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The case for Dynamic Pricing

In a nutshell, dynamic pricing refers to pricing on demand, based on customer value and demand for hotel room inventory. Hitherto utilized static pricing models are now passé, and dynamic pricing is fast-becoming the norm. This is because pricing can not be done in a vacuum. All factors affecting a hotel company are dynamic. This ranges from room offerings to competition and customer perceptions of value, which is key—hotel companies must continually innovate to create more value in the eyes of customers, while becoming more efficient. They also need to price right to ensure no potential profit is left on the table. These two activities will help ensure demand for a hotel's rooms.

Other dynamic factors include competition, distribution channels and market requirements. Hotel competitors are also innovating, moving forward with different products and messages, and targeting different market segments. Distribution channels are being optimized to address the needs (and price points) of different guest segments. Market requirements change dynamically and often. In light of this, hotel companies need to establish means to price their guestrooms dynamically, on an as needed basis, at any given time, and in tandem with what their guests value most.

Why is Dynamic Pricing Important?

Consider for a moment that for any hotel company, its inventory is sold at certain price points, and, further, that the number of guests paying different price points follow a normal distribution curve as shown in figure 1.

With the preset price points, all

the white space under the normal distribution curve for the guest-price mix is LOST opportunity to maximize revenue (number of guests X price points). This is where dynamic pricing can be directly applied – by allowing an almost infinite number of price points (coupled with the corresponding number of guests), the white space under the normal distribution curve is greatly minimized, thereby reducing the lost opportunity, and consequently leading to maximized revenue, as shown in figure 2.

What Is Required for Dynamic Pricing?

Certainly a demand forecasting and pricing system is a prerequisite for any sophisticated dynamic pricing solution. Forecasting a year ahead is not an easy task, particularly when you think of a hotel chain with many hotels,

several thousand rooms, various categories, room types and features, varying lengths of stay, and differing market segments. To price right, hotel companies need to also have a deep understanding of the value of their offerings to the end consumer and use technology to price their offerings accordingly.

However, as happens with any major solution, technology is only one component of the holistic approach that needs to be undertaken. Any solution that is purely technology-based misses other important factors in this dynamic equation, namely people, processes and culture.

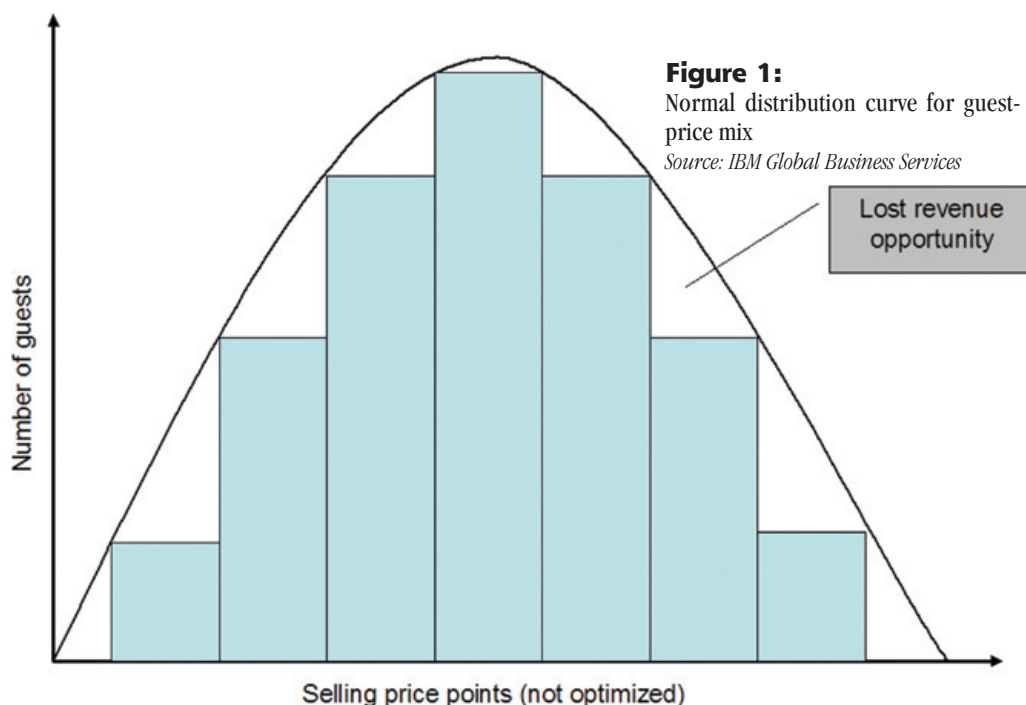
Successful implementation of a dynamic pricing solution requires keen interest and attention to the hotel company's organizational needs. Skilled knowledge workers need to be selected or trained to do the job correctly. Appropriate performance measurement and

reward systems need to be put in place. Processes need to be designed to suit an agile pricing organization. Once the system recommends prices, the organizational infrastructure needs to make the task of implementing and executing new prices smooth and quick. After all, in a dynamic environment, time is of essence.

Finally, an important part of this equation is the culture of the organization which should be based on collaboration, optimizing revenues and profits, and rewarding performance.

The Value Proposition

One may justifiably ask a valid question to ascertain the value proposition for dynamic pricing to support the hospitality industry. The answer is quite simply – the industry has the propensity to close the revenue opportunity gap and generate even greater profits. Consider the graphic that depicts a traditional revenue opportunity frustum. Revenue man-



agers designed the science of revenue management to overcome the problem of revenue left on the table. This was the age of revenue management. Dynamic

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pricing can be used in dynamic packaging situations to maximize the capture of revenue opportunity by factoring guest loyalty, profitability and lifetime value into the optimization equation, and doing so across all revenue generating functions of the hotel, thereby providing hospitality companies with the ability to take maximum advantage of the revenue opportunity (state C).

