SHA533: Pricing Strategy and Distribution Channels in Hotel Revenue Management
This course includes:

- Four self-check quizzes
- One discussion review assignment

Completing all of the coursework should take about six to eight hours.

**What You'll Learn**

- To recommend approaches to making price more variable
- To discuss the implications to revenue management of using various distribution channels

Welcome! Pricing is one of the most powerful tools that a hotel can use to drive revenue. This course, produced in partnership with the Cornell School of Hotel Administration, examines the limitations of the one-price model, the benefits of making price more variable, the wisdom of using rate fences to segment markets, and the challenges and rewards of managing distribution channels in accordance with revenue management principles. The course also looks at customers’ perceptions of fairness regarding pricing policies.

Sheryl Kimes
Professor, Cornell University

Sheryl E. Kimes is a professor of operations management at the School of Hotel Administration. From 2005-2006, she served as interim dean of the School and from 2001-2005, she served as the school's director of graduate studies. Kimes teaches restaurant revenue management, yield management and food and beverage management. She has been named the school's graduate teacher of the year three times. Her research interests include revenue management and forecasting in the restaurant, hotel and golf industries. She has published over 50 articles in leading journals such as Interfaces, Journal of Operations Management, Journal of Service Research, Decision Sciences, and the Cornell Hospitality Quarterly. She has served as a consultant to many hospitality enterprises around the world, including Chevy's FreshMex Restaurants, Walt Disney World Resorts, Ruby's Diners, Starwood Asia-Pacific and Troon Golf. Kimes earned her doctorate in Operations Management in 1987 from the University of Texas at Austin.
Module Introduction: Pricing

Price and duration are the strategic levers of revenue management. In this module, learn how to vary prices to maximize RevPAR. Once you understand how to make prices more variable, discover how to use rate fences to segment your market by price. Learn to match the right room to the right price for the right customer.

Should you make your price more variable? The revenue management approach insists on it. As a revenue manager, you need the flexibility of a variable-price approach to be able to offer the right room at the right price. You need an in-depth understanding of the role of price so you can use price strategically. In this module, begin your investigation of the pricing world beyond the one-price method.

You will also deepen your understanding of variable pricing. Learn how prices were set according to traditional methods and how they are set within a revenue management framework. Learn about positioning your prices in relation to those of your competitors and explore different methods of using available prices in the selling process. As you discover here, creating your optimal price mix includes pricing, positioning, and selling.

This module also continues the exploration of variable pricing. Having considered ways of developing price mixes, we’re ready to examine rate fences to answer the question: Who pays what price? Rate fences establish rules by which customers segment themselves into price groups. Understanding and using rate fences is critical to the success of your variable-price plan.
Read: About the Course Discussions Assignment

Additional discussions with other eCornell students and your instructors can be found in the eCornell Forum. Join in these extended Hotel Revenue Management discussions but only discussions contained within the course can be used in the Course Discussions Assignment.

Discussions with your instructor and colleagues are an important part of your learning. As part of your coursework, you must respond meaningfully to two of the discussion questions in this course.

At the end of the course, you will complete a Course Discussions Assignment. For this assignment, you will write an essay for each of two questions you responded meaningfully to. Your essays could cover new ideas you discovered, changes you will make as a result of this discussion, next steps you will take based on the discussion, etc. Each essay should be about 400 words (two paragraphs).

What is meaningful participation?

A meaningful discussion post:

- Is at least 200 words or more
- Responds directly to the prior post
- Extends the discussion beyond "I agree" or "I think that is right".
- Is on topic and contributes to the core discussion
Read: The Listed Price Hotel

All the rooms at the Listed Price Hotel are available at the same rate, which is listed everywhere the hotel advertises. Some consumers seem to consider their rate too high, but no one has said it's too low. Year after year, the hotel continues to be moderately profitable, and no one on the management team has questioned the rationale behind having just one room rate. What do you think—is it time to revisit the rate structure at the Listed Price?

Explore the activities in this topic to find out about alternatives to the one-price model.
Key Points

Hotel revenue management is all about selling the right room to the right customer at the right price at the right time—that is, selling fixed capacity as profitably as possible.

This course focuses on the notion of "the right price": how to set prices and how to determine who pays what price.

One Price

In the process, we consider how price can be made more variable, why many prices are better than one, and what determines whether your customers are likely to believe your pricing practices are fair.

Let's start with the one-price model, in which a hotel offers only one rate for its rooms. Using this approach, the hotel may achieve high occupancies but miss opportunities for greater profits. As shown in Figure 1, the one-price model fails to capture additional profits from customers who would be willing to pay more and offers nothing to those consumers who insist on paying less.

