Title: Hotel Room Pricing and Yield Management

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Hotel Room Pricing & Yield Management

A Example of Hotel Room Rate

- Rack rate: full price without discount that a hotel quotes as a room charge

Sample Hotel Rack Rates

Room Type	Rack Rate
Standard Double	$ 109.00
Standard King	$119.00
Executive Double	$149.00
Executive King	$164.00
Executive Double (Concierge Level)	$199.00
Executive King (Concierge Level)	$214.00
Double Parlor Suite	$269.00
King Parlor Suite	$289.00

Determining the Proper Room Rate

- Room rates reflect not only costs / investments & rates of return, but also markets (supply & demand) & competition, and quality of management
  - Must be large enough to cover costs and a fair return on investment (internal cost considerations)
  - Must be reasonable enough to attract and retain guests (external market condition)
- Traditional room rate calculation focus on the needs of the enterprises not on the needs of the guests.
- Modern pricing strategies consider the customer's ability and willingness to pay.

Traditional Pricing Strategies

Rule-of-thumb Method

- Building Cost Room Rate Formula
  - The average room rate should equal $1 per $1,000 of construction cost
    - A 200 room hotel, costing $14 million, should have a room rate of _____
      - $14 million / 200 rooms / $1,000 = $70
    - Hotel-industry analysts say the Trump Organization's planned 261-room luxury hotel in the Old Post Office Pavilion in Washington would likely require premium room rates to cover its $200 million development cost. (The Washington Post)
- Shortcomings
  - Only consider historical construction costs and ignore current costs
  - A 70% occupancy assumption is required

Traditional Pricing Strategies
Hubbart Room Rate Formula

- Bottom up approach
  - In contrast to the top down approach used by income statement
    - Start with net income required,
    - calculate costs and expenses,
    - and then determine sales revenue required and prices to be charged

Step 1	Calculate the hotel's desired net income or return on investment
Step 2	Calculate all operating costs
Step 3	Calculate all fixed expenses
Step 4	Calculate non room profit / loss
Step 5	Determine room revenue needed to cover costs & NI / ROI
Step 6	Forecast rooms to be sold based on estimated occupancy
Step 7	Calculate the hotel's required ADR

Hubbart Room Rate Formula - Example

• Net income desired	414,000
• Operating costs	1,102,800
• Taxes, Insurance & leases	273,000
• Depreciation	294,750
• Total (NI + costs)	2,084,550
• Less income from sources other than rooms	(139,200)
• Room revenue needed to meet goals	**$1,945,350**

1. Annual room revenue needed	$1,945,350
2. Number of rooms available (Per Day)	88
3. Annual rooms available (Item 2 x 365)	32,120
4. Number of rooms to be sold (item 3 @70%)	22,484
5. ADR required to meet goals (item 1 / item 4)	$86.52

Shortcomings of Hubbart Formula

- **Shortcomings of the formula**
  - It is inward looking at what the hoteliers need, rather than outward looking at market conditions (what the customers need)
  - Many assumptions are problematic
    - What about net income and operating cost projections?
    - What occupancy rate is attainable?
      - Occupancy is a function of room rate!!
    - What about the role of other departments like F & B?
      - Should low estimates for other departments force us to increase rates?
      - Should high estimates for other departments force us to lower rates?
  - It calculates the average room rate, not the rate for any specific room
- **Summary**
  - It is a worthwhile formula to use as a guideline for zero-based room rates, after recognizing the problems inherent in it.

Square Foot Calculation

- Room rates based on room size
  - Use numbers from Hubbart Formula, but use square footage of room, **not** number of rooms

1. Hubbart formula calculated that annual required revenue is $1,945,350 and the hotel has 27,250 square feet in 88 rooms
2. @ 70% occupancy only **19,075** sq. ft. will be occupied (per day)

   27,250 x 70% = 19,075
3. Annual occupied square footage is **6,962,375** sq. ft. (Item 2 x 365)

   19,075 x 365 = 6,962,375
4. Daily required revenue per square footage occupied is **$0.279** (annual revenue / Item 3)

   $1,945,350 / 6,962,375 = $0.279
5. A 300 sq. ft. room would sell for **$83.82** (item 4 x 300)

   0.279 x 300 = $83.82

   A 450 sq. ft. room would sell for **$125.73** (item 4 x 200)

   0.279 x 450 = $125.73

In-class Assignment

- ✓ **The Hubbart Room Rate Formula**
  - Operating Expenses 2,000,800
  - Taxes and Insurance 400,000
  - Depreciation 350,750
  - Reasonable ROA 900,000
  - Income from other sources 340,000
  - **Amount needed from room sales** **$ _____**

1. Number of rooms available (Per Day) 75
2. Occupancy % 75%
3. Calculate ADR $ _____

- ✓ **The Square Foot Calculation -** use data from the above
  - Hotel has 21,955 square feet in 75 rooms
  - @ 75% occupancy only
  - Daily required revenue per occupied square footage is _____
  - A 300 sq. ft. room would sell for $ _____

Modern Pricing Strategies

Modern pricing systems reflect market condition including competition, supply and demand, etc.

