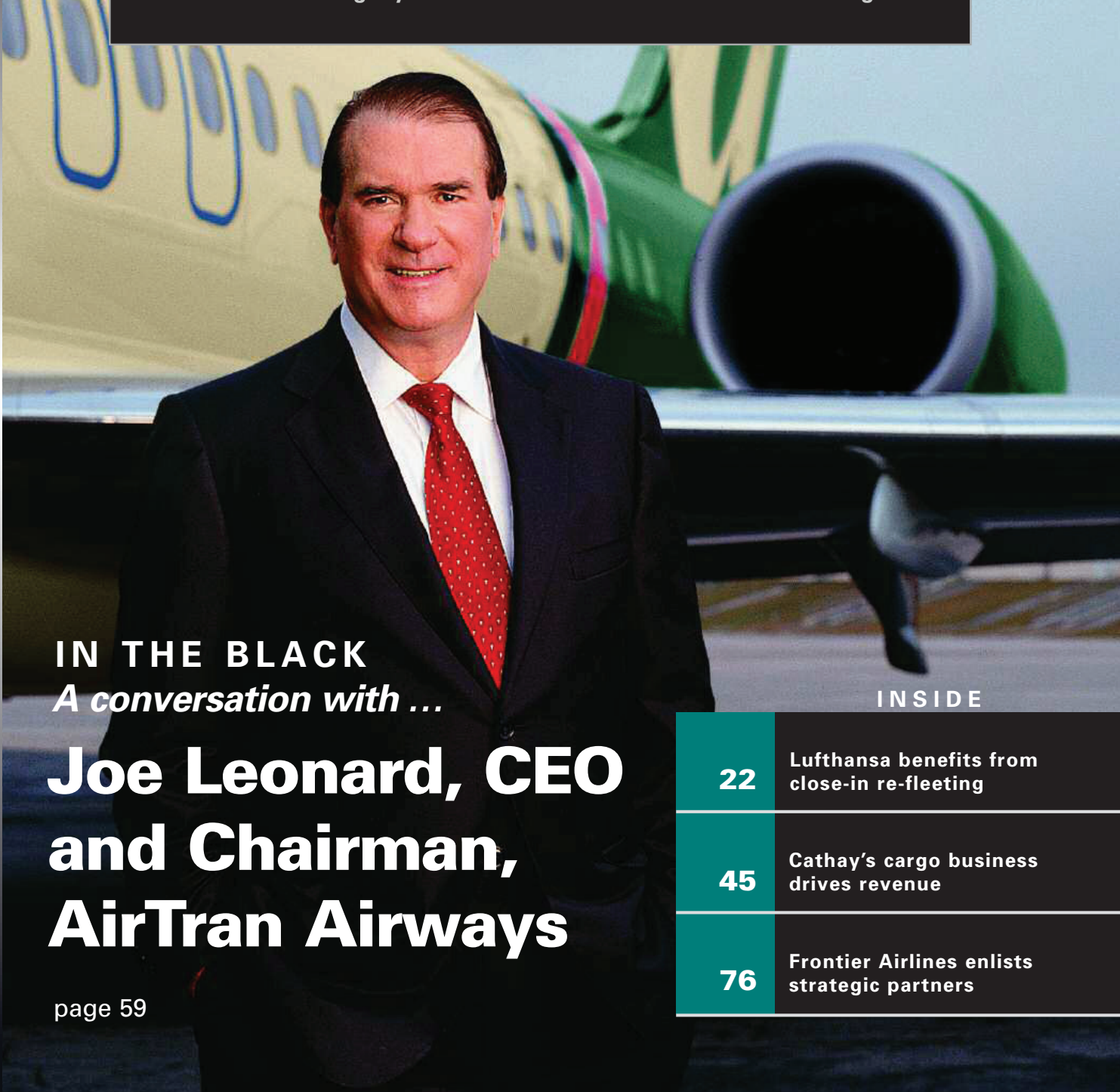


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Taking your airline to new heights



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Unleashing Revenue Management

Although the practice of revenue management has been around for several years, there are still opportunities to further refine the process.

■ By Luc Lachoux | *Ascend* Contributor

Since its development in the 1980s, revenue management has helped airlines maximize yields by optimizing the revenue generated by each seat they offer for sale. Although most airlines realize the financial benefits of the practice, many have not yet taken full advantage of revenue management by implementing business processes that help integrate it with other operational areas.