In this example, total revenue is $800,000 ($4000 per room for 200 rooms) for a new luxury hotel charging a single price.

Three Prices

Let's see what happens when we introduce additional prices. Figure 2 shows the addition of both a higher rate and a lower rate, resulting in greater revenue. With available prices of $5000, $4000, and $2000, total revenue is now $1,100,000. This is a startling improvement over what we found for the one-price model.

Is it really worth creating a rate structure that captures these revenues? Yes. Research shows that a 1% increase in price results in about a 12% increase in net income—not just in the hotel industry, but in a variety of other industries as well.

Not surprisingly, hotels increasingly have moved away from the one-price model and toward a more variable model. Making price more variable is critical to successful revenue management. However, making price more variable is not a
simple task. In early experiments, many hotels made lower rates available only to those customers who asked for them. Those consumers who knew to haggle got lower rates than those who didn't, but when those who hadn’t haggled learned of this, customer dissatisfaction resulted. Through these trials, hotels learned they needed a different approach to making price more variable that would increase revenues and appeal to all of their customers.

How are prices set and selected according to the best revenue management practices? We look at this question and many others in the course pages that follow.
Watch: One Price is Not Enough
Read: Discounting in the Hotel Industry

Key Points

"Regardless of how hotels set their rates, they need to put an end to haggling."

View the "Discounting in the Hotel Industry: A New Approach" article

"Discounting in the Hotel Industry: A New Approach" by Richard D. Hanks et al., published originally in the *Cornell Hotel and Restaurant Administration Quarterly* in 1992, was reprinted in 2002 as a classic in the field of revenue management. The authors present an approach to discounting that is a favorable alternative to haggling. This approach was considered new in the early 1990s, but is widely accepted today.

The article examines several approaches to setting rates including offering a single price, setting rates by room type, and using rate fences. In particular, it looks at industry reaction to rate-fence tests by Marriott in the 1990s. Find out about Marriott's test results and about the authors' recommendations for setting rates.
Read: In the Mix

For years, the Listed Price Hotel has made every room available at the same reasonable price. Lately some of the hotel’s managers have been talking about making room rates more variable. No one on the team feels comfortable leading this effort, so several team members have expressed interest in bringing in professionals from other organizations to provide consultation. The general manager has asked to meet with you to discuss your ideas about how to develop prices. Can you advise the Listed Price on this critical issue?

Explore the activities in the following pages and enhance your knowledge of pricing, positioning, and selling.
Read: Price Elasticity

Key Points

The tendency for demand to change with changes in price is the price elasticity of demand.

In pricing and selling, the challenge for the seller is to be able to distinguish between buyers who are willing to pay a high price and those who are not.

Before we begin to look at pricing and selling strategies, let’s first consider two important concepts central to these topics: demand and the price elasticity of demand. Demand can be defined as the relationship between the price of a product and the quantity of that product consumers will purchase at that price. If the sales volume of the product at its current price is high, demand is high. If consumers are not purchasing the product at its current price, demand is low. The tendency for demand to change with changes in price is the price elasticity of demand.

Inelastic Demand

When consumers purchase about the same quantity of a product regardless of changes in price, demand is said to be inelastic. Here are some situations in which demand is likely to be inelastic.

Few alternatives. Inelastic demand often indicates low competition and highly differentiated services-demand doesn't vary because there are few or no close substitutes for the product. For example, the demand for a particular hotel is likely to be inelastic if that hotel is the only one in the downtown area.

Insignificant price. Demand may be inelastic because the product price may represent a very small portion of the consumer’s budget. For example, the demand for chewing gum and breath mints is likely to be inelastic.

New product. Demand for a product is likely to change over the product’s lifetime. When the product is new, demand may be inelastic because there are few or no other products like it available. However, the demand for this product may become elastic in the long term-competitors may emerge or the product may become less desirable.

Elastic Demand

When consumers purchase significantly less of a product due to price increases and significantly more due to price reductions, demand is said to be elastic. Here are some situations in which demand is likely to be elastic.

Many alternatives. Elastic demand often indicates high competition and standardized services. Products with many close substitutes are usually characterized by elastic demand. For example, a budget motel in a downtown area with three other budget motels is likely to have elastic demand.

Significant price. Demand for products that make up a large portion of the consumer’s total budget tends to be elastic. The
demand for dinner at an expensive, four-star restaurant may be elastic.

