



The search for the best deal: How hotel cancellation policies affect the search and booking decisions of deal-seeking customers[☆]

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ABSTRACT

This study examined cancellation policies and their role in shaping travelers' deal-seeking behavior, exploring the impact of cancellation fees and deadlines on three, mutually exclusive, customers' hotel booking behavior categories: "Book", "Book and Search", and "Search". 291 subjects, who participated in a week long online "booking game", attempted to book a room in a virtual hotel and get the best deal. The results were tested using small sample t-test for comparing proportions between two independent populations, non-parametric multiple pairwise comparisons, and multinomial logit regression models. The findings indicate that the cancellation deadline affected participants' behavior while the size of the cancellation fee had no statistically significant impact. In addition, there was no significant difference between lenient cancellation deadline and no cancellation policy.

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1. Introduction

Tourism suppliers and hotels in particular, promote discounting to an increasing market segment of deal-seeking savvy travelers who use the Internet to find the best deals. At the same time, they continue to add cancellation policies as "hidden traps" that can increase the cost of travel for unwary customers (Perkins, 2004). According to BudgetTravel.com (2005), "there's no blanket travel cancellation policy" and practices vary among the providers of travel services. As a general rule though, the closer the cancellation is to the day of consumption, the harder it is for the customers to receive full refund for their reserved travel service. Catching up with the airline industry's practices, most hotels (over 80% according to Engle, 2009) now charge a late cancellation penalty. Mandelbaum (2008) reports that in 2007, cancellation fees represented 8% of the surveyed hotels' revenues, while DeKay et al. (2004) report that some hotels are assessing penalties for early departure, and that this practice lowers the average early departure rate to 5.3%. This trend toward stricter cancellation policies is reflected in the 17% increase in the number of travel insurance claims that involved non-refundable lodging expenses this year

(Engle, 2009). Car rentals are also exploring new cancellation policies. For example, Hertz is now charging \$25 when a reservation is canceled and \$50 for a no-show (Elliott, 2009). Another indication for the increasing importance of cancellation policies is that the major credit card companies (such as American Express, Visa, and MasterCard) have recently adopted contractual policies which are more in line with the hotel industry's stricter cancellation policies (Wade, 1996).

Interestingly, charging a cancellation fee for a service that was reserved in advance is similar to having no full refund policy for a returned good. Given the well established positive role of refund policies, the hotel industry's move towards stricter cancellation policies (i.e., weaker refund policies) is somewhat counter-intuitive. As outlined by Xie and Gerstner (2007, p. 18), refund policies for returned goods have been shown to signal product quality (Moorthy and Srinivasa, 1995; Shieh, 1996), reduce customers' risk perception (Mann and Wissink, 1988), and increase profit margins (Fruchter and Gerstner, 1999). Several reasons have been suggested in the literature to explain why service providers, and hotels in particular, increasingly impose cancellation fees despite the established benefits of refunds. These reasons can be categorized into two groups of strategic goals:

- (1) Increase revenues
- (2) Affect travelers' booking behaviors

According to the first goal, cancellation policies are designed to increase revenues by capturing some of the revenue lost due

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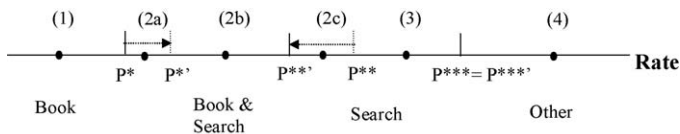


Fig. 1. The impact of cancellation fee on the consumer's strategy.
Figure taken from Schwartz (2006) Fig. 4.

to cancellations and no-shows. The loss is particularly high with last minute cancellations and no-shows, when not enough time is left before the date of stay to sell the unsold inventory to other customers (Xie and Gerstner, 2007; Koide and Ishii, 2005). While overbooking is the traditionally common practice of airlines and hotels, designed to reduce the financial loss associated with last minute cancellations and no-shows (Collins, 2008; Bertsimas and Popescu, 2003; Karaesmen and Van Ryzin, 2004; Liberman and Yechiali, 1978; Subramanian and Lautenbacher, 1999), recent studies have shown that overbooking has a potentially negative impact on customers satisfaction, and consequently on the customers loyalty and their future booking behavior (Lindenmeier and Tscheulin, 2008; Wangenheim and Bayón, 2007). As hotels are more reluctant to overbook because of customer relation concerns, they are more inclined to charge and impose cancellation fees to recover lost income due to last minute cancellations and no-shows. Indeed, DeKay et al. (2004) report that due to stricter hotel cancellation policies, hotels no-show rate has fallen from a high of up to 15%, the level reported in the 1980s by Gould et al. (1980), to a lower rate of 5%.

