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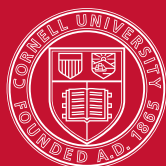


How Hotel Guests Perceive the Fairness of Differential Room Pricing

Cornell Hospitality Report

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by Wayne J. Taylor and Sheryl E. Kimes, Ph.D.



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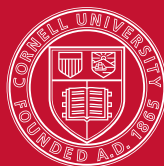
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EXECUTIVE SUMMARY

When customers perceived hotel revenue management practices to be fair, they are more likely to be satisfied with the hotel and are more likely to return to that hotel in the future. In this survey of 815 people, we examined the effects of three factors on the respondents' assessment of the fairness of hotel rate policies. Those three factors were familiarity with the practice, provision of information about the practice, and the brand class of the hotel. Of those three, we found that familiarity with a pricing practice was far and away the most important factor affecting perceived fairness. The implication is that revenue managers should focus their efforts on increasing guests' familiarity with their pricing practices.

Keywords: Pricing, revenue management, hotels, perceived fairness, brand class, familiarity

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In applying revenue management policies, hotels use pricing and duration controls to manage demand and maximize revenue. While earlier hotel revenue management approaches relied heavily on duration controls (that is, restrictions on lengths of stay), pricing strategies have grown in importance. When hotels implement differential pricing strategies, guests are charged different room rates for similar rooms depending on customer characteristics (e.g., senior citizens, employees of certain corporations, or members of certain organizations) and demand characteristics (e.g., day of week, occupancy, city-wide events). Hotels theoretically can charge as many different rates as they would like, but if customers view the hotel's rate policies as unfair, they are unlikely to patronize the hotel in the future.

Since most hotels offer multiple rates for essentially the same type of room, it is important to understand what influences customers' perceptions of fairness. Research has shown that familiarity with a pricing practice and the provision of information about different room rates significantly affect perceived fairness. We wondered, however, whether another factor, namely, hotel brand class (or scale), could affect perceptions of fairness. We have seen no research on this question. In that regard, for example, luxury hotels may be hesitant to implement revenue management pricing strategies for fear of diminishing their appeal to guests¹ or because lowering rates may open the way to commoditization. Alternatively, budget hotels may worry about offending price-sensitive guests through the use of differential pricing.

In this report we examine whether the perceived fairness of differential pricing strategies varies by brand class. First, we will review previous research on perceived fairness, familiarity, and brand class. We will then describe the results of a U.S.-based national survey that we conducted on perceived fairness of hotel pricing practices. We will conclude with a discussion of our results with a particular focus on their implications for hotel managers.

¹ B. Bursner, "Where Discounting Can be Dangerous," *Business Week*, August 3, 2009, p. 49; and L. Volcheff, "Consider Discounting in Today's Economy," *Hospitality Upgrade*, Spring 2009, p. 22.

Existing Studies

When firms use differential pricing, customers are charged different prices for using the same service at the same time depending on the customers' characteristics or factors relating to the demand situation.² Hotels must ensure that their price mix is logical, and they must set conditions, or rate fences, on different price categories to segment their customers based on willingness to pay.³ For example, a customer who books a room many months out might be given a lower rate than a guest who books the day before arrival. Hotels use a variety of rate fences, including physical rate fences (e.g., different rates based on room location or amenities) and nonphysical rate fences (e.g., time of booking, length of stay restrictions). Although these pricing strategies can lead to an increase in revenue, hotels must ensure that customers perceive these practices as fair, as fairness perceptions will affect long-term firm profitability.⁴

² S.E. Kimes and R.B. Chase, "The Strategic Levers of Yield Management," *Journal of Service Research*, Vol. 1, No. 2 (1998), pp. 156-166.

³ *Ibid.*

⁴ D. Kahneman, J.L. Knetsch, and R. Thaler, "Fairness and the Assumptions of Economics," *Journal of Business*, Vol. 59, No. 4 (1986), pp. S285-S300; and D. Kahneman, J.L. Knetsch, and R. Thaler, "Fairness as a Constraint on Profit Seeking: Entitlements in the Market," *American Economic Review*, Vol. 76, No. 4 (1986), pp. 728-741

Perceived Fairness and Perceived Unfairness

When customers assess price fairness, they consider a number of things, including what they've paid before (sometimes referred to as a reference price), what other people pay (sometimes referred to as distributive justice), and how the prices are set (sometimes referred to as procedural justice).

