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### Strategic Revenue Management and the Role of Competitive Price Shifting

Cathy A. Enz Ph.D.

*Cornell University*, [cae4@cornell.edu](mailto:cae4@cornell.edu)

Linda Canina Ph.D.

*Cornell University*, [lc29@cornell.edu](mailto:lc29@cornell.edu)

Breffni Noone Ph.D

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# Strategic Revenue Management and the Role of Competitive Price Shifting

## Abstract

This paper examines whether stable competitive pricing positions yield better average annual RevPAR growth than do price shifts either upward or downward, as compared to competitors' positions. Using property level data on average daily rate (ADR) and average annual RevPAR growth, this study found two contrasting price-shifting strategies. For hotels that were lower priced relative to their competitors in 2007, the most popular strategy was to make price shifts to higher price categories in both 2008 and 2009. In contrast, the most popular strategy for hotels that originally positioned themselves above the competition was to move to lower price categories in both 2008 and 2009. Although RevPAR fell for all hotels during this period, the strategy of shifting to a higher price category was the most successful in terms of average annual RevPAR growth over the three-year period of this study. On the other hand, a shift to lower prices was least successful in delivering RevPAR growth. Overall the results suggest that upward shifts in relative prices are the best way to achieve higher RevPAR growth, and maintaining price stability is the next most viable positioning strategy in terms of RevPAR.

## Keywords

hotels, rate (average daily rate), revenue per available room (RevPAR), pricing

## Disciplines

Business | Hospitality Administration and Management

## Comments

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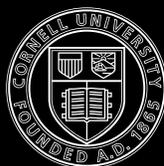
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by Cathy A. Enz, Ph.D., Linda Canina, Ph.D.,  
and Breffni Noone, Ph.D.

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Center for Hospitality Research  
Cornell University  
School of Hotel Administration  
489 Statler Hall  
Ithaca, NY 14853

Phone: 607-255-9780  
Fax: 607-254-2922  
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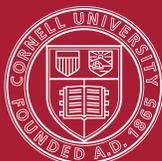
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# Strategic Revenue Management and the Role of Competitive Price Shifting

by Cathy A. Enz, Linda Canina, and Breffni Noone

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## EXECUTIVE SUMMARY

This paper examines whether stable competitive pricing positions yield better average annual RevPAR growth than do price shifts either upward or downward, as compared to competitors' positions. Using property level data on average daily rate (ADR) and average annual RevPAR growth, this study found two contrasting price-shifting strategies. For hotels that were lower priced relative to their competitors in 2007, the most popular strategy was to make price shifts to higher price categories in both 2008 and 2009. In contrast, the most popular strategy for hotels that originally positioned themselves above the competition was to move to lower price categories in both 2008 and 2009. Although RevPAR fell for all hotels during this period, the strategy of shifting to a higher price category was the most successful in terms of average annual RevPAR growth over the three-year period of this study. On the other hand, a shift to lower prices was least successful in delivering RevPAR growth. Overall the results suggest that upward shifts in relative prices are the best way to achieve higher RevPAR growth, and maintaining price stability is the next most viable positioning strategy in terms of RevPAR.



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## ABOUT THE AUTHORS



**Cathy A.ENZ**, Ph.D., is a professor of strategy and the Louis G. Schaeeneman, Jr. Professor of Innovation and Dynamic Management at the Cornell University School of Hotel Administration (cae4@cornell.edu). Her research focuses on hospitality strategy, including innovation, competitive dynamics, pricing strategy, and change management. Among her recent publications are the best-practices series of case studies on innovators in the hospitality industry, with four coauthors, articles in the *Cornell Hospitality Quarterly*, and two new books, *The Cornell School of Hotel Administration Handbook of Applied Hospitality Strategy* and *Hospitality Strategic Management: Concepts and Cases*, 2nd edition.

**Linda Canina**, Ph.D., is an associate professor of finance at the Cornell School of Hotel Administration (lc29@cornell.edu). Her research interests include asset valuation, corporate finance, and strategic management. She has expertise in the areas of econometrics, valuation, and the hospitality industry. Canina's current research focuses on strategic decisions and performance, the relationship between purchased resources, human capital and their contributions to performance, and measuring the adverse selection component of the bid-ask spread. Her publications include "Agglomeration Effects and Strategic Orientations: Evidence from the U.S. Lodging Industry" in *Academy of Management Journal*, as well as articles in *Journal of Finance*, *Review of Financial Studies*, *Financial Management Journal*, *Journal of Hospitality and Tourism Research*, and *Cornell Hospitality Quarterly*.



