Rate resistance, so now what?

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Editor's note: This is the second installment in a two-part column about price wars and rate resistance. Read "Winning the price war."

OK … let's say you've tested for rate resistance, and it's there. And you've had success with adding value and well-fenced promotional specials. But you're running out of options. Now what?

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At this point, you believe you have no choice but to start fighting the price war head on. But before jumping into this bottomless pit of lost profitability, conduct a break-even analysis, which is a calculation of how much incremental revenue and roomnights you'll have to generate for the price reduction to be beneficial. Say your trusty Expedia rep tells you if you lower your prices he can pretty much guarantee an additional 15 percent in volume of roomnights. You have a decision to make: Do you drop price or stand firm?

Here are three examples of break-even analysis based on three different hotels.

Scenario	Hotel A 1-Star	Hotel B 3-Star	Hotel C 4-Star
Current level of room nights sold	315	315	315
Current price	$49	$139	$239
Reduced price	$39	$109	$199
% Discount	25.6%	27.5%	20.1%
Dollar difference guest sees	$10	$30	$40
Revenue needed to break-even	$15,435	$43,785	$75,285
Total rm nts sold @ new rate to break even	396	402	378
Incremental room nights needed	81	87	63
% Incremental room nights	25.6%	27.5%	20.1%
Estimated variable cost	$20	$30	$35
Profit per room before	$29	$109	$204
Profit per room after	$19	$79	$164
Profit needed to break even	$9,135	$34,335	$64,260
Room nights needed to break even in profit	481	435	392
% Incremental rm nts needed to break even in profit	52.6%	38.0%	24.4%

Notice the correlation between the percentage of discount and the percentage of incremental roomnights needed to break even in revenue. The hotel has to ask the question of whether they think the price drop will generate this much incremental business.

The next step is to consider profitability, not just top-line revenue. In these examples, the level of incremental roomnights required to break even in profit ranges from a low of 24.4 percent to a high of 52.6 percent. Now your new best friend, the Expedia rep, suggests he can almost guarantee you 15 percent more business, which falls far short of the needed extra room nights to make this worthwhile.

Playing devil's advocate, what if you do nothing? What if you stood firm and lost some of the volume you originally expected because you didn't drop your price. How much could you afford to lose? Let's say your volumes drop by 5 percent because you didn't play the rate game. When you take into consideration the minimal difference in profit (profit drops but less than you might expect given the hotel is servicing fewer room nights) and the long-term damage done by dropping price, there's more at stake than you might think.

Industrial psychologists say it takes a 30-percent discount to influence a buy. None of these price-drop scenarios offer discounts at the 30-percent level. Here are the realities of a price war:

- it increases sales quickly but at a much higher risk (short-term gain, long-term pain);
- it generates higher costs with less revenue;
- it offers lower rates than the guest is already willing to pay (trade-down);
- it's likely to illicit a competitor's response (everyone loses);
- it makes comebacks more difficult (after 9/11 it took most markets five years to six years to get average rates back up to pre-9/11 levels); and
- discounting in the hotel business doesn't increase volume as much as it decreases revenues (Cornell University study).

So before you give in to competitive pressures, ask the right questions, add value first, fence like your life depended on it, and do the math.