Articles / Whitepapers

Practice: Marketing & Technology

Topic: Pricing Optimization

"We Know Why You Stay!"

…or do we?

By Mark B. Hoare

One of the most successful and award winning travel industry advertising campaigns of recent years belongs to American Airlines who claim "We Know Why You Fly!". The premise of the campaign is to instill a sense of kinspersonship[1] and recognition. Not only recognition of the individual, but also of their [your] differing travel motivations and the needs driving why a particular trip is being taken.

Given that the majority of trips by air involve a hotel stay it's reasonable to suggest that hotels too should stand behind their own "We Know Why You Stay!" claim. It is also reasonable to suggest that the purpose of the traveler's trip is the same whether thinking in terms of the hotel or air component of that same trip.

Where is this leading I hear you say… well, before you leave and flick over to Jon Inge's article bear with me a while longer.

What the American Airlines campaign does not highlight, at least openly, is that each of these reasons for travelling correlates to a very different value proposition for the seat (or a room in our case) in the minds of the travelers, whether they be business or non-business travelers. Accordingly, it is extremely important not to treat every hotel guest as a clone of the other, and not to commoditize the product and the experience based on a misapprehension that all travelers are fixated on the lowest published room rate, and that they can always be swayed to one brand or another simply on the availability of the lowest price.

In a related article written for this same publication some years ago we looked at how one hotel brand discovered that they'd wrongly assumed their branded web-direct channel had a particular type of guest sitting at the other end and made pricing decisions for that web-direct channel accordingly. They discovered, albeit accidentally, that there were actually several customer types with differing value perceptions and very different reasons for booking. Effectively, they were offering discounts to people who weren't looking for them.

[1] Yes I made this word up, but you know what I mean.

This is important because our industry has fixated on low-price for a decade at least, and in turn has caused widespread commoditization of the hotel product. To be slightly lenient to hotel owners and hotel companies they have been inextricably drawn into this state by the advent of: ubiquitous rate transparency, STAR reporting, rate parity mandates from OTAs, competitive set pricing reactivity, meta-search engines, harsh economic downturns, etc.

Some might support the view that the fundamentals of strategic and tactical product pricing have been all but abandoned in the sharp elbowed jostle for lowest price placement based on promoting the least desirable quality, located and configured room. In effect hotels are expending the majority of their time and effort attracting and servicing their least profitable guests. In fact some

hotels implement pricing strategies and booking policies that plainly alienate their best guests. Hypothetically, consider a Ford pricing and selling strategy that is based on advertising and promoting only their entry-level Ford Focus in all their channels of distribution, hoping that that was enough to get the shopper to page down a few times and buy a fully-loaded $43k Ford Explorer. So, how do we correctly value-position other types of rooms and stay experience to align with the numerous reasons why our guests stay with us?

This article focuses on repointing our thinking toward the fundamentals of product pricing and aligning that with a rejuvenated understanding of our guests, why they stay, and how that affects their perceived value proposition at the time of purchase.

Directional-htl has undertaken many assignments related to distribution and rate & selling strategies. In that breadth of experience, we have come across examples of worthy pricing policies and practices. But more prevalently we have experienced the not so worthy.

Contrary to myth, there is no single magic bullet that one can use to repair a poor pricing strategy, rather there's a compelling need to take a step back and acknowledge that the many years of driving gains [successfully] via diligent cutting of costs, and increasing revenues [somewhat successfully] by the investment and deployment of expensive Revenue Management technologies, are pretty much exhausted. So what's left?

In support of evolving to Value Optimized Pricing as the cornerstone of a profitable business model, here are what we believe to be the top areas to focus on:

- **Hotels must define a pricing strategy based on value perception, not cost/+ pricing**

Granted hotels should understand the underlying cost of an occupied room/suite, but should not use a cost/+ pricing model in today's highly fragmented market. Using this method implies the hotel doesn't know, or does not see the benefit in knowing, the value propositions that cause a guest to buy their product or inversely abandon and look elsewhere. Indeed, under certain circumstances it is possible that a hotel will be willing to tactically offer a product at lower than breakeven, cost/-, to stimulate a segment that is known to generate a disproportionately higher incremental spend when in-house. Volume based local corporate rate pricing tactics are an example of this where there's a fixed F&B component to the bundled daily rate.

- **Hotels must resist reacting to marketplace pricing**

Nothing has promoted the commoditization of your hotel more than chasing the pricing tail of your competition. It also presumes that one or more of your competitive-set cluster actually has a pricing strategy worthy of following. I'll leave you to ponder that one. What if you could increase local market share and be at a higher price-point than your competitive-set, simply by offering a unique and tailored value proposition to those travelers looking to come to your neck of the woods?

This is where the big brands actually have a disadvantage in as much as their brand standards do not allow them to assimilate into the location and provide the value add of a differentiated experience. This is of particular benefit when aligning your products with the leisure and Social, Military, Educational, Religious and Fraternal [SMERF] segments who might be looking for accommodations in your area. This ability to promote a more intimate knowledge and established positioning within the locality can support higher price-points than the box brands in the same area.

- **Hotels must accept variable-margin pricing by [room/suite] product**

This issue is typically, but not uniquely, a symptom of Finance being involved in product pricing strategies. It also stems from Cost/+ pricing whereby a hotel may have, say, five room types of incrementally better; quality, appointments, locations, etc. and each is tasked with generating a uniform, say, 40% margin. Again, the value perception the traveler attaches to a particular room type will vary according to their needs and reason for traveling. Maintaining a uniform margin target across all your products will likely drive away those buyers who's value perception doesn't align with the resulting price-point, or inversely will leave money on the table for those who expected to, and would have, paid more.