**Breffni Noone**, Ph.D., is an assistant professor of hospitality management at Pennsylvania State University. Her chief research interests include revenue management, particularly the effect of revenue management practices on customer satisfaction and approach-avoidance behaviors relating to customer relationship management. Her recent publications include articles in the *Cornell Hospitality Quarterly*, *Journal of Hospitality and Tourism Research*, and *Journal of Service Management*.

# Strategic Revenue Management and the Role of Competitive Price Shifting

by Cathy A. Enz, Linda Canina, and Breffni Noone

**R**evenue managers are increasingly essential players in helping a hotel to determine its long-term pricing strategy, which is part of the determination of which demand streams the hotel will accept. The hallmark of a good revenue management strategy is to cost effectively fill the reservation pipeline with high-value business.<sup>1</sup> As revenue management has progressed beyond inventory control to become an a more strategic area of expertise in hotels, the need to have data on segmented pricing, competitive positioning, and consumer behavior has expanded.<sup>2</sup>

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<sup>1</sup> R. Cross, J. Higbie, and D. Cross, "Revenue Management's Renaissance: A Rebirth of the Art and Science of Profitable Revenue Generation," in *The Cornell School of Hotel Administration Handbook of Applied Hospitality Strategy*, ed. Cathy Enz (Thousand Oaks: CA: Sage, 2010).

<sup>2</sup> C. Anderson, "Commentary: Demand Management"; and S. Kimes, "Strategic Pricing through Revenue Management," in *Ibid.*

Numerous studies have confirmed the relationship of pricing strategy and revenue. In particular, studies have shown the negative effects of failing to manage distribution properly, for example, by reducing prices in the face of anticipated low occupancy rates or high inventory.<sup>3</sup> In a study of European hotels, we found that hotels that offer average daily rates above those of their direct competitors have higher relative RevPAR.<sup>4</sup> Most critically, these studies indicate the inelasticity of lodging demand, given that demand is not stimulated by dropping prices in relation to competitors.

This demand inelasticity is an essential factor for pricing strategy, because inaccurate assumptions about customers' price responsiveness have helped to explain why broad-scale discounting doesn't work.<sup>5</sup> A study of American travelers conducted by Maritz, for example, revealed that only 13 percent of respondents had even noticed that hotel rates had decreased, and only 3 percent said that lowered prices made them more likely to stay at hotels.<sup>6</sup> In light of these studies that suggest that price reductions do not stimulate demand, the question of when and how to price effectively remains critical. Hotel managers need to determine the best pricing strategy for maximizing hotel performance. That strategy could be one of price stability or one of changing price category relative to competitors. Most particularly, it's important to determine whether raising or lowering prices relative to the competition contributes more to RevPAR growth.

To explore the comparative merits of price stability and price shifting, and the resulting impact on RevPAR, this study examines three pricing strategies of hotels over the three-year period from 2007–2009. We look at the pattern of compound RevPAR growth rates for hotels that adopted various pricing strategies during this time.

The particular focus of this study is on the revenue effects of price stability of individual hotels over time when compared to their direct competitors in local markets. The question of interest is whether hotels that shift their price position (category) relative to their competitive set reap higher revenue growth per available room. We especially want to know

whether stable relative price positions yield better results than shifting prices.

To answer the question of price stability we examined hotels that shifted their pricing position relative to their direct competitors. We were interested in understanding the differences between hotels that engaged in stable pricing positions compared to their competitors versus those who made a shift in relative pricing category over time. Category shifters are hotels that have moved out of a particular pricing category, and shifted to a price category that was either higher or lower than their category in the previous year. We explore five different price positioning strategies, four of them involving price shifting. Thus, one category comprises "price stable" properties—those that remained in the same pricing category compared to their competitive set between 2007 and 2009.

