Tom Walker | March 17, 2014

Re-Examining the Discount Question

In 2004, Mark Lomanno of Smith Travel Research, together with Linda Canina and Cathy Enz, Cornell University, published what has proven to be an influential paper titled, “Why Discounting Doesn’t Work: The Dynamics of Rising Occupancy and Falling Revenue Among Competitors.” The paper concludes that hotels discounting more aggressively than their competitors achieve a comparative occupancy premium, but that the increase does not offset the room rate sacrifice, eroding RevPAR (revenue per available room) compared with competitors. As RevPAR and demand continue to improve in the industry, questions of discounting efficacy are resurfacing.

As an example, a speaker at HSMAI's 2013 Revenue Optimization Conference (ROC) pulled out a copy of the original “Why Discounting Doesn’t Work” article, waving it at the audience and saying he thought it was one of the most destructive articles to have been published in recent memory. My thoughts don’t diverge terribly from that position and I thought it timely to review why I believe a wholesale dismissal of discounting is inappropriate. The original piece, in my view, employed deeply suspect methodology, briefly recounted here. I end with a final opinion that discounting is just one tool in a revenue manager’s tool chest – a tool that can certainly have a useful place in a revenue manager’s tactical options.

This article excerpts my closing, contrarian argument as published in a previous number of the Journal of Revenue and Pricing Management.

A Self-fulfilling Prophecy

The dynamism of business can make comparative performance difficult to assess. One company might buy another or sell constituent operating units. To assist with fair comparisons, one well-known measure of ongoing results is “same store sales,” or SSS. SSS looks at a consistent cohort of operations to evaluate how business is progressing, other things being equal.

The “Why Discounting Doesn’t Work” methodology explicitly rejects SSS as a standard. Rather, as explained in the Study Methodology, the authors “…eliminated all properties in year t in which the percentage difference in RevPAR exceeded an absolute value of one standard deviation from zero for all hotels in its market segment category in year t-1.”

So properties meeting the “one standard deviation” criterion over one evaluation period but exceeding it in another would be eliminated, while properties that failed to meet the criterion at one time but met it at another would be included for that period. To make the point as clearly as possible, a property included in one year’s data would be excluded from another year’s results if it mounted a discounting campaign and subsequently delivered improved RevPAR greater than one standard deviation measured against competitors.

Contrary to the authors’ assertion that the test provides a conservative measure of price performance, it systematically eliminates any hotel that evolves from conformance with the criterion to exceeding it, and repatriates into the representation any hotel that once exceeded the criterion but later conforms. As acknowledged on page 14, “…23.05 percent of the properties had prior-year performance greater than one standard deviation and 19.93 percent lower than one standard deviation.”

At best, it is a faulty analytical design. At worst, it is a construction, intended or not, that assures no other finding would have been possible. After all (assuming for a moment that price effects can be so surgically isolated), any instance in which price elasticity were great enough that discounting, or failing to discount, produced statistically significant RevPAR differences from the hotels in its market segment would be discarded; the selection parameters render any observed RevPAR differences statistically no different from zero. By definition then, the population of hotels accounted for in any year is accepted precisely because the relevant market and timeframe proved to be comparatively inelastic. A process that investigates the value of discounting under circumstances selected for their inelasticity will inevitably find that deep discounts don’t produce sufficient offsetting demand.

Discounting – Just One of the Available Tools

Discounting may work in some cases and not in others, depending on what is discounted, for what purpose and to what effect. Discounting is one of many tools a hotel operator might use to improve performance. Like any tool, it can be misused. Unfortunately, “Why Discounting Doesn’t Work” applies a cleaver to strategies properly addressed with a scalpel, disparaging discounting per se. It remains for professional hoteliers to assess the value of targeted discounting within the context of their own competitive circumstances. They should not feel that doing so is to practice business heresy.