

Price Matters - Relevance of Strategic Pricing for Swiss Tourism in the Past, Present and Future

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Abstract

In his paper from 2003, Peter Keller postulates that a strategic pricing policy can pose an opportunity for Swiss tourism, strengthening the competitiveness and growth of the industry. This contribution from Peter Keller's celebratory publication on the occasion of his 20th presidency of the International Association of Scientific Experts in Tourism (AIEST) picks up on this assumption and discusses the touristic development and enhancement of strategic pricing over the past ten years of Swiss tourism. In the first section of this paper, empirical evidence of the development of Swiss tourism over time and a discussion of its challenges are presented. The second section addresses the postulated value-based pricing concept, including practical examples from Swiss tourism over the past ten years. The third section offers a conclusion, which discusses the relevance of strategic pricing as a means to strengthen competitiveness with respect to future terms.

Peter Keller has been involved in scientific tourism research as the president of the AIEST for 20 years. Believing strongly in the fact that sustainable tourism research should be dedicated to a holistic, systemic as well as pragmatic approach, he constantly warned of disciplinary and autarchic traits of tourism research (Keller 2007, S. 96ff.). As an advocate of tourism science, which should be concerned with a human, social and cultural scientific reflection without excluding the viewpoint of economics or business administration, he also crucially influenced national tourism politics as a head of the Tourism Department at the State Secretariat for Economic Affairs (SECO).

In his article "Strategic pricing policy as a chance for Swiss tourism" (Keller, 2003, S. 193ff.), he emphasises a "back-to-growth strategy" for Swiss tourism by focusing on a strategic marketing approach, which is oriented towards the "value-based pricing principle" and focuses more on price as a constitutive element. The following paper discusses the past development of the Swiss tourism industry since Peter Keller's article was published in 2003 and notes the value-based pricing approach. For this purpose, we examine the development of Swiss tourism, outline the postulated "value-based pricing principle" and discuss some practical applications from daily touristic business. Finally, we draw a conclusion about the applicability of strategic pricing in the future.

1 Development of Swiss tourism over the past decade and its challenges

Looking back to the development of Swiss tourism as a whole and its specific industries over the past ten years reveals some important insights when considering the relevance of strategic pricing.

1.1 General overview of recent and past developments in Swiss tourism

The development of the number of overnight stays at a hotel is an important indicator when examining the past development of Swiss tourism since 2003.

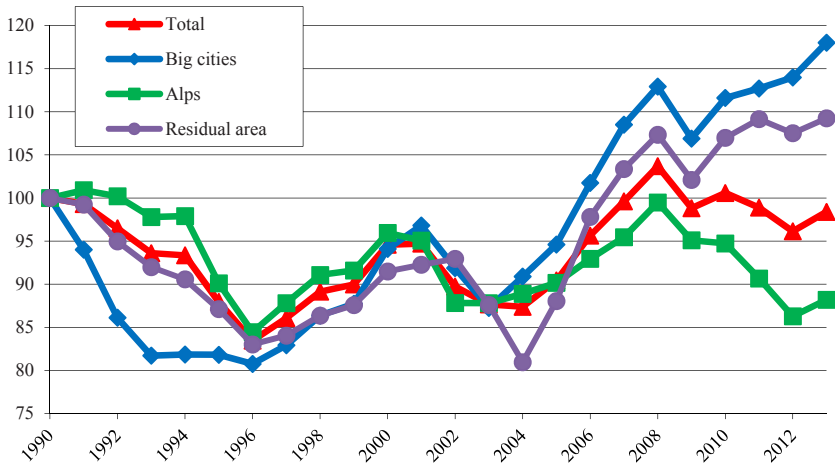


Figure 1: Development of the number of overnight stays at a hotel by region, 1990-2013

Basis: tourism year, index: 1990 = 100

Source: BFS, BAKBASEL in SECO 2013, p. 18

With three slumps in demand and two growth periods, a rough cyclical trend is visible during the considered time period. Peter Keller wrote his paper "Strategic pricing policy as a chance for Swiss tourism" (2003) during the second slump in demand, which was initiated by 9/11 and the SARS virus. Ten years later, Swiss tourism faced the third slump in demand, which mainly affected Alpine tourism to a severe degree. The financial and economic crisis of European countries has led to a massive reduction of incoming tourism from European countries as very important nearby markets for Swiss tourism. Reasons for this decline include the reduction of available income as well as the appreciation of the Swiss Franc, which led to a decrease in demand for Swiss tourism services.

