

A Study on Airline Revenue Management

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ABSTRACT

Revenue management systems are used to determine the optimal price of selling a seat at any given point in time. The information required to be able to make this decision depends on a number of factors, not all of which have traditionally been available. The revenue management is very important in the current scenario because the competition and a variety of economic pressures increase, all airlines, full service and low cost carriers alike, need to maximize revenue in order to succeed and cultivate. Air traffic has grown enormously and expected to have a growth which would be above 25 per cent in the travel segment. In the present scenario around 12 domestic airlines and above 60 international airlines are operating in India. With the growth in the economy and stability of the country India has become one of the preferred locations for the trade and commerce activities. The growth of airline traffic in Aviation Industry in India is almost four times above international average. Aviation Industry in India has placed the biggest order for aircrafts globally. The civil aviation sector is important for India as it is interlinked with other sectors in the economy and generates income and employment. The growth in the Indian economy has increased the Gross Domestic Product above 8 per cent and this high growth rate will be sustained for a good number of years. A well-managed civil aviation infrastructure and efficiently-run, competitive airlines are a must in today's globalized world. The presence of such infrastructure and airlines in India can bring down transport and communication costs, promote commercial and cultural activity, create jobs, and ultimately unify people and markets. Air transport services deliver the final product of civil aviation industries to customers around the globe. The researcher's attempt to study the airline revenue management.

1. Introduction

The revenue management is very important in the current scenario because the competition and a variety of economic pressures increase, all airlines, full service and low cost carriers alike, need to maximize revenue in order to succeed and cultivate. As airlines adapt their business processes and models to meet the current challenges facing the industry, revenue management provides a number of strategies to help increase and maximize revenue. The nature of the airline business is challenging and requires airlines to continually invest in new or updated technologies as a means to grow revenue. One particular area of focus playing an increasingly important role in the success of an airline is the Revenue Management (RM) system.

Revenue management systems are used to determine the optimal price of selling a seat at any given point in time. The information required to be able to make this decision depends on a number of factors, not all of which have traditionally been available. The revenue management paradigm shift demands a holistic, 360-degree approach to forecasting, analyzing and optimizing all revenue streams to help an airline carrier maximize its revenues and impact profitability. It also demands breaking down traditional departmental, data, systems and process silos that are still prevalent today at most carriers. In essence, airlines must become better retailers. In doing so,

they will begin to understand the principles and value of Total Revenue Optimization (TRO).¹

The carrier focused on maximizing revenue through an analytics-based inventory methodology in an effort to that an increasing threat in the market at that time the advent of the low-cost, low-fare carrier. By coupling this inventory, management approach with an innovative variable pricing strategy based on understanding, anticipating and influencing customer behavior, American Airlines was able to maximize its revenue and profits from a perishable resource (airline seats) and compete directly with low-cost carriers (LCCs). This methodology rapidly spread throughout the airline industry. In fact, yield management was recognized as "the single most important technical development in transportation management" for many years, as cited in the book "Revenue Management: Hard-Core Tactics for Market Domination." The airline industry has changed significantly over the past decades, with LCCs now controlling more than 26 percent of the overall market, according to the CAPA Centre For Aviation. This significant change has orchestrated customer demands and expectations for lower fares. These two factors have largely resulted in a commoditization of base fares, leaving airlines to focus their efforts on identifying and managing new opportunities to grow revenue, profit, and productivity, and further differentiate their brands in the marketplace. The

¹ [https://www.sabreairlinesolutions.com, home/software,solutions/product/passenger_revenue_management](https://www.sabreairlinesolutions.com/home/software,solutions/product/passenger_revenue_management)

outcome of their efforts has identified new opportunities for airlines to further increase employee productivity and revenue expansion. For example, having access to an easy-to-use, consumer-grade user experience coupled with seamless inventory and revenue management business processes can drive productivity improvements for airlines.²

- Air traffic has grown enormously and expected to have a growth which would be above 25% in the travel segment
- In the present scenario around 12 domestic airlines and above 60 international airlines are operating in India
- With the growth in the economy and stability of the country India has become one of the preferred locations for the trade and commerce activities
- The growth of airline traffic in Aviation Industry in India is almost four times above international average
- Aviation Industry in India has placed the biggest order for aircrafts globally
- Aviation Industry in India holds around 69% of the total share of the airline traffic in the region of South Asia

2. Importance of the study

The civil aviation sector is an important sector in India as it is interlinked with other sectors in the economy and generates income and employment. The growth in the Indian economy has increased the Gross Domestic Product above 8% and this high growth rate will be sustained for a good number of years. A well-managed civil aviation infrastructure and efficiently-run, competitive airlines are a must in today's globalized world. The presence of such infrastructure and airlines in India can bring down transport and communication costs, promote commercial and cultural activity, create jobs, and ultimately unify people and markets. Air transport services deliver the final product of civil aviation industries to customers around the globe. To provide passenger, freight and mail services, air carriers, business aviation and other commercial operators purchase a wide range of products and services from airports and air navigation service providers, manufacturing and service industries, which in turn depend on numerous suppliers. The researcher's attempt to study the airline revenue management.

