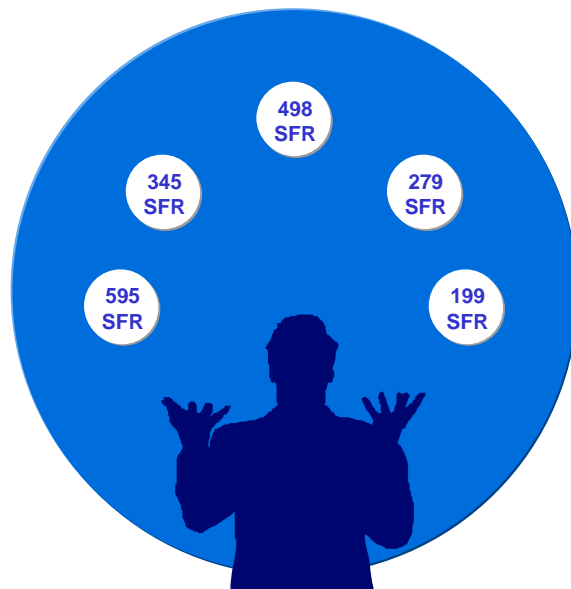

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Pricing in the Swiss Hotel Industry

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Above all other profit drivers, price is clearly the most important – particularly in the service and tourism industry. A “flight from A to B”, like an overnight stay at a hotel, is a service offer that disappears if not used. Unused capacity simply cannot be stored. If the price is too high, then the service is not sold – which means that the contribution margin for this capacity is zero. The cost structure for services is the cause of the problem. Nearly all costs are fixed and incur whether the service is used (and sold) or not. In the service industry, revenue maximization often results in profit maximization. If each customer has a different willingness-to-pay, maximum revenue will still not be achieved by pursuing high capacity utilization with low prices. Because reality has shown that this is a common situation, the challenge is to ask each customer for the maximum price she/he is willing to pay for a specific product. **The important thing to do: make an offer to the right customer at the right time with the right price!**

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Knowing how critical pricing is for a company’s profit situation, you would expect that pricing is given a particularly high priority in the hotel industry. Simon, Kucher & Partners, together with the Ecole Hôtelière de Lausanne, has reviewed how Swiss hoteliers handle pricing management. The results of this study can be applied to other countries with similar management structures, although Switzerland – the birth place of the hotel industry – may possess some additional special attributes.

Design of the study

The study sample included hotels from holiday regions and hotels located in larger cities; all hotels belong to the 3- to 5-star category. The 40 hotels in the sample are situated in the holiday regions of Interlaken, St. Moritz, Flims-Laax and Davos and the cities of Bern, Genf, Zurich and Basel. 62% were 4- or 5-star hotels, the rest came from the 3-star segment.

One-third of the hotels in the sample have no more than 50 rooms, 60% have more than 100 rooms, and three hotels have more than 100 rooms. The customer structure of these hotels is comprised of individual leisure travelers (40%), business customers or group travelers (30%), and regular customers who stay at special rates (30%).

In most cases, the respondents from the hotels were from the upper management level (owners, directors, chief executives (78%)). 22% of the respondents came from the next management level (assistant to director, sales and marketing manager, etc.).

The biggest challenge facing Swiss hoteliers: price setting. In other words, making an offer to the right customer at the right time with the right price.

Biggest challenge: setting the prices right

The biggest challenge in pricing is setting the prices right. When asked about the biggest challenge in pricing (an open question), over 31% of the responding managers stated price setting. The topic of “price pressure from competition” was also named as a challenge and other topics were mentioned much less frequently.