How Does Dynamic Pricing Allow Capture of Additional Share?

Why does dynamic pricing permit the capture of additional share of wallet and consequently, greater profit and ROI? It is recommend that hospitality companies provide personalized services and marketing campaigns aimed at enticing guests to return, and further, hospitality companies force a paradigm shift in thinking beyond room revenue as the sole pathway to enhanced profitability.

By implementing such a strategy, hospitality companies should be able to generate incremental revenue that makes the difference between average and outstanding performance. The benefits are:

- Increased overall occupancy and RevPAR through the enticement of individual guests with personalized marketing offers and packages designed around their preferences, further increasing loyalty and their contribution to the bottom line.
- Increased non-room revenue generated by specifically targeting, attracting and enticing a higher percentage of guests known to have a propensity for ancillary spend on property.
- Targeted marketing to guests across all touch points, with the objective of increasing their overall spend on-property, to the extent possible, instead of permitting revenue leakage to off-site suppliers.
- Increased utilization of hotel rooms and other on-property perishable inventory assets by leveraging real-time yield management capable of truly maximizing usage of underutilized components by targeting specific offers using underutilized components as loss-

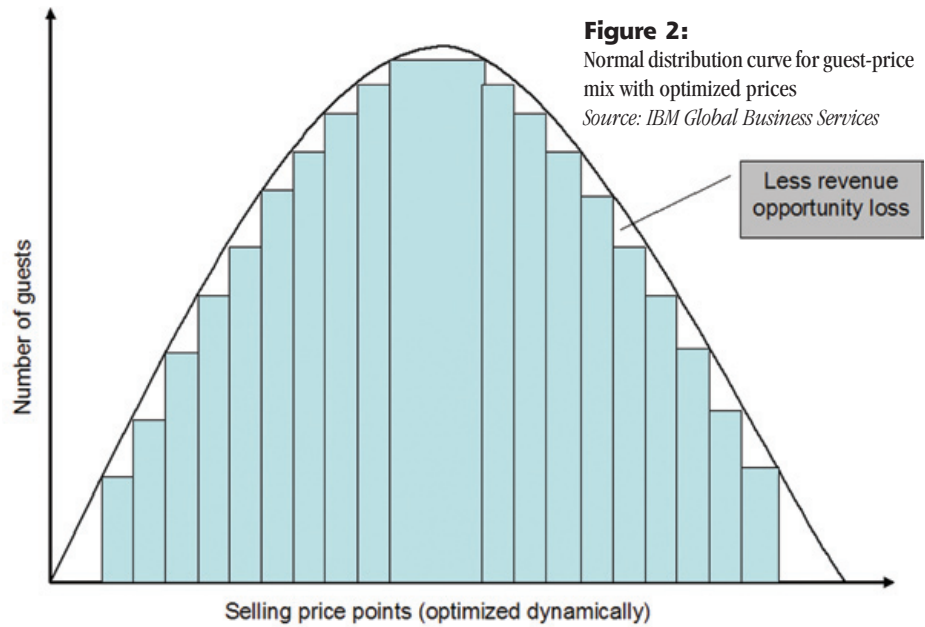


Figure 2:
Normal distribution curve for guest-price mix with optimized prices
Source: IBM Global Business Services

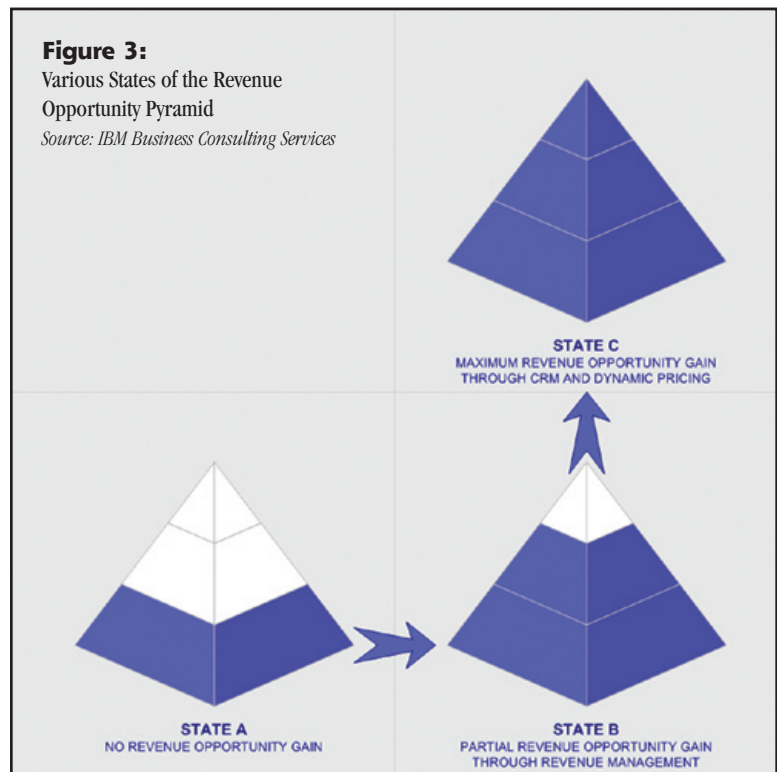


Figure 3:
Various States of the Revenue Opportunity Pyramid
Source: IBM Business Consulting Services

leaders designed to attract specific guests known to spend heavily on them.

Dynamic pricing truly is a boon. It benefits hotels by helping utilize perishable inventory, it benefits guests by creating offerings at attractive price points, and ultimately benefits shareholders and stakeholders by positively impacting the bottom line.

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