

Comp Rooms - More Difficult Than A Free Lunch - By Robert Mandelbaum

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A historical perk for working in the hotel industry is the chance to get a complimentary (comp) room when traveling. One call to your former co-worker or college buddy and you are all set with a free junior suite, complete with a welcoming wine and cheese basket.

Unfortunately, due to the proliferation of yield management tools, increased reporting, and the recent industry recession, hotel managers are increasingly reluctant to offer such acts of kindness to their friends. Managers now have to consider the impact of complimentary rooms on their property's operating statistics, as well as the need to offer an explanation to the hotel's owner. Instead, the 'employee discount' has become the favor of choice.

Of course, there are other reasons to accommodate guests at no charge. Hotels routinely 'comp' rooms for travel agents, meeting planners, and corporate travel executives in an attempt to promote their property. Complimentary rooms are often used as an incentive to secure group business - 'Book 100 rooms, get one free.' While offering rooms for free can be an effective business strategy, the current favorable supply/demand conditions are putting more pressure on hotel managers to maximize revenue at their properties. Therefore, the tendency is to limit the number of complimentary rooms extended to guests for business or personal reasons.

Operating statistics gathered by PKF Hospitality Research illustrate this trend. The number of complimentary rooms offered by a sample of hotels in PKF's Trends in the Hotel Industry database declined 1.3 percent from 2004 to 2005. The result was a decline in the ratio of complimentary rooms to total occupied rooms. In 2004, comp rooms represented 1.63 percent of total occupied rooms. This ratio dropped to 1.57 percent in 2005.

Who Gives Comps?

Since offering complimentary rooms is frequently used as a marketing tactic to entice certain demand segments, it is not surprising that among all property types in 2005 convention hotels (1.91%) and resort hotels (2.01%) offered the highest percentage of complimentary rooms relative to total occupied rooms. Resort hotels will host travel agents and travel writers in an effort to promote their properties. Convention hotels extend free rooms to meeting planners and offer complimentary rooms to attractive conventions based on the number of rooms booked by the group.

On the other end of the spectrum, limited-service hotel operators comped fewer than one out of every hundred rooms occupied at their properties (0.97%). These properties are more dependent on the spontaneous purchase of transient travelers, as opposed to the planned travel of conventioners and resort guests.

Consistent with the examination of complimentary rooms by property type, our analysis finds a strong correlation between the average daily room rate of a hotel and their propensity to offer comp rooms. Hotels in the luxury (1.63%) and upscale (1.89%) market segments extend a greater percentage of complimentary rooms than those in the economy (1.39%) and budget (1.15%) categories.

Statistical Impact

Whether or not to include complimentary rooms in the calculation of room statistics has been a source of debate within the industry. Our firm observes a high degree of disparity among individual properties, chains, and management companies regarding the treatment of complimentary rooms in the calculation of occupancy statistics and average daily room rates (ADR).

The difference between occupancy and ADR statistics with and without complimentary room rates is not that dramatic. However, given the increased attention to ratio analysis, we suggest that owners, managers, and analysts be aware of the handling of complimentary rooms in order properly assess a hotel's performance. This issue takes on greater importance when comparing the performance of one hotel to another, or a group of competitive properties.

Using complimentary rooms in both equations, our sample of hotels achieved an average occupancy of 72.0 percent and an ADR of \$138.57 in 2005. By excluding complimentary rooms from the formulas, the occupancy rate drops to 70.8 percent, while the ADR increases to \$140.78. Again, the differences may not be that significant. However, if a manager's bonus or a management company's incentive fee is based on occupancy and ADR penetration within their competitive market, a couple of occupancy points or a dollar or two of average rate can make a difference.

Confusion also occurs if the complimentary rooms are treated differently when calculating occupancy and ADR. Hoteliers frequently multiply occupancy times ADR as a shortcut to calculating revenue per available room (RevPAR). Unfortunately, if you include, or exclude, complimentary rooms from one statistic and not the other, you cannot use this shortcut math to properly calculate RevPAR.

Guidance Is Coming

The Financial Management Committee of the American Hotel and Lodging Association is currently preparing the Tenth edition of the Uniform System of Accounts for the Lodging Industry (USALI). One of the purposes of the USALI is to provide a consistent standard for the reporting of hotel statistics. Therefore, the handling of complimentary rooms in the

calculation of occupancy and ADR received significant attention from the committee.

The current draft of the 10th edition of the USALI calls for complimentary rooms to be excluded from the calculation of both occupancy and ADR. This is consistent with the historical and current calculation methodology used by Smith Travel Research.

It is important to note, however, that the 10th edition will provide a strict definition of a 'complimentary room' based on the purpose of the complimentary offering. Complimentary rooms, as defined in the current draft of the 10th edition, include free rooms offered to guests, often for marketing purposes, but not related to an existing contractual relationship. Examples of complimentary rooms include rooms provided on a complimentary basis to owners, employees, familiarization tours, friends, and family. Also included are rooms used by the hotel on a short-term basis (i.e. employee relocation, manager-on-duty, etc...). All of these categories will under the Tenth Edition be excluded from both the occupancy and ADR statistics.

