Priceline is one of the Web's most well-known companies. Its "Name Your Own Price" reverse-auction pricing system is a unique business model that uses the information sharing and communications power of the Internet to create a new way of pricing products and services. At Priceline, consumers can enter a bid for travel, hotels, rental cars, and even home financing. Priceline queries its vendors (airline, hotel, and financial service firms) to see if anyone will accept the bid. Priceline offers a compelling value proposition to customers, allowing them to save money by trading off flexibility about brands, product features, and/or sellers in return for lower prices. Vendors also can gain additional revenue by selling products they might not otherwise be able to sell by accepting below-retail price offers, without disrupting their existing distribution channels or retail pricing structure. Priceline is an example of using the Web to achieve efficient price discrimination: charging some consumers much more than others for the same product. In 2006, Priceline sold about 2.8 million airline tickets, 18.6 million hotel room nights, and 7.4 million rental car days.
The original vision of Priceline's founder Jay Walker was called "demand collection." Walker poured millions into the concept of a one-stop shopping center for goods and services from trucks, to toothpaste, to vacation travel. But for much of its early history, Priceline was not profitable. In 1999, it lost over $1 billion. It pared losses to $15 million by 2001, but then, as travel declined after the September 11 tragedy, regressed in 2002, posting a $23 million dollar loss. Key executives resigned. Headlines such as "Priceline on the Ropes* and "Curtain Call for Priceline.com" predominated.

However, in 2003, Priceline recorded its first ever annual profit, recording $10.4 million in net income. The good news has continued since. In 2004, Priceline recorded operating income (income before tax adjustments) of $30 million; in 2005, $35 million and in 2006, $61 million. (During the period between June 2003 and December 2006, Priceline's stock held relatively steady in the mid-$20–$30 range, a vast change from its early years, when it roller-coastered from a high of $160 to a low of $1). In 2007, Priceline continued to exceed analyst expectations, with operating income for the second quarter of 2007 totaling $47 million compared to $19 million for the same period in 2006. Wall Street has rewarded this performance, and the stock has steadily climbed to a price of around $80 a share as of the end of August 2007.

How has Priceline engineered this seeming turnaround? Has it finally found a business model that works? What went wrong with its original business, which initially seemed so promising?

Priceline commenced operations on April 6, 1998, with the sale of airline tickets. To purchase a Name Your Own Price ticket, a customer logs onto Priceline's Web site, specifies the origin and destination of the trip, the dates he or she wishes to depart, the price the customer is willing to pay, and a valid credit card to guarantee the offer. The customer must agree to fly on any major airline, leave at any time of day between 6 A.M. and 10 P.M., accept at least one stop or connection, receive no frequent flier miles or upgrades, and accept tickets that cannot be refunded or changed. Upon receiving the offer, Priceline checks the available fares, rules, and inventory provided by its participating airlines and determines whether it will fulfill the order at the requested price. If so, it notifies the customer within an hour that his or her offer has been accepted. On the consumer side, a central premise of Priceline's Name Your Own Price business model is that in many product and service categories, there are a significant number of consumers for whom brands, product features, and sellers are interchangeable, particularly if agreeing to a substitution among brands or sellers will result in saving money. On the vendor side, the Priceline Name Your Own Price business model is predicated on the assumption that sellers almost invariably have excess inventory or capacity that they would sell at lower prices, if they could do so without either lowering their prices to retail customers or advertising that lower prices are available. Priceline believed that its business model was ideally suited to industries characterized by expiring or rapidly aging inventory (for example, airline seats not sold by the time a flight takes off or hotel rooms not rented), although it did not think that it would be limited to such industries.
Priceline extended its system to hotel reservations in October 1998, and in January 1999, introduced home financing services. It went public in March 1999, and later that year, it added rental cars and even new cars to the mix. To promote its products and the Priceline brand, Priceline embarked on an extensive (and expensive) advertising campaign, hiring William Shatner to become the voice of Priceline, and it quickly became one of the most recognizable brands on the Web.

At the beginning of 2000, Priceline licensed the Name Your Own Price business model to several affiliates, including Priceline Webhouse Club, which attempted to extend the model to groceries and gasoline, and Perfect Yardsale, which used the model to sell used goods online, and added long distance calling and travel insurance. Priceline also had ambitious plans to expand internationally, and in 2000, licensed its business model to companies planning to set up similar operations in Asia and Australia.