Elasticity and Price Sensitivity

In pricing and selling, the challenge for the seller is to be able to distinguish between buyers who are willing to pay a high price and those who are not. Enterprises must be careful not to mischaracterize consumer groups or the elasticity of demand.
Read: Setting Prices

Key Points

In revenue management, it is common to use a combination of demand-based and competitive pricing.

Price is one of the two strategic levers of revenue management and is critically important to increasing revenue. Let's look at a few approaches hotels can use to set prices. As you review these approaches, consider which ones might be suitable for revenue management.

Single-rate pricing

One rate is available to all transient customers. The one available rate can be changed by day of week or by season, but this approach is not designed to respond to changes in demand and does not take into account customer ability or willingness to pay. Single-rate pricing is easy to administer and does not require sophisticated systems to support it.

Cost-based pricing

The most traditional method of setting prices is cost-based pricing. One approach to cost-based pricing is to charge at least a dollar in rate for every one thousand dollars invested in a room. This method is no longer widely used in the hotel industry, although it remains common in food and beverage businesses.

Competitive pricing

Competitive pricing sets prices according to what competitors are charging. This is a common and fairly effective approach in the hotel industry. Now that Internet sites and services have made it easy for customers and potential customers to research your rates and the rates of your competitors, competitive pricing has become increasingly important.

Competitive pricing has its drawbacks. You must be careful, for example, not to follow competitors who aren't making good pricing decisions. It may be preferable to be in the position of price leader rather than price follower.

Demand-based pricing

As the name implies, this approach is designed to respond to levels of demand. Demand-based pricing looks at the price elasticity of customers—that is, how sensitive customers are to changes in price. During low-demand periods, discounted rates are open. During periods of high demand, discounted rates are largely closed.

The approaches to setting prices reviewed here can be used singly or in combination. In revenue management, it is common to use a combination of demand-based and competitive pricing.
Watch: Positioning and Selling Strategies
Read: Positioning Your Price

Key Points

Many factors influence the pricing decisions you make, including the rates your competitors charge and how your product compares to your competitors' products.

Analyze these factors to position your room rates appropriately relative to the competition.

Many factors influence the pricing decisions you make, including the rates your competitors charge and how your product compares to your competitors' products. The following approaches will help you analyze these factors to position your room rates appropriately relative to the competition.

Approaches to Positioning Your Price

Skim - to skim, set your prices higher than the competition does so you can "skim off" the higher-paying customers. If the competition is charging $79, you might set your rates at $89 and $99, in hopes of getting the people who are willing to pay a bit more.

Match - to match, set one rate to match the competition and another rate slightly higher. For instance, if the competition is charging $79, you might also charge $79 for one type of room and have an $89 rate available for a better room or option.

Surround - to surround, offer one price that's lower than the competition's price and one price that's higher. If the competition is charging $79, offer a $69 rate to attract the bargain-seekers, and offer an $89 rate for a slightly better room or option.

Undercut - to undercut, offer a price that is the same as your competition and a lower one as well. If the competition is charging $79, offer a $79 rate and a $69 in hopes of attracting more customers.

Penetrate - to penetrate, set your rates lower than those of the competition. If the competition is charging $79, offer rates such as $69 and $59 in hopes of getting consumers to try your products.

<table>
<thead>
<tr>
<th>Skim</th>
<th>Match</th>
<th>Surround</th>
<th>Undercut</th>
<th>Penetrate</th>
</tr>
</thead>
<tbody>
<tr>
<td>99</td>
<td>89</td>
<td>89</td>
<td>79</td>
<td>69</td>
</tr>
<tr>
<td>89</td>
<td>89</td>
<td>89</td>
<td>79</td>
<td>69</td>
</tr>
<tr>
<td>79</td>
<td></td>
<td></td>
<td></td>
<td>69</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>59</td>
</tr>
</tbody>
</table>

The table above illustrates the five approaches to positioning your price against the competition's. In this example, the competition is charging $79.

Now, print this page to use the table below to help you set prices using the five positioning methods described here. Enter
the competitor rate in the left-hand column, and set your own higher, lower, and equal rates accordingly.

<table>
<thead>
<tr>
<th></th>
<th>Skim</th>
<th>Match</th>
<th>Surround</th>
<th>Undercut</th>
<th>Penetrate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitor Rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$________</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Once you have set your rates, you must decide how to quote those rates in the selling process to get the best price for your product. Let's consider some approaches to selling.

