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## Practice Article

# Competing in an LCC world

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**ABSTRACT** The way in which low cost carriers price their product and revenue manage their flights has posed a commercial challenge to their traditional competitors, and also questions the validity of the conventional airline revenue management theory and practice. This paper examines how they differ in their approach, how airlines are responding and what constitutes an effective response in the changed airline business world. This includes consideration of all the marketing levers (product, price, promotion and distribution) in an integrated way, as well as developments needed in the core revenue management systems themselves.

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## INTRODUCTION

The success of low cost carriers (LCCs) has had a dramatic impact on how airlines compete. This may be clearest in pricing and revenue management (P/RM). In an LCC world, vast numbers of fares have been rendered obsolete and many more simplified. The Saturday Night Stay rule – the backbone of market segmentation between business and leisure – has been crippled. Sophisticated revenue management systems, which had been refined over 20 years, are being outdone by relatively simple rules.

As the airline industry faces up to the fresh challenges of volatile fuel prices and economic recession, the competition for the reduced number of passengers has intensified with, if anything, an increased focus on the price-sensitive segments as airlines struggle to fill their aircraft.

Over the past 5 to 10 years we have seen a variety of tactics for competing in a post-LCC world, as most airlines have adopted those elements of LCC practice that make sense even in a full-service environment. It is clear that



there is no single formula for success: carriers must use a variety of strategies spanning their entire organisation. This paper aims to provide a brief overview of the range of strategies for effectively competing in a post-LCC world, especially those in P/RM.

## WHY HAVE LCCs HAD SUCH A PROFOUND EFFECT ON THE INDUSTRY?

We frequently talk about LCCs as if there were a single LCC formula for success. In fact, the successful LCCs utilise significantly different strategies:

- Some LCCs provide bare-bones service while others offer considerable amenities.
- Some LCCs offer inclusive service while others have ‘unbundled’ the service elements.
- Some LCCs use primary airports while others use secondary airports.
- Some LCCs are hub-oriented while others have sprawling networks.

In fact, there are only two attributes which generally apply to most LCCs:

- they are extremely focused on maintaining a low cost of service; and
- they are generally associated with ‘non-fenced’ pricing.

Over the years traditional airline pricing had become increasingly complex, difficult to explain to customers and expensive to implement. The core concept driving the complexity was that different individuals could and would pay different amounts for essentially the same product – a seat on a flight from A to B. By the introduction of an array of complex rules (‘Saturday Night’ rules, Advance Purchase, and so on) or ‘fences’, the airline industry was able to segment the market effectively and ensure that business travellers paid the higher fares needed to support the relatively high costs of running a traditional airline. However, there are several downsides.

In practice, carriers are not able to tailor their fare structure perfectly to match passengers’ willingness-to-pay. So the same rules which prevent business travellers from accessing cheap fares also prevent genuine price-sensitive personal travellers from using those fares. On many traditional carrier flights there were empty seats which could have been sold but for the fare rules with resulting lower load factors and revenue. These price structures made little sense to the average customer and created an image of airlines as over-priced and exploitative.

Furthermore, traditional airlines have had to:

- develop costly systems and processes to file and manage fares;
- educate reservation agents in the complex task of finding and selling a fare to suit the customer;
- develop reservations and Global Distribution Systems (GDS) to be able to interpret the rules, quote the correct fare and issue tickets; and
- develop complex systems for billing and revenue accounting.

LCCs diverged from the general trend toward aggressive price discrimination and revenue management. They generally did not use fare fences to segregate the market. Originally, LCCs were truly able to stimulate traffic by offering fares genuinely below the traditional carriers’. Within Europe for example, 35 per cent of capacity is now offered by Low Cost operators, much of which has opened up new markets and routes not flown previously. Estimates typically put one-third of this growth being market share switch from existing carriers and two-thirds market stimulation. Now, it is more likely that the traditional carriers will match the LCC fares with at least a portion of their inventory. The LCCs’ simple fare structures are less costly and appeal greatly to the target market.

The adoption of non-fenced fares has undermined the established theory and practicalities

of revenue management. As discussed further below, LCCs typically employed a simple form of revenue management to:

- increase revenues on high demand flights; and
- increase fares for (less price sensitive) late-booking passengers.

Furthermore, the non-fenced LCCs' fares could be purchased by passengers for whom time and schedule convenience rather than price are most important. Fares were frequently so low that such 'service sensitive' passengers could purchase an LCC service even if there were a significant chance that they might bear a nominal change penalty, or in the worst case, throw away a flight coupon, and so removing the need to pay for flexibility. For an LCC carrier competing against a traditional carrier this is a competitive advantage; for a traditional carrier it poses the dilemma of choosing to not respond and lose the customer, or adopt a similar price structure and risk down-trading of its own customers to the lower fares.

