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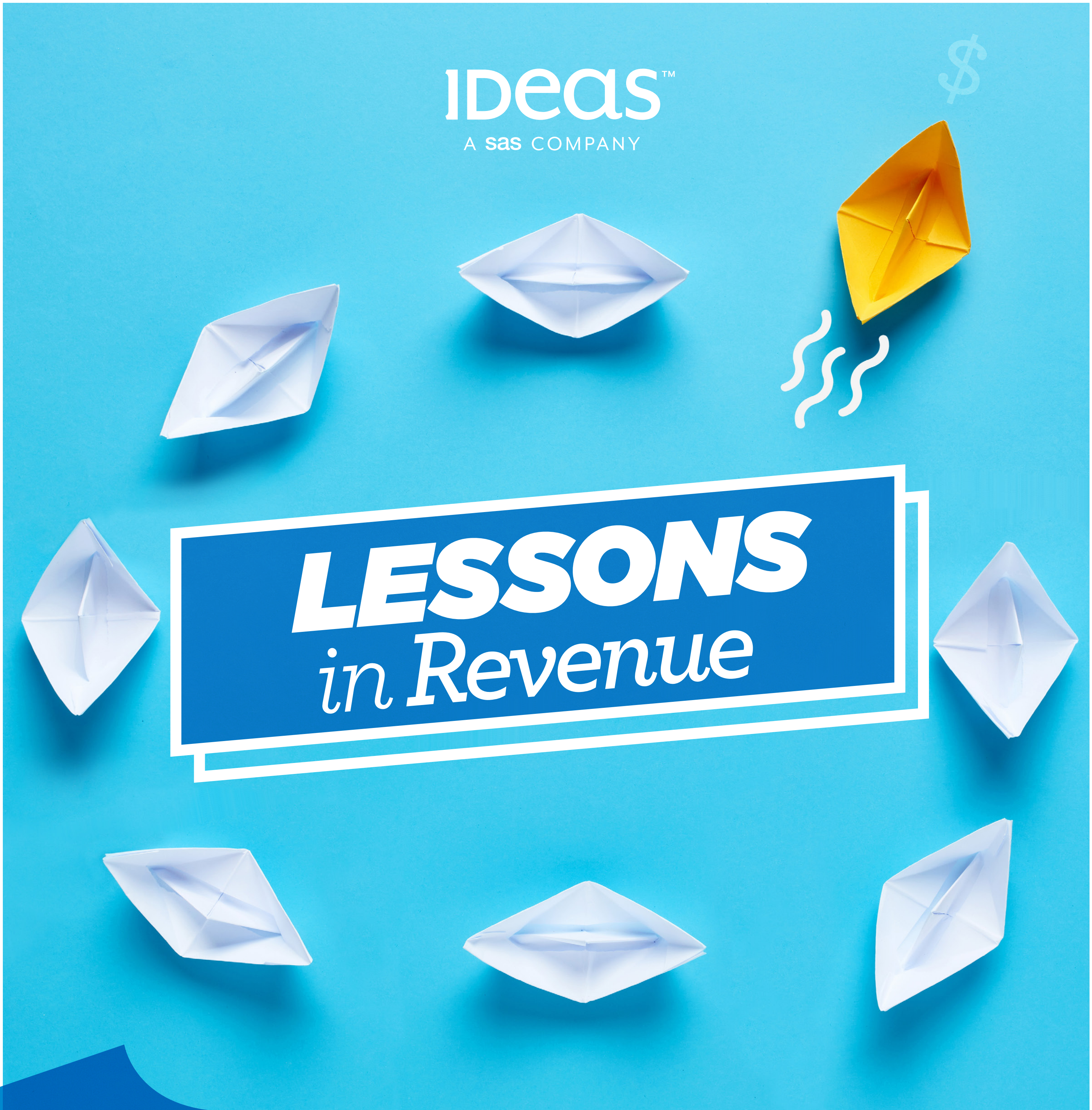

LESSONS in Revenue

BREAKING THE RULES with Demand-based Dynamic Pricing

How Hotels Drive More Revenue by Shifting Away from Rules-based, Reactive Pricing

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By IDeaS Revenue Solutions

"The greatest danger in times of turbulence is not the turbulence – it is to act with yesterday's logic."

