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Abstract

The aim of this study is to examine the relations between the cost structure of sector features and pricing behaviors through the example of the accommodation sector in terms of social responsibility. This has benefited from both the analytical geometry and the income and cost data of a real accommodation enterprise. The findings point out this situation: In the accommodation sector, the fixed costs are high, and the variable costs are low. Thus, the effects of the cost in determining the optimal price, in view of the short term, are at a very low level. There is such a very close relationship between these facts that managers of accommodation enterprises allow more limited time to the subject concerning pricing, instead of to internal matters of the company. In addition, this structure of the sector has an important role in the prevalence of an error in the public opinion that accommodation enterprises allow prohibitive (excessive) prices.

Keywords

demand, cost, price, pricing, accommodation, fixed variable

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The Relations Between Sector Features, Pricing Behavior, and the Concept of Social Responsibility: An Example of the Accommodation Sector

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Abstract

The aim of this study is to examine the relations between the cost structure of sector features and pricing behaviors through the example of the accommodation sector in terms of social responsibility. This has benefited from both the analytical geometry and the income and cost data of a real accommodation enterprise. The findings point out this situation: In the accommodation sector, the fixed costs are high, and the variable costs are low. Thus, the effects of the cost in determining the optimal price, in view of the short term, are at a very low level. There is such a very close relationship between these facts that managers of accommodation enterprises allow more limited time to the subject concerning pricing, instead of to internal matters of the company. In addition, this structure of the sector has an important role in the prevalence of an error in the public opinion that accommodation enterprises allow prohibitive (excessive) prices.

Keywords: demand, cost, price, pricing, accommodation, fixed variable

Introduction

Price is an important variable of mixed marketing. It is a medium which balances the supply and demand in a market economy. There have been various definitions of “price,” including, for instance, “the supply price,” which the sellers agree upon, “the demand price,” which the consumers agree to pay, and “the market price,” in which buying and selling are de facto realized (Türksoy, 1998, p. 111). On the other hand, Abrate and Viglia (2016) say there are dynamic pricing strategies in the hotel industry, which produce incentives to understand the price tactics of every hotel on an individual basis, increasing properties of flexibility and utility of price in marketing programs (Abrate, Fraquelli, & Viglia, 2012; Tanford, Raab, & Kim, 2012), yield management (Emeksiz, Gürsoy & İçöz, 2006), and customer satisfaction (Radojevic, Stanistic, & Stanic, 2015).

To date, many aspects of pricing behaviors have been studied. The main factors to consider in pricing are demand and costs, but there are also other factors. The best price for the enterprise is certainly the price which is over the unit cost. However, this is not adequate. This price should be the one that the consumers agree to pay at the same time. The demand conditions determine this. When demand conditions are considered, the structure of the market and the competition

conditions are in question (Tecer, 1982). A price of any enterprise is to be close to the rival enterprises in market (İçöz, 1996). Besides, the elasticity of demand of the product carries great importance (Tecer, 1982). As for the *other factors*, they are the factors which the enterprise is to consider with the consciousness of social responsibility and public relations. For instance, if there exist value judgments such as *fair price*, enterprises may feel obliged to consider this too. It is also possible to mention various methods within the cost pricing itself. *Full cost pricing* and *variable cost pricing* are examples of these methods.

The aim of this study is to examine the relations involving the cost structure of pricing behaviors, through the example of the accommodation sector, in terms of social responsibility. The lack of a study investigating the relationship between pricing and social responsibility in hospitality establishments constitutes the original part of this study.

Literature Review

The relationship between the costs and the prices has been studied in many aspects up to now. As some writers mention (Collins & Parsa, 2006), full cost pricing is particularly difficult. Thus, as the price determines the sales volume, the sales volume affects the unit cost. The reason for this is that the unit cost also includes a share falling into the unit from the fixed cost. It is possible to say that the higher the level of the fixed cost is, the more disjointed the relation between the price and the unit cost will be in the short term (Kotas, 1975). This situation is particularly valid for accommodation enterprises. It is known that the changes in sales in accommodation enterprises affect the profit profoundly, and this situation is attributable to the poor relation between the costs and operating volume (Hughes, 1986). In lodging enterprises, fixed costs are very high compared to variable costs (Gürbüz, 1998). This also indicates that there is a poor relationship between the cost and the unit cost in short term, notably in accommodation enterprises.

