UDC 911.3

Dmytruk O., Petlina D., Motuzenko O.

REVENUE MANAGEMENT METHODS AND THEIR EFFECTIVENESS IN UKRAINIAN AND RUSSIAN HOSPITALITY MARKETS

This paper studies different methods of Revenue Management, analyzes how applicable and effective they are in Ukrainian and Russian hospitality markets. Reviewed the concept of "Revenue Management".

Keywords: revenue management; pricing optimization

Introduction. Revenue Management is the application of disciplined analytics that predict consumer behavior at the micro-market level and optimize product availability and price to maximize revenue growth [1]. The primary aim of Revenue Management is selling the right product to the right customer at the right time for the right price. Effective price is the price that meets the interests of both the seller and buyer. When talking about the company, already operating in the market, there's no need to calculate the price for it, its management more likely solves the problem of pricing optimization and revenue growth. Every new player in the hospitality market, however, will inevitably have to figure out what price must be set.

Some of the below contents are based on the research of Marina Smirnova, Assistant Director of Revenue and Consulting at Colliers International and discussion with Nataliya Vernyhora – Director of Revenue at Fairmont Grand Hotel Kyiv.

Revenue Management methods. The first calculation method (and the easiest one) is pricing based on set margin adding to the cost of the room. The above way is, however, inapplicable for players just entering the market because they have nowhere to get information about the costs. Consultants and senior staff of the hotel business calculate costs determined as a percentage of estimated revenues on the basis of expert coefficients. Based on these calculations the hotel operators are recommended a certain price, however, it gets adjusted, as a rule, due to various circumstances at later stage.

International practice suggests other methods of calculating the average price for a room. For example, the so-called Hubbert method, which "binds" the average price for a room to the costs incurred by the investor during the construction, given that for every thousand dollars in costs there is $1 in price per room. For example, if construction of 235 rooms hotel amount $95 million, including the cost of construction and installation work not less than 60% or $57 million, the cost of every room is $242.5 thousand. The average price per room shall be about $240 - 250 thousand. The same method is useful for evaluation of existing hotel business as a property: the average sale price is multiplied by the number of rooms and a thousand to obtain an estimated cost.

Despite the downside of Hubbert method, which binds to the price level to "historic" values of the construction costs and does not consider the current costs, this method is quite viable for preliminary calculations [2].

The second type is represented by analog methods. The intuitive method does not operate with concepts of cost, profit and market prices. The operator sets the price guided only by their own prediction and that selected initial prices are correct to some extent. While setting the prices the operator relies on prices of competing players, assuming that the same quality of product implies similar prices. The only advantage of this method is its simplicity. While a drawback is very significant: this method does not take into account the final result - profit. Using analog methods requires adjustments, absence of which may adversely affect the income of the hotel.

Another analog method is the methods of low and high prices. Method of low prices suggests that the operator monitors the pricing policies of competitors and relies on it when choosing his market entry strategy. At the same time it sets lower prices than the competitors. This method takes into account the flexible demand for accommodation services. Markets with flexible demand suffer differently from even a small change in accommodation price, which results in a significant change in demand. Under flexible demand the hotel can earn additional income by lowering the price thanks to increase in turnover, and vise-a-versa: reduction of price per room leads only to decrease in total revenues of the hotel if the demand is inflexible.

Method of high prices is the opposite of the previous one. It suggests setting higher prices in comparison with the main competitors. At the same time an operator who decides to use this method should follow the advertising policy, which stresses the exclusive benefits of the hotel and the premium quality of service. Because the customer strongly associates the quality of service with the price, this tactic provides a chance for success. Recently hotels successfully applied the method of high prices while entering Moscow’s market and a number of other regional ones.

At the same time the above policy has pitfalls: the consumer does not always believe that high prices are backed by high quality services. Comparing inflated prices with offers from other hotels of the same class, the client may prefer not to overpay and choose another hotel [2].

Regardless of whether the operator is practicing the method of high prices or bets on higher hotel load by lowering prices, it can receive the same income. The later is formed based on the average selling price, on one hand, and on hotel load rate, on the other. Result of combining this data gives the revenue per available room (RevPAR) - one of the basic elements of the hotel enterprise economics. Revenue in this case proceeds from the sales of hotel rooms and is calculated from the load and the average selling price without taking into account the costs [1].

There are two main strategies to increase revenue by the sale of rooms. The first one is the price optimization: fewer rooms are sold but at higher prices. The second option is, respectively, the load optimization, which means more sales at lower prices. Each market participant is free to choose any strategy. The choice of strategy depends on the hotel market conjuncture as well as other factors. While choosing it is important to take into account the costs and revenues that are generated by all hotel profit centers, its restaurant first of all. We can assume that by establishing high prices hotel and other profit centers get smaller turnover [2].

Methods of revenue management by setting high or low prices are called natural. They can hardly be qualified as efficient because they don't allow obtaining the absolute maximum revenue. These methods, nevertheless, are the most common and serve to a large number of players on the market.

The method of rate plans is a better solution for revenue management compared with the methods of high or low prices. The basic principle of this method is the ability to offer the same product at various prices to different client groups.

