Objective News for the Global Hotel Industry

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Featured Stories

Love-hate relationship: occupancy, rate

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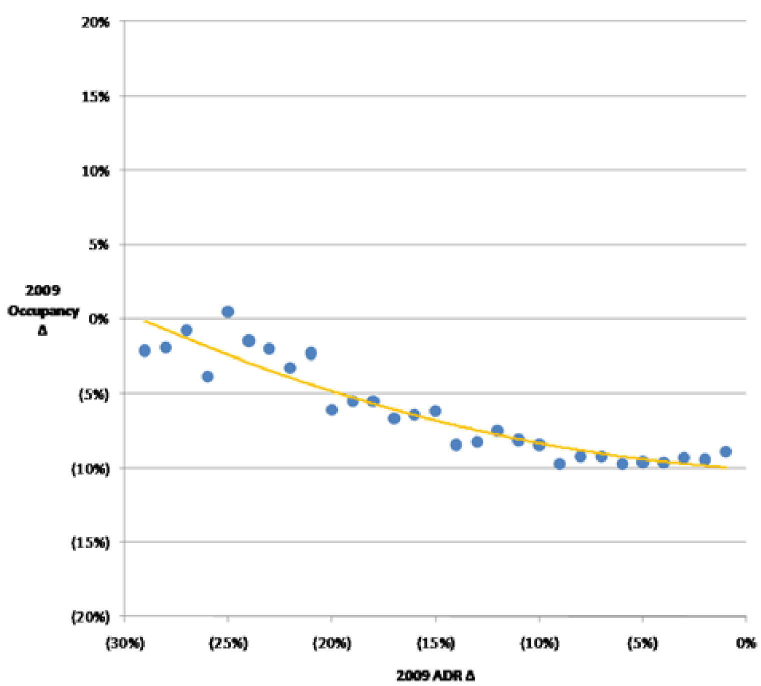
Like most relationships, the connection between occupancy and rate involves a lot of give and take. When times are good, both benefit; when times are bad, one or both are forced to make sacrifices.

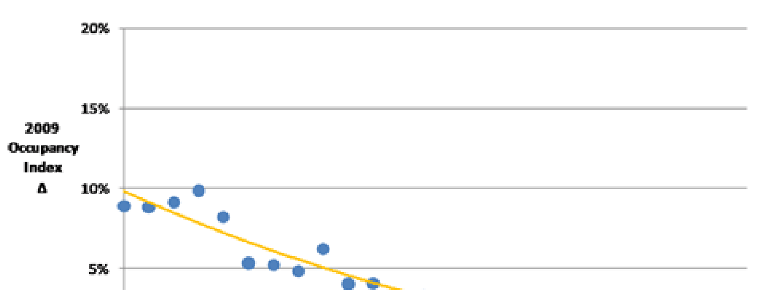
In spite of numerous soapbox lectures declaring “Hold rate! Hold rate!” the majority of the hotels in the United States lowered room prices in the hopes of mitigating occupancy loss throughout 2009. The basic premise of the argument to maintain rate is that hotels cannot create demand under weak economic conditions simply by cutting price. In the Great Recession, businesses and families were saving their money wherever they could. Spending US$150 compared to US$200 on a hotel room would not induce them to travel. Lowering rates would only shift demand that already exists within a market. So, once one property in a market reduced rates, the others were essentially forced to follow in order to maintain market share. Consequently, approximately 80 percent of the hotels in the U.S. experienced declines in average room rate in 2009.

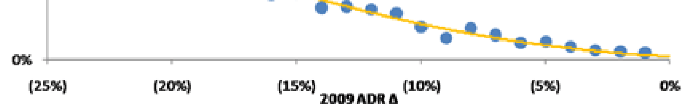
To understand the impact of room rate discounting, we evaluated the performances of more than 21,000 hotels based on their year-over-year room rate declines and the impact on not only their occupancies, but also their performance indices versus their respective competitive sets. Properties were grouped into categories based on their annual change in average rate. The findings were surprisingly telling. As the graph below illustrates on average, the higher the decline in room rate, the lower the decline was in occupancy performance.



Click chart to enlarge.

Statistically, the declines in average rate were highly correlated to occupancy in this inverse manner. (For data geeks out there, the r2 for the relationship is 88 percent.) However, this only tells part of the story. A more relevant comparison is how it altered the hotels’ market positions. The graph below summarizes the impact of rate discounting on occupancy indices for hotels with average rate declines ranging from 0 percent to 25 percent in 2009.

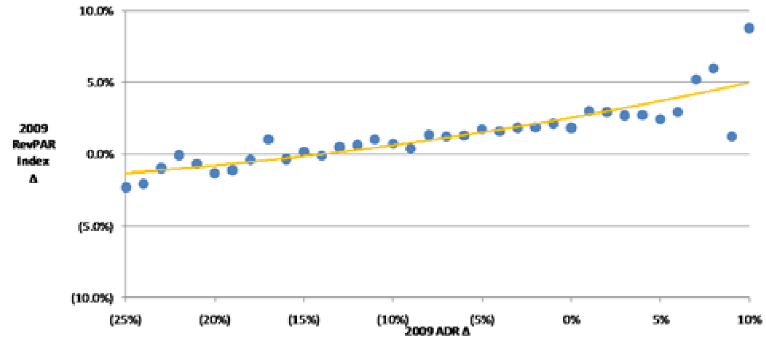




Click chart to enlarge.

For the most part, hotels that lowered their room rates improved their occupancy index. (Through a regression analysis, the r2 for this relationship is a staggering 95 percent.) Basically, the higher the rate of discounting, the higher the improvement achieved in occupancy index. A 5-percent decline in average rate typically equated to a 1-percent improvement in occupancy index, while a 15-percent decline in rate generally drove a 4-percent enhancement to occupancy penetration.

Looking at the overall change in revenue per available room penetration shows the net impact to market position. The chart below also includes properties that increased their average daily rate up to 10 percent in 2009 to further illustrate the effects of dropping rates versus holding, or even pushing rates.



Click chart to enlarge.

It is evident that properties with ADR increases had the largest improvement in RevPAR indices. For properties that lowered their room rates, there is a fairly significant inverse relationship between ADR declines and the change in RevPAR index (r2 = 90 percent). The more properties dropped rates, the worse their RevPAR index change was, indicating that the upside in occupancy performance did not compensate for the sacrifice in rate, at least in terms of competitiveness.

Theoretically, the profit flow-through of holding room rate would be higher than a small gain in occupancy driven by large reductions in room rates, particularly in limited-service properties. Assuming this is the case, it appears that the prognosticators were correct in preaching to the industry that they should hold rate. However, based on the volume of hotels who did not maintain rate, it was easier said than done.

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