

Analysis on Product Differentiation Strategy and Product Innovation of Travel Agency in China

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Abstract In the light of the situation of low-price competition in travel agency industry, this paper analyses the intrinsic mechanism of differentiation competition of travel agency with Hotelling model from the perspective of game theory. The paper indicates that with homogenization of travel agency products, price would be the key element to affect purchase decision of the customers, and only differentiation competition strategy can avoid low-price competition effectively. On the basis of this analysis, the paper puts forward products innovation strategy of travel agency as differentiation competition approaches, and gives suggestions that only after travel agencies has known the market in full detail and grasped the market effectively, can travel agencies strengthen their products' differentiation and exclusiveness and enhance their core competitiveness, including adding innovation elements into products, creating and guiding consumption, cementing differentiation with brand recognition, and constructing refined product.

Key words Travel agency; Product; Differentiation; Innovation

1 Introduction

Products of travel agency are paying services to the tourist customers in order to satisfy different needs of tourist during the trip, through organizing a series of tourism suppliers, which are also called as tourist route or item (Wan Jianmin, 2000). Products of travel agency are special products whose content is intangible service and an assembly product with elements of food, accommodation, transportation, sightseeing, entertainment and shopping, which have the features of intangibility, perishability, and synchronization of producing and consuming.

Products of travel agency has no concrete form, instead, it is an intangible composite of miscellaneous services. Comparing with tangible product, it is quite difficult to protect the intellectual property with the patent, and because of its lack of technology content, it would be so easy to be imitated once it comes into the market, which means great possibility of being replaced. Because most of the travel services prefer not to spend a lot of manpower, material resources and money to develop new products because of lacking initiative and enthusiasm of product innovation, which leads to serious problem of homogeneous products.

In the field of product differentiation and innovation, many researchers in western countries have paid great attention from the marketing and competition strategy point of view. Edward Chamberlin in his 1933 Theory of Monopolistic Competition proposed the concept of Product differentiation. He indicated that in marketing, product differentiation was the process of distinguishing a product from others, to make it more attractive to a particular target market. This involved differentiating it from competitors' products as well as a firm's own product offerings. Bullinger thought people should expect that innovation and product development (or differentiation) should constitute unique selling propositions and a strategy towards gaining new markets (1999). William Baumol stressed that large firms used innovation as a competitive weapon, a compound of systematic innovative activity within the firm. In the future the tourism industry's challenge is to provide increased value for money either through innovation-driven cost reducing changes in production and marketing processes or through product changes providing more varied tourism experiences for quality-conscious and saturated multi-option customers. (Weiermair, 2003).

In China, the research on product innovation and the price was in tourism industry have raised more concern from both academe and business circles in recent years. (Li Jiang 2004) thought that the mismatch between supply and demand caused by annual increasing numbers of travel agencies exceeding the growth rate of the tourist was the key point of low-price competition. (Long Ting 2004) indicated that the reason of this phenomenon was lack of legislative supervision toward the market. (Chen Xiaochun 2006) and (Liu Li 2008) supported that it was the homogeneity of tourist products that

led to price competition. (Wu Xuyun 2000) and (Qi Zipeng 2003) considered that being lack of differentiation was the reason of price war. There are some scholars who thought that the immature consumption psychology was the key problem. This paper will analyses the intrinsic mechanism of differentiation competition, indicating that homogeneity is the reason for price war and differentiation will weaken the degree of price competition.

2 Mechanism Analysis on Product Differentiation of Travel Agency

Product differentiation is a strategy in which travel agencies attempt to create and exploit differences between their products and those offered by competitors. These differences may lead to competitive advantage if tourist customers perceive the difference and have a preference for the difference.

