

# SEGMENTING HOTEL CLIENTS BY PRICING VARIABLES AND VALUE FOR MONEY

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## ABSTRACT

*Segmentation in tourism is especially difficult because of every specific tourism operation or location may have a different set of features, external factors or past marketing efforts. In this study we have focused special attention on yield management, which is one of the more applied pricing policies by hotel managers. Thus, analyzing the use of segmentation variables based on price and value can be very useful for those responsible for managing these pricing policies. Latent class (LC) segmentation has been used to segment the sample of hotel clients'. The main objectives of this study were to answer these important research questions: Are pricing and value for money variables good segmentation bases in clustering hotel clients'?, what type of tourists can be identified through pricing and value for money bases?*

**KEYWORDS:** latent class segmentation, hotels, yield management, pricing, value

## 1. INTRODUCTION

Consumer heterogeneity is one of the most fundamental concepts in marketing strategy; in fact, it is the basis for market segmentation, targeting, positioning, and micro-marketing [Kamakura, Kim & Lee, 1996, Rondan-Cataluña, et al., 2010]. Nevertheless, this process is obviously not equally applicable to all sectors and industries. Focusing in the service sector, clients expect to be treated as individuals and to be provided with the services they desire -not a standard solution [Gwinner et al., 2005]. This idea is even more relevant if the distinctive qualities of services are recognized, such as: service is intangible and heterogeneous; its production, distribution, and consumption are simultaneous processes; it is an activity or a process; it is a core value created in buyer-seller interactions; customers participate in its production; it cannot be stored and there is no transfer of ownership when it is sold [Gronroos, 2000; Svenson, 2006].

The literature documents application of segmentation strategies mainly for tangible products. However, services have been much less focused on this topic (Ehrman, 2006). This study aims to provide knowledge in this critical area of services management. More specifically, this research has focused on tourism, given the great importance of this activity in the economy of the analyzed territory.

Segmentation in tourism is especially difficult because of every specific tourism operation or location may have a different set of features, external factors or past marketing efforts. For example, the benefits searched by tourists visiting a tropical beach may be quite different from other travelers looking for trekking adventures in the Himalaya Mountains. Even, the same travelers may have heterogeneous motives and expectations for a business trip in comparison to a leisure trip for the same destination. For these reasons, all attempt to improve and test segmentation techniques and basis are relevant for tourism practitioners.

In this study we have focused special attention on yield management, which is one of the more applied pricing policies by hotel managers [O'Connor & Murphy, 2008; Jallat & Ancarani, 2008]. Thus, analyzing the use of segmentation variables based on price and value can be very useful for those responsible for managing these pricing policies.

## **2. SEGMENTATION IN TOURISM SECTOR**

Jefferson & Lickorish (1988) indicated that the more common tools of touristic segmentation are: (a) socio-demographic characteristics such as gender, age, family size, nationality and social level; (b) socio-economic variables indicative of occupation and income; (c) travel motivation; and (d) travel patterns of behavior or psychographic groups. However, several research studies documented the fact that demographic segmentation by itself does not provide adequate discrimination between market segments (Juaneda & Sastre, 1999). These authors showed the importance of segmentation by nationality in the Balearic Islands, and that an understanding of these differences greatly enhances efforts towards the development of an appropriate strategic marketing plan for destination areas.

More recently, benefit segmentation has been claimed as a better segmentation basis than previous methods. It was seen as having a much wider range of applications than traditional segmentation techniques since it provided marketers with a fuller picture of customers. Concretely, the advantages of benefit segmentation were its capacity not only to classify customers by benefits sought, but also to profile each segment by using descriptive variables (Frochot & Morrison, 2001). According to these authors, four main categories of applications of benefit segmentation in travel and tourism are evident: (1) destination marketing, (2) targeting specific markets, (3) attractions, events, and facilities, and (4) examining traveler decision making processes.

