# Rate expectations:

## Is dynamic hotel pricing coming of age?

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# Hotel pricing models

**The traditional RFP process is lengthy, laborious and costly for buyers and hoteliers.**
And at first glance it looks like dynamic pricing is much simpler to process. But is it?

| Negotiated | | Dynamic |
|---|---|---|
| Once a year<br>Dependent on travel volume<br>Rate dependent on room type<br>Ancillaries can be negotiated<br>Requires multiple rounds of negotiations | **The RFP** | Unlimited / time frame negotiable<br>Rate based on occupancy at day of travel<br>Discount based on travel volume<br>Ancillaries non-negotiable<br>Discount based on ability to shift market share |
| Can be erroneous and needs to be spot checked | **Rates** | **Discount loading**:<br>• Simple if applied to the whole brand/chain<br>• Messy if some properties are opting out and/or it's unclear who participates and who doesn't |
| Easy to show savings between published and negotiated rate (especially if ancillaries are included) | **Traveler buy-in** | Difficult to explain why the same room has different prices on different dates |
| Inventory of room categories can change daily on hotel discretion<br>LRA should always be part of the negotiated agreement | **Availability** | Good availability as discount is applied to the BAR rates – usually across all categories |
| Historical data available<br>Audit easy as rate is known | **Data** | Very little transparency to date<br>Audit difficult as the BAR on the travel date needs to be known and could be different across distribution channels |

## Who should try dynamic pricing?

Companies with mature travel programs where there is visibility, knowledge of spend and consistent travel patterns.

## The Hybrid model

There are several hybrid models available. The most popular version is to negotiate in your top destinations—and use dynamic pricing for secondary cities.

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# Introduction

If you've ever purchased anything online from an airline seat to a washing machine, then you're familiar with the principle of dynamic pricing. It's simply the changing price of a commodity based on current market value.

In the travel industry, BAR (best available rate) is a hotel's dynamic price. Although BAR has happily co-existed for years with corporate negotiated rates, hotel companies are increasingly using it as the basis for a new method of calculation. In the dynamic hotel pricing model, a hotel buyer and a corporate buyer negotiate a discounted rate which the corporate buyer can then apply to BAR.

This new hotel pricing model is still evolving and we expect to see some changes as it develops.[1]

The objective for this paper is to evaluate this particular pricing model. However, a lack of transparency, consistency and data necessary to evaluate savings impede a straightforward analysis.

Experienced buyers will quickly notice the important differences between this method and that of airline dynamic pricing for corporate travel programs. In the latter, the corporate program's discount is based off a published fare so there is an ability to compare alternative prices and quantify savings.

New pricing models evolve constantly to meet changing business needs. The existing hotel RFP (request for proposal) process—which precedes the annual round of negotiations between buyers and hoteliers—is lengthy, laborious and costly for both parties.

Moreover, as much as the pressure is on travel buyers to contain costs, hotels are constantly trying to increase revenues. They are spending more time and energy on the dynamic pricing model as a viable alternative to those painstakingly negotiated set corporate rates.

## At a glance

| | |
|---|---|
| **RFP** | Request For Proposal: A (customizable) question catalogue corporates send to hotels they'd like to have in their preferred portfolio |
| **BAR** | Best Available Rate: The best non-negotiated rate available at the time of booking |
| **LRA** | Last Room Availability: Contract term that states that the preferred rate/room type is to be available until the hotel reaches capacity |
| **NET** | A negotiated non-commissionable rate used by corporations or groups |
| **ADR** | Average Daily Rate: Actual daily room revenue divide by the total number of rooms sold |
| **RevPAR** | Revenue Per Available Room: Daily revenue divided by the total number of available rooms; an indicator of hotel industry performance |
| **TRevPAR** | Total Revenue Per Available Room: Takes into account what the traveler spends on top of the room rate |
| **Room Night** | One hotel room occupied for one night |

BTN Handbook, [Industry Glossary]

[1] We interviewed travel managers, suppliers and our own subject matter experts in North America for this paper. Other countries, including those in EMEA and Asia Pacific, may use additional variations of dynamic pricing in their region.