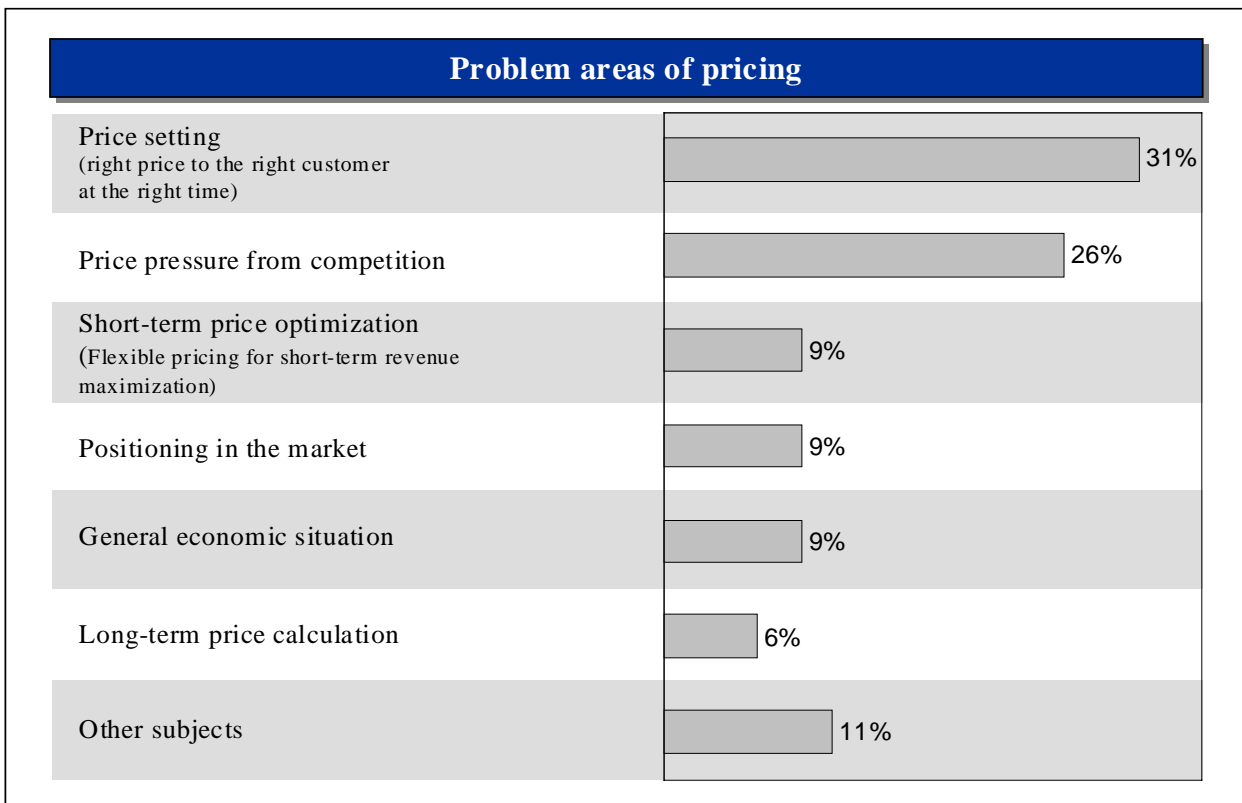


Figure 1: Challenges in Pricing

Setting prices correctly involves addressing three directly related topics:

- Price differentiation according to customer segments (business travelers, leisure travelers, etc.),
- price differentiation according to seasons and, therefore,
- identifying the price which maximizes revenue in a particular situation.

These findings are not too surprising, because the prices for rooms do have a direct impact on the ability to reach the set profit goals. Successful pricing in the hotel industry is dependent on a variety of complex factors, such as utilization, the competitive situation, the competitive advantage of a certain hotel, etc.

Framework of pricing: the strategic triangle

The criteria used by hoteliers for pricing was also analyzed in the study. The customer's willingness-to-pay, ranked just above costs, is the most important criterion for setting prices. The competitive situation was listed as the third most important criterion. These three criteria can be found in the so-called "strategic triangle", as shown in figure 2.