Researchers differentiate between perceived fairness and perceived unfairness.⁵ Consumers are able to quickly identify unfair situations and often have strong negative reactions to them. Conversely, it is more difficult for consumers to assess whether a policy or action is fair. Thus, people usually can tell when something is unfair, but it's harder for them to discern what is fair.

Familiarity

Perceived fairness of pricing practices increases as consumers become more familiar with these practices.⁶ Pricing practices that are initially seen as unfair may become more acceptable over time because they are eventually viewed as "normal." However, although a practice might be considered normal, that does not necessarily mean that people think it is fair.⁷ For example, customers have shifted their fairness perceptions towards differential pricing in hotels. A 1993 study on the perceived fairness in the airline and hotel industry found that consumers viewed the airlines' variable pricing practices as being more fair than when those same practices were used by hotels.⁸ However, eight years later a follow-up study found that consumers rated the pricing practices of hotels and airlines as being relatively the same.⁹ This suggests that as guests became more exposed to variable pricing by hotels their perception of the fairness of that pricing approach increased.

Customers who are familiar with differential pricing practices are less likely to be affected by rate fences and

whether the price is framed as a discount or surcharge.¹⁰ (Discounts are usually considered to be more fair than surcharges.) Customers familiar with an operation may be able to attribute different prices to services offered with different rate fences. Those customers may accept different prices for a hotel room booked far in advance and one that is booked the day before arrival, on the grounds that they represent two distinct types of product and service. In contrast, customers with less familiarity are more likely to make social comparisons based on price alone when evaluating the fairness of a pricing practice.¹¹

Role of Information

Perceived fairness is also affected by the type and amount of information given to customers. If customers understand the reasoning behind a price change, then the procedure is more likely to be perceived as fair. Merely letting the guest know that hotel rates vary, though, is not enough to improve customers' perceptions of fairness.¹² Instead, when hotel guests are given information on factors that affect rates (e.g., day of week, length of stay, how far in advance the booking was made) their perceptions of fairness are likely to improve.¹³

Brand Class

Consumers judge quality using both extrinsic and intrinsic cues. Brand name and brand class are both important drivers of choice.¹⁴ Extrinsic cues related to a brand are typically product- or service-based, consisting of things such as price, brand identity, and packaging. In contrast, intrinsic price cues are attributes that are integral to the nature of the product or service.¹⁵ Less familiar customers are more likely to use extrinsic cues, notably, price, as an indicator of quality, while more familiar customers are more likely to use intrinsic cues, such as the nature of the hotel's service offering.¹⁶ In

⁵ L.E. Bolton, L. Warlop, and J.W. Alba, "Consumer Perceptions of Price (Un)Fairness," *Journal of Consumer Research*, Vol. 29, No. 4 (2003), pp. 474-491; M.C. Campbell, "Perceptions of Price Unfairness: Antecedents and Consequences," *Journal of Marketing Research*, Vol. 36, No. 2 (1999), pp. 187-199; and L. Xia, K. B. Monroe, and J. L. Cox, "The Price Is Unfair! A Conceptual Framework of Price Fairness Perceptions," *Journal of Marketing*, Vol. 68 (October 2004), pp. 1-15.

⁶ J. Wirtz and S.E. Kimes, "The Moderating Role of Fairness Perceptions of Revenue Management Pricing," *Journal of Service Research*, Vol. 9, No. 3 (2007), pp. 229-240.

⁷ Kahneman, Knetsch, and Thaler, *A.E. Review, op.cit.*; and Kahneman, Knetsch, and Thaler, *J. of Business, op.cit.*;

⁸ S.E. Kimes, "Perceived Fairness of Yield Management," *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 35, No. 1 (February 1994), pp. 21-30.

⁹ S.E. Kimes and B.M. Noone, "Perceived Fairness of Yield Management: An Update," *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 43, No. 1 (February 2002), pp. 28-29.