Competitive Pricing	Charge what the competition charges.
Follow-the-Leader Pricing	Charge what the dominant hotel in the area charges.
Prestige Pricing	Charge premium price, and justify it with better product and/or service levels.
Discount Pricing	Reduce rates below those of competitors without considering operating costs.

Room Rate Types

- Special event rate
  - super or premium rack rate
- Seasonal rate
- Negotiated rates
  - Corporate rates; Government rates; Group rates (SMERF, AAA, AARP, tour group, etc.) ; contract rooms
- Fade rate (flex rate)
  - Reduced rate when guests exhibit price resistance
- Package rate
  - American plan (AP) or modified American plan (MAP) rate; All-inclusive plan rate
- Day or part-day or use rates
  - makes possible **over 100%** occupancy

Modern Pricing Strategies
Yield Management

Law of supply and demand:

- Law of demand: when supply is held constant, increase in demand results in increase in price
- Law of supply: when demand is held constant, increase in supply leads to decrease in price

Hotel short-term supply and demand:

- In the short-term, hotel room supply will stay the same; demand will increase and decrease depending on the time frame examined.
- Perishability of hotel rooms.

Yield Management

History

- Airline industry was one of the first to actively manage pricing based on changes in demand
- Other industries with a perishable product followed suit, including hotels, rental car companies, cruise ships, time shares, live theatres

Implementation

- Room rates vary by day of week, time of month, season, or in response to local special events

Techniques

- Based on forecast demand, eliminate discounts in high demand periods, increase discounts in low demand periods, implement “special event” rates, and use MLOS and CTO to maximize occupancy

Yield / Revenue Management

- The act of controlling rates and restricting occupancies to maximize room revenue
- Techniques & procedures used to manipulate occupancy, ADR, or both to maximize room revenue

Room Revenue = Rooms occupied x ADR

To maximize room revenue

Increase

Occupancy

Average Daily Rate

Other Definitions

#1: The first definition for revenue management is a more technical one and is very broad in scope:

*"Revenue management is the art and science of **predicting** real-time customer **demand** at-the-micro market level and **optimizing** the price and availability of products to match that demand."*

#2: The next definition emphasizes the coming together of four important components. This is the second definition as it cannot be accomplished until the first one is understood:

*"To sell the **right product** to the **right customer** at the **right time** for the **right price...*** and via the right channel."

#3: In this definition, the focus is on combining elements of the product, the customer and the price so that they come together to generate the most revenue for a company. Or, more simply put,

"Offering room rates and inventory controls that are most appropriate for the anticipated demand."

Practicing Yield Management
Managing Rate

Knowing demand for rooms is key !

- When demand for rooms is **high**, drive ADR by selling at 'rack rate' or 'special event rate' : e.g. college football game night
- When demand for rooms is **low,** drive occupancy by offering discounts: e.g. night before Thanksgiving
  - ✓lowering room rates may or may not achieve the desired outcome

Yield Management strategy based on room demand

Forecasted room demand	Rate strategy
90-100% occupancy	Offer no discounts
70-90% occupancy	Offer discounts up to 10%
50 - 70% occupancy	Offer discounts up to 20%
Less than 50% occupancy	Offer discounts up to 30%

UNDERSTANDING THE MARKET

Historical Performance

Most revenue executives find that tracking the following information is beneficial to their decision making over time:	
Room nights	Cancellation lead time
Revenue	RevPAR
Lead time/Booking pace	Cancellations
No shows *(both guaranteed and non-guaranteed)*	Transient rooms
Group rooms	Arrivals
Departures	Walk-ins
Extended stays	Early departures
Denials/Regrets *	Source of bookings
ADR (Average Daily Rate)	

Practicing Yield Management

Managing Inventory – stay control

Example: Forecasted room demand (Hotel with 300 rooms)

	Friday	Saturday	Sunday
Rooms left to sell	120	25	250

→ Identifying Saturday as the day for MLOS of two days or CTA to maximize total weekend occupancy

MLOS: "Minimum Length of Stay" Hotel requires guests to stay a designated minimum number of nights

CTA: "Closed to Arrival" Hotel declines reservation for guests attempting to arrive on this specific date

Managing Inventory: Overbooking

- A hotel knowingly sells more reservations than it has rooms available
- The perfect fill is an elusive situation
  - Guest no-shows (8% industry-wide)
  - Cancellations
  - Under-stays
- Common overbooking policies
  - Arranging substitute accommodations
- Consequences of ‘walking’ a guest
  - Financial costs
  - Public relations

Displacement Analysis

- Many hotels now do a displacement analysis for group opportunities, taking into consideration the entire group value and comparing that to the value of transient business that would be displaced by the group. The group value includes all food and beverage spending, meeting room rental and any additional outlet spending that is anticipated, minus any costs that are involved.