The four different price-shifting groups were determined by the timing and direction of a hotel's price category change. One price shifting group changed to higher price categories in both 2008 and 2009. Note that these properties may still be priced lower than their competitive set, but the size of the difference would be smaller as a result of their rate change. Another group comprised hotels that raised rates to a higher price category in 2008 and then dropped to a lower price category in 2009. Again, we speak of bands of percentage difference between the hotels, and the changes are from one band to another, regardless of whether that band is above or below the competitors' prices. The next group shifted to a lower price category in 2008 and then raised rates to a higher price category in 2009. The final group was hotels that lowered their price category in both 2008 and also in 2009.

We argue that different pricing positions (i.e., price stability or category shifting) will shape the degree of growth in RevPAR over the multi-year time period. In light of the previous work that has found demand for hotels to be reasonably inelastic we speculate that stable pricing and shifting to higher price categories will be more likely to deliver positive RevPAR growth than would positioning strategies in which hotel operators lower their prices relative to their competitors.

## Methodology

**Sample.** Working under a non-disclosure agreement, we obtained data from Smith Travel Research (STR), which collects room demand, room supply, and room revenue by property for over 98 percent of the population of branded hotels in the United States. We explored annual price category switching behavior for 7,435 hotel properties in five

<sup>3</sup> W. Cooper, T. Homem-de-Mello, and A. Kleywegt, "Models of the Spiral-down Effect in Revenue Management," *Operations Research*, Vol. 54 (2006), No. 7.

<sup>4</sup> Cathy A. Enz and Linda Canina, "Competitive Pricing in European Hotels," *Advances in Hospitality and Leisure*, Vol. 6 (2010), pp. 3-25.

<sup>5</sup> Linda Canina, Cathy Enz, and Mark Lomanno, "Why Discounting Doesn't Work," *Center for Hospitality Research Report*, Vol. 4, No. 7 (2004).

<sup>6</sup> Rick Garlick, "What if You Reduced Your Hotel Room Rates and Nobody Noticed?" *Hospitality Net*, November 2, 2009, <http://www.hospitalitynet.org/news/4044480.html>, March 10, 2011.

different segments, from luxury to economy. This represents 22,305 observations over the three-year period, from 2007 through 2009. To ensure we had comparable properties, hotels were included in the sample if their RevPAR performance was within one standard deviation of their competitive set's RevPAR in 2006. Properties that had less than 12 months of data were eliminated from the sample. Data were analyzed on a yearly basis to minimize seasonality and pricing irregularities that may have occurred in a particular month that are not representative of the property's overall pricing strategy.<sup>7</sup>

### Relative ADR Pricing Categories and Pricing Positions

The percentage difference in the annual average daily rate (ADR) relative to the hotel's competitive set in 2007 was used as the basis for determining a hotel's original pricing position. The selection of hotels for a competitive set was determined by the hotel in cooperation with STR, and we relied on their categorization of competitors for this study. Hotels were grouped into one of sixteen different pricing categories ranging from a category of more than 30 percent lower than the competitive set to a category of hotels that priced on average more than 30 percent higher than competitors. The placement of hotels in a price category was accomplished by first computing the annual average daily rate (ADR) for each hotel in the sample and for each property's competitive set by year. Then, we computed the percentage difference in ADR between the hotel and its competitors for each year. The percentage difference in ADR was calculated by subtracting the annual ADR of the competitive set from that of the hotel in question and converting that figure into a percentage. The result of this calculation is the percentage difference in ADR from that of the competitive set. For example, if a hotel had an annual ADR of \$42.00 in 2007, and the annual ADR of the competitive set was \$50.00, the percentage difference would be -8.0 percent:

$$((\$42.00 - \$50.00) / \$50.00) \times 100 \text{ percent}.$$

In this example, the hotel would be placed in the 5- to 10-percent-lower relative ADR pricing category in 2007. This process was followed for each year of the study (2007, 2008, and 2009) such that the sample hotels were categorized into one of the sixteen relative ADR pricing categories based on the percentage difference in their ADR from their competitive set.

To establish the pricing positions for the hotels in the study, the relative ADR pricing behavior of each hotel across the entire three years was examined, and the hotels were grouped into one of the five pricing position groups, accord-

ing to the taxonomy that we explained above. Note that the sample consists of properties that did not change pricing categories at all during the time of the study or else changed pricing categories in each of the two years (i.e., 2007–08 and 2008–09). Properties that changed pricing categories in only one of the two years were eliminated from the sample.

