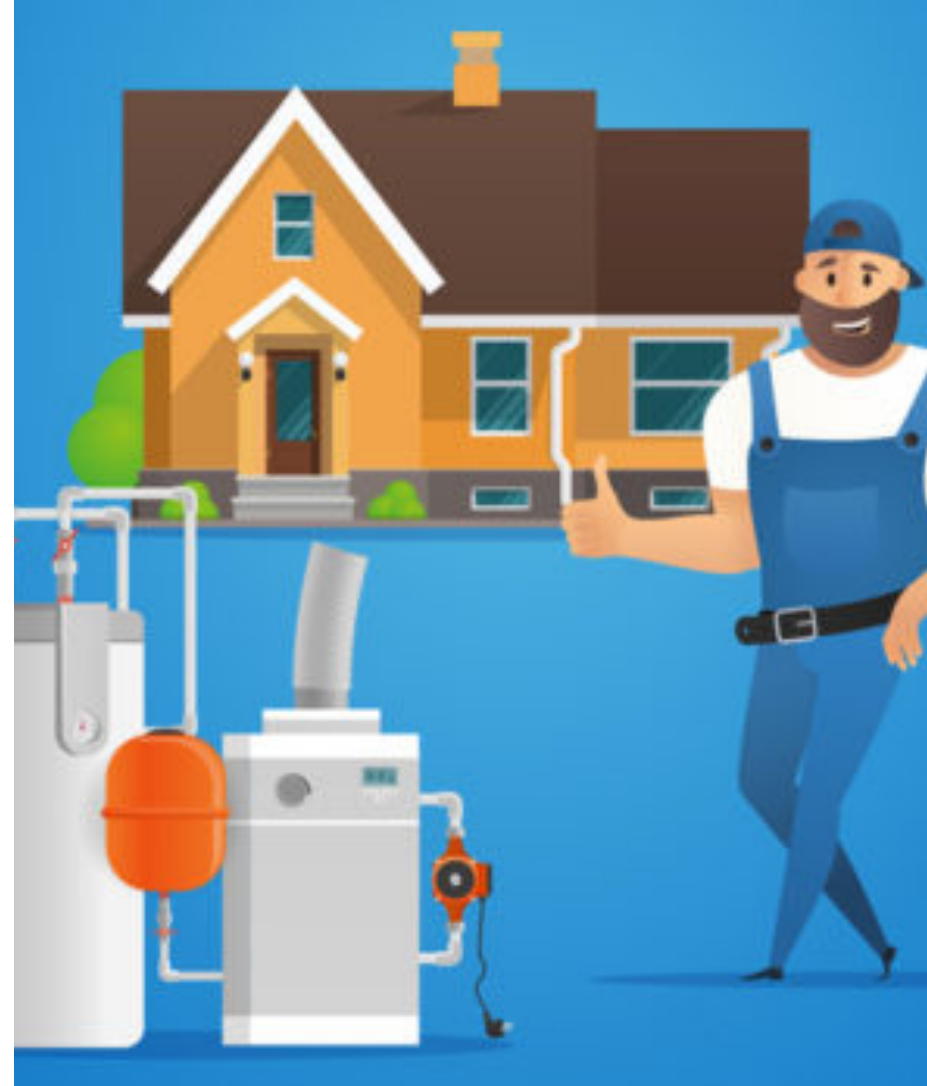
# Recap

- ***WHAT*** flows through the channel?
- ***HOW*** can the service be distributed?
- Which are the determinants of ***WHERE*** distributing the service?
- Which are the determinants of ***WHEN*** distributing the service?

1. How much will you pay for a birthday video by Shakira?
2. **What Makes Service Pricing Strategy Different and Difficult?**

# What Makes Service Pricing Strategy Different and Difficult

- Harder to **calculate financial costs** of creating a service process or performance than a manufactured good
- **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 ([Amazon Prime](#))



