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ABSTRACT

The two cost approaches to pricing hotel rooms — namely, the $1 per $1,000 approach and Hubbart formula — are well discussed in hospitality accounting textbooks. Textbooks cite them as two "well-known" formal pricing approaches. The two approaches determine room rates based on costs, and the Hubbart formula incorporates target net profits. As cost approaches, both disregard market factors in pricing rooms. Many hotel and motel managers, when asked about the two pricing models, showed little knowledge of them. Research studies on how room rates are determined in practice are few. The purpose of this study is to investigate how room rates are determined in practice and how the two cost models are being used by the industry.

One thousand hotels and motels randomly selected from "Who's Who in the Hospitality Industry," which was published by the American Hotel and Motel Association (1993), and "Hotel and Travel Index," by Reed Travel Group (1994), were surveyed by mail questionnaire. The questionnaire was addressed to the general managers of the selected hotels or motels. Two hundred fifteen responses (21.5%) were received. The sizes of the hotels and motels that responded range from 6 to 2,000 rooms. Service types encompass luxury, full-service, limited-service, economy, all-suite, resort, and casino hotels or motels. Most of the hotels and motels in the sample are independently owned and operated. The rest are major chain and multi-brand operations. The majority of the surveyed managers indicated that they had ample autonomy in setting room rates.

The survey results were analyzed. The survey shows that a surprisingly high percentage of hotel / motel general managers have little knowledge about the two cost approaches. While hotel / motel managers who are aware of the two cost approaches are few, even fewer managers use the two methods in room pricing. The managers' knowledge and use of the Hubbart formula are worse than in the case of the $1 per $1,000 approach. Of the 215 surveyed managers, none indicated that the Hubbart formula was often used in room pricing. In contrast to the two cost approaches, commonly used room-pricing methods by managers in practice are competitive survey, psychological pricing, and trial and error. The utility of the two cost approaches in room pricing seems insignificant.

The survey results indicate that supply / demand condition is regarded as by far the most important factor in determining room rates, followed by competition, quality and costs. Other factors considered in room pricing include REVPAR and integrity. Between fixed and variable costs, fixed costs are considered to be more important than variable costs in room pricing by most of the surveyed managers, consistent with the perceived need of

breakeven. An overwhelming majority of the managers indicated that they would be interested in a pricing model that incorporates demand and cost.

The analysis of the survey results reveals that in practice, costs do not play a dominant role in room pricing, as many educators of hospitality financial management think. Room rates are more driven by market forces — supply / demand relationship in particular. There is a need for hospitality researchers and educators to look for more practical models of room pricing. A model that combines costs and market conditions may be the direction for future research in the area of room pricing.