

Revenue Management and Dynamic Pricing

Excerpts of Presentations in Sydney, Melbourne and Brisbane

August 2005

Dynamic Pricing

A husband and wife are travelling by car from Melbourne to Sydney. After almost twenty-four hours on the road, they're too tired to continue, and they decide to stop for a rest. They stop at a nice hotel and take a room, but they only plan to sleep for four hours and then get back on the road.

When they check out four hours later, the desk clerk hands them a bill for \$350. The man explodes and demands to know why the charge is so high. He tells the clerk that although it's a nice hotel, the rooms certainly aren't worth \$350. When the clerk tells him \$350 is the standard rate, the man insists on speaking to the manager.

The manager listens to the man and then explains the hotel has an Olympic-size pool and a huge health club that were available for the husband and wife to use. He also explains they could have used the tennis courts, jogging track, mini-golf, and bowling alley.

No matter what facility the manager mentions, the man replies, "But we didn't use it!" The manager is unmoved and eventually the man gives up and agrees to pay. He writes a check and gives it to the manager. The manager is surprised when he looks at the check.

"But sir," he says, "this check is only made out for \$100."

"That's right," says the man, "I charged you \$250 for sleeping with my wife."

"But I didn't!" exclaims the manager.

"Well," the man replies, "she was here, and you could have."

Dynamic Pricing - Announcements

- **November 2003:** Marriott and American Express changed from fixed pricing to a dynamic pricing model for 2004 rates.
- **October 2004:** Hilton Hotels Corp. and InterContinental Hotels Group on Jan. 1 will eliminate fixed consortia rates available through travel management companies in favour of more fluid pricing.
- **July 2005:** Accor Asia Pacific is adopting dynamic pricing model and reducing fixed-rate allotments
- **August 2005:** Hyatt and Starwood are also said to be working with corporate clients to implement new rate models, claiming flat negotiated rates have become outmoded, as they do not reflect price fluctuations that occur throughout the year.

Dynamic Pricing - Statements

- “It just doesn't make sense to sell at a flat price across the year. Static rates are irrelevant four days out of five when they are either below or above the dynamic market rate”
- “In benchmark cities like Sydney and Singapore the rates are going to be above the market 40% of the time and below it for another 40%”
- “The transparency of Internet rates is turning fixed consortia pricing into a dinosaur”
- “A lot of the traditional pricing models that had existed really are no longer that relevant in the marketplace. A lot of those models were based on setting a ceiling rate, such as a the published corporate rate that automatically puts an artificial ceiling on where the price can go in a demand market”

Dynamic Pricing - Statements

- “We've eliminated static pricing, what used to be known as consortia rates, in favour of providing our best available rate, which is dynamic and can change daily and sometimes more than once a day”
- “We are in a transition. The thing that most people don't realise is that the static rate is becoming antiquated. Hotels really want to have integrity in their pricing and that static rate is an annualised rate. It's going to take care of your high seasons, your low seasons, your shoulder seasons”
- “Very much like the airlines with their restructure, hotel companies are starting to look at what other options are out there besides set negotiated last-room availability rate or non-LRA rate”

Dynamic Pricing – What is it ?

- Dynamic pricing is applying yield management actively (as opposed to passive action)
- **To set the right price for the right customer for the right product at the right time**
- Dynamic pricing requires:
 - a solid understanding of your client base
 - a different negotiation approach
 - a highly skilled revenue management team
 - strong technical support
 - reliance on operations supporting the system

Price (RevPAR) and Profitability

- What is the impact of RevPAR Growth on profitability?
- Consider $\text{GOP PAR} = \text{GOP Per Available Room}$
- Because a lot of expense is fixed, growth (decline) in revenue has a significant impact on profitability
- RevPAR growth through occupancy growth has a cost implication and impact on profitability is thus less significant than growth through rate improvement, which flows straight through to the bottom line

From Rate to Profit

Typical Average Rate

• Gross Rate		\$ 150
• GST	10%	\$ 136
• S&BC	0%	\$ 136
• Comm.	10%	\$ 121
• Freq Fl.	5%	\$ 113
• Cr.card	2.5%	\$ 109
• Amenities	\$ 15	\$ 94
• NET RATE		\$ 94

• Wages	10%	\$ 15
• Other cost		\$ 7
• A&G	9%	\$ 14
• S&M	5%	\$ 8
• POM.	3.5%	\$ 5
• Energy	2.5%	\$ 4
• MGFE	2%	\$ 3
• Expenses		\$ 56

Gross Profit \$ 38 (28%)

From Rate to Profit

10% Rate Increase

- **Gross Rate** \$ 150
- **GST** 10% \$ 136
- **Direct costs** \$ 42
- **NET RATE** \$ 94
- **Expenses** \$ 56
- **Gross Profit** \$ 38
- **Profit Margin** 28%

- **Gross Rate** \$ 165
- **GST** 10% \$ 150
- **Direct costs** \$ 44
- **NET RATE** \$ 106
- **Expenses** \$ 56
- **Gross Profit** \$ 50
- **Profit Margin** 33%