# What are the objectives for establishing prices?

## *Revenue and Profit Objectives*

**->Gain Profit /Cover Costs**

## *Patronage and User Base-Related Objectives*

**-> Build Demand/Develop a User Base**

## *Strategy-Related Objectives*

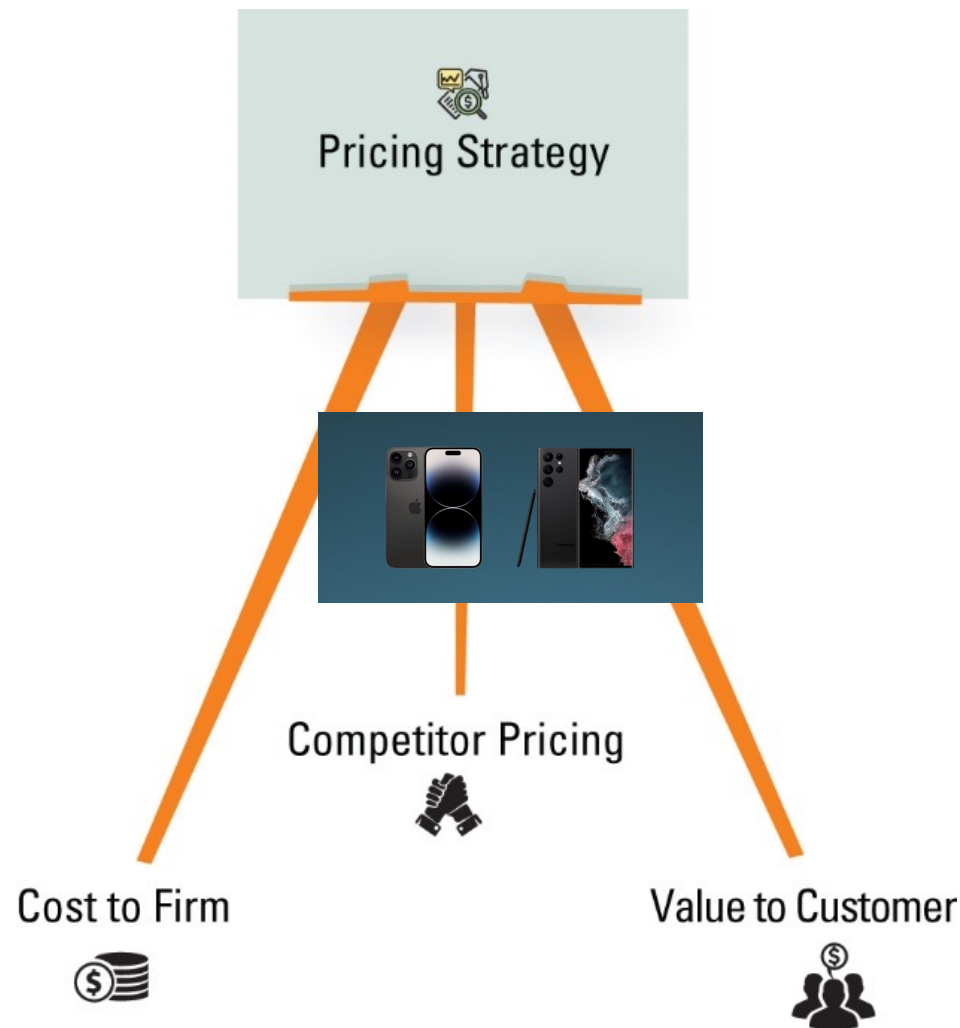
**-> Support Positioning/Support Competitive Strategy**

**Firms have to consider:**

- ➔ Search costs
- ➔ Purchase and service encounter costs, and
- ➔ Post-purchase or after costs, while pricing services



# Pricing Strategy Stands on Three Foundations



**Outline the foundations of a pricing strategy as represented by the pricing tripod**

# 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



# Set prices relative to financial costs

## – iPhoneX

Screen	\$80	Audio Codec	\$2.50
Touch	\$15	Cameras	\$33
Processor	\$26	Battery	\$9
Baseband, RF	\$18	Wireless Charging	\$6
WLAN/BT/FM/GPS	\$6.50	PCB	\$15
NFCchip	\$2.25	Acoustics	\$12
DRAM	\$24	RF antenna	\$5
NAND	\$45	Haptics	\$10
PA	\$8	Appearance	\$53
3D sensing	\$25	Accessories	\$8
Analog device	\$9.50	Total	\$412.75



# Provide examples of related Monetary and Nonmonetary Costs

Fixed costs, variable costs, semi-variable costs, contribution, break-even analysis

