12 Revenue Management in Hotels and Airlines: A Critique

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Learning outcomes

After reading this chapter, you should be able to:

- Critique the application of revenue management in the hospitality and airline industries.
- Understand the above within the specific context of the role of the firm and its operation in a competitive environment.

Introduction

The preceding and subsequent chapters of this text provide a well rounded and insightful description of the underlying theory and application of revenue management. The various sections on theory as well as the case studies provide both academic and practitioner insight into the workings of revenue management. In this section we will critique revenue management in the hospitality and airline industry. This critique will be offered from a number of different perspectives. However, each perspective will address some aspect of the role of the firm and its operation in a competitive environment.

Revenue management in competitive environments

The underlying philosophy of revenue management and its subsequent technological advances focus on generating revenue in a competitive environment. It is, as previously identified, merely a context-specific application of demand and supply analysis that has taken advantage of substantial and rapid developments in statistics, mathematics, forecasting, psychology and operations research, supported by corresponding advances in computing and information technology. Whilst not changing the fundamental aim of the business, which is to sell perishable inventory (hotel rooms and airline seats) in a volatile market, revenue management does embrace a range of management practices. Nearly twenty-five years ago, Kimes (1989) discussed the basics of yield management. However, it was in a subsequent paper (Kimes, 1994, p.14) that she explicitly described yield management (as it was known then) as basically selling "the right inventory unit to the right customer at the right time for the right price". As such, revenue management can be seen as merely a function of inventory management, market segmentation and distribution and price setting. This approach has operated since time immemorial in the hospitality and tourism industry with high rates in the high season and low rates in the low season. However, the advent of information and communication technologies (ICT) has created some significant paradigm shifts in the way businesses go about pursuing revenue. The adoption of increasingly powerful and sophisticated ICT brings various areas of management interest such as distribution channels, market segmentation and price setting into the orbit of revenue management. Therefore, this discussion will address these elements as they apply to revenue management, and not as discrete management practices in their own right.

Revenue management has expanded to mean much more than altering rates in response to demand. The development of pricing conditions such as the booking horizon, prepayments, and cancellation terms have been integral to the development of revenue management. Similarly, inventory control has also supported the development of revenue management. In addition, distribution channel management via the use of online third party vendors as well as direct sales from own websites have played a key role in the establishment of revenue management. Finally, as will be discussed later in this chapter, increasingly sophisticated consumer research methods, especially in terms of decision making preferences, price sensitivity and demand elasticity analysis, have driven the increasing sophistication of revenue management as a vitally important management practice (Cross, Higbie & Cross, 2009).

Revenue management: hospitality versus airlines

Given that the hospitality industry adopted revenue management from the airline industry, it is not surprising that there are several aspects of revenue management that are common to both industries. Most notably, the sale of highly perishable product that has high capital and fixed costs and a low variable per unit cost in comparison to per unit selling price. Further, both industries have enjoyed exploiting the emergent information and computing technologies that have facilitated both revenue management and disintermediation in the form of customer driven online booking and secure online prepayments. However, there are a number of aspects wherein there are significant differences between the two industries that shape some of the front line operations and practices in a revenue management environment (Talluri & van Ryzin, 2004).

Firstly, the most notable is that the airline product (a seat on a leg of a journey) is much more discrete than a hotel room. Apart from additional revenue opportunities, knowledge about the airline seat and leg required is known at the time of booking. In contrast, a hotel room can be booked for one or more nights. However, the length of stay proves to be much more uncertain with guests regularly extending or shortening their booking on very short notice. Secondly, the airlines are able to marshal their passengers before boarding, when decisions about the consequence of overbookings can be made with all parties present. In contrast, with guests arriving randomly throughout the afternoon and evening, the hotel manager must make decisions about the consequence of overbookings before the guests arrive. These differences have given rise to slightly different priorities in the development of revenue management systems in the hotel and airline industry (Cross et al., 2009). None the less, both industries have pursued the use of ICT to engender higher levels of market knowledge, customer engagement and proactive decision making. It is also worth noting that the airlines now calling it "revenue and price optimisation" (Lieberman, 2010, p.4).

Revenue management and business practice

As noted, revenue management has evolved from a simple approach to demand based pricing to a very sophisticated management philosophy that embraces several disciplinary perspectives and advanced digital systems and procedures. As a consequence, the adoption of revenue management has had, and will continue to have, a profound impact in several key operational areas including:

- Sales and distribution.
- Customer engagement.