Because revenue management lies at the core of an airline's ability to make money, it must interact with several key departments across the operation to be as effective as possible. Most commercial and operational areas affect, or are affected by, revenue management decisions and policies. Failing to fully integrate with other departments could lead to different degrees of involvement with or influence on revenue management, which could adversely impact its ability to successfully perform its duty and may even prevent an airline from reaching its anticipated returns.

Interactions with Revenue Management

The revenue management department is at the confluence of multiple key areas that depend on it for access to critical information or data such as inventory. Similarly, revenue management requires information from many departments to make correct decisions. Several areas must interact closely with revenue management, including:

■ Pricing, which identifies the price levels to be offered and, therefore, represents the foundation of revenue management. Competitive pricing information must be communicated to revenue management along with analysis concerning class utilization and fare-structure performance. Revenue management should report back

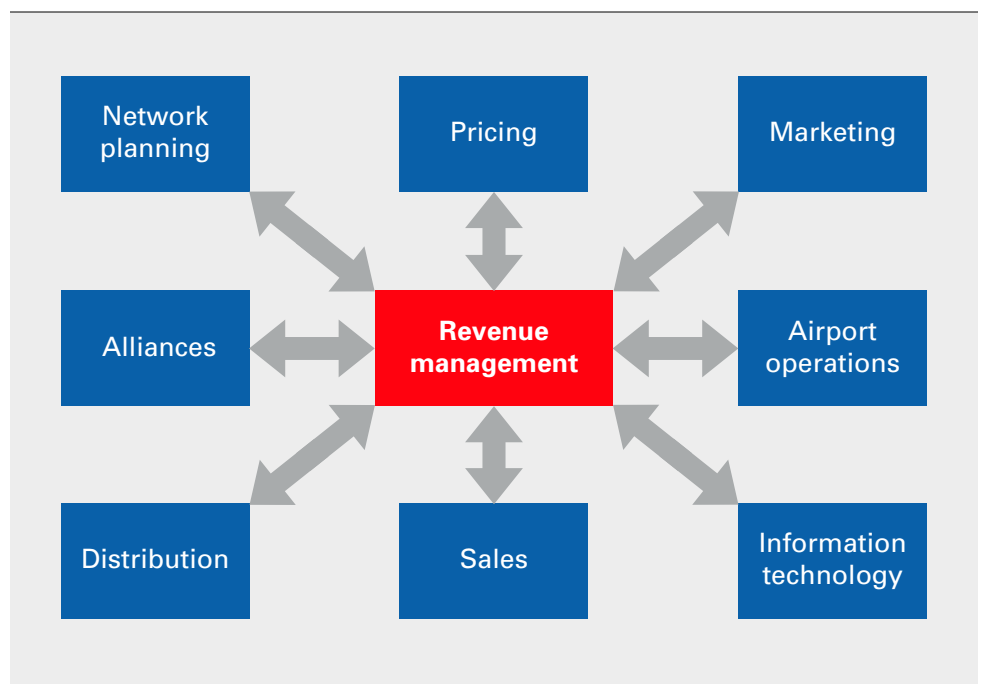
on performance and requirements. Both areas should develop and implement price levels that are competitive and support commercial objectives.

■ Network planning and management, which should interact with revenue management to identify traffic flows and network performance. By providing insight on demand fluctuation and monitoring market changes, revenue management can help network planning more accurately perform its role. Network planning makes assumptions regarding demand, which can be confirmed

or refuted by revenue management data. Capacity requirements or constraints should be shared between the two groups to optimize the schedule.

■ Distribution, which allows coverage of the target market as well as market segmentation. For example, by working in conjunction with revenue management, distribution may support strategies of price differentiation or the ability to stimulate incremental traffic with lower fares without jeopardizing higher revenue from other passengers.

Operational Interaction



Revenue management is part of a complex system of critical corporate functions that interacts with many commercial and operational areas within an airline.

