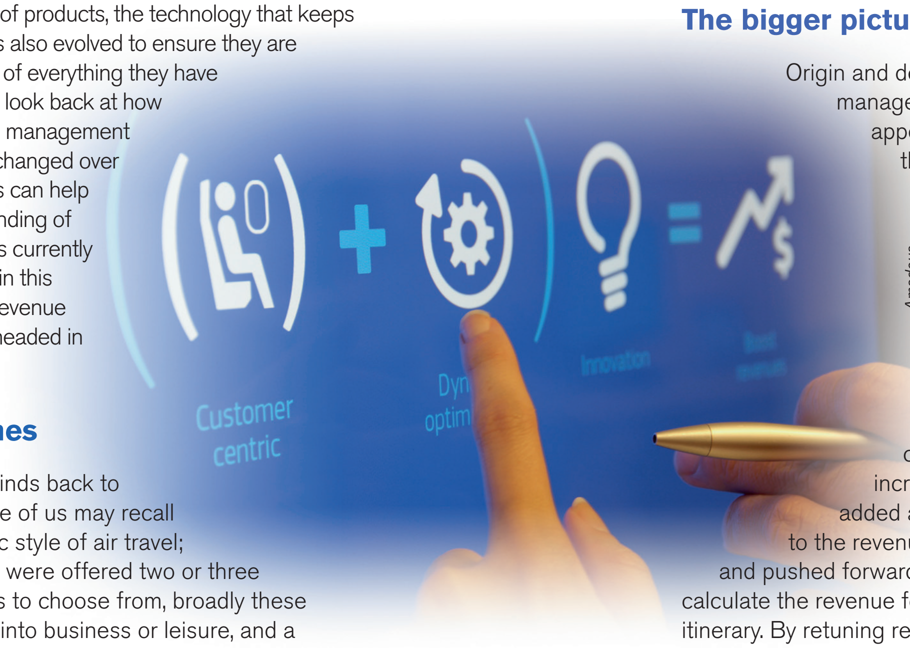
The price is flight

TOBIAS JÖNSSON, VP, Scandinavian Airlines System, looks at the evolution of airline revenue management.

Revenue management has been an instrumental process for airlines for many years, but during the past few decades it has also been in a state of flux. This is due, in part, to the enormous changes that have taken place for almost all airline processes, but also to the creation of the Internet and the rise of the low-cost carrier.

As airlines have had to adjust themselves to a broader and more competitive marketplace and offer growing number of products, the technology that keeps them running has also evolved to ensure they are making the most of everything they have on offer. Taking a look back at how and why revenue management processes have changed over the past 40 years can help give an understanding of what innovation is currently taking place within this field and where revenue management is headed in the future.



Amadeus

Simpler times

If we turn our minds back to the 1970s, some of us may recall a more simplistic style of air travel; where travellers were offered two or three different classes to choose from, broadly these were sectioned into business or leisure, and a rigid fenced fare structure was in place. Airlines were most concerned with filling up the plane or dealing with overbooking, and revenue management techniques allowed this to be done in the most profitable way.

It was not until the 1980s that technology had advanced enough to allow airlines to begin forecasting certain journey legs. Fare classes were split up even further, creating more complexity and allowing airlines to create a more refined customer segmentation with the hope of maximising revenues. SAS were somewhat ahead of the curve and by this time had created its own revenue management system. For most airlines, it was through this yield management approach that they benefited from an average increase in revenue of circa 5% and the value of effective revenue management was well recognised. Despite this, airlines still did not have a complete view of the traveller journey from a traveller's origin to his or her destination. Rather, the focus was on understanding the revenue impact of each leg. The effect of travellers whose journeys included multiple flights and stopovers was still not taken into account in revenue management systems.

The bigger picture

Origin and destination (O&D) revenue management practices first appeared for some airlines in the 1990s; carriers such as SAS and American Airlines aimed to optimise their entire network, not simply managing revenue on a leg-by-leg basis. This era also saw the arrival of new passenger trends, such as more travellers booking their own flights, coupled with a further increase in booking classes. This added an extra layer of complexity to the revenue management process and pushed forward the need for airlines to calculate the revenue for their passengers' whole itinerary. By retuning revenue management to allow for O&D optimisation, the focus of an organisation can be shaped to match its customers' habits and preferences, something that SAS has been aiming towards for many years and had pioneered during this time.

