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The Components of Revenue Management

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Learning outcomes

After reading this chapter, you should be able to:

- Understand that revenue management techniques are based on key elements of the marketing approach: customer analysis, segmentation, pricing policy.
- Recall the key concepts of revenue management and highlight an evolution in the services sector, namely dynamic pricing and its consequences for the consumer.
- Identify the analysis elements and components linked to revenue management: performance indicators, optimization levers, quota restrictions and overbooking.

■ **A preliminary step: market analysis and pricing policy**

□ **Understanding demand and market segmentation**

Pricing: a strategic variable

Pricing is a variable the strategic importance of which has increased significantly in recent years. There is a direct relationship between pricing and the positioning of a company and its products, turnover, and market share (smaller or larger depending on the prevailing prices).

A demonstrated strategically important variable, pricing also has a crucial operational role. It is worth recalling that the mix design needs to be perfectly coherent. Pricing is thus not a free element; rather, it is a variable that needs to correspond to marketing choices such as positioning, or adaptation to client segments, regardless of the variations prices undergo during the different marketing stages of the services offered.

Pricing has been playing a different role since the development of high price variation practices: its job is to best adapt the services offered to the market conditions and fluctuating demand. There should be a direct effect of pricing and pricing variations on the consumers' purchase decisions. A thorough understanding of demand is thus essential to determine optimal price and relevant pricing variations, which are also effective in terms of their impact on demand.

Value analysis

Economic theories contribute to a fuller understanding of consumers' reactions when faced with price variation: they show weaker or stronger sensitivity to pricing - an economic principle - or to quality - a psychological principle. Pricing analysis needs to be placed in a much larger context which incorporates pricing as not just an economic sacrifice made by the consumers, but also one of the factors included in the analysis of value.

The way clients determine value may be personal and subjective (Zeithmal, 1988). Value may be determined in the following way: value corresponds to what one receives for what one gives. Lovelock and Wirtz (2004) used the expression 'net value': the sum of all perceived benefits minus the sum of all the product costs. The greater the positive difference between the two, the greater the net value. Advantages correspond, *inter alia*, to service quality, accessibility, image, secondary/supplementary services, and the environment/atmosphere of the place of service. The perceived costs are embodied in the price paid, but also in the risk, expectations, difficulties in obtaining the service, etc. The greater the positive difference, and the more willing the consumer, the higher the final price. When determining the selling price, one thus needs to consider the whole situation and incorporate the selling price in an overall cost-benefit analysis concerning the perceived value of the service offered, taking into account the importance of the principal service but also that of all its secondary dimensions. Additionally, the consumers' pricing perception represents not only their value analysis but also other exogenous variables such as the intensity of the competition, the communication activities, or the distribution practices.

Market segmentation

Market segmentation is based on the entire set of elements that indicate the consumers' expectations regarding the products and on variables indicating their consumption patterns. To take one example, a new class appeared in the aviation sector at the end of 2009, illustrating the need to adapt products to the market. A class corresponds to a first level segmentation, and each class is targeted at different sub-segments. The traditional configuration is as follows: First Class - Business Class - Economy Class. At the end of 2009, a new intermediate class, called Premium Economy (or Economy Plus), was offered to travellers. This was a

rather exceptional event made necessary by the clients' changing expectations. A sustained trend of the high-end clients who no longer insisted on travelling First Class was combined with a contextual phenomenon linked to the economic crisis that resulted in restricted travel expenses for the Business Class clients. The new Premium Economy class thus responds to the needs of (mainly business) clients forced to downgrade and of (mainly leisure) Economy Class clients desiring to enjoy a little more comfort without paying the high First Class fares.

The new Premium Economy class meets the dual expectation of product and price from a portion of the clientele; at the same time, it contributes to maintaining acceptable price levels for some First Class clients who might otherwise have downgraded to the Economy Class and to upgrading Economy Class clients to Premium Economy. This example illustrates the need to adapt segmentation and product and tariff offers to the clients' changing expectations.

□ **How can one determine optimal pricing?**

Market orientation or cost analysis: two complementary approaches.

The analyses of demand, competition and costs represent the key elements of any pricing policy. The analysis of costs was and has remained a crucial element in determining the optimal selling price. Market-linked elements, however, now play a predominant role, particularly those relating to the appreciation of demand. It has become essential to know the clients' expectations and reactions regarding selling price to enable the price variable to play its part successfully as an information signal (in terms of quality, promotions, etc.) concerning consumers and to guide demand. The studies of acceptable price, value, and price sensitivity feed into the rationale for determining the optimal price, the pricing grid (the various prices for the same product or service), or the numerous selling prices.

Appraising and monitoring the competition

It is essential to monitor competitors' prices, for two main reasons:

- Optimizing one's own prices when there is an upward market pricing trend.
- Modifying, if need be, one's pricing policy if results are down (one should always avoid, as far as possible, any price drops and one should instead favour the reopening of quotas in the low-rate bands or launch special offers).

There are various tools and methods for tracking prices. Certain traditional methods are still in use, such as the direct contact with a mystery client or the straightforward exchange of information with competitors; there is, however, the risk of being accused of price collusion if the 'contacts' lead to price uniformity. It is thus preferable to ask a third party to collect the necessary marketing information as part of one's competitive intelligence strategy regarding one's market.