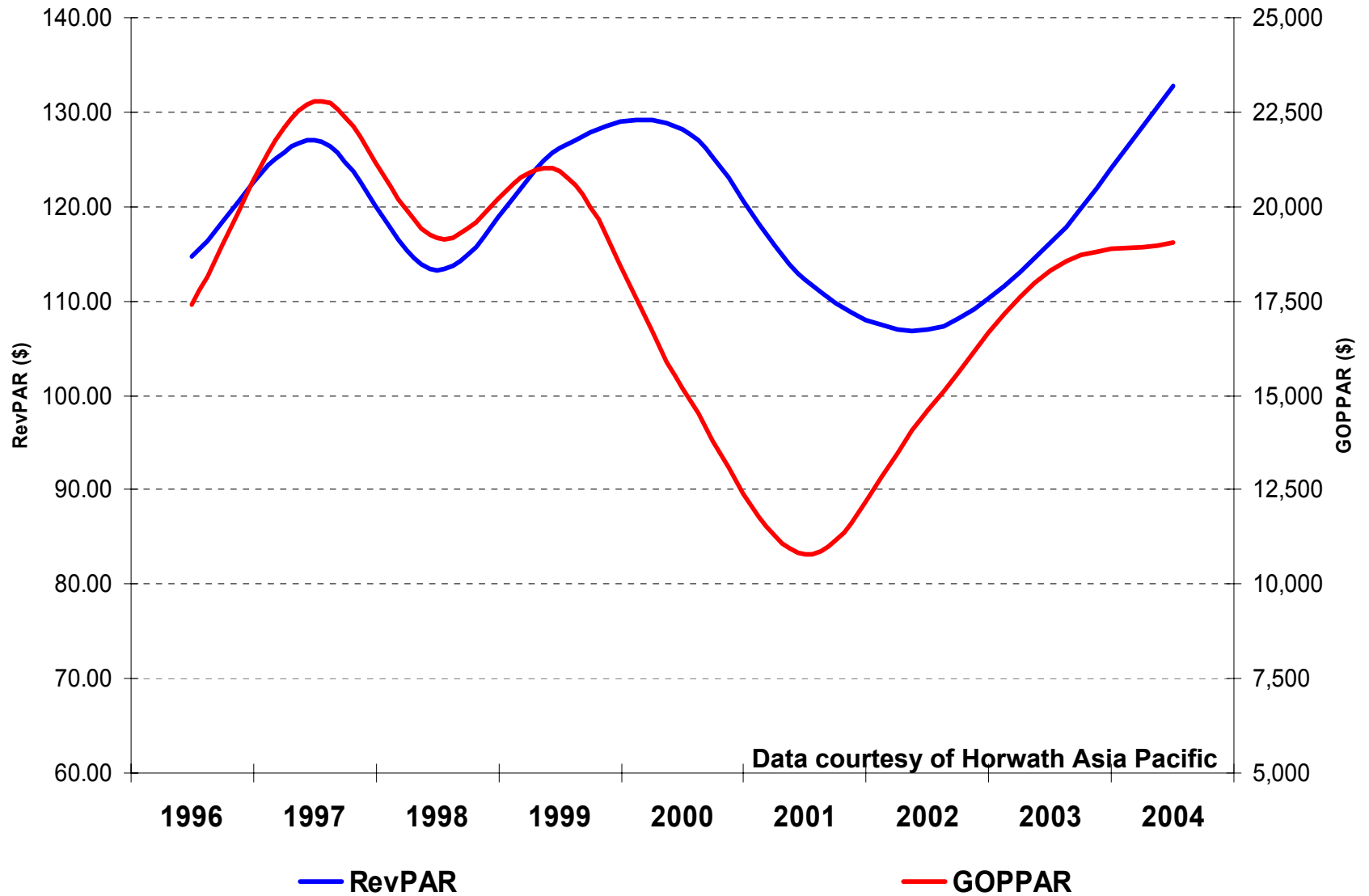
A 10% rate increase results in a 32% profit increase

• Gross Rate		\$ 150
• GST	10%	\$ 136
• Direct costs		\$ 42
• NET RATE		\$ 94
• Expenses		\$ 56
• Gross Profit		\$ 38
• Profit Margin	28%	

