UNIT 4: THE TRAVEL AND TOURISM BUSINESS TOOLKIT

LO1: Examine the key principles of revenue management for the travel and tourism industry

P1 DISCUSS THE RATIONALE AND PRINCIPLES OF REVENUE MANAGEMENT FOR THE TRAVEL AND TOURISM INDUSTRY

Revenue Management; Definition

The use of analytics, which help to predict the behaviour of customers, so that product availability and price can be optimized in order to generate the maximum amount of revenue possible.

It is, essentially, about matching supply and demand and successful revenue management involves understanding how customers think and what their perceptions of value are. This may means also refusing to sell a room today, so that you can sell it for a higher price tomorrow, but it might also mean recognising when demand is low enough that you should sell at a discounted price.

Revenue Management; History

The airlines are credited for developing the foundational science behind revenue management. Almost since the beginning of commercial flight, airlines had attempted to maximize their revenues by focusing on filling as many seats as possible on every flight.

This meant predicting how many booked passengers would show up for a flight and how many wouldn't. Overbooking by that predicted amount was the technique that was deployed to meet their objective.

Revenue Management; History

In the early 1970's, airlines began experimenting with "fenced" pricing such as offering a discount to passengers who booked more than 21 days in advance. This meant that airlines now had the opportunity to sell additional seats that may otherwise have gone empty.

It also meant that the need for tracking and quantitative analysis grew exponentially since customer response to these fare alternatives varied based on season, day of week, time of day, city pair (origin and destination), reason for travel (business or pleasure) and many other variables.

In 1972, Ken Littlewood of British Overseas Airways Company (BOAC) now known as British Airways proposed a rule that discounted fares be accepted if their revenue value exceeded the expected revenue of future full fare bookings. Littlewood's Rule marked the start of what became yield management and later, revenue management.

Revenue Management; Conditions

- Different customers must be willing to pay different prices for the same service or commodity;
- The business must be some ability to predict the changing levels of demand ahead of time;
- Only a fixed amount of resources are available to be sold at any given time;
- A perishable inventory e.g. after a certain point, the resources can no longer be sold.

Revenue Management VS Yield Management

- As a pricing strategy, yield management is concerned with generating the maximum possible revenue from a perishable inventory. Within the hotel industry, this means it is concerned with using data to ensure the right room is sold to the right customer, at the right time, for the highest possible price.
- Revenue management is a related concept, although it has a wider focus. It is concerned with maximising revenue from hotel rooms in much the same way, but also deals with the cost of selling and money made from other aspects, like food and laundry services. It can, therefore, be described as being concerned with the big picture.

Importance of Revenue Management

When a strategist sets the price point whether for a hotel room, airline ticket, or even a hamburger, it must match a customer's willingness to pay for the perceived value of the product or service. For hospitality in particular, our pricing strategies must take on a customer-centric view that demonstrates added value for the customer rather than just setting a company-centric price that is focused solely on profit.

Importance of Revenue Management

Hospitality goods and services are what are considered to be a constrained supply. This basically means that the company cannot necessarily offer up another hotel room on a Saturday night, or a table in a restaurant at 7 p.m. when consumer demand for them increases. Among other responsibilities, revenue managers will help set menu or room prices to ensure that the customers they are serving are getting what they perceive to be a fair value.

Importance of Revenue Management

Revenue management allows businesses to adopt a data-driven approach to decisions on what to sell them. It is a way of ensuring that informed decisions are made and your business does its best to drive revenue upwards, while selling the same amount of products and services as before.

Example

- Have you ever visited the same hotel at different times of the year only to find that the room rate has jumped or declined significantly? That is because hotel rooms don't have a preset shelf-price and pricing must be flexible enough to change with consumer demand.

Revenue Management; Key Performance Indicators (KPIs)

- Occupancy Rate
- Average Daily Rate (ADR)
- Revenue Per Available Room (RevPar)
- Total Revenue/Rooms Sold

Revenue Management; Key Performance Indicators (KPIs)

- Occupancy Rate

This is one of the easiest metrics you can check.

It is the percentage of occupied rooms compared to total rooms over a certain period of time.

Occupancy = Rooms Occupied / Rooms Available

Knowing these numbers will help you create the foundation of your revenue management strategy.

Revenue Management; Key Performance Indicators (KPIs)

- Revenue Per Available Room (RevPar)

RevPar is an operation metric which is analysed by multiplying hospitality properties average daily room rate by its occupancy rate.

You can also analyse RevPar by dividing a hospitality properties revenue by the number of rooms (or beds) it has over a desired period of time.

RevPar = Total Room Revenue / Rooms Available

RevPar only uses room revenue and does not include other revenue streams such as upgrades, spas, restaurant revenue, etc. You can use this analysis to compare performance to other properties, but it could fluctuate greatly by property type.

Revenue Management; Key Performance Indicators (KPIs)

- Average Daily Rate (ADR):

ADR calculates the average price paid per room and helps you determine how much money was brought in per room. You calculate ADR by taking the Room Revenue and dividing it by the number of paid rooms occupied.

ADR = Room Revenue / Paid Rooms Occupied

ADR only considers the rooms that were sold – does not include vacant rooms.

Revenue Management; Steps

- Take a long-Term Approach
- Use Market Information
- Analyses

Revenue Management; Steps

- Take a long-Term Approach

When you only look at your revenue strategy on a monthly, your property could be leaving money on the table. Larger properties generally look at revenue and rates by quarters and seasons, rather than by months. When you take a more long-term approach to rates and revenue, you can more correctly react to current market conditions.

