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### Competitive Hotel Pricing in Uncertain Times

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## Competitive Hotel Pricing in Uncertain Times

### Abstract

This analysis of the pricing (ADR), demand (occupancy), and revenue (RevPAR) dynamics in the U.S. hotel industry for the period 2001 through 2007 demonstrates the potentially negative consequences of attempting to maintain market share by offering prices below those of direct competitors. This seven-year study examined the outcomes of pricing behavior on total rooms revenue and occupancy for hotels and their competitors in both bad times (2001-2003) and good (2004-2007). The results are the same in both periods. Hotels that offer average daily rates above those of their direct competitors experienced lower occupancies compared to those other hotels, but recorded higher relative RevPARs. For 67,008 hotel observations, this pattern of demand and revenue behavior was consistent for hotels in all market segments, from luxury to economy. Overall the results suggest that the best way to have better revenue performance than your competitors is to have higher average rates. The findings suggest that lodging demand may be inelastic in local markets, and hotel operators may wish to resist the pressure to undercut competitors when possible.

### Keywords

hotels, pricing, revenue per available room (RevPAR), average daily rates (ADR)

### Disciplines

Business | Hospitality Administration and Management

### Comments

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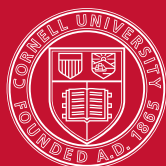


## Competitive Hotel Pricing in Uncertain Times

### Cornell Hospitality Report

Vol. 9, No. 10, June 2009

by Cathy A. Enz, Ph.D., Linda Canina, Ph.D., and Mark Lomanno



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Cornell Hospitality Report,  
Volume 9, No. 10 (June 2009)  
Single copy price US\$50  
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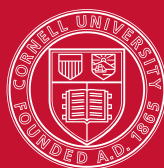
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## EXECUTIVE SUMMARY

**T**his analysis of the pricing (ADR), demand (occupancy), and revenue (RevPAR) dynamics in the U.S. hotel industry for the period 2001 through 2007 demonstrates the potentially negative consequences of attempting to maintain market share by offering prices below those of direct competitors. This seven-year study examined the outcomes of pricing behavior on total rooms revenue and occupancy for hotels and their competitors in both bad times (2001-2003) and good (2004-2007). The results are the same in both periods. Hotels that offer average daily rates above those of their direct competitors experienced lower occupancies compared to those other hotels, but recorded higher relative RevPARs. For 67,008 hotel observations, this pattern of demand and revenue behavior was consistent for hotels in all market segments, from luxury to economy. Overall the results suggest that the best way to have better revenue performance than your competitors is to have higher average rates. The findings suggest that lodging demand may be inelastic in local markets, and hotel operators may wish to resist the pressure to undercut competitors when possible.



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**Cathy A.ENZ**, Ph.D., is the Lewis G. Schaeneman, Jr. Professor of Innovation and Dynamic Management and a full professor in strategy at the Cornell University School of Hotel Administration, where she has served as associate dean for industry research and affairs and as the executive director of the Center for Hospitality Research (cae4@cornell.edu). Author of over eighty journal articles and book chapters, as well as three books in the area of strategic management, her research has been published in numerous academic and hospitality journals, including *Administrative Science Quarterly*, *Academy of Management Journal*, *Journal of Service Research*, and *Cornell Hospitality Quarterly*. She also developed the Hospitality Change Simulation, a learning tool for the introduction of effective change, as well as three other strategy courses, which are available as an online education program of eCornell. A frequent presenter of executive education programs around the world, she consults extensively in North America and serves on the board of directors of two privately owned hotel companies.



**Linda Canina**, Ph.D., is associate professor of finance and editor of *Cornell Hospitality Quarterly* (lc29@cornell.edu). Focusing much of her research on asset pricing and valuation, corporate finance and strategic management, she has expertise in the areas of econometrics, valuation, IPOs, payout policy, mergers and acquisitions, options and the hospitality industry. Her current research focuses on strategic decisions and performance; the relationship between purchased resources, human capital, and their contributions to performance; the relationship between various liquidity measures and profitability; and measuring the adverse selection component of the bid-ask spread. Her recent publications have included *Cornell Hospitality Quarterly*, *Review of Financial Studies*, *Journal of Finance*, *Financial Management*, and *Journal of Hospitality and Tourism Research*.

**Mark Lomanno** is president of STR Global, the leading authority on current trends in occupancy, room rate, and supply/demand data for the U.S. and global lodging industry. In addition to STR's own STAR reports, delivered to a global client base, Lomanno is a frequent contributor to industry publications, including *Cornell Hospitality Quarterly*, *Lodging Hospitality*, and *Hotel & Motel Management*. A frequent participant in industry conferences, he serves on the advisory boards of the HSMIA Foundation, Travel Industry of America, and the Center for Hospitality Research at Cornell University. He is also a frequent guest lecturer at the School of Hotel Administration at Cornell University.



