FUTURES

Future of revenue management — From the plane to the shelf

James Bain

Head of Revenue Management, CrossCountry Trains (Arriva Plc), 3rd Floor West, Meridian, 85 Smallbrook Queensway, Birmingham, B36 9TW, UK
Tel: +44 7767 644834
E-mail: James.Bain@crosscountrytrains.co.uk

James Bain *is the Head of revenue management for CrossCountry Trains based in the UK and part of Arriva Plc. He has worked in revenue management for six years and this was preceded by four years in customer service both front line and strategic planning. Educated in business and finance his first management role was in the retail and Leisure sector before moving to the transport sector.*

ABSTRACT

KEYWORDS: future, retail, customer and profit

The future of revenue management: retail vs service sectors. Deployment of end to end revenue management systems and processes is the next step in the practices evolution. The author has been developing revenue management systems and processes for the past six years.
Journal of Revenue and Pricing Management (2008) **7,** 302–306. doi:10.1057/rpm.2008.22

What is revenue management? Where did it come from? Is it an art or a science? What next?

Four questions that occupy the thoughts of many Chief Executive Officer's (CEO), Chief Operations Officer's (COO), Managing Director's (MD) and Financial Director's (FD) across the world in all business sectors. The practice of revenue management is alleged to give them pure bottomline gain for what is perceived to be minimal investment.

WHAT IS REVENUE MANAGEMENT AND WHERE DID IT COME FROM?

Revenue management as a business tool is widely regarded as evolving in the airline sector where high fixed costs, low variable costs, closed entry and exit points and fixed capacity prevail. Revenue management was heralded as the option to choose to squeeze the most out of business assets that show as huge negatives on the balance sheet.

Revenue management is founded in pure economics where the demand versus supply curves rule. This rule has been implemented in business using computer software that would look at historical trends, fixed capacities and revenue generated and then 'forecast the future', giving the business a 'set of rules' to apply to its assets to maximise their potential. What this practice evolved into was internal price setting based on history. It is not so much revenue management as price manipulation, this being the price the business was willing to bear the asset being sold for at a point in time.

As the evolutionary process proceeded, further details were added to the forecasts including observed demand (what staff saw), no-show data and the overbooking concept

 © 2008 Palgrave Macmillan Ltd, 1476-6930
www.manaraa.com

where a game of chance is played playing off the extra revenue generated for selling more capacity than the physical asset has to offer.

The practice of revenue management was soon deployed across a myriad of business sectors and today can be found in nearly all mass transport modes, tourism, cargo and car rental. This list is nowhere near exhaustive but provides a quick glimpse of the bandwagon factor that revenue management has generated with the sales quote, business case statement and commercial director promise — 'It will add between 5 and 10 per cent to the bottom line'.

I would like to challenge the above quote with two words — '*Has it?*'

Evidence of the success of revenue management programmes and initiatives is limited and is again based on analysis of historical performance. I am yet to find an industry, business or supplier who has developed a fool-proof technique for evaluating the benefit of revenue management in terms of historical performance that can be included as an individual line in a balance sheet or future gain that can be included in revenue forecasts and projections.

In my mind, the reason for the failure to provide tangible success measurement tools is twofold:

- The FD will want validation that the cost–benefit analysis provided in the business case has been delivered and, as a cost accountant by nature, the FD will focus on the cost of the solution; and
- Revenue management is more about customer-subjective value perception, which creates difficulties when trying to measure why customers paid one price and would they have paid a higher price. That is, we cannot measure the potential loss.

Returning to the concept of revenue management being internally focused and deployed to make the most of the asset. From an accountants perspective this is the right and natural thing to do, the FD will always want to know his cost exposure, revenue opportunity and therefore margin. In order to aid the transparency from cost to price and therefore profit the customers, value perception is never considered. We hear phrases such as 'consumers will pay the price we offer', 'we cannot offer a price below our cost plus margin' and 'make sure the yield is not threatened'.