# The background

A strategy for sourcing transient hotels is critical to the success of a global travel program. Although requirements vary by organization, the objective is consistent: to ensure that suitable rooms are identified and made available at a satisfactory rate for the company's travelers while maintaining full duty of care.

When global companies need transient hotels, in varying degrees and in many destinations, they create a hotel program. This includes preferred rates with a number of the global and regional hotel chains and individual properties.

These corporate negotiated rates are most commonly set through an RFP. Although in theory hotel RFPs can be done at any time, they are typically done in late summer. This ensures contracts are in place for the year starting on 1 January, typically for a 12-month period.

RFPs require an enormous amount of property detail to ensure that the hotel is appropriate at both the micro, traveler-level and the macro, company-level. They need to be suitable in price and in conforming to environmental or other duty-of-care standards which organizations might require of their supply chain.

Both travel managers and hoteliers find the process labor intensive for what is invariably only a 12-month price, but it does yield rates that are mutually acceptable. Those rates could either be with or without LRA (Last Room Availability), a guarantee that the rate negotiated for the category of room will be honored by the hotelier until a room of that grade is no longer available in the property. And those rates could either include or exclude certain amenities such as breakfast, in-room WiFi, parking, etc.

Recently, we've seen that room inventory at the grade negotiated has increasingly become unavailable at both non-LRA and LRA rates. The growth in demand which comes with a recovering economy no doubt plays a part. So too, does the increasing sophistication of hotel yield management systems and the relative lack of new capacity entering established markets in North America and Europe.

The need to ensure access to room inventory has prompted many buyers to explore the feasibility of the new hotel dynamic pricing model.

# Dynamic hotel pricing

## The basic mechanics

Hotels have arrived relatively late to the world of dynamic pricing in which hotel revenue management teams make use of complex algorithms to reflect fluctuations in external factors such as competitors' rates and current supply and demand to determine a market rate. Hotels are in very good company; many other service industries are beginning to appreciate what traditionally determines price—supply and demand—varies constantly and that in a modern, automated, web-connected world, prices can be altered regularly in line with changing market conditions. For example, airlines, sporting events, restaurants and theatres are all increasingly adjusting their prices to reflect different demand due to day of the week, time of the day or content of the program.

A hotel's revenue management team will construct BAR, the best available rate at the time of booking, and that rate may fluctuate a number of times a day. But this is where the common definition ends and where perhaps the first point of fuzziness appears.

Adjusting a best available rate should allow properties to maintain rate parity among all their distribution channels. However the publicly available BAR in the GDS could still be higher than what is quoted elsewhere. Or, the rate per night for a three-night stay could be less than the rate for a single stay. There are many variables that affect hotel pricing, one of which is publishing rates on a multitude of distribution channels. This is fundamental in identifying whether a buyer is getting the best rate and what savings could be achieved compared to the fixed rate.

The crux of the dynamic hotel pricing model is that each corporate travel program will be offered a discount or a band of discounts to apply off a chain, a brand, a group of properties or a single property.

But a lack of clarity around the level of discounts and where they're applicable is one reason why measuring savings is challenging for corporate buyers.

The level of discount awarded is thought to be dependent on room volumes and the ability to move market share. The theory is that BAR reflects supply and demand at the time of booking while the discount is determined by the relationship with the specific corporate, its volumes and its profile.

> The size of discount depends on many factors but 20-25% for high room night volumes and 15% or 10% for low volumes is not unusual.

Although in theory BAR takes into account all of the supplier-side market conditions, some, such as the category of the hotel, may also affect the level of discount.

## The variations

Everyone agrees that hotel dynamic pricing means that supplier and buyer move from an agreed 12-month corporate rate code per room category per property to a corporate negotiated discount(s) which can be applied to BAR at time of booking. Hotels may offer travel buyers the same discount across all the brands within a hotel group and all properties. But that is rare and there are a number of variations in the market.

Large hotel groups are likely to have properties with very high occupancy rates in high demand locations and properties that need more guests in other destinations. A single discount rate can seem crude, but it is important to bear in mind that BAR will already reflect the local market conditions. Another idea would be to negotiate corporate rates for high demand cities such as New York, London and Hong Kong and use dynamic hotel pricing elsewhere.

