

FUTURE OF REVENUE MANAGEMENT

Fast forward for hospitality revenue management: After lagging behind other travel industries, hotels now seek advanced revenue management methods

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INTRODUCTION

Airlines were the first to pursue revenue management (RM) techniques to increase profitability in the 1980s. It was only natural that these same techniques were then applied to other travel companies with similar types of reservation systems and

pricing controls, such as rental car companies and cruise lines. Now, sophisticated RM models are being adopted by companies beyond the travel industry, where these methods were first developed. Despite the fact that the hospitality industry has much in common with the other travel industries, however, hotels have been slow to adopt sophisticated RM methods to control room reservations. This paper suggests some of the reasons why the hotel industry has lagged behind its travel industry cousins in the use of RM. Today, however, there are encouraging signs that hotels are becoming more adept at using RM. Recent events have created more favourable attitudes at both the hotel ownership and chain office levels for applying RM methods to manage hotel property room inventory. In addition, there is a movement in the hospitality industry to integrate RM models with customer relationship databases. Will this be a new era for hotels, resulting in the hospitality industry leading its other travel industry cousins to even more advanced techniques in RM in the coming years?

OBSTACLES FOR RM IN THE HOSPITALITY INDUSTRY

The varied and often confusing structure of ownership and management in the hospitality industry has slowed the adoption of sophisticated RM principles to the pricing and availability of room nights. The lodging industry, compared with airlines or cruise lines, is highly decentralised and fragmented with respect to control and accountability for pricing, marketing and distribution. A hospitality chain or brand is often not the owner of the individual hotel property. The hotel property can be owned independently, sometimes the property can be one asset of a portfolio of a private investor, a public Real Estate Investment Trust, or some other institution such as a bank or a pension fund. Through either a franchising arrangement or a management contract, a brand or a management company provides programmes for the individual hotel property. A hotel brand or chain will ensure that the managed property or franchisee receives the benefits of the brand programmes, which include a central reservations distribution platform, connectivity to third-party distribution sources (such as travel agent Global Distribution Systems), as well as brand advertising. Under a management fee arrangement, the hotel property staff are employees of the brand operator, while under a franchise arrangement, the owner either manages the property with his own staff, or can utilise the services of a management company to staff the hotel.

In the hospitality industry, brands or management companies seek to satisfy their property owners in terms of the brand marketing and management services they provide. The owner can have the final say in the pricing and marketing of hotel inventory, although owners are inconsistent as to how much they do get involved in marketing and pricing matters. This has led to the large hotel chains providing

essential support for hotel marketing programmes, but historically, most chains are reluctant to enforce or mandate consistent distribution or pricing policies across all properties. Single image inventory (where the central reservation system is selling from the same inventory as the local property) is a feature of some but not all brands or chains.

The varying levels of systems integration and accountability across different management and ownership arrangements have naturally slowed the adoption of advanced RM techniques in the hospitality industry. More importantly, during the heady days of the late 1990s, the hotel owner or the real estate investment trust often was not focused on the operating performance of the hotel property, since the profitability associated with increased valuation of the property for a future real estate transaction far surpassed any incremental improvement in hotel operating performance.

The owner's lack of total focus in maximising revenues from hotel room inventory has sometimes allowed suboptimal use of property room night inventory. Because both property and national account sales staff derive compensation from the materialisation of group and convention bookings, there is a natural bias at some hotel properties to allocate more inventory to groups to ensure the highest possible group utilisation of the available inventory. Scant attention is paid to analysing whether other channels or customer types would achieve higher revenues or profitability.

Another factor in discouraging adoption of RM techniques is the perception of hospitality executives regarding airline service and pricing. The lodging industry views airline RM to be associated with fare wars, consumer confusion and consumer dissatisfaction with the airline product. Concerns about 'commoditising' the hotel product with an airline-type pricing environment of frequent and aggressive discounting

have always remained high. Even today, the hospitality community is wary of pricing methods that originated in the airline industry.

Because decisions on property pricing and room availability are pushed down to the individual property, staff expertise and resources at the individual property level are often not sufficient to apply the most advanced methods or overcome the persistent problems in centralising controls in pricing across various distribution platforms. Only larger hotel properties will have a staff member designated as a revenue manager and, in most cases, RM responsibilities are delegated to either the property director of sales or the reservations manager for the property. In contrast, airlines and cruise lines and other owner-operator travel companies centralise all decision making and control of pricing and availability through one department. In addition to the centralised decision making, these organisations staff RM departments with individuals who have solid statistical or modelling skills, and there is a healthy desire among these individuals to increase their knowledge and expertise in relevant areas.

The hospitality community has encouraged the development of competitive indices to benchmark performance across the industry. The most widely used benchmarking index is REVPAR, and it is calculated by multiplying the percentage occupancy by the average daily room rate (ADR). Companies such as Smith Travel Research and TravelCLICK collect this information and provide the ability to compare an individual hotel REVPAR against an aggregated REVPAR score for a competitive set of hotels in the same geographical area of a city or suburban area. The REVPAR measure has become the standard for evaluating hotel revenue performance and is even used to determine compensation levels for hotel directors of sales and general managers. The popularity

of the REVPAR benchmarking scale has naturally led to the hotel industry viewing competitive pricing actions as being the main determinant of REVPAR or RM performance. Each week, or month, hotel decision makers seek to maintain or improve their competitive REVPAR rankings by taking pricing actions. While competitive pricing activity is very much a key aspect of RM performance, it is not the sole determinant of optimal inventory usage. Over-reliance on the competitive aspects of the REVPAR index may be inhibiting investigation of a hotel property's intrinsic inventory management challenges, such as identifying unique customer demands for a property that might dictate pricing or availability strategies not related to a specific competitive strategy.