The major expansion of LCCs also occurred at a time when online agencies (that is, Orbitz, Expedia, and so on) made the price and flight availability much more transparent. Further, these systems tended to display alternatives in fare order, making travellers acutely aware of how much they were paying above the minimum fare. The LCCs' lower fares, coupled with better consumer access to price information, has vastly reduced the ability of traditional carriers to use fare rules to segment the market and earn a price premium. The success of LCCs has, as a result, altered the whole trajectory of airline P/RM.

Based upon analysis for the United States in the early years of this decade, the ratio of 'High' to 'Low' fares decreased from nearly 4 to just over 3, indicating that carriers were less able to effectively segment the market and could no longer earn high premiums on business fares.

## HOW DO LCCs PRICE AND PERFORM REVENUE MANAGEMENT?

With their unceasing focus on keeping costs low, LCCs typically employ simple strategies for P/RM.

### Pricing

The newer LCC airlines, not surprisingly, have opted to start with a clean sheet of paper when designing their price structures and gone back to the basics. There are four principles now followed by the majority of self-styled low cost airlines.

#### *Offer a single (or very limited number of) core products*

The LCCs have effectively abandoned the principle of market segmentation. They generally offer a single fare product, albeit at different fare levels. Non-refundable one-way fares are the norm.

They believe that the stimulation of demand outweighs the premiums to be earned from complex fare products. The simplicity is also appealing to the market, works well with online booking engines and helps them maintain low costs.

#### *Price according to supply and demand*

The LCCs keep prices low when demand is weak and there is a need to stimulate demand. They increase prices where demand is strong. This is achieved by having a ladder of fares which increase in relatively small steps (US\$10–US\$20) allowing the price to be adjusted gradually according to booking pace.

The example in Figure 1 is from the easyJet website on 1 May 2008 for a one-way trip from London Gatwick to Barcelona about 3 weeks later. All fares shown have the same conditions and only vary in price. The range is from £47.99 to £302.99, with steps at the lower levels of around £10.


#### *Book early to get cheaper seats*

Although LCCs do not use complex fare rules to segment the market, they do segment the

market based on time before departure. Seats booked early are the cheapest. Close to departure, only more expensive seats are available. They are effectively taking advantage of the fact that less-price sensitive (generally

business) passengers tend to book closer to departure. This is sometimes referred to as 'Invisible Advance Purchase'.

The example in Figure 2 shows the same journey but two months later at the start of the

**Outbound** 

**London Gatwick to Barcelona: all flights**

Wed 21 May	Thu 22 May	Fri 23 May
<p><b>£47.99</b> incl. taxes and charges dep. 06:55, arr. 10:10</p>	<p><b>£97.99</b> incl. taxes and charges dep. 06:55, arr. 10:10</p>	<p><b>£162.99</b> incl. taxes and charges dep. 06:55, arr. 10:10</p>
<p><b>£59.99</b> incl. taxes and charges dep. 10:55, arr. 14:05</p>	<p><b>£117.99</b> incl. taxes and charges dep. 10:55, arr. 14:05</p>	<p><b>£162.99</b> incl. taxes and charges dep. 10:55, arr. 14:05</p>
<p><b>£59.99</b> incl. taxes and charges dep. 14:30, arr. 17:35</p>	<p><b>£97.99</b> incl. taxes and charges dep. 14:30, arr. 17:35</p>	<p><b>£162.99</b> incl. taxes and charges dep. 14:30, arr. 17:35</p>
<p><b>£67.99</b> incl. taxes and charges dep. 19:10, arr. 22:15</p>	<p><b>£117.99</b> incl. taxes and charges dep. 19:10, arr. 22:15</p>	<p><b>£302.99</b> incl. taxes and charges dep. 19:10, arr. 22:15</p>

Figure 1: LCCs vary their fare based on demand.

**Outbound** 

**London Gatwick to Barcelona: all flights**

Wed 23 July	Thu 24 July	Fri 25 July
<p><b>£47.99</b> incl. taxes and charges dep. 06:55, arr. 10:10</p>	<p><b>£64.99</b> incl. taxes and charges dep. 06:55, arr. 10:10</p>	<p><b>£127.99</b> incl. taxes and charges dep. 06:55, arr. 10:10</p>
<p><b>£59.99</b> incl. taxes and charges dep. 10:55, arr. 14:05</p>	<p><b>£84.99</b> incl. taxes and charges dep. 10:55, arr. 14:05</p>	<p><b>£107.99</b> incl. taxes and charges dep. 10:55, arr. 14:05</p>
<p><b>£57.99</b> incl. taxes and charges dep. 14:30, arr. 17:35</p>	<p><b>£74.99</b> incl. taxes and charges dep. 14:30, arr. 17:35</p>	<p><b>£87.99</b> incl. taxes and charges dep. 14:30, arr. 17:35</p>
<p><b>£47.99</b> incl. taxes and charges dep. 19:10, arr. 22:15</p>	<p><b>£72.99</b> incl. taxes and charges dep. 19:10, arr. 22:15</p>	<p><b>£79.99</b> incl. taxes and charges dep. 19:10, arr. 22:15</p>

