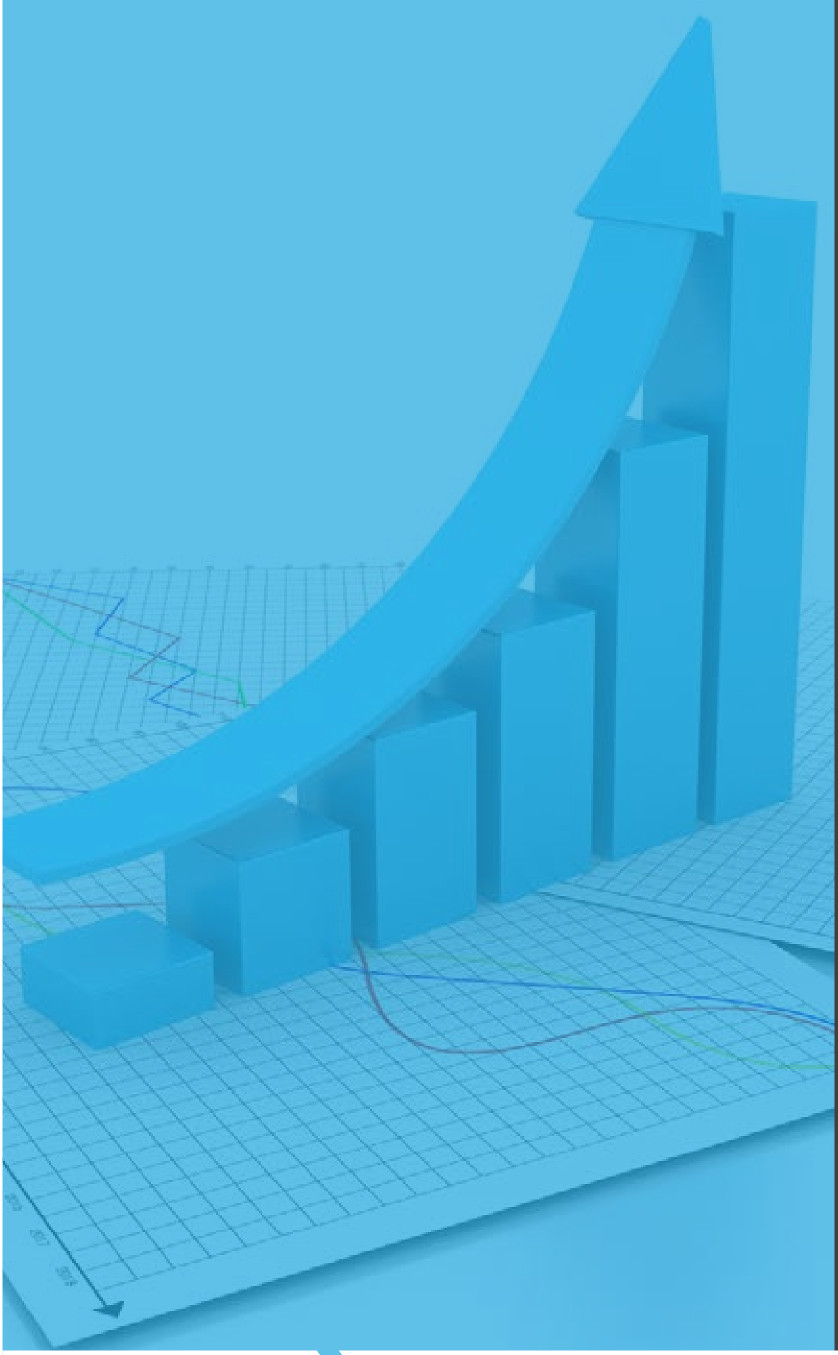
THE KIGO GUIDE TO REVENUE MANAGEMENT



SIMPLE TECNIQUES TO END EMPTY CALENDARS

Our definitive guide on understanding how to make revenue management work for you.

