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Have you flown off course
with your approach to
revenue management?

Opportunities for the
airline and transport sectors





Preface



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, for managing the availability of inventory and monitoring and responding to competitors' prices in the market in the search for competitive advantage and higher yields.

For example, Amadeus, British Airways and Qantas Airways jointly invested in the bespoke “BABS” system to develop what is today the Amadeus ALTEA suite of products, delivering technology to assist airlines with everything from selling their fares through to revenue optimisation and day of operations flight management.

Other technology providers include PROS, Navitaire’s “Open Skies” offering and many others that have benefited from new thinking and ongoing investment and development in this pursuit of revenue optimisation in airline and other industries.

But technology – no matter how good – is only an enabler of a broader strategy and an extension of the skills that reside in the flight analysts, Pricing teams and commercial executives that must deliver revenue outcomes.



Airline executives often ask about impending investment decisions in pricing and revenue management systems.

- What are the benefits of vendor offering over vendor?
- What have others experienced with different vendors?
- How can I build a “revenue”-based business case to support an investment in new technology in such a cost focused environment?
- To what degree are we prepared, as an organisation, for the necessary changes in skills base, approach and practice that these systems demand?

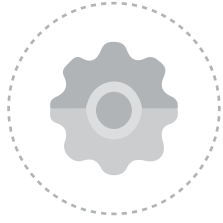
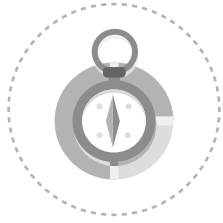
While there is no doubt that technology has helped enable pricing and revenue management teams to respond more quickly. It is likely that the value of these historic or planned investments has been, or will be, under-realised. The investment needs first to be in taking a more holistic view of pricing 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.

While this article is focused on airlines, many aspects are directly relevant to any pricing environment, and the pillars below worthy of consideration for pricing and revenue management executives in any industry.

What is our heading, captain?

There is a single question that an airline needs to be able to answer when thinking about its pricing and revenue management function:

What is the airline's overarching commercial strategy and how does this frame the actions required to sustain and/or improve revenue and yields?



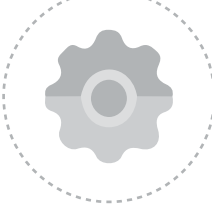







Pillar #1



Does your organisation have an explicit commercial strategy that can be translated into clear and meaningful actions for pricing and revenue management?



It is important to provide a commercial frame within which Pricing & Revenue Management can set its own strategy and guide its day-to-day activities. To be relevant and aligned to the airline's overall goals, it is important to set this within an understanding of the commercial objectives of the airline in terms of brand positioning, market positioning and the airline's business model. This informs where the airline will place itself in a "steady state" environment.

For example, if an airline aims to be a premium carrier, and is investing in superior product (seating, configuration, IFE, etc.) and service with the associated costs, then it should be pricing accordingly to secure an appropriate yield premium and be seeking to be a price leader on those routes where this service is provided.

In practice, this is extremely challenging on existing routes, and is generally not achievable while a new route is being started as it takes time to build capacity, frequency and load over the first few seasons and there are always tactical challenges to be addressed. However, once the carrier becomes established on a route with a

competitive frequency and service then this should be the broad frame of reference.

For each major group of routes and each specific route, an airline should have a route strategy that aligns with its broad commercial objectives: relevant to that set of routes and each specific route – guiding its fleet deployment and capacity, fleet planning, market positioning and competitive offerings.

In these early stages of developing a route, it is important to understand that the airline will generally pay above the odds in commissions and distribution costs relative to the leaders on the route, as it will not have the Point of Sale (POS) presence and branding to create demand at the customer level. For example, if the route is new and the airline has limited services (perhaps due to limited rights or available aircraft), then the objective in the first few seasons may be simply to gain market share so as to get acceptable cash-flow on the routes and to "showcase" the airline's services, while it builds capacity and frequency to a level that is optimum on the route.



Pillar #1 (cont.)



