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# The Yield Management of Tourist Enterprises

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## Abstract

A silent revolution is taking place in the global service industry, including a lot of enterprises in tourist industry, affecting the way companies are managed and operated in a progressively deregulated economic environment. This is the yield management, which originated from the airline industry and is used by many different kinds of tourist enterprises.

This paper is dedicated to study the yield management in tourist industry, especially taking the Chinese tourist enterprises as the example. The fact that yield management is not understood well by so many tourist companies is the reason why this paper is written. The character of being intangible, vulnerable and its particular cost structure are the most important reason for tourist enterprise to apply yield management. When studying the current situation of tourist enterprises in China, some problems facing these enterprises have been found, including that many tourist enterprises do not practice marketing segmentation properly, the particular cost structure do not influence the revenue management, and so on. Finally, the paper describes in detail how to solve problems mentioned through using yield management. Three elements are interdependent, that is, understanding the problems involved, the important principle of yield management application and the process of practicing yield management.

## 1. The Background of This Paper

Whenever we compare the operation of airlines in China and other countries, we pay attention to the fact that the foreign airlines offer price which varies with booking time, customer segmentation and consumption style, etc. But Chinese airlines followed the fixed price for all the flights in the past, where there was no yield management. And now in the market it seems that Chinese airlines offer various price. That is not yield management. In fact, yield management is not understood well by so many tourist companies. Hence it is necessary to communicate the concept of yield management.

After more than 20 years' development, the tourist industry in China has entered another important stage. Because of the low entry barriers and high investment return, the tourist industry has grown very rapidly. However, the severe competition brings about negative effects, one of which is the rate of profit of

the whole industry fall, for example, in 1998, the international tourist operators' average rate of profit is only 1.8%<sup>[1]</sup> On one hand, it is because that the profit is becoming average, on the other, most tourist enterprise do not follow scientific method to analyze the customer segmentation, and fail to connect the pricing strategy with its profit realization. The simple competing method only includes cutting the price, which is far from competitive in the complicated and changing market.

## 2. The Reason Why Yield Management is Important to Tourist Enterprises.

Yield management refers to selling the products to the right customers at the right price at the right time is the central idea of yield management. The enterprises can get the most profit by targeting segmented micro markets to maximize its revenue. The tourist enterprises share some common product characteristics that are, the intangibility, vulnerability and particular cost structure. Yield management can bring benefit to the enterprises having such characters.

### 2.1 The perishable product

Many of the tourist enterprise's products belong to perishable product. Unlike the tangible products, the service in tourist enterprises cannot be stored and sell in another time. In the enterprises with perishable product, time element is very critical in selling the products. Typical examples include airline seats and hotel rooms. Once a flight left the ground, the seats cannot be sold any more; once a night has passed, the bed cannot be slept in.

### 2.2 Cost Structure

The second character is high fixed cost, low variable cost of tourist enterprises. Entertainment parks, hotels and airlines can be very good instances to illustrate this point. The variable costs of the product are low so an incremental sale does not cost the vendor much, but enables the product to be sold at a wide range of prices rather than letting it unsold and spoil. In other words, selling such kind of products for any price, which is over the variable cost, is better

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<sup>[1]</sup> WEI Xiaolan, "Difficult Situation and Solution of Chinese Travel Service," *Tourism Review*, 1999, 4

than not selling at all.

### **2.3 Limited Capacity of the product**

The third character is limited capacity of the product. For example, the number of beds in hotels, cars in the car rental firms, seats in the plane is limited. In this kind of situation, it is very expensive or impossible to increase the available unites of the product.

### **2.4 Product being able to be booked in advance**

The forth is that the product or service can be sold in advance. This ability helps to facilitate segmenting the market, which is an important characteristic of yield management. In airline industry, the traditional usage of yield management can be seen in the separation of business tickets and economical tickets in the airline. That is the basic segmentation in airline industry. But that is far from enough. Now the situation is that more precise segmentation is needed to achieve better performance and revenue.

## **3. Current Situation of Tourist enterprises and problems**

When we study the tourist enterprises and analyze the current situation of tourist enterprises in China, we find some problems facing these enterprises, which can be solved by adopting yield management.

### **3.1 Current Situation of Tourist enterprises**

Since China adopted the Opening and Reform policy, with the development of the tourist industry, tourist enterprises such as airlines, hotels and travel companies have grown very rapidly. And these companies are facing very rosy prospect. Up to now, in China, there are about 17000 tourist enterprises, with 300 billion fixed property value, 200 billion fixed property investment, the direct employee in the industry amounts to 1800 thousand, and annual operational revenue achieves 15 billion Yuan.<sup>[2]</sup>

### **3.2 Problems facing Chinese tourist enterprises**

Although the tourist enterprises in China develop very fast, there are serious problems facing the whole industry. On the one hand, the tourist industry grows every year, one the other, the performance of tourist enterprise in terms of revenue is becoming poor. The problems remained for years, including that many tourist enterprises do not practice marketing segmentation properly, the particular cost structure do not influence the revenue management, the current pricing system does not reflect particular

characteristic of tourist enterprises, and so on.