Figure 2: LCCs offer cheap seats early.

summer holiday period, so still a busy out-bound flight. As of 1 May there are still many more of the lower fares available, particularly on the Friday. As bookings come in these prices will rise.

**Unbundling – Paying for each element separately**

The customer proposition of most LCCs is that you only pay for the elements of the service that you want. So typically food, drink and in-flight entertainment are paid for as extras. This concept has been extended to pricing – if you want to change your booking, you pay for that

when you make the change, rather than buy the freedom to change at the outset. You can now find yourself paying for desk check-in, hold baggage, seat reservation or priority queue, use of a credit card, as well as for change of booking, change of name and on-board amenities.

In the easyJet example in Figure 3, the customer has the option of ‘Speedy Boarding’ for £7.50 (each way) and checking in a hold baggage for £5 (each way). The dialogue continues with offers of insurance and car hire.

These ancillary revenues are becoming a significant proportion of revenue for some carriers – Ryanair for example plans that

The screenshot displays a flight booking interface with the following sections:

- Your selection for 1 adult:** Shows a flight on Friday 25 July from London Gatwick (South Terminal) to Barcelona. The price is £87.99 per person, including taxes and charges. There is a 'Remove' option.
- Speedy Boarding & Speedy Boarding Plus:** Offers 'Speedy Boarding Plus' for £7.50. A description states: 'Get ahead of the crowd with Speedy Boarding/Speedy Boarding Plus! Be among the first through the boarding gate, get the widest choice of seats, and at certain airports get access to a dedicated check-in desk.' The total cost for this booking is £7.50. There is an 'Add Speedy Boarding' button.
- Hold Baggage:** States that 1 passenger can check in a combined total of 1 hold bag(s) for each flight, with a 20kg weight allowance per passenger. The total cost for this booking is £5.00. There is a dropdown menu set to '1 hold bag(s)' and an 'Update hold bag charge' button.
- Sports Equipment:** This section is partially visible at the bottom.

Figure 3: LCCs unbundle their products.

20 per cent of its revenues will be from ancillaries within 3 years (O’Leary, 2008): ancillaries here includes all supplementary revenues including commissions on car hire and insurance sold through its website.

In summary, this style of price structure has the big advantage that it allows the customer to easily make a trade-off between price paid and choice of flight, and this is particularly true when sold through an effective web booking engine. It makes it very easy to buy. At the same time LCCs use the selling process to augment their revenue by charging for each element and promoting extras such as insurance and car hire.

## Revenue management

A leading supplier of systems to LCCs estimated that less than a quarter of their customers used a ‘revenue management’ system, but rely instead on basic inventory control functionality. LCCs typically manage inventory utilising fairly simple availability rules related to expected demand, bookings (or load factor) and time before departure. They still use Booking Classes (BCs) and there is generally one fare per class.

Rules are set up for each season, day-of-week and for holidays/special events. The availability of each BC is dependent on the bookings on the flight and the time before departure. Figure 4 provides an example of rules during a low demand period. If the bookings are below a threshold for a particular BC, that BC is open. (As there is very limited segmentation through fare rules, the passenger will book the lowest BC available. In essence, only one fare is open and applicable at a time.) As bookings grow, the lower BCs are closed down and passengers are forced to buy from the higher priced inventory.

As one gets closer to departure, the LCC may close down some BCs (regardless of bookings) in order to force the late-booking, price-inelastic passengers into higher BCs.

Inventory Control for a high demand flight may look more like Figure 5. Considerably less space is given to the low value BCs. Virtually all passengers are forced to buy-up to the higher fares. Savvy travellers have noticed that during times of high demand, LCC carriers are generally not low fare (see the earlier easyJet Barcelona example).