¹⁰ Wirtz and Kimes, *op.cit.*

¹¹ *Ibid.*

¹² S. Choi and A.S. Mattila, "Impact of Information on Customer Fairness Perceptions of Hotel Revenue Management," *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 46, No. 4 (November 2005) pp. 444-451.

¹³ *Ibid.*

¹⁴ W. Dodds and K. Monroe, "The Effect of Brand and Price Information on Subjective Product Evaluations," *Advances in Consumer Research*, Vol. 12, No. 1 (1985), pp. 85-90; W. Dodds, K. Monroe, and D. Grewal, "The Effect of Price, Brand, and Store Information on Buyers' Product Evaluations," *Journal of Marketing Research*, Vol. 28, No. 3 (1991), pp. 307-319; and N. Dawar and P. Parker, "Marketing Universals: Consumers' Use of Brand Name, Price, Physical Appearance, and Retailer Reputation as Signals of Product Quality," *Journal of Marketing*, Vol. 58 (April 1994), pp. 81-95.

¹⁵ A.R. Rao and K.B. Monroe, "The Moderating Effect of Prior Knowledge on Cue Utilization in Product Evaluations," *Journal of Consumer Research*, Vol. 15 (1988), pp. 253-264.

¹⁶ *Ibid.*; and Dodds, Monroe and Grewal, *op.cit.*

addition, brand expectations have been found to be important predictors of purchase intentions.¹⁷

Looking at those findings, we expected that customers who are less familiar with a particular five-star brand would be more likely to consider the hotel's relatively high prices to be a signal of quality. At the same time, relatively infrequent or new customers would be more likely to view differential pricing practices as less acceptable than those who are familiar with the hotel.

Methodology

We developed a scenario-based survey in which respondents read a paragraph describing a hotel stay and were then asked questions about the stay. The following three factors were manipulated: type of trip (business versus leisure), level of information (information regarding rates was given or not), and hotel brand class (operationalized as five-star or three-star). This resulted in a 2 x 2 x 2 design, for a total of eight unique scenarios, two of which are shown in the box at right. Although not a perfect indicator of consumer behavior, the role-playing scenario approach has been used frequently in consumer behavior research.¹⁸

Respondents were then asked ten questions about the scenario. All variables were measured on a 1 to 7 scale (7 = strongly agree). In addition, respondents were asked for demographic information (namely, age, gender, and frequency of hotel stays).

Perceived fairness was measured with three statements:¹⁹ (1) The hotel is behaving in a fair fashion; (2) I agree with the pricing policies of this hotel; and (3) I consider the outcome of this scenario to be acceptable.²⁰ Respondents' ratings for these three questions were averaged to form a fairness index. The greater the fairness index score, the higher the perceived fairness.

Perceived unfairness was likewise measured with three statements: (1) The hotel took advantage of the customer; (2) People staying in similar rooms should pay the same price; and (3) This class of hotel should avoid this sort of practice. The ratings for each respondent were averaged to form an unfairness index. Again, the higher the unfairness index score, the more unfair the scenario.

¹⁷ K. Gupta and D. Stewart, "Customer Satisfaction and Customer Behavior: The Differential Role of Brand and Category Expectation," *Marketing Letters*, Vol. 7, No. 3 (1996), pp. 249-263.

¹⁸ S.E. Kimes and J. Wirtz, "Has Revenue Management become Acceptable? Findings from an International Study on the Perceived Fairness of Rate Fences," *Journal of Service Research*, Vol. 6, No. 2 (2003), pp. 125-135.

¹⁹ Adapted from: Choi and Mattila, *op.cit.*; and Wirtz and Kimes, *op.cit.*

²⁰ Confirmatory factor analysis was conducted to verify that the variables included for each of the four indices was correct. All Cronbach alphas were above 0.75.

Scenario Template and Examples

Below is the template and two examples of the eight scenarios for this study. Each respondent received one of the eight scenarios, which was presented at the beginning of the survey.