All of the above statements are natural and acceptable in the world of the FD; the problem is we are in a world where the customer is king. As cheesy as this always sounds, it has never been more true than in today's society where choice is wider than ever and the ability of the customer to compare and analyse products is leagues ahead of even five years back; for example, in the UK we now have moneysupermarket.com, gocompare.com and tesco-compare, all internet sites that allow the customer to make a value-based decision regarding profit for them on the purchase they are about to make by quickly comparing the market.

ART OR SCIENCE?

As a practice, revenue management has to evolve with the economic conditions of today's market place. Has it? For me, not yet, too many of us who practice revenue management are still wedded to our forecasts and optimisations that look backwards; there has been a small move towards the integration of the sales channel into revenue management, but for me this is only bringing us into line with high-street and supermarket retailers. Probably not areas where we would automatically consider revenue management to be used, but it is and has been for centuries.

Take the example of Tesco, the UK's biggest supermarket chain, who in 2007–2008 (year ending 23rd February, 2008), made a group profit of £2.7bn, which equates to £85.62 *per* second, £5,137 per minute, £308,219 per hour. How does a business that majors in selling food generate such vast profits when its competitors are lagging so far behind;

www.manaraa.com

Table 1: Retail and service industry comparison

Asset	*Service industry (Air)*	*Retail industry (Tesco)*
Capacity	Planes	Shelves
Price	Internally set	Internally set
Inventory	Demand-driven allocation of capacity to inventory — Seats	Demand-driven allocation of capacity to inventory — Products
Revenue	Free market driven	Free market driven
Demand	Customer value of air travel	Customer value of food
Supply	Driven by customer demand	Driven by entire supply chain demand

J. Sainsburys reported £380 m for year ending 22nd March, 2007 more than £2bn less than Tesco! The answer is revenue management retail style, this practice is not based on historical analysis and forecasting alone for Tesco — is a business strategy that enables all functions of the business behaviour to deliver value for a customer, whether it is internal or external, and is wrapped in 'Every little helps'.

In the retail world the customer is definitely king and recognised as such, I admit the costs are variable and that margin can more easily be generated using traditional business levers such as cost reduction, volume initiatives and positive Gross Profit (GP) management, but as the numbers above suggest competitive advantage can be gained and then converted into financial results through a broader vision and strategy.

If we break the retail world down and relate it to the high fixed cost service industries where revenue management is an integral business part, we will see that there are more similarities than differences. This is highlighted in Table 1.

Table 1 shows the high-level similarities of a service business with high fixed costs and a retail business with high variable costs. The summary is that both business have a level of capacity that they offer products through. The fact that an airline offers seats and a supermarket offers food is irrelevant — they both seek to optimise the amount of revenue generated for each section of space, whether it is a physical seat or a square footage of floor space.

Comparisons can be drawn between the two businesses for allocation of capacity to inventory, the airline will allocate the biggest planes to the routes that will deliver the best return, the supermarket will allocate the biggest shelf space to the products that deliver the best return.

The difference between the two businesses and their approach to revenue management is simple yet fundamental. The service industry takes no account of cost in the allocation of capacity to inventory, it is purely revenue-driven based on demand. The retail industry does take cost into account in the allocation of capacity to inventory, which is translated as GP or Net Revenue.

Both businesses do take into account demand for their products but again due to the service industry ignoring cost in the revenue forecast, the true benefit of the revenue management answer back to analysts is over-inflated and in some cases loss making.

The retail business also integrates customer data into their 'revenue management' strategy, this has been driven through the creation of 'loyalty schemes'. The initial principle of loyalty schemes such as 'airmiles' was to reward high-value frequent customers with an

 © 2008 Palgrave Macmillan Ltd, 1476-6930

www.manaraa.com

incentive to continue that behaviour with a particular business; again this approach was only about customer retention and was not viewed as particularly revenue generative.

The retail business has taken this a step further and has used the loyalty scheme to generate an infinite amount of customer behaviour data, again Tesco leads from the front in this with their Clubcard proposition. This tool allows them to capture all purchasing behaviour of any member and then analyse it any way they choose, including product purchase, socio-economic demographics, life-style choices and value to the business. Tesco contracted Dunhumby to manage this for them, the success of the clubcard has been huge and the data collected are now available to other business for a fee.