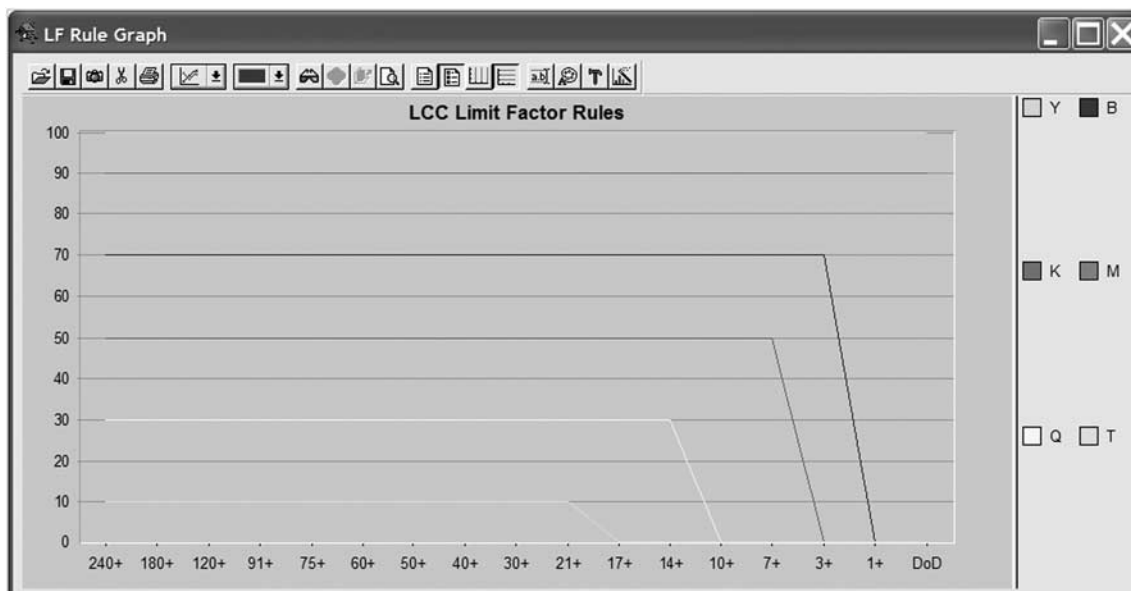


Figure 4: LCC booking rules – low period.

This approach also has the benefit of steering price-sensitive early bookers towards the weaker flights, and holds back higher priced seats on the more popular flights for those willing to pay the higher price.

With non-refundable fares, many (but not all) LCCs do not overbook, further simplifying their processes.

Many LCCs rely on booking behaviour in relation to historic patterns. This may be viewed as a form of ‘Management by Exception’. If the flight is booking as it has historically, then the historic rules are probably sufficient. If the flight is booking materially faster or slower, then it should be flagged for review by the flight controller (see Figure 6).

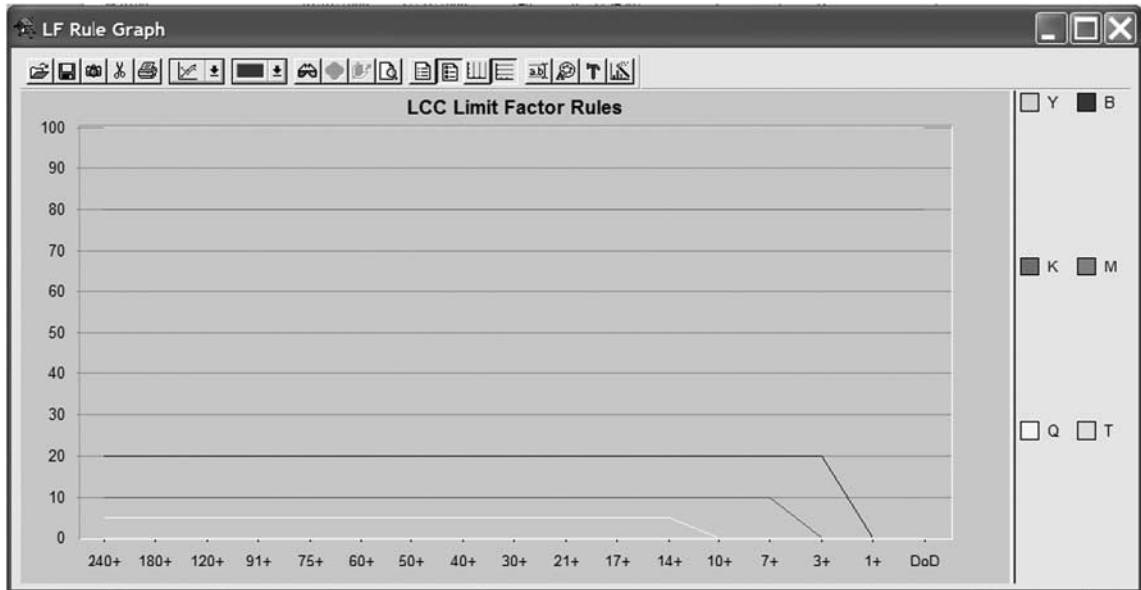


Figure 5: LCC booking rules – high period.

