



Operations Management in Hospitality

Assignment 12

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The importance of price elasticity to revenue management systems in hotels

Price elasticity of demand is used in measuring sensitivity of customers to price changes. Hotel revenue management systems (RMS) are also essential since these programs are based on the ability to anticipate the reactivity of the guests towards the various room rates so that they can maximize revenue as opposed to merely maximizing occupancy. To begin with, elasticity assists a hotel in making decisions on whether prices should be increased or reduced. When demand is inelastic (guests are not that price-sensitive) a rise in room rates will be able to increase total revenue. As a case in point, when there is a peak season like a festival or a conference, business travelers may be predetermined to travel at a particular time and have limited choices. An RMS can raise prices since a 10 percent price rise might cause a decrease in bookings by less than 10 percent causing an increase in the total revenue (Cross et al., 2009).

Second, market segmentation and price discrimination relies on elasticity. Elasticities of various customer groups are different. Pre-booking leisure travelers tend to be more price sensitive as compared to last minute business travelers. This information is used by the revenue management systems to provide discounted advance-purchase rates with the high-flexible rates remaining on the less elastic segments. This gives the hotels the ability to capture more willingness to pay among the customers (Talluri and Van Ryzin, 2004).

Third, promotions and discount decisions are determined by price elasticity. When the demand is extremely elastic in low seasons, reductions in price may greatly boost the amount of bookings and the total revenue. An example is that a resort hotel can provide discount packages when the seasons are low since even a minor reduction would create a similar growth in demand (Hayes and Miller, 2011).

Ultimately, understanding the operation of elasticity assists businesses to make better forecasts and manage their inventory in a better way. RMS models integrate the estimates of the elasticity with the demand predictions to estimate the number of rooms to be sold at each price. Under estimates in elasticity may result to underpricing (revenue lost) or overpricing (unoccupied rooms) and neither of these is very profitable (Phillips, 2005). Overall, price elasticity plays a crucial role in the hotel revenue management since it helps to decide on pricing, customer segmentation, promotions, and demand forecasting. The hotels can maximize their revenue in

the various market conditions by making sure that the prices are adjusted based on the sensitivity of the guests to the price adjustments.

References

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