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### Priceline: Name Your Own Price

#### Introduction

Priceline.com (“Priceline”) is an e-Commerce company that primarily provides online travel booking services for discounted flights, hotels, rental cars, and other travel-related items. The company pioneered a patented Internet-based pricing system called “Name Your Own Price”, which is a special type of reverse auction that helps match buyers and sellers. Priceline applied the Name Your Own Price system to the sale of airline tickets, hotel rooms, and rental cars. This paper focuses on airline ticket services, as it is a major area of the company’s businesses. Ultimately, this paper examines the success and limits of the Name Your Own Price system in providing discounted airfare to online customers under the increasingly competitive environment in the online travel industry.

#### Background

Priceline launched its online platform in 1998. Initially, the platform only allowed customers to buy airline tickets through the Name Your Own Price system. However, the company later adopted the traditional retail model as well, allowing customers to purchase tickets like a typical online sale transaction. As explained later, the simultaneous offering of two pricing schemes exhibits second-degree discrimination, because the two pricing models seem to attract and capture different types of price-sensitive customers.

Essentially, Name Your Own Price is a special type of reverse auction pricing model. In a normal auction pricing model (also called a forward auction), buyers would offer higher and higher bids to compete with each other and win a seller’s item with the highest bid. In this sense, the price of the item would increase over time as more buyers enter the auction<sup>1</sup>. On the contrary, in a typical reverse auction model, a buyer would specify his/her demand for an item, and invites

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<sup>1</sup> Malcolm Tatum, “What is an Online Auction?”, <http://www.wisegeek.com/what-is-an-online-auction.htm>, accessed 29 Nov 2010.

sellers to place lower and lower bids to win his/her business<sup>2</sup>. According to the law of demand, holding all else constant, the decrease in price would lead to an increase in consumer demand. In this sense, in a typical reverse auction, the price of an item would decrease over time, because the buyer would favor the seller who offers the lowest bid.

Nevertheless, Priceline's Name Your Own Price model is not a typical reverse auction. Airline companies do not actively lower their bid to satisfy a particular customer's demand for a specific flight<sup>3</sup>. Instead, airlines pre-set their bids indicating the minimum threshold price they are willing to accept for a specific flight. To carry out the auction, a buyer would have to first enter basic information (departure and arrival dates and airports, personal data, number of tickets), and a dollar bid that indicates his/her willingness to pay for the flight. To confirm the bid, the buyer would have to enter credit card information, for Priceline would immediately purchase the specific ticket if the buyer's bid were above the threshold price of participating airlines. The information asymmetry in the Name Your Own Price system allows Priceline to generate revenue, because buyers do not know the threshold prices for specific flights. For this reason, many buyers may overbid on their flights. Ultimately, Priceline generated revenue from the difference between the threshold price and the customer's bid<sup>4</sup>.

### Restrictions to Name Your Own Price Tickets

Although the Name Your Own Price system could be a huge airfare saver, buyers would have to make certain tradeoffs for their discounted tickets. First, buyers would not know exact flight times and flight route on the specified flight dates until their bid is accepted and their ticket issued. Specifically, by submitting their bid, buyers would have agreed to depart between 6 a.m. and 10 p.m., and arrive by 12:30 a.m. the next day, on the specified flight dates. Second, there may be a maximum of 1 flight connection in each way, with layovers no longer than 3 hours. This would be a considerable tradeoff for business travelers, who normally have strict schedules.

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<sup>2</sup> Shannon Kietzman, "What is a Reverse Auction?", <http://www.wisegeek.com/what-is-a-reverse-auction.htm>, accessed 29 Nov 2010.

<sup>3</sup> Hossein Bidgoli, The Internet Encyclopedia, Volume 2, pg. 131, [http://books.google.com/books?id=gHrImdSu0I0C&pg=PA131&lpg=PA131&dq=the+internet+encyclopedia+hossein+bidgoli+volume+2+priceline&source=bl&ots=tMTeDZWqA0&sig=S6ywwzQvjsXHS9EZyUWKG\\_FQDgxY&hl=en&ei=ApP4TKLeIo6qsAPettjtAg&sa=X&oi=book\\_result&ct=result&resnum=1&ved=0CBMQ6AEwAA#v=onepage&q&f=false](http://books.google.com/books?id=gHrImdSu0I0C&pg=PA131&lpg=PA131&dq=the+internet+encyclopedia+hossein+bidgoli+volume+2+priceline&source=bl&ots=tMTeDZWqA0&sig=S6ywwzQvjsXHS9EZyUWKG_FQDgxY&hl=en&ei=ApP4TKLeIo6qsAPettjtAg&sa=X&oi=book_result&ct=result&resnum=1&ved=0CBMQ6AEwAA#v=onepage&q&f=false), accessed 1 Dec 2010.

