

## Hotel Prices and Customer Perception of Rate Fairness: Analytical Study Applied to Five Star Hotels in Cairo

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### Abstract

Recent studies have shown that online travel purchasers tend to be price driven, it is claimed that among ten travelers, more than half of them seeking the lowest prices of services and most buyers are pulled by online discounts to buy travel services.

Furthermore the model of price discrimination or differential pricing provides an important analytical insight into discriminatory pricing practices. According to that model, prices charged by hotels are not usually proportional to the marginal costs incurred in producing the service. The hotels adjust their prices according to customer, location or product, and purchase volume....etc.

Many hotels are reluctant to implement differential pricing because of potential customer backlash. If customers believe that increased prices are not based on cost increases or changes in market conditions, they may view it as unfair practices. Therefore, this study focuses on answering the question of how a hotel can charge different prices without risking customer perceptions of unfairness. The study uses a questionnaire form to collect research data from the customers of the five star hotels in Cairo. A total number of 120 usable responses were collected. Linear regression was used to test the causal relationships between variables.

**Keywords:** Rate fairness, rate consistency, rate transparency, rate reference, hotels.

### Introduction

Information Technology (IT) has dramatic implications for hotel pricing according to literature studies in this area (e.g. (Enz, 2003, O'Connor, 2003, Carroll and Siguaw, 2003)). The role of IT in pricing is based on its ability to process and exchange large amounts of data instantaneously with a great number of people. This information processing capacity enables a company to analyze relevant pricing data effectively and quickly. The information exchange capacity enables firms to set and change prices in real time and also facilitates online bidding and flexible pricing. All these qualities of the internet are extremely useful in tourism services marketing (Sahut and Hikkerova, 2015).

(Strauss, 2016) indicated that the Internet enables marketing managers to update product databases instantly and continuously, as new product features are developed and price adjustments are made. He added that websites can track customer segments and their sensitivity to prices according to their activity on the site, or past purchase habits recorded in host databases or stored in cookies held on the user's computer (with their permission), e.g. if a customer's history shows two visits to a particular product page, then an automatic online coupon might nudge the unsure customer to buy (Strauss, 2016).

Many hotels benefited of the internet capabilities using what is called differential pricing. Yelkur and Nêveda DaCosta (2001) stated that the model of price discrimination or differential pricing used by Cannon and Morgan (1990) provides an important analytical insight into many discriminatory pricing practices. According to that model, prices charged by a firm practicing differential pricing are not usually proportional to the marginal costs incurred in producing the service. The firms adjust their prices according to customer, location or product. Strauss and Frost (1999) named that approach as "segmented pricing" and said that firms frequently price products differently not necessarily based on cost, but rather on the willingness to pay, and added that segmented pricing can be based on three major factors: customer type, location of product or

service, and product or service offering. It is also possible to customize prices based on the profile provided by the customer, as is the case for most hotel services sold online.

Helsel and Cullen (2006) reviewed the pricing trends in the hospitality industry and assured that many hotel companies have altered their pricing strategies. They also give example of Marriott International and American Express that began to use dynamic pricing model for 2004 rates instead of using fixed pricing model. Furthermore, Hilton Hotels Corporation and Intercontinental Hotel Group removed fixed consortia rates offered to travel management companies in order to reap the benefits of dynamic pricing on the 1st of January 2005. In October 2004, Accor Asia Pacific declared that a dynamic pricing model would dominate their pricing strategies and minimize the usage of fixed rate pricing. In August 2005, Hyatt and Starwood hotels stated that they would prefer to offer new rates for their corporate clients eliminating flat negotiated rates.

Since this strategy may make customers that book the same room for the same period may pay different price, many studies argued that it may be perceived by some customers as "unfair" (Shoemaker, 2003, Wirtz et al., 2003, Mathies and Gudergan, 2007, Lee et al., 2011), and many hotels are reluctant to implement differential pricing because of potential customer backlash if they believed that increased prices are not based on cost increases or changes in market conditions (Kimes and Wirtz, 2002). Therefore, this study concentrates on answering the question of "How a hotel can charge different prices without risking customer perceptions of unfairness".