Another method of cost pricing is variable cost pricing. Though the unit full cost of any products shows differences in respect to its operating volume, it can be said that a certain level of the unit variable cost, relatively independent from operating volume, can exist. Here, the price is determined by adding a suitable margin, including the earnings target and the fixed costs, to the unit variable cost (Tecer, 1982). It can be said that this system is particularly more appropriate for multiproduct companies, because it may be sometimes difficult to make a decision on how much share it would be for every range of products from the fixed cost in order to find out the full unit cost. Moreover, it may not be important to know about it, as the fixed cost will already be paid, because in this type of firm, the problem of protection of a rational relative price balance among the products appears to be another worrying case. For instance, retail dealer or distributor firms consider an optimal balance among the prices of the goods they sell (Harper, 1966; Lach & Tsiddon, 1996), because the price of any product in the same firm may affect the sales of other products (Bojamic & Calantone, 1990; Kotler, 1976). So, for each relative price package, the overall profit made is different. The concept of the choice of an optimal relative price set is called a *price package*, and some writers have studied this subject especially (Adams & Yellen, 1976; McCardle, Rajaram, & Tang, 2007; Schmalensee, 1984).

Whether variable cost or full cost, some studies point out that in cost estimation, most enterprises have not benefited from cost accountancy and its complicated calculations. For instance, according to the findings in the study which Cassidy and Guilding made in Australia on tourism enterprises

(Cassidy & Guilding, 2007), those enterprises do not determine their prices according to detailed cost accounts, but do them in an *intuitive* manner. Other studies indicating the same point (Lewis & Chambers, 2000; Morrison, 2002) are also available. Similarly, the study by Pellinen (2003) points out that most of the tourism enterprises in Finland only follow the leading firms in terms of pricing. This study also points out that the benefit level from cost accountancy in pricing is high only in firms which are superior in respect to competition.

An Analytical Application: Price-Cost Relations and Manager Behavior

At first sight, the concepts of cost pricing and demand pricing seem to be opposite to each other. If pricing is made by putting a planned certain percentage share on the unit cost (full cost or variable cost), would the demand conditions be disregarded? According to some writers, the basic point is how the percentage of profit share is to be determined. Actually, while this rate is determined, firms deliberately or unknowingly take the demand conditions into consideration (Laidler & Estrin, 1989). That the profit share is not the same in each product is essentially the indication of this case. In addition, firms are most likely to display proper behaviors of established manners in business life. Such a behavior relieves the firms of the burden of detailed analysis. For instance, supposing that the margin of profit in a product is accepted as 10% by many firms, this rule may have been established as a consequence of the fact that the optimal margin of profit is such on the condition that, through long years of experience, the demand for this product is to be considered (Gürbüz, 1998). Similarly, there is a rule which is called 1/1000 in hotel management. According to this rule, under the hypothesis of 70% occupancy, 1/1000 of the investment amount per room is to be the room price (Lundberg, 1979). This means that, if the hotel provides 70% occupancy in spite of this price, this hotel can be constructible and viable. Thus, the experiences in the past, pointing out that such a price can meet the costs, are to relieve the enterprises of the difficulties of unit cost calculation. This means that enterprises consider the unit cost automatically. In conditions in which uncertainty exists, these types of rules are regarded as the practical mediums of making rational decisions (Jean-Pierre & Harris, 2008). Even the economists who analyzed the pricing theories consider these practical rules as not the opposite of the theory, but its expansion (Lucas, 2003).

In the previous section, it has been mentioned that some studies point out that the role of the cost assessment in pricing in many enterprises is not strong. However, it is understood that this doesn't refer to an absolute disconnectedness or negligence. Enterprises, in a way, deal with both cost and demand conditions together. For instance, if the manager knows that the overall costs will not considerably change if the sales volume changes, they act in accordance with only demand conditions on making pricing decisions; this is normal. If this manager has acted as if they know this feature of costs, it means that they have actually considered the costs. It can only be said that the effects of the costs are low on the pricing decisions regarding these conditions. Accommodation enterprises are quite typical in this aspect. For instance, in Figure 1, supposing that T_1 line is the demand line estimated for the enterprise by the manager, the enterprise sells as much as Q_1 from the P_1 price. Supposing that the variable cost per unit is C_1 , the total income in the P_1 price is as much square as the $0P_1K_1Q_1$ rectangular, the total variable cost is as much square as the $0C_1K_6Q_1$ rectangular, and the total profit is as much square as the $C_1P_1K_1K_6$ rectangular (In this model, it has been assumed that there are no fixed costs. It is already known that even if the fixed cost exists, it will not affect the short-term pricing decision. Whether the total profit is all actual profit, or if some of it will be used to meet the fixed cost, is a different matter). According

to the manager, if the price falls into P_2 , the sales will rise to the unit Q_2 . Due to the price decrease, the square of the rectangular $P_1P_2K_3K_1$ representing for the decrease in the profit is smaller than the square of the rectangular $K_3K_4K_5K_6$ representing for the increase in the profit due to the sales increase. That is, the net profit will increase according to the estimation. Thus, the manager is supposed to decrease the price to P_2 .