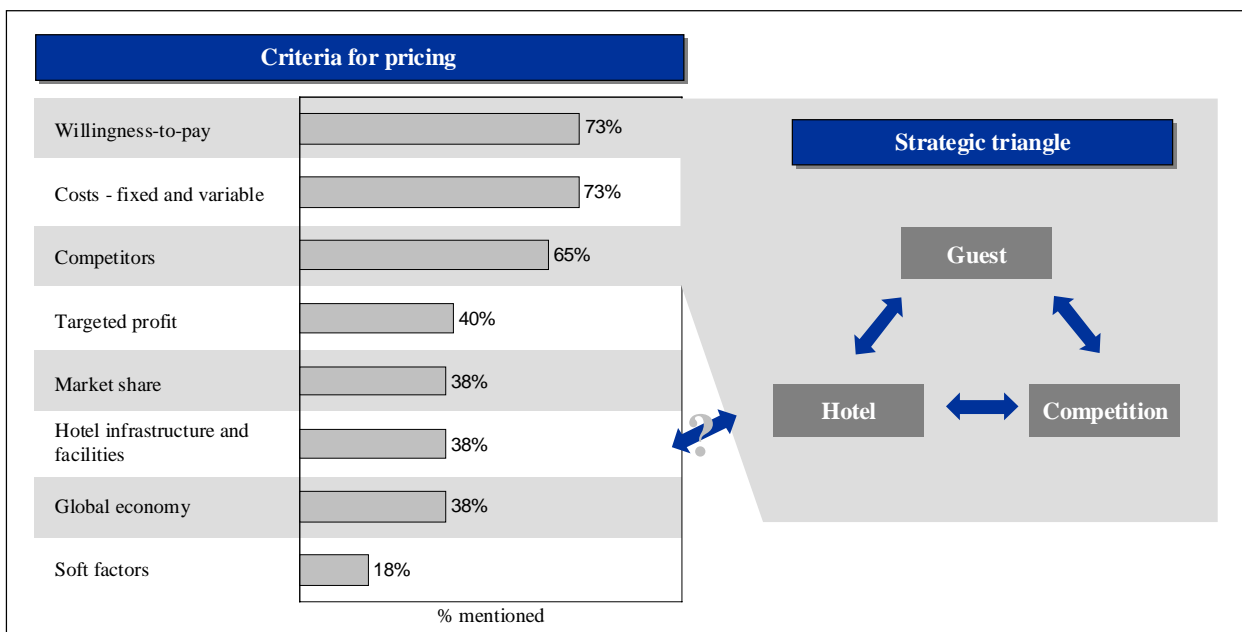


Figure 2: Criteria for setting a price

Price differentiation could become more important in price setting.

This data reveals that the most important factors for setting prices correctly are used by Swiss hoteliers. A potential guest's willingness-to-pay, which is clearly influenced by the competition's offers, is mentioned in the first place. It is rather surprising how frequently costs are mentioned. Considering the cost structure and the hotel's high share of fixed costs, the relatively low variable costs should only play a minor role when setting prices (they should be used as a minimum price).

Only one-third of the hoteliers use systematic market analyses.

The hotel's infrastructure and facilities – the factors seen and evaluated by the customers and on which they base their willingness-to-pay – are essential criteria for one-third of the interviewed managers. Even though these factors have an influence on the willingness-to-pay, a stronger differentiation of the services offered should have a larger impact when setting prices.

Based on these results, the market orientation of the hoteliers is explored further in the following sections.

Most important for setting prices: internal data

More than one-third of all hotel managers surveyed do not use any data or analytical tools for setting prices. This is an astonishing result, as willingness-to-pay, costs and competition were rated as being important. The question remains then: how successful can pricing be if it is not based on solid quantitative analysis? Nearly two-thirds of the managers said they use data and analysis results to support their price setting. Considering the topics discussed in the previous sections, it is only logical that the respondents primarily use internal data in the price setting process. The data used most in this process are historical occupancy rates, revenue development and cost/profit targets. Following far behind, competition and market analysis are systematically used by only one-third of the hoteliers (see figure 3).

It is interesting to note that data like the willingness-to-pay of customer segments at different points of time is not available at all. Ueli Prager, Swiss restaurateur and founder and chairman of Mövenpick, sees this differently: "I myself was never impressed by being a host, but rather by having guests." It seems as if "cost-plus" and

The hotel managers still do not see the customer's perspective and therefore their usage of the best instruments is limited.

"watching the competitors" is the most frequently applied method for setting prices. Gut feeling, not quantitative analysis, is the most influential factor. Why are prices the biggest challenge in this industry? Perhaps because the hotel managers still do not see the customer perspective and therefore their usage of the best quantifying instruments is limited.

Furthermore, these findings reveal a certain reactivity. The market is perceived as a given fact, price adjustments are used only to sustain current occupancy levels. Instead of actively marketing their own product, showing its uniqueness and creating a competitive advantage, hotel managers only observe the competitors' prices. The result is obvious: market forces are accepted as insurmountable, which leads to dwindling yields and continuous price pressure.

In this situation we need to identify possible areas where prices can be increased. With the help of an unerring analysis of both internal data and external market research, the willingness-to-pay can be determined. Taking the competitive market into account, pricing can be optimized to exploit profit potentials without endangering existing occupancy levels. The customers who are willing to pay more than others have to be identified.

