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Pricing strategies to maximize revenues in the lodging industry

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Abstract

Price-ending strategies may be utilized by hotels to signal value or quality. The current study presents that there is a directional relationship between room rates and price-ending strategies. It demonstrates that as average room rates decrease, the price-ending strategies change from whole dollar practice to dollar and cents practice. Results from the qualitative investigation were compared with the room rates from the Internet for 10 US cities. Based on this study, an innovative pricing strategy is presented with a potential gain of \$251 million dollars by conservative estimations (nearly \$555 million if estimated liberally) annually for the hotel industry in the USA. These potential sales are about 0.54% of revenues and 3.9% of industry-wide pre-tax profits. Further studies in consumer acceptance of the recommended pricing strategy are suggested.

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1. Introduction

The purpose of this inquiry is to examine pricing strategies in the hotel industry so as to maximize revenues. A hotel may attempt to achieve a number of objectives when pricing their guestrooms. These objectives may include the following: optimize/

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maximize profitability; maximize revenues; differentiate the product in the marketplace; increase or decrease the pace at which rooms are being sold; increase market-share of a specific brand; achieve a targeted contribution margin per room sold; and communicate price–value relationship of the product to the consumer. Whatever be the motivation, the price at which a hotel attempts to sell their guestrooms will undoubtedly send a message to the consumer. Current research focuses upon two price-ending strategies, commonly utilized in retail settings, to determine if they are utilized in the hotel industry. In the retail industry, these strategies are utilized to send messages about the inherent quality and value attributes of the products.

Previous research indicates that price endings may be utilized to send specific signals to consumers regarding the value or quality of a product. Through an analysis of hotel pricing on the Internet, coupled with qualitative interviews with hotel operators, this inquiry attempts to determine whether a relationship might exist between the message that hotel operators intend to communicate with consumers utilizing price and the price-ending strategies they adopt. Specifically, the factors that are considered by hotels in setting room rates are explored as well as how these factors impact the price-ending strategies utilized and whether the hotels consider the impact of these price-ending strategies on consumer perceptions. Finally, a price-ending strategy is proposed that can contribute significantly to the profitability of the hotel industry.

2. Significance of the study

The price-ending strategy utilized by a hotel can significantly impact the profitability of a hotel operation. Any additional guestroom rate that is earned from a price-ending strategy that increases the average daily rate (ADR) at which a room is sold contributes directly to the profitability of the hotel since no additional expense, with the exception of commission expense should the room be sold through a commissionable third-party, is incurred by the hotel simply because a higher room rate is charged to the consumer. For example, if a 300-room hotel is running 65% annual occupancy and a \$1.00 per room night increase can be achieved in the ADR due to a change in price-ending strategy, this change in price-ending strategy will add \$71,175 in additional profitability to the hotel's earnings before interest, taxes, depreciation and amortization (EBITDA), the most common measure of hotel profitability from operations. If an operator has multiple hotels in their portfolio, the increase in profitability to the company as a whole can be dramatic.

This research will also serve as a foundation for additional inquiries into the effectiveness of various price-ending strategies. Once an understanding of the intentions of hotels is established and price-ending strategies are analyzed, researchers may want to then evaluate how various price-ending strategies are perceived by consumers. This may enable researchers to evaluate the effectiveness of various price-ending strategies and to make recommendations to hotels regarding how specific strategies might be modified in order to ensure that the intended

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