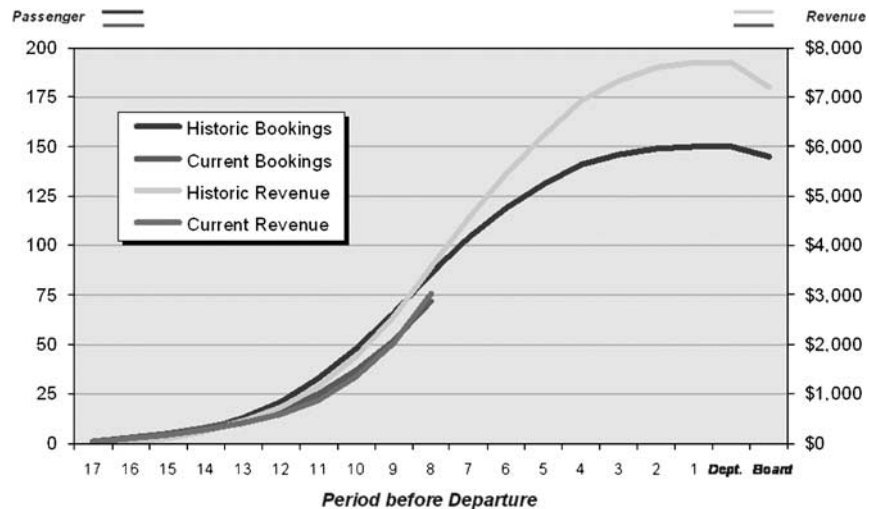


Figure 6: Passenger and revenue performance vs history.



If the controller finds that the flight is booking slower than expected, he will generally search out the underlying cause. His response may be to open up lower BCs, or staying on the same path if he believes that lower fares will dilute yields rather than stimulating demand. If the flight is booking more quickly than expected, then the controller should also search for the underlying cause. However, he will more than likely close down some lower BCs.

While the differences in reviewing flight performance are subtle, LCC controllers

- rely on seasonal, day-of-week and holiday demand patterns, but frequently do not rely on demand forecasts;
- tend to concentrate more than their traditional counterparts on the rate of bookings; they may also have some non-traditional tools for assessing the demand for the flight, such as website hits;
- tend to have better information on the competitive situation, such as their competitors' selling fares.

These tools provide the LCC controllers with quicker feedback on the performance of each flight departure. They are generally more active in reacting to factors influencing consumer choice.

## HOW TO COMPETE IN A POST-LCC WORLD?

Just as there is no one formula for a successful LCC, beyond the obvious focus on cost reduction there is no one method for competing in the current environment. However, there are a number of themes and each carrier must select from these based on its own situation. Each carrier must consider the degree of competition and the strategy of its competitors.

### Emphasise your product strengths and develop service style

To compete with LCCs, existing carriers need to both play to their strengths (product,

range of services and schedule offered, brand loyalty) and address their weaknesses. LCCs generally offer one product. Hybrid Carriers generally offer a range of products with complementary 'fare products'. (Fare products will be addressed later.)

### *Cabins and seating*

This can include First and Business Class cabins. In many markets where there has been a material drop in Premium demand, many carriers are offering 'Premium Economy'. There is probably pent-up business demand by passengers who cannot book in premium cabins (due to corporate travel policies), but would gladly pay a higher fare in exchange for a better seat and more leg room.

### *On-board experience*

A premium product could include better in-flight service, including food and entertainment. Airlines can also work on their customer service 'style' – many LCCs have lower selection standards and do not invest in training and customer service beyond the statutory requirements. Established airlines have a clear opportunity to deliver an improved service through the way they interact with their customers, something it is harder for LCCs to emulate without a sustained investment over time. Of course there is no reason why a LCC should not excel in this area. Southwest is a good example.

### *Ground elements*

The product also includes the booking and check-in experience, such as dedicated and enhanced services at the airport (check-in desks, fast track security channels, lounges, priority baggage and so on). Visible recognition to differentiate the product is also important, such as dedicated cabin crew and on-board rest-rooms all create a sense of higher status travel. Finally, the product includes Frequent Flyer (FF) benefits. Business travellers can frequently be swayed in their service choice

based on FF benefits which may be used for personal travel.

### **Exploit your network and schedule**

Because of the markets LCCs target, few have as rich and far-reaching networks as traditional carriers. Hybrid Carriers should be able to exploit their network advantage to earn a premium:

- in Origin and Destination (O&D) markets not well served by LCCs;
- where LCCs serve less-preferred airports and
- where LCC service is not timed for business needs;
- by extending their network through alliances and code-share.

To be clear, the premium earned is contingent on the degree of competitiveness, and likely will not be as large as in the ‘good old days’. However, every increment helps.