**Top-down price quoting**

The starting point for top-down price quoting is the highest available rate. From there, the seller applies discounts as required to arrive at an acceptable price. In the hospitality industry, a booking agent may begin by quoting a high rate and gradually reduce that rate if the caller expresses an unwillingness to pay. But this method can cause customer dissatisfaction. Hotel guests who paid higher rates may discover that guests who asked for lower rates paid less, and they may be upset!

**Bottom-up price quoting**

This method starts with a low basic price. From there, the seller suggests "extras" that result in higher-priced options. In the hospitality industry, a bottom-up pricing approach might begin with the rate for a basic room and arrive at a higher price through the addition of amenities or deluxe features.

**Best-available-rate (BAR) price quoting**

This approach guarantees that the hotel quotes the lowest possible rate. Hotels developed this approach when they found that customers were able to get lower room rates from third-party Internet sites than from the hotel directly. The best-available-rate guarantee encourages customers to book rooms with hotels directly rather than through third parties.
Menu guide

The menu-guide approach provides a list, or menu, of several different rates for the customer to review. These rates may include a basic rate, an upgraded rate, and a rate available to selected customers through a club membership or other designation. The guest is asked which rate he or she would like to pay.
Read: The Brussels Brasseurs

The Brussels Brasseurs is one of the newest football teams in Belgium and plays in a 20,000-seat stadium divided into three zones. All seats are priced at €20. Most people want to sit in Zone 1, but only 15% of the seats are located there, and according to sales data, the stadium is rarely sold out.

The manager of the Brussels Brasseurs has asked for your help. Can you advise him on how to increase stadium occupancy and maximize revenue?

Explore the following pages to build your expertise regarding rate fences. Then you'll be ready to make your recommendations.
Watch: Introduction to Rate Fences
**Read: A Guide to Rate Fences**

**Key Points**

A wide variety of rate fences exist, including physical, product line, consumer, transaction, and controlled availability rate fences.

A rate fence is a tool sellers use to increase revenue. The rate fence sets the condition consumers must meet in order to qualify for one of the available prices for a product.

Rate fences can be used to provide resources to some and to deny resources to others. For example, some rate fences are designed to provide special rates for certain consumers, while other rate fences are designed to exclude ineligible consumers from special rates.

A wide variety of rate fences exist. Here are some examples.

<table>
<thead>
<tr>
<th>Types of Rate Fences</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Physical</strong></td>
</tr>
<tr>
<td>• Size of room</td>
</tr>
<tr>
<td>• Floor of room</td>
</tr>
<tr>
<td>• Amenities</td>
</tr>
<tr>
<td><strong>Product Line</strong></td>
</tr>
<tr>
<td>• Deluxe</td>
</tr>
<tr>
<td>• Standard</td>
</tr>
<tr>
<td>• Economy</td>
</tr>
<tr>
<td><strong>Consumer</strong></td>
</tr>
<tr>
<td>• Frequent customer</td>
</tr>
<tr>
<td>• Senior Citizen</td>
</tr>
<tr>
<td><strong>Transaction</strong></td>
</tr>
<tr>
<td>• Online reservation</td>
</tr>
<tr>
<td>• Nonrefundable reservation</td>
</tr>
<tr>
<td><strong>Controlled Availability</strong></td>
</tr>
<tr>
<td>• You must ask</td>
</tr>
<tr>
<td>• You must live in the state of New York</td>
</tr>
</tbody>
</table>

Physical rate fences correspond to characteristics of the product. In the hospitality industry, these include the size of the room, the floor on which the room is located, the way the room is furnished, the view the room provides, and the amenities...
available with the room. Such characteristics present opportunities to charge different rates for rooms in the same hotel.

**Product line**

Product-line levels create rate fences according to top-of-the-line, middle-range, and low-end product classifications.

**Consumer**

These rate fences correspond to characteristics of the consumer. The age of the consumer, the institution with which the consumer is affiliated, the consumer's status, or his or her ability to pay can all define rate fences.

**Transaction**

These rate fences are determined by the transaction. For example, nonrefundable reservations or those made online or through a promotion can generate corresponding rate fences. Other transaction particulars suggesting rate fences include time of purchase, place of purchase, and quantity of purchase.

**Controlled availability**

These rate fences are based on coupons, direct mail, geographic location, place of purchase, and negotiations (you receive the price only if you ask for it).
Read: A Commentary on Discounting

Key Points

"It behooves a hotel (or, for that matter, any business) to design its rate fences carefully..."