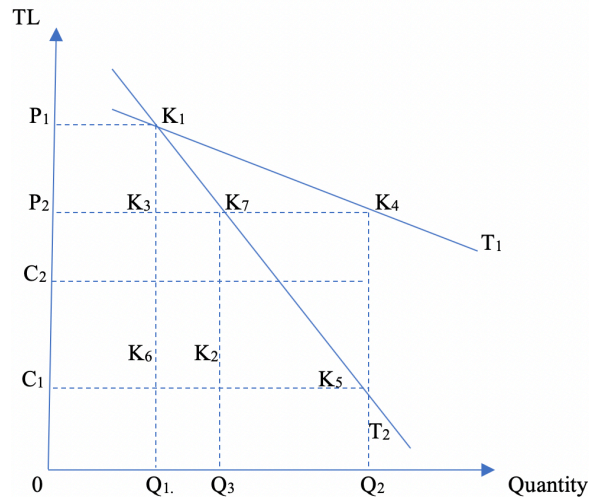


Figure 1. Costs and profits for different operating volumes

According to Figure 1, the manager is mistaken about their estimation and the real demand line T_2 . In other words, the sales will not actually increase up to Q_2 , but up to Q^3 . In this case, the net profit, though it will not increase as much as the manager estimates, still increases, because in this case as well, the square of $K_3K_7K_2K_6$ rectangular is bigger than that of $P_1P_2K_3K_1$. It can be said that even if the manager considers the possibility that they may be mistaken in their estimation, they will not consider it a risk to change the price (In the worst-case scenario, even if both squares are equal, the total profit will not change).

If the assumption is made according to Figure 1, the ratio of unit variable cost within the price is at a considerable level (C_2). It can clearly be seen by analysis that, similar to the above, if the manager's demand estimation is correct, the profit will increase, but if it is incorrect, the profit will decrease. Even if the estimation is correct, the increase in profit will be less in comparison in the case that the unit variable cost is at the level of C_1 .

In summary, the managers of C_2 variable cost firms may consider the change of the price as a risk, and they may prefer to take cost cutting measures in the enterprise, rather than to change the price to increase the profit (As C_2 is a high cost level, even the very little savings as a percentage can increase the profit profoundly. The case is in contrast with C_1 variable cost firms). On the contrary, not changing over the price for C_1 variable cost firms means that they are likely to miss the significant profit opportunities.

C_1 variable cost firms are typically represented by the accommodation sector. In fact, the managers of accommodation companies are known to allot most of their time to matters concerning price, instead of internal matters. This case is explained by the fact that the variable cost is low. The analysis based on Figure 1 belongs to this writer, but the main idea, which is the source of this,

has been expressed by other writers (Gürbüz, 1998; Kotas, 1975). The analysis above indicates that the pricing in the short term in low variable cost enterprises may be considered as a matter independent from cost. However, when one takes a closer look, *independent from cost* means *not considering the cost*, considering that variable costs are very low.

In accommodation enterprises, the subject of whether the price is above the unit full cost or not is a point which should be considered while planning at the stage of the establishment of the enterprise. It is very natural to compare the unit cost with the long term estimated average price at the stage of the establishment of the enterprise. However, once the enterprise is established, the effect of the fixed costs (and, consequently, the unit full cost) on the short-term pricing decisions is low. Thus, it can be said that in accommodation enterprises, the optimal price varies between high and low season (Pan, 2007).

The Concept of Social Responsibility and Pricing

Having emphasized that the relation between the unit variable costs and the price in accommodation enterprises is poor, it should be noted that even under the conditions of a market economy, whether the prices are considered as fair appears to be a remarkable factor which affects the demand. Accommodation managers have always been considered the ones who generally offer high prices and allow a *large deal* (bargain) share over this price (Hanks, 2002). Moreover, books (Grossman, 1991) about *how to make a cheaper holiday* have been published. These are all striking examples, reflecting a different point of view, that the relation between the prices and the costs is poor in the short term in the accommodation sector and that the structure of cost in these enterprises mostly consists of fixed costs.

It is doubtless that for an enterprise, including in the accommodation industry, to exist, it is necessary that its average price in the long term must exceed the average unit cost in the long term. However, considering this, it cannot be said that the short terms are not important, because the long term is formed through the addition of the short terms in succession. Some accommodation managers may allow considerable price reduction for the short term, so as to increase their occupancy, considering that the variable costs are low. However, the new levels of these falling prices may be a reference price for the customers over time. and may also remain the same in the long term. In other words, the reduction of the price, instead of the initiative by the manager, due to the fact that the customers may not find the current price fair, means that the demand line moves to the left, and even if the quantity of overnight stays will not increase, a lower price may be optimal (Gürbüz, 2007).