<sup>4</sup> James Cotter and Bill Marcum, "Limits of Reverse Auction Pricing Strategy and Priceline.com", [http://findarticles.com/p/articles/mi\\_qa5424/is\\_200110/ai\\_n21465959/](http://findarticles.com/p/articles/mi_qa5424/is_200110/ai_n21465959/), accessed 1 Dec 2010.

Also, leisure travelers with very short trips may face the risk of losing one or two vacation days due to late arrivals to and early departures from destinations.

Another major restriction to Name Your Own Price tickets is that once purchased, the tickets would be non-transferable, non-cancellable, and non-refundable. This exhibits product lock-in, because buyers face high switching cost once their ticket is purchased. This lock-in could affect any buyer, because no one could foresee an emergency should it happen on the date of travel. Also, this would affect buyers who are generally fickle, and buyers who tend to have unpredictable schedule. In addition, the tickets would not be eligible for frequent flyer miles, which would be a tradeoff to regular flyers who are members of an airline's loyalty program. There are age requirements as well, as any solo traveler has to be 18 years old and above. If the bid is rejected, customers can only rebid on the exact same flights once every 24 hours. Nevertheless, they can immediately rebid if they make changes to their original itinerary, which may include the agreement to "red-eye" flights that depart before 6 a.m. or after 10 p.m., and an agreement to make more than one connection each way<sup>5</sup>.

Lastly, buyers would not know the exact airline they would be flying with, until their bids were accepted. This has major implications because buyers may end up flying with a small airline with relatively uncomfortable planes. Also, if there were connection flights that involved a change of airline, travelers may have to pay a new set of baggage fees. In addition, if the first flight was late, causing the traveler to miss the second connecting flight, the second airline does not have contractual obligations to help reschedule another flight<sup>6</sup>. In that case, travelers may be forced to pay extra for a new ticket to complete their original flight route.

### Price Discrimination

Essentially, the Name Your Own Price model allows Priceline to target customers who are price-sensitive enough to become more flexible. In other words, the system would attract several types of price-sensitive customers; those who are willing to compare airfares with other travel sites and research about tips on successful bidding, and those who care more about the cost

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<sup>5</sup> Frequently Asked Questions, Priceline.com, <http://travelc.priceline.com/customerservice/customerservice.do?c=&t=rebid&f=searchquestion&p=AIRLINE&question=348&jsk=9903010a1f03010a2010120223173108C301401212&plf=PCLN>, accessed 1 Dec 2010.

<sup>6</sup> How to Book Airfares to Avoid Connection, Luggage, and Fee Problems, <http://www.bidontravel.com/traveltips/air-avoid-prob.html>, accessed 1 Dec 2010

of flying over all other flight preferences. This means the Name Your Own Price system would generally be less valuable to those price-sensitive flyers who care about all the flight details that the system makes opaque, such as departure time, arrival time, airline, flight route, and so forth. To capture price-sensitive customers who are unwilling, or simply cannot afford to be more flexible with their flights, Priceline added the option to purchase tickets through the more traditional retail model. In this model, customers are given all the flight details including the actual airfare prior to purchase. Nevertheless, although still discounted, tickets purchased through the traditional channel would be relatively more expensive, for the company advertises that customers would “save up to 40%” on flights purchased through Name Your Own Price<sup>7</sup>.

By allowing customers to self-select their purchase channel, Priceline is able to apply second-degree price discrimination and target different types of price-sensitive customers. For those who are relatively more price-sensitive, they may find the Name Your Own Price system a burdensome yet valuable tool to obtain the cheapest tickets. For those who are relatively less price-sensitive, they may be willing to pay an additional value to exchange for more certainty and convenience through the traditional retail system. In addition to second-degree discrimination, Priceline uses first-degree discrimination, for its Name Your Own Price system is able to charge customers precisely what they are willing to pay for airfare<sup>8</sup>. Ultimately, the combination of first- and second-degree discrimination allow Priceline to better capture price-sensitive customers of all kinds, thereby creating a competitive advantage for the company.

### Market Competition

Priceline faces several types of competitors. First, there are traditional bricks-and-mortar travel agents that have online full-service websites. Second, there are airline companies that sell their own tickets on their websites, such as Delta, Continental, United, and so forth. Lastly, there are online travel websites that sell discounted airline tickets. The last category can be divided into 2 sub-types. There are comparison sites, such as Kayak.com, that simply aggregate ticket

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<sup>7</sup> Name Your Own Price and Save up to 40% on Flights, [http://travel.priceline.com/travel/airlines/lang/enus/flexAirport.asp?session\\_key=400011AC5C0011AC201012022323376164a0317151&plf=pcln&path=bak](http://travel.priceline.com/travel/airlines/lang/enus/flexAirport.asp?session_key=400011AC5C0011AC201012022323376164a0317151&plf=pcln&path=bak), accessed 1 Dec 2010.

