

Pricing and Revenue Management

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Lecture Overview

- Pricing and the Marketing Mix
- Revenue Management
- Booking Classes
- Network Revenue Management
- Overbooking
- Fare conditions
- Issues
- LCCs
- Last-minute Deals

Pricing and the Marketing Mix

- Pricing decisions cannot be made in isolation
- Depend on other aspects of the marketing mix
 - Product policy
 - Better onboard service → higher utility for consumers → prepared to pay higher price
 - Better onboard service → higher costs → need for charging more (ROI)

Definition of Revenue Management

- Revenue Management
 - “... is a **revenue maximisation** technique with aims to increase the net yield (or revenue) through the predicted allocation of available (...) capacity to pre-determined market segments at optimum price.” (Cooper et al., 2005, p. 398)
 - “Selling (...) to the **right people** at the **right price** and at the right time.” (Cooper et al., 2005, p. 398)
 - “... aim was to ensure a good **mix of high-yield and low-yield passengers** on any route by preventing slippage of high-fare passengers into lower-fare categories.” (Doganis, 2002, p. 282)

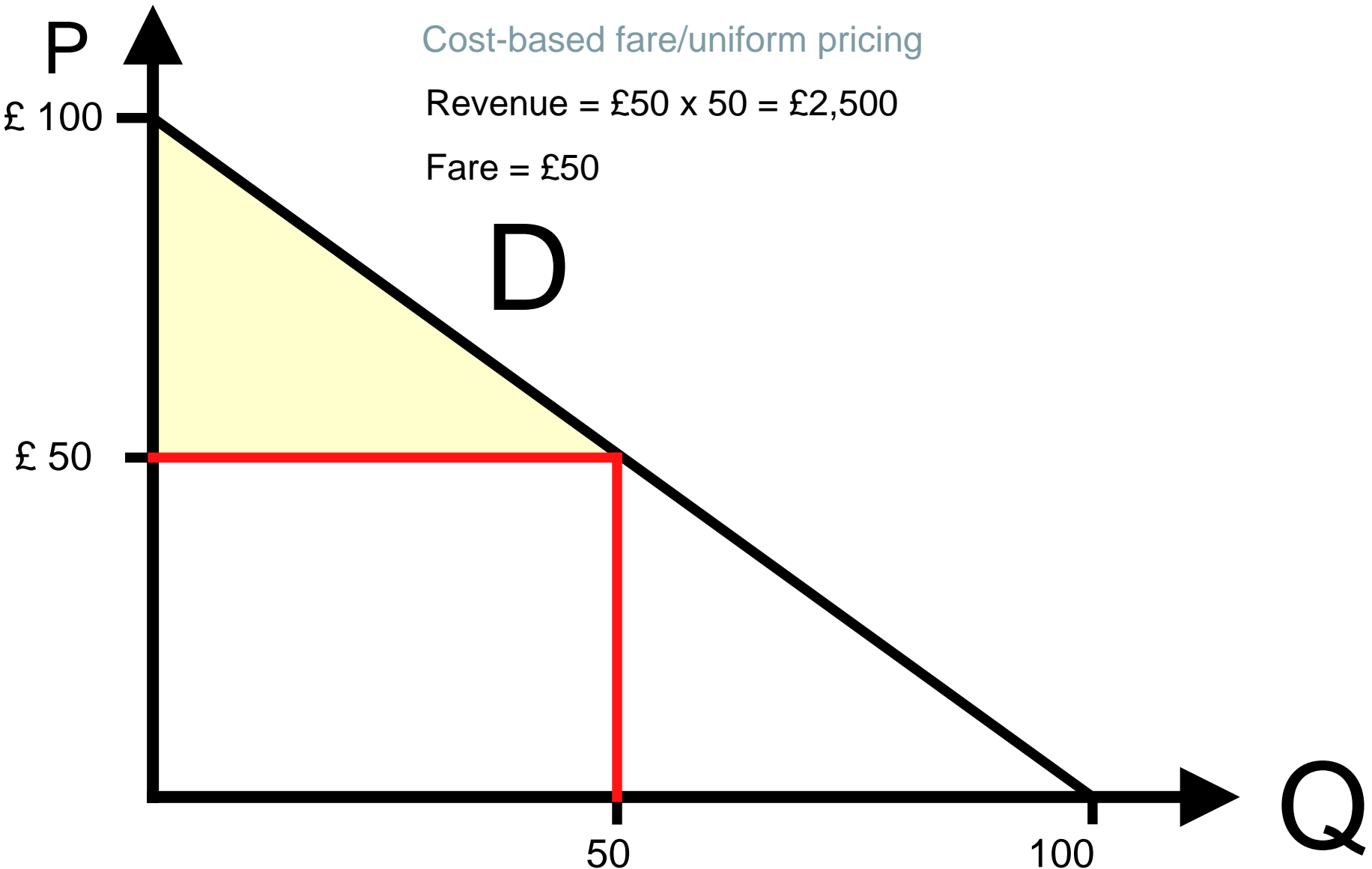
Objectives of Revenue Management

- Revenue maximisation/optimisation
 - Revenue per ASK rather than by RPK
- LF maximisation
- Supported by sophisticated software