Several rate plans covering a large number of separate client categories provide the opportunity of more sales at different prices and thus gain greater total revenue.

Rate differs from the price since it assumes some terms and conditions to be strictly followed. For example, the hotel weekend rate does not mean that lower price is provided to any guest staying at the hotel on Saturday and Sunday. To some extent it means that discount is not related to rate plans. Rate plans always clearly state certain conditions. For example, at a $100 a day rate, a weekend rate of $75 is set for the groups staying in for at least 2 nights and ordering a set menu in addition to accommodation and breakfast.

Each plan includes both its own terms and conditions and a clear purpose for a particular client group. The plan design is preceded by customer base segmentation process. This technique is used by most market players.

Situation on Ukrainian and Russian markets. In Ukraine and Russia where the 4 and 5 Star hotels managed by international operators are hardly present, we can also see that there is a lack of efficient revenue management. Basic pricing methods, nevertheless, are used almost everywhere. The pricing strategies are represented by four main variations:

- By season: it differentiates weekdays, weekends, holidays, periods of exhibition activity, high and low seasons;
- By room type: standard, premium, deluxe (used by almost all enterprises);
- By business resources: it assumes different prices for corporate and individual clients;
- By a number of guests: this means a price lower for groups of customers rather than individuals;

Practice shows that regional hotels in Ukraine and Russia sell from 40% to 65% of the rooms "off the rack". Because of poorly diversified demand operators can avoid more diverse offers and rate plans design. Russian regions face the opposite trend in load management implementation: most hotels charge for advance booking around 25% of the accommodation price [3]. Most of the hotels employ the tactics of increasing revenue by higher prices, which mean they lose the opportunity to work more effectively with discount segments such as tourists and sightseers.

The situation is, however, changing rapidly. Several national management companies and international operators have already gained access to regional markets. Managers of network companies examine the situation on the regional markets and develop competitive prices based on observations. Increased competition turns down the opportunity to inflate the price without thinking about the effective management of revenues.

To monitor the effect of price on the market position of the hotel it's necessary to keep track of the position in question. It involves the collection and processing of various statistics. Data on the average selling price of rooms (ADR) for the year broken down by month, monthly and annual revenue per available room (RevPAR), thus, play a key role. Comparing the number of rooms sold to the same average parameter of the market operators provides the market penetration index. Index above 1 means that the hotel has high demand and value below 1 suggests that the entity gets less market share than it is potentially able. Parameters of competitors' sales, own sales and demand help to estimate the hotel's ability to increase its income by changing the average price of a room [1].

Comparison of the average prices of the room and average revenue per room in regional hotels proves that almost passim the revenue per available room is much lower than the average sales price. The difference between the average price and revenue per available room is about 50%, s that suggests the majority of the market players move towards a higher price while demand optimization bothers them to a much lesser extent. Such a situation is fraught: the slightest change in market conditions may lead to noticeable revenue decrease, which in turn lowers the position of the hotel in the market. Those hotels with revenue per available room close to the sales price witness highly consistent demand. The operators, nevertheless, tend to take advantage of the ability to set high prices. Situation of high demand, which allows selling expensive rooms, stimulates an increase in new hotel projects in the regions: higher prices provide investors with a high refund rate.

Markets of the majority of Russian and Ukrainian cities are characterized by the inelastic demand for hotel services. High prices are factored by lack of trips motivated by popular tourists' attractions, predominance of guests who come for business purposes and cannot amend booking and the lack of substitutes of accommodation. High prices, as a rule, are not backed by the appropriate level of service, which leads to conflict between supply and demand. There is little or none discount policies on the regional markets and in fact the average price is as close to the average rate as possible. The above developments lead to a "seller's market" situation, which happens when the demand far exceeds supply.

Noteworthy is a gap of 100 percent or higher between the price of standard and deluxe rooms at regional hotels, explained by the high demand for luxury rooms [3; 4]. In some regions accommodation rates are set haphazardly and spontaneously. They can be quite similar even in hotels of different segments. Despite the discrepancy of the services to the world standards, prices at different regional centers are, virtually, set at the same rather high level. The hotel loads, nevertheless, don't fall. Altogether described above patterns indicate the inelastic demand and the absence of competition.

Conclusions. Because the sufficient number of investors and international operators plan their entry to regional markets of Ukraine and Russia, representatives of regional hotel markets try to develop their action plan. Domestic operators try to figure out how to cope with the increasing competition. By further employing a high price policy they may lose a certain part of market share, which is likely to go to competitors - hotels managed by international operators, which also set high prices, based, however, on the appropriate product quality. The good solution favours decrease of the average selling prices and a targeted demand groups approach. Otherwise, revenue per available room will inevitably fall due to decreasing load.

References

1. *Cross, R. (1997) Revenue Management: Hard-Core Tactics for Market Domination. New York, NY: Broadway Books.*
2. *Robert L. Phillips: Pricing and Revenue optimization, 2005, Stanford University Press , Stanford, California*
3. *http://prootel.ru*

http://prohotelia.com.ua