3. Review of Literature

Cynthia Barnhart, Douglas Fearing, Amedeo Odoni and Vikrant Vaze (2012)³ This paper summarizes research trends and opportunities in the area of managing air transportation demand and capacity. Capacity constraints and resulting congestion and low schedule reliability currently impose large costs on airlines and their passengers. Significant capacity increases that would solve these problems are not expected in the near- or medium-term. This paper outlines first a number of directions for effecting improvement through marginal capacity increases and better management of demand and available capacity. It then describes strategic initiatives that airlines and civil aviation authorities might undertake over time horizons of

² <https://business.mapsofindia.com>

³ EURO J Transp Logist (2012) 1:135–155. DOI 10.1007/s13676-012-0006-9. Demand and capacity in Air Transportation.

months to years as well as tactical measures that may be adopted on a daily basis in response to dynamic, “real-time” developments like poor weather or schedule disruptions. Research challenges in these areas are identified and classified in terms of specifying, allocating, and utilizing capacity. The first two categories reflect challenges faced by infrastructure providers, the last category challenges faced by airlines.

The Indian expresses (2012)⁴ Terming the aviation sector as the 'real World Wide Web', a study has said it is currently contributing Rs 33,000 crore or 0.5 per cent of India's GDP and supporting 1.7 million jobs in the country, besides creating much-needed critical assets. The study, conducted by Oxford Economics for the International Air Transport Association (IATA) recently, says aviation has not only provided significant economic benefits to the Indian economy and the citizens, but also critical assets on which modern globalized businesses depend.

Anthony W. Donovan (2005)⁵ In this study the complications and challenges that affect yield management practices, the airline industry has greatly benefitted from its implementation. As indicated previously, the airline industry includes the most common features of perishable product, limited supply, varying demand, market segmentation, advance sale of product, and low marginal cost that commonly parallel the successful incorporation of yield management systems. Furthermore, the airline industry fosters the practices of overbooking and discount seat allocation. Since its introduction in the post deregulation era, yield management practices have continued to develop, and have found their way into other industries, namely the hospitality and car rental industries. In the post 911 era, yield management will continue to, have a significant effect on the airline industry. With increased fuel prices, security costs, and low-cost carrier competition, the industry need yield management more now than ever, as it continues to cut costs and maximize revenue. Modern times require the airline industry to explore new ways to adapt to a rapidly changing landscape, but it is safe to contend that the practice of yield management will continue to benefit this vital industry for years to come

4. Methodology

This research paper is an attempt of conceptual research, based on the secondary data sourced from journals, magazines, articles and media reports. This research design was adopted to have greater accuracy and in-depth research study. Information from different news articles, books and websites sources are used.

5. Theoretical Framework

Airline revenue management has become a largely tactical, yet essential tool in many markets, and sophisticated vendors now provide off-the-shelf revenue management solutions. Now, for most airlines, revenue management is not a competitive

⁴ Aviation sector contributes 0.5% of GDP, Agencies , Agencies : New Delhi, Sun Apr 01 2012, 14:25 hrs

⁵ Donovan, A. W. (2005). Yield Management in the Airline Industry. Journal of Aviation/Aerospace Education & Research, 14(3). Retrieved from <https://commons.erau.edu/jaaer/vol14/iss3/9>

advantage. Instead, the broader airline leadership team or the CEO must clearly define the airline's vision, by which the entire team is guided and must work towards in order create and sustain competitive advantages. No longer can revenue management be a "strategy" on its own. It is definitely not considered a tactic to let revenue management "black box" analytics determine which customers are served independent of a corporate vision, of schedules, sales, loyalty, and customer service. Instead, airline revenue management should in fact be used to implement the defined corporate strategy. On the other hand, revenue management is an important tool for validating the overall airline strategy. Since its principal role is to allocate demand over scarce capacity, revenue management is constantly monitoring demand. The function is in an ideal position to see if the other strategic initiatives are driving demand as expected, and whether it achieves alignment with the airline's corporate priorities.⁶

6. Revenue Management: The Validation Role

Airlines today differentiate themselves on three primary dimensions:

- Schedule
- Product
- Pricing/Ancillary

Revenue management can validate each of these strategic differentiators.

Schedule

Most airlines pursue a schedule strategy that sets them apart from their competitors by focusing on certain markets. American Airlines has the largest schedule in DFW and expects to gain a share premium from Dallas-based passengers. Allegiant Air offers mostly a low-frequency service to smaller, under-served communities. As bookings and competitive fares are monitored, revenue management in these airlines can help evaluate whether these schedule strategies in conjunction with other functions – are in fact driving demand accordingly.