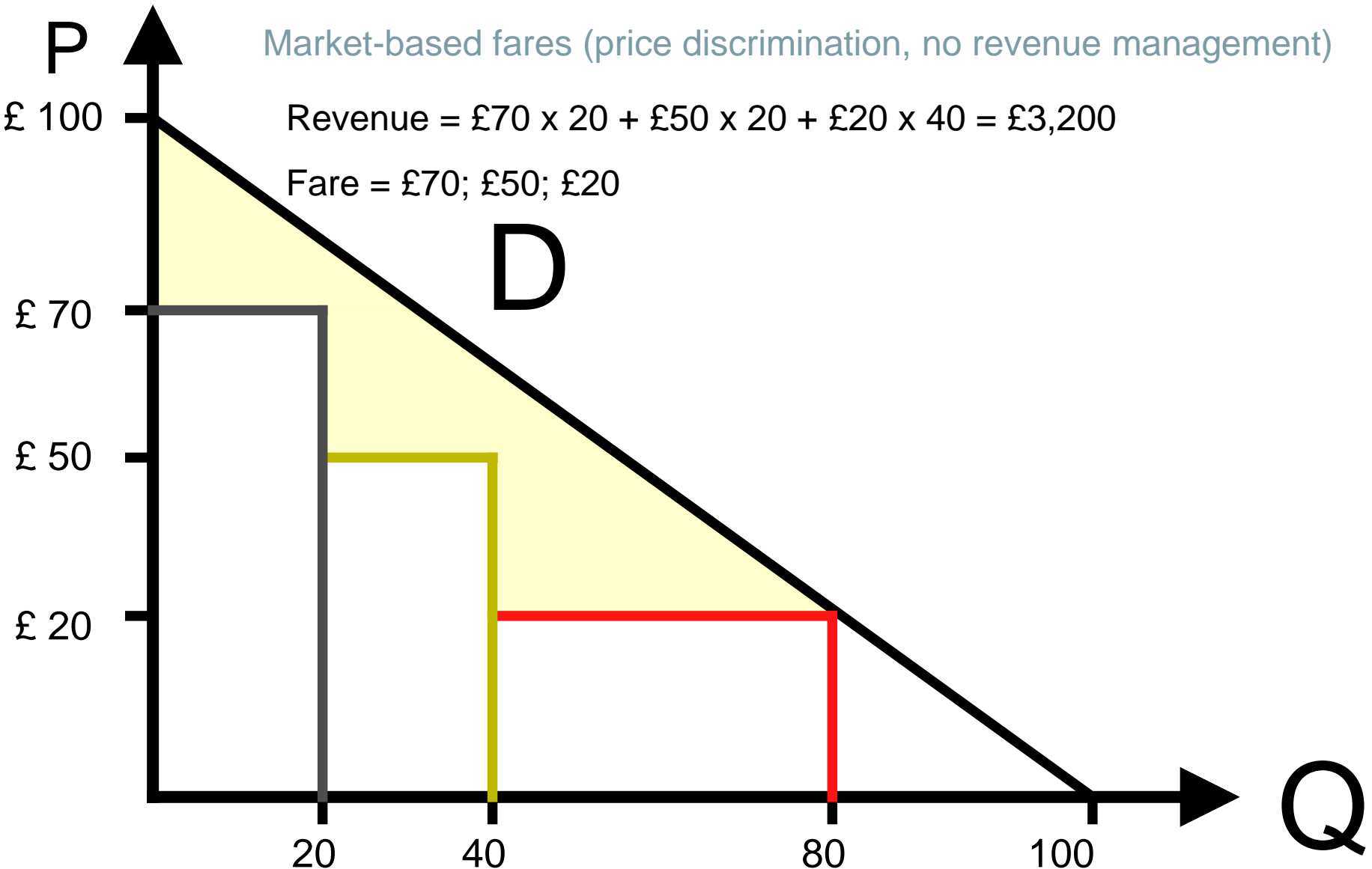
Revenue Management and Price Discrimination