Peter Drucker

Table of Contents

> *"Price perception of travel has changed…We are selling at a more expensive rate and this is now becoming profitable for the hospitality business and acceptable to the client…We are just at the beginning of a new story."*
>
> **Patrick Mendes**, *CEO*, Accor, *Financial Times*

Welcome to the Elite School of Smart Pricing

In today's marketplace, hoteliers have an increasing array of data and tools at their disposal to make smarter pricing decisions. Operators that rely on outdated methods and legacy technology are increasingly at a disadvantage.

A forward-looking approach to revenue strategy focuses on outperforming the market based on current conditions, not on meeting budget targets set last year. This requires an automated, analytics-based RMS that recognizes the dynamic nature of demand across business types.

To make progress, sometimes it's necessary to break the rules. With a dynamic demand-based pricing approach, hoteliers can have the confidence they're leveraging the latest tools and methodologies to achieve the most profitable business mix, whether managing revenue at the property, regional, or enterprise level.

Dynamic Pricing: The Ultimate Flex

Hotel revenue management is by nature a disciplined function. It requires adherence to proven methodologies and practices to manage pricing and inventory to maximize revenue and optimize profitability.

But some rules are meant to be broken. Too many hotels continue to follow rigid, outdated pricing rules and reactive measures that hold them back from achieving their full revenue potential.

While most properties follow some form of dynamic pricing, recent advances in pricing tools and strategies are separating the leaders from the followers. Today's revenue strategists don't wait for occupancy to reach a certain threshold before increasing rates. They don't wait for competitors to make the first move. And they don't apply the same pricing and inventory controls to all types of business.

Since the pandemic, hoteliers have learned that travelers have a higher tolerance for high prices than previously thought, as long as the rates are backed up by quality. Room demand is constantly changing, and pricing should reflect those changes. A truly dynamic approach to pricing is a process of continually anticipating demand, assessing price sensitivity, and flexing rates by room type, product, and length of stay to capture the most profitable business mix.

In today's highly competitive marketplace, demand-based dynamic pricing is the ultimate flex. But it requires access to the right tools and data and a willingness to break free from restrictive rules. Here we explain how it works.

Kicking It Old-School: Rule-based, Reactive Pricing

In the past, hotels took a relatively static approach to room pricing. More recently, greater adoption of revenue management systems (RMS) has enabled more hotels to take a dynamic approach to selling. Yet, despite advances in technology and know-how, many hotels still continue to follow rudimentary pricing methods.

Common approaches include:

Reactive pricing: Competitor rates are monitored closely throughout the year, and pricing is adjusted in response to competitor behavior. For example, if a competitor's rates go up by $20, the hotel's rates go up by $20 to maintain a consistent differential.

Budget-driven revenue management: During the annual budget process, the hotel sets targets for average daily rate, occupancy, RevPAR, and revenue for the coming year. Throughout the year, the targets are used to guide revenue management decisions and evaluate performance.

Rules-based pricing: Around the same time, the hotel prepares a rate schedule, establishing pricing for each room type and product, with fixed tiers or percentages to flex pricing up or down based on changes to occupancy or other pre-set parameters. For example, if occupancy reaches 80 percent, then rates go up across the board by $30 or, if 80% of the standard rooms are sold, then close the booking of advance purchase rates.

Dynamic pricing of the base room type: Only the entry-level room type is dynamically priced, and all other room types are linked to it with fixed incremental supplements. For example, the supplement between a Superior room and a Suite is fixed at $150, which neglects the actual demand of each room type.

Connected products: Select products are tied to best available rate (BAR) or retail rates according to pre-established tiers or fixed percentages. If BAR rates are adjusted up or down, so are the rates for all linked products, while independently priced products are adjusted according to their individual demand trends. For example, a static 15% discount off Advance Purchase rates throughout the year.

Limited controls: This method of pricing is based on inventory controls. The pricing rules here are simple and inflexible, such as minimum length of stay, closed to arrival, and overbooking limits.

Pricing by day: Only pricing and yielding individual days while neglecting potentially higher revenues from bookings that arrive earlier and stay longer. For example, by only yielding on price on a Friday night, guests trying to arrive on Thursday for 2 or more nights will be less likely or not able to book. This has a much higher impact on properties with substantial long stay business.

Partial automation: The RMS recommends pricing based on user-defined rules, and the revenue manager reviews and validates recommendations and manually updates rules and rates.