(Zhu Shuzhen 2004) used to explain the mechanism of enterprises’ price competition from the perspective of game theory, and used Hotelling Model to illustrate the pricing activities of the enterprise. This paper quotes this model to analyze the mechanism of differentiation competition of tourist product. In order to simplify the Model, a hypothesis was made to have only two travel agencies in the certain market of tourist resource. These two companies produce products with same substance, but with space difference. Because of the fierce competition, the two agencies are not independent, which means that the product price of one of the two will influence that of the other. And both of them have their own market power which comes from purchase intention of the customers who buy goods from the nearest enterprise or buy what they love best. And the degree of the intention can be measured with the length of the distance between these two enterprises. Then, it is supposed that there is a linear city whose length is 1, the consumers distribute evenly during the space of (0,1), density of distribution is 1. The two travel agencies locate at both ends of the city, agency 1 locates at the point of $x=0$, and agency 2 locates at the point of $x=1$. The product cost of the two agencies is c , the transportation cost of consumers’ purchase is direct proportionate to distance between the two agencies, unit transportation cost is t . The consumer at x purchases from agency 1, it will cost him tx for transportation; if from agency 2, it will cost him $t(1-x)$. The two agencies are supposed to establish their products’ price, considered that p_i as the price of agency i , $D_i(p_1, p_2)$ is demand function with $i=1, 2$. If there is no difference for the consumers to purchase from either of the agencies, the consumers living at the left of x will purchase from agency 1 while those at the right of x will purchase from agency 2, and the demands are $D_1=x, D_2=1-x$. x meets the conditions of: $p_1+tx=p_2+t(1-x)$.

Demand functions will be:

$$D_1 = (p_1, p_2) = x \frac{p_2 - p_1 + t}{2t} \tag{1}$$

$$D_2 = (p_1, p_2) = 1 - x = \frac{p_1 - p_2 + t}{2t} \tag{2}$$

The profit functions are:

$$\begin{aligned} \pi_1(p_1, p_2) &= (p_1 - c) D_1(p_1, p_2) \\ &= (p_1 - c) (p_2 - p_1 + t) / 2t \end{aligned} \tag{3}$$

$$\begin{aligned} \pi_2(p_1, p_2) &= (p_2 - c) D_2(p_1, p_2) \\ &= (p_2 - c) (p_1 - p_2 + t) / 2t \end{aligned} \tag{4}$$

The prices for maximize profits are:

$$p_1^* = p_2^* = c + t \tag{5}$$

The profit at equilibrium is:

$$\pi_1 = \pi_2 = t/2 \tag{6}$$

In above formulas, the unit distance cost for consumers to purchase is t , that is differentiation rate of product. When $t=0$, there is no difference between products of different travel agencies, which means that the products are homogenous, and there is no purchase intentions for consumers or no special intentions for products of different travel agencies. So, the consumers will pay attention to the price of the products and to buy for the lowest price. The result of the game between travel agencies is to reduce the price, till the level that they can endure, that is marginal cost, or even to lower point which will lead to “zero profit” or “minus profit”. When $t \neq 0$, the bigger t is, the larger the difference between consumer’s

purchase intention and product's features supplied by travel agency, which indicates that the opportunity becomes small for the other travel agency to replace the product. In this way, the travel agency can sale the product with skimming pricing method for getting more profits.

On the base of above analysis, product homogeneity may lead to fierce price competition, while product differentiation can weaken or avoid it. The effective way to cast aside price competition is to implement differentiation strategy, that is, product innovation. Differentiation can enhance the price sensitive of the consumers, by which consumers' loyalty can be established, and comes little possibility to lose customers for the replacement with lower price.

Differentiation is not only a source of competitive advantage, but also the way through which the quality of products is improved over time thanks to innovation. Launching new products with entirely new performances is a radical change, often leading to changes in market shares and industry structures. Differentiating a product (or service) gives its producer more pricing power and even a degree of monopoly. There are a number of ways in which a company can seek to differentiate its products, and the paper focuses on product innovation.

3 Innovation Strategy of Product Differentiation of Travel Agency

Innovation is at the heart of any successful company's agenda so it is very worthy of discussion on the role that innovation plays in securing competitiveness. According to OECD, the definition of "product innovation" is, "the introduction of a good or service that is new or significantly improved with respect to its characteristics or intended uses. This includes significant improvements in technical specifications, components and materials, incorporated software, user friendliness or other functional characteristics." In tourism industry, innovation is the effective way to change price competition into product and quality competition, or differentiation competition.