Fundamentally, however, it is important to keep in mind which segment of the market the service on the route is targeted at. For example, if the service is targeted at the Indian sub-continent as a labour market provider to the Middle East then positioning for a price premium may not be the best path; a better goal may be one of volume/market share. This may have knock-on implications for configuration of the aircraft deployed and the frequency of service. By contrast, if the route is focused on a high-yielding leisure and business markets then the strategy may be to have a 3-4 class configuration. In that case, positioning for a yield premium will be important, given all the associated cost implications for the schedule, frequency, configuration, inflight service, etc.

This interdependence of commercial strategy with the physical fleet highlights the challenge for airline executives. Airlines constantly have to make difficult trade-offs regarding the route and market choices and the implications for fleet complexity in aircraft type and configuration. In the absence of a clear



commercial strategy that can act as a “true north”, airlines are inevitably – and sometimes, in extreme cases, haphazardly – drawn into the vortex of building fleet complexity and associated cost in their businesses, thus eroding profitability.

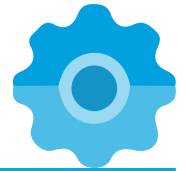
Naturally, route plans must be reviewed and adjusted seasonally or when there is a major discontinuity, such as entry of a major new competitor or a fundamental shift in a POS market. This ensures that the plans remain relevant, and that they translate the broad commercial objectives for the airline into meaningful actions for Route Managers to take.

So, the questions are:



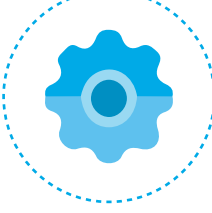
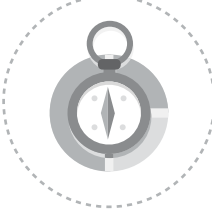


- Does your airline have coherent strategies for each region it serves (developed in conjunction with Sales and Corporate) and anchored in the airline’s broader commercial strategies?
- Can these plans cascade into meaningful and integrated strategies for the Revenue-optimisation, Scheduling, Fleet-Planning and Sales functions?



Pillar #2



Do the processes that underpin your pricing, inventory management and demand forecasting enable revenue organisation?



Revenue optimisation requires optimisation across three levers: price, capacity and demand. Pricing needs to work closely with Sales to understand competitor pricing at the route and POS level. Scheduling needs to work with both Pricing and Sales to adjust capacity, either reducing or increasing capacity to optimise yields and revenue with regard to the strategy for each route/route group. An additional overlay is that airline loyalty programs need to have input into this dialogue to ensure that an appropriate number of seats are being made available for redemption purposes to underpin the value proposition of the loyalty program and meet any regulatory requirements.

Many of these decisions are necessarily made a long time in advance. To make this work in practice, there needs to be a continual direct, and managed, interaction between these functional areas to agree the steps to be taken in the near and longer term to deliver on the route group and route strategies. Some airlines adopt the approach of regular meetings or calls involving representatives from each functional area. Most airlines today are using business intelligence tools to help focus

discussions on routes, POS and periods in the booking cycle that fall outside of agreed business rules.

A typical cadence for this form of discussion would include:

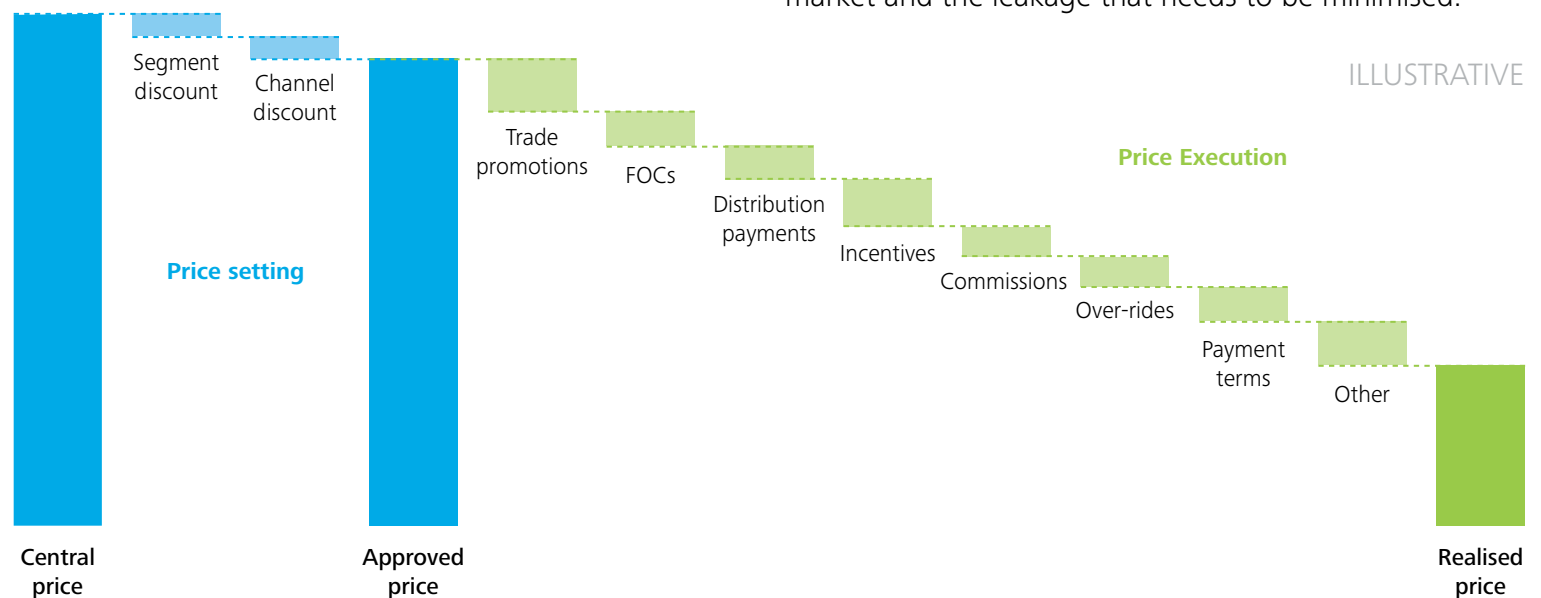
- **Weekly reviews** of the outlook for each route group and route with a focus on “hot spots” where load is not building as expected. Where load is soft, these reviews can drive tactical action in certain POS or channels to market (trade sales, direct sale, etc.), result in the opening of lower yield booking classes, or adjustments in capacity. Where load is coming in more strongly than expected, this should drive decisions to add capacity or to close off lower-yielding booking classes to maximise yields.
- **Monthly reviews** of the performance of overall route groups, where the discussion is focused on more mid-term and competitive matters on the route.

Pillar #2 (cont.)

- **Seasonal reviews**, where the overall strategy for the route group and specific route are discussed and reviewed, and the framework re-set with regard to the objectives for that route in the season/year ahead. These discussions may inform discussions about the fleet units being used to service a market, the frequency of operation that should be targeted to serve the market segments of interest, and distribution initiatives that may be required to gain better access to target segments or to reduce distribution costs (e.g. commission payments and incentives).

The core feature is the dialogue, and informed debate that should occur, rather than a heavy reliance on technology to drive key decisions.

In the centre of the need for collaboration and constructive debate across the three functional levers that will drive quality revenue is the issue of pricing. There is merit in considering pricing in two parts: price setting and price execution (as shown in the chart below). Price setting needs to reflect an understanding of the price the market will pay for carriage between two or more points for a particular offering and the competitive factors that will impact this. Price execution is all about how that price is then delivered to the market and the leakage that needs to be minimised.





Pillar #2 (cont.)



Price Execution

The total fare shown on airline tickets is a composite of listed tariff fares, surcharges and government taxes. These are the 'formal' items on the ticket. While at face value many of these are aligned between carriers, they are not necessarily so in the resultant price offered to the customer. Commissions, incentive commissions and override payments to industry partners are also part of this interplay, and those further adjustments in the marketplace often result in a final 'informal' (market) price of the ticket.

The Sales function largely deals with price execution. This function takes a centrally set price and distributes this into the market through various channels. Price leakage occurs through each channel in terms of sales commissions and incentives paid to wholesale and retail travel agents, distribution payments to GDS (global distribution system) providers, FOCs (Free of Charge tickets) and other general incentives. These costs need to be understood and managed and that is chiefly the domain of Sales & Distribution.



