The Revenue Management Mantra

R4 The Right Unit, to the Right Resident at the Right Time for the Right Price

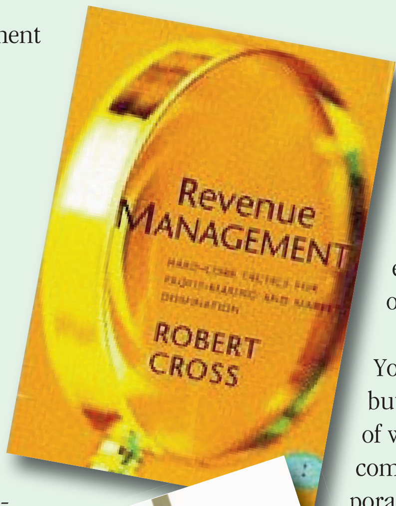
This Q&A with Robert G. Cross, Chairman and CEO at Revenue Analytics will help apartment executives understand and implement an effective revenue management program.

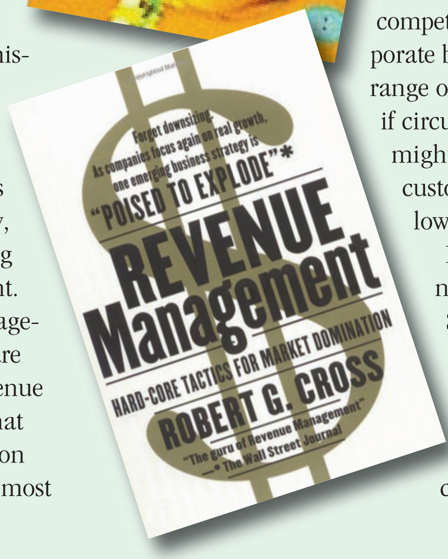
In preparation for the upcoming Apartment Revenue Management Conference, Sept. 12-14, 2011, in Scottsdale, Ariz., *units* magazine spoke with Robert G. Cross, Chairman and CEO at Revenue Analytics, to gather his insights on revenue management trends, strategies and best practices that can be applied to the apartment industry.

For information about the conference, speakers and education sessions visit www.APTRevenue.com.

units: What is the most common misconception about revenue management?

RC (Robert Cross)***:*** The most common misconception is that revenue management is simply a way to drive rates, which causes two issues. The first set of issues involve an over-sense of glee in the owner/operators eyes, misunderstanding the real opportunity, and fears by the residents that they are going to be revenue-managed out of the apartment. Another misperception is that revenue management is merely a system or a piece of software and not a process or a way of business. Revenue management is all about understanding what the customer really wants and how to position products and rates in a way to optimize the most value from the customers.





units: Can you provide examples of companies reconciling the goals of street-level empowerment of employees with centralized yield optimization efforts? How do you bridge the two seemingly different efforts between centralized pricing/discounts and empowering employees to act in the best interest of the organization at the point of sale?

RC: Virtually all industries have this issue. You need a central command and control aspect but at the same time you want street knowledge of what customers are willing to pay and what your competitors are doing. The best practice is to incorporate both. Empower the individual with a narrow range of rates so they have some flexibility if circumstances require. The problem, as you might guess, is that the employee is looking the customer eye-to-eye so they tend to go to the lowest rate.

It is the course of least resistance which may not be the most profit maximizing approach. So the best practices are to give them a range which they can work within and then measure where all the agents fall within that range over time.

units: So, when thinking about community marketing materials would you list the current rent range or would you list an exact rate?

RC: I suggest you put the high end of the range in marketing materials so there is room for negotiations if needed. It is a good reason to have the range pretty narrow because if you have too high of a rate people are going to look at it and think it is out of their price range. It should be relatively close to what the transaction price is going to be. I really do like empowering employees with a little discretion to drop the rate to close the deal, and it makes prospects feel better.

units: Would the same hold true for renewals versus new leases?

RC: You should have designated renewal rates per unit and give a little flexibility to those residents who you really want to stay.

units: What would you tell skeptical apartment owners who fear having to rely on computerized programs with little to no "human" input when determining rents?

RC: The fear of technology is a little bit justified; you just can't turn over something that critical to your business like revenue management to a computer. But to me, the greater fear or concern would be that you aren't looking at everything in a very objective manner. You could possibly be turning over decisions that make a huge difference between profit and loss to an agent who may or may not have much experience. The problem gets complex very fast. Let's say very simply you have one property with 100 units, you have 20 floorplans, five lease options and four seasons. Well that is 400 decision variables right there. Then you have to balance what is available, what is coming available, what is expected demand over time and the terms of current leases. Now you are talking about 1000s of decision variables. So let the computer handle those calculations and give a recommendation and then give the onsite individual some discretion.

units: Taking human aspects and emotions out of pricing has enabled revenue management software to provide consistent and unbiased pricing recommendations, is there ever a time when a company should re-incorporate the "human element" into revenue management strategies?

RC: The best approach is to strike a balance between people and the technology upfront. It really shouldn't be the concept of "re-incorporating" the human element. The system should be designed with human involvement. It is funny because the common error for people before they get into revenue management is that they focus more on intuition and market knowledge. When they finally get the message of revenue management and the need to be more sophisticated in the decision-making process, they tend to swing all the way to the other end of the spectrum which is 'Oh, let's have systems that spit out decisions.' The best approach, and I believe people who have done this for a while understand this, is finding this balance between what is the appropriate role for the human and what is the appropriate role of the machine. Computers are great for gathering, collecting and analyzing data and for projecting demand, they are great for doing complex calculations. But people are also really good at understanding the information which is not in the system. They can evaluate what they know about the market, demand or what they know is happening in the housing market or credit market that is impacting demand. So you really need both.

units: What happens with data collection – when it comes to revenue management and price optimization, do you need data or does it really just come down to types of units, availability, etc?