- **Hotels must incentivize Sales and Front Office staff on profit margin**

One of the most prevalent issues directional-htl comes across when evaluating a hotel company's current rate and selling strategy is the practice of incentivizing Sales and the Front Office based on maximizing; Occupancy[OCC], Average Daily Rate [ADR], or in more forward thinking properties, Revenue Per Available Room[RevPAR]. While all of these are key performance indicators they all ignore profit and either fixate on heads-in-beds or top line revenue. RevPAR is simply a blended performance measurement of the two. Profit Management, measured by GOPPAR (Gross Operating Profit Per Available Room), will, in our assessment, supplant Revenue Management as the practice of choice over the next decade. Those hotel companies that are already making the move to Value Optimized Pricing strategies will be the best positioned to capitalize on this inevitable shift from Revenue focus to Profit focus.

- **Hotels must accurately profile and segment their customers**

At the heart of "We know why you stay!", you must think differently about how you define your hotel's segmentation. Put yourself in the traveler's shoes and identify their characteristics and tailor your product, bundling, pricing, and channels of distribution to align with the most important

aspects of each segment's travel needs. Remember that the very same guest may belong to two or more segments. The individual trip's purpose, conditions under which the trip is taken, and traveler's lifestyle will have a direct correlation to the traveler's Value Perception.

By way of an example, in a recent assessment we found that environmentally conscientious travelers, whether traveling on business or leisure, will actually pay a premium to enjoy a room that features Green amenities and features such as: biodegradable toiletries, hypo-allergenic beds and bedding, energy efficient lighting, recycled stationery, chlorine free bathroom tissue, etc. This doesn't imply that the whole hotel has gone Green but a product has been created to align with this growing travel segment, and at a price-point higher than the comparable room's BAR rate.

Perhaps a more recognizable example is the provision of a business oriented floor/room type product that tightly aligns to the needs and desired stay experience of the business traveler, featuring a smaller bathroom space in favor of a larger bedroom with an ergonomically designed, and technologically efficient work zone. Include a room-service breakfast and internet access into the bundle and they'll be in heaven, and pay a premium for the experience.

- **Hotels must focus on their most profitable guests/segments**

It would be reasonable to expect that hotels are fully aware of who their most profitable customers are, however, this is not the case in directional-htl's experience. As already discussed, the maniacal focus on Lowest and Best Available Rate, Price Parity and other constraining factors such as agreeing to Last Room Availability on mega-OTA sites and backfilling excess capacity with lower rated group and tour business has distracted hotels from developing a deep and actionable understanding of who their most profitable customers are, and are spending most of their time and effort distributing to and attracting their least profitable guests.

Many hotels depend too heavily on the merchant and opaque OTAs to drive heads-into-beds thus driving occupancy and the delivery of the inherent spin-off of incremental spend. Wrong, on a number of counts. The guests booking you thorough these channels are 99% price sensitive and far more likely to patronize the local eatery than your restaurant or lounge bar. Added to that the booking's cost-of-acquisition erodes between twenty and forty percent off what was already your best available rate.

- **Hotels must avoid pricing policies that drive away high-value guests**

We have spoken a lot about the selling price and profitability, but of equal importance in Value Optimized Pricing, and something that will become evident when a hotel can truly stand behind a "We Know Why You Stay!" claim, is to not impose pricing and selling conditions that alienate high-value client segments.

For example, a client of directional-htl was challenged with a loss of Business traveler share to their competitive set, despite their having a better product and service, and a very competitive price-point. Location issues were ruled out, user generated reviews were above average, the loyalty program effect was also proven not be the culprit. Only when we reviewed the booking policies of the property did we identify that the Business traveler was avoiding the property because of the blanket 50% deposit at time of booking, and 7 day cancellation penalty policies. Their competitive set all had a guarantee to Credit Card, and 24 hour cancellation policy in effect.

We concede that the above focus areas are just a bulleted listing, and that they all need to be integrated into a planned approach aimed at transitioning from current-state to a Price Optimized operation. So before identifying the relevance of each focus area for a particular hotel or hotel brand, and before prioritizing the sequence in which addressing them will drive the best incremental benefit, directional-htl recommends a thorough benchmarking of current-state indexed against best practice, and leading practice in those cases where an hotel has already made a move toward being pricing centric.

Making this move will not be easy. Following a decade of focusing on: Cost Containment, Occupancy, Average Daly Rate, Revenue Per Available Room it is perhaps apposite to use the analogy of entering into rehab… that is to say, a tough journey ahead with a high likelihood of slipping right back into old habits. However, when developed over a strong understanding of what facilities and experience guests want out of a hotel stay, hotel companies that are ready to embrace and hold fast to Value Optimized Pricing will lead the charge back to controlling Price and become the industry's leading practitioners of Profit Management. For those of you who read the book Blue Ocean Strategy[i] you will readily identify the similarity between fighting in the Red Ocean of commoditized competitive Best Available Rate pricing, and moving out into the Blue Ocean of Value Optimized Pricing.

In the follow up to this "We Know Why You Stay!" article, we'll take a much closer at one of the most useful of all tools that enables us to fine tune our Product and Service pricing to the Value Perceptions of the growing number of different guests/segments that use our hotels… namely, Conjoint Analysis. ■

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[i] Kim & Mauborgne, Harvard Business School Press, 2005