This study focuses on the second strategic goal of cancellation policies. That is, the notion that cancellation policies can affect travelers' search behaviors in a manner that is more desirable, or profitable, to the tourism provider. This study explores the notion that in an advanced-booking environment, where savvy, transient customers are using the Internet to search for better deals, cancellation policies might play an important role by impacting the search and booking behavior of these deal-seeking, advanced-booking consumers. For example, there are many indications that deal-seeking travelers continue to search after they have made a reservation, looking for an even better deal for the same tourism product or service. If a better deal is found after they made their initial booking, these deal-seekers cancel their existing reservation and rebook the better deal. Guidelines on how to minimize the costs associated with trip cancellation are posted on Web sites that target deal-seekers (e.g., Dratch, 2008; Perkins, 2004). These guidelines include tips such as: read cancellation policies before you book reservations, make workable cancellation policies an item on your shopping list, cancel as early as possible, talk (politely) to the right people, and call rather than go online. The Advanced Booking Decision Model (ABDM, outlined in Schwartz, 2000, 2006, 2008) provides a theoretical decision-making framework to explore some of these issues of deal-seekers search and booking behavior. The model explains how a deal-oriented traveler optimizes her/his booking decision, deciding whether to book, to book and continue to search for a better deal, or to continue to search without booking. Among other factors, the analytical model argues that the higher the cost associated with the cancellation fee, the more one is likely to choose a "Book" strategy or a "Search" strategy over a "Book then search" strategy. At the core of this expected utility maximization argument is the notion that an expected high cancellation fee makes the switch to the better deal more costly, and therefore less attractive.

Specifically, this study examines the assertion of the ABDM regarding the impact of hotels' cancellation policies on transients' search and booking behaviors.

2. Research question

This study sets out to empirically test how reservation decisions are impacted by cancellation policies, exploring the possible impact of the size of the cancellation fee, the strictness of the cancellation policy, and the timing element (that is, the cancellation deadline).

3. Hypotheses

The ABDM predicts that cancellation fees affect customers' booking decisions. This is evident when one considers the options available to the advanced-booking traveler: "Book," "Book then search," "Search," and "Other." According to the model, the expected utility-price equations that describe the thresholds, or switch points, between strategic decision zones also contain a cancellation fee element. The price P^* (the room rate at the switch point between the "Book" and "Book then search" strategic zones) and P^{**} (the room rate at the switch point between the "Book then search" and the "Search" strategic zones) are given by $P^* = Sn / ((D - F)P_d(1 - P_v))$ and $P^{**} = -P_v(P_b + R_a - R_b) / (FP_d(P_v - 1) - P_v)$. The corresponding utilities are given by $U^* = R_a - Sn / ((D - F)P_d(P_v - 1))$ and $U^{**} = -P_v(P_b + P_d[(1 - P_v)(F - D)[P_b + r_a - r_b] - SnF] + (r_a - r_b) + Sn) / FP_dSn / (FP_d(P_v - 1) - P_v)$.

The impact of cancellation fees on the switch points as predicted by the ABDM is illustrated in Fig. 1 (Schwartz, 2006). The above set of threshold equations predict that when the cancellation fee ("F" as denoted in the original model) is increased, the "Book" strategy's upper boundary moves to the right (to P^*). This means that more room rates will then fall into the "Book" zone and that some people who were previously likely to use the "Book then search" approach (i.e., customers in 2a) will now be more likely to simply "Book."

However, this same increase in the cancellation fee also decreases the "Book then search" upper boundary from P^{**} to $P^{**'}$. This decrease of the "Book then search" zone implies that the higher cancellation fee will cause some who previously responded with a "Book then search" approach to a given quoted price (i.e., customers in 2c) to now respond with a "Search" strategy.

It should be noted though, that the "Book then search" customers in 2b are not affected by the increase in the cancellation fee. Customers who take the "Book then search" approach (but who were not in the 2c or 2a zone) will not change their booking decisions because of higher cancellation fees. Customers in the "Other" zone (that is, zone 4) will not be affected.

The "Book then search" strategy is most likely to be affected by the size of the cancellation fee. When the cancellation fee is high, the "Book then search" strategy is less attractive than the "Book" and the "Search" strategies. In other words, the cost of "Book then search" is higher when cancellation fees are high, so customers are more likely to either "Book" or "Search." Thus, hypothesis one is as follows:

H1. When the cancellation fee is higher, fewer customers are likely to "Book then search," and more are likely to either "Book" or "Search."

Wood (2001) provides some empirical insight on the impact of return policies to customers' decision-making processes in remote purchasing environments (i.e., ordering products through catalog sales). She observes that subjects appear to order products with more careful consideration and delay purchase decisions when a restricted return policy is imposed. Because a non-lenient cancellation policy reduces consumer choice (or flexibility), which can result in delayed decision-making, it follows that when a cancellation deadline is stricter, the "Book" and "Book then search" strategies are less attractive than the "Search" strategy. This suggests that when the cancellation deadline is stricter, customers are

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