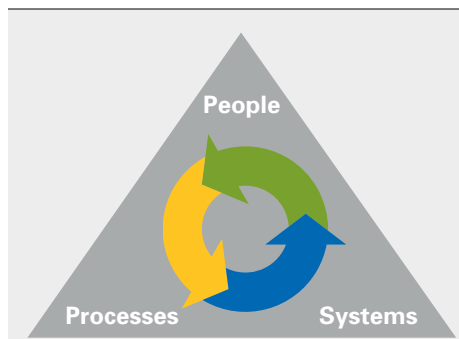


- Sales, which should work with revenue management to ensure it reaches the client base, including individual passengers, corporations or special markets. Sales also should provide revenue management with valuable market and competitive information obtained through its unique position among the airline's distribution partners such as tour operators and travel agencies, and sales must carefully coordinate its objectives and strategies with revenue management. Failing to do so and to understand each others' goals leads to great difficulties in ensuring revenue optimization.
- Airport staff and operations, which are at the forefront of oversold flights. While they must handle the outcome of inaccurate decisions such as dealing with passengers who are denied boarding, they also significantly contribute to data integrity by ensuring that operational/flight close-out statistics are perfectly accurate and provide qualitative information to revenue management when interpreting demand fluctuations. Accurate and relevant operations data is essential to proper demand and show-up rate forecasting by revenue management. Airports and operations play an important role by complying with proper procedures and notifying revenue management of irregular operations that may skew data. Communication is therefore very important and is more effective when formal processes are in place to facilitate it.
- Alliance management, which must also coordinate its activities with revenue management so the two groups can understand each others' areas of intervention to achieve maximum benefits. Alliances represent the opportunity for more than one airline to derive commercial and operational synergy from their partnership by allowing partners to sell seats on each others' flights. Because revenue management oversees its airline's inventory, the revenue management strategy should reflect the overall alliance strategy.
- Information technology, which provides sophisticated systems used by revenue management in its daily tasks. Sound revenue management practices should involve the integration of all systems and the adaptation of business processes.
- Revenue accounting, which processes all revenue and passenger information by accounting for all lifted ticket coupons. The revenue accounting relationship with revenue management provides data necessary

to analyze key performance indicators. By providing detailed information about the sales of each ticket, revenue accounting also enables compliance monitoring and revenue integrity. Additionally, fare rules and conditions are used to prevent revenue dilution and segment markets. Revenue integrity and compliance are therefore a significant contributor to revenue.

- Marketing, which identifies opportunities to reach all or certain potential customers. Revenue management can assist marketing in identifying target market opportunities because of its close monitoring of demand, future bookings and flight performance. For example, if a promotion involves seat inventories, revenue management will ensure access to specific inventory.

Revenue Management Aspects



Three main aspects of high-performance revenue management includes knowledgeable people, advanced technology and sound business processes.

The Role of Revenue Management

Revenue management relies on historical performance to forecast demand at various price levels. It then allocates future seat inventories to optimize expected revenue. When successful, a key accomplishment is the ability to sell a unique product (the seats of a single flight or different flights in a single market) to customers who may be willing to pay different prices for it. Even with today's trend toward simplified pricing and lower number of fare buckets, the relationship between demand and price still exists.

Traditional airline pricing has generally relied on fare rules and conditions to segment markets. A tradeoff was established between price and ticket flexibility, and the cheaper the ticket, the most restrictive it would generally be with conditions such as refundability, abili-

ty to make changes, length of stay or advance purchase. The trend of simplified pricing structures that are easier to understand for consumers decrease the ranges between lowest and highest fares. Discounted one-way fares are often available, and discount prices no longer mean extremely restrictive conditions. Traditional fare rules help control revenue dilution by forcing fare up sell when certain criteria are not met. Relaxing terms and conditions on most fares results in significant pressure on the revenue management team since inventory levers are the only way to ensure that the price charged reflects the demand at all points during the booking life of a flight. Strong interface with pricing is necessary as well as systematic processes to ensure that revenue opportunities are captured.

Revenue management analysts must continuously manage several risks, including:

- Selling a seat at a price below the airline's optimum rate (revenue dilution),
- Setting the price higher than what passengers are willing to pay, resulting in empty seats (low-revenue spill),
- Overestimating or underestimating the demand in the low- or high-price ranges, leading to high revenue dilution and low-revenue spill.