Template

You are going out of town on a [*Type of trip*: "business" or "leisure"] trip for a couple of days. You will be staying at a [*Brand class*: "five-star hotel (similar to a Ritz-Carlton, St. Regis, or Four Seasons) which offers amenities such as personalized service, automatic turndown service, 24-hour room service, and valet parking." or "three-star hotel (similar to a Holiday Inn, Courtyard by Marriott, or Four Points by Sheraton) which offers amenities such as room service, a fitness center, and a full-service restaurant."]

[*Information level*: "When quoted the room rate, the reservation agent explains that the prices for the hotel vary by day of week and how far ahead you book. The rates tend to be higher when booked close to arrival and on certain nights." or (scenario skips to next paragraph with no information given).]

While socializing with other guests at the hotel, you find out that even though they're staying in a similar room, some of them are paying a lot more than you and some are paying a lot less than you.

Example 1: Five-Star Business Trip with Information

You are going out of town on a business trip for a couple of days. You will be staying at a five-star hotel (similar to a Ritz-Carlton, St. Regis, or Four Seasons) which offers amenities such as personalized service, automatic turndown service, 24-hour room service, and valet parking.

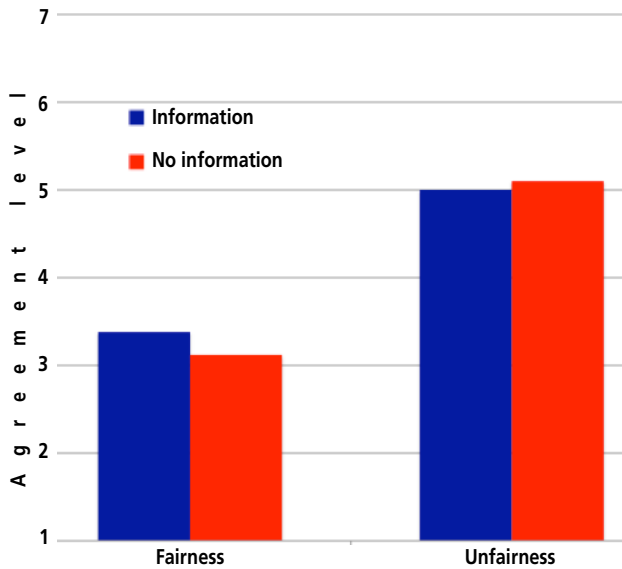
When quoted the room rate, the reservation agent explains that the prices for the hotel vary by day of week and how far ahead you book. The rates tend to be higher when booked close to arrival and on certain nights.

While socializing with other guests at the hotel, you find out that even though they're staying in a similar room, some of them are paying a lot more than you and some are paying a lot less than you.

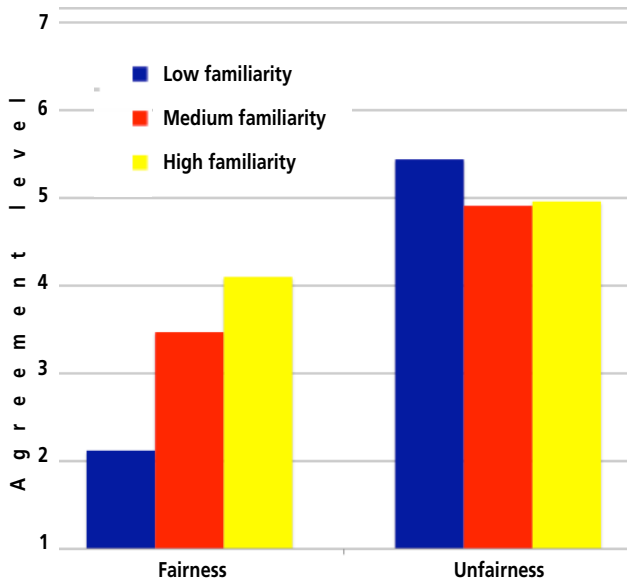
Example 2: Three-Star Leisure Trip with No Information

You are going out of town on a leisure trip for a couple of days. You will be staying at a three-star hotel (similar to a Holiday Inn, Courtyard by Marriott, or Four Points by Sheraton) which offers amenities such as room service, a fitness center, and a full-service restaurant.

While socializing with other guests at the hotel, you find out that even though they're staying in a similar room, some of them are paying a lot more than you and some are paying a lot less than you.