Price-setting is the domain of Revenue Management. This group needs to

- Be able to respond quickly to market behaviour,
- Maintain a constant focus on tariff structure, considering such matters as the step-ups between prices at each level of fare across the tariff,
- Be aware of the pricing strategies of benchmark competitors on each route, and
- Stay ahead of developments in regulatory and taxation environments that have an impact on airline ticket sales.

Clearly there is a high degree of complexity for any airline in determining exactly what prices it is competing against in the market, and a robust dialogue must exist between front-line Sales staff and the Pricing areas, i.e., between those setting the price and those taking it to market.



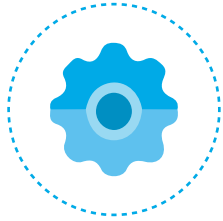
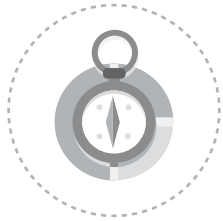
Pillar #2 (cont.)



The key considerations in the development and distribution of ticket prices to market typically include:



1. Do the step-ups between fares look logical? Are they structured in conjunction with the fare rules to encourage travellers to “buy up” the yield curve rather than trade down? Do the price steps and the design of the tariff reflect, to the maximum that the airline can control them, a deep understanding of the consumers being targeted in each market?
2. Is there a mechanism in place to ensure that both Sales and Pricing are constantly aware of benchmark competitor prices in the market?
3. Is the competitive response process appropriate and rapid, both to capture revenue and reduce the risk of loss of revenue, and does it support the Sales teams in the execution of their obligations?



For example, it is not uncommon for Sales personnel to complain that the Pricing function is too slow to respond to their requests for access to certain price



points or inventory buckets, resulting in lost sales.

One approach an airline can take is to give the field sales team greater authority to set price locally versus keeping a high degree of centralised control over inventory and the listed fares tariff to drive yield. The trade-off is that if control is centralised then the process to support Sales needs to be quick and effective. SMG Technologies, Lufthansa (*PriceLine*), Amadeus and Sabre amongst others all offer solutions to help monitor competitor fares and to file fares and these types of solutions can arguably have a greater impact than investments in improving O&D (origin & destination) forecasting tools.

4. Is the interplay between pricing and inventory being well managed? Is the inventory available at stepped pricing being opened and closed in a manner that encourages the market to buy up and to maximise yields?

Pillar #2 (cont.)



Practice

I once asked an airline's Pricing team to walk me through the process of how they set a price in the market. The team, with many years of experience, were unable to do this and as they worked through my request had many disagreements highlighting the inconsistent approaches being used in that airline.

Building an approach to price-setting that can be taught, replicated and improved in a systemic and methodical manner to drive better yield and revenue results is fundamental.

- Can your Pricing managers map or explain in simple and clear terms the process for how pricing works?
- Is the process commonly understood across the Pricing team?
- Is market intelligence immediate and of high quality?
- Is there an audit trail (for where there may be regulatory review)?
- Does the team maintain a close focus on the automated distribution of prices through GDS systems, and develop good working relationships with those partners?
- What regard is given to the marginal cost of carriage?
- How does the team consider competitor pricing?

- Are the benefits of pricing relationships with other carriers being optimized?
- Does the process consider price elasticity in key markets?



Pillar #3



Have you balanced the investment in skills and capabilities of your workforce to keep up with your technical systems?

In many airlines there has been a significant investment in complex IT systems for O&D forecasting and inventory management. Relatively little has been done in comparative terms with regard to pricing technologies and even less in building the capabilities of the team of flight (Inventory) analysts, Route Managers and Pricing analysts together to actually use these systems to their fullest extent and to understand strategically what they are meant to do.