> *"We believe the era where we can fill up rooms at high rates by doing nothing is gone. It's a competitive market out there, and we must grab every opportunity we can. We can upsell when we can, but when we cannot, we need to stay competitive. This aspect is difficult for humans to manage, and that's where revenue management technology becomes essential."*
>
> **Nikolas Ioannidis,** *Owner,* Belvedere Hotel Mykonos, Greece

The School of **Hard Knocks**

While rule-based, reactive pricing methods may appear to serve hotels well, they bring challenges that inevitably harm performance. Here are several common scenarios:

Under-pricing: The forecast predicts soft demand, and the revenue manager reduces rates accordingly, only to realize that demand is stronger than expected. But it's too late—the hotel has filled up with lower-value business and must turn away higher-value business.

Over-pricing: Or the reverse happens—the forecast predicts strong demand, and the revenue manager increases rates only to discover that demand is softer than expected. Last-minute discounts fail to pick up the slack, and a large proportion of rooms sits empty.

Moving targets: The hotel often finds itself with empty rooms it can't sell due to unexpected no-shows and last-minute cancellations. On nights of high demand, it often oversells and relocates guests.

Lost business: High-value long-stay guests are often turned away or lost because the hotel is sold out on select dates or rates are too high and pricing is inflexible.

Frequent (free) upgrades: When demand is high, the hotel oversells its base room type or increases pricing across the board due to fixed offsets. In either case, premium rooms don't sell, and a lot of free upgrades are doled out.

Pricing wars: In response to a competitor lowering rates, the hotel lowers its own rates. Other hotels follow suit, and the cycle repeats itself, resulting in a pricing war “race to the bottom” in which everybody loses.

Lack of confidence in the RMS: Senior management often questions the RMS’s recommendations, and the revenue manager can’t explain the rationale or rules logic. As a result, manual overrides are frequent, yet no one is sure if they improve outcomes.

Too much tactical work: The revenue manager spends so much time analyzing competitor rates and RMS pricing recommendations, and then updating rules and rates that there is little time left for strategic planning.

> *“Travel sticker shock is giving way to anger for many consumers... In fact, far from price gouging, hotels have taken almost no price increase in real terms... Everything from fuel and heating, to wages, to food costs, to laundry supplies are more expensive today... The inflation data suggests that most hoteliers are increasing their prices to keep pace with their rising costs. If they aren’t making more profit, that’s not price gouging.”*
>
> **Seth Borko,** *Skift.*

The Modern Approach: Demand-based Dynamic Pricing

The above scenarios are all too common when hotels employ oversimplified, rules-based methods of forecasting and pricing that don't reflect the dynamic nature of real-world demand. Often, this approach isn't due to lack of will or know-how within the revenue team; it's due to limited capabilities of the RMS and an overreliance on manual processes.

In recent years, revenue management has evolved from being highly tactical and hands-on to become far more strategic, analytical, and automated. The shift has been enabled by the latest advances in technology, improvements to data availability and quality, and scientific approaches to proven methodologies.

At the same time, pricing methods have evolved, too. The modern approach to pricing strategy utilizes several key components:

Dynamic Forecasting

Demand conditions are in constant flux. If hotels forecast only once per month, they make decisions based on outdated data. To ensure optimal pricing, the RMS must forecast dynamically, repeating the revenue optimization cycle several times daily.

This involves following a continual process of four key steps:

1. **Forecast:** Predict room demand based on current data inputs.
2. **Optimize:** Determine the best business mix to maximize RevPAR and profit.
3. **Control:** Apply pricing and inventory controls to achieve optimal revenue and profitability.
4. **Monitor:** Track booking activity and changes in demand.

Demand-based Pricing

Rather than focus solely on occupancy and competitor behavior, pricing is driven by demand. To forecast demand, the RMS factors in the full range of demand influences—not just rooms on the books, booking pace, and historical performance but also market demand, competitor behavior, price sensitivity, uncertainty, and the impacts of pricing adjustments. Demand is forecasted granularly by market segment, channel, room class, and product.

More Proactive, Less Reactive

A dynamic, holistic approach to forecasting allows hoteliers to anticipate demand and price strategically rather than wait to see if bookings materialize or cancellations come in. This helps ensure the most desired business is captured from the beginning. If booking patterns change, pricing adjustments are made in real-time.