Different brands within the same hotel group may also offer varying discounts as dynamic programs tend to be tiered by service level. Lower service brands normally offer lower levels of discounts than full service hotels.

Some corporates might negotiate corporate negotiated fixed rates with their top 20 or top 50 properties and use the dynamic rate for properties which are used less frequently.

A corporate rate is almost always contracted for 12 months. There is no reason why the discounts awarded under the dynamic model can't be set for a longer period, as long as the corporate travel volume doesn't change significantly. The BAR will reflect changes in the market and will typically apply only to the negotiated room grade, e.g. the standard room. Amenities are an important element of corporate negotiated rates as the RFP may be issued on a room-only basis but the final agreed rate may include a chargeable extra such as in-room WiFi, breakfast or parking. In the dynamic model, amenities must be negotiated separately.

It is also important to note that a group or chain-wide deal might not include every property. In some chains, properties  opt in to a program, rather than opt out. If only a small number of the brand's worldwide properties opt in, the value of a dynamic program is limited.

> More transparent and comparable data, such as the comparable savings between a discounted rate and the negotiated fixed rate or the average price difference between a negotiated rate and BAR, are needed to aid booker decision-making.

## Relative values

Many industry experts believe that achieving savings by leveraging suppliers is now limited among mature travel programs so it makes sense for travel buyers to look for savings in other ways.

Both buyers and hoteliers find the RFP process onerous. Now, discounts tend to have more longevity than corporate rates so the process should be less frequent and thus save time and money in the management process for both sides.

Many corporate buyers maintain that negotiated rates only have value with LRA. It is important not to confuse LRA with availability. LRA means that the property will uphold the agreed corporate rate only if that category of room is available.

Buyers with LRA might very well find that when making a booking request, there is no longer availability for the standard room at the negotiated rate but there might be for a junior suite at another price. This used to happen with late bookings in popular cities but hotels' increasingly sophisticated yield management systems are now closing out some inventory in favor of certain clients (e.g. those that have booked longer stays) or for popular midweek, high-rate times.

This practice does not violate a corporate agreement. There is nothing to prevent 80% of a property's rooms being graded as standard on a Friday, Saturday and Sunday but only 20% be categorized as such on a Tuesday or Wednesday. Grades of rooms can also be closed out at a certain price point.

> With no availability in the room category for which the corporate rate has been negotiated, buyers are forced to book either another grade of room or another property.

Everyone understands that there will be times when the rate is sold out but everyone also has the proverbial tipping point. If the rate is frequently unavailable, it is time to review the model.

While most travel programs focus on cost savings, others put availability at specific properties as a priority.

Therefore, dynamic pricing is especially attractive to organizations with high room volumes in high demand markets where pressure on capacity usually results in that unappealing combination of high corporate negotiated rates and limited availability.

With corporate negotiated rates, the travel manager can set an accommodation budget. Discounts off fluctuating rates may deliver savings, but measuring them is difficult. One method might be to compare the average rate paid in one month to that in the same in the previous year. Predicting the annual spend to set a budget is challenging because the next year's trajectory of BAR is unknown. Forecasting can help, but unanticipated blips from tsunamis to political terrorism, from avian flu to political unrest, can all push down demand—and rates. And sometimes unexpected events can move prices upwards more than expected.

Corporates need to work out an effective method of communicating the mechanics and benefits of the dynamic hotel pricing model to travelers.

## The travelers

Change and uncertainty are disruptive to travelers. They must be assured that quality hotels at a reasonable rate will be available in the dynamic pricing model.

Travelers are increasingly using online sites to research flights and hotels, so a negotiated rate is likely to look cheaper in a way that a discount off the public rate might not. Corporate travel departments need to make the savings derived from a dynamic pricing agreement visible to all their stakeholders, both senior management and travelers. Otherwise travelers might think they are paying much more than before.

Communication of the benefits will maximize compliance. Explain the new process to travelers so that they understand that discounts will be applied to any of their bookings made via any approved booking channel as long as the traveler is identified as being a company traveler.

# Beyond the room rate

Hotels need to maximize their revenues per square foot but their revenues are not just from their room rates.

Hotels typically measure themselves by three KPIs: ADR (Average Daily Rate), occupancy and RevPAR (Revenue per Available Room). Success in office, corporate office and bonus terms depends on these metrics which dynamic pricing can facilitate.