Where in the service industries do we capture such detailed customer data. Again I accept the argument of frequency of purchase from a retail business compared to a service business and the challenges this gives to build relationships with customers, but this should not be used as an excuse for not aspiring to the levels set by the retail businesses.

The final comparison that can be drawn between the retail and service industries is the sales channel or distribution channel, depending on where you sit. Most people, when asked, would say that the sales channel in a retail business is the checkout; I would argue that this is the payment point and that the sales channel is the merchandising of the store from the entrance to the exit, that is, end to end. How many of us have bought products that we never had any intention of buying when we first entered a retail store, why do we do this? Because it is presented to us in such a way that highlights the value it will give us for the price the retailer is willing to accept.

I believe that a service industry treats revenue management as a science where we can make a customers part with their money; however, a retailer treats it as an art, encouraging customers to part with their money.

WHAT NEXT?

In the service business we need to learn from the supermarket high-street retail approach. For most of us selling service products, we have limited sales channels where we can shape the journey the customer goes through to complete their purchase. We do not make it flexible, offer choice, comparison or put much effort into explaining the value the customer will derive from our business.

The dotcom bubble is growing rapidly (again!) as a retail medium and again it is obvious that retailers have managed to translate their physical store sales channels into virtual ones and make it work. Service industries are improving but too much focus is given to the 'booking process' (payment point), the opportunity lies in developing our sales channels to highlight the value of our product and the flexibility the customer can have for a set of prices while capturing as much customer data as possible.

So where does this leave the future of revenue management, for me on a precipice. In order to survive and evolve, we, as practicing revenue management professionals, need to broaden our horizons when looking at best practice and successful businesses.

The incorporation of customer behaviour into forecasts and optimisations based on information other than historical demand levels is the first step. To do this, it is necessary to capture more customer data, this can be done through loyalty schemes but can also be done by sales channel enhancement where the experience of 'shopping' with a service business is expanded from the ABC of the booking flow to the merchandising of our product in terms of what it will give the customer rather than what it will give the business.

I believe there is a strong case for the adoption of net revenue into forecasts as this is the true benefit to the bottom line of any P&L. The employment of retail principles of GP management and the allocation of capacity to inventory on this basis will drive further benefits to business and will allow for more tangible benefit calculations to be made.

المنارة للاستشارات
www.manaraa.com

We must not forget that demand is always constrained, supply is always finite and there is a point in time where the benefit tips from the positive to the negative. By measuring this on pure revenue we have been misleading the businesses we work for as their will is always the law of diminishing returns to account for in line with the cost of service provision. Hence, the true benefit of revenue management in the future is the revenue generation minus the cost of delivery with the law of diminishing returns applied.

Furthermore, we must always be conscious that as we analyse data, KPI's and report on performance, we must keep the customer at the forefront of our planning. There have been examples of huge investment in technologies for businesses that have failed to deliver the benefit because the customer proposition was compromised, ignored or allowed to remain static.

Revenue management now more than ever has a role at the centre of any business that wishes to drive growth in terms of not only financial numbers but also customer wealth. By adopting an economists view of the world and understanding customer value, we will be able to evolve our function from pure number crunching and analysis to business strategy planning and profit driving.

For me there are three key elements that the revenue management must adopt:

1. *Acknowledge* that a customer, not a system, generates revenue.
2. *Integrate* customer behavioural data into forecasts and optimisations.
3. *Merchandise* sales channels to engage better with customers.

The adoption of the above three principles (AIM) will allow revenue management to move forward and become a truly tangible business asset.

The future for revenue management is in our own hands to lead and evolve. By embracing emerging technologies from the internet and smart cards/phones to understanding social changes, society developments and customer value perceptions, we are able to re-focus revenue management to become a business strategy rather than a 'value add on'.

© 2008 Palgrave Macmillan Ltd, 1476-6930
www.manaraa.com

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

المنارة للاستشارات

www.manaraa.com