Distribution Strategy

- Creating an appropriate distribution strategy has also become a very important part of revenue management. More and more, the industry is becoming aware of the importance of analyzing its costs and profitability by channel.
- **2012 2nd Quarter Global Hotel Industry Data – distribution channel performance (top 50 markets)**

<table>
<tr><td>Property direct (36.7%)</td><td>Global Distribution System (GDS) 9.1%</td></tr>
<tr><td>Chain / brand website (21.3%)</td><td rowspan="2">OTA (merchant model vs. opaque model) 16.8%</td></tr>
<tr><td>Central Reservation office bookings (16.1%)</td></tr>
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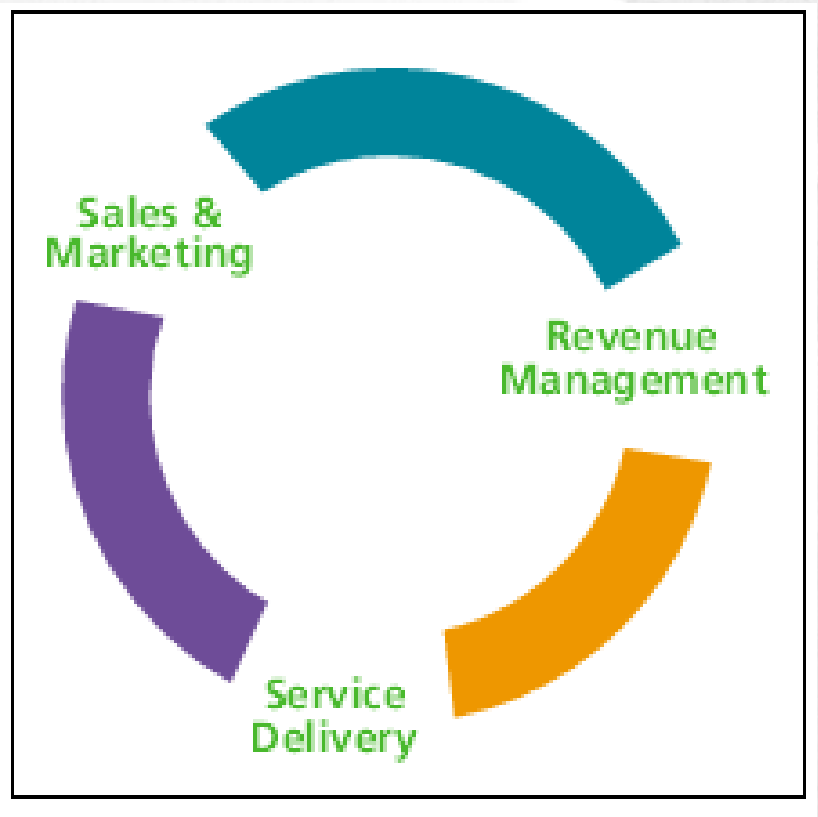
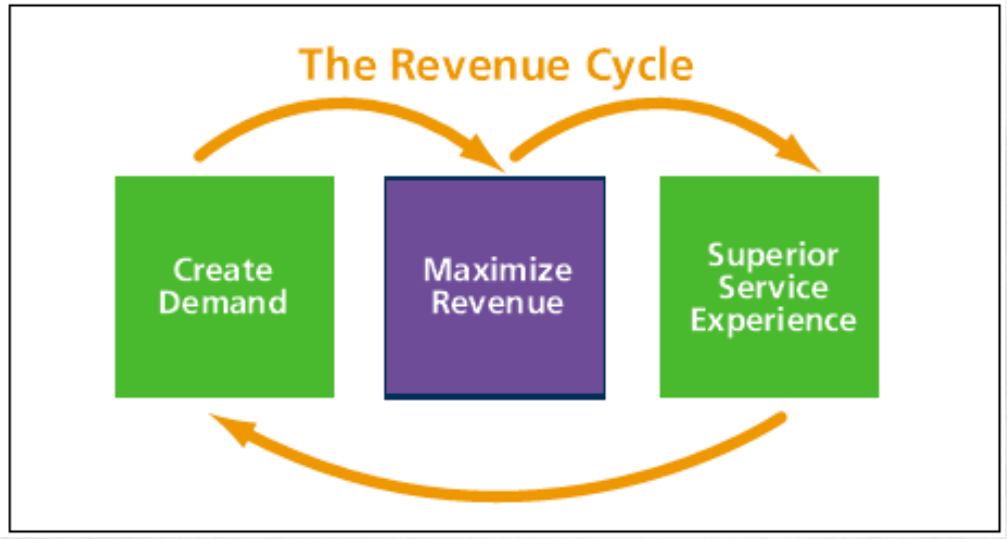
INTERDEPARTMENTAL INTEGRATION & ORGANIZATION

Integrating Revenue Management into the Organization





Price-Occupancy Mix

- Assumes 200 rooms and a 30-day month, what are the monthly gross yield for these three hotels with different ADR and occupancy?

Hotel	ADR ($)	Occupancy %	Monthly Gross Yield (revenue)
A	75	60%	
B	100	45%	
C	50	90%	