In "A Retrospective Commentary on 'Discounting in the Hotel Industry: A New Approach,'" Professor Kimes looks back at the article by Richard D. Hanks et al., published originally in 1992 in the Cornell Hotel and Restaurant Administration Quarterly, and argues that (ten years later) the hotel industry is gradually catching on to Hanks's revenue-enhancing technique.

Read more of what Professor Kimes has to say about the increasing use of discounting in the hotel industry.
Read: Rate Fence Mistakes

Key Points

Though the rate-fence concept is simple, creating good rate fences and using them effectively are not.

Rate fences are used widely in the hotel industry and in many other industries, too. Though the rate-fence concept is simple, creating good rate fences and using them effectively are not. Here are some mistakes to avoid.

Too much focus on discounts

One of the biggest mistakes that hotels and other industries make is to focus too much on creating rate fences that allow customers to qualify for discounted rates, and not enough on creating rate fences for middle- and high-end rates. What about those customers who may be willing to pay more? It’s a mistake to leave them out of your rate-fence strategy.

Not effective

Some rate fences are not effective. For example, consider a rate fence that is meant to qualify customers for a discount. If the customer qualifies simply by showing a coupon or asking for the discount, it’s not an effective rate fence.

Allowing everyone to qualify for your discounted rates is a mistake. The rate fence should provide value for both you and your customer. When creating a rate fence, think about how you will ensure that people who don’t qualify aren’t included.

Too difficult
When designing a rate fence, keep it simple. Reservation agents and front-desk clerks have limited time to spend qualifying customers, so be sure the rate fences you develop are easy to administer. Be sure your customers can understand them, too. If a rate fence is difficult to follow, it will not be successful.

Insufficient price differentials

Make sure there are significant differences between prices. For example, if you decide to charge $110 for a room with a view and $100 for a room without a view, customers may not see these prices as different.

Wrong segmentation criteria

Try to use objective criteria rather than personal criteria. It's much easier to ask customers whether they work for a particular company or are members of a particular group than to ask how old they are or what color their eyes are.

Unfair

For businesses using demand-based pricing, rate fences address the issue of perceived fairness, providing a way to implement revenue management with reduced risk. If fences will be seen as fair, they need to be logical, transparent, clearly communicated, and fixed so they cannot be circumvented.
Read: Benefits of Rate Fences

Key Points

Rate fences provide flexible pricing using rules that enable your customer base to segment itself.

Consumers consider rate fences to be fair, and fair practices are very important to the future success of the business.

Rate fences provide flexible pricing using rules that enable your customer base to segment itself. Here are some of the key benefits they provide if they are designed well and used effectively:

1. Increased sales to price-sensitive consumers using lower rate options. Without discounts, these consumers might not purchase the product at all. With discounts, they can be "priced into the market"—that is, offered a price they are willing to pay. For example, a group of consumers might think a price of $200 is too expensive for the latest cell-phone technology, but that group may readily buy cell phones priced below $100 through a special offer. The key is to develop a rate fence that appeals only to this part of the market.

2. Increased sales at higher rates. Rate fences offering benefits such as a complimentary breakfast, flowers for the room, or airport transportation target those hotel customers willing to pay a higher rate.

3. Increased revenue. For example, if a spa treatment is made available at only one price, price-sensitive consumers may find that price too high, and some customers might end up paying less than they were willing to pay. If the spa offers several price options and creates appropriate fences, these additional revenues can be captured.

4. Increased market share. Again, a lower price may make it possible for price-sensitive consumers to become customers, increasing the market share; or special offers to groups (for example, a corporate discount, a credit-card offer, or travelers’ club discount) may add new consumers to the product’s market.

5. Market segmentation that will help you meet customer needs as you increase revenue. Consumer response to your rate fences, especially through purchasing, may provide you with important market data regarding consumer preferences. For example, will your customers accept restrictions of time and date to get a lower rate, or would they rather pay full price? Are certain amenities so important that your customers will pay a higher price to secure them? Your knowledge of what's important and unimportant to your customer groups will help you meet their needs.

6. A positive image of the business. Consumers consider rate fences to be fair, and fair practices are very important to the future success of the business.
Activity: **Fill the Stadium**

An assessment activity appears below. Fill the stadium to demonstrate your understanding of the concepts introduced in this module.
Module Introduction: Managing Price

Let's consider two important price-management issues. First, customers don't automatically see variable-pricing methods as positive, so this module helps you fine-tune your management of customer perceptions and address questions of fairness. Second, this module considers the complexities of multiple distribution channels and examines the challenge of distribution-channel management.