- Price discrimination (vs uniform pricing)
 - Charging **different prices to different customers** (for the same/a similar product)
 - Difference in price is not primarily based on difference in costs
 - Based on **utility** for customer (willingness to pay)
 - Different customer segments have different price elasticities
 - Based on **different time preferences** (willingness to pay to be on a certain flight rather than another)

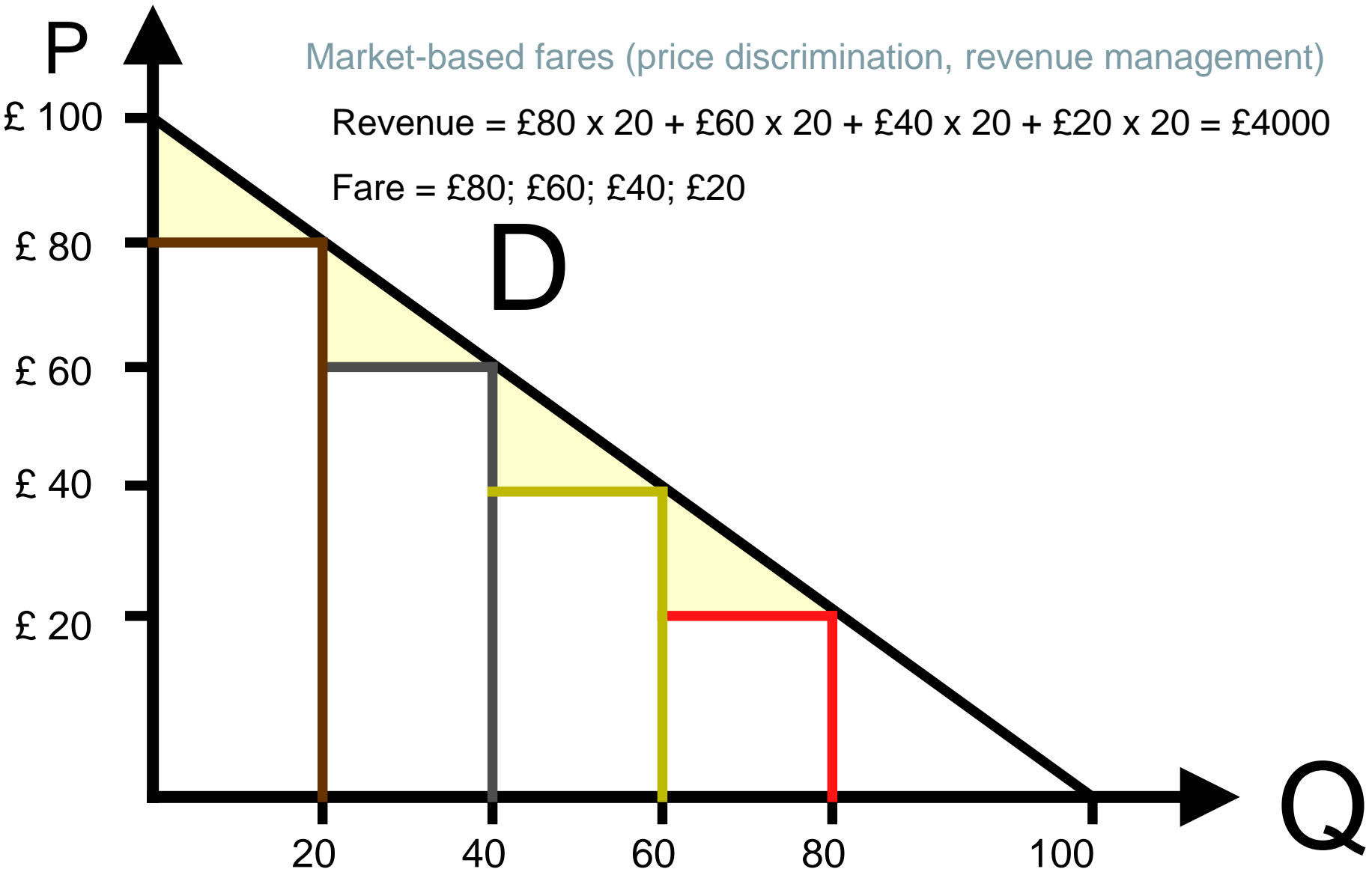
Revenue Management



Revenue Management



Revenue Management



Booking Classes & Fares

- Fares in air transport are primarily differentiated by **cabin class**
 - eg First, Business, Economy
- Within these cabin classes they are further differentiated into **booking classes**
 - Each cabin class can have numerous booking classes
- Booking classes are made up by fares with different conditions for purchase (= **fare conditions**)
 - Related to the willingness to pay