# Competitive Hotel Pricing in Uncertain Times

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**M**any hoteliers contend that discounting room rates is a necessity during tough economic times—and also a strategy to “steal market share” in good times. With the current economic slowdown, issues surrounding room rate positioning have again surfaced. Looking back to other economic recessions, the challenges facing the lodging industry after September 11, 2001, led many hotel operators to discount in the hopes of stimulating consumer demand or capturing additional market share from their competitors, with the objective of enhancing revenue. Other operators resisted discounting, and faced what *Lodging Hospitality* editor Edward Watkins called the dilemma of the empty room.<sup>1</sup> As the economy began to recover, the industry saw demand and then prices rise, starting about 2004. Then, as 2007 came to a close, the industry again appeared to be bracing for another bout of bad times—and as we now know, those bad times arrived. Once again, some hotels have discounted their prices while others have held fast. As Patricia Davis, corporate director of revenue management for Kor Group, stated: “When times are good, you set up your strategy and sort of just close (deals) as business comes in as you expect it, but when you’re in a situation like right now, where the unexpected happens every day, you’re trying to figure out what to tweak.”<sup>2</sup>

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<sup>1</sup> Ed Watkins, “Readers React to Rate Dilemma,” *Lodging Hospitality*, Vol. 59, No. 8 (2003), p. 4.

<sup>2</sup> Adam Kirby, “Revenue Management Automation Boosts Efficiency by Making Forecasting Automatic; Revenue Managers Can Double as Marketers,” *Hotels*, February 1, 2009, [www.hotelsmag.com/article/CA6633402.html?q=pricing](http://www.hotelsmag.com/article/CA6633402.html?q=pricing).



We have been investigating this matter of hotels' pricing strategy in relation to their competitive set. This paper reports the outcomes of our study of the pricing, demand (occupancy), and revenue (RevPAR) dynamics in the U.S. hotel industry for the periods of 2001 through 2003 (which we characterize as bad times) and 2004 through 2007 (which arguably were strong economic times). Our goal is to understand the financial ramifications of hotels' competitive pricing behavior in both bad and good times.

A common observation about the hotel industry is that properties tend to set prices based in part on their competitors' pricing practices. However, competitors' decisions to adjust their prices are not well understood, and so it is not always clear why some competitors reduce their rates or why others follow. The many factors shaping pricing decisions include cost, value, and elasticity.<sup>3</sup> The strategy of lowering rates to satisfy customer demand, often called value pricing, is not a substitute for maintaining high quality, and can be extremely risky.<sup>4</sup> However, many hoteliers have noticed that value pricing can sometimes increase market share through larger volume, and if costs are controlled, then aggressive

room pricing can elicit positive results. On the other hand, if low prices fail to cover such costs as maintenance and reserve for replacement, the long-run benefit may be diminished. The question to examine is whether holding rates higher than the competition (and suffering through reduced occupancy) is the better course. The study we conducted indicates that maintaining your hotel's rate positioning (compared to the competition) is the better course.

We must emphasize that this paper focuses on hotels' rate setting in comparison to competing hotels. The study looks at hotels that price above their competition and those that price below their competitors. We compare how each set of hotels compares with regard to customer demand and total rooms revenue per available room. We acknowledge that cost and total revenue management issues are critical in making pricing decisions, but this investigation focuses only on issues of occupancy and revenue in competitive situations. Our decision to examine pricing behavior among competitors is due to the fact that many individual hotels are profoundly influenced by the actions of their direct competitors. If competing hotels in a local market drop their prices, owners and operators feel pressure to follow by dropping prices to maintain parity with their competitive set.

Jeff Higley, editor of *Hotel News Now*, is among those who have argued that holding rate is important for lodging

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<sup>3</sup> J.M. Stibel, "Discounting Dos and Don'ts," *MIT Sloan Management Review*, Vol. 49, No. 1 (Fall 2007), p. 8-9.

<sup>4</sup> David K. Hayes and Lynn M. Huffman, "Value Pricing: How Low Can You Go?," *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 36, No. 4 (February 1995), pp. 51-56.

business health in both the short- and long-term.<sup>5</sup> This advice is based on the view that rate reductions if improperly conceived or poorly executed would not improve revenues and could be dangerous for all players in the industry. A particular issue relating to the failure to maintain rate integrity is the phenomenon of anchoring. If customers see a hotel property charging a particularly low rate (in comparison to the competitive set), the customers may come to view that low rate as the “actual” value of the room.

In our examination of competitive pricing, our focus is on individual hotels and their comparably performing direct competitors in local markets. To ensure that our study captures the competitive pressures which accompany pricing activities, we compare a hotel’s pricing strategies to that of its competitive set of like hotels with similar previous revenue performance. In short, we only look at competitors who were comparable in their rooms revenue performance for the previous year.

The competitive set is a key element of this study for the simple reason that an individual hotel’s occupancy is influenced by the actions of its direct competitors. While pricing guidelines may be set by brands and corporate strategy, pricing behavior is fundamentally driven by what is happening in local markets. The results of our study should help a hotel manager understand pricing behavior and determine pricing strategies.