Rooms provided due to a trade-out arrangement, rooms provided in connection with a promotion (i.e. stay two nights, get one free), or rooms provided as part of a group contract (i.e. book 50 rooms, get one free) are not classified as complimentary rooms, and are therefore considered occupied rooms in the calculation of occupancy and ADR.

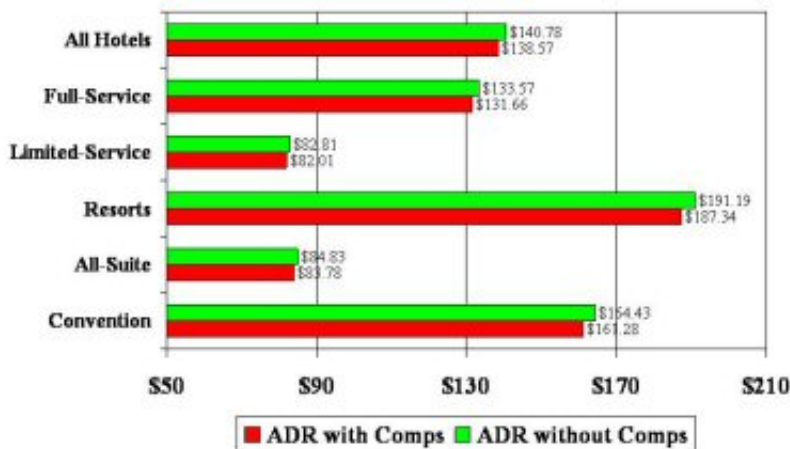
Consistency Counts

Hoteliers will continue to debate whether or not complimentary rooms should be included in the calculation of occupancy, and/or ADR. It is true that no direct revenue is derived from a complimentary room and therefore distorts the ADR. On the other hand, a hotel does incur the variable incremental costs of servicing a complimentary room. Thus, the case can be made that complimentary rooms should be treated like any other occupied room when conducting ratio analysis.

The key is consistency in the handling and reporting of complimentary rooms. It is important for all parties to have confidence in the ability to make performance comparisons from one hotel to another, or one hotel to a competitive set.

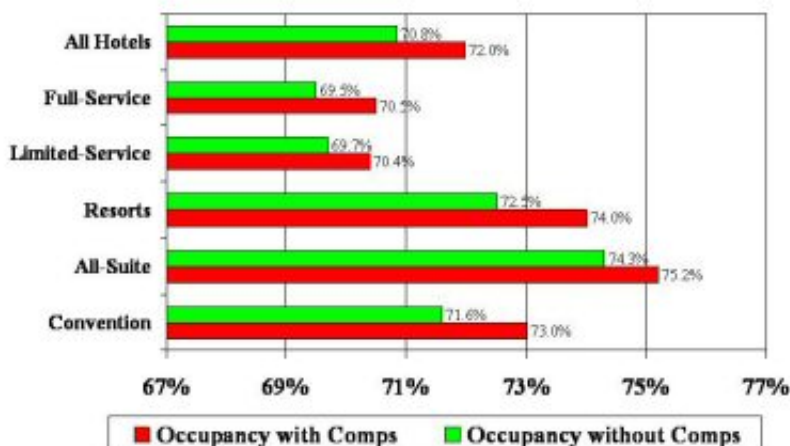
Despite the historical disparities and changes to future standards, one thing is for sure. It is tougher to find a free room these days.

IMPACT OF "COMP" ROOMS ON 2005 ADR By Property Type



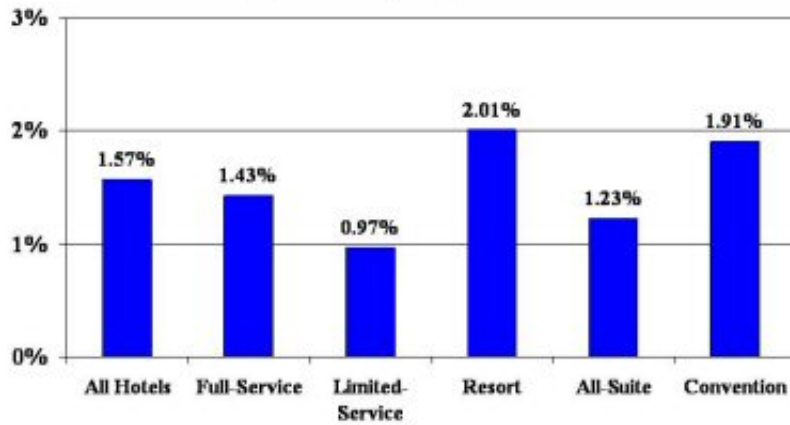
Source: PKF Hospitality Research

IMPACT OF "COMP" ROOMS ON 2005 OCCUPANCY By Property Type



Source: PKF Hospitality Research

**COMPLIMENTARY ROOMS
AS A PERCENT OF TOTAL OCCUPIED ROOMS
By Property Type - 2005**



Source: PKF Hospitality Research

Robert Mandelbaum is the Director of Research Information Services for PKF Hospitality Research. Special thanks to the members of the AH&LA Financial Management Committee.

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