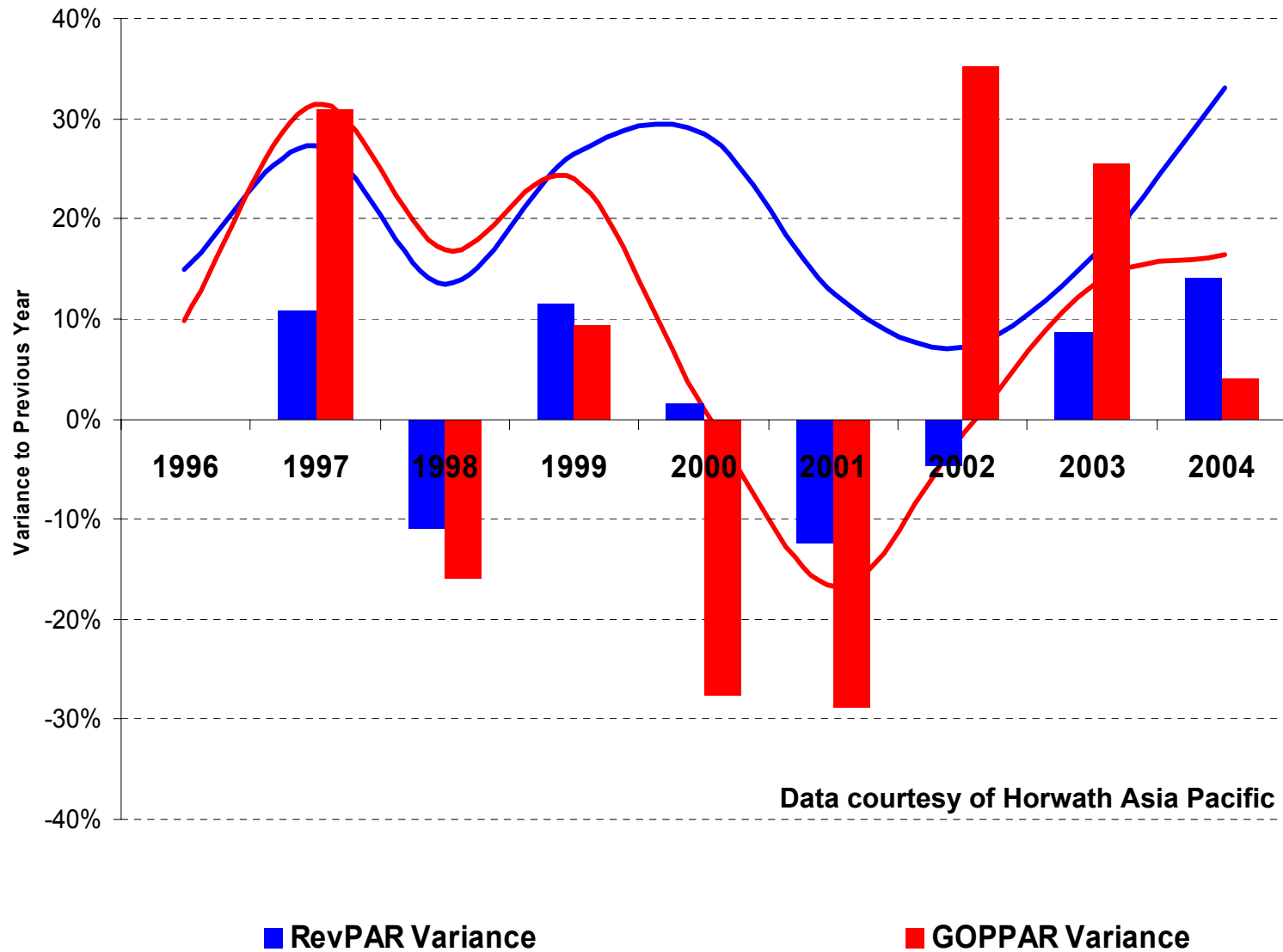
• Gross Rate		\$ 135
• GST	10%	\$ 123
• Direct costs		\$ 39
• NET RATE		\$ 84
• Expenses		\$ 56
• Gross Profit		\$ 28
• Profit Margin	23 %	

