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# 7

# Revenue and Yield Management

## 7.1 Introduction and objectives

Yield management, and more recently revenue management have gained in popularity within hospitality, tourism and events sectors. Initially a technique used within the airline industry it has been adapted and products and services offered have been adapted to maximise the potential of this approach.

After studying this chapter you should be able to:

- Understand the concepts of yield/revenue management
- Appreciate the characteristics needed for successful revenue management within organisations
- Develop knowledge of revenue management calculations and processes; and
- Identify revenue management limitations in different environments, including profit maximisation issues.

The difference between yield and revenue management are dealt with within this chapter, in general the wider term, 'revenue management', will be used to encompass both terms. 'Revenue management' is used as a specific term in the context of this chapter, but readers need to be aware the term is also used more generally in relation to the manipulation of revenues in annual financial accounting reports. This other use of the term relates to manipulation, or 'managing' revenue so it is reported in a specific accounting year, or sales managed so it falls within the following financial year – this can sometimes be confusing when conducting a general Internet search – reader beware!

### 7.1.1 Difference between yield management and revenue management

Yield management arrived first and very much focused on maximising the revenue yield from the combination of selling price and volume of activity. In some respects, early yield management could be seen as tactical, rather than strategic and had a narrower focus – for example selling a plane seat, event ticket, or a hotel room, but not considering ‘secondary’ spend in other areas (food, drink, merchandising, additional baggage allowance), or the costs associated with the sale. Revenue management is seen as a development of yield management, in some ways that is considered more strategic and looks at ‘the bigger picture’, considering the fuller implications from a strategic perspective, so has a broader focus.

## 7.2 The concept of revenue management

The predicament in many service-based industries is that different buyers have different behaviour and it is not always the customer willing to pay more that books the longest in advance – this can cause issues. Imagine the situation, the summer flight schedule is released and a tour operator wants to book 50 seats each week over June–August, but given the size of the booking they want a substantial discount. As an airline company, do you take the booking? The problem is you could book this business eight months in advance, but then the planes become full and an independent traveller wanting to book at the last minute, at full price, has to be turned away. The same scenario can happen in other environments – a coach tour operator wanting to book 30 rooms weekly at a seaside hotel a year in advance, but wanting a discount. Does the hotelier take bookings and allow discounts, or do they keep to their full (tariff) rate and hope other people will book nearer to the time of arrival?

Traditionally, before revenue management there were two key elements monitored, independently, when monitoring sales revenue. Sales revenue is made up of price achieved multiplied by number of units sold. Traditional measurement has therefore been around average spend, or average achieved price and percentage of capacity utilised. In hotels these would be the average room rate (ARR) and the occupancy %, the percentage of room stock used. In airlines it is the average ticket price and % seat usage per flight. For events, again average ticket price and the % of capacity usage, whether this be festival space, seating capacity or venue capacity, depending on the type of event.

Even using these traditional mechanisms, managers would have experience from the past to know key points when to discount and when not to discount, but this could be ad hoc and when a new manager is appointed they may not have the same understanding of the local environment.

It is clear in service based situations there are points where discounting, and offering lower prices, is needed to encourage activity (units sold). Depending on the service being sold when this discounting is can vary – for a seaside hotel it may be the winter, for a business hotel the weekends, for a country house hotel mid-week, for a wedding venue mid-week, for a holiday package out of season and so on. In some environments, such as summer holiday trade there is a peak season, shoulder seasons around this and an ‘off-season’ period. In the middle of winter in Cardiff, Wales, one day, hotels can be offering their lowest rates, but 24 hours later offering their highest tariffs – why? One day it is just a cold February day out of season; the next day there is a major international rugby match at the Millennium Stadium bringing 70,000 people to the event in Cardiff, many wanting overnight accommodation.

There are many definitions of revenue management, but generally they relate to:

*Selling the right product, to the right customer, at the right time, at the right price.*

From the examples given above it is clear different types of customers exist, with different buyer behaviour and in order to maximise revenue returns on any given day there needs to be awareness of this. As a manager you may ask, can a premium be charged today, or do we have too much spare capacity and need to offer discounts to attract other types of customers to buy our services? Revenue management goes beyond a manager’s experience, it is a more structure way of tactically predicting the market based on sophisticated modelling of past buyer behaviour to make predictions about the future. The system effectively ‘allocates’ saleable units to specific market segments, based on predictions of the future, often with the use of very sophisticated revenue management computer software. The key to revenue management is that it is systematic and evidence-based, grounded on more than an individual’s human judgement.

## 7.2.1 Yield management formula

The basic yield management formula for identifying the yield achieved is simply comparing the revenue achieved with the maximum potential revenue.

$$\text{YM\%} = \frac{\text{Achieved revenue}}{\text{Potential revenue}} * 100$$

### Example

On a specific night a hotel has 100 rooms available, with a full tariff rate of £120 per room, therefore its maximum potential revenue is  $100 * £120 = £12,000$ . However, on that night it sold 70 rooms and achieved an average room rate of £90, therefore its achieved revenue is  $70 * £90 = £6,300$ .

$$\text{YM\%} = \frac{£6,300}{£12,000} * 100 = 52.5\%$$