## **Literature Review**

### **Yield management and differential pricing.**

Revenue management (RM) has been practiced in the hotel industry for over twenty years and has been adopted by nearly all of the major hotel chains and many independent hotels (Kimes, 2008). It was defined as the process of allocating the right type of capacity to the right kind of customer at the right price so as to maximize revenue or yield (Kimes, 1989) cited in (Mayouf, 2010). In the case of hotels, yield management is concerned with the number of rooms that should be sold at various rate levels. It consists of two separate but related parts: room-inventory management and pricing. The inventory-management process deals with how different types of rooms are to be allocated to demand while the pricing procedure is more concerned with the best prices to charge in different situations (Kimes, 1989) cited in (Mayouf, 2010).

Hotels use differential pricing strategy to set and manipulate rates of rooms sold through its' online systems, these strategies have become a critical element of its yield management strategies (El Haddad et al., 2015). Prices charged by hotels applying a yield management strategy frequently vary according to channel, product, customer, and time, as a result of changes in supply and demand information and condition (such as events, demand changes, and competitor's action) (Haws and Bearden, 2006, Ng, 2010, Legohérel et al., 2013).

### **The concept of price fairness**

Researchers have argued that the differential pricing incorporated with the yield management strategy may be perceived by some customers as unfair practices (Shoemaker, 2003, Wirtz et al., 2003, Mathies and Gudergan, 2007, Lee et al., 2011). The customer perception of fair or unfair was defined by Bolton et al. (2003) as "a judgment of whether an outcome and or process to reach an outcome are reasonable, acceptable, and just". The cognitive aspect of this definition indicates that price fairness judgments involve a comparison of a price or procedure with a

pertinent standard, reference, or norm to develop the conceptual meaning of fairness (Xia et al., 2004).

Choi and Mattila (2004) revealed that, perception of price unfairness is significantly related with the customer response behaviors, Xia et al. (2004) argued that unfair price perception, will jeopardizing the bond between the customers and the hotel operators, and highlighted three customer response behaviors; no action, self-protection, and revenge, where customers might have the tendency to seek revenge to show their dissatisfaction feelings towards the hotel when they are being driven by strong negative emotion like anger or outrage (Xia et al., 2004). Furthermore (Chiang and Jang, 2007) assured that customer perceptions of price fairness are a major determinant of their purchase decision making.

### **Theories explaining the customer perception of price fairness**

The subject of perceived fairness has been investigated thoroughly in the past by social behavioral scientists and has resulted in various theories and conceptualizations that attempt to explain how people form perceptions of fairness, these theories includes;

#### **Distributive justice theory**

The theory of distributive justice implies that "a man's rewards in exchange with others should be proportional to his investments". Thus, perceptions of fairness are not merely derived from looking only at the resultant outcome, but also at the investments made. Based on this discussion, individuals judge transactions to be fair, if their investment to profit ratio corresponds accordingly with all the involved parties. The involved parties might be of a direct nature, e.g., buyer-seller, or of an indirect nature, e.g., two buyers from one single seller Homans, (1961), cited in (Røkenes and Prebensen, 2012)

#### **Adaption level theory**

Adaption theory implies that perceptions about a given price are evoked not just by comparing the actual price with an internal adaption level price (or reference price), but also by considering the magnitude of difference between those two prices. Relative to this difference, responses are formed about whether the price is regarded as being too expensive, inexpensive or neutral Helson, (1964) cited in (Oh, 2003).

#### **Equity theory**

Equity theory suggests that "individuals evaluates the ratio of the investments they make to a particular exchange to the profits they derive from it, relative to the investments and profits allocated to their exchange partners, in other words, individuals are concerned not only with the absolute level of outcomes, but also with fairness of outcomes for both parties involved in transactions. (Adams, 1965) cited in (Jiang, 2014).

#### **Procedural justice**

In contrast to distributive justice which explains perceived price fairness on the basis of final outcomes, procedural justice mainly considers the process by which the outcome has been derived as significant in fairness perceptions. If the processes involved in creating prices are based on established norms and standards, the price is perceived as being fair (Thibaut & Walker, 1975) cited in (Heo and Lee, 2011)

### **Dual entitlement theory**

Dual entitlement (DE) suggests that "a consumer is entitled to a reasonable price based on reference transaction, and a company is also entitled to a reasonable profit based on reference profit", that means, while people tend to accept price increases when costs increase, they would not accept price increases if costs have not increased. Based on this principle, a hotel is not allowed to increase profits if it violates the entitlement of a guest, whereas, it is acceptable for a hotel to protect profits if the reference profits are threatened (Kahneman et al., 1986) cited in (Jiang, 2014).