Assuming you're familiar with the pricing, positioning, and selling approaches you'll need to implement variable pricing, you're ready to consider some of the management aspects of variable pricing. With variable pricing, your customers may be confused by price changes and what seems like price inconsistency. If they have expectations about what your product should cost, will they consider your variable-price practices fair? This module takes an in-depth look at the interaction of price changes, perceptions of fairness, and revenue.

Consumers interested in booking hotel rooms have many options available to them, including phoning the hotel directly, using a central reservation desk, searching the hotel's Web site, using an online service, or contacting a travel agent. This range of choices presents management challenges for hotels, because hotel managers must coordinate the reservation information coming in from multiple channels. In addition, they must select what channels to use, set appropriate rates for channel sales, and allocate optimal numbers of rooms to each channel. In this module, consider distribution channels and the management issues they create.

Let's discuss! If you have not already done so, this would be a great time to respond to the course discussions. Don't forget that you will have a Course Discussions assignment due at the end of the course!
The Archipelago Hotel is committed to providing excellent service, and that can be seen in the many efforts its staff members make to build strong, positive relationships with their guests. The Archipelago's competitor, the Tidal Vista Resort, targets a similar clientele, and is well known for its spectacular ocean views. Around a glass-topped table at a local café, several travelers shared some thoughts about the two hotels. As luck would have it, the beverage manager of the Tidal Vista overheard their conversation!

From what the manager could tell, one traveler was a first-time guest at the Archipelago. He had stayed at the Tidal Vista during his previous visit to the area, but decided not to return because, as he said, "Their rates went up-for no reason!" A second traveler had been a guest at the Archipelago many times over the years. He reported that his room rate was higher this time, too, but he was not concerned. "It's a fair price," he told the others. Several at the table agreed.

On her way back to work, the beverage manager wondered what the Tidal Vista had done wrong. Both hotels raised their rates, but their customers responded differently.

For more insight into the question of how best to change prices, please explore the resources in the following pages.
Watch: Reference Transactions
Read: Perceived Fairness

Key Points

"Researchers have shown that fair behavior is instrumental to the maximization of long-run profits."

View the "Perceived Fairness of Yield Management" article

What do your customers consider fair practices? This is a question you must consider when developing prices and determining how to sell rooms. Certain revenue management practices may be viewed as unfair, especially by consumers who aren't familiar with an approach they encounter or have not been given sufficient information about how an approach is being used. If customers view your practices as unfair, they will be less likely to support your business in the future.

Read "Perceived Fairness of Yield Management" by Professor Kimes to see how consumer perceptions can change over time and to gain some interesting context for the two fairness polls you encounter in this course.
Key Points

Applying revenue management practices to pricing is complicated by what customers believe about fairness.

Consumers may perceive demand-based pricing techniques as unfair.

Best-available-rate practices have turned individual room rates into important competitive information.

Applying revenue management practices to pricing is complicated by what customers believe about fairness. Here we look at customers' perceptions of demand-based pricing and best-available-rate pricing. Do your customers believe these practices to be fair?

Perceived Fairness of Demand-Based Pricing

Revenue management pricing is usually a combination of demand-based pricing and competitive pricing. Consumers may perceive demand-based pricing techniques as unfair for at least two reasons. First, the higher price during periods of higher demand may exceed consumers’ reference price. Complicating this issue, consumers may have derived their reference price from a lower price offered by the same hotel during periods of lower demand, creating a low perceived value.

The other reason is consumers may not see the hotel as providing more value for the higher price. This violates the principle of dual entitlement: customers are entitled to a reasonable price and firms are entitled to a reasonable profit. Related to this principle are the following hypotheses:

- Raising prices to maintain profits is fair.
- Raising prices to increase profits is unfair.
- Maintaining prices when costs decrease is fair.

If consumers believe the hotel is raising prices for no reason other than to increase profits, and if they see no increase in value for the higher price, they will view that price change as unfair.

Perceived Fairness of Best-Available-Rate Pricing

Just as changing prices can lead to customer perceptions of unfairness, so can blending prices.

For many years, hotels quoted customers interested in a multinight stay one nightly rate for all nights, even if more than one rate was applicable. The hotel either selected one available rate and applied it to all nights or calculated the average rate for all nights—a blended rate—and applied that to all nights.

Increasingly, the use of blended rates has decreased and night-by-night rate quoting has increased. In part, this is because hotel Web sites and online resellers have made extensive information about room rates abundantly available. Their best-available-rate practices have turned the individual room rates into important competitive information.