### Average Annual RevPAR Growth

The annual compound RevPAR growth over the 2007–2009 period was computed for each hotel as:

$$\{(Value_{2008} \div Value_{2007}) * (Value_{2009} \div Value_{2008})\}^{1/2} - 1.$$

Average annual RevPAR growth was computed separately for each hotel. The final data presented were the averages for all hotels that occupied a given pricing strategy across the sixteen relative ADR pricing categories (eight pricing categories higher and eight lower than the competitive set).

### Results

We should note that the years 2008 and 2009 were difficult for the United States hotel industry. The industry's occupancy dropped, average daily rate fell, and revenue per available room decreased during this time period. Instead of RevPAR growth, the results of our study reported broad RevPAR declines. Since we are studying growth, we'll term this negative RevPAR growth. Consequently, in light of the general poor performance of the industry in 2008 and 2009, our study will focus on the pricing behavior that produced the smallest negative growth in RevPAR.<sup>8</sup>

### Pricing Below the Competition

The average annual RevPAR growth rates over the period 2007–2009 for hotels that engaged in different positioning strategies and priced below their competitive set in 2007 are shown in Exhibit 1 (next page). Let's start with the stable price hotels. They experience a negative RevPAR growth of -8.97 percent, which was a comparatively decent performance for this period. The data reveal that the pricing position that consistently yielded the least negative RevPAR growth for hotels that were already pricing lower than their competitors was that of moving to a higher price category in both 2008 and 2009. For example, hotels with average rates slightly below their competitors (i.e., 0-2% below) in 2007 which moved to higher price categories for the next two years experienced a negative RevPAR growth of -8.57 percent, which was the smallest loss for any category. Contrast this negative growth to the -10.97 percent experienced by other hoteliers originally pricing in the 0- to 2-percent below competitor category who moved to lower ADR categories in those years.

It is interesting to note that moving to higher price categories was a popular positioning strategy for hotels that

<sup>7</sup> J. Ismail, M. Dalbor, and J. Mills, "Using RevPAR to Analyze Lodging-segment Variability," *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 4 (2002), pp. 73-80.

<sup>8</sup> In subsequent analyses we have found the results to be robust and true in time periods of rising occupancies and ADRs.

## Average annual RevPAR growth 2007–2009 for hotels that price below their competitive set

Average Annual RevPAR Growth by Pricing Position					
Relative ADR Price Category in 2007	Price Stability	Category Shifting Positioning Strategies			
	No Change in Price Category in 2008 or in 2009	Higher Price Category in 2008 and in 2009	Higher Price Category in 2008 and Lower Price Category in 2009	Lower Price Category in 2008 and Higher Price Category in 2009	Lower Price Category in 2008 and in 2009
<b>Panel A: Lower Prices</b>					
0-2% Below	-8.97	-8.57	-10.15	-10.41	-14.05
<i>N</i> Observations	44	151	138	130	110
2-5% Below	-8.63	-7.90	-9.08	-11.15	-12.83
<i>N</i> Observations	112	201	180	147	99
5-10% Below	-10.09	-8.15	-8.15	-10.40	-12.84
<i>N</i> Observations	371	241	169	194	67
10-15% Below	-9.98	-8.06	-10.22	-9.48	-13.43
<i>N</i> Observations	245	161	134	141	54
<b>Panel B: Much Lower Prices</b>					
15-20% Below	-8.80	-5.32	-8.61	-7.99	-11.65
<i>N</i> Observations	173	95	58	95	24
20-25% Below	-7.87	-6.05	-10.28	-10.35	-14.52
<i>N</i> Observations	89	67	25	54	18
25-30% Below	-12.49	-7.87	-8.82	-10.17	—
<i>N</i> Observations	48	40	17	22	0
More than 30% Below	-9.42	-2.30	-7.07	—	—
<i>N</i> Observations	85	13	11	0	0

had originally priced just under their competitors (Exhibit 1, Panel A). For the group of hotels that priced no less than 15-percent below their competitors in 2007, 64 percent of them moved to higher groups in at least one of the two years, 25 percent of them did not move at all, and the remaining 11 percent moved to lower categories in both years. Hotels that priced much lower than their competitors (Exhibit 1, Panel B), tended to prefer a positioning strategy of no change in price category; 42 percent of them did not move to a different pricing category over the study period. This approach proved to be less successful than others in terms of stanching the loss of RevPAR, but it was still better than a strategy of moving to a lower category. The most negative RevPAR growth across all of these lower pricing hotels was for hotels that moved to even lower price categories for both 2008 and 2009.