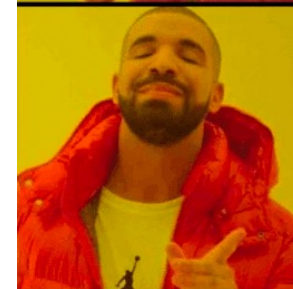
- **Related Monetary Costs**

Customers incur significant financial costs in searching for, purchasing, and using the service, over and above the purchase price paid to the supplier

- **Nonmonetary Costs**
  - Reflect the time, effort, and discomfort associated with the search, purchase, and use of a service
  - Time costs
  - Physical costs
  - Psychological costs
  - Sensory costs



**\$10.00**  
+\$2.39 Shipping



**\$12.39**  
& FREE Shipping

# 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

**BUT, customers care about value to themselves, not what service production costs the firm**

# Competitive-Based Pricing

Which clinic would you patronize if you needed a chest x-ray (assuming that all three clinics offer good technical quality)?

## Clinic A

- 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

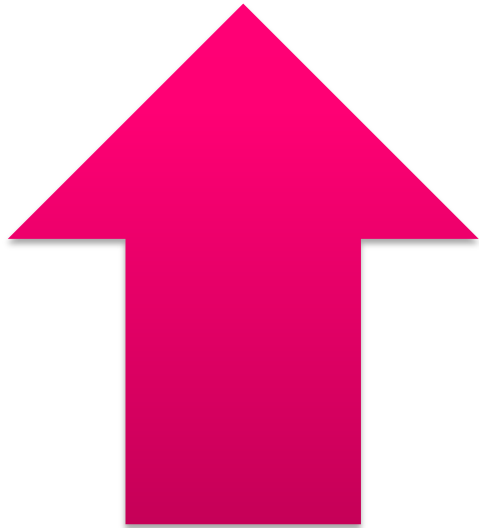
## Clinic B

- 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

## Clinic C

- 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

# Competition-Based Pricing



## Price competition increases due to?:

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



## When can 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

# Value-Based Pricing



# Value-Based Pricing



# Value-Based Pricing: Understanding Net Value

**Net Value** =

Perceived Benefits to Customer (Gross Value)

-

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:**

## **What are the Strategies to pursue 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**

**If you book a flight to return to your home country now, will the price differ from the one shown one day before the flight?**