A new measure has tripped into the hoteliers' lexicon: TRevPAR or total revenue per available room. Travel buyers are increasingly looking at total cost and hotels are increasingly focused on TRevPAR, making the traveler profile important.

**The client profile**

Hoteliers openly concede that some business travelers are more attractive for their business than others. As one Continental hotelier explained, "Brits are a good clientele to have because they like to entertain and spend a bit of money. A four-night American stay is great because they spend on things like business usage and cleaning."

The longer the average guest stays, the more likely a hotelier is to incentivize the client for its business because the probability that the traveler will spend on other hotel services increases.  Buyers should consider negotiating on additional amenities that are popular with their travelers.

"There is an appetite for change but it has to be a model which allows both parties to feel that they're achieving their ultimate goals."

**Marian G McLain**, Vice President, Global Sales – Intermediaries, Marriott International

# Conclusion

### Refining the model

Travel buyers are often frustrated that they cannot make use of corporate negotiated rates because of inadequate room inventory. In addition, suppliers and buyers both find the existing RFP process very time-consuming and expensive.  They're both seeking a simpler, viable alternative.

Metrics are the biggest stumbling block to more widespread acceptance of the hotels' dynamic pricing model. A fluctuating rate makes it difficult to budget, and quantify savings.

The reason for this is the lack of visibility of a corporate negotiated rate for a property with which the buyer has undertaken a dynamic pricing agreement. As corporates now regularly use best price on the day as well as corporate rates for airline tickets, many understandably see the inability to have this shopping facility to compare before purchase as an impediment.

The solution could very well be located in the booking system technology, which will need to change soon. In the interim, buyers need to find metrics that give them the confidence to adopt dynamic pricing and communicate the benefits to their stakeholders.

Some of these might include more specific information about rate availability, an ability to compare—and choose between—a corporate rate and the dynamic discount, and industry standard BAR forecasting. It is crucial that buyers have the ability to review historical BAR.

Corporate negotiated rates allow buyers both to demonstrate savings internally and be more confident about meeting budget. This drawback to the dynamic model could be rectified if more accurate and widely accepted BAR forecasts were available.

Another factor which affects meeting budget expectations is greater than expected swings in BAR. In the existing model, the discount may be guaranteed but 20% off US$180 per room night yields quite a different number from 20% off US$300 per room night. The higher the BAR, the more you are paying. The hotel may be preferred at 20% off $180 but non-preferred if it is 20% off $300. This drawback could be fixed with a ceiling rate as a safety net in the event of much larger than expected rate swings were introduced.

"To design and implement a sustainable and scalable dynamic or hybrid hotel pricing program, you must extend the same transparency and trust to your preferred partner as you would expect from them."

**Steve Sitto,** Sr. Manager, Global Travel, Genentech, Inc., a Member of the Roche Group

A number of the factors that affect room rates, such as how far out the booking is made in relation to the stay, are accounted for in the movement of BAR. But others, such as the level of incremental spend, are not easily assessed by a formula that includes room night volume but ignores length of stay or purpose of trip.

There is also the thorny issue of the effects of fluctuations in BAR. Lower than expected volume can push BAR down. What happens if the person books in advance and the hotel then has a lower BAR at time of check-in?

Without doubt a number of hotel companies are embracing dynamic pricing. Some believe such methodology is preferable to corporate negotiated rates. This in itself does not mean that it is to the disadvantage of buyers. It does, however, mean that buyers need to arm themselves with as much information as possible about methodology and the model's potential benefits and drawbacks in order to make a decision that best matches their organization's corporate culture and strategy.

## Dynamic hotel pricing model: Buyer's checklist

- ✓ Establish how many and which of the group's properties the contract includes
- ✓ Ask to see the BAR rates for the previous year
- ✓ Review the risk of BAR increase in key markets
- ✓ Establish the average number of rooms available for your chosen category on the nights you are most likely to book rather than as an annual average
- ✓ In the early stages hold regular reviews with your suppliers and check the achieved price vs. your past ADR (average daily rate)
- ✓ Audit room availability and ADR

# For more information

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## About Advito

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