Practice Article

The evolution of hotel revenue management

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ABSTRACT In this article, I discuss the history of hotel revenue management (RM) and trace its evolution over the past 25 years. The most important change in hotel RM has been its evolution from a tactical inventory management approach to a more strategic marketing approach.

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INTRODUCTION

Since starting at Cornell in 1988, I have had the wonderful opportunity to observe the development of revenue management in not only the hotel industry, but also how revenue management (RM) developed in other industries. The differences between how RM is practiced now versus even 10–15 years ago are quite stark. To me, the change that has had the most impact has been the evolution of RM from a tactical inventory management approach to a more strategic marketing approach.

For example, back in the early years of hotel RM, rates were assumed as given that the inventory management system opened and closed. We did not necessarily look at how to develop other market segments to fill slow demand periods or for that matter, even try to understand if the prices that were being offered were optimal. How things have changed! While the inventory management aspects of RM are obviously still there, RM has become a much richer and more strategic field of business.

This is demonstrated in a number of ways including the organization of the RM function, the role that pricing now plays, the application of RM principles to other parts of the hotel and the change in how RM performance is measured.

In this article, I will provide an overview of the evolution of hotel RM organizational structures and RM systems. Subsequently, I will discuss the impact that distribution channels have had on the evolution of hotel RM and talk about the increasing importance of pricing and marketing analytics. After a brief overview of the state of total hotel RM, I will conclude with some thoughts on what hotel RM may look like in the future.

ORGANIZATION

Hotels began to be aware of what was then called 'yield management' (YM) in the late 1980s and early 1990s. The YM function was seen as primarily a rooms-related function and as such was usually assigned to the Reservations department, which at that time was most frequently located within the Front Office department. Hotel chains typically had very small RM departments (perhaps 2 or 3 people) and RM was primarily done at the property level.

Since RM was largely seen as an inventory function in which room rates were opened and closed, the Reservations Manager had the responsibility for ensuring that the reservations agents were aware of which rates were available on any particular day. Rate fences (the reasons why customers pay different rates) were typically not used and many hotel chains used a top-down selling approach in which the highest rate available was quoted first, and if the guest demurred, lower rates were offered. Not surprisingly, this rate-quoting approach was not well received since it was viewed as unfair (Kimes, 1994).

The placement of RM in the Front Office/Rooms Division inevitably led to conflicts with the Sales and Marketing department. The Front Office/Rooms Division was more focused on transient room sales, while the Sales and Marketing department was more focused on group sales. Typical conflicts entailed the Front Office complaining that the rates being offered by Sales and Marketing to groups were much too low and were affecting transient room sales and the Sales and Marketing department complaining that the Front Office was holding back too much inventory for transient business when they should have been releasing it for additional group business.

The power differential between the Reservations Manager (a fairly low level position) and the Director of Sales and Marketing (a fairly high level position) exacerbated these conflicts as did the fact that the two departments tended to operate on separate information systems. The Rooms Division worked off of their Property Management System and the Sales and Marketing Department either had a fairly simple computer-based system or more frequently a paper set of records. Frequently, the two departmental systems did not communicate so it was very difficult for anyone to have full information to make good decisions.

In the mid-1990s, RM still tended to be associated with the reservations department, but many chains started to move the RM function (and in some case, the reservations department) into the Sales and Marketing department. The level of conflict between reservations and Sales and Marketing went down to some extent, but the power differential between the Reservations Manager and the Director of Sales and Marketing sometimes resulted in less than optimal decisions.

In an attempt to alleviate these conflicts and take the focus away from optimizing rooms revenue from solely transient or group business, some chains moved RM into a separate department reporting directly to the General Manager. Interestingly, about half (51.7 per cent) of respondents in a 2010 study that I conducted on the future of hotel RM, felt that RM would be located in a separate department (Kimes, 2011). The second most common response was Sales and Marketing (29.5 per cent). Only 5.6 per cent of respondents felt that RM would be located in the Rooms department

This very much changed the nature of RM within the hotel since the revenue manager was now in a fairly high level position with responsibility for all rooms revenue. Not surprisingly, as RM gained in importance, the skill levels required of a revenue manager moved from one of fairly tactical opening and closing of rate classes to a more strategic focus on total hotel revenue. For example, in the 2010 study, respondents were asked to indicate the future importance of nine different characteristics (1–5, 5 = very important) that Revenue Managers of the future should possess. The most important characteristics were analytical skills (4.57), leadership skills (4.32) and communication skills (4.24) followed closely by a formal RM education (4.13) and negotiation skills (4.06). The least important characteristics were a rooms or reservations background (3.46 and 3.34, respectively) (Kimes, 2011).

In addition, while RM had evolved as a very decentralized approach, many chains developed RM clusters and began to regionalize, and in some circumstances, even completely centralize the RM function. As evidence, the majority of respondents in the 2010 study felt that RM would be either centralized (33.8 per cent) or regionalized (38.5 per cent) in the future. About 15.8 per cent felt that RM would continue to be decentralized, while 6.4 per cent felt that RM would be outsourced (Kimes, 2011).

SYSTEMS

During the late 1980s/early 1990s, hotels were using a fairly basic threshold curve approach in which rates were opened or closed based on predicted occupancy levels. Marriott was one of the early pioneers in RM and in a 1992 paper, discussed their foray into rate fences and length of stay controls (Hanks *et al*, 1992). This represented a fundamental shift in hotel RM practice. While Marriott largely developed their own RM software system, many other chains relied on RM vendors (for example, Aeronomics, DFI, Talus). The systems were still primarily inventory focused (and rates were considered to be a given), but their use streamlined the job of the revenue manager and allowed revenue managers to reduce their emphasis on inventory allocation issues and instead shift their on other aspects of revenue generation.

