8 Restaurant Revenue Management

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Learning outcomes

After reading this chapter, you should be able to:

- Understand the issues of significance when determining revenue management strategies in the restaurant sector.
- Critique the concepts of capacity management, time management, menu management and price management in the context of restaurants, and be familiar with the concept of customer perception management.
- Appreciate that slightly different revenue management approaches are required in the restaurant sector when compared to hotels and airlines.

Introduction

Restaurants can improve their revenue by increasing the number of customers they serve and/or the amount of money that is spent by each guest. Additional seats or drive-through windows, extended operating hours, and additional food service units are all examples of restaurant efforts to increase their capacity to serve more guests. Conversely, suggestive selling by service staff, creative menus, and special discounts for very large purchases are examples of efforts to increase the amount of money each customer spends. Revenue management is one of the ways to increase revenue in restaurants.

The basic rationale of revenue management is the efficient use of fixed, perishable capacities by charging customers different prices for identical services in an attempt to balance the demand and revenue per capacity unit (Kimes, 1989; McGill & van Ryzin, 1999). Revenue management works in industries that typically have perishable inventories, fixed capacities, a high fixed and low-variable cost structure, variable demands, and a segmentable market (Kimes, 1989; Berman, 2005).

In addition, reservation systems can help manage demand forecasting because such systems can calculate inventory units in advance of consumption. Airlines and hotels, which are normally considered as traditional revenue management industries, have successfully adopted revenue management techniques; more service industries, which have similar business characteristics, have begun to adopt revenue management practices (Chiang, Chen & Xu, 2007). Non-traditional revenue management industries include restaurants, heritage sites, tourist attractions, ski resorts, golf clubs, cruise industries, resorts, casinos, theme parks, and healthcare facilities. Research has indicated that these industries share most of the common business characteristics of traditional revenue management industries. Thus, these industries have the potential to incorporate revenue management.

However, non-traditional revenue management industries such as restaurants have unique business characteristics. One of these unique characteristics is the service capacity, which is an important consideration for the implementation of revenue management. Examples of traditional and non-traditional revenue management industries are presented in Figure 8.1. The figure shows the typology of revenue management industries based on the flexibility of the service capacity. This service capacity depends on two characteristics: the physical constraint of the business and the duration of service use by a customer.

	Traditional revenue management industries	**Non-traditional revenue management industries**	
Industry examples	Hotels Airlines	Restaurants Golf clubs	Theme parks Tourism attractions
Service capacity	Fixed	Relatively fixed	Relatively flexible
Duration of service use	Fixed	Variable	Variable
Physical constraint	Highly constrained	Constrained but elastic	No constraints and elastic

Figure 8.1: Typology of revenue management industries

The physical constraints of non-traditional revenue management industries such as restaurants, golf clubs, and theme parks differ from those of traditional revenue management industries. Unlike hotels and airlines (e.g., the number of available hotel rooms or flight seats per day), the total service capacity of non-traditional revenue management industries (e.g., the total number of available table per day in restaurants) is not fixed because the duration of service use by customers is unpredictable. Likewise, the physical constraints in the non-traditional revenue management industry are elastic.

First, the duration of the service use by customers is unpredictable and variable in non-traditional revenue management industries. All passengers board and exit a flight together and the check-in and check-out time for a hotel has already been set. However, some people spend three hours in restaurants for their lunch, whereas others may need only one hour.

Some non-traditional revenue management industries, such as theme parks or tourism attractions, have relatively flexible service capacities because of the variable duration of service use and the relaxed physical constraint. Generally, no fixed number of attendees or visitors is imposed by theme parks or tourism attractions; the duration of their stay is not predictable. Those non-traditional industries tend to have an excess capacity during low-demand seasons and excess number of customers at high-demand seasons or on weekends. An excessive number of visitors, that is over the optimal capacity, during the high-demand periods often causes problems. Therefore, revenue management can be a useful strategic approach to alleviate demand fluctuation and to maximise revenue.

Other non-traditional revenue management industries such as restaurants or golf clubs have a limited space for their business activities and their temporal capacity is limited. However, they are likewise physically less restricted than traditional revenue management industries. For example, the addition of chairs or tables, as well as the changes to the table layout, is possible in restaurants, whereas the addition of one more seats in a flight (or one more room in a hotel) is not feasible. A restaurant may have an outdoor patio seating area during good weather to expand their capacity during peak periods. In a restaurant, therefore, the total available seating capacity per day is not fixed because of the variable duration of the meals of customers as well as their loose physical constraints.

Revenue management generally involves segmenting customers, setting prices, controlling capacities, and allocating inventories to maximise the revenue generated from a fixed capacity. Fixed service capacity is a key characteristic of successfully applied revenue management. Capacity limitation generally enables a firm to build variable pricing policies and proper rate fences. If the service capacity is not limited, businesses are less able to apply variable pricing, particularly imposing premium pricing during peak periods. For instance, customers believe the value of the flight ticket during peak period is higher and are willing to pay more because seats are limited during peak periods. Therefore, the core principles of revenue management pricing are based on the customer perceptions of value rather than of cost and their different valuations for service products of limited availability, according to the demand fluctuations. Thus, service capacity influences the customer perception of value for a service. These unique characteristics of restaurants pose special challenges to restaurant operators and consequently require more creative revenue management strategies.