A 10% rate decrease results in a 26% profit decline

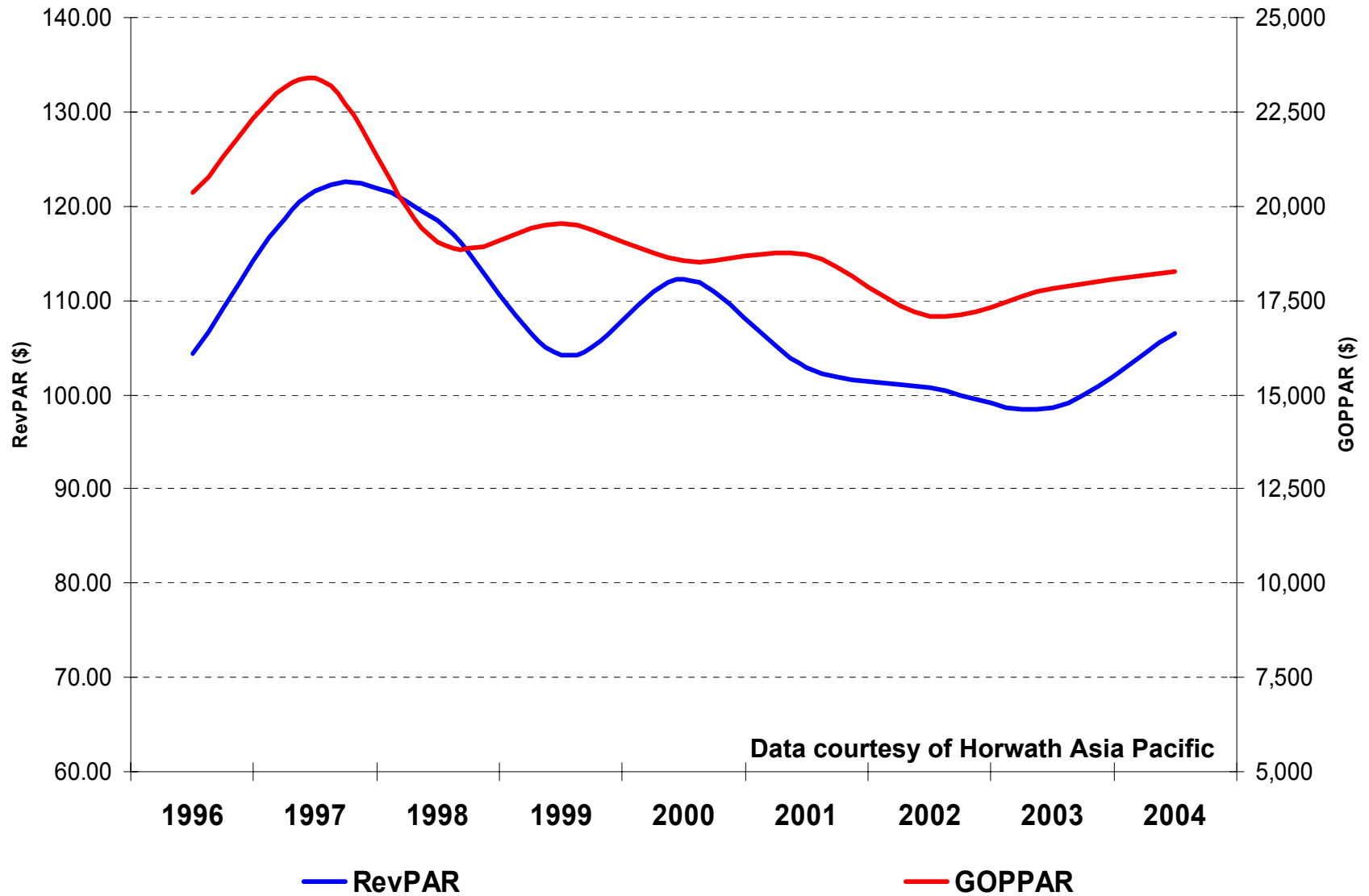
RevPAR and GOPPAR - Sydney



RevPAR and GOPPAR - Sydney

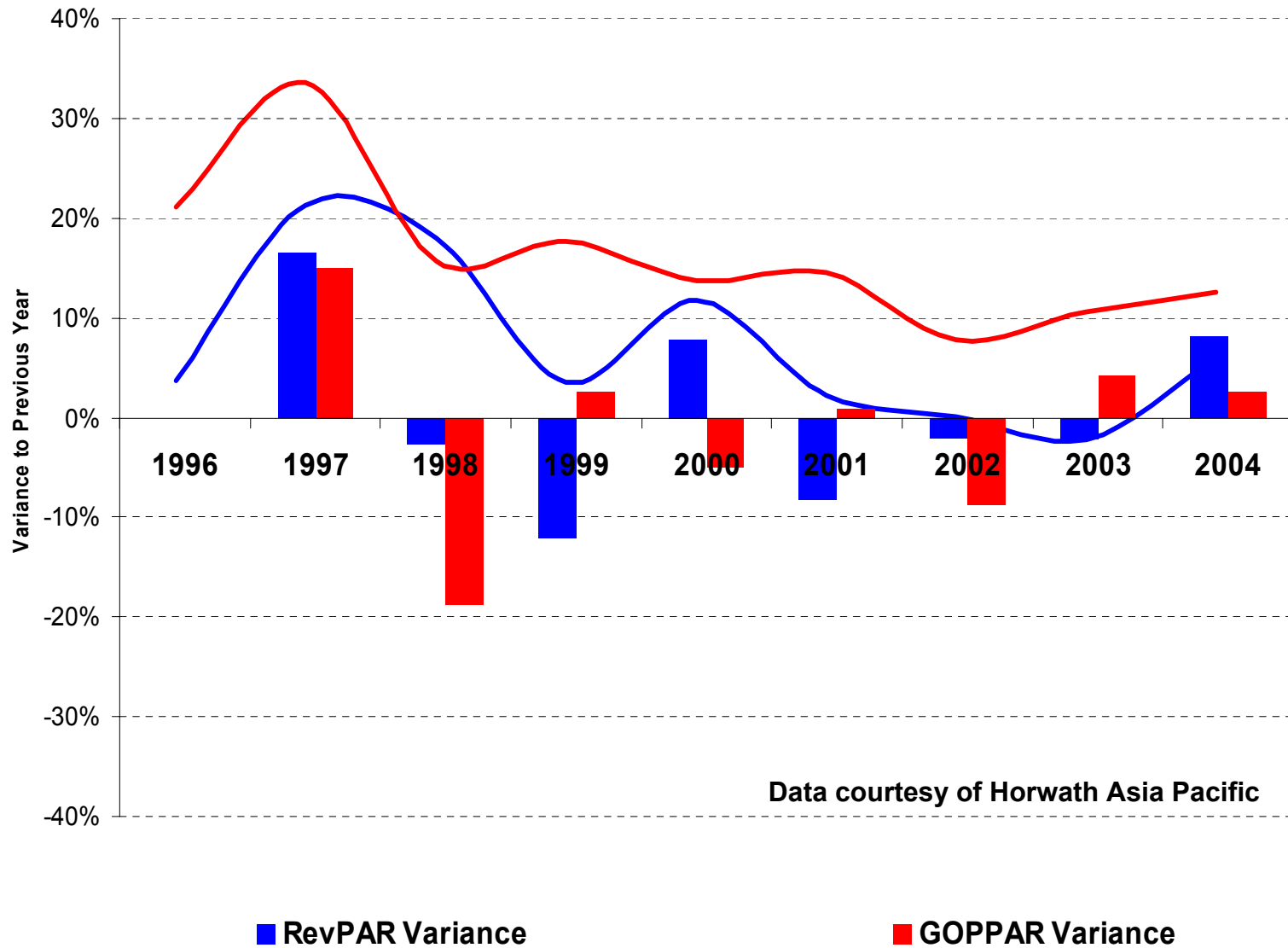


RevPAR and GOPPAR - Melbourne

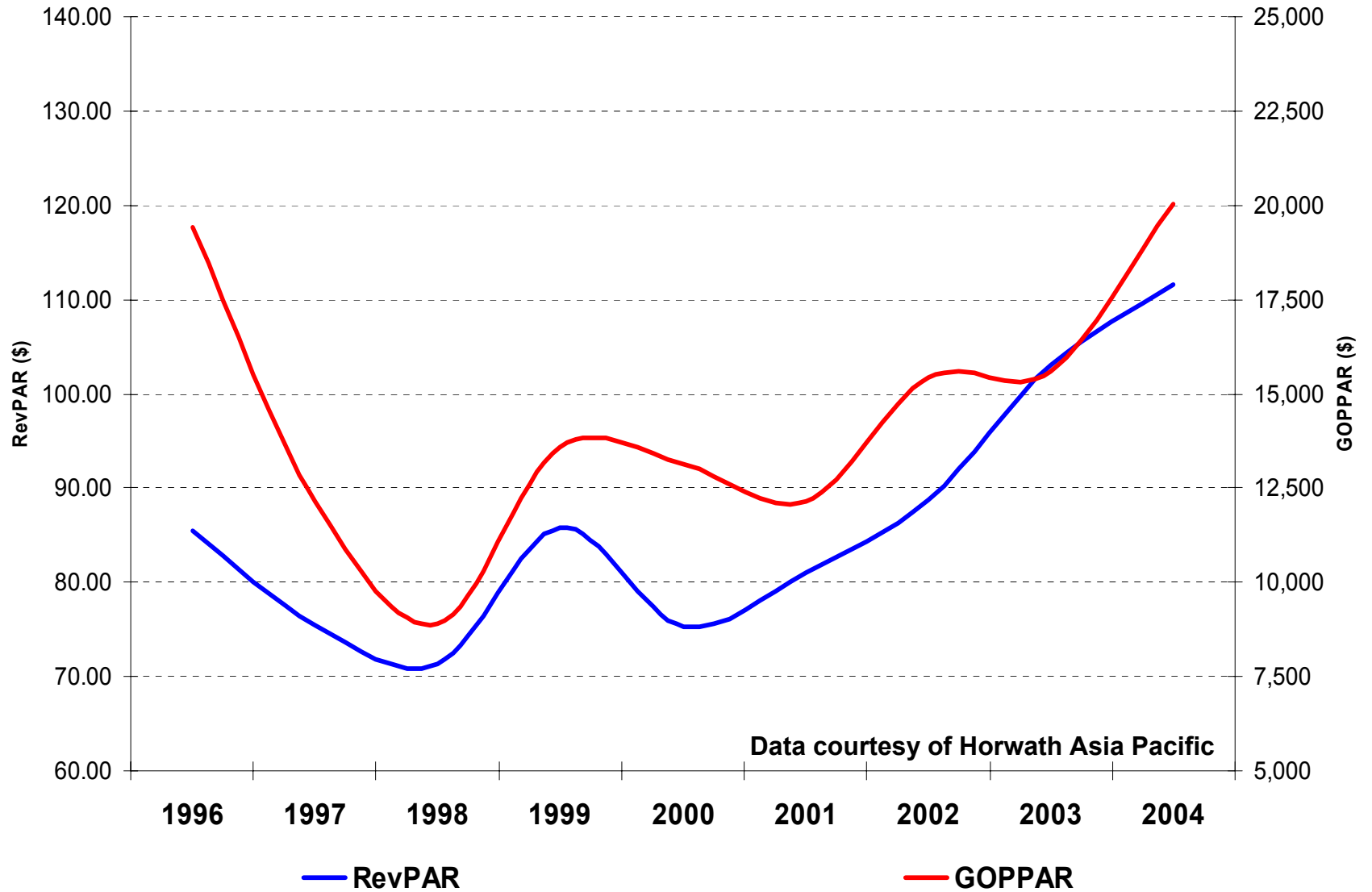


Data courtesy of Horwath Asia Pacific

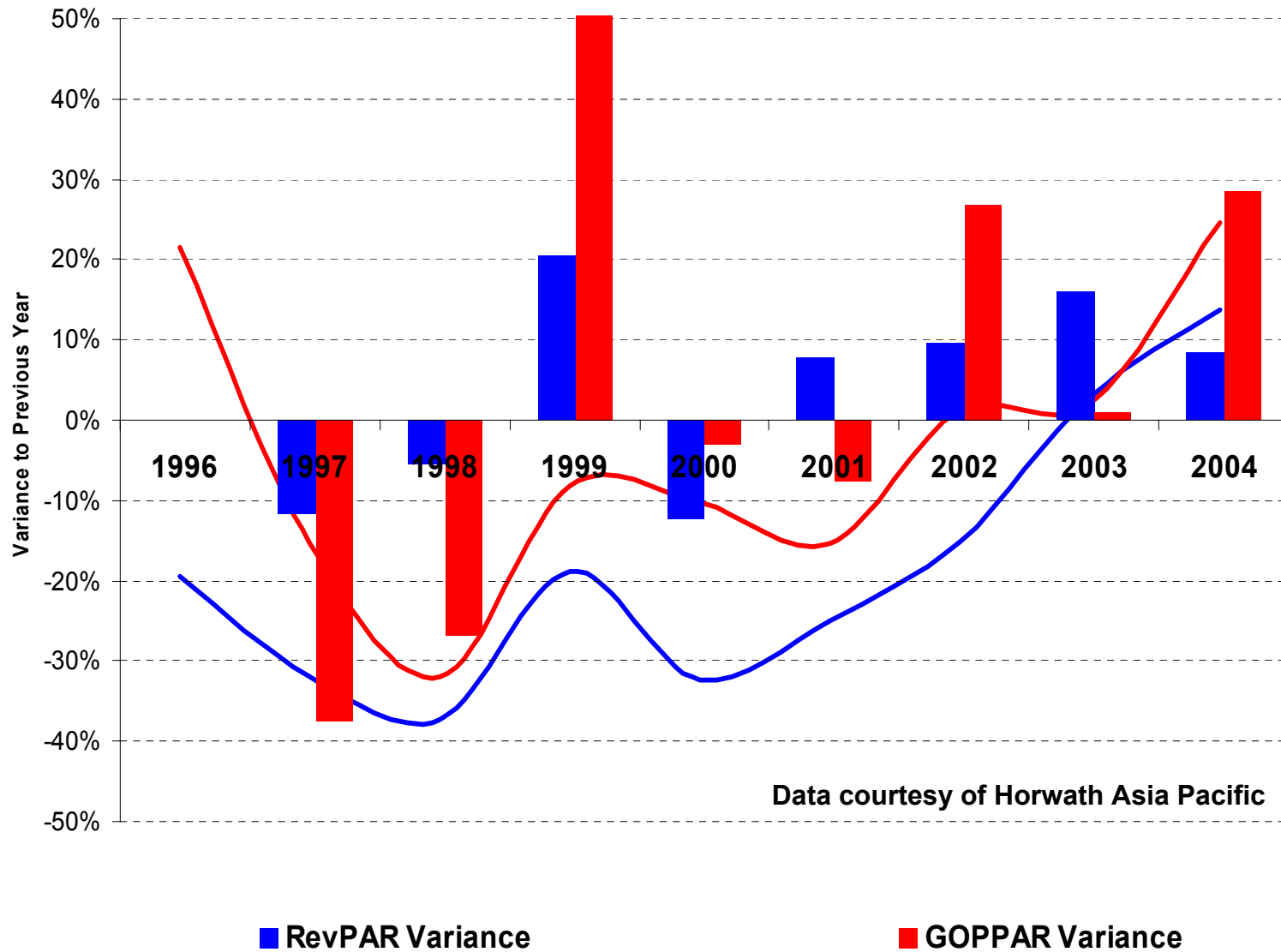
RevPAR and GOPPAR - Melbourne



RevPAR and GOPPAR - Brisbane



RevPAR and GOPPAR - Brisbane



Long Term vs. Short Term Yield Strategies

Yield Management

- Yield Management = Revenue Management
- Invented by airline industry, but also applied in cruise lines, car rental and other service industries
- To sell the right **product** at the right **time** to the right **customer** at the right **price**
- **Product** is not just a room, but the whole package of tangibles and intangibles, including flexibility and refundability of the booking
- Long term pricing strategy = **pro-active**
 - What if things do not go as planned?
- Daily yield management = **re-active**

Long Term Yield Strategy

- **Pro-active** = needs careful planning
- Should be based on your marketing and business plan
- Analyse market supply
 - Determine competitive set
- Decide on property positioning strategy
 - Target market and market segments
 - Occupancy strategy or rate strategy (or both)?
- Review demand projections
 - Project market occupancy
 - Market penetration analysis
 - Project property occupancy levels
- Decide on pricing strategy

Short Term Yield Strategy

- **Reactive** = response to changing environment
- Required if your long-term plan needs fixing
 - Seasonal impacts (weather)
 - Unforeseen events (strikes, disasters)
 - Competitive pressure
- Aimed at maximising RevPAR by making short term decisions
 - Yield management software
 - Ad-hoc discounts and packages
 - “Lose-it rates” for short term bookings
- Short term strategy should not undermine long term objectives
 - A quick decision can have a long-time impact
 - Dropping rate is easy – recovering is hard work

The old way.....

