

Are Luxury Hotels recession proof? - By Jonathan Barsky and Lenny Nash

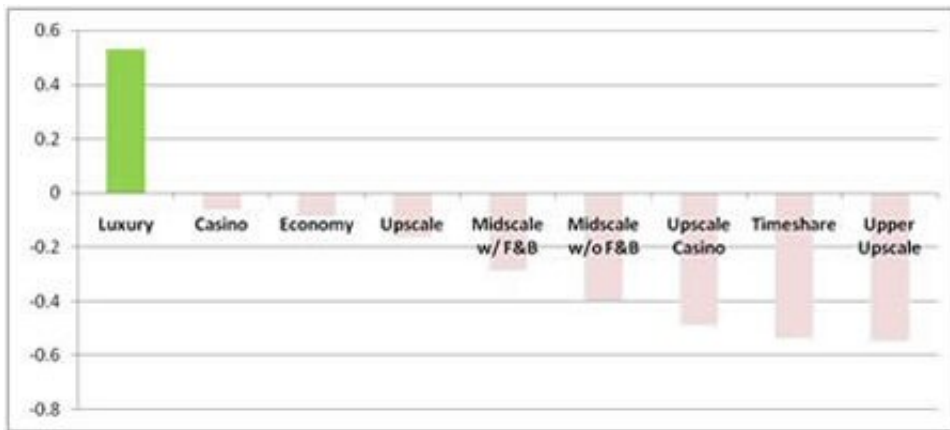
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How pervasive will the economic downturn be across the hotel industry? Will all hotels feel the pain or will some hotels be more resilient while others more vulnerable? And which customers will keep spending and help pull some hotels through current recessionary pressures?

To help answer these concerns Market Metrix examined the recent price sensitivity of the US hotel market. By tracking how much more a guest would be willing to pay per night before switching to another hotel ('Price Premium'), the Market Metrix Hospitality Index monitors price sensitivity of hotel guests. This evaluation is helpful to understand brand equity and to evaluate the components that affect rate tolerance.

Our analysis compared 2006 and 2007 results for all hotel properties. The results indicate that most hotel guests are becoming more price sensitive and are not willing to tolerate the same price increase as they were a year earlier.

Price Sensitivity by Hotel Segment



All guests, except those staying in luxury hotels, are less tolerant with rate increases than they were in the previous year. Only luxury hotel guests indicate a willingness to accept larger rate hikes compared to a year earlier.

So are luxury hotel rates too low? Perhaps. In fact, luxury hotels boosted rates by 6% in 2007 and maintained their occupancy levels (71%). Surprisingly, Upper Upscale hotels also boosted rates in 2007 (4%), but even with a smaller increase their guests show more resistance to future rate increases.

	Price (ADR)		
	2006	2007	Increase
Luxury	\$275	\$293	6%
Upper Upscale	\$153	\$159	4%

Source: Smith Travel

At least part of the price strength of luxury hotels can be explained by the size of this segment - there are not many luxury hotels and the number of guests able to afford luxury accommodations has risen dramatically in the past few years. This positive relationship will continue as long as the number of new luxury properties does not grow faster than the number of persons willing to pay their premium prices. Hotel room rates in popular cities will continue to escalate as demand outstrips supply. While the luxury segment represents only a relatively minor percentage of the total guestrooms in the US, they're a much greater factor in the revenue arena.

Guests willing to pay more

Another explanation for the price strength of luxury hotels is their well-off customers. Luxury hotels typically cater to a distinct kind of guest, often wealthy individuals to whom price is less of a factor in selecting a hotel. These affluent income groups have been less affected by the economic downturn than that of lower income groups. Affluent buyers aren't particularly affected by rising interest rates and mortgage related problems. So luxury hotel guests have the ability to absorb the cost increases rather easily. In addition, international tourists, taking advantage of a weakening US dollar, are looking to the US as a prime vacation spot and are spending more money, often upgrading to higher-end, luxury accommodations.

But wealthy and international guests should not get all the credit for the price strength of these top tier hotels. Some credit must go to the hotels for attracting these guests and creating revenue in the midst of economic uncertainty. Comparing luxury hotel brands (2006 vs. 2007), Intercontinental and Grand Hyatt showed the biggest gains in guest loyalty.

But a lack of price sensitivity should not be viewed as a green light to raise luxury hotel prices. Excessive pricing in this fragile economy can create ill will and tarnish a brand. For other hotel segments, slashing prices as a reaction to the recession is never good for business in the long run, and could also erode brand image. Instead, hoteliers need to take an aggressive approach to keep paying customers happy. Market share is more important than ever in a downturn. That means holding the line on extra fees and complementary services, and maintaining investments in service recovery and loyalty programs.

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