In Europe many LCCs use secondary and often remote airports because of the lower cost. Stansted for London is much less convenient than Heathrow or Gatwick, Hahn is not a serious contender for business travel to Frankfurt.

### **Design and use fare products aligned with your market needs**

Traditional and Hybrid Carriers have always attempted to serve several market segments within the same aircraft and brand, and have used fare rules as a primary tool. As fewer and fewer business travellers on short-haul markets now purchase fares in the premium cabins, so the importance of price structure and inventory control has become more important. As a result, most carriers have redesigned their fare structures to achieve the best (for them in their markets) balance between segmentation to maintain yield and low prices to compete with LCCs.

The key elements that are generally followed are:

- Simplify – remove little used fares and eliminate redundant fare rules; reduce

the number of fare types within the structure.

- Compete with part of Inventory – include a ladder of low fares within the price hierarchy that can be used to stimulate demand on weak flights.
- Flexibility – one key differentiator that can be easily retained even with one-way fares is flexibility. Fares are frequently grouped into ‘Fare Families’ with identical flexibility rules and associated fees. These Families can be branded and explicitly used when marketing and selling via the web. Qantas pioneered this approach which is now common and has been further developed as a concept by Air Canada.
- Conditions – ‘Saturday Night Stay’ and other journey rules such as Minimum or Maximum stay. Each carrier should review the trade-off between the risk of trade down and losing market share. Many have decided in favour of higher volumes at lower yield and removed these critical rules that make for a much simpler fare structure. However, others with predominantly business travel have opted to maintain or re-introduce these conditions, perhaps competing with LCCs with discounted round trip fares.
- ‘One way pricing’ – One way pricing significantly reduces the carrier’s ability to segment the market. However, it is necessary in many competitive environments. As a minimum most carriers today allow full combinability on a half round trip basis within a defined set of economy fares. This supports web booking engines which ideally display fares on a one-way basis, but still allows retention of some rules such as minimum stay.
- Align fares with products – as a logical consequence of the Fare Families approach, it makes sense to review what other product elements can be bundled or unbundled in each Fare Family.

Hybrid Airlines should not forget about ancillary revenues. While some ancillary revenues undercut



the brand the airline is trying to project, others such as charging for a second hold bag, lounge access, booking changes, and so on, are rapidly becoming the norm for established airlines. For airlines with significant direct sales, the commission on additional items such as car hire and insurance can be material.

### **Invest resources in gathering market intelligence**

Identifying and synthesising the most relevant data in a cost-effective way is a key step to competing effectively. As the airline is fundamentally competing in each O&D market, this is the best place to start. O&D market data should include:

- Overall demand for key O&D markets, including seasonality and the impact of holidays/special events
  - Distribution of Demand by Distribution Channel and Point of Sale
  - Distribution of Demand by Service Oriented versus Price Oriented Passengers. There is currently no perfect methodology. However, an imperfect understanding of the breakdown is better than none.
  - Competitive Schedules in key O&D Markets. (This may include direct and connecting services. In some high volume markets, it may include time-of-day.)
- Competitive selling fares currently in key O&D markets by:
  - Competitor
  - Departure Date
  - Fare Product (if possible)

Some less-traditional sources of data include:

- Website hits (to gauge current interest)
- FF behaviour
- Very current Market Share information from MIDT, TCN or GDS/Online Agency Shopping data

- Sales force intelligence (most LCCs do not invest in large sales forces)

### **Develop a better understanding of market behaviour**

It is becoming more and more popular for carriers to create data warehouses to store the significant volumes of data related to competitive markets for analysis. Some of the important concepts which may be addressed with available data include:

- Demand Seasonality and Trends
- Distribution and Booking Patterns of Service Oriented versus Price Oriented Passengers
- Passenger Choice Factors for different types of passengers – such as
  - Fare Elasticity – market response to change in average fare levels
  - Fare Cross-Elasticity – how fare differentials between your airline and competitors affect market share
  - Carrier Preferences
  - Time of Day Preferences
- Risk of Trade-Down
- Re-capture Rate

There is significant effort on enhanced technology which will be able to estimate these various factors and consider them in optimising revenues.

### **Improve the use of automation, such as forecasting and optimisation**

Forecasting (even elaborate forecasting) at the flight-leg or flight-segment level is becoming less and less adequate. Some (mainly LCC) carriers have responded to this situation by eliminating forecasting from their Revenue Management processes. We believe that improvements in theory and forecasting techniques are important to maximising revenues for Hybrid Carriers.