## The Study

In cooperation with the Center for Hospitality Research at Cornell University and Smith Travel Research (STR), we explored pricing behavior using 67,008 hotel observations over a seven-year period, from 2001 through 2007. In each year we began with a sample of between 11,056 (2001) and 16,369 (2007) hotels. The data were drawn from the STR databases, which compile monthly room demand, room supply, and room revenue by property for over 98 percent of the population of branded lodging properties in the United States.<sup>6</sup>

By arrangement with STR, we obtained monthly property-level data over the seven-year period.<sup>7</sup> Data were

<sup>5</sup> Jeffrey Higley, STR releases 2008, 2009, 2010 projections. *Hotel News Now*, October 23, 2008, [www.hotelnewsnow.com/Articles.aspx?ArticleId=253&ArticleType=0](http://www.hotelnewsnow.com/Articles.aspx?ArticleId=253&ArticleType=0).

<sup>6</sup> We would have preferred to explore GOPPAR (gross operating profit per available room), but unfortunately this bottom line information is not available. Business mix data would also be valuable for understanding pricing behavior but is also unavailable for comprehensive industry analysis.

<sup>7</sup> Extended stay hotels were excluded from this study because the typical traveler stays more than ten days at these hybrid apartment-all-suite-hotel complexes. This lengthy stay means that these operations have distinctive demand characteristics. We also excluded resorts because of their seasonality (many close for parts of the year), and their all-inclusive nature, particularly with regard to including meals in the room rate.

analyzed for each year rather than on a monthly basis to avoid pricing irregularities that may have occurred in a particular month that are not representative of the properties’ overall pricing strategy.<sup>8</sup> We aggregated STR’s monthly rooms data to arrive at the annual number of rooms sold, annual number of rooms available, and annual rooms revenue for each property and each property’s competitive set for each year. The relevant competitors were determined by the individual hotels, which provided their competitive set choices to STR. STR supplied the total monthly rooms data for the competitive set by property. Properties that had less than twelve months of data were eliminated from the sample.

The key variables of interest in this study are the percentage differences between each hotel and its competitive set on price, demand, and revenue. Annual average daily rate (ADR), occupancy, and revenue per available room (RevPAR) were computed for each property in the sample and for each property’s competitive set. To assess the pricing strategies we then compared the percentage difference in ADR between the hotel and its competitors. To calculate percentage difference in ADR, we subtracted the annual ADR of the competitive set from the that of the hotel in question and converted that figure into a percentage by dividing the difference by the annual ADR of the competitive set and multiplying by 100. The result of this calculation is the percentage difference in ADR from that of the competitive set. For example, if a specific hotel had an annual ADR of \$50.00, and the annual ADR of the competitive set was \$60.00, the percentage difference would be -16.7 percent ( $[(\$50.00 - \$60.00)/\$60.00] \times 100$ ). Since the sample hotel in this example was lower priced than its competition, we would say that the percentage difference in ADR was negative, and the hotel’s \$50.00 price represents a difference of 16.7 percent below its competitive set. The percentage differences in RevPAR and occupancy were computed similarly.

To ensure that these comparisons are not driven by non-competitors, we excluded properties that were unable to achieve a percentage difference in RevPAR within one standard deviation of the average of their competitors (that is, one standard deviation from a zero difference from that average). It is important that the performance of a given hotel be comparable to that of its competitive set; otherwise the study may err by attempting to compare substantially different hotels, or, in any event, hotels that are not actual competitors. There are many reasons why a hotel may not be comparable to its competitive set. Some properties are included in a hotel’s competitive set because they are nearby, even though they serve a different market segment. In such a case, the performance differences of two adjacent (and nominally

<sup>8</sup> Joseph A. Ismail, Michael C. Dalbor, and Juline E. Mills, “Using RevPAR to Analyze Lodging-segment Variability,” *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 43, No. 4 (2002), pp. 73–80.

competitive) hotels are not due to differences in pricing strategies.

The competitive set, as defined by Smith Travel Research, requires a minimum of four properties to generate competitive set reports. It is possible that there are some locations in which there are fewer than four comparable hotels—perhaps only one. For those properties, it is impossible to create a comparable competitive set. For example, if the competitive set of an economy hotel contained only upscale properties, then its price and RevPAR are probably lower than those of its competitors regardless of the hotel's pricing strategy. If we included this property in the sample then we may make erroneous conclusions that lower relative prices are associated with lower relative RevPARs, when in fact it may be impossible for an economy hotel to achieve RevPAR performance at least as great as that of upscale properties. Hence, to err on the side of a conservative and fair comparison, we eliminated from our sample any hotels for which their past performance was not comparable to that of their competitors. While this approach reduced our sample size, it does provide a cautious approach to comparing prices among competing hotels.