Everything you need to know about Revenue Management for Vacation Rentals and how to use it

How much can you sell a glass of water for? On the street, to a passer-by, probably nothing. In the desert, to a thirst-crazed traveller? Probably anything. Perception and demand for products is constantly shifting. This is the basic principle of revenue management - understanding the right times and the right people to sell your product to. We've compiled a guide to understanding this, and how start using it for your business.

In This Guide

In this guide we will be focusing on:

- Defining revenue management
- Applying it to vacation rentals
- Examining case studies
- Applying the principles to other industries
- Looking out for some of the pitfalls to avoid
- Taking the theories and putting them into practice

What is Revenue Management?

The concept began with American Airlines. After deregulation in 1978 they were suddenly faced with significantly lower-cost competitors. What they chose to do was identify the flights with the biggest competition and saw the amount of seats they were failing to fill. They then collated all this data and used it to provide a set number of competitive prices for seats that would most likely be empty in their current system. These seats were only available if booked in advance. This not only provided revenue where before they would have incurred losses but it also took customers away from their new competitors.

The next to follow suit were the Marriott hotel chain. They used the same principles to create 'Fenced' discounts for rooms.

Rate fences tested or under consideration

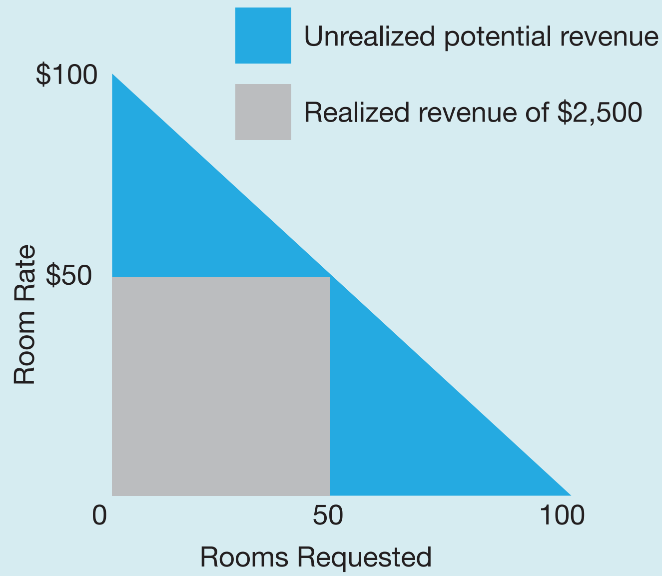
Rule type	Advance requirement	Refundability	Changes allowed	Required time of stay
Advance purchase	3 days	None	None	Weekday
Advance purchase	7 days	Percentage	Change date of stay, but not number of room nights	Weekend
	14 days	Fixed-dollar	Unlimited, no refund	
	21 days	Full	Unlimited	

They used their existing data and then predictions to work out the number rooms they can offer at a lower rate and when to offer them. You can read a detailed report on exactly how they did this here. By doing this, Marriott was adding $150-$200 million in revenue by filling rooms at a lower cost that were going empty anyway.

Richard D. Hank, Robert G. Cross, and R. Paul Noland. " Discounting in the Hotel Industry: A New Approach." Cornell Hotel and Restaurant Administration Quarterly (2002) : 96-97. Online.

