

## Shaking up the foundations of revenue management and pricing

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### Revenue Management and Pricing in the time of crisis recovery

Imagine starting over with a clean sheet of paper and changing the way of doing revenue management and pricing. What should be done differently? Within a couple of weeks, historic data as the foundation to monitor trends and performance has become irrelevant, shaking up the foundations of revenue management and pricing. Many variables have changed or are unknown within the equation forecasting future demand and predicting demand patterns. IATA estimates an industry drop in per passenger revenue of \$314 billion and a full-year demand decline by 55% compared to 2019 based on a scenario with domestic travel restrictions up to three months and international restrictions beyond three months.<sup>1</sup> Airlines have to come up with a quick answer of how to make decisions and how to adapt the steering of revenue and pricing to recover from this crisis and to build the foundations for a sustainable future as outlined in the following article.

### Adjust the decision making in revenue management and pricing

From now on data analysis and decisions have to be made on a different basis. There is no historic comparable data with which to compare the performance when airlines resume their passenger services operations. Traditionally, airlines conducted their analysis based on historic data, comparing this year's data to last year's at the same point in time. Therefore, Lufthansa Consulting takes the position that data as the foundation of decision making has to be approached in a different manner based on the following three measures.

#### *1. Consider market-specific factors and context-specific data.*

There are various market-specific factors to contemplate in the decision-making process such as the stage of the crisis recovery, the competitor's reaction, shifts in market share, capacity changes, the change in customer segments (leisure, business, VFR), the change in price-sensitivity and the change of customer behavior (i.e. advanced purchase of tickets, minimum stay). Also, context-specific data, such as travel bubbles, restrictions, economic trends, have to be included in the equation to forecast future demand and to incorporate in the decision-making process.

#### *2. Understand customer behavior on touch points based on real-time dashboards.*

This allows companies to quickly detect opportunities, to remain competitive and to respond faster to markets in a rapid-changing environment. Additionally, real-time data permits businesses to react to constantly changing situations as new regulations become effective. In the end, every customer counts for the airline to recover revenues and to secure the liquidity of the company.

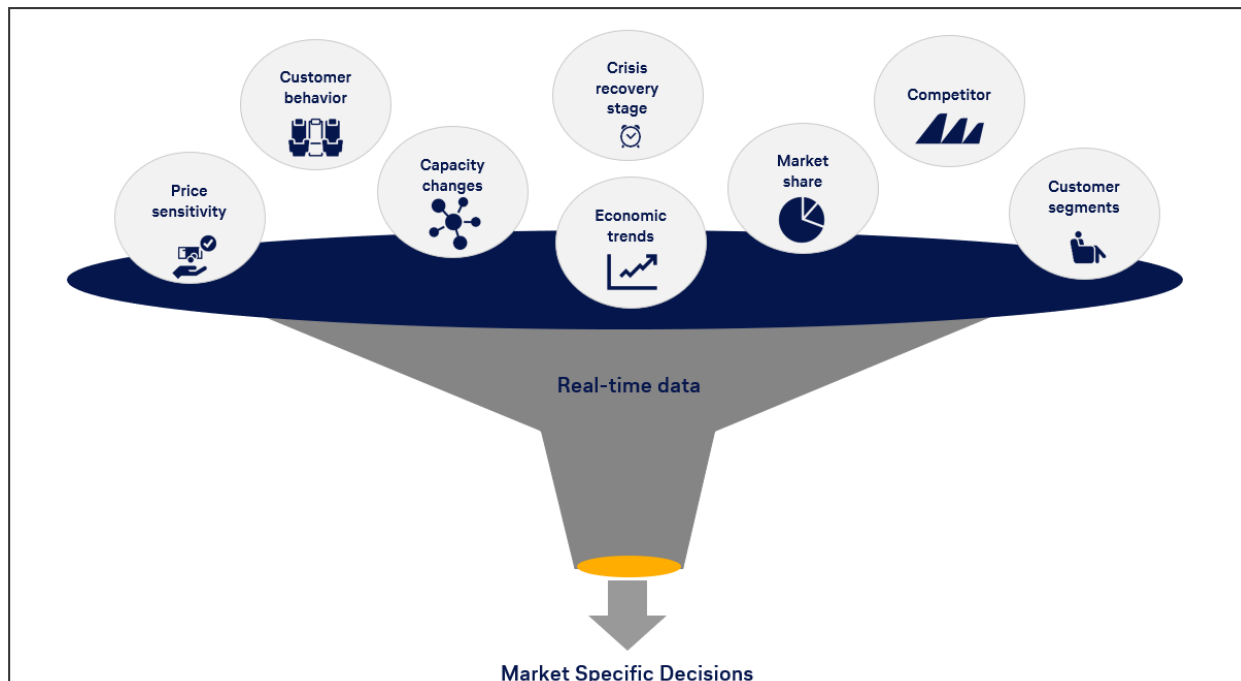
#### *3. Define a common timeline and targets for revenue growth.*

The targets with a corresponding timeline have to be redefined and should be communicated across all key commercial areas and in close alignment with network planning and fleet management to work unitedly towards a common goal.

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<sup>1</sup> <https://www.iata.org/en/pressroom/pr/2020-04-14-01/>

Figure 1 Re-evaluate key factors as a foundation for decision making post-crisis (Source: LH Consulting)



### **Adapt the steering of revenue management and pricing**

The philosophy of Revenue Management and Pricing is the ability to have the right product for the right customer at the right time for the right price in order to maximize revenue and capitalize on the passenger's willingness to pay. The impact of the Covid-19 pandemic forces airlines to change their revenue management and pricing approach. A hybrid approach, combining machine learning and human interaction, allows the automation of processes with the option of human intervention. For the immediate crisis recovery, Lufthansa Consulting recommends that airlines should adapt the steering of revenue management and pricing based on the following four measures.

