MODULE 3

FIXING ROOM RENT

Room rate, which is the daily rate charged for the usage of a hotel room and its services, is one of the traveller's basic criteria for choosing a particular hotel for stay. The basis for charging room rate differs from one hotel to another. Hotels display their room rent on tariff cards, which provide information about theroom rate for different types of rooms available in the hotel.

FACTORS AFFECTING ROOM TARIFF

Price is one of the major elements involved in marketing and positioning of a product or service. The price of goods and services of a hotel should cover the cost of production, overheads, and a fair amount of profit, so that the hotel business remains sustainable and profitable. The price band of a hotel attracts a particular segment of clients, and thus decides the positioning of a hotel and its services in the market.

The room tariff of a hotel must generate optimum revenue for the hotel and proprietors the return on their investment. The rate of the hotel is decided by considering the following factors:

1. **Cost:** The total expenditure that is incurred in providing services and products to the ultimate consumer of the hotel services is the cost. The total cost can be divided into fixed cost, material cost, and labor cost. The higher the investment that has been made in a hotel property, the higher would be the room rent.

2. **Level of services:** The level of services offered by a hotel determines the room rent to a large extent. Hotels offering services such as spa, gymnasium, banquet halls, and speciality restaurants will charge a higher room rent in comparison with other hotels offering limited services. Asthe star classification of hotels is based on the level of services, the hotels that are classified as five star or above have better services and higher room rents compared to those classified as four star or below. The guest

and staff ratio would be higher in five-star hotels as they provide morepersonalized guest services.

3. **Competition:** The competition between similar hotels (i.e., hotels with similar standards and providing similar services and facilities in similar locations of the city) in the market also plays an important role in determining the rack rate of the hotel. The higher the competition, the lower will be the room rent. Hotels with similar standards have competitive rates.

4. **Target market:** The target market also governs the rack rate of a hotel room. Hotels, while selecting their room rates, find out the disposable income of their target segment. Thus, a budget or limited-service hotel quotes lower prices to attract guests with less disposable income, and an up-market hotel quotes higher prices for its products.

5. **Location:** The location of the hotel also plays an important role in determining the room tariff Hotels in a city centre or business centre (eg., Nariman Point, Mumbai), near places of tourist interest (e.g., Taj Mahal, Agra), or on scenic locales (e.g., beaches of Goa) would have a higher tariff. The location of the room also determines the room rate. Rooms with a better view (sea view/mountain view/pool view) would have higher charges compared to rooms facing a parking lot or a noisy commercial street.

BASIS FOR ESTABLISHING END OF THE DAY

Once the room tariff has been decided, every hotel has to decide about the criteria for establishing the end of the day' to post the room charges into the guest accounts. ***The end of the day*** is an arbitrary time that is supposed to be theend of the financial transactions for a particular day. As hotels remain functional round the clock, it is very important to ascertain the time which will be treated as the end of the day and the beginning of a new day. For establishingthe end of the day these three ways are considered:

- **Fixed check-in/check-out time:** Almost all the hotels follow the fixed check-in/ check-out system for establishing the end of the day. In this system, a particular time is fixed to mark the end of the day. In general, it is 12 noon; this means that a day begins in the hotel at 12 noon every day,regardless of the actual check-in time of the guest.

The major advantage of this system of charging the room rent is that the same room can be sold more than once in a day. This system is normally adopted by commercial hotels.

For example, Himanshu checks into a hotel at 12 noon on 15th July and meets a client at 4 pm He has to catch an international flight at 3.00 am on 16th July. He finishes his dinner and checks out of the hotel at 11 pm. (15th July) to catch the flight. Rajesh pays the room rent for one might (15th July).

Saloni arrives into the hotel at 5.00 am (16th July), and after a day's rest, she hasto catch a train at 11 p.m. on 16th July. She checks out of the hotel at 10 p m. (16^{th} July). Saloni has to pay two nights room charges, that is, 15th July (12 pm)to 16th July (12 p.m.) and

(16th July 12p.m. to 17th July 12 p.m.) The hotel has given Rohan and Aryan the same room and has charged both of them for 15th July night as their stays overlapped. Thus, it has generated optimum revenue.

- **Twenty-four hour basis system:** In this system of charging the room rent, there is no fixed check-in/check-out time. A room is assigned to a guest for twenty-four hours from the time of his/her arrival. This system is generally followed in transit hotels and hotels that are located in the vicinity of railway stations, where guests normally stay for few hours. In this system, the hotel does not allow any relaxation of time after the completion of 24 hours of stay.