- Contracted rates are offered on “run of house”
 - “free upgrades” during high demand periods
- High volume contracts get lower rates
 - is actual production in line with rate offered?
- Next year’s rate based on past performance
 - Looking backwards, not forwards!
- Long term contracts made on today’s rates
 - Is that rate appropriate for the contract period?
- Focus on quantity not quality (more is better)
 - High rate business is more profitable!

...and what is changing

- Diversified pricing strategy based on lead time
 - Long-term bookings at lower rates, but limit availability
 - Higher rates for short-term bookings, unless the expected occupancy is low and discounts are appropriate
- Dynamic pricing models: redefine contracts
 - Rate structure by room type, not “run of the house”
 - Rate goes up when demand increases
 - Enforce this structure where possible
- Reward and Punishment.....
 - Award volume discount based on actual production, not on predictions or last year’s production
 - Reward commitment but charge for flexibility

It's all about being "Fair"

- What is fair?
 - The value to the hotel must be equal to the value to the guest:
 - The guest should get a reasonable price that allows the hotel to make a reasonable profit
 - Raising rates to maintain profit (compensate for increased cost) is considered **fair**
 - Maintaining rates when costs decrease is **fair**
 - Raising rates to increase profits is **unfair**
- Yield management is opportunistic and thus unfair
- Then how do we raise rates without being unfair?
 - Increase the reference base (rack rate) and provide discounts
 - "Hide" the rate increase through packaging with other services (Bfst)
 - Increase the (perceived) value of the rate through additional benefits
 - Attach restrictions to existing prices, so higher prices with less restrictions seem fair in comparison (lead times, minimum stay, deposit, cxx penalty (this is the airline system.....))

Potential problem areas

- Do not abuse yield opportunity
 - Provide arguments to support rate increases
 - Be transparent in rate policies and explain the structure
 - When offering discounts, attach booking restrictions
 - When asking high rates, be more flexible
 - Do not insist on high rates when not appropriate
 - Be mindful of the need for repeat business
- Good yielding is an art, not a science
 - Provide training and education
 - Provide (technical) support system
 - Do not leave to inexperienced staff

Common mistakes at the desk:

- Change rates upon the slightest objection at registration, even when guests already hold confirmed reservations.
- Override rate restrictions in PMS and CRS systems for callers who simply ask about lower options.
- Provide special “favours” in terms of room upgrades, often in the spirit of hospitality, to repeat guests.
- Routinely apologise and make excuses when quoting higher rates, thus positioning them in a negative way. (“All I have left is our \$X rate.”)
- Offer rates that have restricted availability to those who don’t qualify.

Better ways of dealing with guests:

- Stay firm on price whenever possible at registration or check-out.
- Quote higher rates with confidence, over the phone or in person.
- Resist what is becoming a routine guest negotiating tactic of simply asking for a discount just to check the reaction of our staffers.
- Position higher rated rooms and rates in a positive way.
 - “Fortunately, I still have some rooms left during that time and the rate is \$X.)
- Understand why hotels market different rates according to market segmentation, and how the costs greatly vary according to the channel.
- Understand why the same room may attract a different at different times, due to changes in demand

It's all about Perception

- **Position higher-rated rooms in a positive way.**
“Fortunately we still have some options for you during that time,”
or “ what I still have available is...”
- **Reference higher-rates to position lower-rates as being “already discounted.”**
“Normally, Sir, these rooms go for \$125, but due to (special circumstances) we are able to extend a rate of \$100 for the dates you are looking at.”
(This stops the guest from asking about the \$75 rate.)
- **Explain why lower rates cannot be extended.**
“Sir, the \$75 rate is sold out at that time.”
(This works far better than saying “that rate is not available,” which implies that it exists, but the guest can't get it.)

Top Five “Must Do’s” to Raise Room Profitability

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1: Build a Revenue Management Team

Revenue management is a discipline; it is a structured business process. Put responsibility in the hands of your top managers and create a revenue management team that is personally involved in goal setting, decision-making and pricing management. Then give them the tools they need to put a systematic approach in place. Systems are key because they lift rate optimization from guesswork and finger-crossing to a checklist of best practices that result in increased revenue.

2: Know Yourself and Your Competitors

Know what kind of hotel you operate and assess if you are doing all you can to meet your customers’ needs. If other properties in your market offer free Internet connections, do the same to build parity, or go further to differentiate your hotel as a foundation for higher rates.

This leads to the next step:

competitive performance comparisons that let you know what properties like yours charge for each segment in your market, their RevPAR and occupancies. This gives you a valid benchmark against which to measure your strategy’s success.

