

The Data-Driven Competitor Strategy

Hoteliers Leverage a Quantitative Approach to Drive Business Performance

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Intense price competition is the new reality. This has been brought on by savvy customers and extreme price transparency. In the hospitality industry, the pressure on price levels remains unprecedented, and it isn't going to subside anytime soon.

Just when businesses grasped how Internet search engines put comparison shopping a click away, mobile devices changed the game. The Internet made it possible for travelers to instantly find the lowest prices — and now with mobile devices, the lowest prices can instantly find them. Mobile and social media alerts have turned price transparency into price hyper-transparency.

If businesses aren't careful about being sucked into the pricing hype, they may do serious damage to their profit margins by unnecessarily matching a competitor's unrealistic price. At the same time, price transparency is here to stay, and hotels cannot afford to ignore competitors' rates when setting their own. So, how can companies survive this high-wire balancing act without resorting to blindly matching every price in the marketplace?

To turn transparency from a threat into an opportunity, hotel operators must take a data-driven approach to identify and consider the right competitors at any given time. This requires putting aside gut-feel and preconceptions — and taking a more quantitative approach that measures customer responses to price changes, competitors' price changes, competitive attributes and recurring patterns like seasonal trends.

Developing the Right Competitor Set

Not all competitors are created equal. Nothing throws more money away than price matching against a hotel that is not a true competitor. Unfortunately, identifying “true” competitors can be a challenge when comparing historical price and sales data against conventional “wisdom” within an organization.

Comparing known market shares and revenue results to a hotel’s own historical price data will often show that a competitor thought to be significant actually has very little impact on market share or influence on product demand. That’s why the development of an accurate competitor set, or comp set, is fundamental. And by utilizing publicly available price information captured from the Web, it’s also become easier. An accurate comp set is the key to identifying a business’s own optimal price and can enable advanced software tools like price optimization. Price optimization can find the pricing “sweet spot” by identifying opportunities to price above or below the competition and ultimately generate the most revenue.

Developing the comp set in a systematic manner can decrease common pricing mistakes. For example, JDA Software has encountered hospitality companies with economy properties that were excessively under-pricing relative to a full-service competitor down the street. A quantitative comparison revealed that the economy property did not need to price as low as it had been to win business away from the fancier property.

Creating a comp set starts by examining the attributes of a potential competitor’s products or services and identifying those that most closely align with the company’s own offering. In the case of hospitality, this might include location, amenities such as a swimming pool or furnishings, customer service and so on.

A common approach for identifying a comp set based on attributes is score-based benchmarking.¹ Starting with a company’s own property as a reference point, assigned a baseline score of zero, the potential competitor’s individual attributes are then scored with positive or negative values. For example, if the competition has a swimming pool and the baseline company does not, then the competitor might be assigned a “+2” score in that category. Conversely, if the competitor does not have turndown service and the baseline company does, the competitor might receive a “-2” score. Add all the attributive scores for each competitor, and those competitors whose total scores come closest to zero are those who best align as candidates for the attribute-based comp set.

An attribute-based comp set can also be described as a “comparable set,” properties that share the same traits and operate similarly.² However, the key to deriving an accurate comp set is identifying the closest substitutable option from the customer’s perspective. This provides a more nuanced and accurate comparison matrix as opposed to

simply sorting competitors into broad categories such as economy or luxury based on product attributes. In a recent hospitality study by Cornell University, a cluster analysis of the average daily rate of properties in one U.S. urban area has revealed that upscale properties were directly competing with economy properties due to the discrepancy between their intended product type and customer perception of their competitive position. This study further alludes to the fact that identifying the correct comp set should consider not only product attributes but also pricing and demand patterns.³

Market Reference Price Is Key

As competitors’ prices fluctuate more rapidly than ever, hotels must be nimble enough to change with them — or not change at all if that is what an optimal pricing strategy dictates. Accomplishing this requires both an accurate comp set and an estimation of customers’ willingness to pay given the prices that the comp set is charging. This market reference price represents the prevailing comparison point that customers have in mind when weighing alternative choices and prices.

A market reference price, based on an accurate comp set, is a critical input to the process of identifying the price that generates maximum revenue and profit. Fortunately, this is where transparency and e-commerce make this process easier than it used to be. Screen-scraping tools collect automated price shops from the Internet, making it easy to gather competitor pricing and effectively establish a market reference price at specific points in time. For example, a hotel room rate may have a list price of \$149, but if four competitors price it at \$140, \$136, \$134 and \$130, respectively, a customer’s perception of the rate — also known as the market reference price — would be approximately \$136.



¹ P. Mayock, “Harnessing the Power of Value Proposition,” *HotelNewsNow.com*, April 2010.

² G. Hartmann, “Do You Have the Right Comp Set?” *HotelNewsNow.com*, June 2010.

³ J. Kim and L. Canina, “Product Tiers and ADR Clusters: Integrating Two Methods for Determining Hotel Competitive Sets,” *Cornell Hospitality Report*, Vol. 9, No. 14, 2009.

A market reference price should take into account the dynamic nature of prices over time, comparing the price of a service or product across alternatives, and ultimately offering insight into the elasticity of demand (i.e., demand measured as a function of a company's own prices and simultaneous competitor prices for comparable products or services).

Seasonality and Strength Positioning

While making these comparisons and refining comp sets, often a stronger or weaker competitor might still stand as a substitutable option in the customers' eyes. These competitors may be better or worse than the baseline company in one or more characteristics. These attributes can be associated with a certain price differential to adjust the competitors' prices when calculating a market reference price using strength positioning.

Returning to the hospitality example, suppose there are several factors that create a differential between two properties due to an added service or better location. It is possible to calculate a specific price differential and still evaluate the two competitors. For example, strength positioning enables a company to factor in that a specific competitor is commonly \$50 more than its own rate, so before computing the market reference price, that competitor's rate is adjusted down by \$50 to make the properties comparable. By doing so, the comp set can continue to be refined for more accurate results, as this will often change the mix of competitors.

Strength positioning isn't the only factor that must be considered while developing the market reference price. In industries such as hospitality, seasonal changes may also affect the competitor set — and therefore the market reference price. In these cases, it is critical that a company analyze price-shop trends based on season, which may include weekday versus weekend patterns, to statistically identify which competitors have pricing strategies most similar to the company's own and adjust comp sets accordingly. Without making those adjustments, the company is likely to make incorrect pricing conclusions throughout the year.

It Starts With Clean Data

While automated Internet price shops have certainly provided a significant amount of intelligence upon which to make informed decisions, it is important to remember not to follow this data blindly. Very often screen-scraped prices will need to be cleaned based on a number of factors. For example, there may be holes in the data when there is

no available product or service for a particular price shop. If a hospitality competitor sells out of rooms on a certain date, then there is nothing to base assumptions upon. In these cases, it is crucial to create viable assumptions to algorithmically fill in these gaps as accurately as possible.

In other instances, there may be pricing outliers that decisions should not be based upon. These include deep discounts or statistically erratic prices. In those instances, it also pays to have logic built into the system that can scrub the data so it doesn't skew the results.

Compete More Effectively — And Profitably

Armed with a properly quantified competitive set and the latest price optimization technology, a company can learn which prices and competitors are relevant and which ones can be ignored. Elasticity analytics and revenue management have now intersected in the form of price optimization, driven by real-time competitor data available via automated price shopping. Best of all, it allows hotels to compete more effectively and profitably in this new pricing reality. ■



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