### **Price perceived fairness research in hospitality**

In hospitality, a few number of studies addressed the perceived fairness of prices and identified the factors affecting the customer perception of price fairness.

Kimes (1994) compared customers' acceptability on differential pricing between airline industry and hotel industry and found that airline customers were more likely to accept this pricing strategy than hotel customers. But a follow-up study by Kimes (2002) conducted eight years later shows that there were no difference between airline customers and hotel customers.

Bolton et al. (2003) conduct a study to investigate the role of three reference points -past prices, competitor prices, and costs - on fairness judgments, and found that guests' perceived fairness was affected by several factors including past prices, competitor prices, and cost of goods sold.

Choi and Mattila (2004) conducted a study researching perceived fairness associated with dynamic pricing in the hotel industry by using. The independent variables used in their design were price outcome, information, and reference price type (expectation-based comparison and social comparison). The study showed that when hotel customers received room rates that higher than the rates that given to others, they perceived the pricing practice less fair than when they received the same rates as others. Results also showed that reference type matters only when customers compared their rates with others (social comparison), and the comparison outcome was that they perceive the practice as unfair.

A similar study conducted by Taylor and Kimes (2010) was to determine whether the perceived fairness of hotel revenue management (RM) pricing strategies was influenced by brand class, information, and familiarity. They found that brand class does not impact perceptions of fairness and RM pricing practice strategies are controlled by familiarity and the provision of information.

Rohlf's and Kimes (2007) examine customers' perception on best rate guarantee pricing strategy. They found that infrequent travelers judged best rate pricing most fair. In contrast, frequent travelers were essentially indifferent to the two pricing approaches

Choi et al. (2009) examine the effect of price disparity across multiple distributions channels on guests' perceived fairness, focusing on the moderate role of rate frame. This study has significant contribution to the research on effect of pricing strategies over perceived fairness.

### **Hypotheses development**

Previous studies revealed four main factors affecting the customer perception of price/rate fairness, these factors are;

### **Reference rate**

Reference rate has been the subject of a large number of researches by both economist and marketing scholars. It can be conceptualized as a rate/ price expectation based on customers' memories of previous information (Mazumdar et al., 2005). Two broad types of reference prices have been identified in the consumer behavior literature: internal reference price and external

reference price. Internal reference price is defined as a memory based price derived from previously encountered prices, whereas external reference price can be defined as a marketer-supplied price at the point of purchase (Mayhew and Winer, 1992)

In sectors highly characterized by dynamic pricing scenarios (the airline, hospitality, and retail industries), consumers can frequently pay a different price for the same good or service, increasing the potential for perceptions of unfairness with respect to past purchases and contextual cues (Xia et al., 2004).

According to Kahneman et al. (1986) cited in (Gazzoli et al., 2008), fairness is governed by the principle of dual entitlement, which supports the argument that customers are entitled to the terms of the “reference transaction,” and companies are entitled to their reference profit. The principle of dual entitlement is also based on two hypotheses: customers think that it is fair if companies increase their prices if costs increase as well and customers view it as an unfair practice if companies increase their prices when the cost of production did not increase. Therefore, if a hotel increases the rates for the rooms due to a corresponding increase in the cost of selling that room, and sets a consistent rate increase across all its online channels, customers will view this increase as fair. However, if that particular room is sold at the company's website at an increased price compared to the other online intermediaries, then customers will view the price posted on the brand website as unfair.

Thus, the first hypothesis of this study is developed as follows:

*H1: The customer reference price has a significant influence on the customer perception of rate fairness.*

### **Rate consistency**

Hotels must care about rate consistency/ parity/ equality, which is defined as setting the same rate structure across all distribution channels (Gazzoli et al., 2008). When the revenue management department of a property controls rate parity, rate integrity is assured. As a result, the customer becomes more confident and trustful of the hotel's brand website while making reservations online. In addition, by setting consistent rates across all distribution channels, a hotel can assure its customers that no cheaper rates exist elsewhere. Therefore, besides delivering the “best rate guarantee” promise, rate parity also serves as a controlling agent of rate and brand erosion for the hotel companies. The issue of inconsistent pricing can be related to the theoretical perspective of perceived fairness (Gazzoli et al., 2008).