### Pricing Strategies and Hotel Differences

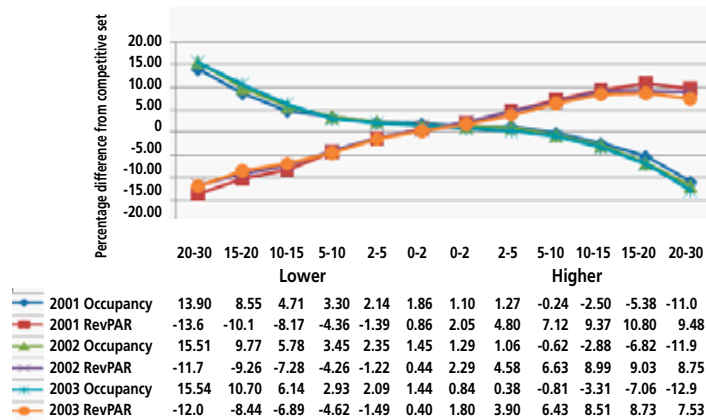
The sample hotels, comprising 67,008 observations, were grouped into twelve different pricing strategies based on the percentage difference in their ADR from their competitive set. For example, a hotel with an annual rate that was 5- to 10-percent higher than its competitors would be grouped with other hotels that had a similar price difference from their competitive set. The price difference categories ranged from 20- to 30-percent above the competitive set to 20- to 30-percent below the competitive set. After grouping hotels according to their pricing differences, the percentage difference between each hotel and its competitive set on occupancy and RevPAR were calculated and mapped.

### The Bad Times

First, we examined all hotels during the turbulent years of 2001 through 2003. Exhibit 1 shows the average percentage difference in occupancy and RevPAR performance for hotels that had higher ADRs than their competitors or lower ADRs compared to their competition. Overall, for hotels that held their price below that of their competitive set, average percentage differences in occupancies were higher, but average percentage differences in RevPARs were lower, compared to their competition. This pattern of stronger occupancy but

## EXHIBIT 1

### RevPAR and occupancy percentage differences from the competitive set, 2001–2003



ADR percentage difference from competitive set

weaker RevPAR when rates were low compared to the prices of competitors was true for hotels in all three years.

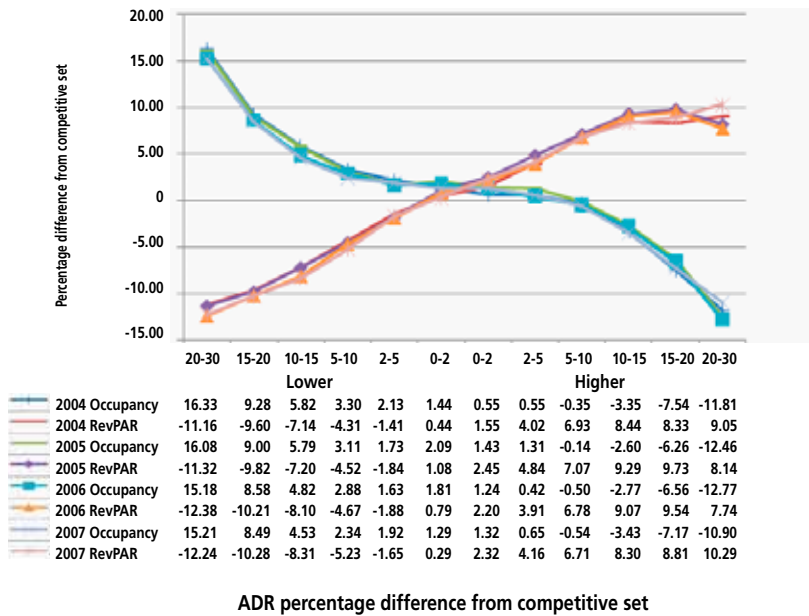
As shown in Exhibit 1, the maximum occupancy advantage over the competitive set was obtained by those hotels that had the lowest comparative ADRs. For example in 2003, hotels that had ADRs 20- to 30-percent lower than their competitive set also had 15.54-percent higher occupancies. More critically, however, these low-price hotels also reported the lowest comparative RevPARs. Clearly, the strategy of putting heads in beds was accomplished by setting low relative prices. In 2003, the hotels with prices 20- to 30-percent below the competition reported annual RevPARs of 12.0 percent below the competition. In sum, while the goal of increased occupancy was achieved, the consequence for these hotels was RevPARs substantially lower than those of their competitive set.

Hotels that set their relative prices lower than those of competitors by less than 2 percent, on the other hand, experienced both occupancy and RevPAR premiums relative to their competitors, as did hotels that held their relative prices higher by less than 5 percent. When hotels' relative prices were more than 2 percent lower than the average of their competition, those hotels were rewarded with higher comparative occupancies, but punished with lower relative revenue. Hotels with relative prices more than 5 percent above the competition, by contrast, saw comparatively lower occupancies, but were rewarded with higher relative revenue.

According to the data, the maximum performance benefit for hotels in 2003 was obtained by those maintaining prices 15- to 20-percent above those of their competitive set. Hotels with these comparatively high rates recorded a 7.06-percent lower occupancy, but had the largest compara-

**EXHIBIT 2**

**RevPAR and occupancy percentage differences from the competitive set, 2004–2007**



tive RevPAR, 8.73-percent higher than competing hotels. In each of the three years, the hotels that did not undercut their competitors on price saw higher comparative revenues per room. Likewise, in all three years, those hotels that offered average daily rates below their competitive set were relatively lower RevPAR performers, despite higher occupancies. These results might provide some support for the idea that demand is inelastic in bad times because those with lower relative prices also have lower comparative revenues. It appears that offering relatively lower prices does not stimulate sufficient demand to permit higher revenues. Let's examine what happened in the booming economy of the subsequent years.