Remember these numbers change weekly, so assign someone on your revenue management team to build an index of competitors’ performances and track how your property stacks up over time.

3: Set Prices Strategically

Once you understand your own property and how your competition is setting rates, you can use the information to price your property’s segments strategically.

To do so you need to know which booking channels your customer segments use and the costs of these channels. With this knowledge, you can structure your rate offerings intelligently for each individual sales channel, such as call centre, Travelocity or walk-in, to get the maximum revenue possible.

Since different segments of your business use different sales channels to book, evaluate your business mix and price channels to optimize your rates for each segment.

4: Determine Which Guests Are Most Valuable

Assess your business segments for their value. Does your corporate segment book more rooms at higher rates than your package or leisure guest segments? Do you know what channels they use? Twenty-something business travellers do not call the 800 number like their more seasoned colleagues; they are more likely to log on and book through a different channel.

Most revenue management teams are surprised to learn where the majority of their business originates. The most profitable segments and channels are different for every property. When you run the numbers and know the answer for your hotel, you will see where to allocate your sales resources to drive the most potentially lucrative business mix.

5: Forecast Demand, Not Just Occupancy

Above all, become an expert at forecasting demand, not just occupancy. When you know your demand you can take the right action to manage your rates and stay controls.

Forecasting demand allows you to intelligently balance what your competitors are doing with your customers’ expectations and the overall demand in the market place.

For example, projecting a future date at 101 percent might not be high enough when you consider no shows, early departures and cancellations. But a forecasted demand level of 110 or 130 percent suggests you not only have the opportunity to drive rate, but also duration, and you therefore need to set up significant stay controls and increase rates. Your goal, of course, is always to get the highest rate while still selling out your property.

How to make Projections....

- Review and project new additions to supply
- Review macro economic environment
- Analyse demand growth predictions
- Combine supply and demand to arrive at occupancy projections
- Review historic market response to occupancy shifts and predict rate movements
- Prepare marketing plan and set property rate strategy

Top Ten Revenue Management Mistakes Hotels Can Make

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Hotel On-line.com

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10: To recognize Revenue Management as a job done only by the Front Office of a hotel.

A husband helps his wife to do parallel parking: “More to the right! Now backward! A lot more to the left! All the way! Forward! Now backward! A bit more! Oh my... Now get out and see the damage you’ve done.”

9: To allow an internet discounting agency to sell our rooms at prices of their choosing, then complain about the erosion of rate integrity.

Simple math: the Manager to the Merchant: “Two plus two equals four, doesn’t it?” To which the Merchant replies: “Not so fast. Am I buying or selling?”

- 8: As a revenue maximisation strategy, to claim differentiating your hotel on service excellence and then promote discounts, "value package" offerings, free frequent guest points and other freebies.**

An incoming call to Excellent Service Hotel is put on hold. "Your call is important to us. Please, wait until the next available operator." And it goes on for five more minutes in a loop. When the call is finally taken, a discount of 10% is offered from the room rate without even verifying the required membership. Go figure.

- 7: To think that weekday strategy and weekend strategy can be the same.**

Could we have a Sunday Brunch on Wednesday evening?

- 6: To expect that the "flag" (brand) will fill the hotel without us lifting a finger.**

In the long run we always tend to get what we've paid for.

- 5: To count revenue dollars as equal, regardless of the distribution channel they came through.**

"Each animal is equal but some animals are more equal than others." George Orwell wrote this or something very similar in his book "Animal Farm." Do we know what costs are associated with selling a room night through our own corporate call centre? Our own hotel's website? A GDS? An e-merchant? A travel agent? A direct call from a return guest? An association?

4: To think that short term goals must always have priority over long term goals.

Don't even think about it...

3: To be convinced that artificial intelligence (RM software) is superior to human intelligence.

Murphy's Law: "To err is human but to really mess things up you need a computer." Computers are great tools in the decision making progress. They work faster and more accurately with extensive databases and can crunch a lot of variables. Sensible managers should always make a sanity check on any results and override even optimum outputs if they believe that that is the right thing to do. The system is not the solution and media is not the message. We, humans should know better.

2: To believe that the right price for a room night is established on our costs and ROI expectations.

The right price is established by the market. We should charge exactly what the market is able and willing to pay, not a dollar less. Can we try to go for a little higher price than this? The consumer today will find this out in a heartbeat and may go after a better deal for a comparable product.

1: To believe that discounting is an effective way of increasing revenue.

Smart operators, selling an experience-based, intangible product do not discount. (The oldest profession comes to mind: they offer a variety of things but discount is not one of them. They understand: how can the full fee ever be collected if the same experience is available at a discount?)

Remember.....

- Its all about how well you forecast demand and manage your rates, and how clearly you understand your markets and the channels you use to sell rooms.
- If you don't know where you're going, you are never going to get there. In revenue management it is the same: if a hotel has no clear strategy, has no thorough understanding of its customers current needs and wants, it can't anticipate market trends and it can't tell how it measures up to its comp set, it is impossible to deploy the right revenue management tactics.

You're only as smart as your dumbest competitor:

If someone is taking prices into the ditch, then all competitors are probably going right down with him



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