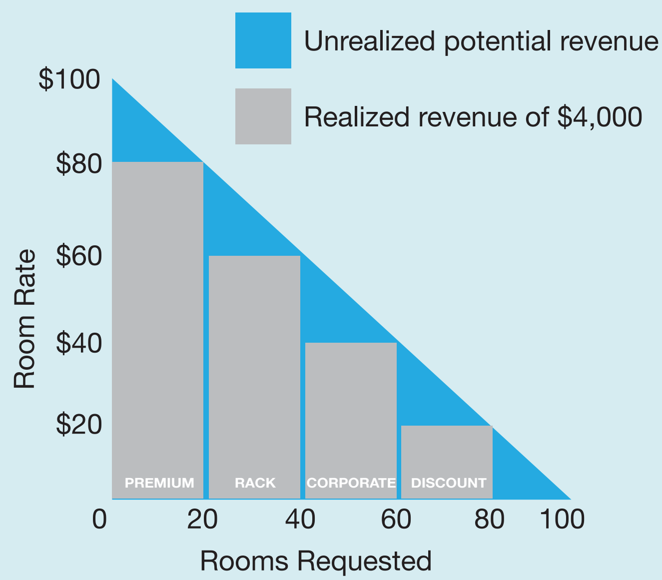
Revenue expectations for a single room rate

When a hotel offers a single room rate, some guests who book a room would have been willing to pay more than $50 (represented by the upper triangle in color). Others are unwilling to pay even $50 and leave rooms unfilled, represented by the lower triangle in color. Together, those triangles represent unrealized potential revenue. The realized revenue of $2,500 is the product of 50 room-nights sold at $50 each.



Revenue expectations for multiple room rates

When a hotel offers several room rates, guests can be differentiated according to their willingness to pay a particular rate. While some guests still cannot be accommodated by the four hypothetical rates shown here, that number (and the unrealized revenue that they represent) is much smaller than in Exhibit 1. The realized revenue of $4,000 is the sum of 20 room-nights sold at $80 each, 20 room-nights sold at $60 each, 20 room-nights sold at $40 each, and 20 room-nights sold at $20 each.



Richard D. Hank, Robert G. Cross, and R. Paul Noland. '' Discounting in the Hotel Industry: A New Approach.'' Cornell Hotel and Restaurant Administration Quarterly (2002) : 96-97. Online.

How can I use Revenue Management?

The great thing is that this is not impenetrable business theory, it is just simple and effective ways to use information to make your business more profitable. You can use the principles of it without great experience or hiring expensive consultants. In fact, you probably use some of the basics already.

Summer is generally the peak season for vacation rentals and price is going to reflect this. This is not rocket science, your product is worth more to more people at this time. What revenue management allows you to see are the other patterns that lie under the surface.

To apply revenue management you need to understand your product. Vacation rentals are:

- ✔ Finite
- ✔ Perishable
- ✔ Variable

You have a fixed amount of rooms or properties available - this is what is meant by 'Finite'. You cannot suddenly find a room even if there is someone willing to pay 10 times your normal rate.

Secondly, shops can reduce prices if products don't sell. Whilst you can do this,

they have a greater time period to hold onto their goods and try new ways to attract customers. And if it doesn't sell, they still have their stock. Vacation rentals don't have this luxury. If you fail to book a night in your property, it slips by empty and cannot be reclaimed. This is what is known as a 'perishable inventory'.

Finally, **different people are willing to pay different amounts at different times** for your properties; they are variable. Business travellers will have set amounts that they can pay but will be more willing to pay the higher price within these parameters. Younger people are generally more focused on price than amenities. Finite, perishable and variable inventory are the three perfect conditions to implement revenue management.

Whilst you may not be able to avoid ever letting a property go empty, you can use revenue management to cut down on these losses. The first step is **Data Collection**. With vacation rentals you are in a great position to use the data that your customers give you. They leave all their details, you can see which portal they booked through and you can store this. A complete Vacation Rental Software will keep lists of this data so not only can you collect information but you will be in the position to use it. Imagine you have a cancellation of a two stay week stay in an expensive property. Using your data you will be able to see which of your customers book last minute stays in properties of a similar price and style. You can then produce relevant and appreciated promotions and offers.

There is a reason big businesses are constantly after people to sign up to lists and websites. This information is useful and they use it to know when people want their product and how much they are willing to spend.