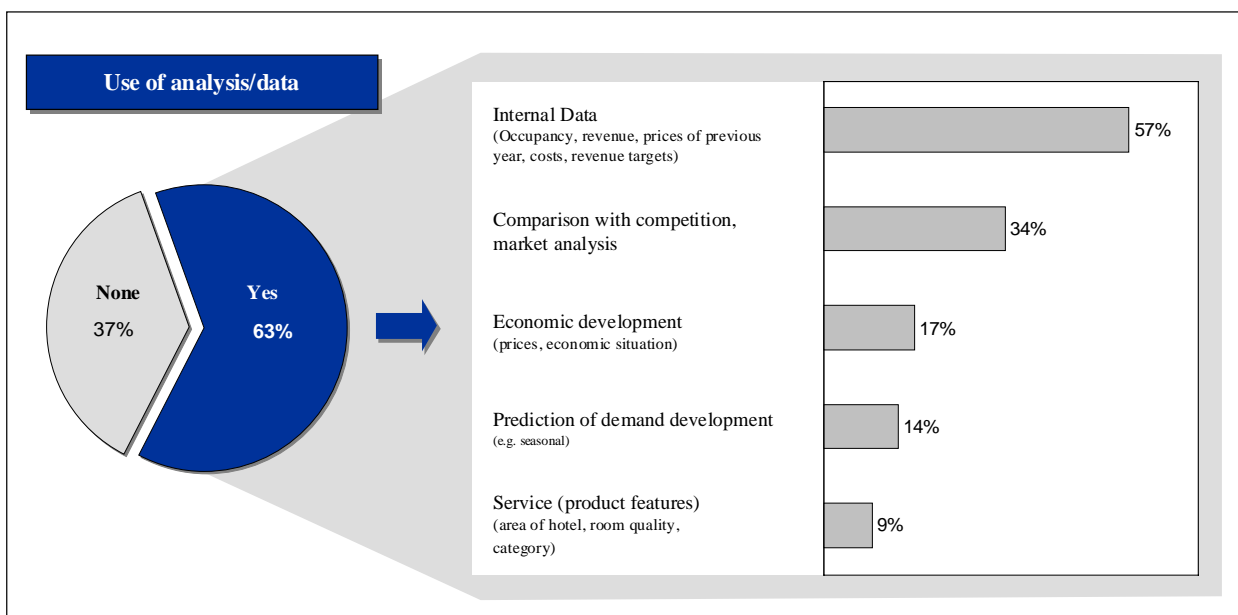


Figure 3: Use of analysis/data for pricing purposes

Today, advanced analytical tools are available to closely and realistically track the customer's objectives and willingness-to-pay.

This task cannot be accomplished relying just on gut feeling. Although the personal experience of hoteliers is an important factor not to be underestimated, it is almost impossible to draw conclusions about potential customers who have never been in the hotel before. Market research plays a crucial role here. Today, advanced analytical tools – like conjoint measurement – are available to closely and realistically track the customer's objectives and willingness-to-pay. With the help of further statistical methods, customer segments can be identified for which tailor-made services can be designed and priced. Data about the daily hotel business can be another important source of information if analyzed with the right tools. Last but not least, the subjective impressions of management can be used for the quantitative analysis with the help of e.g. PRICESTRAT workshops. The combination of all these data sources in a market simulation model will enable management to optimize its pricing process. This approach usually leads to a significant increase in return on sales.