Bigne & Andreu (2004) presented an empirical study into tourist segmentation based on consumption emotions evoked by the enjoyment of leisure and tourism services. Barroso et al. (2007) found four major clusters of tourists emerge—according to the tourists' need for variety. Their results showed that significant differences exist among these segments in terms of the effects of a destination's image on tourists' intentions to return to a destination; and their intentions to recommend it to friends and relatives. Previously, Yuksel & Yuksel (2002) identified five distinct segments focused on tourists' dining experiences. They revealed that greater variation in satisfaction was explained when analysis was undertaken at market segment level compared to aggregate market level. Inbakaran & Jackson (2005) found four discernable clusters of resort visitors. Their results show that gender does not have much influence whereas life-cycle, education and age have considerable influence in segmenting the resort clientele. Dey & Sarma (2010) found three segments of tourists in North-East India according to travel motivation: (1) nature-loving explorers, (2) nature-loving vacationers, and (3) change seekers. The motivation factors they analyzed were the following: fun and independence, vacation, health and recognition, wander thirst, and nature. A novel method to segment tourist markets associated with dominant movement patterns of tourists is presented by Xia et al. (2010). The process consists of

identifying dominant movement patterns of tourists; those who travelled with the same dominant movement pattern were divided into different segments based on the geographic, socio-demographic and trip-related behavioral variables. This method is very useful to develop tour packages.

With regard to value for money, it is one of the four dimensions that Sweeney and Soutar (2001) developed for measuring perceived value. Value for money is part of the sacrifices (price, time, effort, risk and convenience) made by the customer; the other part that conforms perceived value are the benefits (economic, social and relationship) received by the consumer. In a tourism context, Sanchez et al (2006) developed a scale of measurement of the overall perceived value of a purchase (GLOVAL). They paid special attention to identifying the cognitive and affective dimensions. Recently, other studies have analyzed perceived value and value for money in the tourism scope (Choong-Ki, Yoo-Shik & Seung-Kon, 2007; Chen & Chen, 2010) but they have not use these variables as segmentation bases.

After a revision of many studies about segmentation in the tourism sector, it has been proved that variables related to prices and value have not been used as the only segmentation basis. This paper tries to fill this gap because price is a decisive variable in decision making about hotel selection, especially for those managers applying yield management. In addition, behavioral and psychographic segmentation bases have been used.

Concretely, the main objectives of this study are to answer these important research questions:

- a) Are pricing and value for money variables good segmentation bases in clustering hotel clients'?
- b) What type of tourists can be identified through pricing and value for money bases?

### **3. PRICING IN HOTEL SECTOR**

Among all the different pricing policies available for hotel managers, yield management has become one of the most important in recent years. In fact, prices in the whole tourism industry (e.g. airlines, hotels) are based almost exclusively on the "yield management" policy (Avlonitis & Indounas, 2007). Yield management policies deal with, first conduct market segmentation, and second set different prices according to the identified segments, and thus maximize revenues and available capacity (Selmi, 2010). Therefore, this highlights a key aspect of yield management that is market segmentation. In this context, an important aspect is that clients from different segments do not perceived the use of this practice as unfair (Kimes, 2002). Taking into account the relevance of segmentation in yield management, what segmentation bases are more appropriate for this topic? We hypothesize that variables related to price will be the best choice because segments will be based on price perceptions.

A more widespread definition on yield management is a sophisticated way to manage the offer/demand, manipulating prices and available capacity simultaneously. Then, through yield management, managers may allocate the available capacity at any time, monitoring the segments, and setting prices according to their price sensitivity. In addition, they charge lower prices to price-sensitive segments and higher prices to those segments that show a greater willingness to pay (Avlonitis & Indounas, 2007).

In general, yield management and revenue management are often used as synonyms in the service industry. However, it should be noted that revenue management or yield management tend to be used more profusely in hospitality industry (e.g. Choi & Mattila, 2005; Noone & Mattila, 2009). However, this pricing policy can be used in numerous industries. Marchionna (2005) considers its application in: airlines, hotels, wholesale tour operators, restoration, urban and suburban transportation, long distance rail passengers', electricity generation and distribution, use of infrastructure for freight transport, telephone services, use of roads and public streets, occupation of hospital beds, operating room use, and, finally, industries with inflexible production capacity and fluctuating demand.

In the case of hotels, some research has been published on how the presentation of the Best Available Rate (BAR) influence on the perceived price fairness. In this sense, Rolhs & Kimes (2007) suggest that non-blended rates are perceived by hotel clients as fairer, more acceptable and more reasonable than blended rates. The former includes a price list that is increased or decreased according to the number of the nights included in the booking; in the latter the price shown to the customer is the average price of all nights included in the booking. This is to say that non-blended rates provide more information than blended, and customers perceived that as prices fall, their profit increase, encouraging the purchase or booking. Rohlfs & Kimes (2007) and Wirtz & Kimes (2007) found that customers' familiarity to this pricing policy may influence their reaction to it. Thus, perceived price fairness caused by this strategy is influenced by the amount of information given to customers (Kimes, 1994).