For example, a vacation manager in late August may see that the final two weeks of September are empty in 3 out 5 of their properties. They reduce the price in order to attract more customers but find that they still don't attract any bookings. This could be because vacation rentals need to be booked in advance. Few people will have the time or flexibility to take advantage of an impromptu sale in this industry. But, if they were to collect data, they may see that these two weeks have been empty for the last three years in a row. There is a consistent low demand for this product at this time. Revenue management using a reservation system would allow them to notice this trend and offer a reduced rate earlier in the year. It will also allow them to market it more creatively than just a panic price slash which may have the adverse affect of just making the product seem less desirable overall.

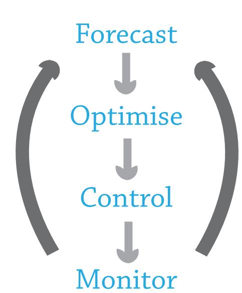
This will also be applicable inversely. If you can see areas that are consistently in demand then you may be able to increase the price. Kigo users use the reporting functions to check the details of their guests and which portals they have come from. Understanding the demographics of the people who are booking your properties is important to know how to pitch your listing and advertising. This information will also be key for your revenue management efforts. **Revenue management is basically the science of using information to understand what your product is worth to different people at different times.**

These principles do not just apply to the timing of your product, but also where you present them. Different customers have different requirements and expectations. Generally speaking, web users are more discerning when it comes to price. You can use A/B Testing to find out the range between portals and demographics. Your data may show you that males, aged 45-54 that saw your product in a magazine advert are the least focused on price. This gives you valuable information when it comes to where to pitch a reduction and where to push your higher value products.

You could use revenue management to find out when you get the most business travellers. Or see the weeks in which your most popular property is most frequently empty. It could be that after analysing your data for months you find that listing one property with a 17% discount, in the last week of March gets an increase in bookings from single business travellers that don't smoke and own a cat. This is an exaggerated example but the point is: You have the choice as to how much data you choose to collect. You then choose how you will analyse it and how you choose to make forecasts with this information. There is no limit to how deep the rabbit hole goes.

After you have begun a system of data collection, and forecasted the upcoming demand, the next step is to optimise your pricing and inventory restrictions. If you have a standard rate of $100 per night for a property, this is your optimum price. If your calendar is booked for 90% of the time during the summer then the value of the night is averagely $90. It therefore does not make sense to offer the rooms at less than this price during the summer. Specifically, if your property is not filled up to your expected 90% occupancy rate, you should not aim to sell nights at less than your $90 average price. Consider your forecasted booking as one guest, booking one property. They contact you and tell you they would like to book your property and are willing to pay the full price, however, they only want the property for 90% of the month. Another guest contacts you and says they would like to book the full month but would only be willing to pay 85% of the standard room rate. The first guest is a more profitable option despite leaving you with unbooked rooms.

If you have reached your forecasted occupancy then it makes sense to consider lower amounts for your remaining unbooked nights. The more data you have collected, the stronger your forecasting will be. This in turn, puts you in the best possible to make the right choices to optimise your available revenue. Whenever your forecasting tells you to expect bookings, aim to bring in the highest price per night available. Your minimum price should be indexed to the probability of booking.



An Amazing Success Story

How do you fill a hotel? How do you fill a hotel three hours drive from the nearest city? How do you fill a hotel three hours drive from the nearest city where they don't serve booze? Seems somewhat difficult, doesn't it?

Complex mathematical revenue management allows this Cherokee casino to fill 586 rooms at a tremendously low rate and still make a profit. They operate by using a card that tracks customers' transactions. The room may be complimentary on the surface but the customer 'Self-Prices' with the amount they gamble. The casino forecasts how many high value customers to expect over a night and keeps lavish suites free for them. It also keeps 100-120 rooms free on Friday nights because it knows to expect that many walk-ins. This can be applied in regards to vacation rentals. For example, not aiming to book your high cost properties early at a discounted rate. If you have the information that your most expensive property was booked only one week prior to arrival 90% of the time then you know that you can keep the regular price for longer. These principles have become ingrained in Air Travel and hotel consumerism so that a lot of people expect a sliding price scale the closer they book to the date they want to rent or travel.

