What the Heck is Hotel Revenue Management, Anyway? A Hotel Marketer’s Guide to Revenue Management - By Neil Salerno

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Revenue management has become a somewhat controversial buzzword in our industry. As with many common terms, revenue management seems to have various definitions depending upon whom one asks. Since its inception in the early 80’s, thousands of hotels and just about every airline have used revenue management successfully.

As is my practice, I looked for a simple definition of revenue management, how it came about, and how it is being utilized. In straightforward terms, revenue management is a technique to optimize income revenue from a fixed, but perishable inventory. The challenge is to sell the right rooms to the right customer at the right time for the right price.

The Brief History of Revenue Management

The airline industry launched revenue management practices after government deregulation in the early 1980s. Although yield management techniques became a common practice among airlines during that time, revenue management may reasonably be assigned an inception date of January 17, 1985 when American Airlines launched its Ultimate Super Saver fares in an effort to compete with the low cost carrier PeopleExpress.

Revenue management was born out the need to fill at least a minimum number of seats without selling every seat at discount prices, the idea was to sell enough seats to cover fixed operating expenses. Once fixed expenses were covered, and there were now fewer remaining seats to sell, they could then sell the remaining seats at higher rates to maximize revenue and profits.

Revenue management uses the basic principles of supply and demand economics, in a tactical way, to generate incremental revenues. There are three essential conditions for revenue management to be applicable:

There is a fixed amount of resources available for sale.

The resources to sell are very perishable.

Customers are willing to pay a different price for using the same resources.

The hotel industry fits these criteria extremely well. Obviously, hotels have a fixed inventory of rooms to sell, these rooms are also extremely perishable. You may not have thought about it, but hotel rooms perish every day, any room that is unsold tonight is gone forever. There is also no question that different segments of business are willing to pay different rates under various circumstances.

Revenue management is of especially high relevance in cases where fixed costs are high as compared to variable costs. The less variable costs there are, the more added revenue will contribute to overall profit. This makes revenue management perfect for the hotel industry.

Effective market segmentation is the key to successful revenue management for hotels. Market segmentation begins with seasonal demand. For years, hoteliers recognized that almost all hotels experience periods of high and lower demand. This is even more obvious in hotels, located in resort and attraction areas.

Hotels quickly recognized that consumers would also pay more for rooms with a superior view, such as ocean or mountain views and other unique features of their location, larger or unusual rooms, and rooms with unique features.

Hotel revenue management hit its stride when hoteliers examined airline RM and realized that the factors of supply and demand, beyond natural seasonal demand, present opportunities to generate higher revenue. As room demand increases and room supply decreases, hotel rate opportunities also increase.

The airlines have taught us that supply & demand opportunities appear all year long because of conventions, group bookings, room production through web site marketing, special events and local attractions, all create revenue management opportunities.

How Revenue Management is Applied

Most hotels start with market segmentation to begin the revenue management process, what types of business can your hotel serve and based upon market conditions, room supply vs. room demand. What rates are marketable for each segment of business?

I have seen many different market segmentation breakdowns, it largely depends on the location, type of hotel, franchise or independent, number of rooms, public space, and other factors. A sample might include corporate transient, leisure transient, Internet bookings, conference groups, association groups, etc. Each market segment has its own level of rate tolerance.

Remember to concentrate on occupancy first and average rate, second. As advance reservations increase, rates should also increase. The strange part is that many hoteliers think the opposite. How many times have you seen hotel rates suddenly decrease a week or so before the arrival dates? This is the direct opposite of good revenue management.

Too many hoteliers set rates blindly for the future and then, panic when reservations are disappointing just a week or two in advance. Most hotels should take a picture of reservations at least six months in advance, many hotels should lookout a year or more into the future. Advance reservations represent occupancy demand for each night in the future. Use special rates, packages, and group discounts to build future demand, then adjust rates upwards to match that demand.

When reviewing future reservations remember to check past history for those dates, movable holiday dates, current and past booking pace. There is little room for guesswork when planning your sales strategy. Revenue management can benefit almost every hotel. Get to know the business flow of your hotel and adjust rates and promotions based upon knowledge and not guesswork.

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