

PRICING METHODOLOGY

Pricing the Room

The Bottom up approach to fix the room price is extensively used in hotel industry. To decide the average selling price per room, this approach considers operating costs, desired profits and expected number of rooms sold. In other words, this approach starts with desired profits, adds income taxes then adds fixed charges and management fees followed by operating overhead expenses and direct operating expenses.

First, we should determine how much profit we should aim at. This in practice would be determined by reference to profits achieved in recent years, current trends in hotel occupancies and pattern of cost behaviors

Secondly, we must determine our operating costs for the next period (usually next year). This in an existing hotel should not present undue difficulties, as particulars of operating expenses are available for the several past years. One projection of operating costs should be therefore be reasonably accurate.

Finally, having determined the required level of profit and the total of operating expenses we arrive at the required required volume of rooms sales. Given the estimated percentage of room occupancy we can then calculate the desired average room rate

HOTEL ABC

200 rooms
Investment 3 000 000
ROI 10%
tax rate 50%

CHART 1

| | | |
|----------------------------|---------|---------|
| Depreciation | | |
| Building | 300 000 | |
| Furniture | 150 000 | 450 000 |
| Rates and insurance | | 140 000 |
| Admin and general expenses | | 220 000 |

| | |
|-----------------------------|---------|
| Advertising and promotions | 130 000 |
| Gas and electricity | 80 000 |
| Repair and maintenance | 160 000 |
| Interest | 340 000 |
| Rooms Dpt - Operating costs | 680 000 |
| Coffee shop - Dpt profit | 80 000 |

CHART 2

| | |
|-------------------------------|------------------|
| Net profit (after tax) | 300 000 |
| Tax | 300 000 |
| Depreciation | 450 000 |
| Rates and insurance | 140 000 |
| Admin and general expenses | 220 000 |
| Advertising and promotions | 130 000 |
| Gas and electricity | 80 000 |
| Repair and maintenance | 160 000 |
| Interest | 340 000 |
| Rooms dept - operating costs | 680 000 |
| | <u>2 800 000</u> |
| Less: Coffee shop Dpt. profit | 80 000 |
| Volume of room sales required | <u>2 720 000</u> |