Other Industries

Most hotels use some revenue management in some form or another. The results of increasing occupancy rates and reaching new markets are too lucrative to ignore. Other industries are now realising that these ideas can be applied to their businesses if they understand the basics.

To see how the same ideas can applied across a different industry we are going to do a comparative case study on how an Art Gallery could utilise the core tenants of revenue management. Like hotels and vacation rentals a gallery has a finite inventory. It will have a maximum amount of visitors it can accommodate. In theory, any number of guests below this maximum can be counted as lost revenue. This can be compared to an empty night in a vacation rental property.

Our imagined gallery is a city-based space and currently employs no revenue management systems. They are open Monday to Saturday, 10am-6pm and charge a fixed admission rate of $10. They have no advanced booking system in place.

Similar to the Marriott, the first option for the gallery could be to introduce 'Fenced Discounts'. A standard way to do this would be by age, for example a $5 reduction for those over 65s and under 18. This could also apply to students. These are generally price sensitive groups that may have been put off by the initial price. When considering groups like this it is important to view the discount as $5 gained, rather than $5 lost. You are getting visitors that you may not have had before rather than reducing the price for customers that would purchase anyway.

The next step could be to implement an advanced booking system via the website. This could feature a special 'Advance booking price' of $8. This does two things: it attracts people due to the lower price and the guaranteed entry but it also allows you to collect data on who your customers are. You will be able to see in advance the numbers you can expect per day, including your average numbers of walk-ins. From there you can then see the demographic of the people that preferred to use the booking system. You will also be able to send them appropriate promotions and offers.

Whilst knowing when to cut your price is key, you will also need to know when it is advisable to raise it. This where fenced pricing are less applicable for our gallery. Imagine charging $12 for admission on Wednesdays, or charging men more than women. To be able to raise your price you need to demonstrate that the product or service is better than usual, that you are offering something extra. A gallery owner could do this by segregating a new temporary exhibition that is not part of the usual collection. Then offering the usual rates for the normal entrance and $13 for both parts. By presenting this as time limited the gallery owner also encourages people to opt for the complete tickets by using scarcity. It is a temporary exhibition so take the chance now or miss out. The customer is receiving something extra for their extra initial outlay.

Entrance to gallery differs from a rental in that the customer can choose the length of their stay, and still pay the same amount. This is what is known as implicit time. Whilst this can create good value, it has the effect of making enterance seem overly expensive if it is nearing the end of the day. A special afternoon rate of $6 after 4pm would be a way to entice passing people. It shows the customer that you understand the value of your product has diminished and that your are offering them a fairer rate. Analysing your data of walk-ins after 4pm, before and after the discount would show easily if this method brings in more revenue or not.

As you test and alter these strategies you will be able to see which of these are increasing your revenue most. Also, as you gather more information on the requirements of your customers you will be able to bring in more creative ideas. Imagine the gallery notices they receive most advance bookings for times when the gallery is otherwise quiet. The owner could opt to open earlier on a set morning each month and sell a limited amount of higher cost tickets. This not only gives the customer the quiet experience they wanted but it has an air of exclusivity and creates revenue in the previously ‘dead’ time. If this was to prove popular there would be scope for expert guides or evening events. By understanding the varying wants of your guests or customers you can not only generate more revenue but also provide a better product or service. Good revenue managers understand the basic principle that what is good for the customer, is good for the business.

Myths and Fallacies of Revenue Management

Revenue management only works when demand outstrips capacity

Applying the basic principles regarding price structure and inventory restrictions in times of low demand is still effective. Well applied revenue management will help to generate demand as well as increasing profitability. Knowing you are entering a period of low demand means you can be confident you are not wasting potential revenue by offering promotions when people would be more willing to pay the standard price. It also lets you know the best times to try things to add value to your property.