3.1 To grasp the market and add innovation elements into tourist product

Along with the development of society, economy and culture in China, the disposable income increases steadily, the income group becomes divided, the consumption idea of Chinese people changes, and the innovation together with hierarchical escalation of tourist product has become the key of improvement of tourism industry. In order to solve the problem of product homogenization, more innovation elements should be added into development of theme product, deep exploitation and utilization of tourist resources. First, leisure element. Leisure activity has already been one of important components of people's life, and leisure industry is growing up. Traditional tourism must take the chance to enrich the intension and extension of tourist product in order to adapting to the change of the era. That is to change sightseeing tour into leisure vacation tour. Second, experience element. Tourism economy has entered the time of experiencing economy, along which people's consumption method is taking a change. The value of tourist product is to arouse the sense of auditory, taste, visual, smell, touching, and to create happy feelings through experience. Competition in mature markets leads to pressure to add more experience to products. Third, participation element. The consumption capacity of Chinese people has enhanced a lot in recent years, the contemporary tourists prefer more active and exciting activities to programmed travel arrangements. They pay more attention to experience the process. Forth, automation element. The mode of travel goes towards acting on tourists' own, more and more tourists go in for individuation, diversification and freedom.

3.2 To subdivide the market and lead consumption creatively

The target of tourism service is tourist with rich emotions. Customers from different fields have different needs and perceptions and because of different age, sex, nationality, occupation, culture, hobby and tourist motivation, travel agencies must provide different and individualized products to satisfy the various demands. Tourism product development is mainly undertaken to facilitate product diversification, development or improvement of tourism products with the help of knowledgeable and qualified staff. It aims at enhancing visitor experience by building consensus and strategic alliances with business stakeholders in order to bring about socio-economic growth. After having subdivided the market, different products can be designed according to the special features of the segment market. In this market can the travel agency create distinguished products with its advantages, which will improve the satisfaction of the customers. Many travel agencies in foreign countries have operated in this way for avoiding market competition. Such as Studiosus Tourist Ltd. Co. in Germany, it has established its core-competitiveness by producing cultural trip. It has been regarded as the No. 1 cultural trip operator in Europe.

3.3 To enhance the foundation of the market and innovate brand product

Brand can make the product appear different to consumers. Tourist product development aims at long-term sustainable development by the execution of a number of strategies. These strategies bring into focus a generic idea to increase competitiveness. Tourism product development helps in improving product quality by complying with the standards set by international benchmarks. Though the characteristic of intangibility of tourist product makes it impossible to show itself when the customer purchases it, brand makes it possible to identify the difference from the other products. Brand can also meet the need of outstanding emotionality and encourage consumers to purchase it. Good brand makes more profits through good service quality. A travel agency with famous brand will be quite outstanding in the market and with excellent image and higher recognition. Brand can also be taken to protect the product of the travel agency from being counterfeited.

3.4 To consolidate the market and create competitive products

To develop competitive products is the inevitable course for a travel agency to solve the problem of product homogenization and to implement differentiation strategy. But, during the procedure of implement, there comes hitch-hiking. In order to fulfill product innovation, the travel agency needs to spend a large amount of manpower, material resources and money. But the new product is quite easy to be copied. In order to avoid such kind of things, competitive service element should be added. The value-added service and fine sentiments service are the embodiment of elaboration that will be the unique element market competition.

Market demand is changing all the time. Old product will be replaced ultimately, that's the reason that sustained product innovation becomes more and more important. New vitality should be infused consequently into products to guarantee its competitiveness and its differentiation. Besides this, quality assurance, marketing practices, and customer and employee satisfaction were among the most important areas or fields for product innovation.

4 Conclusions

Product homogeneity and low-price competition of travel agency lead to inferior quality of the tourist service, which not only infringe upon the legal rights of the consumers, but also influence the profits of the enterprise, sometimes even the existence of the enterprise. On the other hand, product differentiation can increase the satisfaction for the consumer from its consumption. With this background, the paper analyzes the mechanism of price competition and the motivation of implement differentiation strategy. Only when the products are homogenous, price becomes the key element to judge the purchase activity. And at the same time, for travel agency, the result of game theory in Hotelling Model is to reduce the price of the product. In order to avoid low-price competition, travel agency must carry out differentiation competition strategy via product innovation, by adding innovation elements to create consumption, to identify product differentiation with brand, and to construct competitive product by service innovation.

In the future research, the effect to gross profits of travel agency caused by differentiation rate will be taken into account.

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