When the variable costs are low, it is really a bargain chance for customers. Moreover, because of the same reason, the price may be considered as unfair by the customers. Some studies indicate that the view that the customers adopt the *judge* thesis, simply in an opportunist approach in order to be able to buy the products more cheaply, is not completely true. As a consequence of this, if the customers, in fact, can be told the reasons why the prices are not unfair, the positive result of this action can be seen. Surely, it is a question which should be dealt with at not only the level of sector but at the level of enterprise. In fact, some studies show that the customers simply do not consider the price in assessment of what they consider fair, but that they consider why and how the decision of pricing is taken (Galston, 1980; Martins & Monroe, 1993; Martins & Monroe, 1994). On the other hand, some studies indicate that the customers pay their attention to the ratio

among the prices which the company allows to both the former and the new customers, rather than the price itself (Cox, 2001).

Methods

This study has benefited from both the analytical geometry and the income and cost data of a real accommodation enterprise. The relation between the price and the cost, according to these figures, has been inspected.

Data Collection

The sample of this study is a five-star hotel. The data shows that the low month in this enterprise is January and the high month is August. Comparing the demand data and the total income with the total cost of these two months, the findings should show the unit cost information and the unit price, considering the margin between these.

Findings

Cost-Price Relation in a Five-Star Hotel: An Empirical Application

In Table 1, some data of May and August 2018 of Hotel A, a real accommodation enterprise, is shown.

Table 1. The Data of Hotel A

Cost & Unit	May 2018	August 2018
General Cost	₺3,222,641	₺4,269,443
Unit Cost	₺352.2	₺267.8
Personnel Cost	₺1,532,207	₺1,861,951
Quantity of Overnight (Quantity of Unit)	9,149	15,943
Average Price Per Overnight	₺400	₺557
Variable Personnel Cost per Overnight Unit	₺48.5	₺48.5
Ratios of Personnel Costs Within the Total Cost	47.54%	43.61%
Unit Variable Cost	₺154,077	₺154,077

₺ = Turkish Lira

With reference to Table 1, the analyses are below.

Analysis 1: General Cost

The cost equation of *A* accommodation enterprise is $C = F + (V \times Q)$.

Where:

C represents the total cost,

F is the total fixed cost,

V is the variable cost per overnight unit, and

Q is quantity of overnight.

As seen in the table, the general cost for May is ₺3,222,641, and the general cost for August is ₺4,269,443. The margin between the general costs of these two months is ₺4,269,443 - ₺3,222,641 = ₺1,046,802.

It is acknowledged that this margin stems from the margin between the quantities of overnight and they are all variable costs, because, when the quantity changes, the fixed costs do not change. In that case, if this margin has been divided into the margin between the May and August quantities (that is, $15,943 - 9,149 = 6,794$), the unit variable cost of this enterprise is obtained.

If so, the unit variable cost is $\text{₺}1,046,802 / 6,794 = \text{₺}154,077$.

As the May quantity is 7,512 units, the total of variable cost in May is,

$$V = 9,149 \times \text{₺}154,077 = \text{₺}1,409,650$$

As the total cost in May is $\text{₺}3,222,641$, the fixed cost of *A* accommodation enterprise is,

$$F = \text{₺}3,222,641 - \text{₺}1,409,650 = \text{₺}1,812,991.$$

So, the general cost equation of the enterprise is,

$$C = \text{₺}1,812,991 + (\text{₺}154,077 \times Q).$$

So, finding out the ratio of the fixed cost within the August general cost,

$$\text{₺}1,812,991 / \text{₺}4,269,443 = 0.42$$

Even in August when the occupancy is very high, the fixed cost ratio is at the level of 42%. It can be acknowledged as an identical fact that within the total cost, the fixed cost ratio is high, while the unit variable cost is low. However, as seen in the table, the ratio of unit variable cost within the price falls up to 27% in the normal August season. One should remember the information mentioned in previous sections that the relation between the costs and the short-term pricing decisions in the enterprises that their variable cost level, which is low, is generally poor.

It will be seen by the following analysis whether this is real or not for this enterprise.