For hotels that priced 5- to 10-percent below their competition in 2007, the best two positioning strategies were to either move to higher pricing categories in both years or to move to a higher category in 2008 and then to a lower

group in 2009. Moving to a lower price category in 2008 and then moving to a higher category in 2009 was one of the two best strategies for hotels that priced 10- to 15-percent below the competition in 2007. However, hotels that priced much lower than their competitors (i.e., 25-percent lower or more) showed the most negative RevPAR growth by maintaining a positioning strategy of price stability (see Exhibit 1, Panel B). For these very low priced hotels, moving to a higher price category produced better results, although we note that most of these hotels did not in fact move to a higher price group.

Overall, the results show that the largest single strategy was price stability (29% of hotels), followed by moving to higher price categories in 2008 and 2009 (24%). The least frequently deployed strategy for hotels which priced below competitors in our sample was the approach of moving to even lower price categories in both 2008 and 2009 (9%). Overall, the results suggest that a large portion of hotels that were lower priced in 2007 either maintained price stability with no change in category or else moved to a higher price category. In both cases these were the most successful strate-

## Average annual RevPAR growth 2007–2009 for hotels that price above their competitive set

Average Annual RevPAR Growth by Pricing Position					
Relative ADR Price Category in 2007	Price Stability	Category Shifting Positioning Strategies			
	No Change in Price Category in 2008 or in 2009	Higher Price Category in 2008 and in 2009	Higher Price Category in 2008 and Lower Price Category in 2009	Lower Price Category in 2008 and Higher Price Category in 2009	Lower Price Category in 2008 and in 2009
<b>Panel A: Higher Prices</b>					
0-2% Above	-8.60	-8.41	-8.94	-8.16	-10.97
<i>N Observations</i>	39	109	124	150	140
2-5% Above	-7.97	-7.87	-10.06	-9.46	-12.88
<i>N Observations</i>	118	97	151	182	183
5-10% Above	-8.95	-8.09	-11.62	-8.31	-11.76
<i>N Observations</i>	319	104	138	179	222
10-15% Above	-7.61	-7.97	-11.74	-7.85	-14.72
<i>N Observations</i>	155	61	96	127	151
<b>Panel B: Much Higher Prices</b>					
15-20% Above	-8.22	-9.60	-11.38	-8.16	-13.69
<i>N Observations</i>	64	21	41	57	95
20-25% Above	-9.20	1.81	-12.05	-6.52	-12.71
<i>N Observations</i>	29	4	18	35	55
25-30% Above	-8.26	—	-16.16	-10.78	-9.57
<i>N Observations</i>	13	0	9	15	21
More than 30% Above	-10.83	—	—	-15.97	-17.82
<i>N Observations</i>	57	0	0	10	24

gies in terms of minimizing the negative average annual RevPAR growth over this period.

### Pricing Above the Competition

Exhibit 2 shows the average annual RevPAR growth for hotels that priced above their competitive set in the base year of 2007. Once again, looking at our benchmark of no change, we see that for higher priced hotels (shown in Exhibit 2, Panel B) a positioning strategy of no change in price category was better than lowering price categories. These data show that the strategy of moving to a lower price category in 2008 and 2009 was a costly approach which produced the most negative RevPAR growth for hotels in seven of the eight price categories studied. Only hotels that priced 25- to 30-percent higher than their competitors in 2007 experienced less negative RevPAR growth by moving to a lower price category in both 2008 and 2009.

For hotels that priced just above their competition (i.e., 0-2% above), a strategy of first moving to a lower group and

then moving to a higher group in 2009 yielded the least-negative RevPAR growth. Moving to a lower price category and then moving to a higher group was also a productive strategy for hotels that priced 15- to 20-percent above their competitors in the base year. Maintaining price stability was the best strategy for hotels that priced 10- to 15-percent above competitors, and also for those that priced 25-percent or more above their competitors.

