



## Price strategies by German and British tour operators in Mallorca



Joaquín Alegre, Maria Sard\*

Department of Applied Economics, University of the Balearic Islands, Edificio Jovellanos-Campus UIB, Crta. Valldemossa Km. 7.5, 07122 Palma de Mallorca, Illes Balears, Spain

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### ABSTRACT

This paper analyses the price strategies used by major German and British tour operators for holiday packages in Mallorca. The analysis differentiates package holidays by price (cheap, mid price and expensive), first trying to identify the existence of different strategies for each price level and, second, whether these price strategies have changed during the recent economic crisis. The main results show that, in the German market, there is a clear market leader, while, in the British market, no price leader can be observed. The two markets have reacted differently to the economic crisis. In the German market, the leader-follower model was maintained. In the British market, the economic crisis has led to a more uniform price distribution, with reductions in the prices of cheaper holidays and price rises in the case of the top end of the market. The results were obtained by estimating a hedonic price model using quantile regressions.

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### 1. Introduction

The European tour operator market is a mature one dominated by German and British tour operators, and so, their behaviour largely determines the prices of package holidays at many Mediterranean destinations. The market structure of the German and British tour operator markets has the features of an oligopoly (Bastakis, Buhalis, & Butler, 2004; Baum & Mudami, 1994; Evans & Stabler, 1995; Long & Shi, 2017): 1) In both markets, a limited number of large tour operators compete with one another, alongside numerous small tour operators who do not compete with the major ones (Davies & Downward, 2007, for the British market). 2) The large tour operators' high market concentration (over 50% of the market) gives them market power (the capacity to set prices above the marginal costs). 3) At the same time, tour operators stand out for their strategic interrelations. This means that tour operator price strategies take into account rival behaviour and these strategies will vary, depending on the economic context.

A price strategy is a long-term framework for setting basic prices, whereby an initial price is set for a product together with the proposed direction of price movements across the product lifecycle (Lamb, Hair, & McDaniel, 2002). Hence it is a strategic decision that must take into account the behaviour of rival companies and it

must be adapted to fit in with different economic scenarios during the product lifecycle. "A key element of the marketing strategy is companies' pricing strategy" (Kim, Natter, & Spann, 2009, p. 44). Price strategies do not only generate more benefits for the tour operator; they also constitute a key negotiating tool among agents in the tourism sector (Falzon, 2012). Consequently, familiarity with tour operator price strategies, the type of price competition in which they engage, and the changes in price strategies that they make when an economic crisis occurs can contribute to the design of better tourism price negotiation policies at destinations. The better understanding of tour operators' price strategies should contribute to a better price negotiation by the accommodation sector.

Over the years, tour operators have used different price strategies. For instance, until the early 1990s, the structure of the UK tour operator market was oligopolistic with price stability (Baum & Mudami, 1994). However, this price stability could easily be dashed given the fragility of its coordination, due to mistrust and uncertainty of its conjunctural variations. Consequently, implicit price agreements might easily be broken, heralding the beginning of a price war. Evans and Stabler (1995) confirm the occurrence of price wars during this period due to the existence of strategic groups and uncooperative behaviour among UK tour operators. At the same time, given the low number of major tour operators (in both the British and German markets), this could theoretically also lead to a price leadership situation, with one tour operator acting as the market leader and setting benchmark prices while all the others

\* Corresponding author.

E-mail addresses: [joaquin.alegre@uib.es](mailto:joaquin.alegre@uib.es) (J. Alegre), [maria.sard@uib.es](mailto:maria.sard@uib.es) (M. Sard).

act as followers. Because this is a mature market, non-price competition (package differentiation, advertising, quality variation) is also a possibility, which would lead to market segmentation (for instance, the family or adults-only segments) and, by extension, to less aggressive price competition. Given all the above, diverse price strategies can be used by tour operators, and it is even possible for these strategies not to revolve around prices.

Price strategies can also change in the event of a demand shock, such as one caused by an economic crisis. In such an event, the context changes and former price strategies can be drastically modified. From a situation of relative stability, a price war can begin or else there can simply be coordinated price cuts so as to maintain existing market shares (maintaining the stability). There can also be heavier specialization in segments with a higher purchasing power that are less vulnerable in crisis situations. Likewise, tour operators might choose to combine both strategies, cutting the prices of their cheaper packages (directed at the sector of the population most heavily affected by the crisis) and raising the price of their most expensive ones (aimed at the segment of the demand lesser affected by the crisis).

Given the multiple price strategies that can be used in an oligopolistic market, we thought that it would be interesting to analyse prices set by tour operators under two perspectives. First of all, a comparative analysis was made to check whether the price strategies of the German and British tour operator markets (both mature markets) differ, examining package holiday price segments (cheap, mid-price and expensive packages). Secondly, an analysis was made to see whether their price strategies have changed as a result of the recent economic crisis, comparing the price strategies used during two different periods, 2007 and 2010. In short, the aim of this paper is to analyse the price strategies used by major tour operators across the price distribution of both markets and to examine whether they undergo changes in times of crisis at a mature sun and sand destination like Mallorca.