Automation and the use of RM has always been a higher priority for airlines compared with the hospitality industry. For large airlines, with thousands of flight departures every day, manual methods are clearly insufficient for maintaining price and availability controls, so the development of statistical forecasting models and the implementation of optimisation algorithms were a natural progression after the installation of automation. In contrast, most hotels, even those with more than 700 rooms, are regarded by many in the hotel industry as properties that can easily be revenue managed through largely manual methods. Often, the property staff conducts weekly meetings to decide on all price and availability changes. The market knowledge and intuition of the property staff is usually viewed as superior to a forecasting model, and the REVPAR benchmarking index appears to provide enough guidance without the use of an optimisation algorithm. Given the prevailing desire to maintain manual control, hotel managers therefore have a higher degree of scepticism of the benefits derived from advanced RM techniques.

The exception to this attitude of favouring manual control is found at resort and casino properties. These properties actively seek out sophisticated RM methods because profitability is dependent on solving the complex challenges of driving revenues across many lines of businesses: casino, restaurants, spa, sport activities, etc. Developing an optimal mix of the contribution by each line of business and forecasting usage by various customer segments is seen by resort operators as essential to profitability.

NEW ENVIRONMENT FOR HOTEL RM ADVANCEMENTS

With the slowdown in the economy which first appeared in 2000, conditions in the hotel industry have radically changed. These changes have led to a significant shift in attitudes toward hotel ownership and management more favourable to advanced RM techniques.

More owner focus on operating performance of their properties

With the slowdown of the economy, the frenzy of buying and selling of hotel properties also slowed, so that owners are now more naturally focused on maximising the operating performance of their assets. Over the past couple of years, many owners, REITS and management companies have created RM positions in their organisations, and promoted former property revenue managers to head up support for RM across their portfolio of properties. These new RM executives liaise with the individual property staff and the brand/chain RM departments to ensure that the owner's interests are understood by all organisations involved in executing RM strategies.

Online distribution woes lead to enhanced attitude towards RM

After airlines cut off commissions to online Internet agents, third-party distributors such as Hotels.com, Expedia and Travelo-

city became aggressive in driving higher commissions or mark-ups on hotel inventory sold on their websites. In the past couple of years, the hospitality industry has concluded that these distributors were provided too much leverage owing to the lack of clear direction provided to the individual property. The lack of centralised yield controls over hotel inventory was also a major contributing factor to the excessive margins provided to online distributors. To overcome these missteps, many brands have mandated unified pricing and lowest rate guarantees through their own websites. Some brands, such as Marriott, have now insisted on consistent pricing integrity across all distribution channels. With the focus now on eliminating unique prices even at third-party distributors, there is more emphasis on centralising control across many distribution platforms. New connectivity and technology are being provided by chains, third-party distributors and property management system vendors to ensure that all room nights are priced and controlled from a single host inventory. These changes are creating momentum for increasingly more sophisticated uses of RM software.

Powerful customer databases and relationship management programmes

With the popularity of hotel loyalty programmes, and the growth of customer databases with customer preference information, hoteliers are seeking to integrate this information with RM methods. A major hotel brand recently named a CRM specialist to head its RM department. Many in the hospitality industry believe that the next advances in hotel profitability will come from integrating advanced RM methods with channel management capabilities and customer database applications. The use of email and online e-commerce methods are considered essential for executing these new strategies.

HOSPITALITY POISED TO LEAD TRAVEL INDUSTRY WITH RM SOPHISTICATION

Today, the attitudes towards RM have never been brighter in the hospitality industry. After years of disagreement or indifference, owners, brands and property staff are united in agreement on the need for price integrity, increased yield controls across distribution platforms, and the potential benefits for utilising customer databases.

Advances in technology are helping to create this more positive environment for RM. In the past, RM software installation has been inhibited by the requirement to interface with local property management system (PMS) software and hardware. Some properties simply could not afford to update their older PMS to take advantage of RM advancements. With the evolution in Web-based systems for channel management and connectivity to various distribu-

tion platforms, however, these problems are starting to disappear. In fact, some PMS vendors are now able to provide a complete ASP solution to a local property, eliminating the barriers for adapting RM applications to outdated hardware and software of a local property reservation system. With brands and properties now more flexible to select a technology that works for their needs, even greater interest in advanced RM methods is likely.

Perhaps the decentralisation and fragmentation of the hotel industry can now work in its favour, by encouraging innovation and testing of different ideas from many sources. Evidence of this new spirit of innovation has already been seen with the hotel industry's interest in CRM-RM integration. With tens of thousands of hotel properties worldwide, there surely will be enough ideas generated to lead the travel industry forward.