#### *1. Manage the short-term and long-term differently.*

Adjusting the set-up carefully for the flights further out is one way for airlines to protect the revenue in a fast-moving environment, especially during peaks such as holidays. Traditionally, airlines would plan ahead as soon as the flights were within system range (~12 months prior to departure) with minor adjustments in the set-up closer to departure to protect the seats for customers with a higher willingness to pay. These are traditionally business passengers. However, the future success of the revenue steering will depend on an even more flexible and dynamic approach for the flights closer to departure time; airlines must react fast to changing circumstances. The lifting of travel restrictions in China has shown that there is more demand than capacity in the beginning, which is an opportunity for the airlines to capitalize on the willingness-to-pay for immediate travel. That is why, planning the crisis recovery phase is crucial.

#### *2. Re-evaluate traffic flows and markets.*

Especially in the short-term, Origin and Destination (O&D) strategies have to be adapted to the change in demand due to travel restrictions and travel bubbles. This will also lead to a hub consolidation for network carriers. The advantage of a hub model versus a point-to-point model is the opportunity to

merge demand flows. Furthermore, there is a potential to serve more restricted markets as these markets have experienced a higher capacity reduction.

*3. Test the price-elasticity per market and understand market-specific changes.*

Market-specific modifications in the strategy are essential to react to the fast-changing environment. Before Covid-19, airlines had two common reactions: either they would pursue high volume with lower yields or higher yields with a lower load factor. The relevant question is if this strategy is still valid as low fares might not stimulate demand in the post Covid-19 world. Also, the stage of the crisis recovery plays a significant role. There will be an increased demand in the short-term as there has been little movement with the lock-down and travel restrictions in place. In the medium-term, there will be a disproportion between the capacity added by airlines and the demand. However, the demand and supply should find its balance in the long run. For this reason, fare reductions should be done with caution to prevent revenue dilution. This must be monitored carefully, reviewed constantly and adapted quickly and decisively.

*4. Validate the pricing structure.*

Fares and fare conditions have to be market-specifically adapted as the historic customer behavior might not be in line with the future behavior of the customer driven by the pandemic. Therefore, the pricing team has to test the willingness-to-pay under consideration of the competition and the fare conditions. Examples of the most common fare conditions that should be validated are seasonality, minimum stay, advanced purchase, changeability and refundability.

Figure 2 Approach for adjusting the decision making and adapting the steering of revenue and pricing (Source: LH Consulting)



**Find tailored solutions in revenue management and sales**

Airlines have reacted to the need of customers for more flexibility, as shown in Figure 3. A comparison of top 15 airlines by Available Seat Kilometer (ASK) in 2019 shows that all airlines allow refunds for a specific period with some exceptions in their booking policy. However, 12 out of 15 airlines (except the Chinese carriers) have changed their rebooking policy towards flexible conditions and added vouchers to incentivize customers to rebook their flights with the opportunity to change the O&D. The increased flexibility for the customer allows the airline to protect its cash flow. Nevertheless, the trend in the industry is to set an end date for the flexible rebooking and refund policies as those 12 airlines limited the options to rebook and to refund without paying any fees.



Figure 3 Comparison of top 15 airline’s reaction by ASK triggered by Covid-19 in 2019 (Source: AirportIS)

Airline Name	Airline Code	ASKs in billion	Rebooking without fees	Issue of voucher for rebooking	Rebooking allows a change in the OnD	Refund
American Airlines	AA	454	✓	✓	✓	✓
United Airlines	UA	445	✓	✓	✓	✓
Delta Air Lines	DL	437	✓	✓	✓	✓
Emirates	EK	382	✓	✓	✓	✓
Southwest Airlines	WN	258	✓	✓	✓	✓
China Southern Airlines	CZ	232	✗	✗	✗	✓
Qatar Airways	QR	231	✓	✓	✓	✓
China Eastern Airlines	MU	206	✗	✗	✗	✓
Lufthansa	LH	198	✓	✓	✓	✓
Air China	CA	195	✗	✗	✗	✓
Ryanair	FR	194	✓	✓	✓	✓
British Airways	BA	190	✓	✓	✓	✓
Air Canada	AC	181	✓	✓	✓	✓
Turkish Airlines	TK	178	✓	✓	✓	✓
Air France	AF	160	✓	✓	✓	✓

This is also an opportunity to change fare structures by offering more flexible fare conditions to gain customers back. An alternative form of payment can include monthly installment payments. For example, a paid membership subscription for travel benefits or buying flight passes can be a new model to retain customers. This model allows customers flexibility without requiring the airline to sell tickets at a price too low to make a profit.

*‘We are not expecting to re-start the same industry that we closed a few weeks ago. Airlines will still connect the world. And we will do that through a variety of business models. But the industry processes will need to adapt. We must get on with this work quickly.’*

*Alexandre de Juniac, Director General and CEO, IATA<sup>2</sup>*

### Conclusion

Now more than ever, thinking outside of the box, being creative with tailored solutions and making decisions backed with Live Data makes the difference in recovering revenues to secure the liquidity and survival of a company. Real-time data will play an important role for airlines to adjust their decision making by considering market-specific factors and context-specific data. Based on these insights, revenue management and pricing have to be done differently with a flexible and dynamic approach for flights in the short-term and protection of the revenue further out. Furthermore, traffic flows have to be re-evaluated, the price-elasticity per market has to be tested and pricing structures have to be validated. Finally, finding creative and tailored solutions impacts significantly the ability to recover revenues.

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*Further insights from Lufthansa Consulting’s aviation experts are available at <https://www.lhconsulting.com/insights/news/>*

<sup>2</sup> <https://www.iata.org/en/pressroom/pr/2020-04-07-02/>