#### **3.2.1 Structure Adjustment is disregarded**

In the past 20 years, the development of tourist industry has been depended on large-scale investment and construction. The profit of tourist enterprises has been realized by raising the product price. When the market stayed in the seller's market, it is possible to maintain operation. But when the tourist enterprises are facing the changing exterior environment, especially the serious competition of enterprises from home and abroad, at the same time, the seller's market has turned to buyer's market, the structure conflicts of the industry has become obvious. Taking hotel as an example, for years hotels adopt one fix rate, the change of the market does not influence the operation strategy of hotels. Many hotels do not pay attention to prepare guest history file, and not realize its importance and hotels disregard the market segmentation. About travel agency, the administration does not pay enough attention to the low profit situation and long-term development, thus many poor performance aiming to short-term profit can be found in many travel companies.

#### **3.2.2 Lack of competitiveness**

Nowadays, many tourist enterprises have high operational cost. In terms of competitiveness, Chinese enterprises are poor compared with many foreign companies.

For example, a lot of single hotels have been built. They are small in terms of scale, do not join in any global reservation network, and also cannot afford to invest any management software. The situation of travel agency is more difficult, small companies cover a large percentage of the whole industry. These small companies compete by blindly cutting price, and accordingly lower the quality of the products. Hence, a lot of complaints take place. Checking airlines and car rental companies presents the same finding.

#### **3.2.3 Too much interference of the government**

For long, tourist industry has been interfered by government of many levels, which hindered the natural competition of enterprises in the market. What is most evident is the transportation industry. From the deregulation of American airlines, we can draw a conclusion that the free pricing stage owing to deregulation is the preparation phase for enterprises to adopt yield management willingly. Taking airline as an example, for years, the airline industry has been in charged by China Civil Aviation Bureau. The decision of airplane purchase, personnel administration is made by the bureau, the airline companies cannot make these decisions that should be their responsibility. So the companies cannot join in the market competition as true enterprise. The bureau also controls the pricing and route decisions. Many companies are poor in

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<sup>[2]</sup> Statistic Report of China National Administration of Tourism

terms of management; fail to adopt tools to combat in the market, such as pricing, product strategy, and so on. At the same time, the service of airline companies does not differentiate from each other, so the competition between them becomes the simple cutthroat competition.

#### **3.2.4 Low Level of Technology in Tourist Products**

In developed countries, technology can be seen more often than before in tourist enterprise. But in China, the technology level in tourist enterprises is low. Taking travel agencies as example, many companies do not join in any central reservation system. Even the use of computer is limited. So the operational cost is quite high, lowering the profit level. Now China has become a member of WTO, tourist enterprises will face more fierce competition from foreign countries. The low level of technology adopted will not result in fast, accurate and timely service, which is the most important characteristic of future tourist industry.

Besides the above problems mentioned before, we can also find other problems, such as poor infrastructure condition, sustainable development of tourist industry is facing difficulties, and not sufficient domestic tourist consumption. There are many reasons, but it is important to pay more attention to the interior management mechanism, in order to achieve efficient competition.

### **4. How to Solve the Problems**

Yield management, also cannot solve all the problems facing tourist enterprises, can help greatly to solve problems mentioned. Yield management system helps companies to make good decision through data analysis and forecast, and achieve better service performance. It should be realized that the most important reason is that there are many attitude mistakes and operational barriers, so the starting point to practice yield management is to understand the problems involved.

#### **4.1 Attitude Mistakes and Operational Barriers**

In reality, the idea of yield management is being used by some of the firms, but not deeply. What is hindering the using of yield management? We have met some common misunderstandings upon this concept. The following is a look at three popular misunderstanding about yield management's role and effect.

##### **4.1.1 Misunderstanding 1**

The first and most popular misunderstanding about yield management is that it is a computer system. Discussions of yield management appear to be inevitably linked to computer systems. With computer-based tools as its key component, yield

management can be defined as a decision support system. As being introduced before, yield management can be used to forecast demand, to optimize reservation-inventory allocations, to limit discount availability, and so on.

But yield management is neither a purely computer system nor a set of mathematical techniques. In fact, other yield management practices can be implemented with little or no investment in computer resources. Yield management programs also involve other elements other than computer modeling, for example, education and training, an appropriately designed and delivered product, and corporate policies and procedures that encourage revenue enhancement. Those three areas must be addressed in a coordinated manner when developing or enhancing a yield management program.

##### **4.1.2 Misunderstanding 2**

Another misunderstanding is that yield management takes control away from employees.