Additionally, revenue management compiles and analyzes the show-up rate to accurately oversell flights. Seats that would have otherwise remained empty as a result of passengers not showing up for their confirmed flights may then be sold, improving the total revenue.

The role of revenue management is a continuous process of price setting for future flights. The optimal selling price constantly changes as reservations are made, demand materializes and the market conditions evolve. Revenue management effectively implements these price decisions by opening or closing inventory at various values. Revenue management must therefore continually assess the inventory and price positions of all future flights to ensure optimal total revenue.

Revenue management decisions are often made by sophisticated decision-support systems. Analysts must ensure those systems use accurate data or otherwise face the risk of implementing sub-optimal inventory. Additionally, the systems must be monitored and sometimes influenced to reflect recent market evolution that is not yet reflected in the historical data and to ensure that they accurately and appropriately account for all relevant elements.

Implications for Revenue Management

The complicated nature of revenue management is two fold. On one hand, it reflects the high level of complexity residing within the very nature of the discipline. On the other hand, it illustrates that a lack of coordinated approach between revenue management and most other areas within an airline will most likely contribute to fully or partly derailing the effort, which will yield sub-optimal results.

Sound revenue management practices represent a fascinating challenge because of the multitude of factors involved. High performance revenue management organizations, however, rely on two key elements:

- Comprehensive business processes that determine revenue management decisions,
- Systematic performance measures.

“Sound revenue management practices represent a fascinating challenge because of the multitude of factors involved.”

Business Processes

Business processes — detailed instructions defining the steps required to accomplish certain tasks or activities; required inputs, methodologies and requirements; and expected outcomes — should have a well understood purpose and be integrated as part of the work flow. They also represent the foundation for the role of revenue management.

Business processes should be comprehensive, exhaustive and explicit, and should also provide details of revenue management’s interaction with all other relevant areas. Business processes should describe the entire chain of activities required from revenue management, the dependencies to and from other departments (for example pricing), and the input and output of information required. The nature of the relationship, the level of authority of each area, and the inputs and outputs of the relationship should be clearly defined and shared with all involved areas.

Very specific business processes

ensure that revenue management activities fully capture and address all the elements that make its environment highly complex. Lack of effective revenue management business processes, or of their enforcement, results in sub-optimal performance. Other area’s objectives may then supersede those of revenue management, particularly if department strategies and goals are not well coordinated. For example, business processes should facilitate the systematic revenue impact evaluation of special inventory requests, such as groups. A clear business process describing how to estimate the potential revenue displacement and what data to use, when to perform the calculation, and how to handle the outcome, will ensure the revenue opportunities are captured, and the revenue risks are minimized.

A common observation when assessing the performance of a revenue management department is that while certain activities may be performed very skillfully, others are often overlooked. Day-to-day inventory management, for example, may be performed adequately while strategy formulation and measuring against it may be neglected, leading to potentially repeating unidentified errors of the past. Clearly defined business processes should ensure that the full life cycle of revenue management is addressed and that all roles and responsibilities are explicitly established along with expected timelines. The heavy workload many times results in skipping certain elements such as measuring performance that are of significant importance. Business processes should therefore cover all activities, roles and responsibilities of the revenue management cycle, including:

- Formulating the revenue management strategy — Business processes should indicate when the inventory strategy should be formulated and reviewed, what elements should be included, what data should be calculated, how its success will be measured, who should participate, and which other departments should provide information.
- Forecasting the demand — Business processes should describe the activities required to ensure the integrity of the data entered into the revenue management systems as well as the actions that must be taken to ensure that the a high-quality forecast is generated and that it is validated throughout time.
- Implementing inventory management levers — These levers depend on the revenue management system that an airline

uses and represents different ways seat allocations are made to reflect the demand.

- Monitoring ongoing results — Business processes should specify timelines for ongoing results monitoring as well as the data to be monitored. The goal is to identify gaps between demand forecasting and materializing results to determine revenue opportunities early enough to capitalize on them.
- Measuring post-departure results — Calculation of the revenue management key performance indicators such as spill, stifle, spoilage and denied boarding represent a very systematic and rigorous activity, and the business process should focus on taking actions based on these results.

Performance Measures

Revenue management is a quantitative discipline that, because it relies on statistical models and logic as well as commercial experience, can be measured. Different indicators help identify fluctuation of market demand (disconnect between forecast and results) but also fully reflect the ability to optimize the levers available, which enable effective measurement of revenue management.