Best-available-rate (BAR) pricing, the approach in which the lowest (best) rate is quoted for each night of a multinight stay,
has made the use of blended rates impractical, regardless of the distribution channel.
Read: How to Change Price

Key Points

Customers are more likely to support companies they believe practice fair pricing.

They may view an increase in price as unfair if they cannot attribute it to cost increases or general market shifts.

Research indicates that customers are more likely to support companies they believe practice fair pricing. For this reason, it's important to manage price increases very carefully.

Customers form their perceptions of fairness based on reference prices and reference transactions. They may view an increase in price as unfair if they cannot attribute it to cost increases or general market shifts. Taking steps to present the increase in an acceptable way will help you manage customer perceptions through the price change. For example:

Inform the consumer:

- Make information about the price change available.
- Present a balance between customer value and company value.
- Use either physical or nonphysical characteristics to differentiate the new, higher-priced products.

Change the consumer's frame of reference:

- Raise the reference price.
- Use one or more of the following methods to change the reference transaction:
  - Offer additional benefits with the product or service, such as additional amenities or food and drink discounts.
  - Sell the product or service as part of a package, such as a cruise package or weekend getaway.
  - Attach restrictions, such as requiring a minimum length of stay, imposing a cancellation penalty, or making reservations nonrefundable.
Read: The Tidal Vista

The Archipelago Hotel is a successful, upscale hotel on a luxuriant Pacific island. Its competitor, the Tidal Vista Resort, offers similar ocean views and beach access on the same lush island but is unable to achieve the high average daily rate and excellent RevPAR that characterize the Archipelago.

What puts the Archipelago ahead of its competition? For one thing, the hotel manages its distribution channels extremely well. The Tidal Vista Resort, on the other hand, has had problems in this area. It has relied heavily on phone reservations through its parent company’s reservation desk and has only recently begun to take reservations through the corporate Web site. The Tidal Vista is working on building its own Web site and has been looking at channels such as Expedia and Hotwire, too. The new sales manager is anxious to add several distribution channels as soon as possible.

With so many online options open to it, where should the Tidal Vista focus? And, whatever it decides, what new management issues should it be prepared to face?

To find answers to these questions, please explore the resources in the following pages.
Watch: Distribution Channels
"If current trends continue, three Internet intermediaries will soon account for 15 percent of total hospitality revenues."

View the "An Examination of Internet Intermediaries and Hotel Loyalty Programs: How Will Guests Get Their Points?" article

Expedia, Orbitz, Hotwire...these are just a few of the online options available to hotel customers looking for the right room at the right price. The same online options that have made hotel-room shopping so much easier for customers have created management challenges for hotels and other branches of the hospitality industry. Among these challenges is the issue of loyalty programs. How to handle loyalty-program "points" has become a key focus of contention between hotel chains and the online intermediaries that sell their rooms.

In this article, Professor Judy Siguaw and Bill Carroll examine this issue, one of the complexities of distribution-channel management. Read what they have to say about loyalty programs—in the current situation and in the future as they see it—in "An Examination of Internet Intermediaries and Hotel Loyalty Programs: How Will Guests Get Their Points?"
Intermediaries for hotel-room distribution include traditional travel agents, online intermediaries, and travel-management companies.

Although the consumer’s experience of intermediaries is usually no more complicated than direct communication with the hotel, intermediaries complicate the sales and reservation process for the hotel.

Hotel rooms are available to consumers through a variety of channels. A consumer may choose to be in touch with the hotel directly by phone, in person, or through the hotel Web site; or indirectly through an intermediary. Intermediaries for hotel-room distribution include traditional travel agents, online intermediaries, and travel-management companies.

Although the consumer’s experience of intermediaries is usually no more complicated than direct communication with the hotel, intermediaries complicate the sales and reservation process for the hotel. However, tools such as the Global Distribution System (GDS)—an electronic system used to store and retrieve information and conduct transactions related to travel—simplify communication between intermediaries, hotels, and hotel customers. GDS providers such as Amadeus, Galileo/Apollo, Sabre, and Worldspan are prevalent in the hotel-room distribution chain.