<https://www.youtube.com/watch?v=EhhLXZB3kRw>

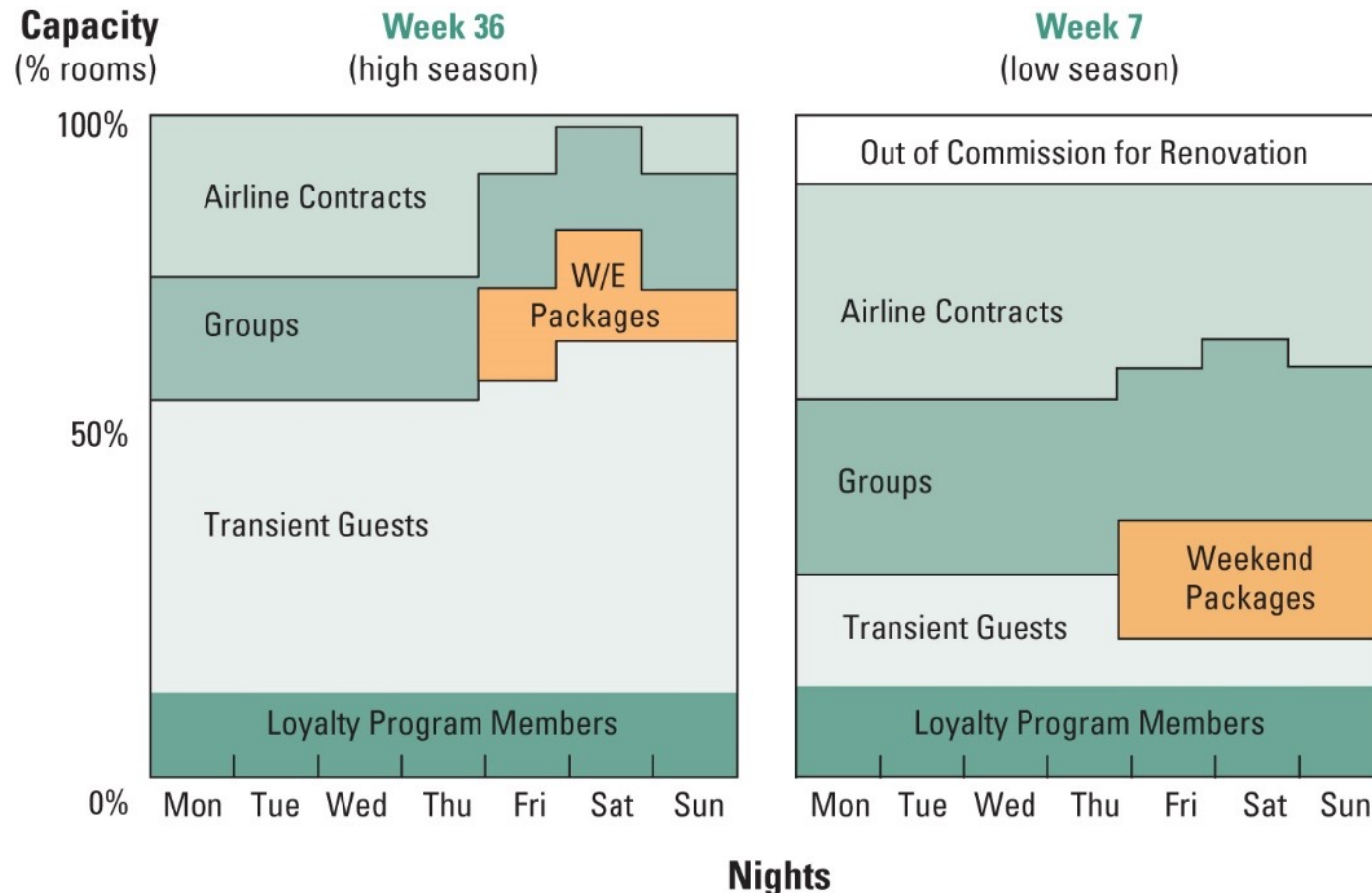
# Dynamic prices – Revenue Management: Maximizing Revenue from Available Capacity at a Given Time

- **Most effective in the following conditions:**
  - ➔ High fixed cost structure
  - ➔ Relatively fixed capacity
  - ➔ Perishable inventory
  - ➔ Variable and uncertain demand
  - ➔ Varying customer price sensitivity
- **Revenue management (RM) is price customization**
  - ➔ Charge different value segments different prices for same product based on price sensitivity

# Maximizing Revenue from Available Capacity at a Given Time

- **RM uses mathematical models to examine historical data and real time information to determine**
  - ➔ **What prices to charge within each price bucket**
  - ➔ **How many service units to allocate to each bucket**
- **Rate fences deter customers willing to pay more from trading down to lower prices (minimize consumer surplus)**

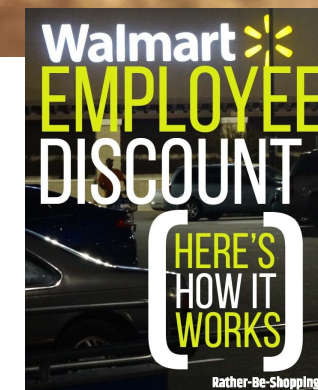
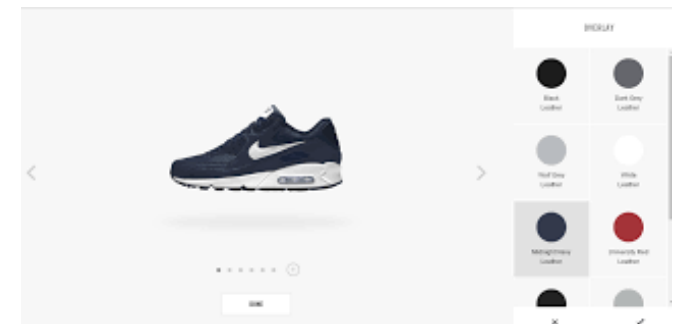
# Setting Capacity Allocation Targets by Segment for a Hotel



The figure above is an illustration of the capacity allocation in a hotel setting, where demand from different types of customers varies not only by day of the week but also by season.