Revenue Management requires an automated system

Whilst with big business, the sheer amount of data being collected and analysed will require an automated system. For vacation rentals getting started is simple. The first step is always to collect data. Booking statistics, customer information and your rate information can all be collected in a simple document. Forecasting does not have to rely on complicated algorithms and programs. You can look over previous years and get a sense of what to expect just from reading this data.

Revenue Management is only suitable for large businesses

This is not the case, successfully applied revenue management techniques can work with businesses with only one property. Unless your property, is fully booked, at your maximum rate all your round then you can use revenue management. One property will still have the opportunity to make the most of every potential night. You can still work out the times when your property is likely to be in demand and when it is more likely to be empty to develop a competitive strategy.

Strategy and Tactics

The differences between the two. Strategy is the longer term goal of your revenue management strategy. Whether this is to fill up your calendars or just increase the revenue from your properties, your strategy is the ultimate aim of your revenue management. You should keep this in mind when implementing any procedures as there can be numerous outcomes from revenue management. You need to keep this objective at the forefront of all of your revenue management tactics.

The tactics are the direct actions you take to achieve this goal. These could include creating ring-fenced discounts, offering promotions or choosing which demographic to target. A good strategy contains numerous tactics.

Problems with Revenue Management

These practices may sound logical but revenue management can prove to be difficult to implement effectively. There are many things to consider that you may never be able to even measure. Could you harm your brand by changing your price structure?

If a customer sees that your price varies at different times and on different portals it may have the effect of creating confusion and doubt.

Is this even ethical? A tenant of revenue management is to group your customers into categories divided by what they will pay for your product. Airlines know that business travellers, needing to fly the same week will be in a position to pay more than a leisure traveller booking in advance. Is it right that some people end up paying more for essentially the same product or service because the company knows that they can? Would we consider it ethical if a cafe were to raise its prices every time it rained?

All of this points to an important consideration for revenue management - that it should be transparent and clear. Customers will appreciate knowing in advance what your prices are. Chopping and changing at the last minute will reduce the trust from the customer. If you appear unsure about your pricing, how will your customers feel sure that the price they are paying is what the product is worth.

Good revenue management is about making your product appealing to different sectors of the market that you may not have reached before. It is not an opportunity to squeeze last minute revenue from your current customers. There is also an argument that reducing the cost of your property can have the effect of reducing the perceived value, and in turn the actual value of it. If you engage in the strategy of not letting any potential customer walk away - slashing your prices to ensure booked nights - you may see negative effects. Whilst it may seem advisable to rent a night for any price rather than letting it go empty, consider the costs and work you will have to complete. Consider the effect on your brand and the perception of your product. Booking vacation rentals is about setting a price that offers value, meets demand and generates profit. Revenue management is the theory behind understanding that this is a changeable price. The practice of forecasting is knowing when it will change and having concrete data on the best price to set to still ensure you are making profit.

From Theory to Practice

Remember to trust your results over the data. Results may vary from what you expect, but as you continue to use these ideas, your previous results will become part of your data. You will be able to see where revenue management has given you the biggest growth and also the areas where it is not working. You can then make tweaks and modifications to your system.

We hope this has given you an insight into this practice. Click the links to find out more or read case studies of success stories. To implement revenue management effectively, you will need a sophisticated system to collect your data and manage your different properties, rates and portals. If you want to see how Kigo can help you collect the information to use revenue management effectively request a demo today.

References

Discounting in the Hotel Industry - A New Approach

The “Killer Application” of Revenue Management: Harrah’s Cherokee Casino & Hotel

Revenue Management

Revenue Management Applications In Untraditional Industries

Effective Revenue Management in the Hospitality Industry

Revenue Management Challenges for 2013 A Top-Five List

Revenue Management - Second Edition

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