**The Good Times**

As the industry began to rebound in 2004, one might expect that the outcomes of pricing behavior would also change, but this turned out not to be the case. Exhibit 2 shows the percentage differences in RevPAR and occupancy performance for hotels that offered lower ADRs than their competitors did from 2004 through 2007 and for those that maintained higher ADRs compared to their competitive group. Interestingly, the analysis suggests a pattern of occupancies and RevPARs similar to what we saw in the previous analysis. Hotels that undercut competitors' rates experienced higher occupancies, but their average RevPARs were lower than those of their competition. This pattern of higher occupancy but lower RevPAR was similar to the pattern found for the 2001–2003 period.

For each year from 2004 through 2007, the maximum occupancy advantage over the competitive set was obtained by those hotels that priced 20- to 30-percent lower than their competitors did. In 2007, for example, hotels that had the lowest ADRs relative to their competitive set also

**EXHIBIT 3**

**Distribution of hotels by competitive price category, 2001–2007**

Pricing Category	2001-2007		2001-2003	2004-2007
	Number of Observations	Percentage of Observations	Percentage of Observations	Percentage of Observations
20-30%	3,082	4.60%	4.56%	4.62%
15-20%	4,135	6.17%	5.97%	6.29%
10-15%	6,835	10.20%	10.02%	10.31%
5-10%	10,182	15.20%	15.23%	15.17%
2-5%	7,397	11.04%	11.27%	10.90%
0-2%	5,297	7.91%	8.05%	7.82%
0-2%	5,185	7.74%	7.83%	7.68%
2-5%	6,943	10.36%	10.55%	10.25%
5-10%	9,222	13.76%	13.68%	13.81%
10-15%	5,056	7.55%	7.71%	7.44%
15-20%	2,345	3.50%	3.38%	3.57%
20-30%	1,329	1.98%	1.75%	2.13%
<b>Total</b>	<b>67,008</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

had 15.21-percent higher occupancies. This performance benefited them little in terms of revenue, as these low-price hotels still had the lowest comparative RevPARs. Thus, we observe that in good times, lower rates yielded occupancy benefits, but diminished RevPAR when compared to competing hotels.

It is interesting to note, as shown in Exhibit 3, that around 66 percent of all hotels were pricing within 10 percent of their competition. The most frequent price position for hotels that undercut their competitors was 5- to 10-percent below the competitive set. For properties that charged a premium compared to competitors, the most popular price point was also in the 5- to 10-percent difference range. In total almost 30 percent of the hotels in this sample set their prices either 5- to 10-percent above their competitors or 5- to 10- percent below the competition.

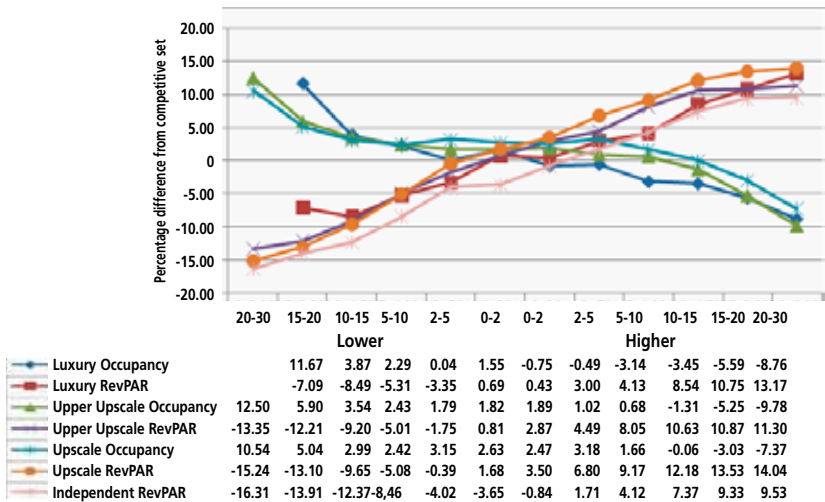
Only 7 percent of hotels were found in either of the extreme pricing levels, that is, 20- to 30 percent above competitors or a similar range below the competition. Finally, 16 percent of operators kept their prices nearly identical to the competition, with rates either 0- to 2-percent above competitors or no more than 2 percent below. Another 21 percent of hotels set their prices within 5 percent of the competition. The percentage of properties in each relative pricing category is similar for both of the test periods. This summary of hotels' pricing behavior from 2001 through 2007 shows that a large portion of hotels strive to price close to their competitors, but a policy of undercutting or aggressively pricing by 5- to 10-percent relative to the competition is the most common pricing strategy.