The most significant implication that emerges from the lack of price consistency is the perception of price fairness (Choi and Kimes, 2002). (Yelkur and Nêveda DaCosta, 2001) found that inconsistent rates among various distribution channels further create consumer perceptions of unfair pricing. So Enz (2003) emphasized that hoteliers need to be more selective about the rates they provide to third party sites to insure that they are actually generating incremental revenues, and Pointing out that consumers frequently search multiple channels for the cheapest price, and expect cheaper prices online.

Therefore, the study also hypothesizes that:

*H2: Rate consistency has a significant influence on the customer perception of rate fairness.*

### **Rate transparency**

Information transparency can be defined as the degree of visibility and accessibility of information (Zhu, 2002).

In the hotel pricing arena, rate transparency has been defined as the ability for customers to see the rate for each night of their stay (Rohlf's and Kimes, 2007). They also found that hotel pricing

that showed the rate for each night of a hotel stay was perceived to be more fair, reasonable, acceptable, and honest than showing the average rate per night, even though the total price was the same and suggested if the hotel offers two different prices it is preferred that the lower of the two rates be as a discount while the higher rate be described as a premium (Rohlf and Kimes, 2007).

Travel websites also differ in the amount of detail they provide about individual pricing components. Studies have shown that providing detailed information about a hotel's variable pricing policies increases perceptions of fairness and satisfaction with the booking process and can make customers more tolerant of rate increases (Choi and Mattila, 2006).

The concept of rate transparency was addressed in different studies as rate information (Choi and Mattila, 2005, Campbell, 2007), Price familiarity (Wirtz and Kimes, 2007, Taylor and Kimes, 2010), price transparency (Xia et al., 2004, Rothenberger, 2015).

Thus, the study hypothesizes that:

*H3: Rate transparency has a significant influence on the customer perception of rate fairness.*

### Customer experience

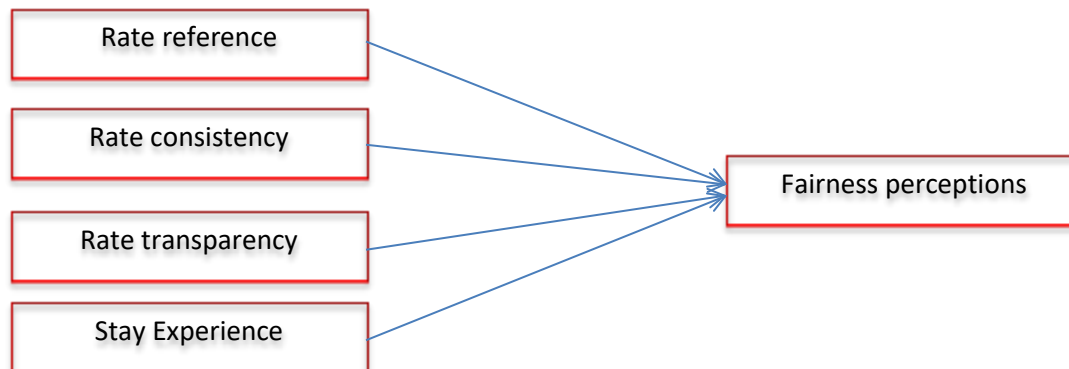
Based on the Equity theory which indicates that "individuals evaluates the ratio of the investments they make to a particular exchange to the profits they derive from it (Jiang, 2014). So when customers evaluate a hotel rates as fair they expect to have actual experience during their stay at that hotel deserves these rates. Customers usually evaluate their stay in the hotel in terms of the hotel location, room amenities, cleanliness, and service quality.

Consequently, the study also hypothesizes that:

*H4: Guest stay experience has a significant influence on his perception of rate fairness.*

To sum up, the study has four hypotheses measuring the effect of factors affecting customer perception of hotel rate fairness (Figure 1).