Commercial Levers and Other Revenue Streams

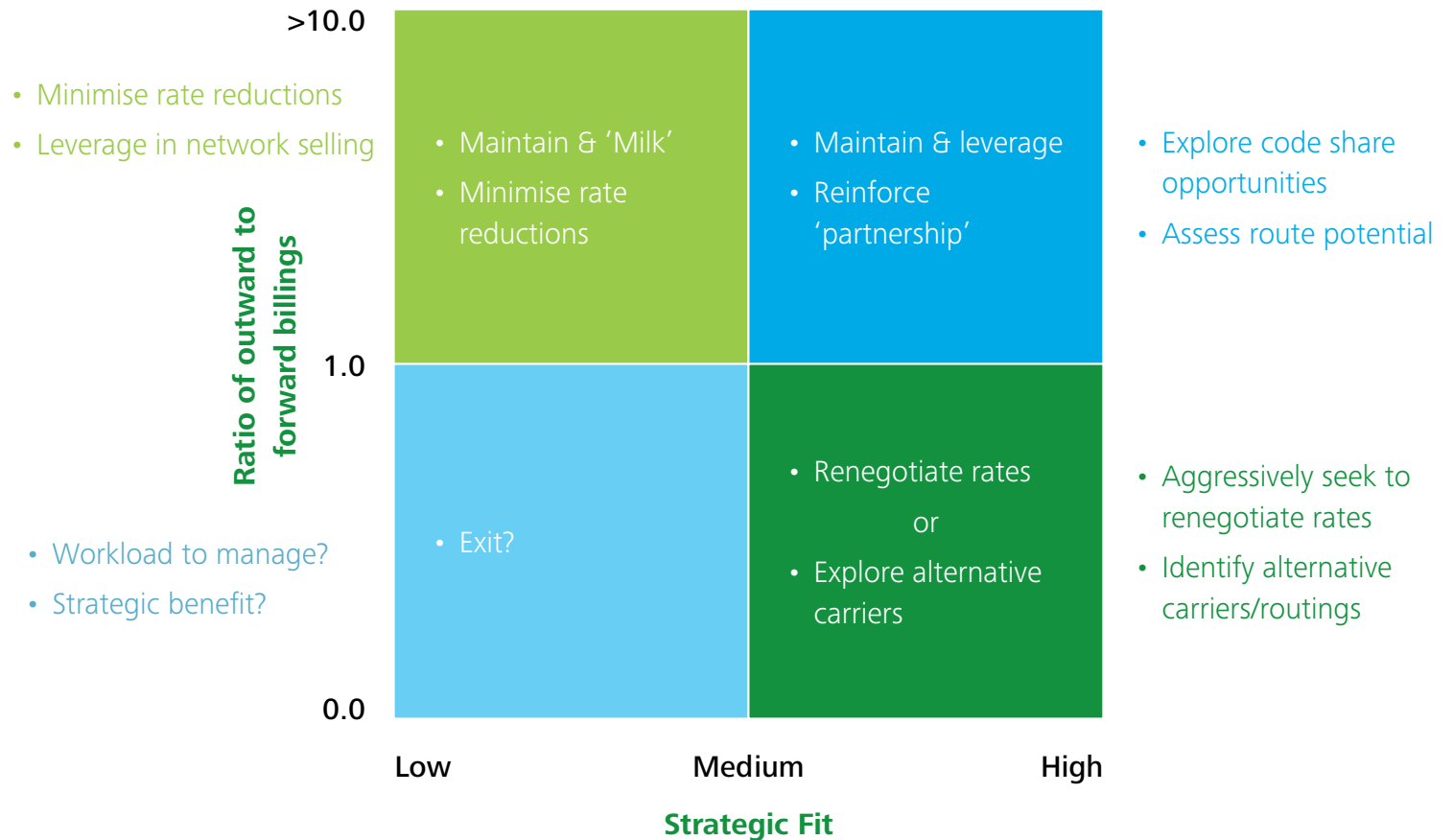
Pricing and Revenue Management teams must use a range of commercial tools to capture revenue where their fares are sold in conjunction with other carriers. The maximisation of airline revenue is not confined to the simple interplay of inventory and listed price, under discussion.

Two of the additional tools which flow from a structured revenue management regime are Proration contracts: Special Prorate Agreements (SPAs) and Provisos.

SPAs are negotiated bilateral agreements between two carriers that specify how the fare paid by a consumer will be shared between those carriers. They are unique to those carriers, designed to improve pro-rated revenue to both carriers, the SPA being a commercial agreement with incentives for each carrier to use and promote the services of the other.

Pillar #3 (cont.)