Analysis 2: Personnel Costs

The largest item of the total cost in *A* enterprise involves personnel costs. The ratios of personnel costs within the total cost are, as in the table, 47.54%, in May and 43.61%, in August. The fixed cost burden is much more in personnel costs itself. When a similar calculation above is made for personnel costs (according to the data in the table), personnel costs equation,

$$C_{PERS} = \text{₺}1,088,481 + (\text{₺}48.5 \times Q)$$

Thus, the proportional share of personnel fixed costs in August within the all personnel costs is, $\text{₺}1,088,481 / 1,861,951 = 58\%$.

As seen above, the fixed feature of personnel costs is too much, and at the same time, the largest amount of the total cost makes up personnel costs. It is also understood that this point plays an important role on the fixed heavy cost of the enterprise.

Analysis 3: Average Price Per Overnight

As seen in the table, the average price in May is ₺400, and in August, ₺557. The overnight of August is considerably higher than May overnight. Thus, in August, both the demand amount is much more, and the price is higher.

At the same time, it can be acknowledged that the overall (full) unit cost in August (₺267.8), due to the increased occupancy ratio, is below the overall unit cost in May (₺352.2). In the table, this is clearly seen. The basic point here is the connectedness between the unit cost and the price. As can be seen, the unit cost from May to August has fallen to ₺267.8 from ₺353.2, and the price has increased up to ₺557. This case fits with the expectation that the relation of price to cost would be disconnected in enterprises in which the variable cost level is low, leading naturally to the result in Analysis 1.

Conclusion

The factors which affected the pricing in the enterprises have largely been discussed in literature. Of these factors, the cost and the demand variables are the most important ones. Initially, it seems to be contradictory that the enterprise determines prices according to the cost structure or considering the demand. When a profit of share is added as a percentage to the unit cost (whether to the unit variable cost or the unit full cost), the amount to be sold—as well as the price obtained—is determined spontaneously. On the other hand, when a price aiming at a certain sales amount is determined, what percentage of the share of profit, to be allowed to the unit cost, would be has spontaneously been determined. However, there are more findings in which these two-pricing methods can be applied together. The details of this subject are discussed in the study.

The argument, in which how much the costs are considered in pricing decisions, has two different dimensions. The first one is the difficulties of cost calculating in enterprises, but the difficulties of cost calculating do not bring about the disregard of the costs in the firms. Some norms established in sectors fill this gap to a great extent. The second dimension is how much the costs affect the pricing, even if the costs are known. This study is particularly related to this second dimension of the issue.

In enterprises in which the fixed costs are weighted, that is, in which the unit variable cost is low (typically in accommodation enterprises), the cost-price relation is quite variable in the short-term pricing decisions. This is normal, because when the price changes, both the quantity of sales and the volume of sales change. On the other hand, the total cost does not change too much. Therefore, while the pricing decision is taken, the manager can act relatively independently from the costs. However, if it is noticed, this disregard does not mean *never consider the costs*. On the contrary, the manager has acted with consideration of the fact that *the total cost will not change with the sales a lot*. That's why it can be said that, in fact, the manager has acted considering the costs. Both the results of this analytic study and its empirical research confirm all these points (It is doubtless that one cannot be say the same things concerning the long-term pricing decisions in accommodation decisions. Certainly, there should be a closer relationship between the average price for the long term and the average unit cost for the long term).

It is known that the managers of accommodation enterprises allot their limited time to various daily matters, are more interested in matters concerning customers and pricing, and allot less time to internal matters (that is, they are extrovert managers, not introvert). The accommodation managers have always been considered as the ones who generally offer high prices and allow a large deal (bargain) share over this price (Hanks, 2002). This analysis attempts to clarify in which sectors the managers are introvert and extrovert. It is obvious that the subject is related to the structure of cost. For instance, for the managers of manufacturing companies in which the unit variable cost is at a very significant level, not to consider changing the price or not being interested in price matters means *to avoid the risk*. In the accommodation enterprises in which this case is the contrary, the same behavior means *to neglect considerable profit opportunities*.

Another dimension in which there is a deep gap between the unit variable cost and the price involves the discussions relating to perceived fair price. This is a negative case for the accommodation enterprises, and it may lead to an error in the public opinion, in which these companies are not conscious of social responsibility and are untrustworthy. Thus, the demand for accommodation may negatively be affected. Introduction of the sector's character to the public in a positive way may give rise to positive results in terms of demand, because there have been findings relating to the fact that the customers not only pay attention to what decisions are taken, but also care about why and how the decisions are taken, and make judgments about fairness.

In this study, the relationship between price and cost has been investigated only in one accommodation enterprise. Other pricing strategies in hospitality establishments have not been emphasized. Future studies can research the relationship between cost and other price strategies. The data in this study belong to a city hotel. In future studies, the cost-price relationship in the holiday hotel or chain hotel can be investigated and compared.

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