# Designing Rate Fences

- **Price customization** — charging different customers different prices for the same product
- Rate Fences can be either **physical** or **nonphysical**.
  - ➔ **Physical fences** refer to tangible product differences related to the different prices
  - ➔ **Nonphysical fences** refer to differences in consumption, transaction, or buyer characteristics, but the service is basically the same



# Key Categories of Rate Fences: Physical (Product-Related) Fences

## Product-Related Fences

Rate Fences	Examples
<b>Physical (Product-Related) Fences</b>	
Service Level	<ul style="list-style-type: none"><li>• Priority wait-listing, separate check-in counters with no or only short queues</li><li>• Improved food and beverage selection</li><li>• Dedicated service hotlines</li><li>• Personal butler</li><li>• Dedicated account management team</li></ul>
Other Physical Characteristics	<ul style="list-style-type: none"><li>• Table location pricing (e.g., restaurant table with view in a high rise building), seat location pricing (e.g., a window or aisle seat in an aircraft cabin)</li><li>• Extra legroom on an airline</li></ul>



# Key Categories of Rate Fences: nonphysical fences

Rate Fences	Examples
<b>Nonphysical Fences</b>	
<b>Transaction Characteristics</b>	
Time of booking or reservation	<ul style="list-style-type: none"> <li>• Discounts for advance purchase</li> </ul>
Location of booking or reservation	<ul style="list-style-type: none"> <li>• Passengers booking air tickets for an identical route in different countries are charged different prices (e.g., prices tend to be higher at an airline's hub because of higher frequency flights and more direct flights)</li> <li>• Customers making reservations online are charged a lower price than those making reservations by phone</li> </ul>
Flexibility of ticket usage	<ul style="list-style-type: none"> <li>• Fees/penalties for canceling or changing a reservation (up to loss of entire ticket price)</li> <li>• Nonrefundable reservation fees</li> </ul>

# Spotify plans (and fences)

## Pick your Premium

**1 month free**

### Individual

\$9.99/month after offer period  
1 account

- ✓ Listen to music ad-free
- ✓ Play anywhere - even offline
- ✓ On-demand playback

**GET STARTED**

Terms and conditions apply. 1 month free not available for users who have already tried Premium.

**1 month free**

### Duo

\$12.99/month after offer period  
2 accounts

- ✓ 2 Premium accounts for a couple under one roof
- ✓ Duo Mix: a playlist for two, regularly updated with music you both enjoy
- ✓ Ad-free music listening, play offline, on-demand playback

**GET STARTED**

Terms and conditions apply. 1 month free not available for users who have already tried Premium.

**1 month free**

### Family

\$14.99/month after offer period  
6 accounts

- ✓ 6 Premium accounts for family members living under one roof
- ✓ Family Mix: a playlist for your family, regularly updated with music you all enjoy
- ✓ Block explicit music
- ✓ Ad-free music listening, play offline, on-demand playback
- ✓ Spotify Kids: a separate app made just for kids

**GET STARTED**

Terms and conditions apply. 1 month free not available for users who have already tried Premium.

**1 month free**

### Student

\$4.99/month after offer period  
1 account

- ✓ Hulu (ad-supported) plan
- ✓ SHOWTIME
- ✓ Listen to music ad-free
- ✓ Play anywhere - even offline
- ✓ On-demand playback

**GET STARTED**

Offer currently includes access to Hulu (ad-supported) plan and SHOWTIME Streaming Service, subject to eligibility. Available only to students at an accredited higher education institution. 1 month free only open to higher education students who haven't already tried Premium. [Terms and conditions apply.](#)

# Ethical Concerns in Pricing

- **Many services have complex pricing schedules**
  - ➔ hard to understand
  - ➔ difficult to calculate full costs in advance of service
- **Unfairness and misrepresentation in price promotions**
  - ➔ misleading advertising
  - ➔ hidden charges
- **Too many rules and regulations**
  - ➔ customers feel constrained, exploited
  - ➔ customers unfairly penalized when plans change

# Designing Prices with Fairness

- Design clear, logical, and fair price schedules and fences
- Use high published prices and present fences as opportunities for discounts
- Communicate consumer benefits of revenue management
- Use bundling to “hide” discounts
- Take care of loyal customers
- Use service recovery to compensate for overbooking