Targeted Dynamic Pricing

A granular approach to forecasting enables a granular approach to dynamic pricing. Once the hotel knows how much demand exists for each business type, it can decide specifically what to accept and what to turn away. Rather than make sweeping pricing changes, the hotel can be more targeted and precise by engaging in dynamic pricing strategies.

- **By room type:** Recognizing that different room types have different demand patterns, price sensitivity, and competitors, the RMS analytically determines the ideal pricing and inventory controls for each room type independently.

  Not only does this generate more bookings, it also reduces overselling of entry-level rooms and increases sales of higher-tier rooms. For example, if demand is low for deluxe room types but high for superior rooms, the hotel may offer deluxe rooms at a lower increment to capture more revenue and avoid upgrades.

- **By product:** Key products such as advanced purchase, packages, and loyalty rates are priced dynamically based on the unique demand patterns of each product. Products may be priced independently or linked to other products so that when pricing for the base product flexes, so does the pricing for the linked products.

  The RMS also accounts for the fact that changes in the pricing or availability of one product may affect demand for other products. For example, closing out an advanced purchase product will likely increase demand for other discount products.

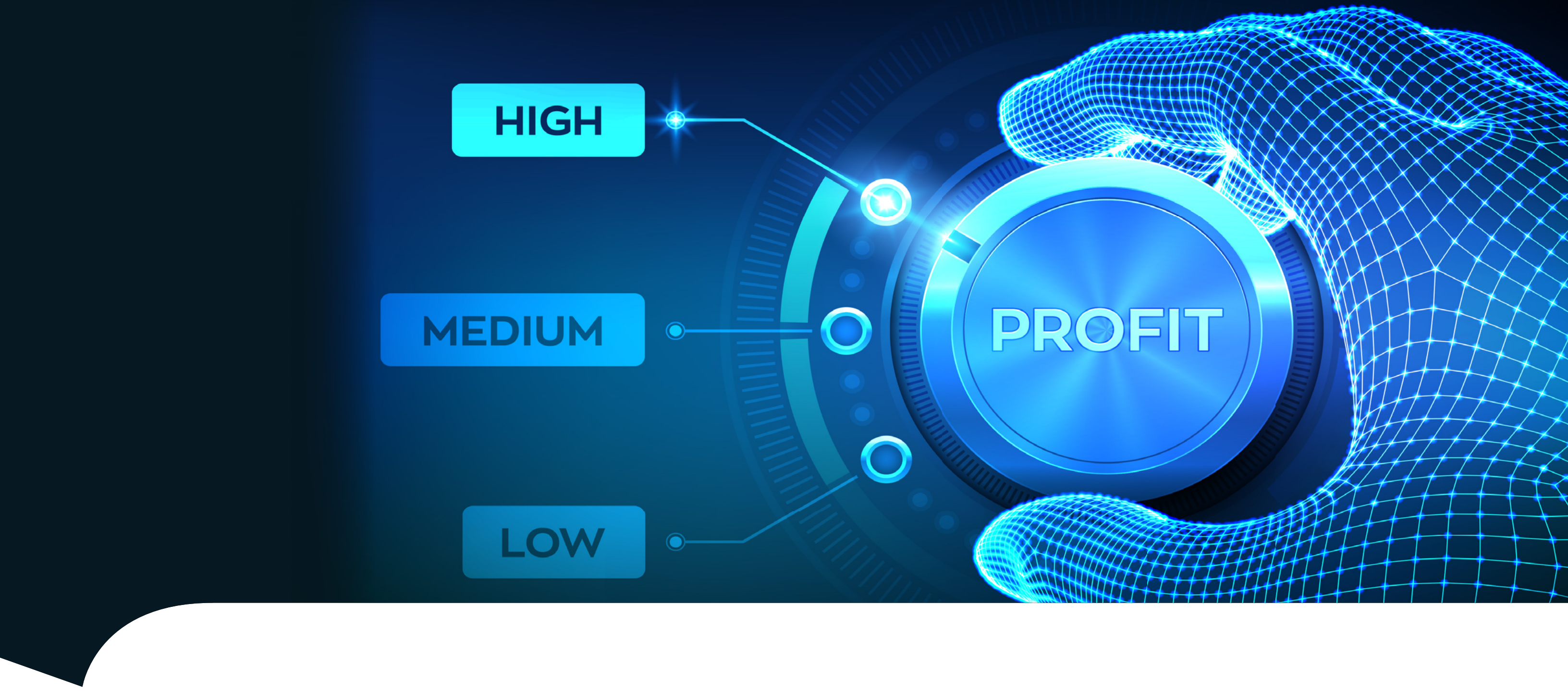
Balancing Automation with User Control

The complex nature of pricing optimization today makes it virtually impossible to effectively manage manually, especially when revenue managers oversee multiple properties. Yet when pricing isn't adapted to market conditions, revenue opportunities are missed.