In addition, in the early years, revenue management systems (RMS) were generally not integrated with the PMS or group management system (GMS). The RM was frequently charged with printing out reservation information from the PMS and entering it into another system and vice versa. Not surprisingly, this did not always happen as planned and led to some less than optimal decisions being made!

DISTRIBUTION CHANNELS

The rise of online travel agents (OTAs) in the early 2000s also had major impact on hotel RM. While a number of hotel chains had computerized RM systems by this point, the systems were not well set up for the proliferation of OTAs and other distribution channels. As a result, the Revenue Manager was given the time-consuming task of manually managing the multiple distribution channels. Again, not surprisingly, this led to some less than optimal decisions.

Before the proliferation of OTAs and other online distribution channels, hotel rate structures were fairly hidden, but OTAs made hotel rate structures much more transparent to customers and competitors. While this increased the power of customers to be able to compare rates, it reduced hotel's control over their rates. This, combined with the fact that the OTAs were charging substantial commissions, led to a rather tense relationship between the hotel industry and OTAs.

PRICING AND MARKETING ANALYTICS

In the early days of RM, room rates were taken as a given and the revenue manager (or reservations manager) simply opened and closed the rates based on demand. While the Sales and Marketing departments were certainly using market segmentation for their group business, not much market segmentation was going on for transient customers. By 2010, RM had taken on a much more sophisticated marketing approach with careful focus on identifying niche markets that could help fill hotels during slow times.

Interestingly, the rise of OTAs led to a change in hotel pricing practices. Up until around 2005, hotels charged the same rate for the entire length of a guest's stay. In contrast, Expedia was charging different rates for different days of a guest's stay (according to former students who worked at Expedia, this was because of a technical glitch that they hoped to rectify!). When customers would look for rooms on Expedia, they would notice that Expedia offered a lower rate than the hotel did for a specific day, and as a result, complain to the hotel. Within a few years, Best Available Rate (BAR) pricing became the hotel industry norm (Rohlfs and Kimes, 2007).

The use of BAR pricing led to the question of what the BAR price should be. Historically, hotel room rates were set based on market conditions and demand and analytical approaches were rarely used. Since 2010, hotel chains and hotel RM companies have been approaching pricing in a much more analytical way, but there is still much room for improvement (Kimes, 2011).

Another interesting development has been the integration of marketing analytics with RM. Hotel chains such as Marriott and Fairmont are increasingly using data analytics to better understand customer-spending behaviors, their propensity to stay at multiple properties and their long-term relationship with the chain. Even the name of the RM department has changed in some companies. For example, the RM department at Marriott is now called Consumer Insights and Revenue Management, while the one at Fairmont is now called Revenue Management and Analytics.

INTERPLAY OF OWNERSHIP STRUCTURE AND TOTAL HOTEL RM

In the 1990s, hotel chains primarily owned and operated their hotels; but in the past 15 years, have mostly divested them. Hotels are now owned by individual and groups of investors and asset managers play a much more important role and are constantly trying to leverage the owner's investment. This has led to an increased emphasis on generating revenue from not only room sales but from other departments within the hotel.

The change in ownership structure combined with the increased sophistication of the RM function has led to a focus on applying RM to other departments including function space, restaurants and spas. A number of chains have applied RM to their function space and several of the hotel RM vendors offer RM function space capabilities.

The focus on total hotel RM has further transformed the role of a revenue manager from a tactical focus to a much more strategic focus that entails not only being able to navigate political differences among disparate departments, but also to manage the change process.

RevPAR has remained the dominant performance measurement for hotel RM for years, but the emergence of total hotel RM has led to some doubts as to whether RevPAR is the best measure of performance. For example, in my 2010 study on the future of hotel RM, only 18.6 per cent of respondents felt that RevPAR would be the performance measurement of the future. GOPPAR (Gross Operating Profit per available room) (29.3 per cent) was the most common response. Other highly ranked performance measures were TotRevPAR (Total Revenue per available room) (20.5 per cent) and TotRevPASF (total revenue per available square foot) (13.5 per cent) (Kimes, 2011).

THE FUTURE

What will hotel RM look like in the future? On the basis of my experience, conversations and observations, I believe that hotel RM will become even more strategic in nature and that the use of marketing analytics will greatly increase. Also, as respondents reported the 2010 study, I believe the RM function will become more centralized with only larger, complex hotels having dedicated revenue managers.

There is also the possibility that RM might be handled by other organizations. Hotels have been talking about total hotel RM for over 5 years, but still, implementation process has been rather slow. This slow progress, combined with the pressure from asset managers and owners to leverage their investment has led to some OTAs moving into the RM space in an attempt to offer total hotel RM. For example, CTrip has hired a number of revenue managers and is offering PMS and RM systems to hotels.

Similarly, Priceline has acquired OpenTable (the largest restaurant reservations company in the United States) and a RM software provider. These strategic moves of CTrip and Priceline combined with the current ownership structure of most hotels raise interesting questions about the future of hotel RM. Will RM still be something controlled by the hotel chains or will it emerge into a function that is offered by OTAs? Only the future will tell!

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