Unlike traditional revenue management, one important current direction is to approach the market as a whole (including all carriers and services in the market). It then proceeds to allocate passengers to services based on service quality and fares, and passenger choice preferences. There are numerous advantages to this approach:

- Forecasting at a more aggregate level is more reliable than forecasting at disaggregate levels.
- The forecast can take into account major trends, such as service growth, fare levels, economic factors, exchange rate, and so on.
- The forecast can be modified based on booking activity (or other measures of current demand).
- The forecast can treat Fare- and Service-Oriented Passengers differently:
  - Fare-Oriented Passengers can be stimulated/de-stimulated based on the discount fare levels, and allocated to services primarily on price
  - Service-Oriented Passengers are allocated, based on their passenger choice

preferences, among the services based on service attributes and fares.

- The forecast can be allocated among competing services based upon Passenger Choice Factors. This is an extension of the techniques to estimate passenger choice, in the face of service and fare differences, for Network Planning (see Figure 7).

This current approach to forecasting fits an intuitive understanding of the market much better than traditional revenue management assumptions. It also works toward integrating P/RM with Network Planning. Plus, it greatly reduces one of the major limitations with traditional revenue management – forecasting when conditions have materially changed in a market (that is, new competitor, fare changes, and so on)

Similar progress is being made in Optimisation algorithms. It is becoming clearer that revenue is maximised by control at the O&D market level. Despite a ‘lull’ in O&D revenue management implementations while carriers digested how to compete in the post-LCC world, more Hybrid Carriers will migrate to

Org	Dst	Flight(s)	Dep Time	Arr Time	Elap Time	Cnx	Stop	Days	CSI	Pax		
Stn	Stn	Flight(s)	Time	Time	Time	Cnx Stn	Days	Share	Share	Share		
1	BOS	CMH	AA 4559	19:00	21:10	02:10	0	___6_	0.343	1.5	43.12	3.9
2	BOS	CMH	AA 4559	20:15	22:25	02:10	0	12345_7	2.059	9.1	96.22	8.8
3			<b>Total AA</b>						<b>2.402</b>	<b>10.7</b>	<b>139.34</b>	<b>12.8</b>
5	BOS	CMH	B6 1265	09:05	11:15	02:10	0	1234567	13.338	59.2	429.65	39.3
6	BOS	CMH	B6 1001 / B6 1093	06:00	10:20	04:20	1	JFK	0.372	1.6	1.92	0.2
7			<b>Total B6</b>						<b>13.710</b>	<b>60.9</b>	<b>431.56</b>	<b>39.5</b>
9	BOS	CMH	DL 5045	07:45	10:02	02:17	0	123456_	1.936	8.6	37.86	3.5
10	BOS	CMH	DL 6340	14:19	16:30	02:11	0	12345_7	2.214	9.8	257.62	23.6
11	BOS	CMH	DL 6412	18:00	20:11	02:11	0	12345_7	2.214	9.8	219.67	20.1
12			<b>Total DL</b>						<b>6.365</b>	<b>28.3</b>	<b>515.15</b>	<b>47.1</b>
14	BOS	CMH	US 3299	15:30	19:23	03:53	0	___6_	0.051	0.2	6.74	0.6
15			<b>Total US</b>						<b>0.051</b>	<b>0.2</b>	<b>6.74</b>	<b>0.6</b>
17			<b>Total BOS to CMH</b>						<b>22.528</b>	<b>100.0</b>	<b>1,092.79</b>	<b>100.0</b>

Figure 7: Example of airline network planning tool showing passenger share versus schedule quality share (CSI) on the Boston to Columbus route



next generation O&D revenue management systems. These systems will include:

- Recommendations by O&D market and BC/Product
- Consideration of the Risk of Trade-Down on recommendations
- Dynamic Pricing for the Fare-Oriented segment of the market
- Rules for BC closures (as discussed earlier) implemented at the O&D market level

### **Take advantage of inventory capabilities**

Inventory Systems have been responding to current market needs with enhanced capabilities. One challenge concerns the ability to cost-effectively control the passengers in different markets differently. For example, it may be beneficial to close the lower classes for local point-to-point markets to get price-inelastic passengers to 'buy up', while at the same time keeping deep discount classes open in connecting markets to try to stimulate demand and/or capture market share. Ideally what is needed is to be able to apply different control strategies in the various local and connecting markets.

One of the tactics that many Hybrid Carriers have adopted is to compete with the LCCs on a portion of their inventory. In practice, this may mean different things to different carriers:

- O&D Control allows carriers to control each O&D market differently.
- Point-of-Sale control allows carriers to control differently based on the Point-of-Sale of the passenger.
- Most Inventory Systems allow a carrier to treat some of their BCs as LCC-competitive.
- Capabilities such as Dual and Hybrid Nesting allow carriers to differentially control Local vs Connecting Passengers.