Product

Virgin America and Jet Blue are among the best known U.S. airlines that employ a product strategy to complement their schedule strategy. They both strive to offset the schedule advantages of their much larger competitors with a unique customer experience.

Pricing/ Ancillary

Spirit Airlines and Allegiant Air both have a greater focus on ancillary than other airlines. Allegiant Air positions itself as a "travel company," selling all aspects of travel. Spirit Airline strives to reduce the base fare and use ancillary pricing to gain high total revenue. Revenue management at each of these airlines should see demand consistent with corporate goals as generated by other functions that drive demand (schedules, customer experience, sales, marketing, etc.).

7. Revenue Management: Alignment with Corporate Strategy

In addition to validating corporate strategy, revenue management is a tool for the implementation of the strategy. The function must ensure successful coherence with airline-wide business priorities, and this alignment comes in many forms:

Customer Selection

Revenue management is designed to prioritize passengers based on fares and to give seats to the highest fare. Even if the statistically optimum solution is only a \$1 better than the next alternative, and those \$1s can add up to tremendous value over all the price points on all flights. However, as a strategic tool, revenue management needs to recognize the value of a more robust solution that biases availability to its target market segments, rather than always seeking the additional \$1 from non-targeted (presumably more transitory) market segments. Greater availing for frequent flyers or for corporate customers are examples of strategic initiatives. One airline I worked with specifically rejected the "optimum" revenue management solution in favor of a more explicit focus on local passengers whom it felt were more consistent with their long term corporate plan.

Branding

The last seat on a flight could sell for \$1000 for a desperate passenger. On the other hand, to fill an empty plane, an airline could charge \$19 for incremental passengers. A pure revenue maximization strategy can lead to even more market mayhem than the confusing airline pricing structure does already. Instead, a "full service" airline is reluctant to confuse the market with \$19 fares and the "low fare" carrier is reluctant to try to extract the last dollar out of its customers. Revenue management must operate within the constraints of the brand, and serve to support the airline's brand image in the marketplace.

Market Share

When threatened by a new competitor, or when trying to gain a foothold in a new market, gaining market share may be more important than revenue maximization per the revenue management model. Also, many airlines serve "strategic" routes to maintain a presence in key points of sale, so tactics should conform to strategic objectives.

Ancillary

Pricing and revenue management departments must adopt a "total revenue" perspective as Spirit Airline and Allegiant Air had. Although all airlines need to be pursuing "total revenue management", these two airlines have even greater reliance on ancillary fees. Maximizing revenue from the base fare, as done in most airline revenue management systems would potentially conflict with the overall strategy of the airline.

Cash Flow/Risk Tolerance

Although cash flow is less a strategy than a tactical necessity for some airlines, revenue management must be in sync with the corporate direction on cash. Restricting sales in anticipation of future bookings may not meet the short-term cash needs of the airline. Also, an airline may prefer to prudently position itself for a future economic weakening as

⁶ www.rategain.com/airfare/intelligence, <https://www.iata.org>

opposed to assume the “status quo” in the face of extraordinarily strong market demand. Airline revenue management has become a strategic tool, not an effective strategy on its own. It has key and integrative roles in both validating and implementing corporate strategies with the respective functional departments, both which are critical for effective strategy execution.⁷

Airlines are often held up as the epitome of best practice in pricing and revenue management. The industry has invested heavily in developing sophisticated systems for forecasting demand, managing the availability of inventory, and monitoring and responding to competitors’ prices in the market. This serves them well in the search for competitive advantage and higher yields. But technology no matter how good is only an enabler of a broader strategy. It is an extension of the skills that reside in the flight analysts, pricing teams and commercial executives who must deliver revenue outcomes. While there is no doubt that technology has helped enable pricing and revenue management teams to respond more quickly, it is likely that the value of these historic or planned investments has been, or will be, under-realized. The investment needs first to be in taking a more holistic view of pricing and revenue management, in which airlines step back to consider their commercial strategies and how these translate into the strategies, architecture and operations of the pricing and revenue management functions.⁸

8. Conclusion

The Revenue Management for Aerolineas Argentinas, discusses how the South American-based airline transformed its revenue management and revenue integrity processes using Sabre AirVision Marketing & Planning solutions and experienced double digit grow. Airlines can take advantage of demand management and forecasting, determine overbooking levels, and manage fare values as pricing updates become available. Implemented at over 80 airlines, the core of PROS Passenger RM is proven, proprietary pricing science that provides airlines with the stepping-stones to full offer optimization. Air transport has traditionally experienced higher growth than most other industries. Demand for air transport is closely linked with economic development; at the same time air transport is a driver in an economy. The contribution of air transport and related civil aviation industries to local, regional or national economies includes the output and jobs directly attributable to civil aviation as well as the multiplier or the ripple effect upon other industries throughout the economy.

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