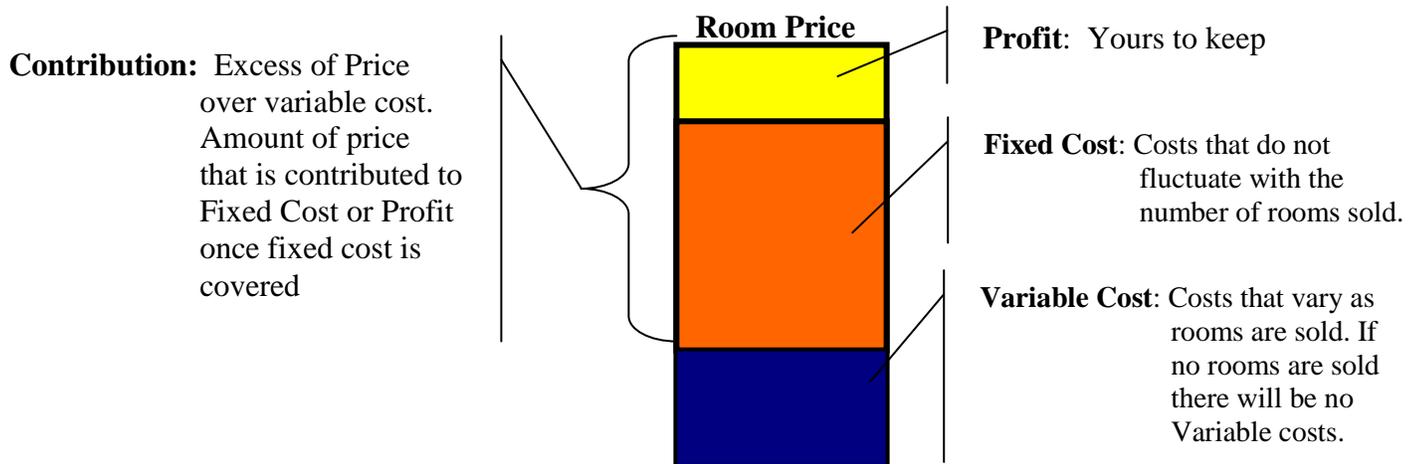


Why should hotels be any different than airplanes?

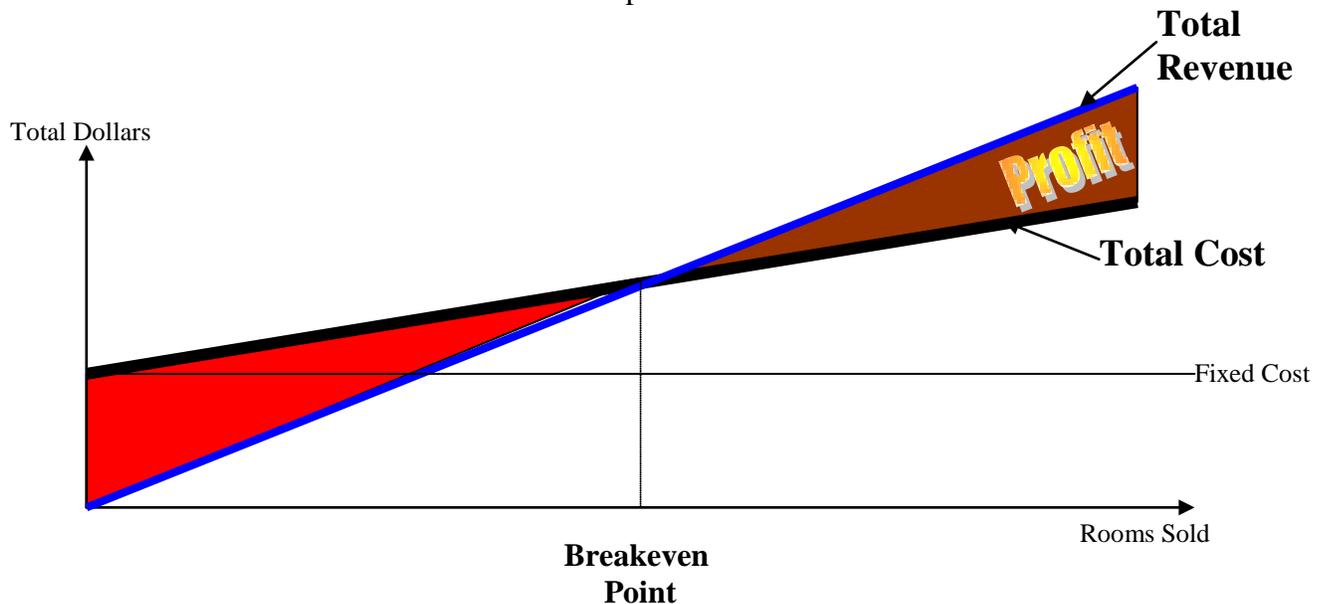
Why should hotels be any different than airplanes? Both have perishable products. Both have high capital cost. Both have low variable cost. Gone are the days when a plane will take off with half the seats empty. Next time you're in an airplane, compare the price of your ticket to the occupied seat beside you. Don't be surprised if the difference is as much as 50%. Airlines know that vacant seats are lost profit. Hotels are exactly the same. To see the logic of this let's review the basic economics.