In many airlines it is common for there to be a proliferation of SPAs. This arises as an SPA creates a virtual extension of the carrier's network and is seen as a way to improve the selling proposition. However, by entering into these in an unstructured manner, airlines can erode their ability to negotiate attractive deals, in fact confusing the selling proposition and value of these bilateral agreements. Considering SPAs with regard to their commercial value and strategic importance helps to contain SPA proliferation while also maximising the value of those SPAs an airline chooses to enter (see the chart below).





Pillar #3 (cont.)



Clearly, ensuring that the Pricing team actively works with Sales to optimize SPAs can drive substantive value. Building capabilities in the pricing and revenue management function to think strategically when using SPA or other tools is just as important as investing in technology.



Provisos are another pro-ration tool available to airlines in their pursuit of revenue. Provisos are unique to the airline industry and are another revenue-sharing mechanism, ensuring that an operating carrier receives a minimum amount of revenue when sold in conjunction with a sector on another carrier.



The effective management of provisos requires the use of a scenario analysis tool that integrates with the revenue accounting system. Generally only the more sophisticated carriers use this (e.g. BA, CX, SQ, LH, QF, etc.).

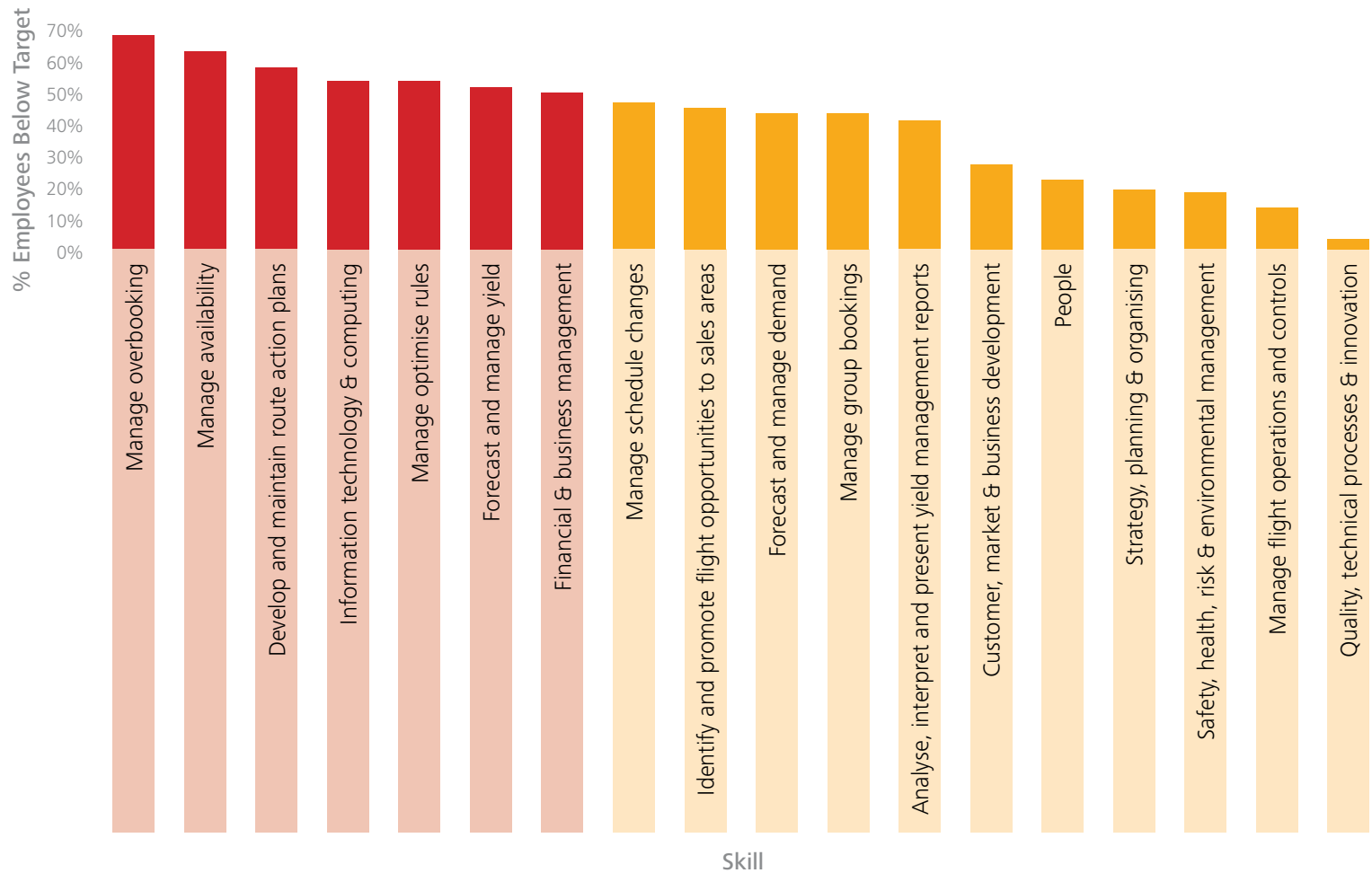
No matter how good an airline is at managing its tariff structures, its competitive activity or its SPAs and Provisos, failure to build and execute foundational capabilities in the core pricing and revenue management skills can have disastrous consequences, leaving significant revenue unrealized.