- **Number of nights:** This system is a modification of the 24-hour system. Here, the rent is charged on the basis of the number of nights spent in the hotel room. If a guest does not stay at night a half-day rent is chargedfrom him/her. This system is now outdated and not so popular.

ROOMS RATE DESIGNATION

A hotel designates a standard rate for each category of rooms offered to guests. Apart from the standard rates, hotels also offer discounted rates to attract additional business from multiple market segments. Hotels have various room rate designations these are:

1) **Rack rate:** Hotels generally fix a standard rate for each category of rooms offered for accommodation to the guests. The standard rate of a particular type of room before any discount is called rack rate. Traditionally, a rate board was placed near the room rack, and hence the name rack rate. The tariff card of a hotel should mention the taxes applicable on room rents. For example, the rack rate for a standard room may be Rs5000++ (these ++ means exclusive of taxes or taxes extra).

2) **Corporate rate:** This is a promotional rate to attract the corporate market segment rate is generally to-20 per cent lower than the rack rate. For example, The corporate for a standard room may be Rs 4000++.

3) **Seasonal rate:** Depending on the desirability of a location at a particular time of the year, destinations have high, low, and shoulder seasons. Destinations such as hill stations or beaches receive heavy tourist traffic during particular period(s) of the year,

the rest of the year is a lean period in terms of tourism. The duration when the tourist traffic (and the demandfor hotel rooms) at a particular place is high, it is known as the peak season. When the demand for hotel rooms drops down, it is known as the off-season. During peak season, hotels do not offer any discount, rather they may charge a higher room rate, known as the seasonal rate. In order to attract the guests during low-demand period, hotels offer a discounted rate known as the off-season rate. Hotels in these locationis mention their seasonal and off-season rates clearly on the tariff card. For example, rainyseason is off season in Shimla, whereas winters and summers are season time, as visitors go there to see snow in winters and to escape the heat during summers.

4) **Advance purchase rate:** Though popular in the airlines industry, the advance purchase rate is a relatively new concept in the hospitality

industry. It entails heavy discounts on room rates when room bookingsare done in advance. The rate of discount depends on the advance period and the number of rooms available at the time of booking, that is a hotel may offer more discount for a room that is booked two months in advance compared to a room that is booked 15 days in advance. The advance booking of rooms ensures a certain amount of revenue at a given time and thus helps the management in planning a revenue management strategy.

5) **Weekday/Weekend rate:** Some of the hotels observe a fluctuation in their occupancy levels with regard to the days of the week. The demand for rooms in a hotel is perhaps more on certain days in a week. Hotels analyse their demand levels over a period of time and fix a higher rate during high-demand periods and a lower room rate during low-demand periods. In vacation/resort hotels, the weekend rate would be higher than weekday rate as the demand for rooms is higher during weekends.

6) **Day and half-day rate:** The day rate, charged from the guests not staying overnight at a hotel, is lower than the rack rate For instance, if a guest checks in at 10 a.m. and checks out the same evening at around 5p.m., he/she may be charged the day rate. However all hotels may not have day rates. Sometimes a guest might wish to stay for a very short duration of time, not exceeding five hours. For example, a transit traveller, who has to catch a flight in few hours, might want to take rest ina hotel, or a person might want to rent a room for a short business meeting. In these cases, the half-day rate, which is a bit higher than the numerical hall of the rack rate, is charged from guests

7) **Group rate:** Since a large group more than 15 persons provides bulk business to a hotel, it offers discounted rates to groups. The group rate depends on the number of persons in the group and the frequency of their visits. The rates are negotiated by the sales team of the hotel and the representatives of the group.

8) **Tour group (series group) wholesale rate:** These are heavily discounted rates for wholesalers who operate a series of tours for groups arriving and departing together. For example, a tour operator may conduct a week's tour of the Golden Triangle (Delhi Agra Jaipur Delhi) on the 2nd, 12th, and 22nd of every month for groups of 20 people The tour operator guarantees the hotel that it would provide this series of business every month for a period of one year. In return, the hotel offers a heavy discount to the operator and allocates or blocks' rooms for the series for the entire year.

9) **Travel agent rate:** Travel agents sell travel products such as hotel rooms or airlines bookings on a commission basis to the end users (guests). They provide a substantial volume of business to hotels, hence, hotels offer them special discounts and commissions. Some of the major travel agencies are Cox & Kings, Thomas Cook, etc.