Taking into account the aforementioned ideas, and mixing behavioral and psychographic segmentation bases, the variables that have been used in this study are related to prices and prices perception of hotel clients. More exactly, the research incorporates: a) Two behavioral bases: price paid (Euros per night) and additional spending in the hotel (in Euros). These variables can be considered as measures of objective prices. b) Two psychographic bases: value for money perceptions and willingness to pay. These two variables are measures of price perceptions. As it was previously mentioned, value for money is a component of customer value and can be viewed as comparing the benefits and sacrifices, and represents monetary valuation (Nasution & Mavondo, 2008).

In the survey, value for money perceptions were measured with 5 items using a 7-point Likert scale and adapted from the scale of Martín-Ruiz et al. (2007), see table 2. With regard to willingness to pay, it was evaluated with the statement "I will come back to this hotel even if the price will increase until \_\_\_\_%".

Furthermore, some covariates related to socio-demographic and behavioral characteristics were used in order to better describing the groups of clients. These covariates are: client loyalty (How many times have you stayed in this hotel?), group size (How many people are staying with you?), age, gender, stage of education achieved, incomes, family size, motives for the trip, and type of stay.

Summarizing, we hypothesized that pricing variables are good segmentation bases for hotels that use yield management as pricing policy.

## **4. METHODOLOGY**

### ***4.1. Latent class segmentation***

Latent class (LC) segmentation has been used to segment the sample of hotel clients'. LC models are a kind of mixture model. Mixture models refer to procedures for dealing with heterogeneity in the parameters of a certain model across the population by imposing a mixing distribution on some or all the parameters of that model. One may assume that parameters of a model are heterogeneous across consumers and follow a certain distribution among the population. This distribution can be assumed to be either continuous or discrete (Wedel & Kamakura, 2000). LC models, therefore, present a powerful tool for market segmentation. They estimate utilities for each segment and the probability that each respondent belongs to each segment (Wilson-Jeanselme & Reynolds, 2006). A large number of such models have been developed, and several studies have demonstrated their superior performance over traditional clustering-based techniques (DeSarbo & Wedel, 1994). The main characteristic of this methodology, contrary to the clustering-based segmentation, is that it can be used with qualitative variables -nominally scaled- (Kamakura & Wedel, 1995). Moreover, the creation of a posteriori segments is another advantage over other segmentation types, because a priori segments may be firmographically distinct but may not behave differently with respect to the variables analyzed in the study (DeSarbo, Jedidi, & Sinha, 2001).

Summarising, an LC cluster model identifies clusters that group cases sharing similar interests or characteristics. Some advantages over traditional cluster analysis are embodied in probability-based classification. Cases are assigned into groups based upon membership probabilities estimated directly from the model (Bond & Morris, 2003; Ramaswamy et al., 1996; Vermunt & Magidson, 2003; Vriens, Wedel, & Wilms, 1996). The estimation method starts with a hierarchical cluster and continues with the iterative algorithm expectation-maximization (EM), until the combination of model and number of clusters is found that enables the collection of more information. Then, the number of clusters in the sample is identified by looking at which alternative displays the smallest Bayesian Information Criteria (BIC) (Barroso-Castro et al. 2007).

With regard to the statistical software, Latent Gold 4.0 has been used to estimate LC cluster models and SPSS 15.0 for the descriptive analysis.

#### 4.2. Sample

A simple random sampling method was used to collect information of 2400 hotel clients (1235 males and 1.165 females), by means of personal interviews performed by trained interviewers during the months of December 2006 and January 2007. They were interviewed in 83 hotels (around 30 clients in each hotel) selected randomly in all Andalusian provinces in the south of Spain. The average age is 42.6 years old. The 80.9% of respondents stay in the hotel for leisure motives, the 14.1% for working motives, and the 5% for personal motives. In addition, the 78.4% of respondents stayed in the hotel where they were interviewed for the first time, 9.5% for the second time, and 12.1% for the third or more times.

## 5. RESULTS

The first step in analyzing latent cluster results is to set the number of groups. The 2-cluster model obtains the minimum Bayesian Information Criterion. The optimum number of clusters that minimizes the BIC index (1.386,1182) is two (Table 1).

Table 1.