However, by fall 2000, the picture no longer looked so rosy. In October 2000, after only 10 months of operation, Priceline’s affiliate Priceline Webhouse Club, unable to raise additional financing, shut down its business, after running through $363 million. The financial climate at the time, with its renewed emphasis on profitability, made it impossible for Jay Walker, Priceline’s founder, to raise the additional hundreds of millions that would be required before Webhouse might become profitable. Walker did not see the closure as a failure of the Priceline business model, however. Instead, he characterized it as the result of the “fickle sentiments” of investors. Many analysts did not accept Walker’s characterization. Instead, they pointed to other factors. First, many of the major manufacturers of food and dried goods chose not to participate in Priceline Webhouse. So, to generate consumer interest, Priceline Webhouse subsidized discounts on most products itself. Although some major manufacturers, such as Kellogg’s and Hershey’s, did eventually sign up, many, such as Kraft, Procter & Gamble, and Lever Brothers, did not. The second miscalculation was that bidding on groceries and gasoline did not exactly provide a “hassle-free” way to shop. Customers were required to bid on and pay for groceries online, then use a special identification card to pick them up at a participating supermarket. If the particular items purchased were not available at the store, the customer would either have to go to another store or return at another time. To many, the demise of Priceline Webhouse highlighted potential cracks in the Priceline business model and raised strong concerns about its ultimate extensibility. Priceline’s founder Jay Walker resigned in December 2000.

New management sharply curtailed Priceline’s expansion and laid off over 1,000 employees. Priceline Chairman Richard Braddock said, “Priceline will entertain selective expansion... with stringent financial controls. We’re going to make money on this and move forward.” In 2002, Priceline focused on its core business of travel reservations, shedding its auto sales and long distance telephone units. Its only non-travel business today is its 49% interest in Priceline Mortgage. And in 2003–2004, it tweaked its business model once again, adding new discount ‘retail’ airline ticket and rental car services to complement its hallmark Name Your Own Price offerings, in order to compete more effectively with firms such as Expedia.
Travelocity, Hotwire, and Orbitz for the business of the consumer who prefers to book a specific airline or rental car. Although these services are not as lucrative as the Name Your Own Price model (it takes 1.5 to 2.5 retail plane tickets to bring in the same gross profit as a single Name Your Own Price ticket), and to a certain extent “cannibalize” its Name Your Own Price tickets, Priceline has made up at least some of the difference in increased volume. To further support this strategy, Priceline acquired a majority interest in TravelWeb, a consortium of five large hotel chains that provides Priceline with access to discount hotel rooms, purchased Active Hotels and Bookings B.V., a European hotel reservation service, and in 2005 extended its retail strategy to the hotel market. In 2006 and early 2007, Priceline focused on adding to its full-service travel offerings in the United States, and recognizing that the growth of the domestic online market for travel services had slowed, on building its brand in Europe. Its international business represented approximately 54% of its gross bookings during the first half of 2007, and was a substantial contributor to its operating income during that period. Prior to the fourth quarter of 2004, substantially all of its revenues were generated in the United States. Priceline expects that the international segment of its business will represent a growing percentage of its business in the years to come.

As noted above, these strategic moves by Priceline have succeeded in generating annual profits since 2004. However, although Priceline is currently “in the black,” a rosy future is by no means assured. Priceline faces industry-wide shrinkage in all forms of travel caused by the fear of terrorism and war. In addition, Priceline faces extraordinary competition, not just from other online middlemen such as Expedia, Travelocity, Hotels.com, Hotwire, and CheapTickets, but also from the direct discount sales by airlines. Its business model today (discount travel services) is a mere shadow compared to Jay Walker’s expansive vision. So even though right now it looks as if Priceline will survive, the question remains: for how long and on what terms?

Case Study Questions

1. What are the core components of Priceline’s business model?

2. Do you think Priceline will ultimately succeed or fail? Why?

3. How has Priceline (and similar online services) impacted the travel services industry?

4. Follow up on developments at Priceline since September 2007 when this case study was prepared. Has its business model and/or strategy changed at all, and if so, how? Who are its strongest competitors? Is it profitable or operating at a loss?

Sources: