The New Zealand Hotel Research Bulletin, No. 1

March 2008
Room Rates : Staff Turnover

From small increases – great gains can be made.

What is your staff turnover percentage like?

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Commerce Division Research Bulletin No 1.

March 2008
Welcome to New Zealand Hotel Research Bulletin from Lincoln University… a new research publication for the New Zealand Hotel Industry

You have received this edition of the New Zealand Hotel Research Bulletin as your hotel is part of the Lincoln University New Zealand Hotel Database or you are a key player and decision maker regarding hotel management or development in New Zealand.

The purpose of the New Zealand Hotel Research Bulletin is to present pertinent and relevant New Zealand and international research, links to hotel information and updates on Hotel Management education at Lincoln University - including upcoming graduates seeking employment. Relevance is important and our focus is to present research in such a way that you find it easy to read, informative and at times provocative. Future editions of the New Zealand Hotel Research Bulletin will be sent electronically to all hotels who provide us with a permanent managerial email address – see page 12 for how to get in touch with us.

A fundamental requirement of any university is to be actively engaged in research and develop ‘new knowledge’ which informs the professional community in which the research was conducted, and students in related learning programmes. Timely dissemination of new knowledge is critical, and while students are often immediate recipients, we will use this publication as the vehicle to inform the professional New Zealand hotel industry. There is a serious lack of hospitality research, and in particular hotel research, that focuses on markets outside the USA\(^1\), however, Lincoln University aims to fill the research and knowledge gap for New Zealand. Lincoln University was the first and remains New Zealand’s only university with a dedicated Hotel Management degree and in acknowledging the hotel industry’s significance to the New Zealand economy is pleased to be the industry’s research and management education specialists.

In this first edition of the New Zealand Hotel Research Bulletin, we present a demonstration of our research and new knowledge development capability that can add value to the New Zealand hotel industry in terms of past hotel average room rate analysis, and a commentary on Australian hotel turnover research.

One of the main tools Lincoln University will be using for our ongoing research and analysis of hotel performance (both in New Zealand and internationally) will be HotelBenchmark™ by Deloitte. HotelBenchmark™ is the world’s largest independent

hotel performance database making it the ideal vehicle to compare not only New Zealand hotel performance in terms of national, regional and city (Auckland, Rotorua, Wellington, Christchurch and Queenstown) activity, room size comparisons performance, but also New Zealand’s performance against other countries. Lincoln University and HotelBenchmark have joined forces to take the data provided by New Zealand hotels participating in the HotelBenchmark™ (currently 70 hotels), and subject it to further analysis. It is this database (not individual hotel data) that Lincoln will further analyse including comparisons and correlations to other industry variables to indicate trends. HotelBenchmark™ allows individual hotels to monitor monthly and daily hotel performance, competitor set analysis results; all a must in today’s competitive environment. The more hotels that participate in the HotelBenchmark™ Survey the more comprehensive the data set and analysis. If you are not presently participating but want to, check out www.HotelBenchmark.com. There is no cost to add your hotel’s data.

Knowledge and its appropriate use is power!

By reviewing and analyzing past performance it is possible to consider future opportunities. Research and analysis of HotelBenchmark™ data is part of an ongoing agenda at Lincoln University and we are very grateful to Deloitte for allowing us access to this impressive and critical dataset.

We hope that you find the New Zealand Hotel Research Bulletin of value in providing specific industry commentary regard hotel performance and pointers in forward planning. If details in the New Zealand Hotel Research Bulletin need further explanation, do not hesitate to get in touch. If you have any thoughts or comments that you wish to share with us on how we can improve our service to the hotel industry, we would be pleased to hear from you.

Finally, if you have any project, research/analysis that you need help with, please get in touch.

Regards

Anthony

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From small increases – great gains can be made….

(*Statistical base data used in this section is from HotelBenchmark™ by Deloitte)

For years New Zealand hoteliers have said that hotel room rates are too low and provided a raft of reasons as to why this is the case; some of which we will cover in the future editions of the New Zealand Hotel Research Bulletin. However, holistically, the competitive nature of the industry has seen hotels unnecessarily financially underperforming with dramatic individual hotel and industry results. In 2000 (the base year of all our research) the New Zealand Average Room Rate (ARR) - otherwise known as the Average Daily Rate (ADR), was $114.48. Ending December 2007 the ARR was $137.58, representing a 20.17% increase. Considering the accumulative Consumer Price Index (CPI) over the same time was 20.2% (ending Dec 2007 Quarter) ARR is marginally behind inflation. There is an economic argument that says this may be OK if costs in other areas have reduced (e.g. due to the use of technology), however, in reality, it is questionable if this is the case. Using inflation adjusted room figures; room rates are slightly cheaper in 2007 than they were in 2000!

In this first issue of the New Zealand Hotel Research Bulletin we review the national position of hotel performance since 2000 and present the ARR position that hotels might have seen if each year the ARR had been increased by 5%, as opposed to average of 2.8% or less that was actually achieved. We accept that many industry managers are focused on Revenue Per Available Room (RevPAR), but, for the purposes of this demonstration we only make reference to the ARR as this is where room revenue begins. We demonstrate the outcomes of a 5% increase via a scenario of the impact on a 150-room hotel. In Table 1, we have applied a 5% increase to the base year (2000) and then each year after that. Given New Zealand’s (average) per annum CPI increase was 2.8% and during that time tourism grew, this increase should have been achievable.

While the potential losses in Table 1 cannot be recouped, it does make a dramatic statement. Yet, even more important is what we can learn from this. Therefore the pressing question is: Can this practice of less than CPI increases continue? The best way to demonstrate this to managers, owners and other stakeholders is to project present performance forward – see Table 2.

The demonstration shows the actual *ARR in column 3. Column 4 presents a 5% increase added to the previous years ARR. Column 5 shows the potential loss per room (by not adding 5%) which finally is multiplied by the *Occupancy for that year and by 365 days to establish an overall potential loss (column 6).
Table 1  Demonstration of past Annual Potential Room Revenue Loss  
(* HotelBenchmark™ by Deloitte data)

<table>
<thead>
<tr>
<th>Year</th>
<th>* OCC %</th>
<th>* Achieved ARR</th>
<th>ARR with 5% increase</th>
<th>Potential Dollar Revenue lost per room</th>
<th>Annual Potential Room Revenue loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>66.5</td>
<td>$114.48</td>
<td>$120.20</td>
<td>$5.72</td>
<td>$208 403.69</td>
</tr>
<tr>
<td>2001</td>
<td>68.0</td>
<td>$113.94</td>
<td>$126.21</td>
<td>$12.27</td>
<td>$456 968.47</td>
</tr>
<tr>
<td>2002</td>
<td>71.7</td>
<td>$121.34</td>
<td>$132.52</td>
<td>$11.18</td>
<td>$439 072.03</td>
</tr>
<tr>
<td>2003</td>
<td>71.5</td>
<td>$126.22</td>
<td>$139.15</td>
<td>$12.93</td>
<td>$506 206.25</td>
</tr>
<tr>
<td>2004</td>
<td>76.0</td>
<td>$126.51</td>
<td>$146.11</td>
<td>$19.60</td>
<td>$815 502.46</td>
</tr>
<tr>
<td>2005</td>
<td>71.6</td>
<td>$132.39</td>
<td>$153.41</td>
<td>$21.02</td>
<td>$824 167.66</td>
</tr>
<tr>
<td>2006</td>
<td>71.0</td>
<td>$134.42</td>
<td>$161.08</td>
<td>$26.66</td>
<td>$1 036 529.63</td>
</tr>
<tr>
<td>2007</td>
<td>70.0</td>
<td>$137.58</td>
<td>$169.14</td>
<td>$31.56</td>
<td>$1 209 502.48</td>
</tr>
</tbody>
</table>

Table 2 sets out to help us understand future impacts of present actions given the following assumptions: occupancy percentage (arrived at by averaging the occupancy of 2005-2007 column): an average rate of inflation 3% (a New Zealand government target) added to the 2007 ARR, and then each year after) is shown in column 3. In column 4 a 5% added to the ARR of the base from 2007, and then each year after (column 4). Column 6 then anticipates the annual potential room revenue loss per year.

Table 2  Demonstration of future Annual Potential Room Revenue Loss

<table>
<thead>
<tr>
<th>Year</th>
<th>Anticipated OCC %</th>
<th>Anticipated ARR with CPI 3% increase</th>
<th>Anticipated ARR with 5% increase</th>
<th>Anticipated Revenue lost per room</th>
<th>Anticipated Annual Potential Room Revenue loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>70.8</td>
<td>$137.58</td>
<td>$144.46</td>
<td>$6.88</td>
<td>$266 650.68</td>
</tr>
<tr>
<td>2008</td>
<td>70.8</td>
<td>$141.71</td>
<td>$151.68</td>
<td>$9.97</td>
<td>$386 643.48</td>
</tr>
<tr>
<td>2009</td>
<td>70.8</td>
<td>$145.96</td>
<td>$159.27</td>
<td>$13.31</td>
<td>$515 835.73</td>
</tr>
<tr>
<td>2010</td>
<td>70.8</td>
<td>$150.34</td>
<td>$167.23</td>
<td>$16.89</td>
<td>$654 783.40</td>
</tr>
<tr>
<td>2011</td>
<td>70.8</td>
<td>$154.85</td>
<td>$175.59</td>
<td>$20.74</td>
<td>$804 073.13</td>
</tr>
<tr>
<td>2012</td>
<td>70.8</td>
<td>$159.49</td>
<td>$184.37</td>
<td>$24.88</td>
<td>$964 323.86</td>
</tr>
<tr>
<td>2013</td>
<td>70.8</td>
<td>$164.28</td>
<td>$193.59</td>
<td>$29.31</td>
<td>$1 136 188.54</td>
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<tr>
<td>2014</td>
<td>70.8</td>
<td>$169.21</td>
<td>$203.27</td>
<td>$34.06</td>
<td>$1 320 355.91</td>
</tr>
</tbody>
</table>

Scenario

<table>
<thead>
<tr>
<th>Rooms</th>
<th>150</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>5.00%</td>
</tr>
</tbody>
</table>

Scenario Table

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Rooms</th>
<th>150</th>
</tr>
</thead>
<tbody>
<tr>
<td>% Increase</td>
<td>5.00%</td>
<td></td>
</tr>
</tbody>
</table>
This demonstration only considers the present competition/hotel room stock and ignores the fact that thousands of new hotel rooms and apartments are scheduled to be built in New Zealand in the next three years; potentially making the above position worse if hotels continue to discount in the face of competition.

- **So why have hotel room rates moved so little?**

The present stock of hotel rooms creates competition and as stock continues to increase competition will get fiercer. Naturally, in the drive for occupancy and yield, hotel managers eye their competitive set’s ARR and Yield figures (usually via a self selected Competitive Set Analysis, a feature like MarketShare available via HotelBenchmark™) – a process technically called reference pricing. And, as can be expected, the actions from holding close to, or undercutting the competition in effect keeps rates as they are (what many industry commentators’ term as low), or drives rates down. The result is potential lost revenue – lots of room revenue!

- **What’s the solution?**

A tough question! Many successful industry leaders suggest: Be brave; charge a room rate appropriate to the value of the product in the same competitor set and not necessarily the total market competition.

However, this is easier said than done! Or is it? If all hotel room rates (within the competitor set) increased by 5% as of next week there would not necessarily be any collusion to fix prices as hotels already have a raft of different rates, it is just that all rates have moved. This ‘possibility’ accepts there are some rates under contract, but when they are up for renewal, they will move.

Let’s compare this strategy with that of another industry: petrol. Petrol prices at competing pumps move up and down within hours of each other – with the justification of variable costs of the price of the oil barrel. Arguably hotels variable costs also move up and down on a regular basis.

All this said, setting room rates is a major challenge that requires much research on such things as industry movement.

- **But with present and increased competition we will always see rate gouging by some, therefore lowering the overall rate.**

In the commercial world there are always going to be some businesses that take this strategic path. However, while they might receive some immediate gain in market share, if some guests return to their ‘usual hotel’, the lower rate did nothing to improve long-term occupancy. In the meantime the guest received a cheaper room, but the overall
industry ARR was lowered. Discounting (as a result of competition, and frankly that is what we are talking about) to gain market share is not necessarily a smart long term strategy.

- Can you prove discounting (as part of a competition strategy and its relationship to RevPAR) does not work?

Yes we can. Enz, Canina and Lomanno (2004) wrote a most compelling article titled, *Why Discounting Doesn’t Work: The Dynamics of Rising Occupancy and Falling Revenue among Competitors*. Their research results (drawn from 6000 hotels) presents what we might consider common sense: that by increasing rates above the competition a hotel may loose occupancy but may also increase RevPAR. The converse was also proved true. The former research was undertaken in what could be termed ‘tough industry times’, 2001-2003. So, in 2006, Canina and Enz (2006) revisited their research to check if the results were still valid given that business confidence had improved. They were. Their 2006 research report, *Why Discounting Still Doesn’t Work: A Hotel Pricing Update*, is excellent reading for any manager who thinks otherwise.

The fundamental and compelling thing that we can learn from this research is that hotels should not discount, yet this is a practice well established in the New Zealand hotel industry.

- Where to from here?

Lincoln University will continue to monitor hotel performance via HotelBenchmark™ and report on changes in future editions of the *New Zealand Hotel Research Bulletin*. Potential analysis can include breakdowns for Quenstown, Christchurch, Wellington, Rotorua, Auckland, South Island, North Island, Under/Over 100 room properties etc. We would be interested in your feedback on this topic. See page 12 for how to get in touch.

- What do our closest markets think of room rates?

**March 03 2008, Australian: 9.00am – General Manager Daily New Update (page 1)**

BRISBANE: Hotel rooms in Brisbane are far too cheap and should be sold for $300 a night, says the head of the group that owns the Sofitel Hotel,

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Thakral’s managing director John Hudson. In the hotel side of its business the earnings of $34 million were the highest ever achieved for the period, up 10 per cent on the previous year despite major refurbishments at two of its largest properties, the Sofitel and the Hilton on the Park in Melbourne. The average room rate across the portfolio increased by nine per cent to $174.91, but Mr Hudson said it should go much higher. “I still think fundamentally hotels in Australia are ridiculously cheap,” he said. “They [rooms in Brisbane] fail to get the rate that people get overseas.” Mr Hudson said customers had had it “too good, for too long” and if they wanted to stay in Brisbane they should have to pay for it.

**What is your staff turnover percentage like? Is your hotel worse than any other?**

Chances are no-one wants to openly talk about their staff turnover, but it is certainly at the forefront of everyone’s mind. Every business needs turnover; it is the level, within categories that you need to manage. No two hotels will, or should, have the same turnover levels or costs. But, it is important that you benchmark yourself against comparable competitors.

Recording, analysing and improving your management of employee turnover is important and to offer some assistance as to benchmarking your position we report on research completed in Australian 4 and 5 star hotel accommodation industry in 2006. This report (with a base of 64 major hotels) advises that managerial turnover is 39.1% per annum with operational staff turnover 50.74% per annum. The report states that regard turnover costs: “… the average cost for replacing executive managerial and supervision staff was $AUS109,909.00 per hotel per annum. This figure does not include intangible costs such as the transaction costs associated with loss in quality, loss of decision making; loss of business acumen and leadership hiatus”. Also “The average cost for replacing operational staff was $AUS9,591.00 per employee” (p. 4). A full breakdown of the report numbers is shown in Table 3.

- **So how do New Zealand hotels compare?**

At present New Zealand has no collective public/industry data and analysis relating to ‘hotel employee turnover’ and associated costs; therefore it is not possible to benchmark. However, individual hotels will be able to look at the Australian statistics and make their own comparisons.

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Lincoln University is keen to assist the New Zealand Hotel Industry to establish its benchmark position in this regard and has received permission from our Australian counterparts (who undertook the Australia Research) to replicate the same survey here in New Zealand. If as an industry you feel that this is a worthwhile project, please get in touch.

Table 3  Demographics and Turnover Statistics in Australian 4-5 Star Hotels

<table>
<thead>
<tr>
<th>Total Staff Turnover</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Category</td>
<td>Total Number</td>
<td>Total Turnover</td>
<td>Total % Turnover</td>
</tr>
<tr>
<td>Managerial Employees</td>
<td>1919</td>
<td>752</td>
<td>39.19</td>
</tr>
<tr>
<td>Operational Employees (Including Casuals)</td>
<td>8627</td>
<td>4378</td>
<td>50.74</td>
</tr>
<tr>
<td>Total Employees (Including Casuals)</td>
<td>10546</td>
<td>5130</td>
<td>48.64</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Turnover by Group</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff Category</td>
<td>Total Number Employed</td>
<td>Total Turnover No.</td>
<td>Total Turnover</td>
</tr>
<tr>
<td>Management Level</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Executives</td>
<td>275</td>
<td>101</td>
<td>36.76</td>
</tr>
<tr>
<td>Department Managers</td>
<td>660</td>
<td>271</td>
<td>41.06</td>
</tr>
<tr>
<td>Supervisors</td>
<td>984</td>
<td>380</td>
<td>38.62</td>
</tr>
<tr>
<td>Total Managerial Employees</td>
<td>1919</td>
<td>752</td>
<td>39.19</td>
</tr>
</tbody>
</table>

| Operational Level     |          |          |          |
| Full-time Employees   | 3816     | )        | Split not possible within data collected |
| Part-time Employees   | 1411     | )        |
| Casuals               | 3400     | )        |
| Total Operational Staff | 8627     | 4378     | 50.74    |

<table>
<thead>
<tr>
<th>Turnover by Category</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Category .</td>
<td>Total Turnover No</td>
<td>% of Total Turnover</td>
<td></td>
</tr>
<tr>
<td>Executives</td>
<td>101</td>
<td>1.97</td>
<td></td>
</tr>
<tr>
<td>Department Managers</td>
<td>271</td>
<td>5.29</td>
<td></td>
</tr>
<tr>
<td>Supervisors</td>
<td>380</td>
<td>7.42</td>
<td></td>
</tr>
<tr>
<td>HR Staff</td>
<td>45</td>
<td>0.87</td>
<td></td>
</tr>
<tr>
<td>Sales and Marketing</td>
<td>88</td>
<td>1.71</td>
<td></td>
</tr>
<tr>
<td>Front Office</td>
<td>575</td>
<td>11.22</td>
<td></td>
</tr>
<tr>
<td>Kitchen</td>
<td>810</td>
<td>15.81</td>
<td></td>
</tr>
<tr>
<td>Restaurant/Bar</td>
<td>1318</td>
<td>25.73</td>
<td></td>
</tr>
<tr>
<td>Housekeeping</td>
<td>991</td>
<td>19.35</td>
<td></td>
</tr>
<tr>
<td>Administration &amp; Finance</td>
<td>112</td>
<td>2.18</td>
<td></td>
</tr>
<tr>
<td>Maintenance/Grounds</td>
<td>169</td>
<td>3.30</td>
<td></td>
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<tr>
<td>Sport/other</td>
<td>107</td>
<td>2.08</td>
<td></td>
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<tr>
<td>Gaming</td>
<td>58</td>
<td>0.95</td>
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</tr>
<tr>
<td>Health</td>
<td>105</td>
<td>2.05</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>5130</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>
• **Should New Zealand Hotels be worried about their employee turnover?**

Until we have reliable data to compare hotels the only data hotels have to work with is their own statistics. You should be worried if your internal benchmark data suggests the situation is getting worse, but then this must be tempered with the impact that the external environment is having on all business.

• **What is the latest research saying about this issue and the best way forward?**

There are numerous tools and techniques that you can use to try and reduce employee turnover, but, if you do what you have always done: you will get what you have always got!

Emerging international research, some completed by Lincoln University, suggests new themes related to employee management, e.g. thinking in terms of Human Capital Strategies and Management and Organisational Social Capital Development. Many leading organisations are now focusing on their Human Capital as it remains their only true competitive advantage. Research is suggesting focusing on the front-line employee and the challenges that exist there is fire-fighting. Major gains can be achieved when organisations focus on middle and senior managers who develop strategy for and manage the frontline staff; it is this level that can make the greatest impact – right down to improving the financial bottom line, yet is a sector that we have not focused on in the past. Managers have been ‘too busy working in the business and not spending enough time on the business’.

To help the hotel and tourism industry overcome this managerial professional development challenge, Lincoln University offers a Master of Professional Studies – Tourism and Hospitality Management - professional development targeted specifically at developing middle and senior managers, which leads to increased gains in business management and productivity. A key and unique factor of this professional development is the entry requirement – at least two years managerial experience. An undergraduate degree is not necessary.

There are a number of New Zealand senior hotel managers already undertaking this professional development. If you want to know more about how to grow your own managers, provide a retention tool not previously considered, increase business productivity, reduce turnover, please see the last page of this Bulletin – we are happy to talk through how we can help your business.

What is clear is that the hotel industry (and many other industries) must re-think their overall Human Resource Management strategies.
How much is your middle and senior managerial turnover costing you?

If you are not sure and take the Australian research as a benchmark you are looking at managerial turnover at 39.19% costing $AUS109,909.00 per hotel per annum. In effect hotels are loosing in excess of 1 in every 3 managers each year!

So what’s one retention tools that you can use to slow down managerial turnover?

Try offering professional development that:

- Proves you are seriously interested in their personal future
- Proves that you want them to personally grow and develop now
- Is part-time and by distance (with full technology backup) so no time away from work
- Potentially secures their commitment to you for 3-4 years, and more importantly for the hotel/company…
- Increases their performance and value during that time!

What is it and what does it cost?

Its Lincoln University’s Masters in Professional Studies – Tourism and Hospitality, which costs only $1,530.00 per manager per paper! Managers study a maximum of 2-3 papers each year. There are 8 eight papers in a Masters degree which takes 3-4 years part-time to complete, by distance. That’s only a total of $12,240.00 to secure a 3-4 year commitment and improve business outcomes! Everyone wins!

Yes – hotel middle and senior managers – GM’s, Assistant GM’s, Room Division Managers, Food and Beverage Managers, Executive Housekeepers, Executive Chefs, senior departmental supervisors, etc can work toward a Masters Degree! Managers do not need an undergraduate degree to enter the Masters Programme – but do need to have at least 2 years of managerial experience. Key topics include: Leadership, Strategic Management, Marketing, Project Management, Services Management, Service Profit Chains, etc.

The next enrolment date is late July – so there is time to find out more and get key managers into an excellent executive professional development programme.

See the last page of this Bulletin for details.
The Lincoln University hotel database

For research purposes Lincoln University has developed a New Zealand hotel database which presently lists 225 hotels (counting for just over 26,000 hotel rooms). Our qualification for inclusion in the database is that the property must have 35 commercial accommodation rooms. The database is regularly updated.

How to get in touch with us…

With environmental sustainability and general efficiency in mind future editions of The New Zealand Hotel Research Bulletin will be sent electronically. If you wish to receive a copy please email us detailing a permanent managerial email address for your hotel.

Our email address is: briena@lincoln.ac.nz

Do you have comments, news, etc?
Send it to:
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Phone: 03 325 3838, Extn 8294
Email: briena@lincoln.ac.nz

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The HotelBenchmark™ Survey by Deloitte contains the largest independent source of hotel performance data in the world and tracks the performance of over 7,800 hotels and 1.3 million rooms every month. Monthly surveys are produced on the following areas:

- Four regional rate and occupancy surveys covering Asia-Pacific, Europe, Central & South America and the Middle East & Africa.
- Thirteen country/sub region rate and occupancy surveys for Australia, Benelux, China, Germany, India, Italy, Japan, New Zealand, Nordic Countries, Qatar, Southern Africa, Spain and UK.
- Two city rate and occupancy surveys for London and Paris.
- Monthly profitability surveys on Germany and London.
- On an annual basis we produce profitability surveys tracking performance across all regions of the world.
- Daily HotelBenchmark™ tracks rate and occupancy everyday for a number of markets across the Asia, Europe and the Middle East.

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Low-price Guarantees: How Hotel Companies Can Get It Right

Vol 5 No 10
By: Steven A. Carvell Ph.D. and Daniel C. Quan Ph.D.

Executive Summary: With the growth of the internet, the increase in the volume of online bookings has altered and multiplied the hotel industry's distribution channels. While this growth has driven up the profits of online travel agencies, hotel operators are experiencing a loss of control over the pricing of rooms and a potential transfer of pricing authority to third-party internet-based companies. The popularity of such services stems from consumers' desire to obtain the lowest rate within their desired market segment. One possible cure applied by many hotel chains is to offer a best-rate guarantee on their own web sites. A calculation of the option value of such guarantees shows, however, that current rate guarantees have little value to consumers. Instead, an application of option-pricing approaches demonstrates how a hotel company can structure a best-rate guarantee that would provide value to consumers by offering the guest the option of purchasing a price guarantee. Such an option would give the guest the lowest price posted on a specified set of web sites, up to the time the guest arrives at the hotel. The pricing of this option would be based on a well-established exotic-option pricing formula. A demonstration of how to price this best-rate guarantee shows that its value (and its price) diminishes as the arrival date approaches, so consumers should be willing to pay for the option, because the price is set according to the likelihood that prices will change. Using this approach hotel companies should be able to eliminate the incentive for consumers to engage in search-and-switch behavior, reestablish the price integrity of their product, and simultaneously create a revenue stream from the sale of the best-rate-guarantee options to their customers.
Setting Room Rates on Priceline: How to Optimize Expected Hotel Revenue

Vol 8 No 4
By: Chris Anderson Ph.D.

Executive Summary: This report and tool combination develops a novel approach to set prices on Priceline.com to maximize revenues received from releasing rooms to Priceline. When setting rates on Priceline, hotel properties face a straightforward auction-like pricing decision. Priceline is an opaque channel with no property information communicated to the consumer. As such other factors (e.g. brand, amenities, location) play no role in setting rates. Properties face what appears to be a dilemma-set prices higher to make more revenue but potentially lose the sale, or set prices lower to make the sale but leave some money on the table. This report provides a brief introduction to Priceline.com and discusses the daily data that properties receive from Priceline. The report then outlines how these data can be used to the advantage of the property in setting Priceline rates. A fully functional model implemented in Excel accompanies this report in the form of a Cornell Hospitality Tool. As the user of this model you simply copy and paste data you receive from Priceline into the tool.

All model inputs are automatically updated and optimal prices calculated.
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