The most frequently deployed strategy for the hotels that originally positioned themselves above the competition was to lower prices in both 2008 and 2009. It is intriguing that this was the most popular strategy, used by 891 hotels (26%), since it was also the least successful in limiting RevPAR losses. It is also curious that the most successful strategy, namely, rising to higher price categories in 2008 and 2009 was the least common pricing strategy; only used by 396 hotels (12%) in our sample.

A final analysis was conducted to determine whether the three pricing strategies studied were used to differing de-

## Percentage breakdown of price strategies by segment

Price Strategy	Segment							
	Luxury		Upscale		Midscale		Economy	
	<i>N</i> Observations	Percentage	<i>N</i> Observations	Percentage	<i>N</i> Observations	Percentage	<i>N</i> Observations	Percentage
No change in either year	247	26.88%	630	25.44%	619	23.87%	259	28.49%
Down in both 2008 and 2009	192	20.89%	457	18.46%	445	17.16%	121	13.31%
Up in at least one year*	480	52.23%	1,389	56.10%	1,529	58.97%	529	58.20%
<b>Total <i>N</i> observations</b>	919		2,476		2,593		909	

\*Note: Hotels that went up in at least one year may have dropped down in the other year or gone up in both years. Hotels that changed in one year only were eliminated from the sample.

grees by hotels in various segments. A breakdown of strategies by segment (see Exhibit 3) reveals that the most popular pricing strategy was to price shift to a higher category in at least one of the two years under study. A price strategy of no change or lower pricing in both 2008 and 2009 was half as likely to be deployed by hotels in each segment. A comparison across segments revealed few differences in the percentage of hotels that chose one of those three strategies. Budget hotels were the most likely to make no change in pricing (as we said, 38.3 percent of budget hotels did not change price category), but a good one-quarter of hotels in each of the other segments also elected to keep their relative pricing similar from year to year. Another pattern found in the data was that lower segmented hotels tended to deploy the price-dropping strategy to a lesser degree than did higher segmented hotels, although this strategy was still used less often by hotels in all segments, and the differences across segments were modest. Overall in each segment the percentage of hotels that selected the strategies of higher and lower price shifting and same price category were comparable.

### Conclusion

The competitive positioning findings of this study and the impact of positioning on annual RevPAR growth should serve to assist revenue managers and other decision makers as they strive to effectively understand and manage demand. The findings from this price switching study revealed that bold category shifting behaviors produced both positive and negative consequences, depending on the direction and timing of the move, as well as the hotel's initial pricing strategy with regard to the competition. Hotels that shifted their price category by moving to higher prices did much better than others in minimizing negative RevPAR growth

experienced by all hotels. This positioning strategy was particularly productive for hotels that were already pricing lower than their competitors, and was frequently deployed by hotels in these pricing situations.

Hotels that priced higher than their competitors appear to have been tempted to move to a lower category in the hopes of gaining more occupancy. Moving to a lower pricing category was the most popular strategy and also the one that was most costly in terms of negative RevPAR growth. On balance, this was a poor strategic choice for hotels regardless of whether they originally were higher or lower priced than their competitors. The hotels that moved to lower pricing categories saw much greater loss in RevPAR.

While owners and managers face challenges in determining the right pricing strategy in difficult markets, the evidence from this study clearly suggests that a major upward shift to a higher price category yields the best possibility of RevPAR growth (or smaller loss). For hotels that are already pricing above their competitors, shifting to lower pricing categories and then making a major shift to a higher category worked for some, as did maintaining rate stability and moving to a higher pricing position. Based on this study and others, we continue to suggest that hotels should not follow a path of overall price reduction, while acknowledging that targeted discounts and promotions are necessary and appropriate. The results of this study confirm the outcome of RevPAR losses that accompany a positioning choice of reducing rate categories as against competitors. We hope that this study is reassuring for those who need to convince key decision makers that offering overall average prices higher than those of competitors is the best way to get desired returns. If raising prices with major shifts upward is not feasible, then maintaining price stability is the next best approach. ■

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