Revenue Management for Dummies (like me) - Part Two - By Neil Salerno

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Knowing Why is More Important than Knowing How

I received such an overwhelming response from my last article on revenue management; I thought this might be a good opportunity to amplify my thoughts a bit. I was pleased to also hear from hoteliers in several foreign countries who share a strong interest in revenue management procedures. I truly believe that revenue or yield management can benefit hotels of any size, anywhere, for it is as much a state-of-mind as it is a technique.

The Importance of Knowing 'Why'

Many years ago, a mentor told me that understanding 'why' something is done, is far more important than knowing 'how' it is done. Knowing 'why' gives people the ability to be innovative and the creativity to improve how something is done to get even greater results. Those only knowing 'how' are doomed to repeating what they've always done.

The Occupancy Crunch of the mid 80's

To understand why our industry turned to revenue or yield management, we need to revert back to the good 'ole days. In the 60's, the industry consisted primarily of large city-center hotels and small independent hotels in secondary cities and highways. The 70's and 80's saw the growth in the explosive growth of hotel franchising.

In the years following the expansion of new hotel construction in the 70's and 80's, our industry began to feel the affects of overbuilding; consumers had many more choices and hotel demand rapidly declined. The result was that hotels needed to do more to grow business in this new competitive environment...a lot more.

With suppressed occupancy demand, it became obvious that hotels could no longer rely solely on increasing occupancy to improve profits; it became necessary to manage and control how room revenue was generated. We would have to create more profit from flat or even declining occupancies by managing our inventory and rates.

Poor Decisions Followed 9/11

In the months following 9/11, many hotels committed the ultimate sin of drastically reducing their rates, thinking that this would boost falling occupancy. Well, it didn't; all it accomplished was that, at best, they sold a few more rooms at lower rates, in most cases, resulting in lower total room revenue.

During this time, a few smart hoteliers held-fast with their rates, but created lower 'sale' rates, to pirate business from the competition and to help drive occupancy. This gave them the opportunity to close 'sale' rates as demand improved on specific dates, therefore yielding higher room revenue whenever possible.

Only in extremely rare cases have reduced rates generated enough occupancy to offset a rate reduction; resulting in lower total room revenue. To compound this problem, any additional occupied rooms gained by reducing rates, increases rooms expense and lowers profit. It just doesn't make sense to reduce rates, which are almost 100% profit.

The goal of revenue management is to strike a balance between maximizing occupancy and increasing average rates as much as possible.

The Airlines' Revenue Management Model

With suppressed occupancy demand, overall rate increases would be difficult to sell to a traveling public which now had more choices; there had to be a better way. In the 80's, hotel experts eagerly watched the airlines' rate experiment which openly offered lower fares, to build their base-business; then close those lower fares and offer higher fares for shorter-term bookings. This improved their sales, while sustaining rate growth. Many people predicted that there would be considerable consumer back-lash.

The result was that the airlines received little negative feed-back; instead consumers viewed it simply as a means to book lower fares. It's still common for passengers to sit together comparing different fares to the same destination; you've probably done it many times yourself.

Seasonal versus Daily Demand

Revenue management principles apply to all levels of demand. Resort hotels with seasonal rates have been using a form of revenue management for years by posting higher or lower rates based upon seasonal demand; this is the essence of revenue or yield management. If these hotels thought they could get 'in-season' rates all year long, they certainly would. They are adjusting for supply and demand.

Yield management provides the ability to build a 'base' of business by posting a wide range of rates, low to high, to appeal to the broadest range of consumers. For hotels which are capable of handling group business, this is the theory behind quoting lower rates for groups; getting the business on-the-books. Once this base business is booked, either by groups or transient individuals, lower rates can then be closed for sale. This is daily demand.

It’s important to understand that yield management is the process of closing-out lower rates when there are fewer rooms to sell; leaving only higher rates as occupancy increases. Rates are not increased; lower rates are closed for sale. There is an important distinction between the two.

As demand increases, there are more methods of yielding higher revenue; the use of restrictions. Many hotels use restrictions very effectively. E.g. hotels with high weekend demand often restrict weekend reservations to a minimum of two nights by placing a minimum of two nights stay on Saturday, the more popular night. This limits stays to Friday/Saturday or Saturday/Sunday, the two weaker nights. The same can be applied to holiday periods.

The key to successful revenue or yield management is to review advance reservations and make rate close-out decisions as often as might be necessary; generally, three times per week. Hotels practicing revenue management gain an insight into the ebb and flow of business, knowledge of reservations booking pace, and a true understanding of factors which impact occupancy and average rate.

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