However, while this new O&D focus has had a major impact on revenue management, it was not until the Internet transformed how airlines distributed their products in the early 2000s that the field really changed for good. Online travel agencies fast became a key distribution channel for airlines and upped the ante in an already competitive sector. Low-cost carriers (LCCs), leveraging the Internet as a distribution channel, grew massively in popularity with their simplified products attracting a new demographic of traveller. This was of particular relevance to SAS, as short-haul flights are a necessary part of the infrastructure in the Scandinavian region and ~70% of SAS revenue was directly exposed to LCC competitors.

The rise of LCCs pushed many airlines to split off products such as meals, extra baggage and extra legroom into separate ancillary services, creating a minefield for revenue management — where not just flight tickets had to be optimised but a whole new raft of variables was introduced. As a result, new simplified fare structures were rolled out by many airlines which could manage one-way tickets, as well as round trips, as a means of competing against LCCs with a clear product offer.

Many airlines realised the revenue management systems that were still in place from the 1980s and '90s were simply not designed for this new simplistic fare structure, or the new demographic of highly price-sensitive travellers, and many saw dramatic reductions in revenue as a result. Some airlines actually decided to turn off their revenue management systems to combat the 'spiral-down' pricing effect that had emerged, as in certain cases they did more harm than good. Clearly, this was not a long-term solution. The airline industry saw millions invested and sadly wasted as it became apparent the systems would need to be entirely redesigned to cope with these new fare structures, which required revenue management systems to calculate a traveller's willingness to pay.

SAS had one of the most advanced and experienced revenue management teams but needed a technology provider to partner with to create a future-proofed revenue management system that would have enhanced usability, as the current system had grown too complex.

Innovation in today's environment

The introduction of 'fare families', a process that helps airlines package booking classes, fares and services into branded products, has allowed airlines to react to travellers' demands for travel products that are simpler and easier to purchase, as most ticket sales are now done by the consumer themselves, not by a professional travel agent. It has also caused a shift of focus for revenue management teams, as they focus their efforts on creating a system that can estimate the willingness to pay and optimise each fare family.

Revenue management has now firmly cemented itself into airlines' infrastructure as a tool that is critical for structure and evolution of the airline, rather than simply used for overbooking. Now, airlines have the ability to input their business knowledge, meaning revenue management can be used to steer the commercial and business objectives of an airline. This means new recruits to a revenue management team are now chosen for not only their prowess within data analytics but also their business knowledge.

SAS

Airline revenue management systems had to be revised to cope with competition from low-cost carriers.

Customer centric revenue

With so much innovation having already taken place, what does the future hold for airline revenue management? Moving forward from just understanding a traveller's willingness to pay; airlines need to determine the optimum price point, for the best product offer, for each traveller and present this as a real-time offer to the customer. This is certainly the direction of the combined thinking of SAS and Amadeus. In 2013, SAS entered into partnership with Amadeus in order to build this solution and leveraged the ability of our revenue management team that has brought us this far, with the creation of the Amadeus Revenue Management Competency Centre. The centre set up in order to work on new revenue management solutions and has paved the way for future innovation that will help shape the next-generation of revenue generating products and services for Amadeus' airline customers.

This unfixed, dynamic pricing approach we mention will rely on airlines harnessing increasing external data sources for example, macroeconomic or weather data, could help to refine pricing decisions. They will also need to understand the variations of habits within traveller segments, particularly as passengers expect increasingly individualised offers and airlines offer a greater variety of routes thanks to interline partnerships.

Other factors, such as customer loyalty, complicate dynamic pricing but will also have to be built into the systems of the future. This will ensure that airlines are rewarding high-value customers appropriately with a clear understanding of what loyalty is worth to their business. It is this, and effectively incorporating ancillary services into revenue management, that is something that SAS and Amadeus are working towards for the future.

Advances in revenue management practices such as these will allow the network carriers to differentiate themselves and, in fact, now lead the way for LCCs in terms of taking revenue management to the next level and delivering truly instrumental commercial value for an airline.

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