A related challenge for Carriers is to capture the additional revenue available from late, non-price-sensitive passengers, even if there are no

binding capacity limitations. A traditional revenue management system would tend to allocate space to the lower classes in this situation which would, without the protection of fare rules, result in down trading and dilution. Many Hybrid Carriers have taken to using LCC-type 'rules' (discussed earlier in this paper) to force late-booking passengers into higher fare BCs. This would be more effective if applied by market or group of markets, rather than by leg or segment.

There is a range of technologies to address these opportunities. However, whatever choice a carrier makes, systems with appropriate capabilities must be in place. Otherwise, the workload on flight control staff can increase beyond their ability to keep pace.

### **Make the most of marketing, sales and distribution**

One area of weakness for traditional airlines is an enduring perception in the market that they are 'high fare'. This view is actively propagated by the low cost competitors at every opportunity. This often continues after a 'new fare structure' is developed because, despite the best efforts of the P/RM teams, the new lower fares are not actively promoted and the market remains unaware of the fares. The LCCs spend a higher proportion of their income on advertising, and employ a much more direct approach that focuses on price. Many established carriers have tended to reserve publicising low fares for 'seat sales'. This practice tends to re-enforce the impression that most of the time their fares are exorbitantly expensive. A good example is British Airways. Before 2002 they virtually never mentioned fares in their advertising, which tended to dwell much more on the on-board product or the airline's image. Since they reworked their price structure in 2002, they now consistently advertise their low fares in most markets, and over time the perception has gradually shifted.

The second area of weakness to tackle is the booking engine itself – there are now myriad examples of how to make it easy for customers

to choose the right flight/price combination by use of calendar displays, colour coding and a minimum of clicks. This is also an excellent vehicle for selling extras – a balance has to be struck between going for the extra revenue and introducing so much clutter into the website that booking becomes an unpleasant experience. The easyJet website (shown earlier) illustrate this – their website has regularly won awards. Ryanair is probably pushing the boundary in terms of the number of steps needed to complete the booking and further decisions required, but does not appear to be suffering.

Finally, LCCs tend not to have a sales force deployed across their network, whereas established carriers do. They can be an invaluable source of competitor and market information, and can provide useful feedback on what is actually happening at airports, what the local press are saying, and other useful information that can inform head office decisions on when and how hard to compete on price.

## CONCLUSIONS

The success of LCCs has had a profound and lasting effect on P/RM, and on the airline industry in general. Not only has the LCC model proven to be profitable, but passengers naturally prefer its lower fares and fewer restrictions.

In responding to the challenges in an LCC environment, it is up to each carrier to find a niche within which it can succeed. However, there is no one strategy which will succeed for all carriers. Instead, there are a variety of tactics which carriers can choose among. The boundaries between what is Low Cost and what is Traditional are increasingly blurred with all airlines now trying to mix and match the elements from both models to give them the best position in their target markets. The speed with which all carriers are adopting elements of the LCC approach has gathered pace as the economic uncertainty increases price sensitivity.

The range of tactics covers all areas of importance to airlines:

- Product
- Network
- Pricing
- Revenue Management
- Marketing, Sales and Distribution
- Cost Control

The areas of P/RM have been particularly heavily impacted.

In the current environment it is considerably more difficult to segment the market. Many airlines are focusing less on implementing fare conditions to segment the Service Oriented portion of the market, and much more effort trying to determine how to effectively price, market and sell to the Fare-Oriented sector of the market.

Many carriers have conducted a comprehensive Fare Product Re-design to better address the Price Oriented market and exploit the benefits of online selling. Often the result has been a ladder of one-way prices with limited rules and limited flexibility. Many carriers have begun to unbundle their products.

The Pricing changes have had a knock-on impact on revenue management. The reduced use of fare rules has put increased pressure on revenue management. Revenue management now frequently bears the responsibility for adjusting to demand peaks and valleys. Further, use of rules such as Invisible Advance Purchase frequently provides the only means of market segmentation.

For most airlines, P/RM has now become an integrated function with responsibility for flight performance. P/RM effectively decides the price and availability on each flight each day. In addition, stimulation of the price sensitive market and the resulting increase in load factors has made P/RM even more important.

Where the original tenets of revenue management are no longer valid, airlines and vendors have responded to the current



environment through the collection of data, re-development of theory and enhancement of tools to support the changes. Greater emphasis is being placed on the 'comprehensive market view', gathering and using information about competitors' pricing and schedules. Airlines are working to gain a better understanding the passenger choice process. Business processes are adapting and systems are changing to incorporate these new factors into P/RM decision making.

Airlines do not all have similar resources to address the issues in the same way. Airlines must identify what tools are cost-effective for them in managing the different sectors of the market and competing effectively. Success will depend upon insightful decisions and expert execution regarding the issues that are important to your airline.

## REFERENCE

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