Figure 1: Research Framework



### Methodology

#### Research approach

According to the aim of this study, the researcher adopted the deductive approach. He develops and tests four hypotheses to explain the relationships among variables. These variables include customer perception of hotel rates fairness and suggested factors affecting their perception including rate reference, rate consistency, rate transparency, and customer stay experience. The researcher used quantitative method to investigate these hypotheses (linear regression model is employed to test the relationships among variables).

### Data collection and sampling

The study used a questionnaire form to collect research data from the customers of the five star hotels in Cairo, all five star hotels in Cairo were asked to participate in this research and only 12 out of 36 hotels agreed, each hotel sent the online version of the questionnaire form to about 30 guests that have reserved rooms online. A total number of 120 usable replies were obtained (about 10 from each hotel in average) after excluded invalid and incomplete responses, representing response rate of 33.33 percent which is found acceptable. Questionnaires were sent randomly to online purchasers within each hotel.

The questionnaire comprised three parts, the first part assess the effect of customer rate reference, the customer perception of rate consistency, and the customer perception of rate transparency (Likert scale of 1-5 "disagree/agree" used in this part). The second part evaluates the customer experience during the stay (Likert scale of 1-5 "very bad/very good" used in this part). And the third assess the customer perception of the hotel rate fairness (Likert scale of 1-5 unfair/Fair) used in this part. Question's statements were adopted from previous studies and modified to fit the purpose of the study.

### Validity and reliability

This study adopted items from different studies and modified questions to fit the purpose of the study. So for validity concerns, the survey was piloted on a sample of 40 customers in addition to some academics to check its face and content validity. The comments of respondents related to language and design of questionnaire were considered in the final form. For reliability of constructs, Cronbach's alpha coefficient was calculated and exceeded 0.70 for all constructs meaning that the questionnaire results are reliable (Hair et al., 2010).

### Results of the study

#### Respondents profile

Table 1: Respondents Gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	66	55.0	55.0	55.0
	Female	54	45.0	45.0	100.0
	Total	120	100.0	100.0	

As illustrated in table (1), (55%) of the study respondents were males, while females represent (45%) of the respondent.

Table 2: Respondents Age

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than 25	6	5.0	5.0	5.0
	25 to 34	48	40.0	40.0	45.0
	35 to 44	42	35.0	35.0	80.0
	45 to 55	18	15.0	15.0	95.0
	more than 55	6	5.0	5.0	100.0
	Total	120	100.0	100.0	

Table (2) shows that the majority of the study respondent ages were between 25 and 45 years old (90%) and this may refers to the nature and subject of the study as it targeted the customers that have reserved a hotel room online through the hotel website of through and other online distribution channel.

**Hypotheses-testing using regression model**

Table 3: Coefficients of determination and correlation

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.966 <sup>a</sup>	.933	.930	.294
a. Predictors: (Constant), Internal reference rate, External reference rate, Rate consistency, Rate transparency Experience.				

As shown in table (2) the examined factors (Internal reference rate, External reference rate, Rate consistency, Rate transparency Experience.) can explain 93% of the variance in customer perception of rate fairness.

Table 4: Multiple Regression ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	137.417	5	27.483	317.036	.000 <sup>a</sup>
	Residual	9.883	114	.087		
	Total	147.300	119			
a. Predictors: (Constant), Internal reference rate, External reference rate, Rate consistency, Rate transparency Experience.						
b. Dependent Variable: customer perception of rate unfairness						

The researcher used the regression analysis to test the relationship between the customer perception of hotel rates fairness and suggested variables include rate reference, rate consistency, rate transparency, and customer stay experience. According to table (1), the overall multiple regression model was significant as ( $f = 317.036$  and  $p < 0.05$ ).

Table 5: regression Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.225	.116		-1.939	.045
	Reference rate: Internal reference rate	.222	.063	.199	3.538	.001
	External reference rate	.169	.067	.149	2.517	.013
	Rate consistency	.202	.048	.193	4.232	.000
	Rate transparency	.307	.064	.301	4.779	.000
	Experience	.259	.075	.198	3.481	.001
a. Dependent Variable: customer perception of rate unfairness						



The researchers also used the regression model to measure the causal relationships among the constructs. As illustrated in table (3) it was found that the model constructs have significant effects on customer perception of hotel rate fairness. Which means that, four hypotheses in this study are supported and only one hypothesis was rejected, and that will be shown in more details in the following lines.