EXHIBIT 1**Fairness and unfairness ratings based on information level**

Note: High agreement = 7; low agreement = 1; N = 815.

EXHIBIT 2**Fairness and unfairness ratings based on familiarity level**

Note: High agreement = 7; low agreement = 1; N = 815.

Familiarity was measured with two statements: (1) I have experience this sort of pricing; and (2) I am familiar with this type of pricing. The ratings for each respondent were averaged to form a familiarity index. Respondents with a familiarity index of less than 3 were considered to be unfamiliar with the practice, those with an index between 3 and 5 were considered to be moderately familiar, and those with an index above 5 were considered to be very familiar.

Finally, the questionnaire measured the likelihood that the respondent would return to the hotel and recommend it to others. The ratings for each respondent were averaged to form a return index.

Conducted in fall 2008, the survey drew 815 completed responses. Our sample was taken from a survey panel that specializes in providing representative samples of the U.S. population. The respondents were representative of the U.S. population by gender (48% male, 52% female) and by age (11%, under 25; 27%, 25-39; 30%, 40-54; and 33%, 55 or above).²¹

Validating Brand Class through Star Level

To determine whether respondents recognized the difference between the star levels within the scenarios, respondents were asked to indicate the level of service that they expected from the type of hotel presented in the scenario. The respondents who received five-star scenarios rated the expected service level as significantly higher (5.83) than did those who saw three-star scenarios (5.02). Thus, we conclude that respondents recognized the difference in the star levels in the scenarios. We used analysis of variance (ANOVA) to analyze the data. All relationships referred to as significant were statistically significant at the $p < 0.05$ level.

Results

Information. Respondents who were given information about the reasons for price differences rated perceived fairness as significantly higher (3.38) than those who were not given information (3.12). The provision of information did not have a significant effect on perceived unfairness (information, 5.00; no information, 5.10; Exhibit 1).

Familiarity. Respondents who were more familiar with differential pricing policies rated the scenarios as significantly fairer (low familiarity, 2.12; medium familiarity, 3.47; and high familiarity, 4.10) and as significantly less unfair (low familiarity, 5.44; medium familiarity, 4.91; and high familiarity, 4.96; Exhibit 2).

²¹ U.S. Census Bureau, *Age and Sex* (2007). Retrieved January 1, 2009, from U.S. Census Bureau: http://factfinder.census.gov/servlet/STTable?_bm=y&-geo_id=01000US&-qr_name=ACS_2007_3YR_G00_S0101&-ds_name=ACS_2007_3YR_G00_

Brand class. Brand class does not appear to influence perceived fairness or perceived unfairness. There was no significant difference between the perceived fairness ratings for three-star (3.19) and five-star hotels (3.30) and also no significant difference in perceived unfairness (three-star, 5.07; five-star, 5.03; Exhibit 3).

Type of trip. Respondents from the leisure scenarios rated the pricing policies as significantly fairer (business, 3.14; leisure, 3.35) and as significantly less unfair (business, 5.17; leisure, 4.94). There were no significant differences by age, gender, information, or brand class (Exhibit 4).

Frequency. Perceived fairness increased and perceived unfairness decreased with frequency of hotel stays. Respondents who had never stayed at the sort of hotel described in the scenario had a fairness index of 2.54, while the most frequent guests (those who had stayed at that type of hotel six or more times per year) had a fairness index of 4.07. Similar results were found for the unfairness index (never stayed, 5.19; frequent, 4.66)