The traditional remote markets, such as North America and Japan, showed a slight reduction as well, and the new growth markets (BRIC, gulf nations, etc.) - despite their high growth rates on a modest level (from a 1% share in 1995 to a 10% share in 2012) - could not close the gap left by the nearby markets. For the nearby markets, the number of overnight stays in a hotel accounted for 33% of the total demand in 2009 and for 27% in 2012. With this development in mind, the changing travel behaviour of the new growth markets compared to the nearby markets bears big consequences. Most notably, the touristic hotspots in Swiss cities and some destinations in the Alps are very popular for short visits with guests from the new growth markets. A one-week ski holiday in the Alps, how-

ever, still does not seem to be the primary focus of this target group (BFS 2014/Schweiz Tourismus 2013, S. 4).

The significant decrease in the number of guests from nearby markets visiting the Alpine regions, as well as the structural challenges of the touristic suppliers in the Alps both negatively influenced the *number of overnight stays* at hotels. From 2009 onward, the big cities and the remaining regions recovered relatively quickly from the financial and economic crisis (see figure 1), while the Alpine regions continuously incurred losses in demand until 2012 (BFS 2014/BAKBASEL 2012a). In the *international context*, the development of the Swiss hotel industry, as measured by the number of overnight stays in a hotel, was not able to keep pace with neighbouring countries (BFS 2014 / Eurostat 2014 in: Seco 2013, S. 27ff.).

Arrivals have increased by 25% since 1990, but the number of overnight stays in hotels decreased by 4% within the same time span. The consequence of these developments is a shorter duration of stay, also due to the trend towards short trips by Swiss guests and the strengthening of the Swiss cities as touristic destinations (BFS 2014/ BAKBASEL 2012a).

The relevance of the *summer season*, measured by overnight stay in hotels, has declined as a tendency, but is still higher than the *winter season*. During the summer season, mainly the Alpine regions have lost guests due to the intensification of the competitive situation with other destination (BFS 2014/BAKBASEL 2012a). The strengthening of year-round tourism is particularly difficult with respect to the Alpine regions.

In sum, the overall *nominal gross value added* of tourism still increased distinctly over the last decade. The touristic gross value added from 2001 to 2010 was approximately 2% on average. Compared to Swiss tourism in total, the hotel and hospitality industry as a core area performed weaker over the last decade (BFS 2012).

The weak position of the Swiss tourism industry with respect to *competitiveness in terms of price* is a major concern. In the "Travel & Tourism Competitiveness Report" published by the World Economic Forum (WEF) (2013), Switzerland ranks 139th out of the 140 countries examined. The corporate structure as well as the higher input and labour costs massively weaken Switzerland's competitiveness in terms of price (Seco 2013, S. 42ff.). Although competitiveness in terms of price improved between 2001 and 2008, the recent unfavourable development of the exchange rate has worked against the efforts of the suppliers (BAKBASEL 2012b).

1.2 Developments in the Swiss hospitality industry

Taking an in-depth look at the development of the corporate structure in the hotel industry reveals a continuous structural change since 1990. The number of hotels has decreased while holding the number of beds constant, which means that the average *size of the hotels* has increased. Primarily, hotels in the lower classification categories and in rural regions have vanished from the market (BHP 2012). However, the small and medium enterprises still form the backbone of the Swiss hotel industry (Müller et al. 2008, S. 5) as 90% of the hotels barely reach 50 rooms each.

The quarterly survey of the Economic Research Institute (KOF) for the hotel industry shows a distinctive decline in *revenue* over the last four years (Abrahamsen et al. 2009).

The *gross operating results* of the Swiss hotel industry developed positively from 2005 to 2008, in line with the number of overnight stays. From 2009 to 2011, the earning power of most hotel categories decreased. In general, the earning power for urban hotels is stronger than for Alpine hotels. The fact that the generated operating results hardly cover the fixed costs and that breaking-even seems to be an operational challenge is alarming (Hotelleriesuisse in: Seco 2013, S. 20ff.).

The recent history of the *monetary development of the hospitality industry*, as measured by the gross value added, shows slumps in 2009 and 2011. Between 1997 and 2010, the gross value added developed negatively over a longer period, with a yearly decline of 0.5%. The gastronomy industry stagnated and the hotel industry declined with a yearly decline of 1% (BFS 2013).

Decreasing earning rates in the Swiss hotel industry have a negative impact on the *financing framework conditions* for replacement and capital widening investments. The risk assessment produces worse results and the funding gap between debt and equity capital increases (Seco 2013, S. 22ff.).

Although the corporate structural change in the Swiss hotel industry has only selectively improved the competitiveness, the financial results illustrate this result and can offer some hope for the future.

