By Tim Coleman

Good fences Make Good Neighbors, and Great Hotel Rates

A 17th century adage reads that good fences make good neighbors. Although Robert Frost questions this logic in his poem, "Mending Walls," it is undoubtedly good advice in the world of hotel business when rephrased to read good fences make good hotel rates. What exactly do we mean by this? Fences keep people and animals where they should be and out of places we do not want them to go. For example, when this saying was popular, fences were meant to keep your neighbor's horses out of your barley patch. Similarly, when we discount our hotel rates, we want to attract new customers that would not typically pay our standard rate. However, if we can help it, we do not want to offer these discount rates to people who would have been perfectly willing to pay our normal, higher rate.

An example with some simple math will show how important this is: Let's say your tidy 100-room hotel is steadily bringing in 70 percent occupancy at an ADR of $100, so you earn $7,000 in revenue per day. One day, your new, optimistic leisure sales manager, Sally Occupy, pops in your office and says our rate is too high, we could get a lot more business if we charged $69 like everyone else does, and we would fill all our rooms. Sure enough, you acquiesce and lower your rate to $69, and, lo and behold, you soon run at full occupancy, for total daily revenue of $6,900. Sally feels great and wants to throw a party because all your rooms are now full. Unfortunately, you have higher room cleaning costs from 30 more occupied rooms and $100 less in revenue every day, so you cannot afford a party. Sally either needs to learn about simple forecasting for ADR and occupancy, or better yet, take a course in fencing all discount rates.

Sally's big error is that she didn't count on all the current customers also getting her $69 rate. So, how can she keep this from happening? She simply needs to put fences around these rates to keep current customers away from them. These fences are not made out of rocks, wooden pickets or metal mesh; rather they are composed of the terms and conditions that we put on our discount rates that make most of our current customers averse to, or even ineligible for them. For example, if all of Sally's current guests were under 50 years old, and she provided the $69 rate only for senior citizens, she could count on none of the old customers paying less and only new customers getting the $69 rate.

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Fencing her discount rates will provide an entirely different financial picture for Sally's hotel. She will keep getting her daily revenue of $7,000 from her current guests, and pick up an additional $69 from 30 extra senior citizen guests for $2,070 in incremental revenue each day, more than enough to pay for a party. Of course, this assumes that there are enough senior citizens in the market to take the deal.

The keys to success in setting up these fences are creative thinking and leveraging your knowledge of current guest behaviors and the number of available guests that you can target from competitors. The most famous example of excellent fencing comes from the airline world. Back in the 70s, airlines were regulated and could not offer a discount rate unless they provided a justification that the rate would generate new revenues more than they diluted current revenues. That's where I got my graduate education in rate fences.

At the time, most airlines knew from their research that personal travel was more price elastic than business travel. This was true primarily because business travel was paid for by the employer, not the individual traveler. This meant that, on a relative basis, lowering the price would result in no increase of price-inelastic business travel, but a substantial increase in price-elastic personal travel. They also knew that, by and large, most business travelers flew on business days of the week, but wanted to be home on Friday. Conversely, most personal travelers wanted to go away for a long weekend. The solution was to offer a highly discounted rate, such as 40 percent off, for round-trip air travel that stayed away from the origin city over a Saturday night. American Airlines was the first company to launch this fenced fare called Super Saver, and it worked like magic for several decades as all airlines matched it.

This fare was attractive to the personal traveler but a total turnoff to the business traveler who wanted to be home with the family for the weekend soccer and tee ball games. The theory was that no matter how deep the discount, business travelers would not use this rate. Therefore, the level of the discount could be set at the rate that would result in the highest total new revenue from the personal travelers who use the new rate.

The better you are at fence building, the more effective your rate discounts will be at generating, rather than diluting, revenue for your hotel. The trick is to come up with appropriate fences for each promotional rate at your property to avoid revenue dilution (guests buying a room for $69 when they would have paid $100). Below is a useful check list for thinking up creative rate fences.

1 Geographic fences. If all your current business is from the United States, then look at foreign markets for incremental business. Perhaps you can contact a European or Asian wholesaler and offer an attractive rate for their business. It will be new business for your property so you can offer a low rate without diluting your current revenue stream. The key to success of this tactic is to ensure that this wholesaler does not permit purchases from the United States.

2 Time-of-purchase fences. If you know that all of your current customers book within two weeks of arrival, you might try to institute an advance purchase fence where you offer lower fares only to customers willing to purchase 21 days in advance. This fence is a little less foolproof so you need to watch out for current customers just changing their purchase behavior to book earlier. Also, you need to be careful to avoid revenue loss from taking too many of these incremental customers, because they may start taking rooms that you could sell later to your regular $100 customers. This is called revenue diversion, when you manage to fill rooms with low-rated business and block higher rated buyers.

3 Distribution channel fences. This is very problematic these days because most hotels practice rate parity to participate in the OTA channels. However, if you want to challenge this paradigm because you happen to get so few rooms from OTAs, you could strike a deal with an OTA that does not currently provide any traffic to your property in exchange for exclusivity. This fence also is perilous for the same reasons cited for the time-of-purchase fences.

4 Opaque channel fences. Hotwire®, Priceline™ and wholesaler package rates are my favorite fences because in an opaque channel, the customer does not know the identity of the hotel until after they make the purchase, and in the package channel, they do not know the rate. The advantage of this type of fencing is that probably none of your current loyal guests will be willing to make this trade-off. The other side of this same coin is that few, if any, of these guests are likely to be loyal to your brand going forward. If you use this strategy, I recommend a comprehensive program to get these guests into your database and loyalty programs. You might even provide them a point incentive for joining your program. Or, if they are already a member of your frequent guest program, you certainly do not want to reward them for an opaque stay, but you could offer them the opportunity to earn these points back if they stay again in say, the next six months.

5 Product fences. If you have some rooms that no guests like to stay in, like a low-rise building or a back lot view in a beach hotel, then you can offer a low rate for customers willing to take one of those rooms. Make sure there are plenty of pictures to keep your higher priced customers from being attracted to these rooms. This strategy can also be dangerous if not properly promoted and disclosed, but is especially effective in conjunction with an up-sell program.

Armed with this checklist and your own creative imagination, you should see increasing revenues shortly. And if you are using good practices, you can avoid some major pitfalls. Hopefully, your good fences will make good neighbors even in today's hotel marketplace.

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