### Pricing by Market Segment

Hotels are typically categorized into broad price and quality bands, including luxury, upper upscale, upscale, midscale with F&B (full service), midscale without F&B (limited service), and economy. Hotels in these market segments vary on rate, amenities, facilities, and services. A preliminary examination of the data revealed only modest differences in the pricing behavior of hotels in various market segments. Since the pattern of pricing is similar for all market segments we gathered upmarket hotels into one group and low-price hotels into another group, to examine patterns of pricing for several market segments. For this taxonomy, we relied on STR's market scale segments, grouping hotels based on their actual, system-wide average room rates. We aggregated the pricing data for the entire seven-year time

#### EXHIBIT 4

### RevPAR and occupancy percentage differences for luxury, upper upscale, and upscale hotels, compared to the competitive set, 2001–2007



horizon because the yearly patterns were not substantially different.<sup>9</sup>

### Luxury, Upper Upscale, and Upscale Hotels

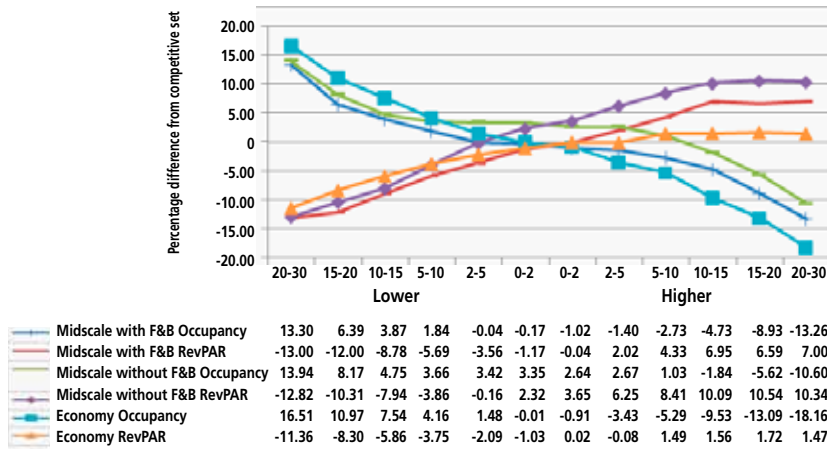
Beginning with the most luxurious hotels in the United States, as shown in Exhibit 4, occupancies are generally lower when rates are comparatively higher. However, the hotels that maintained prices above those of the competition showed solid RevPAR superiority. In a pattern that is different from the industry as a whole, both occupancies and RevPAR were relatively higher for upper upscale and upscale hotels that priced as much as 10 percent higher than their competitors did. The expected decline in occupancies compared to competitor hotels was observed only after upscale and upper upscale hotels set prices 10- to 15-percent above the competition. The largest percentage advantage occurred in upscale hotels, followed by upper upscale properties and then luxury hotels. We note that luxury hotels that priced 20- to 30-percent above their competitors had 13.17 percent higher RevPARs.

<sup>9</sup> For those interested in more detailed data on individual years and market segments see Cathy A. Enz, Linda Canina, and Mark Lomanno, "Why Discounting Doesn't Work: The Dynamics of Rising Occupancy and Falling Revenue among Competitors," *Center for Hospitality Research Reports*, Vol. 4, No. 7 (2004); [www.hotelschool.cornell.edu/research/chr/pubs/reports/abstract-13599.html](http://www.hotelschool.cornell.edu/research/chr/pubs/reports/abstract-13599.html); and Linda Canina and Cathy A. Enz, "Why Discounting Still Doesn't Work: A Hotel Pricing Update," *Center for Hospitality Research Reports*, Vol. 6, No. 2 (2006); [www.hotelschool.cornell.edu/research/chr/pubs/reports/abstract-13848.html](http://www.hotelschool.cornell.edu/research/chr/pubs/reports/abstract-13848.html).



**EXHIBIT 5**

**RevPAR and occupancy percentage differences for midscale and economy hotels, 2001–2007**



**ADR percentage difference from competitive set**

Modest price undercutting of up to 5 percent showed the greatest comparative occupancy levels for hotels in the upscale segment. Deeper reductions, 5 to 10 percent, yielded the highest comparative occupancy levels for hotels competing in the upper upscale segment. Finally, when luxury hotels held rates 10 to 20 percent lower, they experienced the greatest occupancy percentages of any high-end hotels. Luxury hotels did not engage in price cuts beyond that point, unlike some hotels in the upper upscale and upscale segments. Modest RevPAR premiums were found regardless of segment for hotels that held their room rates less than 2 percent lower than competitors. Setting rates much lower yielded diminished RevPAR for all high-end hotels. We also note that, regardless of market segment, hotels that undercut competitors' prices took away market share from their competitors and enjoyed relatively higher occupancy. Those hotels lose in terms of RevPAR, however, even if they win in terms of occupancy.

Upscale and upper upscale hotels that priced within 2 percent of their competitive set are quite similar in their RevPAR and occupancy performance. It appears that room rates that are set a modest 2 percent higher or lower relative to the competition are both viable strategies for hotels in these market segments. Luxury hotels fare better by pricing 2- to 5-percent above their competitors in that their RevPAR performance is 3.00 percent above competitors, while occupancy is a mere .49 percent below their competitors, a smaller penalty than that of hotels which price less than 2 percent above the competition.