1.3 Developments in the cable railway industry and the fragmentation of destination structures

Examining the development of the *cable railway industry* reveals a distinct rise in the amount of transported people within the last 20 years, compared to the number of overnight stays in hotels. The transport frequency strongly depends on day-trippers, for which the weather plays a key role due to the short term planning aspect of day trips. The growth of the transport frequency, however,

hides the fact that skier days and tourism revenues, especially in winter, are both declining. In addition, the cable railway industry faces big economic challenges in the future due to climatic change (Seilbahnverband 2012; Lehmann 2013, S. 67).

Similar to the hotel industry, the *destination structures* in Switzerland are still fragmented. According to the Swiss Tourism Federation (STV), no less than 561 tourist offices and tourism organisations existed in 2012. Among them, approximately 444 organisations focus on local marketing efforts and approximately 117 focus on regional marketing (STV 2012).

The facts and figures outlined above show that Alpine tourism faces a particularly challenging situation. Many actions and methods to improve the basic framework conditions have been undertaken in Swiss politics, for example intensifying tourism marketing (Schweiz Tourismus 2013). The touristic suppliers, however, still have to meet their fate. A possible strategy could therefore be the application of the pricing policy recommended by Peter Keller (2003).

2 Discussion of the enhancement of the value-based pricing concept

Three different pricing approaches are common in theory and practice (Nagle/Hogan 2007; Hinterhuber 2008; Siems 2009):

- a) Cost-based pricing
 - b) Competition-based pricing
 - c) Value-based pricing or customer-oriented pricing
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- a) The cost-based pricing approach primarily pursues a price determination based on accounting data. To determine the selling price, a profit margin is added on top of the production cost.
 - b) The competition-based pricing approach takes rivalry prices and offers into account. A price differentiation, which depends upon competitors' actions, is strived for by the creation of unique selling points (USPs).
 - c) The value-based pricing approach, in contrast, pursues a price determination based on the value added for the customers and aims at skimming their willingness to pay (Hinterhuber 2008, S. 42). To exploit the willingness of customers to pay optimally, price differentiation is necessary and creates an added value for the customer. Only with price differentiation it is possible for customers to choose their best-perceived cost-benefit ratio (Lauszus/Sebastian 1997).

Both empirical practice and research agree to the fact that the value-based pricing approach implies higher profits than the other two pricing approaches (Kühn/Pfäffli 2007; Michel/Pfäffli 2009). In reality, however, cost-based and competition-based pricing approaches are still dominantly practiced (Cavusgil et al. 2003; Avlonitis/Indounas 2006; Hinterhuber 2008).

To implement the value-based pricing strategy, price differentiation can be shaped according to different criteria (Homburg 2012, S. 711ff; Hinterhuber 2008; Taube 2014):

- Individual-related price differentiation: A certain group of guests will be subject to a price differentiation due to their specific characteristics. The tourist vendors thereby hope to improve the customer relationship. An example might be a student rate for the mountain railways.
- Regional-related price differentiation: At the core of this price-setting strategy are geographically diverse market segments. The respective price therefore depends on the origin of the buyer. By specifying prices in the respective currency of the guests' countries of origin or by setting specific exchange rates, an alternative regional price differentiation can be achieved. In this way, price differentiation is less evident and therefore better accepted by all customers.
- Season-related price differentiation: The price with this price-setting strategy depends on the time of purchase or consumption. Seasonal prices for hotel rooms are a well-known example.
- Performance-related price differentiation: The final price is determined in consideration of the concept of customer needs. An illustrative example could be VIP tickets for cable railways, which guarantee the customer priority access and a parking lot next to the infrastructure.
- Quantity-related price differentiation: Here the focus lies on the willingness to pay. The price varies depending on the quantity demanded, as it is, for example, in the case of price deductions.
- Bundle-related price differentiation: With this price-setting strategy, one price is offered for a whole bundle of products. A price deduction for the cable railway after the second overnight stay in a hotel is an example illustrating this strategy.