Selection of latent clusters

		LL	BIC(LL)	Npar
Model1	1-Cluster	-595.1259	1440.5114	65
<b>Model2</b>	<b>2-Cluster</b>	<b>-510.1771</b>	<b>1386.1182</b>	<b>95</b>
Model3	3-Cluster	-481.157	1443.5824	125
Model4	4-Cluster	-458.1315	1513.0358	155
Model5	5-Cluster	-436.7593	1585.7959	185
Model6	6-Cluster	-427.365	1682.5117	215

Furthermore, the segmentation variables related to price and value for money perceptions and willingness to pay (psychographic bases) were significantly different in the two clusters (according to the p-values of the Wald test, and z-values). However, price paid per night and additional spending in the hotel (behavioral basis) were not statistically significant in both groups of clients. The covariates statistically different in both groups are: client loyalty, age, and level of studies achieved by the respondents. The description of the two latent clusters is exposed in table 2. Cluster one includes 67.72% of clients of the sample, and cluster two incorporates 32.28%. With regard to the segmentation variables the average price paid by both groups was quite similar (around 66 €/per night). However,

the additional spending of clients from cluster two was over 10 €(on average) higher than in cluster 1. The key variables that provoked the division of client hotels into two groups are the 5 variables related to pricing and value for money perceptions and the one related to willingness to pay. The clients of the first cluster show a significant better perception of hotel rates, with hotel value for money perceptions over 6 points on average (with a maximum scale of 7 points). Clients from the second cluster scored perceptions of hotel rates around to 4.5 points. Furthermore, the people of the first group are willing to pay until 6% more for the same hotel, but in the second group this percentage is only 0.78%.

Table 2.  
Description of segments

	Cluster1	Cluster2
<b>Cluster Size</b>	0.6772	0.3228
<b>Indicators</b>		
<b>Price paid per night (in Euros)</b>		
Mean	65.877	66.8607
<b>Additional spending (in Euros)</b>		
Mean	16.9172	26.7739
<b>I believe that the hotel rates are reasonable* (1 Totally disagree...7 Totally agree)</b>		
Mean	6.2728	4.637
<b>In general, the price charged by the hotel seems reasonable, given the costs involved by my accommodation* (1 Totally disagree...7 Totally agree)</b>		
Mean	6.1169	4.5028
<b>Compared to the price of other hotels, the price that I have paid in this hotel is a normal price* (1 Totally disagree...7 Totally agree)</b>		
Mean	6.0553	4.6319
<b>The hotel offers good service, considering the price I have paid for it* (1 Totally disagree...7 Totally agree)</b>		
Mean	6.2103	4.5703
<b>The value of the hotel makes it worth the money, time and effort invested on the accommodation* (1 Totally disagree...7 Totally agree)</b>		
Mean	6.0552	4.6322
<b>Willingness to pay*</b>		
Mean	6.0032	0.7829
<b>Covariates</b>		
<b>Type of Accommodation</b>		
Bed only	0.0937	0.1334
Bed and breakfast	0.2812	0.4001
Half board	0.0937	0.1334
Full board	0.3751	0.3331
All inclusive	0.1562	0
<b>Number of nights in the accommodation</b>		
Mean	5.2191	4.2656
<b>Trip motive</b>		
Leisure motives	0.5938	0.8666
Working motives	0.3749	0.1334
Personal motives	0.0312	0
<b>Client loyalty*</b>		
First time	0.6876	0.5998

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Second time	0.25	0.2668
Third or more times	0.0625	0.1334
<b>Gender</b>		
Male	0.6562	0.3334
Female	0.3438	0.6666
<b>Age*</b>		
Mean	45.0031	41.1251
<b>Level of studies*</b>		
Primary	0.3751	0.1997
Secondary	0.2187	0.1334
Vocational training	0.0937	0.1334
College	0.3125	0.5335
<b>Family size</b>		
Mean	3.4059	3.2673
<b>Incomes (in Euros)</b>		
Mean	2215.4305	2010.336

\*Statistically different in both groups

In relation to the covariates that help to describe both groups, average incomes and family size are slightly higher in the first latent segment. More differences appear in the level of studies because a much higher percentage of clients have tertiary studies in the second latent cluster than in the first (53.35% vs. 31.25%), and 37.51% of people in the first one achieved only primary studies vs. 19.97% in the second group. The average age is 45 years old in cluster one and 41.12 in the second group. With regard to gender, females are double-sized in the second latent cluster than in the first one, the reverse occurs with males. Although the level of loyalty is scarce in both groups, is even lower in cluster 1, because 68.76% of respondents of this group were the first time visiting the hotel vs. 59.98% in latent segment two. The majority of clients from the second group (86.66%) stayed in the hotels for leisure motives, this percentage was 59.38% in the first one; conversely, working motives were higher in latent cluster one. Finally, not significant differences were found with regard to the type of accommodation in both group of clients, but in the first one 15.62% enjoyed all inclusive vs. 0% in the second.