Let’s take a look at the use of intermediaries—are they popular? Consider these figures:

- One in four hotel bookings is made through a GDS (source: TravelClick)
- One in five bookings is made through a travel agent
- One in four Americans uses the Internet to make travel plans

Internet Intermediaries

Internet intermediaries include familiar companies such as Expedia, Travelocity, Orbitz, and Hotwire. Though these Internet options may look similar to the consumer, they differ significantly by business model. In addition, they differ from hotels’ own branded Web sites, which also are readily available on the Internet but are not intermediaries. Let’s examine some of the more popular intermediary types to see how they differ.
Types of Internet Intermediaries

- Merchant model
  - Hotel offers a net wholesale rate often 20-35% below retail
  - Intermediary can decide what to charge
  - Typically, large advertising budget
  - Intermediary handles very high volume
  - Examples: Expedia.com, Hotels.com, Travelocity

- Opaque/auction model
  - Consumers bid on rooms
  - Consumers do not know the names of the hotels prior to bidding
  - Reservations are nonrefundable
  - Examples: Priceline.com, hotwire.com

- Retail travel model
  - Reservations and services are available online only
  - Intermediary uses traditional travel agents
  - Commissions are usually around 10%
  - Examples: Orbitz, American Express

Note: Retail is also available on merchant and opaque sites.
Associated Costs

Here's a look at some estimated costs associated with various distribution elements and options. These are based on a $100 room and are adapted from "Demystifying Distribution" (Cindy Estis Green, TIG Global Special Report, 2005).

The cost to the hotel per reservation for a $100 room:

- Call to hotel: $10
- Call to central reservation service: $25-$30 ($2-$4 per inquiry plus $6-$12 per net booking)
- Hotel Web site: $10
- Internet intermediary, merchant model: $25-$35
- Internet intermediary, price-opaque model: $18-$38
- Internet intermediary, travel-agent (retail) model: $18-$23
- GDS: $5

Distribution-Management Issues

As a revenue manager, there are many aspects of distribution management you need to be aware of. You need to allocate the best number of rooms to each distribution channel, set the right rates for those rooms, and determine optimal length-of-stay combinations. In addition, you'll need to examine the costs associated with each distribution channel, as well as its productivity.
Hi. This is Sherri Kimes. I hope you learned a lot about pricing and managing your distribution channels. As I mentioned before, pricing and distribution-channel management are two of the really exciting things that are going on in revenue management. What's exciting about this is it's changing all the time and a good revenue manager has the opportunity to use this to help the hotel make more money.

Thank you and I hope you enjoyed the course.
Glossary

average daily rate

the sum of all room-night rates paid divided by the number of room-nights purchased.

best-available-rate (BAR) price quoting

a method of price quoting whereby reservation agents quote the best available rate for each night of a multiple-night stay. As a result, guests may pay a different rate for each night they stay at the hotel.

bottom-up price quoting

a quoting strategy whereby reservation agents quote prices beginning with the lowest rate.

competitive pricing

a pricing strategy whereby prices are set strategically in relation to those of the competition.

cost-based pricing

a pricing method whereby prices are set according to how much the product costs the seller, rather than according to demand or in relation to those of the competition.

demand-based pricing

pricing which is sensitive to demand patterns at the hotel—specifically to hot, warm, and cold periods.

distribution channel

any one of the channels through which a consumer can purchase a room at a hotel: by phoning the hotel, through an online intermediary, through the hotel Web site, through a travel agency, etc.

dual entitlement

the general perception that customers are entitled to a reasonable price and that firms are entitled to a reasonable profit.

elastic demand

demand that changes when prices are changed.

inelastic demand

demand that remains constant regardless of changes in price.

menu guide

pricing by menu guide involves presenting consumers with a menu of rates, then asking them to choose the
rate that applies to them.

multiprice model

a model of pricing where prices are varied methodically in order to increase demand.

perceived fairness

the degree to which a price, restriction, or rate fence is perceived as fair by the public.

positioning

strategies for setting prices in relation to those of the competition, including \textit{skim, match, undercut, surround,} and \textit{penetrate}.

price elasticity of demand

the degree to which demand can be affected by changes in price.

rate fence

tool for segmenting the market in order to tap the greatest possible demand. Rate fences can be based on characteristics of the product or of the consumer, can be physical or nonphysical, and can involve special promotions or coupons.

reference price

the price consumers think is appropriate and fair for a product or service.

reference transaction

the way customers are accustomed to a hotel room being sold.

single-rate pricing

a price strategy, strongly discouraged in revenue management, in which a hotel charges the same rate for all rooms.

top-down price quoting

a method of price quoting in which reservation agents quote the highest price first and then introduce lower and lower prices in increments.
Supplemental Reading List

The Center for Hospitality Research provides focused whitepapers and reports based on cutting-edge research.

The following articles are presented in .pdf format. You will need Adobe Reader® to view these articles. If it is not already installed on your computer, you can download it (free) from the Adobe Web site.