Allocation of Seats to Booking Classes

- **Fare-mix optimisation**
- Main question: *How many seats should be sold at what price?*
- Based on forecasts and market research
- Setting limits for booking classes
 - How many seats will be sold in each booking class?
 - Upper limit: physical capacity of aircraft + overbooking

Allocation of Seats to Booking Classes

- Problems related to the allocation of seats to booking classes
 - Too many seats allocated to discounted booking classes
 - → **Spillage**
 - Limited accessibility and availability for price inelastic segments that book last minute
 - A higher average fare could have been achieved
 - Not enough seats allocated to discounted booking classes
 - → **Spoilage**
 - More seats could have been sold on the flight

Allocation of Seats to Booking Classes

- Seat accessibility
 - Availability of seats (at last minute) important for certain segments
 - Why?

Network Revenue Optimisation

- How many seats to allocate on a short-haul flight to **point-to-point** traffic and how much to **connecting** traffic
- Latter one will generate less revenue on that route, but will provide further revenue on the connecting leg
- When flying via a hub airport passengers usually have **more choices** on their O&D routing than on point-to-point routes → **lower fares** on connecting routings (as more competition)
- **Lower willingness** to pay for **connecting services** vs point-to-point → lower fares on connecting routings

Network Revenue Optimisation

- Example: VIE – LHR – LAX
 - O&D demand VIE – LAX can be satisfied by numerous airlines (eg not only via LHR but also FRA, CDG, AMS, ORD...)
 - O&D demand VIE – LHR and LHR – LAX gives limited alternative routings for travellers
 - → Revenue VIE – LHR & LHR – LAX > Revenue VIE – LHR – LAX

Network Revenue Optimisation

✈ Outbound - Friday 16 September 2016						Price
11:50 16 Sep	13:25 16 Sep	Vienna	Heathrow (London)	BA0697 British Airways	Euro Traveller	€964.14 1 passenger Email price quote Baggage allowance Currency calculator
16:10 16 Sep	19:20 16 Sep	Heathrow (London)	Los Angeles International (CA)	BA0269 British Airways	World Traveller	
✈ Inbound - Saturday 24 September 2016						
21:35 24 Sep	16:00 25 Sep	Los Angeles International (CA)	Heathrow (London)	BA0268 British Airways	World Traveller	
19:40 25 Sep	22:50 25 Sep	Heathrow (London)	Vienna	BA0706 British Airways	Euro Traveller	
✈ Change flights						

Passenger	Fare	Taxes, fees and carrier charges per person	Total price**
1 Adult	€599.00	€365.14 ⓘ	€964.14

✈️ Vienna - Heathrow (London) - Friday 16 September 2016					Price
Departs	11:50	16 Sep	Carrier	British Airways	€206.89 1 passenger Email price quote Baggage allowance Currency calculator
Arrives	13:25	16 Sep	Cabin	Euro Traveller	
Flight	BA0697				
✈️ Heathrow (London) - Vienna - Sunday 25 September 2016					
Departs	19:40	25 Sep	Carrier	British Airways	
Arrives	22:50	25 Sep	Cabin	Euro Traveller	
Flight	BA0706				

[✈️ Change flights](#)

Passenger	Fare	Taxes, fees and carrier charges per person	Total price**
1 Adult	€120.00	€86.89 ⓘ	€206.89

✈ Heathrow (London) - Los Angeles International (CA) - Friday 16 September 2016					Price
Departs	16:10	16 Sep	Carrier	British Airways	£777.75 1 passenger
Arrives	19:20	16 Sep	Cabin	World Traveller	
Flight	BA0269				
					Email price quote
✈ Los Angeles International (CA) - Heathrow (London) - Saturday 24 September 2016					Baggage allowance
Departs	21:35	24 Sep	Carrier	British Airways	Currency calculator
Arrives	16:00	25 Sep	Cabin	World Traveller	
Flight	BA0268				

[✈️ Change flights](#)

Passenger	Fare	Taxes, fees and carrier charges per person	Total price**
1 Adult	£450.00	£327.75 ⓘ	£777.75

$$€599.00 + €365.14 = €964.14$$

$$€682.42 + €496.52 = €1,178.94$$

Exchange rate: £1 = €1.25 (12 April 2016)