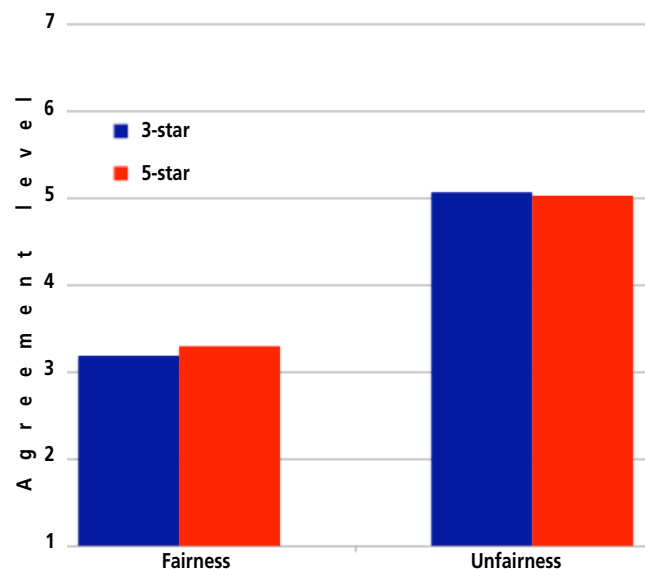
Age and gender. Men had a significantly higher average fairness index (3.47) than did women (3.02), and younger respondents considered differential pricing practices to be fairer than older respondents did. Similar results were found for the unfairness index. Women considered the pricing policies to be significantly more unfair (5.29) than men did (4.81), and older respondents considered the practices to be significantly more unfair than did younger respondents.

Analysis of Variance Results

We developed a two-way ANOVA with fairness index and unfairness index as the dependent variables and with brand class, information, trip type, and familiarity as the independent variables. The only factor that was significant for both the fairness index and the unfairness index was familiarity with the pricing practice, while trip type had a significant relationship with the unfairness index (but not the fairness index). This analysis reinforces the finding above that respondents from the business scenarios felt that the pricing practices were more unfair. None of the other factors had a significant effect on fairness or unfairness.

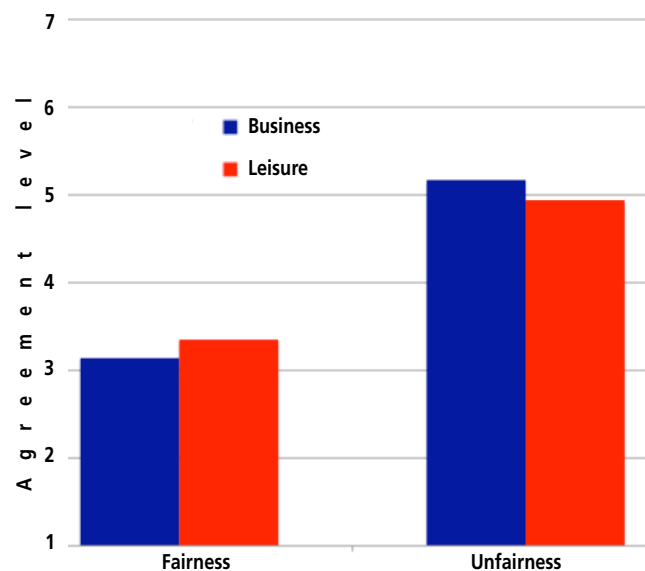
Our analysis of the effects of combinations of factors found that the only significant difference found was for the combined impact of brand class and familiarity on the unfairness index. This means that respondents who were more familiar with differential pricing practices at five-star hotels viewed these practices as less unfair than did respondents who were more familiar with similar practices at three-star hotels (Exhibit 5, overleaf).

EXHIBIT 3
Fairness and unfairness ratings based on brand class



Note: High agreement = 7; low agreement = 1; N = 815.

EXHIBIT 4
Fairness and unfairness ratings based on purpose of travel



Note: High agreement = 7; low agreement = 1; N = 815.

EXHIBIT 5**ANOVA results****Tests of Between-Subjects Effects for Fairness**

Dependent Variable:Fairness

Source	Type III Sum of Squares	df	Mean Square	F	Sig.
Corrected Model	418.394a	14	29.885	13.117	0
Intercept	6572.84	1	6572.84	2884.873	0
BrandClass	0.178	1	0.178	0.078	0.78
Type	0.407	1	0.407	0.179	0.672
Information	1.031	1	1.031	0.453	0.501
Familiarity	365.047	2	182.524	80.111	0
Information * Familiarity	5.442	2	2.721	1.194	0.303
BrandClass * Familiarity	0.403	2	0.201	0.088	0.915
Type * Familiarity	3.544	2	1.772	0.778	0.46
BrandClass * Information	1.71	1	1.71	0.75	0.387
Type * Information	1.199	1	1.199	0.526	0.468
BrandClass * Type	4.88	1	4.88	2.142	0.144
Error	1822.705	800	2.278		
Total	10836	815			
Corrected Total	2241.099	814			

