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A Retrospective Commentary on “Discounting in the Hotel Industry: A New Approach”

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Abstract
The hotel industry is gradually catching on to this revenue-enhancing technique.

Keywords
hotel industry, revenue-enhancement, physical rate fences, non-physical rate fences, reservation system

Disciplines
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Comments

A Retrospective Commentary

on

"Discounting in the Hotel Industry: A New Approach"

The hotel industry is gradually catching on to this revenue-enhancing technique.

BY SHERYL E. KIMES

The article by Hanks, Cross, and Noland (reprinted on the following pages) remains an excellent and timely work. Although ten years have passed since the article was published, I am struck by how compelling a case the authors made for rational pricing and also by how long it has taken the hotel industry to adopt rational-pricing techniques. The authors describe a typical haggling reservation request in which customers who insist on lower rates typically receive them. Unfortunately, up until a few years ago, this top-down pricing approach was still the norm. Only in the past few years have chains other than Marriott started to adopt some of the ideas presented in this article. The basis for this assertion is discussed in the box on the next page.

The authors make the point that segmenting customers solely on their knowledge of playing the system may lead to short-term revenue gains but result in long-term revenue loss as customer dissatisfaction increases. They advocated having a logical reason for different rates and described Marriott's experience with advance-purchase, non-refundable room rates.

The airline-style non-refundable room rates described in the accompanying article are still around today, but those are certainly not the dominant type of rate fence that hotels use. Rate fences can be physical or non-physical in nature and represent the reason *why* customers pay different rates.

Physical rate fences include room type, view (e.g., ocean or city skyline), room location (e.g., which floor), presence of amenities (e.g., concierge level versus run-of-house or business rooms equipped with high-speed internet access and fax machines). As the authors pointed out, some physical rate fences, most notably room type, can lead to reduced revenue since only so many of a particular room type exist.

Non-physical rate fences include customer characteristics, transaction characteristics, and consumption characteristics.[1] Rate fences based on customer characteristics restrict dis-

[1] Robert J. Dolan and Hermann Simon, *Power Pricing* (New York: The Free Press, 1996).

counted rates to members of certain organizations (e.g., AARP or AAA), employees of certain companies (e.g., corporate volume discounts), and certain groups of customers (e.g., frequent guests, senior citizens, or employees). As the authors point out, many hotels use such fences, although at the time the accompanying article was published, most hotels did not do a good job of integrating those rate fences into their reservation process.

Rate fences involving transaction characteristics include restrictions on time of purchase (e.g., the advance-purchase restrictions described in the article), place of purchase (e.g., cheaper rate for reservations booked on the internet), level of risk accepted (e.g., non-refundable reservations), and limited availability (e.g., use of coupons). Time-characteristic rate fences include day of week, time of year, and length of stay.

Companies in other capacity-constrained service businesses (e.g., sports arenas, golf, and self-storage companies) have begun to adopt revenue management and have quickly adopted the concept of rate fences. For example, the Colorado Rockies implemented demand-based pricing for the 2002 baseball season. Ticket prices vary by quality of opponent, day of week, seat location, and incremental benefits provided.[2] Trogon Golf, a U.S.-based company managing over 100 golf courses around the world, has adopted revenue management and has limited discounted weekday rates to members of its frequent-player program. In a similar example, Sovran Self-Storage, one of the largest publicly traded self-storage firms in the United States, uses revenue management by offering discounted rates only to repeat customers and to customers who pre-pay and meet minimum length-of-rental requirements. Both organizations carefully designed their rate fences, provided thorough training for their facility managers and call-center employees, and tracked financial performance. As a result, those companies have met with great success.

Regardless of which rate fences are used, managers must ensure that the rate fences are clear, logical, easy to communicate, and difficult to circumvent. As Hanks *et al.* point out, poorly designed rate fences can result in customer (and employee) confusion and dissatisfaction. Research has shown that customers who believe that a hotel is trying to take advantage of them are unlikely to patronize that hotel in the future.[3]

It behooves a hotel (or, for that matter, any business) to design its rate fences carefully, thoroughly train its reservations and front-desk employees, and ensure that its rate fences are integrated with its reservation system. Well-designed rate fences offer hotels the opportunity to customize their rates to better meet customer needs while at the same time increase revenue. ■

A Change in Reservation Policies?

I teach a course in revenue management at Cornell, and every semester my students conduct an informal pricing study of several large hotel chains in major cities. The students are given the dates of travel and are directed to try to obtain a lower rate by asking the simple question, "Do you have anything lower?" I also ask the students to change the nature of their request (e.g., "I'm making a reservation for my boss" versus "I'm making a reservation for my family"), and I ask international students to adopt a thick accent and play the "I'm new to your country and don't know how things work" game.

My students and I have been doing this same exercise for over ten years, and I have seen considerable changes in the past two to three years. Whereas five or more years ago, students typically obtained discounts of 50 percent or more by simply asking for a lower rate, in the past few years, most hotel chains have adopted the rational-pricing approach advocated by Hanks, Cross, and Noland. The students still ask the "do you have anything lower" question, but rather than automatically being offered a lower rate, they are asked various questions designed to determine whether they qualify for a discounted rate.

As refreshing as the transition to rational pricing is, unfortunately, some things haven't changed. International-sounding students are often quoted higher rates than American-sounding students, and students calling to make a reservation for a fictitious boss are quoted higher rates than when they call to make a reservation for their hypothetical family. The ethics of these practices are certainly questionable, and if customers became aware of such rate quotes, dissatisfaction would surely occur.—*S.E.K.*

[2] David Leonhardt, "Tiptoeing Toward Variable Pricing," *New York Times,* May 12, 2002, p. A1.

[3] See: Sheryl E. Kimes, "Perceived Fairness of Yield Management," *Cornell Hotel and Restaurant Administration Quarterly,* Vol. 35, No. 1 (February 1994), pp. 22–29; Sheryl E. Kimes and Jochen Wirtz, "Perceived Fairness of Demand-Based Pricing for Restaurants," *Cornell Hotel and Restaurant Administration Quarterly,* Vol. 43, No. 1 (February 2002), pp. 31–38; and Sheryl E. Kimes and Breffni M. Noone, "Perceived Fairness of Yield Management: An Update," *Cornell Hotel and Restaurant Administration Quarterly,* Vol. 43, No. 1 (February 2002), pp. 28–29.

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