## 6. DISCUSSION AND CONCLUSIONS

The main objectives of this study were to answer these important research questions: Are pricing and value for money variables good segmentation bases in clustering hotel clients'?, what type of tourists can be identified through pricing and value for money bases?

In reference to the first question, using only pricing variables as segmentation bases two groups of tourists have emerged applying latent cluster segmentation techniques. If these variables would not have been discriminating enough, no clusters had been identified. As noted above, in a latent cluster analysis, initially, the number of segments was unknown. Therefore, as two latent clusters arose from the analysis we can affirm that in this case, 8 variables related to price and value for money were applied, but only 6 shown discriminating powers. Price paid per night and additional spending in the hotel were not valid segmentation bases. It seems that these measures of objective prices are not valid segmentation bases, as the perceptions of value for money and prices are. It is likely that neuronal processes provoked by perceptions of price and value for money enjoyed in a hotel are more relevant in decision making than the objective monetary value of the price paid or additional spending in the hotel. But the latent segment more price-rigid paid a bit more per night and spent more as additional expenses than the other segment. It is very interesting that clients who paid more are more price-rigid,

perhaps because they know they could achieve a cheaper option. According to results, perception of prices are more relevant than objective prices in order to segment hotel clients', this means that the image of prices generated by customers minds' are even more decisive in consumer behavior than objective prices.

In consequence, marketers that apply yield management in their firms should take into account price perceptions of clients, and pricing decisions should be made communicating properly changes in prices and the reasons behind it (Martin-Consuegra et al., 2007).

Next, in order to answering the second research question the description of both segments is exposed. Clients from Cluster one or "price-elastic" segment really believe that the hotel rates are reasonable. In addition, they think that the price charged by the hotel is reasonable, given the costs involved in the accommodation, and they have a good perception of prices in comparison to other hotels they have visited. Furthermore, they manifest a good perception of price-service quality relationship. In general, they have an excellent perception of value of their accommodation including economic and non-economic efforts. Perhaps, the most outstanding characteristic of this segment is that they are willing to pay almost a ten percent more of the price they paid. This is a key-point for marketers, indicating that people who have a good perception of prices and value are willing to pay more. This idea links with other studies that demonstrated the influence of perceived price fairness on customer satisfaction, loyalty and price acceptance (Martin-Consuegra et al., 2007). With regard to demographic variables, clients that are included in this group tend to book full board and bed and breakfast accommodation; there is a much higher percentage of clients visiting the hotel for working motives than in the other segment; the majority of them are males and they are visiting the hotel of the interview for the first time; they are four years older in average than clients of the other segment; and they are focused in two level of studies more than 1 in 3 have primary studies and almost other third part have tertiary studies. It is remarkable the fact that average incomes of these clients are around 10% higher than in the other segment. Probably, this last information and the fact that a big percentage of clients of this segment visit the hotel for working motives, and therefore their firms likely pay their accommodation influence their higher willingness to pay.

Clients from cluster 2 or "price-rigid" segment show a significant lower score in price perceptions, value for money and price-service quality relationship. And, they are not willing to pay more for the accommodation. People from this group were accommodated in the hotels mainly by leisure motives, and however they are a bit more loyal than the others. The percentage of women in this group is double-sized than in the other segment. They are four years younger and more than a half have studied at college level.

In summary, marketers of hotel chains who use yield management policy, which is a common practice in this sector (Avlonitis & Indounas, 2007), should try to use segmentation bases based on price perceptions and willingness to pay. These segmentation variables are essential to adapt yield management and other pricing policies to clients because they hide motivations of purchase behavior and satisfaction.

Finally, some limitations of this study have to be mentioned and are the base for work in forthcoming papers. The segmentation methods applied in this manuscript have the implicit assumption that segments are stationary in structure and characteristics, but segments could change over time. Wedel and Kamakura (2000) described dynamic segmentation approaches that could be applied to this analysis in further research. In consonance with other authors' recommendations (Brusco et al., 2003; Mort and Drenan 2005; Nysveen et al. 2005), the idea of joint segmentation on multiple bases applied in the tourism area or extensions that permit overlapping cluster membership should influence future research efforts.

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