Pillar #3 (cont.)

A project undertaken by one airline, defined the skills required to be an effective flight analyst, route manager, etc. Each individual rated themselves against a set of agreed skills. The self-evaluation was then reviewed and moderated in consultation with their manager. The results highlighted some significant gaps in capability (see the chart below).

Average Below Target for All Jobs – Greatest Gap



Pillar #3 (cont.)

As illustrated, this particular airline failed to have some core skills embedded in its teams to be able to effectively manage for revenue and yield maximization – no matter how solid the technologies it had in place! Understanding the capabilities of the team is paramount and an investment in building the skills of the team may far outweigh the benefits of investing in new technologies. The key is to understand where you are in terms of maturity and capability when making the trade-offs: whether to invest in people, process, or systems at a point in time.

Self-maintenance: Cost control

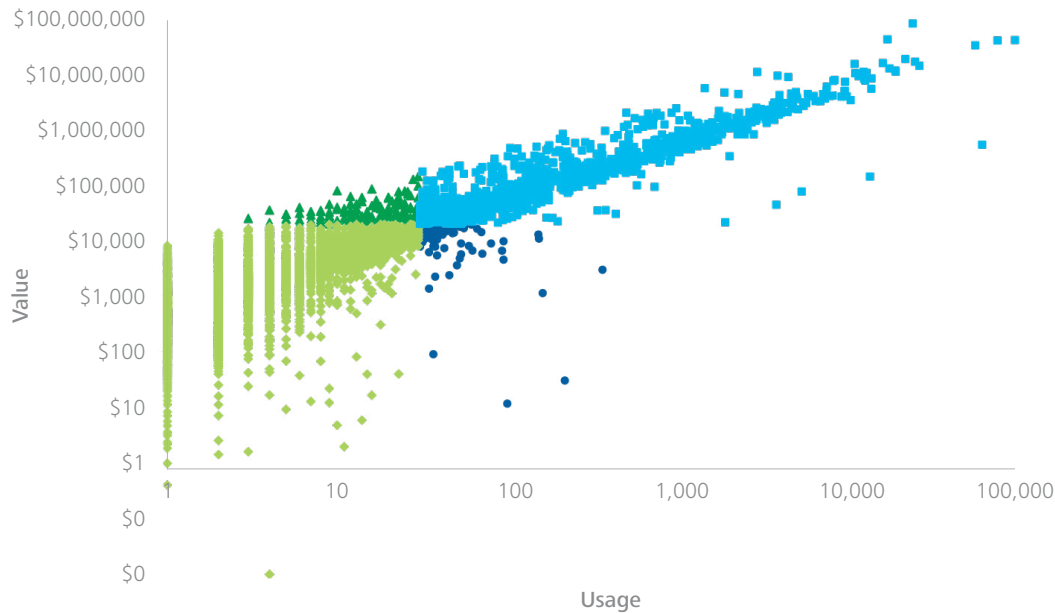
A skill not identified through this work was one of simple “health and hygiene”. When airlines put a fare in the market, it is identified through a fare basis code (FBC). The FBC is the identifier that is used by automated systems and travel agents in the calculation of ticket prices. This code is filed centrally with the global tariff companies, and re-distributed to the IT systems of the airline and its distribution partners, until such time as the airline actively withdraws the FBC. Worldwide, thousands of these codes are transacted every day, and the database storage of them for all airlines numbers in the tens of millions. There is, of course, a cost for such storage.