Revenue management performance measures must reflect the ability to forecast high and low revenue demand and to adjust inventory to demand fluctuations. These measures are based on class allocations, availability, demand and final passenger counts in each class at various points during the booking life of flights. They are generally known as high-yield spill and low-yield spill, or stifling, and they are the basis of revenue management actions that help achieve maximum revenue. Other measures such as denied boarding and spoilage should gauge the ability to predict show-up rates. Additional measures may include more elaborate models that reflect the success in taking advantage of revenue opportunities.

Measuring performance on an ad hoc basis allows some assessment of the level of success. Systematic measures, however, provide the unique opportunity to incorporate the most recent observations into the decision process. From a more passive role, performance measures become an active contribution to the improvement of performance. Revenue management departments generally provide the airline’s measure of commercial performance, such as revenue, load factor and revenue per available seat mile/kilometer. Those measures, however, reflect the collec-



tive performance of the airline but do not isolate revenue management activities. In addition to the more general commercial performance, calculation of spill, stifle and spoilage reflects revenue management's ability to perform within its scope, forecasting demand and managing inventory to generate maximum total revenue. Timely and systematic use of these measures yields significantly better results than reviewing them on an ad hoc basis because booking trends can be identified as they occur and actions taken while the opportunities still exist.

Failing to measure performance is comparable to driving a vehicle while being blindfolded. The direction is uncertain, and the consequences very costly.

To provide the most benefits, performance measures should be part of the business processes. Measures then become part of the decision process but also of quality control. They also help identify training and development opportunities.

Making it Work

Because of its importance, airlines devote tremendous amounts of resources, both human and technological, to revenue management, which is at the core of an airline's commercial function. It ties together areas throughout the organization in a single discipline that relies on a scientific approach and on the quality of information.

The large investments required to operate a state-of-the-art revenue management department should justify taking exceptional steps to ensure its success. Ensuring that all required activities and tasks are performed and that all related areas within the airline support this corporate initiative should be a priority.

Designing, implementing and monitoring compliance for comprehensive business processes addressing all aspects of revenue management and all roles of the organization is the first requirement for a successful return. Performance measures imbedded in these business processes are the next required elements that will significantly increase likelihood of success. **E**

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Stop the Leak

By more closely coordinating their departments, airlines can recover substantial amounts of revenue lost each year to leakage.

■ By Lauren Lovelady | *Ascend Staff*

The events of recent years have dictated that airlines worldwide focus on cutting costs to survive. Perhaps now is the time to give more attention to another factor equally important to an airline's success — preserving revenue.

The importance of actually flying a schedule that generates expected revenues cannot be overstated. But what if this doesn't happen? Instead of automatically looking for ways to cut costs, airlines should look for ways to guard against revenue leakage — the inadvertent loss of revenue — in all areas of their operation.

Imagine a schedule moving through an airline's various departments as oil flowing through a pipeline. If there is even a small leak between each segment of the pipeline, at the end there will be significantly less oil than at the beginning, and it will be worth considerably less. The same principle applies to an airline's product. Although each department may handle its schedule-related tasks proficiently, a lack of coordinated technology, processes and communication will ensure a less-than-smooth transition from one area to the next and weaken the product and its ability to generate expected revenues.

Sources and Solutions

Identifying the sources of revenue leaks and implementing solutions to minimize them is certainly a challenge, but it can translate into millions of dollars in annual revenue for an airline. It's an opportunity to strengthen the business and squeeze more revenue from existing assets.

“... lack of coordinated technology, processes and communication will ensure a less-than-smooth transition from one area to the next and weaken the product and its ability to generate expected revenues.”

Some of the most common sources of revenue leaks and methods for reducing their impact include:

- Lack of coordination between schedule planning, pricing and revenue management — Schedule planning creates the optimal schedule based on an origin and destination strategy and passes it to pricing and revenue management. Using their own systems and data, which are often leg-based, pricing and revenue management assign pricing and yield controls without knowledge of schedule planning's O&D strategy.

Airlines can resolve this issue by implementing processes and software in these areas that share the same data and interpret it the same way as well as establishing regularly scheduled meetings with representatives from scheduling, pricing and revenue