The structure of this paper is as follows. In the following section, a review of literature is made, both on the use of the hedonic price method for package holidays and on the general application of quantile regression (QR) and their use in the field of tourism. Then, a description is given of the data that was used. Next, an outline is given of the hedonic price model within the context of QR. Subsequently, the main results are explained, before concluding with a summary and discussion of some of the tourism policies that can be derived from the obtained results.

## 2. Literature review

Despite the importance of the tour operating industry in the tourism sector, this industry has been subject of scant analysis. The first papers of the eighties and nineties discuss on a theoretical basis the market structure of the tour operators in different countries (Baum & Mudami, 1994; Curtin & Busby, 1999; Fitch, 1987; Sheldon, 1986; Taylor, 1996). Yale (1995) perform an in depth analysis of the business of tour operators in the UK. He states that tour operators have a great market power, and are vertically integrated. Williams (1996) also highlights the tour operators' market power in the UK and German markets.

Maybe due to the lack of relevant empirical data, the hedonic price method had been a methodology used to analyse the effect of the tour operators on the package holiday prices. Some of these studies introduced the tour operator as an explanatory variable, but very few papers focus on the tour operators' effect on prices. Taylor (1995) analyses package holiday price competitiveness in Mediterranean destinations, emphasizing tour operators' high bargaining power. Sinclair, Clewer, and Pack (1990) in Malaga, Aguiló, Alegre, and Riera (2001), Aguiló, Alegre, and Sard (2003) in

Mallorca, Papatheodorou (2002) and Haroutunian et al. (2005) in different Mediterranean destinations, examine package holiday prices using hedonic price functions and conclude that there are statistically significant price differences among tour operators.

However, the hedonic method has been used to a lesser degree in tourism economics as a way of analysing price strategies. The paper of Hartman (1989) is the first to use the hedonic method to design optimal pricing strategies for luxury hotels in the business travelers segment. Regarding package tours, Aguiló et al. (2003) analyse the German and the UK tour operators' price strategies in Mallorca using the estimates of the hedonic price function. Alegre and Sard (2015) calculate a hedonic price index to analyse the effects of the crisis on the prices of package holidays to the Balearic Islands sold by a sample of British and German tour operators. The paper shows that the price management during the crisis held by tour operators was not base in dropping prices despite the evident fall in Balearic tourism demand during the period.

Nevertheless, in all these studies using the hedonic method, the implicit prices of the package holiday characteristics are econometrically estimated through a conditional mean regression. However, as Costanigro, McCluskey, and Mittelhammer (2007) point out, there is no reason to suppose that implicit prices remain constant across the price distribution. The tourist valuation need not necessarily be a static one. A QR model is an alternative means of analysing the effect of package holiday characteristics across the entire price distribution.

QR have been widely applied in numerous different fields, such housing (García & Raya, 2015; Liao & Wang, 2012; Chasco & Sánchez, 2012; Mak, Choy, & Ho, 2010; Zietz et al., 2008; Coulson & McMillen, 2007), education Buchinsky (1998) or healthcare (Koenker & Hallock, 2001). In tourism, some authors have used QR models, although their application to price analyses is limited (Raya, 2013). Table 1 point out the main papers using QR in tourism.

Table 1 shows that there are no previous research on the analysis of the price differences among tour operators along the price distribution. This paper aims to fill this gap and make an in-depth dual analysis of tour operator price strategies by examining whether they remain stable across the price distribution or whether they vary when cheap package holidays are compared with expensive ones and, secondly, whether the price strategies used by tour operators change with the economic crisis. Therefore, the main contribution of our paper to the literature on tourism consists of providing empirical evidence on price strategies by German and British tour operators using a new methodology. Under our knowledge, it is the first paper that uses QR to analyse the price strategies of tour operators.

## 3. Data and descriptive statistics

The database is based on information from the travel brochures of 6 German tour operators and 5 British ones selling packages in 3 and 4 stars hotels in Mallorca during the summer seasons of 2007 and 2010. We only analyse packages in 3 and 4 stars hotels as those are the more representative in Mallorca (both categories represent the 87.8% and the 88% of the hotels in 2007 and 2010, respectively; Agència de Turisme de les Illes Balears, 2016). These two years were chosen in order to analyse whether the tour operators modified their price strategies and in what way, during a period of economic crisis.

Information from the brochures of ITS, Jahn Reisen, Alltours, Neckerman, 12 Fly and TUI was used, comprising a total of 1611 and 1946 German package holidays in the Balearics in 2007 and 2010, respectively. In the case of the British market, 238 and 274 package holidays were taken into account in 2007 and 2010 respectively, sold by Thomson, Airtours, First Choice, Portland Direct and

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