Pillar #3 (cont.)

As with many businesses, airlines are therefore dealing with a continuously proliferating corpus of prices and their technical coding. Traditionally, airlines are not good when it comes to actively withdrawing FBCs. The attendant effect is that fares, particularly local tactical price deals, can be sold to consumers at out-of-date prices and the costs of storage continue in silence. The undetected continuation of these relic, yet still active, commercial deals can present the risk of yield dilution and an incremental cost burden (as shown below).

Distribution of Fare Bases for a Region



LO LO	HI HI	LO HI	HI LO
80.14%	16.12%	2.09%	1.8850%
1.87%	97.50%	0.18%	0.0037%
1.73%	97.52%	0.56%	0.19%

- More than 95,000 active fare basis codes network wide
- 74% represent <9% of volume and <15% of revenue network wide
- Significant scope for rationalisation
- Labour and data storage efficiencies available
- Revenue benefits of ~\$XX m p.a. network wide

Pillar #3 (cont.)

Leadership – Right People, Right Goals

Capability also needs to be considered in terms of leadership. At the simplest level, if the leader of the Pricing & Revenue Management function is not confident to hold a robust discussion with Sales peers then yield can be eroded quickly and become subordinate to revenue. Having key personnel in the Pricing & Revenue Management leadership roles who have worked in, and are respected by, Sales can be beneficial. The counter to this is that someone coming from outside of the Sales function will not be imbued with whatever culture an airline's Sales teams may have (for better or worse!). That said, setting the right KPIs to engender the right behaviour is fundamental. These KPIs should be directly linked back to the overall commercial strategy of the airline.



Pillar #4



Are KPIs and accountabilities aligned to commercial strategy to enable revenue management teams to focus on profitability?

Ultimately the objective is to maximise the departed revenue per aircraft for any schedule being flown.

A frequent question is:

“What is the best way to encourage the focus on, and realisation of, flown revenue in terms of how Pricing & Revenue Management is organised and measured?”

There is an argument to organise by broad regional POS to ensure that the Pricing teams and Inventory Managers are aligned with the Sales teams, which are generally POS-aligned. Examples of this might be ‘Americas/ Canada’, ‘Eastern Europe’, ‘Pacific Nations’, ‘Western Australia’. This reflects the need to sell and price in a specific market and to understand the nature and behaviours of each POS. However this internal alignment generates a POS view and does not always maximise the performance on the overall route, since by the nature of air travel worldwide, each route is sold onto from multiple POS. A POS-determined inventory allocation

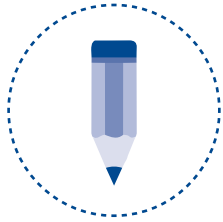
may not be optimal when considered from a route perspective. POS-based KPIs can fail to reflect, moreover, can actively conflict with, the need to optimise overall route performance.

Another view is to organise by routes and route groups. In this model teams have responsibility for pricing on the route from the major points of sale and for managing inventory accordingly. This keeps reasonable alignment with a POS-oriented Sales organisation but can result in complexity in some markets. For example, where an airline has a dominant POS (e.g. its country of domicile), there is the risk of inconsistencies in pricing or inventory management strategies within that POS.

Some airlines run a hybrid model where the dominant POS falls under a single Pricing team and pricing for inbound POS falls within the route manager’s remit, along with inventory management for the route group. What is most important is ensuring that within whatever structure Pricing and Revenue Management adopts, there is a clear link back to, and accountability for, flown revenue at an appropriate level of the function.



In summary



All players in the travel, hospitality and leisure sector, such as airlines, hotels, ferry, bus and rail operators, face revenue optimisation challenges as their inventory effectively evaporates at a point in time. Maximising revenue and profit is as much a science as it is an art, requiring ongoing assessment of the market and competitive landscape.

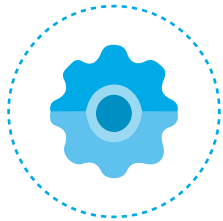


While investment in technology is important, enterprises need to match this with investments in developing sound commercial strategies, as well as the people and processes to enable them.



About us

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