**Midscale and Economy Hotels**

Economy hotels can see relatively stronger occupancy by maintaining lower prices relative to the competition. For hotels in this segment that price 20- to 30-percent lower than their competitors, dramatic occupancy differences (16.51-percent better than competitors) can be obtained, as illustrated in Exhibit 5. It is unfortunate that this market share benefit also yields a substantial RevPAR underperformance, 11.36-percent lower than that of direct competitors. The experience of economy hotels that undercut their competitors on rate is similar to hotels in other segments. Their RevPAR suffers in relation to the competition. Economy hotels that price above their competitors see lower occupancy, but enjoy modest RevPAR benefits. In this

market segment RevPAR premiums are far more modest than in the midscale segments. Midscale hotels without food and beverage that price above the competition appear to have the most dramatic RevPAR benefits of the downmarket hotels. By the same token, midscale hotels with food and beverage have the largest RevPAR penalty when they price below the competition.

Lower occupancies and higher RevPARs are the norm for hotels that price above their competition in midscale and economy segments. Midscale hotels with food and beverage and economy hotels also see lower occupancy when they price just a little below the competition (less than 2 percent). Only hotels in the midscale segment without food and beverage see stronger occupancy for being modestly aggressive with rates. As one might expect, the greatest benefits from maintaining low prices was experienced by economy hotels that pursue this strategy, because their customers are considered to be the most price sensitive. Nevertheless, even in the economy segment higher prices of over 5 percent above competitors produced RevPAR benefits of about 1.5 percent (1.47–1.72%).

For all of the market segments in this seven-year period, the pattern of results reported in this study shows that undercutting competitors' prices leads to higher occupancy and lower RevPAR compared to the competition. The lower occupancy that comes with higher prices is more than offset by improved RevPAR. The dynamics between price and occupancy appear quite stable from segment to segment, but the degree to which higher relative prices produce lower relative occupancy does vary by segment.



## Popular Pricing Strategies

Since the most common price points in our sample were an average rate of either 5- to 10-percent above the competition or 5- to 10-percent below, we wanted to take a closer look at hotels in these two ranges. As shown in Exhibit 6, economy hotels were the biggest beneficiaries in terms of relatively occupancy when they priced 5- to 10-percent below competitors. A key exception here is that midscale hotels with food and beverage hotels do not get the same occupancy benefit from lower prices. We believe this is because this segment generally benefits when customers trade down to this segment from upscale properties.

For hotels that priced 5- to 10-percent above their competitors, the occupancy or demand penalty was greatest for economy hotels. Luxury hotels also saw substantially lower occupancy (3.14% lower) when pricing 5- to 10-percent above competitors. However, we see smaller occupancy differences for upper upscale hotels, which may be receiving customers that have traded down from the luxury level. The most interesting finding in this regard was for midscale hotels without food and beverage, which had higher occupancy than competitors when they priced 5- to 10-percent above the competition. This market segment was the only segment to see stronger occupancy when they charged higher prices than competitors.

Hoteliers who enjoyed the highest relative RevPAR when pricing 5- to 10-percent above their competitive sets were in the upscale, midscale without food and beverage, and upper upscale market segments (see Exhibit 6). Economy hotels, on the other hand, gained a RevPAR advantage of only 1.49 percent by charging elevated prices, which is not surprising given the customers' price sensitivity. The benefits that were obtained by midscale limited service hotels (8.41% higher) were notable, and again may be a function of customers' trading down. Once again, regardless of price segment, RevPAR benefits come to hotels that price above their competitors and consistent RevPAR penalties come to those which price below their competitors. The percentage differences in reduced RevPAR for low-price properties were similar across market segments, but those differences were the greatest for midscale full-service hotels and luxury hotels.

## Advice in Uncertain Times

Our analysis of the results of a large sample of hotels' pricing behavior over a seven-year time horizon, in bad and good times, and across diverse market segments raise the follow-

### EXHIBIT 6

#### RevPAR and occupancy percentage differences by market segment for hotels that price either 5- to 10-percent above or 5- to 10-percent below their competitors, 2001–2007

Market Segment	Occupancy Difference when Pricing Below Competitors	Occupancy Difference when Pricing Above	RevPAR Difference when Pricing Below Competitors	RevPAR Difference when Pricing Above
Luxury	2.29% Higher	3.14% Lower	5.31% Lower	4.13% Higher
Upper Upscale	2.43% Higher	.68% Lower	5.01% Lower	8.05% Higher
Upscale	2.42% Higher	1.66% Lower	5.08% Lower	9.17% Higher
Midscale with F&B	1.84% Higher	2.73% Lower	5.69% Lower	4.33% Higher
Midscale without F&B	3.66% Higher	1.03% Higher	3.86% Lower	8.41% Higher
Economy	4.16% Higher	5.29% Lower	3.75% Lower	1.49% Higher

ing implications, which we present as a series of questions and answers.