3 Approaches for implementing price differentiation based on daily business in tourism and its opportunities

In his article, Keller (2003) emphasises that it is desirable for companies as well as for destinations to develop strategically towards price differentiation. The challenge of doing so rests on business-to-customer relationships (B2C). The

new possibilities emerging in the field of information technology (IT) should be used to properly exploit the potential of yield management for the whole travel experience of a guest. Various examples of applied value-based price differentiation can be cited for Swiss tourism:

- In December 2013 the Swiss Tourism Organization started a marketing campaign called "Pay what you want" to assess the willingness of customers to pay for a two-night stay. The guests could decide how much they wanted to pay for their second overnight stay. The intention behind the marketing campaign was to increase the occupancy rate before Christmas time and to try out an innovative pricing-model, which in this case was a special form of *individual-related* price differentiation (Schweiz Tourismus 2013; Tagesanzeiger 15.02.14).
- A form of *regional price differentiation* is applied in the destination of Grächen, which offers a fixed exchange rate of 1.35 CHF/EUR instead of 1.20 CHF/EUR. With this price differentiation, guests from countries utilising the Euro should be attracted by an especially low-priced offer (Grächen 2013).
- Price differentiation in a *seasonal sense* is already well established in the hotel industry due to seasonality, weekday rates, duration of stay and room categories. Hotel guests as well as flight passengers are very used to seasonal price differentiation (Michel/Pfäffli 2009, S. 30).
- An example of *performance-related price* differentiation is the VIP-ticket offered for the mountain railway in the destination of Flims/Laax (Flims Laax 2014).
- Swiss hotels also try to have some sort of price differentiation by offering *quantity discounts* and packages, for example an offer of "4 nights stay and 3 nights pay" during the off-season.
- Actions such as selling ski passes to hotel guests at the low price of CHF 25 from the second overnight stay onward, which was done in the destination of Engadin, can be cited as an example of *bundle-related price differentiation* (Engadin –St.Moritz 2014).

The above-mentioned examples highlight that the value-based pricing strategy has already been applied in Swiss tourism. However, the strategy was not successful in every case. The marketing campaign "Pay what you want", for example, was not really successful, mainly because guests weren't accustomed to this pricing model and therefore were irritated rather than positively surprised.

4 Relevance of value-based pricing for strengthening competitiveness of Swiss tourism in the future and its threats

The discussion with regard to the development of Swiss tourism and especially to the hotel industry, as well as the theoretical pricing approaches and their implementation, leads to the following insights:

Alpine tourism is particularly under pressure due to its well-known structural weaknesses and the latest developments on the demand side. The price competitiveness is still weak due to the strong Swiss Franc and despite lower factory costs.

New information technologies have strongly improved the strategic development of the touristic suppliers towards price differentiation and price flexibility. As shown in section 3, different strategic pricing policy measures have been adopted. However, guests coming to Switzerland still criticised the cost-benefit ratio in a representative survey. The cost-benefit ratio is seen as the primary weakness of Swiss tourism (TMS 2011).

A yield management approach for destinations is still challenging, especially because the distribution and sale of the product "overnight stay" can be processed by the hotel itself, the destination channel, and other booking platforms such as HRS or booking.com. Today's booking platforms possess market power as best-price sellers and benchmarking instruments. Price differentiation has become more and more difficult under this restriction, even though booking platforms in the EU are no longer able to claim the best-price guarantee in contractual agreements with the hotel industry. This frequently used practice is now prohibited because it leads to distortions of competition (htr 20.12. 2013). The application of a strategic pricing policy on a destination level is limited due to a wide variety of booking channels. Managing each booking channel is very time-consuming for a touristic supplier.

The high costs and price level in Switzerland prevails. Due to the existing pre-conditions, a cost leadership strategy (Porter 1980) as a strategic success factor for a touristic supplier will not be possible even if structural change leads to larger firms.

The steady rise of different electronic distribution channels particularly provides touristic suppliers with an opportunity to make use of the *value-based pricing* approach. The difficulties arising from properly defining the market segmentation and specific prices (Michel/Pfäffli 2009) remain a big challenge for the small corporate structure of the tourism industry.

The strategy of *value creation for the customer*, which is derived from the value-based pricing approach, still seems to be rewarding. Some framework conditions, such as high factory prices, can hardly be changed by the industry. The

strengthening of the competitive position by a niche or a differentiation strategy (Porter 1980) will therefore most likely remain the main growth strategy for Swiss tourism in the future. Thus, innovative and qualitative touristic products are a precondition for successful Swiss tourism at a given price level. However, the relevance of human capital for tourism as a service industry has to be highlighted. Peter Keller has already pointed to the problem of touristic jobs with respect to their attractiveness (Keller 1996). Nevertheless, for Swiss tourism, a high quality of service, well-educated employees as well as stable framework conditions are essential to be successful in the future.

In his position at the State Secretariat for Economic Affairs (SECO), Peter Keller sought to strengthen some of the tourism policy parameters with a growth-oriented subsidy policy (Keller 2002). Thus, despite the "‘internationalisation’ of the industry and a ‘localisation’ of services" (Keller 1997), tourism continues to be an important strategic branch of the industry in some regions (Keller 2002). Peter Keller helped to create the basis for this fact. Thank you!

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