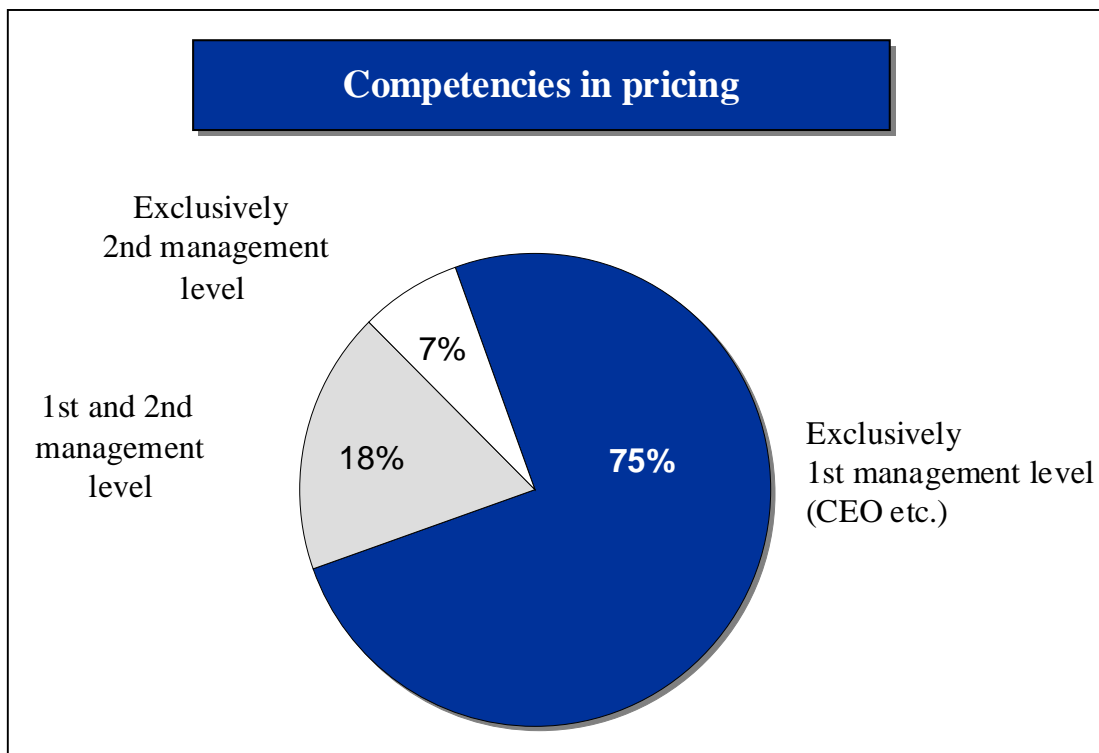


Figure 4: Competencies in Pricing

Pricing: a CEO's task

Aside from how you set prices, the organizational setting and the frequency of pricing reviews are important factors for efficient pricing. Swiss hoteliers still regard pricing as a task for upper-most management. In 75% of the hotels, pricing is handled exclusively by the top manager. In 25% of the hotels, the second management level, i.e. managers from the front office (reception, rooms division) or the back office (sales, business development) are responsible for pricing.

This comparatively high prioritization of pricing in the hotel management hierarchy could be a result of limited management resources, especially in single hotels. As the price is the most crucial profit driver, this prioritization makes good business sense. The top management's deep involvement in pricing issues can and should make the close monitoring of developments a high priority.

It remains unclear whether the competency for pricing is restricted to setting standard prices or if, for example, a receptionist can decide in special cases on the price for a certain room. In such a situation, it soon becomes clear how sophisticated pricing in a hotel is. A hotel will lose money when the rate available in the Internet is higher than the price offered by the receptionist a few moments later on the phone. The guest might have been willing to pay the higher Internet tariff. The interface between strategic pricing and operative yield management frequently reveals huge potential for profit increases. 75% of the respondents said that they would follow existing guidelines regarding pricing. But only in hotels belonging to an international chain are the guidelines stipulated in a handbook.

A standard rate adjustment is made once a year in half of the hotels; 27% of the hotels follow a more regular pattern. A small proportion of the hoteliers (15%) see rate adjustments as an ongoing process. Price adjustments, as part of the "core decisions", are made based on developments in demand. 61% of the hoteliers make adjustments for private customers; with business customers, only 52% of the hotels react to changes in

demand (figure 5). About one-third of the hotels said they do not adjust prices at all.

Sudden changes in the economic environment and dynamic market developments suggest that a more frequent review of the pricing situation would help to create improvements. Regular pricing reviews are essential for developing a framework for dynamic pricing. This fine-tuning should not only be based on internal data, but it should also take input from external sources into account.