While rules-based pricing tools are a step above manual processes, they require considerable time and effort to manage rules and implement recommendations. An analytics-based, decision-making RMS leverages sophisticated pricing models and algorithms to continually evaluate demand and automate pricing decisions. For hotels wishing to have greater control and predictability, the RMS allows users to create customized parameters for rates, discounting, and rate changes.

In either scenario, the RMS and the revenue manager work hand in hand, playing to one another's strengths. The RMS handles most tasks, alerting the revenue manager to situations that need attention, and the revenue manager inputs information the RMS doesn't yet know about, such as a new event or a group that's about to go definite. This frees up the revenue team to focus on commercial strategies that drive demand.

> *"Dynamic pricing is poised to become one of the core capabilities that sets winners apart in the retail landscape of the future. Simply put, dynamic pricing is the (fully or partially) automated adjustment of prices. It's a staple of the travel industry: dynamic pricing is the norm for airline tickets, hotel rooms, and ride-sharing services."*
>
> *McKinsey & Company*



8 Ways to Capture More Revenue with Dynamic Pricing

Recent advances in RMS technology enable even more sophisticated approaches to dynamic pricing. Here are some examples of new solutions to common challenges.

1. Set Rate Floors and Ceilings

When hotels adhere to rigid rate tiers, pricing often doesn't match what travelers are willing to pay. As an example, the market may be willing to pay $230 for an entry-level room, but rate tiers require the system to choose either $220 or $240. If the hotel quotes $220, it misses out on revenue. If the hotel quotes $240, it risks losing the booking.

An advanced RMS allows hotels to set rate floors and ceilings for each room class without being restrained by fixed tiers. The RMS calculates the optimal price within those parameters, analyzing demand, competitor rates, price sensitivity, and the impact on other room types. In the above example, then, the rate would be quoted at $230, capturing the booking at the highest rate guests are willing to pay.

2. Calculate Opportunity Cost

Hotels are moving beyond simple inventory controls like adding minimum length of stay requirements and close to arrivals to more effective controls like last room value (LRV) or rate hurdles. With this approach, the RMS analyzes demand and assigns a daily value by room type and length of stay that is the minimum acceptable rate.

LRV is not the price at which the hotel should sell rooms but rather the minimum value it can expect to obtain from established rate plans and available demand. To be bookable, a rate must meet or exceed last room value. As demand fluctuates, so does the LRV to help ensure the hotel accepts only the most valuable demand across all arrival dates.

3. Dynamically Price Extended Stays

Hotels often lose long-stay reservations due to high demand on select nights, even when the business has high value to the hotel. Often that's because pricing is set individually for each night without considering the impact of longer stays on surrounding nights. Moreover, legacy pricing systems often limit the hotel's ability to price for extended stays.

An advanced RMS enables hotels to dynamically price extended stays independently of shorter stays. Pricing is established based on each reservation's total value across the stay. Other products such as advanced purchase and bed & breakfast packages can be linked to the base product, ensuring that long-stay guests receive discounts no matter which product they purchase.

By sacrificing some ADR, the hotel maximizes revenue performance on peak and shoulder nights and can compete more effectively with extended-stay hotels and private rentals. Longer stays also reduce room turnover, save operating costs, and ease the burden on housekeeping staff. The same principle can be applied to other products too – such as independently priced bed & breakfast packages or loyalty discounts.

4. Price for Profitability

At a time when growth in hotel profitability has stagnated, the need to rein in acquisition costs has become more urgent. To this end, new features in revenue management systems now enable hotels to factor net revenue into pricing decisions.

Hotels can view forecasts of ADR, RevPAR, and average acquisition costs by channel, as well as metrics that exclude channel costs like Net ADR and NetRevPAR. This provides a more complete picture of revenue, costs, and profitability for each channel. Changes can be tracked over time by channel, helping revenue managers make better decisions about which channels to prioritize and where to offer promotions. This results in better distribution decisions, lower acquisition costs, and increased profitability.