Yield management tools may accomplish some routine actions previously performed by employees. It's easy to understand. However, a yield management program, containing tools that recommend specific courses of action, will not take over a company's decision making.

For example, yield management tools might suggest that no more reservations be accepted at a specific discount rate for a particular night, or that a group rate of \$75 is too low for a certain set of nights. But the ultimate decision and responsibility for accepting those recommendations, or over-riding them and choosing a different course of actions, rest with a hotel's staff.

##### **4.1.3 Misunderstanding 3**

The third misunderstanding is that yield management works only when demand exceeds supply

The best-known applications of yield management are overbooking and discount control. They are very useful when excess demand exists. That causes many people believe that yield management only works when demand exceeds supply. But in fact, not only when demand exceeds supply, but also when supply exceeds demand, yield management can be reliable.

For example, Marriott's use of low-price advance-purchase rates is an attempt to attract customers who would normally stay at low-priced hotels. Those new products do not create demand so much as under the previous pricing regime. Yield management helps a hotel modify its pricing structure and control the sale of its product so that the hotel can expand the appeal of its product while mitigating revenue dilution that would result if such changes were not controlled.

So, besides price discounting, yield management can identify opportunities to improve the pricing

structure. Raising and lowering prices dynamically for a given date, depending on demand, is a business decision. Yield management focuses on how much of a product to sell at established prices; it works all the time.

## **4.2 Principle of Yield Management Application**

In order to apply yield management, enterprises should follow certain principles. The successful yield management companies also create some organizational characteristics.

Continuous improvement should be embraced and the company is committed to the strategic process of yield management; it should create or use proper computerized yield management software to better their performance.

The company should thrive on changes, at the same time it emphasizes its perishable inventory, tries to connect the changes inside and outside the company with the sales of the products. And when the company balance its inventory and demand, what is emphasized is not only cost, the competing environment is more important.

The company should do a lot of customer research, and recognize the customer's expectation about the products and the price, which set the base of their comprehensive pricing strategy. What's more, the company must forecast the potential demand at different price or sales point, and allocate its capacity according to the structure balance.

It is important that such company rarely oversells prime inventory while rarely undersells fringe inventory; they limit the amount of discount business; and they always attach various conditions of sale to every price offer, and so on.

In sales, the company pays more attention to the micro market, that is the different customer types, not the whole market. Thus fixed price should not be followed.

The company should make good use of the value cycle of every kind of product, and try to sell it when it is highly valuable. This decision should be based on fact, instead of imagination.

## **4.3 The process of practicing yield management and solving the problems**

In yield management, the total revenue is more important than sales volume or sales price. In order to achieve that, five parts of process are necessary. They are market segmentation, price management, demand forecast, capacity management and booking negotiation.

### **4.3.1 Market Segmentation**

No company can satisfy the needs of all customers. In order to achieve success, it is necessary to do market segmentation. Not only tangible goods can

have differentiated markets, but also service can identify evident segments. Market segmentation is important in that various customer group can be recognized according to their behavior, thus different price structure, business strategy and other marketing motivation can be established. According to Philip Kotler, in segmenting the market, the criteria such as geographic, demographic, psychological and social elements can be used.<sup>[3]</sup>In fact, besides these criteria, service can also be segmented according to the willingness to pay for a product or service, and time when customers need the product as well. In tourist industry, according to these criteria, tourists can be listed into different categories. Different types of customers have evidently various price acceptance levels.

### **4.3.2 Price Management**

Price management refers to that the enterprise provide different price to various segments according to the change of demand systematically.

Taking airline as an example, if the airline has mastered the data about the customer type and their different demand, it can set up different price level and price structure. For example, the airline can provide a discount price to those customers who book early. In fact, both the discount price in low season and the high price in high season of many tourist enterprises belong to price management.

### **4.3.3 Demand Forecast**

A company forecast the future demand according to the analysis on past sales and known trend in the future, and based on this, the company can rationally and accurately forecast the scale of different segments and according price acceptable.

Forecast is a very important process on yield management. In order to forecast systematically, the company must possess data information and scientific statistical method. The company must have both interior and exterior information.

### **4.3.4 Capacity Management**

To manage capacity of a company means to limit or adjust the availability of certain product or service according to the demand of customers. In fact, some enterprises can change the capacity, but some cannot. But some enterprises can class the capacity and implement certain limitation to some product.

### **4.3.5 Booking Negotiation**

Because most products and services of many tourist enterprise can be booked, when customers book, the company can negotiate effectively. When there is a

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<sup>[3]</sup> Philip Kotler, *Marketing Management*, tenth edition, Prentice-Hall, 2001,10

chance that the company can negotiate with the customer, it should try to sell the most expensive product and realize the greatest value of the products.

To sum up, yield management is a scientific method to make the enterprise realize optimal revenue, whose core is price control, capacity management and booking sales. Moreover, we believe it is the right time for our enterprises to understand this idea and implement this business practice.

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