Dynamic Hotel Pricing: Signs of a Trend?

How does dynamic hotel pricing work? Why are dynamic rate agreements controversial among travel buyers? Are they likely to become commonplace within travel programs?

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In January this year, *CWT Vision* noted that dynamic hotel pricing would be a key trend for travel management over the next few years, based on a survey of suppliers and global clients. Yet there have been few signs of a shift toward dynamic rate agreements—the majority of corporate buyers prefer to negotiate flat rates wherever possible. Is this likely to change?

Dynamic vs. flat rates

Dynamic pricing was first introduced in the early 2000's by hotel groups such as Marriott, Hilton Hotels Corporation and InterContinental Hotels Group, primarily in the United States and some European countries. It has since grown among chains in other regions.

Hotels that use dynamic pricing replace their static rack rate by a best available rate (BAR) that fluctuates with supply and demand. Corporate customers can negotiate a fixed discount off the BAR if they have sufficient room-night volume, signing a contract with a single property or a chain. Alternatively, they can continue to negotiate a fixed rate, which most hotels still offer.

The right room at the right time at the right price?

Hotels have been keen to promote dynamic pricing agreements as a more customer-oriented alternative to negotiated flat rates. They argue several benefits:

- Dynamic rate agreements consistently provide a discount on the public BAR and may be lower than negotiated flat rates on any given day.

- Discounts apply year round on all room types, unlike flat-rate agreements which are typically negotiated on standard rooms only and have "blackout" periods during peak demand.
- The time-consuming request for proposal process is streamlined and thus drives savings.
- Rate loading into global distribution systems (GDSs) is simplified and more accurate.

Despite these arguments, most travel buyers continue to prefer flat-rate contracts when they can leverage significant volumes with individual properties. Some CWT clients have signed chain-wide dynamic pricing agreements, particularly in the United States, but in most cases they account for only a small portion of their hotel program.

Overall resistance to dynamic pricing agreements stems from the fact that **hotels have been slow to provide concrete evidence of fair or added value**. In other words, companies are not given the hard data they need to evaluate dynamic pricing proposals and compare them with negotiated rates. Nor can they effectively compare proposals from the various hotels competing for their business. For travel managers considering a dynamic hotel agreement, two issues are worth noting:

- **Hotel revenue management techniques.** Although dynamic room pricing is said to mimic the sophisticated revenue management techniques used by airlines, it is by no means identical. Both hotel and airline revenue management analyze market demand and supply, predict customer behavior and allocate limited resources to specific types of customers. Where they differ is in the quality of the data and the methods used to calculate fair market rates. While the majority of airfares are available on GDSs, hotel inventory remains highly fragmented. This said, weekly reports such as those provided by Hotelligence and Smith Travel Research provide hotels with historical data such as occupancy rates and average daily rates for their city. Few hotels, however, have access to the kind of revenue management technology employed in air pricing, as the investment is often too high for properties that function as individual cost centers.
- **Spend management and savings metrics.** Because rates change frequently—sometimes hourly—and tend to be applied at the precise time of booking, companies have trouble knowing the price travelers should be paying, how much hotel spend should be budgeted and how much will be saved through a dynamic pricing agreement. For the same reason, rate auditing becomes a challenge and there is no guarantee that the correct negotiated discount is being proposed to travelers. Companies that have tested dynamic pricing agreements report soft-dollar benefits in terms of a simplified request for proposal and negotiation process. But these alone are insufficient to convince most travel managers to convert from flat-rate negotiations that bring measurable savings.