10) **Volume guarantee rate:** Hotels offer a special rate (lower than the rack rate) to attract high volume of business from special market segments. A hotel may have a contractual agreement with a company, according to which the company's representatives are entitled to a special discounted rate when they reserve a room in the hotel. The percentage of discount will depend on the volume of business promised and the mutual understanding between the hotel and the company at the time of making the agreement A frequent business customer might be offered a CP (Continental Plan) at thestandard room rate.

11) **Airlines/Crew rate:** It is a special discounted rate for the crew of one or more airlines that offer certain volume of business throughout the year on aconsistent and continuous basis.

12) **Government rate:** When government officials travel for official work, they are given a travel allowance to cover their hotel, meals, and other out-of-pocket expenses. Based on their designation, this amount is fixed and given in advance. A hotel interested in catering to this segment may quote room rates that match their travel allowances. The hotel may ask for proof of identity from guests before they can avail the government rates.

13) **Educational rate:** Educational rates are special rates offered by hotelsto students and educationists who have a limited travel budget. They are a significant source of business because of their large numbers andfrequency of visits. They provide a large chunk of repeat business to hotels.

14) **Membership rate:** Membership rates are offered to guests who are members of influential organizations that provide high volumes of business to hotels. The membership rates are much lower than the rack rates and may also include discounts on food and beverage. Special discounted rates are given to FHRAI

members, UN employees, travel writers, etc.

15) **Introductory rate:** The introductory rate is offered by a hotel on the opening of a new property in town. It is a part of a new hotel's marketing strategy to make inroads into the existing market by offeringa price lower than what is offered by competitors with the same standards. In general, the introductory rate is offered till the hotel is established.

16) **Complimentary rate:** When a hotel does not charge the room rent from a guest, it is known as complimentary rate. Hotels generally offer complimentary rooms (also called comp rooms) to the tour/group leader. They also offer comp rooms to tour operators, travel agencies, and local dignitaries who are vital to the public relations programme of the hotel. Hotels also provide complimentary rooms along with marriage packages and bulk bookings.

17) **Crib rate:** This is the rate charged for children above five years and below 12 years of age accompanying their parents. The hotel provides a crib bed in the room for infants.

18) **Package rate:** A package rate is quoted for a bouquet of products or services. The rate is generally lower than the sum of the prices of individual products or services offered in the bouquet. These rates are tailor-made for specific guest requirements, A package rate may include room rent, meals, special arrangements (such as marriage set- ups, banquet halls, and meeting room and may also include products and services offered by other service providers such as transportation (rail, road, and air), and sightseeing

There are some packages mentioned below offered by the hotel:

- **Meeting package:** A complete meeting package includes the residential arrangement of the delegates, meeting room, food and beverage requirements (meals, tea/coller. snacks, along with transportation facility, audiovisual equipment like projectors to the meeting delegates.

- **Meal package:** A meal package is the combination of room rent and meals, which may cover all major meals or a combination of breakfast and lunch/dinner. The hotel offers meal packages based on the requirement of guests and the suitability of the hotel's operations. The various meal plans offered by hotels are discussed at length in the subsequent section.

- **Marriage package:** A marriage package includes all the necessary arrangements for marriage, such as mandap, priest, party hall/lawn, accommodation for the marriage party, arrangement of reception buffet, and even a complimentary room/suite for the newly wedded couple.

- **Holiday package:** A holiday package includes transportation, accommodation, meals, guide, and sightseeing at the destination. In general, this package includes non-hotel products from other serviceproviders like airlines.

Room Tariff Fixing

Fixing of room tariff is a difficult task for the management. If the management fixes a low room rent, the hotel operations might not be economical. However, if the rate is to high, guests may not patronize the property. Hence, an accurate and competitive room rent is one of the prerequisites for running a successful hospitality business. A hotel fixe the room tariff on the following bases

- Cost-based pricing
- Market-based pricing

I. Cost-based Pricing

Cost-based pricing is a room rent determination technique that covers the basic cost operations at a given level of service, plus the predetermined percentage of return on investment (ROI). It involves the determination of all fixed and variable costs associated with a hotel. After the total costs attributable to the hotel have been determined, managers add a desired profit margin to cach unit, such as a 5 or 10 per cent mark-up. The goal of the cost-oriented approach is to cover all costs incurred in producing or delivering the products or services and to achieve a targeted level of profit.