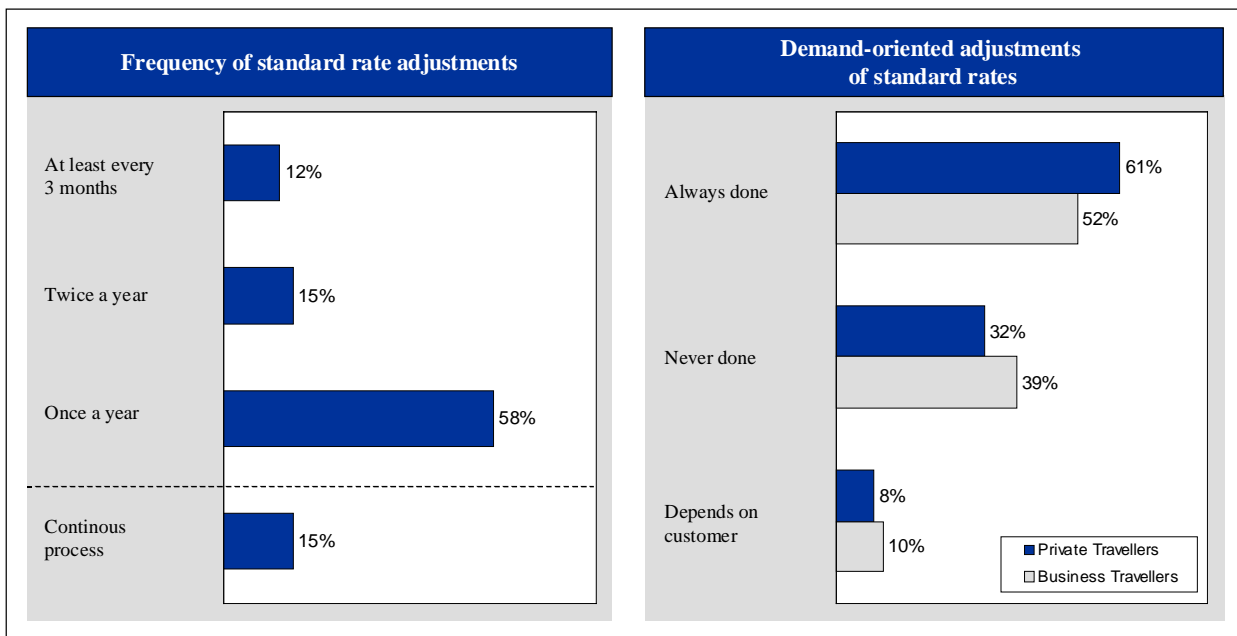


Figure 5: Price adjustments

Conclusion

Price is the most important profit driver in the hotel business. At the same time, pricing is the biggest challenge hoteliers are facing today. Setting the price right involves:

- Knowledge of value drivers and customer preferences,
- price differentiation according to customer type (business travelers, private travelers, groups, etc.),
- price differentiation according to seasons and determination of the price to maximize revenue in certain situations.

The company's cost situation still has much influence over its pricing. At the same time, systematic analysis and data interpretation are poorly developed. The following questions must be answered:

- Have targeted segments and potential customers been analyzed according to their service requirements and willingness-to-pay?
- Which conclusions can be drawn from internal data already available? How can these be transformed into pricing decisions?
- Can the existing management know-how be utilized for pricing decisions? How can gut feeling be quantified?
- Does the pricing process receive the right amount of attention? Are the necessary management resources available?
- Are dynamic, short-term price adjustments (e.g. by means of yield management) implemented? Is the yield management based on a stable price differentiation?

The following multi-phase procedure is recommended for reviewing and optimizing the pricing process:

1. Pricing audit: analysis and evaluation of current pricing process
2. Analysis of internal data sources and identification of further information requirements
3. Option: by means of market research, evaluation of customer service requirements and willingness-to-pay
4. Development of an optimal price structure and price levels
5. Development of a company-specific pricing process
6. Implementation of pricing measures

To achieve a better overview of customer requirements in the hotel industry, a second study has been conducted. This study takes a closer look at the willingness-to-pay of customers for different services. The results of this second study will be published soon in a paper belonging to this series.

Ralph Engelmann is a director with SIMON ♦ KUCHER & PARTNERS Strategy and Marketing Consultants. He focuses on the development of marketing strategies for service industries. He has conducted numerous national and international projects for companies in the travel and tourism industry (tour operators, hotels, car rental companies) and the telecommunication industry (wireline, wireless, internet) dealing with various topics (strategic planning, price/product strategies, tariff structures etc.). Some of his customers are companies like Arcor, Bundesverband der Autovermieter, Debitel, Deutsche Telekom, Ecole Hôtelière de Lausanne, Mobilcom, Nouvelles Frontières, Polska Teleconia Cyfrowa, Swisscom Mobile or T-Online. Ralph Engelmann is a co-author of various articles on the telecommunication and travel and tourism industry. He is member of SIMON □ KUCHER & PARTNERS' competence center Travel & Tourism and jointly responsible for its business development.

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