Example

- If you're in the high season and bookings are soft, you have an idea what you need to make up in the following months. Or, if your next month's bookings are higher than expected, you can raise rates to make up for this month's lost revenues

Revenue Management; Steps

- Take a long-Term Approach

The thing to remember here is that you should be looking at your rate and revenue targets by quarter or season instead of monthly. Every property is different, so there is no definitive forecast structure that makes sense for every property.

Revenue Management; Steps

- Use Market Information

Large branded hospitality properties have the benefit of knowledge. They have the resources to purchase market reports that include information about rates, availability, and projected demand.

If you don't have the resources to buy your own market research reports because they are expensive, you can also check your local tourism websites and offices for up-to-date information.

Revenue Management; Steps

- Use Market Information

Tourism offices often publicly release information on demand forecasts, upcoming events, and other information that could be useful while planning out demand that influences rates.

You want to make yourself aware of market trends as well as local travel trends to have the most success. Knowledge is power and you want to prepare yourself as much as possible.

Revenue Management; Steps

- Write Analyses

Large branded hospitality properties write analyses every month that report on how rates and revenue performed. This could be very time consuming for any hospitality property owner, so you might want to consider just analysing those months where you don't meet your goals. This is important because it means that you did not correctly read the market.

Detailed reports containing how and why you missed your goals will help you prevent those mistakes in the future. Analyses are particularly helpful for the same season next year when market trends tend to copy each other. Without analyses, you might not remember exactly what happened a full year earlier.

Yield Management; Definition

1. Yield management is a procedure which is used by service organisations to maximise revenue under conditions of fluctuating demand and where the product is perishable (Ross and Johns, 1997).
2. Valls (2009) defines yield management as "the price established paying attention to the different categories from consumers with the aim of being able to maximize the yields".
3. In other words, it is a "method that helps to sell the correct product to the appropriate consumer, at the suitable moment and price", allowing it in this way to maximise income (Kimes and Chase, 1998)

Example

Joe may book a flight to California for $500 during the morning and Jane may book the same flight for $800 that evening.

Joe was able to receive the better price because the flight still had plenty of open seats and the airline was trying harder to
entice customers to purchase a ticket.

Yield Management; History

The airline industry instituted the first use of yield management after deregulation in the late 1970s. The airlines blocked out certain time periods when seats on flights were priced at certain levels; the potential passenger either booked the flight at the price quoted or found other means of transportation.

This bold marketing policy met with some problems but established the economic structure of airfares.

Yield Management; History

Hotels share similar operational features with airlines. Each has a fixed number of products (hotel rooms and airline seats) that, if not sold on a certain day or flight, cannot be resold. Airlines and hotels sell to market segments that have distinct needs in product and service level.

Each has demand periods (holidays, weekdays, and weekends in hotels; holidays, weekdays, and time of day for airlines), which place the provider in a favorable position. Airlines and hotels have various rates from which guests can choose.

Reservations are the key operational concept that allows managers to use yield management.

Yield Management; Importance

Essentially, by strategically editing prices on hospitality goods, like hotel rooms, rental cars, plane tickets, and more, businesses can find the right price to reach the customer during that period in time. This reduces the likelihood of lost revenue and can help hospitality businesses manage their product and revenue streams, even when demand varies.

The importance of yield management really lies in its flexible nature. This helps to serve both customers and businesses. If a hotel notices a drop in registrations, they can use yield management pricing techniques to help bring in more people at a discounted rate.

With that strategy, a hotel earns some revenue on the room (though perhaps less than what they'd earn during a busier season or on average) and a customer feels like they've snagged a great deal, making them even happier with their choice, which could potentially translate to additional bookings with that business down the road.

Measuring Yield

- *Formula **1**: Potential Average Single Rate:*
- ♦*Potential Average Single Rate* = (Single Room Revenues at Rack Rate) / (Number of Rooms Sold as Single)
- *Formula **2**: Potential Average Double Rate:*
- ♦*Potential Average Double Rate* = (Double Room Revenue at Rack Rate) / (Number of Rooms Sold as Double)
- *Formula **3**: Multiple Occupancy Percentage:*
- ♦*Multiple Occupancy Percentage* = (Number of Rooms Occupied *by more than 1 Person*) / (Total Number of Rooms Sold)
- *Formula **4**: Rate Spread:*
- ♦*Rate Spread* = (Potential Average Double Rate) – (Potential Average Single Rate)
- *Formula **5**: Potential Average Rate:*
- ♦*Potential Average Rate* = (Multiple Occupancy Percentage * Rate Spread) + (Potential Average Single Rate)

Measuring Yield

- *Formula **6**: Room Rate Achievement Factor:*

♦*Room Rate Achievement Factor* = (Actual Average Rate) / (Potential Average Rate)

- *Formula **7**: Yield Statistic:*

1. *Yield Statistic* = (Actual Rooms Revenue) / (Potential Rooms Revenue)

2. *Yield Statistic* = ((Rooms Nights Sold) / (Rooms Nights Available)) * ((Actual Average Room Rate) / (Potential Average Rate))

- *Yield Statistic* = Occupancy Percentage * Achievement Factor
- *Formula **8**: Identical Yields Occupancy:*
- ♦*Identical Yields Occupancy* = (Current Occupancy Percentage) * (Current Rate / Proposed Rate)
- *Formula **9**: Equivalent Occupancy:*

1. *Equivalent Occupancy* = (Current Occupancy Percentage) * ((Rack Rate – Marginal Cost) / (Rack Rate * ((1 – Discount Percentage)) – Marginal Cost)

2. *Equivalent Occupancy* = (Current Occupancy Percentage) * ((Contribution Margin) / (New Contribution Margin))

Measuring Yield

- Example Calculations:

https://hmhub.me/wp-content/uploads/2018/01/Yield-Measurement.pdf

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