Tests of Between-Subjects Effects for Unfairness

Dependent Variable:Unfairness

Source	Type III Sum of Squares	df	Mean Square	F	Sig.
Corrected Model	84.343	14	6.025	2.534	0.001
Intercept	16307.813	1	16307.813	6858.131	0.000
BrandClass	0.009	1	0.009	0.004	0.952
Type	10.41	1	10.41	4.378	0.037
Information	4.375	1	4.375	1.84	0.175
Familiarity	27.105	2	13.552	5.699	0.003
Information * Familiarity	7.341	2	3.671	1.544	0.214
BrandClass * Familiarity	25.988	2	12.994	5.465	0.004
Type * Familiarity	2.35	2	1.175	0.494	0.610
BrandClass * Information	3.152	1	3.152	1.326	0.250
Type * Information	0.562	1	0.562	0.236	0.627
BrandClass * Type	1.199	1	1.199	0.504	0.478
Error	1902.304	800	2.378		
Total	22780.444	815			
Corrected Total	1986.648	814			

Linking Perceived Fairness to Return Intentions

Finally, we developed a regression model to see whether the fairness index and unfairness index could be used to predict whether respondents would return to the hotel (measured by the return index). The resulting standardized model was:

$$\text{Return Index} = 0.785 * \text{Fairness Index} - 0.155 * \text{Unfairness Index},$$

which indicates that the fairness index had more of an effect on intent to return to the hotel than unfairness did. The model was significant and explained 61.6 percent of the variation in the return index.

The Importance of Familiarity

In this study, respondents' perceptions of fairness and unfairness were influenced mostly by familiarity with the pricing policy. As customers become more familiar with revenue management pricing practices, they become more accepting of those practices. Although the provision of information and trip type did have a significant effect on perceived fairness and perceived unfairness when tested in isolation, the effect of those two factors was dwarfed by the impact of familiarity. Brand class does not seem to affect perceived fairness or unfairness; this may indicate that consumers view differential pricing as an industry-wide practice.

Since familiarity is the key factor associated with perceived fairness and perceived unfairness, managers should focus on finding ways to increase customer familiarity with their pricing practices. We suggest the following three ways to do this, including:

1. Provide information on the different rates available and the conditions associated with those rates on the hotel's website, on third-party websites, and through the reservations office.
2. When developing promotions, be sure to specifically mention the conditions that go along with the promotion. For example, promotions should focus on a season (e.g., summer prices) or make it clear in other ways

to guests that booking early will allow them to lock in lower rates.

3. Train reservation agents and front desk clerks on how to provide accurate information on the different rates available and the associated conditions.

By increasing guests' familiarity with differential pricing practices, hotel managers can help ensure that these practices are perceived as fair which in turn will have a significant effect on customer return intentions.

Limitations and Future Research

The primary limitation of this study is that consumer intentions are not the same as consumer behavior. While scenario-based surveys work reasonably well to predict consumer behavior,²² they are not perfect indicators. Another way to approach this question of guests' assessment of the fairness of hotel rate-setting practices for different hotel scales or segments would be to conduct a series of experiments in which respondents are presented with varying room rates for different brand classes of hotels and to test whether there are significant differences in their reactions based on brand class.

Other possible limitations include the fact that it is possible that the type of information provided in the scenarios may have affected the results. In addition, we considered only three- and five-star hotels. It is possible that we needed to manipulate other variables to ensure that respondents truly understood the differences between the two sets of hotels. Perhaps we should have created a greater gulf between the two scenarios, say, by comparing one-star or budget hotels with five-star properties.

Finally, since familiarity was shown to be the most important factor affecting perceived fairness and perceived unfairness, it would be interesting to study the most effective ways to develop customer familiarity with differential pricing practices. Again, an experimental approach might work well. ■

²² Kimes and Wirtz, *op.cit.*

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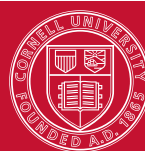
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