Buyers beware

CWT advises clients to continue approaching dynamic pricing with caution and offers the following advice:

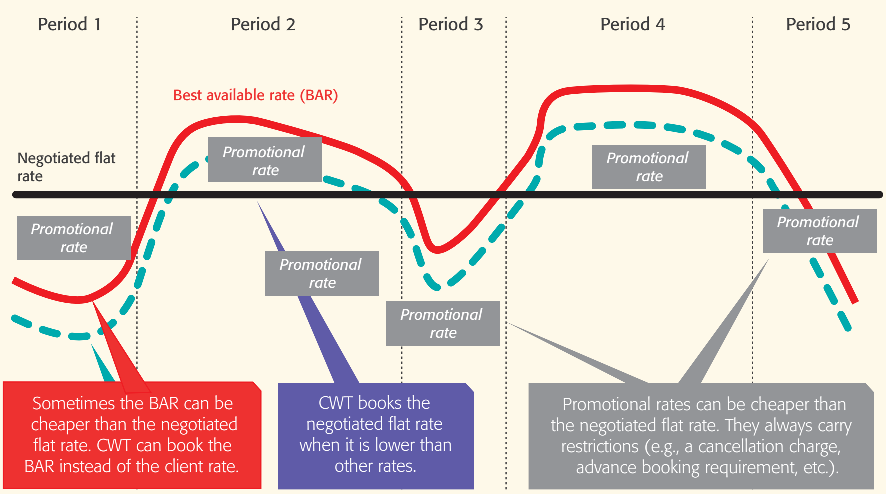
- **Continue to negotiate flat rates wherever possible**. This sets a ceiling price regardless of market conditions. Furthermore, companies with flat-rate contracts remain free to use other rates if they are lower at any given time. These include the dynamic BAR, the dynamic consortia rate available through CWT and promotional rates.
- **If a dynamic pricing proposal is on the table, seek hard evidence of savings and other benefits**. To reduce uncertainty, some companies establish a rate cap and/or a limit on the frequency of rate changes in a given time period. As with all hotel agreements, negotiations can include amenities such as breakfast, Internet access, airport transfers and parking, as well as minimum/maximum stay requirements during peak periods.
- **If a chain-wide agreement is signed, provide clear guidelines to travelers on when to use the chain vs. other preferred properties.** There is a tendency for travelers to favor a chain for all trips, especially when loyalty points are offered, and this can dilute the benefits of the overall hotel program—in some destinations, the chain property is in fact a secondary alternative, not the primary preferred property.
- **In all cases, ask suppliers for detailed reporting** during the life of a contract and track market conditions closely. Always use year-earlier pricing patterns as a data platform on which to negotiate new terms.

Some more tips

- **Optimize travel policy and traveler compliance** with a clear mandate regarding the use of preferred booking channels (i.e., the travel management company or the corporate online booking tool). This ensures that travelers have access to the lowest rate—be it the negotiated flat rate, the consortia rate, the BAR or promotional rates—at the time of booking. According to in-depth research conducted by the CWT Travel Management Institute, *Playing by the Rules: Optimizing Travel Policy and Compliance,* rates obtained by CWT are on average 20 percent lower than those obtained directly from hotels or through Web booking sites.
- **Remember that long-term relationships are best for hotels.** The hotel business is cyclical and supply will eventually catch up with demand. Hotels need loyal clients to help them through less lucrative times. Travel buyers can leverage this fact of life to negotiate more favorable terms.

Dynamic vs. static rates

In a dynamic pricing environment, a flat-rate agreement sets a ceiling price regardless of market conditions. Clients remain free to choose other rates if they are lower at any given time.



Source: CWT Travel Management Institute

A change in sight?

In a survey published last year[1], 90 percent of hoteliers said they believed dynamic pricing is here to stay while 65 percent of buyers stated the practice will never gain traction.

In the current buyers' markets, where supply is greater than demand and likely to stay that way for the next 18 months, hotels are struggling to promote dynamic agreements as a viable alternative to negotiated flat rates. If dynamic agreements are to gain acceptance, the hotel industry must demonstrate more clearly the value they can bring.

Nevertheless, the trend is likely to swing toward mainly sellers' markets, where demand outstrips supply. Then hotels will have more leverage to promote dynamic pricing as their preferred way of doing business with companies. Change, as they say, may be inevitable. n

[1] *Dynamic Pricing Friend or Foe?* Bte tourism and consulting, Buckheister Management USA Inc., 2007.