5. Optimize the Value of Groups

Group pricing has always been a challenge for hotels. Finding the ideal price that secures the group and satisfies the hotel's revenue needs without displacing more profitable business can seem like a guessing game. However, new pricing tools are taking the guesswork out of group proposals. Before submitting a bid, a hotel can determine the group's estimated total value and profitability, as well as the value of any potential business being displaced.

The revenue manager enters the proposed dates into the RMS, along with projected costs such as commissions and complimentary rooms and estimated ancillary revenue such as food & beverage and meetings & events. The system calculates displacement and provides recommended rates and break-even rates, as well as projected revenue and net profit. If the group is flexible, it can suggest alternative dates when profitability may be higher, and a lower room rate can be extended due to lower displacement.

6. Sell Virtual Room Types

A frequent challenge in inventory management is that available room types don't meet market demand. For example, a hotel might have high demand for king-bedded rooms from corporate travelers during weekdays, but on weekends the demographics change to families who want suites and connecting rooms. Paying for two separate rooms or a large suite may be cost-prohibitive for families, and the hotel loses needed business.

New RMS features provide more flexibility, allowing hotels to combine room types to create "virtual room types," also known as component pricing. For example, a connecting king room and double room can be combined to create a family suite on weekends. Virtual room types are also appealing to resort properties, where two or more villas can be combined into one large villa. The capability opens up new markets for hotels, drives more revenue, and helps them compete with private rentals.

7. Leverage the Potential of Artificial Intelligence

Today, advanced RMSs are powered by AI and machine learning, processing vast amounts of data to anticipate demand, optimize pricing and controls, and make pricing and revenue decisions more quickly and accurately than humans could ever dream of. Over time, the system gets even smarter, constantly learning and improving.

Advanced RMSs can also allow users to simulate their decisions before committing to them. For example, testing their intended pricing strategies before sending them out to selling systems, thus mitigating any risk of losing revenue and market share.

In the future, the role of AI in revenue technology will only grow, taking on an increasing number of tasks. This will free up revenue teams to undertake deeper analysis and conceive and implement commercial strategies that drive higher demand and profitability.

> *"As we grew our portfolio of extended-stay properties, we knew we would need an advanced, automated solution to enable us to maintain our centralised approach to revenue management without sacrificing efficiency or profitability."*
>
> **Michael Kowalzik** *Managing Director,* Brera Service Apartments

5 Steps to Transition to Demand-based Dynamic Pricing

Shifting to a demand-based dynamic pricing approach won't happen overnight; it will require careful planning and coordination across departments. Here are five key areas to focus on at the outset.

1. **Align the stakeholders:** Dynamic pricing isn't the exclusive concern of the revenue manager. It's a group effort that requires buy-in at all levels—including the revenue team, senior management, and ownership—and keeping an open mind to finding new ways to resolve long-standing challenges.
2. **Start small and experiment:** Rather than try to do everything at once, hoteliers should begin with small steps. For example, pricing dynamically for each room type and length of stay on high-demand dates and then moving on to products.
3. **Invest in a modern RMS:** Demand is too volatile and pricing is too complex to manage by spreadsheet or with a legacy RMS. Hoteliers must carefully vet providers to ensure they employ the data inputs and models required to support dynamic forecasting and pricing.
4. **Master the system:** This means committing to learning the RMS inside and out, taking advantage of features like What If analysis and analytical tools to guide decision-making and build consensus. When stakeholders understand how the RMS works and makes decisions, they will have more confidence in the system.
5. **Commit to learning:** Travel trends and technology are constantly evolving, and that requires a dynamic approach to learning and upskilling as well. This means taking advantage of learning opportunities provided at industry conferences, in webinars, in training programs, and in educational resources provided by technology partners.

Find Out More

To learn more about dynamic forecasting, check out these other ebooks from IDeaS:

- Dynamic Demand Forecasting: How to Use Real-world Data & Insights to Drive Better Hotel Revenue Performance
- Demand or Occupancy Forecast? The Hotelier's Guide to Forecasting for Commercial Strategy & Operational Planning

> *"By selecting a preferred RMS provider, we can now work strategically as a team. This system ensures our commercial teams are working together from the top down. This collaboration provides the insights we need to drive our profitability forward and has shown immediate and measurable results."*
>
> **Sam Keyte** *Corporate Director, Revenue Optimization,* Nobu Hotels

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