Table (3) illustrates the remission coefficients between constructs which revealed that;

- 1) The increase of the consistency between the customer internal reference rate and the current hotel rate by one unit leads to increase in the customer perception of the hotel rate fairness by 0.222 of the unit ( $\beta=0.222$  and  $p<0.05$ ).
- 2) The increase of the consistency between the customer external reference rate and the current hotel rate by one unit leads to increase in the customer perception of the hotel rate fairness by 0.222 of the unit ( $\beta=0.222$  and  $p<0.05$ ).

Consequently, the study accepts the first hypothesis (*H1: The customer reference price has a significant influence on the customer perception of rate fairness*)

- 3) The increase of customer perception of rate consistency across the different distribution channels by one unit leads to increase in the customer perception of the hotel rate fairness by 0.202 of the unit ( $\beta=0.202$  and  $p<0.05$ ).

Accordingly, the study accepts the second hypothesis (*H2: Rate consistency has a significant influence on the customer perception of rate fairness*).

- 4) The increase of customer perception of rate transparency by one unit leads to increase in the customer perception of the hotel rate fairness by 0.307 of the unit ( $\beta=0.307$  and  $p<0.05$ ).

Consequently, the study accepts the third hypothesis (*H3: Rate transparency has a significant influence on the customer perception of rate fairness*).

- 5) The increase of customer good evaluation of his stay experience by one unit leads to increase in the customer perception of the hotel rate fairness by 0.259 of the unit ( $\beta=0.259$  and  $p<0.05$ ).

Accordingly, the study accepts the fourth hypothesis (*H4: Guest stay experience has a significant influence on his perception of rate fairness*).

## **Discussion of findings**

The present study intends to identify the factors affecting hotel customers' perception of hotels rate fairness, depending on reviewed literature, four different factors were assessed;

The first factor is customer rate reference; the study investigated the influence of customer internal and external rate reference on the customer perception of hotels rate fairness and found that the increase of the consistency between the customer internal and/or external reference rate and the current hotel rates leads to increase the customer perception of the hotel rate fairness. This agrees with (Mazumdar et al., 2005) who assured that both the internal and external rate reference influence the customer perception of rate fairness.

The second factor investigated in this study was the customer perception of rate consistency across all the hotel online distribution channels. The study assured that the increase of customer perception of rate consistency leads to increase in the customer perception of the hotel rate fairness. That agrees with (Choi and Kimes, 2002) and (Yelkur and Nêveda DaCosta, 2001) who found that inconsistent rates among various distribution channels further create consumer perceptions of unfair pricing.

The third factor that investigated in this study was rate transparency; the study revealed that the increase in customer perceived rate transparency leads to increase in the customer perception of

the hotel rate fairness. And that is in line with (Xia et al., 2004, Choi and Mattila, 2005, Rohlf and Kimes, 2007).

The fourth factor investigated was the customer stay experience, and the study assured what was cited in (Jiang, 2014) bases on the Equity theory. It assured that the increase of customer good evaluation of his stay experience leads to increase in the customer perception of the hotel rate fairness.

This study will be useful for hotel manager and hotels revenue managers as it sets some guidelines to apply a differential pricing and caring about the customer perception of rate/price fairness through applying the following guidelines that revealed of an academic field study hotel managers and revenue managers can avoid the practices that causes the customer perception of unfairness.

### **Recommendations**

The study recommends the hotel managers to care about the following practices to maintain the customer perception of room rate fairness.

1. The hotel room rates should be suitable to the customer gained experience during his stay at the hotel.
2. Set the same room rates across all online distribution channels.
3. Try to set the hotel room rate similar to or less than the rate of similar rooms on the competitor's website and if your rates are higher, give your customers more details about the hotel privileges and facilities included.
4. Be sure that there is no cheaper prices for your hotel room rates than the rates offered on the hotel own website
5. When you increase the hotel room rate give the customer more services to be included with that room rate and vies versa.
6. Provide information on the different rates available and the conditions associated with those rates on the hotel website and third-party websites and reservation office.
7. When developing promotions, be sure to specifically mention the conditions that go along with the promotion. Or make it clear in other ways to guests that booking early will allow them to lock in lower rates.
8. Train reservation agents and front desk clerks on how to provide accurate information on different rates available and associated conditions.

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