

Pricing & Value Perception

Section Objective:

- Understand the core components of pricing and its impact (in a variety of demand periods) on value perception.

CORE COMPONENTS OF PRICING

Determining the optimal rate for a product can be a challenging task and there are many factors that must be considered. Some of the primary factors are:

Demand

Section 3 considered the concept of unconstrained demand. It is important to recognise when unconstrained demand exists as this has a considerable impact on pricing opportunity. If more customers than you can accommodate want to buy your product this is a strong signal that you may have opportunity to increase the price. Conversely, when you have excess capacity this also needs investigating. If the market is buoyant and your competitors are busy, your lack of demand may be a signal that your customers do not consider your offer as 'value' and your pricing may be incorrect. However, if the market is all operating at similar occupancies, then lowering your rate may only damage your hotel's profitability.

Customer Willingness to Pay

Often referred to as either price elasticity or price sensitivity, the willingness of different segments to purchase our products is an important consideration in setting optimal price points.

The willingness to pay factor often leads to what is considered as pricing differentiation or discrimination. This exists when the same product is offered to different segments of customers at different prices based on their willingness to pay or value perception.

The insensitive markets are those customers who do not react strongly to changes in price, while the sensitive segments will see significant demand changes as a result of price changes.

The formula for understanding price sensitivity, known as price elasticity of demand, is:

$$E_d = \frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}} = \frac{\Delta Q_d / Q_d}{\Delta P_d / P_d}$$

where E_d is elasticity of demand; ΔQ_d = change in quantity demanded; Q_d = quantity demanded

ΔP_d = change in price and P_d = price

Market Based Pricing

A market based pricing strategy is one that evaluates the price points offered by similar products in the same market place. It is

important to ensure that only products that your customer would consider as either similar or 'substitutes' are considered. Your pricing is then set in relation to these products, taking into account any product or service variants. For example, once you have completed your value matrix, you may set your price slightly lower than a competitor if they offer a superior product or location. If you have a higher quality product or service, you may opt to set the price higher or match the pricing in times of weak demand to gain an increased market share.

Profitability and Costs

It is important to ensure that, when setting price, you understand both the operational and transactional costs associated with the sale. The operational costs are those associated with the operational servicing of that guest (e.g. room cleaning and amenities) while the transactional costs are those associated with accepting that particular reservation (e.g. credit card fees and commissions). Understanding the net profitability of each transaction is important, as it may influence your pricing and your optimal segment plan.

Negotiated Pricing

Offering a negotiated price as a way of asking for a volume commitment is a tactic that has been in use for quite some time. In this arrangement both parties offer something in the negotiation process. The hotel offers a rate that is lower than a publically available one and the client gives a commitment to

giving a minimum number of room nights to the hotel. The rate that is offered can be fixed (by day of week or season) or it can be offered as a percentage off of the Best Available Rate. When offering negotiated or discounted pricing, it is important to ensure that any transactional costs are kept to a minimum.

Price Fences or Restrictions

A coherent pricing strategy is one that offers discounts in a strategic way to specified market segments (in other words, the discounting is discriminatory). Price fences allow the seller to control who has visibility of, and access to, any discounts that are available. This ensures that customers who are not price sensitive do not receive an unnecessary discount. When this happens, it is known as rate dilution. Your segment strategy should include details of the types of fences and restrictions that are appropriate to, and will be accepted by, this group of buyers.

Examples of price fencing could be:

- Controlling room type availability
- An advance purchase rate
- Deposit required
- No cancellations permitted
- Saturday night stay required

- Minimum stay required
- Qualifying criteria (e.g. membership of a specified group)

Review Questions: Pricing and Value Perception

Question 1 of 3

If the market is operating at similar occupancies, then lowering your rate is the best way to increase revenue and profitability.

- A.** True
- B.** False



Check Answer