RC: Both. The more data you have, the better the system's going to be able to make a decision and the better an individual can make a decision. But it really is hard to collect all the data you want. You know your availability and lease rates but you don't know what is offered in the market place and you may not know what your competitors are offering. The more information you have the better decision you are going to make. So the first step is making sure you are collecting and saving the data in the most accurate manner, consistently over time.

units: In your book "Revenue Management: Hard-Core Tactics for Market Domination," you talk about Carol the barber and her Tuesday/Saturday micro-markets – what is the more effective way for apartment owners to determine their micro-markets? Do they need to look far beyond standard demographics such as age and income?

RC: That is a great question and it really gets into who are they (residents) and what do they want. How do you identify them? Who looks but doesn't book; who comes in but doesn't talk to you. What are the motivating factors for them to rent? There are a lot of ways to segment people. Demographics tell us very little. We need to understand buying behaviors that drive demand. What are the needs driving people, is there a sense of urgency, are they being relocated? Those are the types of segmentation criteria you can use besides the traditional demographic approach. It may actually give more insight into their willingness to pay.

units: Apartment communities have historically run between 3 percent and 7 percent vacant. Now with potential availability through site such as AirBnB.com and other micro rental sites, we have the ability to overlay a hospitality or bed and breakfast model on top of the long-term apartment rental model. It offers the potential for filling in vacant days. But it is essentially a new business with new regulatory and operational challenges. So the question is – do companies ever adopt new business models to sell to new micro-markets or to sell excess inventory? Has it ever been worth it to change the core business to sell unsold or re-optimized goods?

RC: The first thing that comes to mind is that the graveyards of companies are scattered with the bones of those who changed their business model to chase incremental demand! Now that is not to say there aren't opportunities, there are. The questions you have to ask before you start chasing that demand are: how big is this opportunity, what is the impact on your process, your employees and your current residents? Owners need to think about those factors. All that being said, revenue management was started because there was excess inventory in the airline industry but they were looking at 40 percent excess not 3 percent to 7 percent. It can be risky and needs to be carefully evaluated.

units: Do you have any examples of consumers organizing to push back against rent being revenue-managed or having experienced variable pricing? Are group discounts like AAA or AARP a reaction or resistance to price variability and can these discounts—whether a consumer deal or business-to-business standing discount—be somehow optimized perhaps through selective display of availability?

RC: It is so fascinating—consumers hate variability pricing and complain loudly when the price goes up. However, they love it when the price goes down—but you never hear a word. What some companies are doing with AAA and AARP, instead of giving a fixed rate they are offering a fixed discount off a variable rate. This seems to be working pretty well. The members seem to think they gain an advantage from membership in the organization and it also gives the company the opportunity to flex the rate based on market demand. Members are still receiving a perceived value even though rates may be higher.

units: With homeownership rates currently at 66.5 percent, down substantially from the 2004 high of 69.2 percent, and the apartment industry riding a strong wave of new or returning renters, how can apartment owners continue to raise rents without being perceived as gouging consumers during today's difficult economy?

RC: Revenue management really is not about rate maximization but about rate optimization. It really works to look at the long-term impact on residents. What is the lifetime value of the customer or customer segment? Sometimes you must forgo a near-term opportunity to gain the long-term value.

units: The apartment industry shares several similarities with the hospitality industry, but price elasticity is slightly more difficult. Due to the long-term nature of the rental housing market, it's not uncommon for a new resident to pay less for the same unit as a renewing resident. In your opinion, when customer satisfaction is so critical, how do you respond to a renewing resident who expects the same rate as a new resident?

RC: There are a lot of industries where this happens—such as cable television—in which new customers are given the promotions and discounts to sign up for their service. Then you have the customer who missed the sale—they buy food or clothing and it goes on sale the next week. Those things happen. Price variability goes both ways. Occasionally the non-resident rate is more than the resident rate. As a resident, you have the ability to lock in your rate and know what you are going to pay. There are those residents who say, 'Well, I am going to sign a lease down the street and get the first month's rent free.' Truthfully, you may not want that resident.

units: You have worked as a trusted advisor to some of the leading Fortune 500 CEOs and CFOs, what is the biggest take away you received by working with them? How can apartment owners/operators apply this insight into their business practices?

RC: CEOs have an enormous amount on their minds. They are constantly being pulled in many different directions. They are always trying to balance the competing interests of investors, employees and customers. Great CEOs think in terms of solutions, not problems. A CEO thinks, aside from balancing competing interests, in terms of dates and dollars. When is this going to be done, how much is it going to cost and what is the ROI? When trying to determine if they should get into revenue management, there is always the question of what it is worth to us. We should do this. It is the right thing to do—How much money will this make us? Quantify this for your CEO.

units: Where is revenue management failing? Are there companies or sectors where revenue management efforts have hurt the company either because of something intrinsic to the company or optimization is somehow not right for the business or industry sector?

RC: I have never seen it fail when implemented correctly, because again, it is not about the system. I have seen errors by people who thought this was just a way to drive rates. In order to make it work, you have to work with it. But the returns are incredible and if done right, the returns are there for the residents as well.

units: Finally, do you believe every apartment owner/operator should engage in revenue management? If so, why?

RC: Absolutely, without a doubt (laughing). This is so easy to answer. If you're not being successful then you just don't get it and you don't know what revenue management is about. You're thinking about it as either a technology OR a process. Fundamentally, revenue management is about understanding. You are getting all the data, you are doing all the analysis to fundamentally understand who your customers are, what their needs are, what are their alternatives, how they are likely to react, what do we have available. Once you know all of this, you can then position yourselves to sell the right unit to the right customer at the right time and at the right price. That is the mantra—we call it R to the 4th.