The traditional pricing policy can be summarized by the following formula:

Cost +Fixed profit percentage = Selling price

The following are the two widely used cost-based pricing techniques:

1. Rule of thumb approach
2. Hubbart formula

1) Rule of Thumb Approach

Rule of thumb is the oldest method of determining the room rent of any hotel. According to this approach, the room rent should be fixed at the rate of 1 for each 1000 spent on the construction and furnishing of the room, assuming that the average occupancy is 70 per cent for the year. If the hotel incurs a total expenditure of 15,00,000 on a room, the room rent will be 1500 according to the rule of thumb approach.

This is a traditional approach considering only the cost that is incurred at the time of starting the operation. If we try to establish the room rent of a hotel after 10 years of its operation, the rate would be the same, though the cost of operation of the property would have increased manifold. There are several other drawbacks associated with the rule of thumb approach; some of them are as follows:

- It considers only the cost incurred in constructing the room. It does not consider factors such as inflation, competition, and fixed expenses.

- It considers the average occupancy to be 70 per cent, which might not be achieved by many hotels due to several reasons. Therefore, hotels expecting a lower occupancy should set a higher rate to attain the same revenue.

- The ROI is not considered. If the money invested in constructing and furnishing the hotel room had been invested in the market for the duration of one year, it would have generated income for the investor.

- It does not consider the depreciation of fixed assets or the elevation of land costs.

- Establishing a hotel requires a large sum, which is generated through borrowing from family, friends, financial institutions, and public through the sale of shares and debentures. The owner of the hotel has to pay the debt and interest on the sum received irrespective of the volume of business generated by the hotel. This factor is not considered in this approach.

- The hotel business may incur some unexpected and unavoidable expenses, the provision for which is not made in this approach.

- The rule of thumb approach also fails to consider the contribution of other facilities and services (food and beverage service, laundry, health and fitness services, and recreational services) for the profitability of the hotel while setting the price of a room.

2. Hubbart Formula

The rule of thumb approach is an old and traditional way of determining the room rent of a hotel. It is unscientific and suffers from many drawbacks. The Hubbart formula, which is a scientific way of determining the room rent, was developed by Roy Hubbart in America in the 1940s. It resolves all the problems of the rule of thumb approach. The following steps are involved in calculating the room rent according to the Hubbart formula:

- Calculate the total investment including the owner's capital and loans, both secured and unsecured. Once the total investment has been calculated, calculate the fair of return on investment (ROI), which is the amount that would have been generated if the money invested in the hotel business had been invested in the open market.

- Calculate the total expenses such as operating expenses, overheads, depreciation of fixed assets, interest paid, and heating and lighting that will be incurred during hotel operations.

- Combine steps 1 and 2 to find out the gross-operating income that is necessary to cover the operating cost, investment, and ROL.

- Calculate the income generated from other sources of income, such as food and beverage sales, laundry, rent and lease of the hotel area, and fitness centre. Subtract the same from the amount calculated in step 3 to find out how much profit is expected from the room sales. This will be the total revenue generation by the room sales.

- Calculate the total number of the guest rooms available for sale by multiplying the total number of rooms with the number of days in the year. Make the provision for expected average vacancy during the year. This step will provide the total number of rooms available for sale.

- Divide the revenue generation (result from step 4) by the total number of room (result from step 5); the result obtained will be the average daily rate, which will cover the cost of operations and fair ROL

II. Market-based Pricing

Market-based pricing is setting a price based on the value of the product in the perception of the customer. The concept is based on an idea of what the ultimate consumer of goods and services, that is, the guest, is prepared to pay and then use this as a starting point. In this case, the hotel works backwards as it first makes an accommodation product available at a price that a guest is willing to pay and then it tries to cut down on the cost to achieve a reasonable rate of return on that basis.

Some common methods of market-based pricing are as follows:

- **Competition-based-** Arriving at a pricing based on competing hotels' rates
- **Market tolerance-** Checking competing hotels' best available rates for a room. These rates can be ascertained by the hotels by calling up the competing hotels without disclosing their identity.
- **Rate cut-** Lowering of rates to increase occupancy levels, especially during off season
- **Inclusive and non-inclusive rates-** Charging room rates on the basis of meals, provided on a CP/MAP/AP basis
- **Guest requirements-** Varying room tariff as per guest requirements, for example, early check-in an CP basis or late check-out on MAP basis

When compared to market-based pricing, cost-based pricing is more scientific and practical as it takes into account factors such as the rate of return on investment, operating cost, overheads, and fair profit. In market-based pricing, one can get the advantage of selling the same product over a range of prices.