Part I

Revenue Management Concepts and Techniques

1 The Emergence of Yield Management

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Learning outcomes

After reading this chapter, you should be able to:

- Understand the historical development of yield/revenue management since its origins in the 1980s.
- Define revenue management and explain its underlying principles.
- Understand how revenue management techniques have greatly expanded and affected various application sectors.
- Appreciate the concepts of Total Revenue Management and Revenue Integrity, which are representative of the evolution of revenue management towards a more general business management (pricing, client relationship, distribution etc.) of hospitality and tourism.

The origin of yield management

The foundations of yield/revenue management were laid during the 1980s, whether viewed from an academic or managerial perspective. The first studies, including those of Littlewood (1972), introduced the notion of revenue maximization for a given capacity rather than the maximization of the occupancy rates of an aircraft (i.e. number of passengers).

From a managerial perspective, the emergence of yield management is associated with the evolution of the airline industry in the United States at the end of the 1970s. Deregulation in the sector brought in by the Airline Deregulation Act of 1978 led to the development of numerous companies, thus creating a situation of strong competition. In this context, players tend to launch price wars. Price cutting, the weapon most rapidly set in motion, enables companies to recapture or keep their market share points. This tactic, however, tends to be followed by an identical action from competitors. A price war is then set in motion. The short-term, life-saving solution proves to be destructive in the medium and long term for most of the players. In this context, yield management contributes to avoiding a price war completely or partially. Massive price-cutting exercises are then replaced by finely tuned price variations which are better adapted to the clients' profiles, sales time periods, and product types. These thoughts then led to the emergence of yield management during the air transport crisis in the United States. Operators went progressively from the logic of optimization of occupancy rates to that of optimization of the revenue generated by the sales made, without trying to fill the plane 'at any cost'.

The development of Global Distribution Systems (GDSs) during the same period facilitated the application of yield management techniques and contributed to their spread. Thus, American Airlines is presented as the company which used the first yield management methods, taking advantage of Sabre, its computerized distribution system.

Principles of yield management

Principles

Yield/revenue management rests on the principle of strong price variation adapted to the market context (i.e. demand intensity, demand type, competitors' practices). It contributes to the protection of high-contributing clients, while enabling access at more attractive prices in off-peak periods or for bookings made long before the booking date (early booking). The system presupposes a thorough client segmentation, which integrates the value given by the client to the service ('target valuing') and the consumers' sensitivity to price and quality.

A more finely-tuned selection level related to the practices of yield management consists of giving priority to high-contributing clients who will accept higher prices, rather than trying to serve all clients. It thus marks the end of the 'first come, first served' system. Henceforth, clients are selected according to their profile and their potential contribution, and the door is always kept open for the best clients. In this context, and in order to enable a genuine consumer price reaction, service fares are fixed in line with the demand analysis.

In addition, revenue management as a decision-making tool contributes to a partial reduction of the risk inherent in any business decision, as it is based on the accumulation of data (past, present, and future). The role and business skills of the revenue manager or of the sales personnel remain essential, and complement the real support provided by the computerized decision-making tools.