



Hotel room rate pricing strategy for market share in oligopolistic competition — eight-year longitudinal study of super deluxe hotels in Seoul

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Abstract

This paper examines pricing strategies and business performances of super deluxe hotels in Seoul. To achieve this purpose, empirical research is conducted on the basis of data from 1989, when the formation of the present product life cycle stage and the market structure began, to 1996. Through quick cluster and regression analysis, a separation of the price competition between groups of hotels is identified. By ANOVA, pricing strategies and market shares of selected leading hotels are compared. As a longitudinal study, the same research design is applied based on four two-year periods. The final part of the paper evaluates the results of the statistical analysis and discusses important findings and implications of the four two-year periods, respectively. © 2000 Elsevier Science Ltd. All rights reserved.

Keywords: Hotel room rate; Pricing strategy; Oligopolistic competition; Oligopolistic market structure

1. Introduction

The effects of price changes are more direct, and appeals based on price are the most effective to communicate the overall product quality to consumers. Nevertheless, in spite of the great importance of price, the volume of academic research on hotel room rate pricing issues has been modest at best. At an aggregate level, pricing research has been the forte of economists.

The study of hotel room rate pricing originated with Meek and other important studies are indicated in Tables 1 and 2.

However, none of the literature related to hotel room rate pricing addressed the real-world situation. As Eliashberg and Chatterjee (1985) stated, the literature does not contain clear answers to the question of how well the models predict actual behavior. The author believes that this paper is the first application in hotel room rate pricing strategy which is based on real-world empirical data (Chung, 1995a, 1997).

2. Market situation and market structure

2.1. Product or industry life cycle

The Korean hotel industry had been experiencing a major boom until the 1988 Seoul Olympic Games.

It recorded amazing growth rates in terms of both revenue and the number of foreign tourists. Since then, the growth rate has been decelerating noticeably, as can be seen in Table 3 (Korean National Tourism Corporation, 1987–1997).

This phenomenon indicates that the Korean deluxe hotel market had already entered into the maturity stage of the product or industry life cycle as of 1988. However, with the 2002 World Cup Soccer Games in the offing, the Korean deluxe hotel market is expected to boom again. Thus, the market conditions will be constantly changing, requiring more-than-ever the formulation of an effective hotel room rate pricing strategy.

2.2. Market structure

There are 12 super deluxe hotels in Seoul now (1998). Compared to Korean industry averages, business performances of super deluxe hotels are par excellence in

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Table 1
Key points of hotel room rate pricing literature review – economics approach

| Author (year) | Key points |
|------------------|--|
| Meek (1938) | <ul style="list-style-type: none"> ● Development of a theory of hotel room rates based on the fundamental principles of supply and demand under the assumptions of short-term analysis, rational economic decisions, complete knowledge, complete occupancy, homogeneity of dates, and homogeneity of rooms |
| Cournoyer (1972) | <ul style="list-style-type: none"> ● Lag effects of price increases and price elasticities of demand strongly affect hotel room rates |
| Kotas (1980) | <ul style="list-style-type: none"> ● In industries where fixed costs are high and variable costs are low, such as the hotel industry, costs play a secondary role to demand in pricing. It should be market-oriented and the main factors which influence tariffs are the type of customer, local competition, trends in room sales, time of year, etc. |
| Shaw (1984) | <ul style="list-style-type: none"> ● Economic theory has provided a sound theoretical pricing model, i.e., peak load pricing theory, that takes into account product non-storability, fluctuating demand, and high fixed costs. Peak load pricing theory demonstrates that hotel rooms can achieve long run profit maximization |
| Gu (1997) | <ul style="list-style-type: none"> ● Optimal hotel room rate is a function of variable costs and two features of the demand for hotel rooms such as potential demand for rooms and the price sensitivity of the demand |

terms of size, guest room occupancy rate, and average room rate, which are the *major* indices used for evaluating hotel quality. Table 4 shows top 15 hotels among the 404 tourist hotels in Korea. The rankings are based on the results of evaluations according to the above three variables (Chung, 1995b). All 11 hotels in this study, rank within the top 15.

The competitive market structure is a, key area in pricing. Although Martel (1974) one of few, if any, authors who studied the market structure of the hotel industry, defined the hotel industry as a monopolistic competition, it is different from the author's viewpoints because he included all classes of hotels and even motels. The author defines the super deluxe hotel market in Seoul as a continuum of an oligopoly, as indicated in Fig. 1.

The rationale of Fig. 1 is shown in Table 5. Table 5 shows that a certain hotel competes or not with others for a certain type of demand. For example, hotel H_1 and hotel H_2 compete for D_2 and D_3 , but they do not compete for D_1 or D_4 . However, hotel H_1 and hotel H_5 do not compete for any demand types, although the competition is by no means disconnected among five hotels. In a marketing sense, the market structure should be defined according to the micro competition concept — the competition is formed within the similar product

Table 2
Key points of hotel room rate pricing literature review – marketing approach

| Author (year) | Key points |
|---------------------------------|---|
| Lewis (1986) | <ul style="list-style-type: none"> ● Set hotel room rates fairly based on the customer, maintain them, and tell customers. Price stability is a focal point – pricing, not discounting. |
| Relihan (1989) | <ul style="list-style-type: none"> ● Yield management, as a proven technique for maximizing hotel room revenues, can be effectively practiced by analyzing pricing structure, using reservation systems to the fullest, and saving reservation history. |
| Hanks, Robert and Moland (1992) | <ul style="list-style-type: none"> ● Different customers are charged different hotel room rates to serve the dual purposes of capturing more revenue and satisfying more customers. Hotel room rate must be set based on segmentation strategy by erecting “fences” – allowing customers to segment themselves into appropriate rate categories on the basis of their needs, behavior, and willingness to pay rather than a single rate or rates by room type. |
| Shaw (1992) | <ul style="list-style-type: none"> ● Price-sensitivity measurement (PSM) is useful to determine the threshold range in price. |
| Kimes (1994) | <ul style="list-style-type: none"> ● Success of hotel room rate pricing depends on the customers' viewpoint that the transaction (yield management) is fair. Maintaining the balance between the reference transaction and educating customers about the practice of yield management are two key success factors. |
| Arnold (1994) | <ul style="list-style-type: none"> ● Cost cutting has gone dry, and improved profits require improved hotel room prices. Hoteliers should become more aggressive on hotel room rate pricing as demand increases. The only opportunity for real revenue growth is to increase hotel room rates beyond the inflation rate. |
| Lewis and Shoemaker (1997) | <ul style="list-style-type: none"> ● Customer's perception of price-value, particularly within the range of acceptable prices regardless of price sensitivity, is the core issue of hotel room rate pricing. Customer's perception includes specific brands, the competition, and variations within a product line. |

classes and product forms; and within the similar customer classes and types. Although all 11 hotels in this study are super deluxe and business hotels, they have very wide price bands — difference of price within the same industry (see Fig. 6) — because of the heterogeneity of location, brand reputation, quality of service and facilities, etc. This means that most hotels have different customer classes and types and, accordingly, the competition is formed within separate groups of several

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