Definitions:

Price Structure



So how does this relate to the number of rooms sold? As the number of rooms sold increase over a fiscal year the contribution accumulates towards Fixed Cost until Breakeven. After this the Contribution is all profit.



Therefore in theory as soon as sufficient rooms have been sold to cover their variable and all fixed cost for the year (breakeven) any amount of the room price over the variable cost (housekeeping, laundry, soaps etc) is all profit. Considering that variable cost is about 30% of room sales. That leaves a whopping 70% going into the 'bottom line'. If only it were that simple.

Hotels don't operate this way. Overhead costs and cash flows continue all year, while operating expenses are not easily subdivided into fixed or variable cost. Hoteliers have to serve several markets with various demand elasticities. Within this framework, setting prices can be as dangerous as 'Day Trading' on the stock market.

Hotel Revenue Managers must contend with Business travelers or 'walk-ins' that book late and are willing to pay higher prices, while higher occupancy levels can be ensured with lower paying conventioners and vacation travelers that book in advance. So the balancing act is between high occupancy rate at lower average room rates or lower occupancy rates at higher average room rates. Since every room-night is perishable, managers are like air traffic controllers, navigating the next 365 days of this complex market to a successful landing. Even if a hotel is well managed and the market responds to their efforts, success can be usually measured at 75% occupancy levels. This simply means that 25% of the annual room-nights do not land.

So the question facing the Revenue Manager is simple. Normal marketing efforts have not allowed the 25% 'unoccupied' rate to decrease; so do we discount prices? The idea of 'discounting' must be introduced as a secondary pricing policy. You discount only when the room-night will be otherwise lost. Normal pricing allows for a range of product price to satisfy a range of market segments. Discounting comes into effect when supply is guaranteed to be greater than demand. This would be normal fluctuations during a day of the week or month of the year. It is at these periods when the discounting can use the 'Contribution' method of pricing.

Here's the rule: The price can be set low but must cover the variable cost. The rule must be applied with caution and care, and only if the rooms are going to be excess capacity. If applied too liberally in periods of low demand, it can undermine the primary pricing policy and alter the market elasticity. Discounting should be part of a strategic market plan to enter alternative markets.

CTEX Group (www.ctex.com), with offices in Toronto, New York, London and Barbados, is a company that offers specific solutions to vacancy by way of private capital and travel management programs.

Well applied discounting can be a true advantage increasing:

- Occupancy levels
- Total Revenues
- F&B Sales
- Yield Percentages

A simplified example: Given:

- 150 Room Hotel
- \$120.00 Average Room Rate
- Normal 75% Annual Occupancy Rate
- Increase Occupancy Rate by 10% all at $i_c/2$ Average Room Rate

		Current Occupancy		Increased Occupancy*	% Increase
Number of Rooms		150		150	
Occupancy Rate		75%		84%	
Annual Rooms Available		54,750		54,750	
Occupied Rooms		41,063		46,063	10.9%
Rack Rate	\$	140.00		140.00	
Average Room Rate	\$	120.00		114.57	-4.7%
Revenue Per Available Room (RevPar)	\$	90.00	\$	96.39	6.6%
Yield % (Actual/ Potential)		64%		69%	6.6%
Departmental Revenues					
Room		4,927,500		5,277,500	
Food & Beverage	per room = \$50.00	2,053,125		2,303,125	
Other	per room = \$10.00	410,625		460,625	
Total Revenue		7,391,250	100%	8,041,250	100%
Departmental Costs					
Room	% of Room Revenue = 25.0%	1,231,875		1,319,375	
Food & Beverage	% of F&B Revenue = 45.0%	923,906		1,036,406	
Telecommunication	% of Room Revenue = 0.75%	36,956		39,581	
Other	% of Room Revenue = 0.50%	24,638		26,388	
Total Departmental Costs		2,217,375	30%	2,421,750	30%
Departmental Income		5,173,875	70%	5,619,500	70%
Undistributed Operating Expenses					
Admin. & General	% of total revenue = 10%	739,125		804,125	
Management Fee	% of total revenue = 3.5%	258,694		281,444	
Marketing	% of total revenue = 5%	369,563		402,063	
Repairs & Maint.	% of total revenue = 3%	221,738		241,238	
Utilities	% of total revenue = 5%	369,563		402,063	
Total Undistributed Operating Expenses		1,958,681	27%	2,130,931	27%
Income Before Fixed Expenses		\$3,215,194	44%	\$3,488,569	43%
					7.8%

The results of this is to increase RevPar and Yield by 6.6%; Revenue is increased by \$650,000 or 8.7%.

The critical concept here is that a prudent manager can obtain better RevPar's, Revenues, Cash Flows and Profits by carefully applying discounting to the normally vacant rooms. To the right manager, vacant rooms can be thought of as an opportunity for profit.

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