<sup>8</sup> DeJong, “How Price Discrimination Will Be Different in the Online World”, <http://faculty.darden.virginia.edu/gbus885-00/Papers/PDFs/DeJong%20-%20PriceDiscrimination.pdf>, accessed 30 Nov 2010.

information from other travel websites to lower user search costs<sup>9</sup>. In addition, there are websites that are in more direct competition with Priceline, such as Hotwire, Orbitz, and Travelocity. These online travel agencies deal directly with airline ticket vendors for discounted tickets.

It may seem ironic that airline companies would supply discounted tickets to Priceline and its close competitors and risk hurting their own ticket sales on their websites. Nevertheless, this is an attempt to defend the airlines' common practice of third-degree price discrimination. Generally, airline companies would raise ticket prices to customers who have relatively inelastic demand, such as business, last-minute, and same-day travelers. If airlines had offered discounted airfare on the same flights directly on their websites, the companies would risk losing regular high-paying customers, for these flyers may develop more incentives to pay less than they would normally have<sup>10</sup>.

To prevent undercutting their own pricing structure, airlines are inclined to supply cheap tickets to online agencies like Priceline and Hotwire. Moreover, airlines generally incur little cost to fill an additional empty seat, because flights tend to incur high fixed cost and little marginal costs. In this case, Priceline and competitors like Hotwire serve as additional ticket outlets to fill airplane seats. Although tickets sold through Priceline and Hotwire would be relatively cheaper, airlines would still benefit from the incremental ticket revenue, which is most likely greater than the marginal cost of filling the seat. After all, some revenue from a price-sensitive passenger is better than none from an empty seat.

Of all online travel agencies, Hotwire seems to be the Priceline's closest competitor, for Hotwire also sells discount opaque tickets in the name of "Hotwire Hot Rates". Like Priceline, Hotwire Hot Rate fares do not provide specific flight times or airline names prior to purchase. Moreover, departure and arrival times could range from 6 a.m. to 10 p.m., and tickets are also non-refundable, non-transferable, and non-changeable once purchased. Nevertheless, Hotwire is more specific by designating the approximate connections by "0-1 stops" or "2+ stops" on the fare preview page. This provides more certainty than Priceline's opaque fares, which only indicates there may be more than one connection per way. Overall, the two companies mainly differ in their pricing systems. Hotwire uses a traditional retail system where it publishes the

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<sup>9</sup> Cruzob Travel, "Travel Agency", <http://www.cruzobtravel.com/world-travel/travel-agency.htm>, accessed 1 Dec 2010.

<sup>10</sup> Jessica Labrencis, "Naming Your Own Price for Airfare", <http://www.smartertravel.com/airfare/Airfare-Part-Naming-your.html?id=16412>, accessed 1 Dec 2010.

airfare prior to purchase, whereas Priceline uses a unique reverse auction model and prompts user to place a bid for airfare. Although Priceline also offers the option of traditional retail pricing, that system does not sell opaque tickets, for it is intended to target customers who are relatively “risk-averse” and favor more certainty in their flight schedules.

### Limits to Name Your Own Price

Although Priceline can be truly differentiated by its patented Name Your Own Price model, there are still potential limits to the reverse auction pricing strategy. First, the concept behind Name Your Own Price may be difficult for some to understand. For this reason, users may have to invest time to research about the model and tips on successful bidding. Since bids can only be submitted once every 24 hours, first-time bidders may be discouraged by a rejected bid and abandon the auction.

Second, some online agencies, like Hotwire and Orbitz, are actually backed by several major airlines, such as American, Continental, and United. In 2001, Orbitz and Hotwire had agreed to share customers as each party allowed users to view the other party’s rates on its website<sup>11</sup>. As online agencies allowed greater access to each other’s site, there may be significant reduction in search costs, allowing customers to better compare airfares. As a result, the overall price dispersion of online tickets may decrease. Potential bidders of Priceline may find a better deal elsewhere. Moreover, since more airline companies are investing in online travel agencies, they may not be as readily to provide highly discounted airfares to Priceline. Instead, the airlines backing Hotwire may provide more discounted airfares in anonymity to Hotwire’s Hot Rates service, thereby helping Hotwire gain competitive advantage over Priceline.

Lastly, although Priceline’s Name Your Own Price system only allows buyers to bid on the same flight once every 24 hours, there are ways to get around the restriction and immediately rebid. This is due to the relatively easy access to past user experiences, reviews, and tips on successful bidding on advisory sites and discussion forums on the Internet. As more users gain the knowledge and skill to minimize a successful bid, Priceline would receive less revenue as the likelihood of user overbidding decreases.

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<sup>11</sup> Greg Sandoval, “Orbitz, Hotwire to share customers”, [http://news.cnet.com/Orbitz,-Hotwire-to-share-customers/2100-1017\\_3-270188.html](http://news.cnet.com/Orbitz,-Hotwire-to-share-customers/2100-1017_3-270188.html), accessed 1 Dec 2010.