- Does aggressive pricing relative to the competition lead to increases in occupancy and ultimately increases in RevPAR?*

—Yes and no. Offering guests prices that are lower than the competition does lead to higher occupancy percentages for the lower-price hotel, but these comparatively lower prices also result in lower RevPAR performance than the competition.
- What happens when a hotel sets prices higher than its competitors?*

—Hotels that charge prices higher than their competitors have lower occupancies, but higher RevPARs, especially when they set prices significantly higher than those of their competitors. In adjusting prices, some competitors may experience customers' trading down to lower market segments, particularly out of luxury and full-service midscale hotels.
- What is the best way to make money compared to your competition? Should a hotel adjust its rates to fill rooms or maintain prices to earn what it can from customers?*

—The best way to have higher revenue performance than your competitors is to maintain higher rates than they do. A hotel should not set its rates below those of its true competitors if it wishes to enjoy a RevPAR premium.
- Do the dynamics between changes in price and occupancy differ by price segments (e.g., upscale, economy) or vary by year?*

—This study found small differences by market segment or by years of a strong or weak economy. The pattern of results is consistent across segments and years. We conclude that in good times or bad, setting prices higher than your direct competitors yields higher room revenues, while pricing below your competitors does not stimulate sufficient demand to provide the revenue boost needed to make up for the lower rates. Guests of luxury hotels appear to be insensitive to price positioning, while customers of economy hotels are quite sensitive to small price differences.

### Next Steps—Hotel Pricing Strategies

A wide variety of opinions exist on how to set hotel room rates. Many contend that discounting room rates is a necessity during tough economic times. As Jeff Higley put it: “The calls for a halt in discounting will fall on deaf ears as long as there are bills to pay. And as long as its part of a yield-management program, there’s nothing wrong with discounting.”<sup>10</sup> Along the same line, one hotelier recently noted, “It’s pure common sense to react to the elasticity of demand, especially in the current climate.”<sup>11</sup> Contrary to what common sense may suggest, this study implies that lodging demand is price inelastic. The evidence seems to suggest that lower prices mean lower revenue. Some hoteliers are cognizant of the need to maintain rates: “You’ve still got fixed costs for staff and energy,” said one. “So it’s a much better route to offer a complimentary spa treatment or bottle of Champagne in the room, as you’ve got all the people there anyway.”<sup>12</sup> Another suggested: “You’ve also got to be careful not to attract the wrong type of customers to your business, which you may do if you drop your rate dramatically.”<sup>13</sup>

Our study shows that hotels in direct competition bring in more money when they have comparatively higher prices. By contrast, hotels that offered low rates captured market

share from the competition, but they did not gain higher RevPAR. This may be due to the possibility that stealing share is not the same thing as stimulating new demand.

Nothing in these results suggests that good yield-management programs are not appropriate. To the contrary, in a study of over 30,000 hotels between 2001 and 2005, two of the authors found that hotels that priced above their competition were most effective at revenue management, defined as the rate-to-occupancy relationship.<sup>14</sup> So while good revenue management is essential, this study suggests there is nothing wrong with holding rates steady in both good or bad times, even when your competitors are adjusting their rates. For most market segments, holding rates even a small degree above the competition proved advantageous. Maintaining rates in a competitive market when others are pricing aggressively will mean relatively lower occupancy but your hotel will make up for the fewer filled beds with higher RevPAR, as compared to the competition.

In conclusion, this study argues against the race to the bottom that we have seen in so many markets. One hotelier put it this way, “When people break ranks it makes you look expensive. You obviously can’t have a cartel, but it also makes it difficult to put rates back up.”<sup>15</sup>

Each manager, owner, and chain executive will need to decide on their own how to deal with the challenges of pricing in a difficult market, but a policy of matching competitors’ rate cuts puts your hotel at the mercy of the most foolish or most desperate competitor. The race to the bottom is augmented by the transparency of pricing today. You gain no competitive advantage by lowering your prices because your competitors know almost immediately about your strategy and can instantly match it.<sup>16</sup> In short, not only can you not count on stronger revenue with lower prices, but once prices are reduced, it can be difficult to raise them. ■

<sup>10</sup> Jeffrey Higley, “Discounting Isn’t Bad When It’s Done Correctly,” *Hotel & Motel Management*, July 21, 2003, p. 8.

<sup>11</sup> Emily Manson, “To Discount or Not to Discount?,” *Caterer & Hotelkeeper*, Vol. 198, No. 4559 (2009), p. 44.

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*

<sup>14</sup> Linda Canina and Cathy A. Enz, “Revenue Management in U.S. Hotels: 2001-2005,” *Center for Hospitality Research Reports*, Vol. 6, No. 8 (2006), pp. 2-10.

<sup>15</sup> Manson, *op.cit.*

<sup>16</sup> Mark Lomanno, “Discounting Rates Leads to Decreased Product Value,” *Hotel & Motel Management*, Vol. 223, No. 21 (2008), p. 22.

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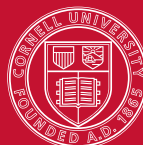
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