Overbooking

- Why?
 - **Misconnections**
 - **No-shows**
 - **Late cancellations**
- Reduce spoilage
- Spoilage costs vs. DBC and customer loyalty
- Lower no-show rates on flights with more non-refundable/rebookable tickets

Fare Conditions

- To avoid slippage of high-fare passengers to low-fare classes
and
- to avoid that too many low-fare seats are sold (revenue dilution)
 - Fare conditions
 - Day-to-day monitoring of seat availability
 - Sales data
 - CRS & GDS utilisation
 - ➔ Complex and critical task

Fare Conditions

- **Restrictive conditions** of discount fares, “fences”
- Aim: **to make certain market segment book certain fares**
- Examples
 - Maximum/minimum stay limit (incl. “Sunday”-Rule)
 - Departure time limits (day of week, etc.)
 - Purchase time restrictions (advanced purchase, eg APEX fare)
 - Routeing restrictions
 - Restrictions on name changes
- **LCCs weakened the fare conditions** of network airlines
 - Often one-way pricing which is now also adapted by some network airlines

Fare Conditions

✈ Heathrow (London) - Johannesburg - Friday 02 September 2016					Price
Departs	19:05	02 Sep	Carrier	British Airways	£956.75 1 passenger
Arrives	07:05	03 Sep	Cabin	World Traveller	
Flight	BA0055				
					Email price quote
✈ Johannesburg - Heathrow (London) - Friday 09 September 2016					Baggage allowance
Departs	21:10	09 Sep	Carrier	British Airways	Currency calculator
Arrives	07:20	10 Sep	Cabin	World Traveller	
Flight	BA0054				

✈ Heathrow (London) - Johannesburg - Friday 02 September 2016					Price
Departs	19:05	02 Sep	Carrier	British Airways	£2,056.75 1 passenger Email price quote Baggage allowance Currency calculator
Arrives	07:05	03 Sep	Cabin	World Traveller	
Flight	BA0055				
✈ Johannesburg - Heathrow (London) - Friday 09 September 2016					
Departs	21:10	09 Sep	Carrier	British Airways	
Arrives	07:20	10 Sep	Cabin	World Traveller	
Flight	BA0054				

Flight	Fare conditions	Additional features
Heathrow (London) to Johannesburg	Changes Time/date changes permitted at any time before each flight departure for a change fee of £100 or an upgrade fee of £100 plus any difference in fare. Changes subject to availability. Fees apply per ticket If you want to cancel your flight There are no refunds except for any government & airport taxes	Operated by British Airways <ul style="list-style-type: none"> 31in seat pitch (78cm), lumbar support and adjustable headrest Non-stop entertainment: blockbuster movies, TV and audio channels Complimentary three course meal and drinks Check in online or on your mobile View all features
Johannesburg to Heathrow (London)	Changes Time/date changes permitted at any time before each flight departure for a change fee of £100 or an upgrade fee of £100 plus any difference in fare. Changes subject to availability. Fees apply per ticket If you want to cancel your flight There are no refunds except for any government & airport taxes	Operated by British Airways <ul style="list-style-type: none"> 31in seat pitch (78cm), lumbar support and adjustable headrest Non-stop entertainment: blockbuster movies, TV and audio channels Complimentary three course meal and drinks Check in online or on your mobile View all features

Flight	Fare conditions	Additional features
Heathrow (London) to Johannesburg	Changes Time/date changes permitted at any time for the difference in fare. Changes subject to availability If you want to cancel your flight If you cancel a refund is permitted, subject to recalculation of the fare for any journey flown. There are no cancellation fees.	Operated by British Airways <ul style="list-style-type: none"> 31in seat pitch (78cm), lumbar support and adjustable headrest This fare entitles you to choose your seat at any time prior to check-in Non-stop entertainment: blockbuster movies, TV and audio channels Complimentary three course meal and drinks View all features
Johannesburg to Heathrow (London)	Changes Time/date changes permitted at any time for the difference in fare. Changes subject to availability If you want to cancel your flight If you cancel a refund is permitted, subject to recalculation of the fare for any journey flown. There are no cancellation fees.	Operated by British Airways <ul style="list-style-type: none"> 31in seat pitch (78cm), lumbar support and adjustable headrest This fare entitles you to choose your seat at any time prior to check-in Non-stop entertainment: blockbuster movies, TV and audio channels Complimentary three course meal and drinks View all features

Revenue Management: Issues

- Disadvantages of price discrimination
 - Complex fare structure
 - “Fences” need to be developed
 - Training costs
 - Negative consumer perception
- Extreme forms of price discrimination reduced as LCCs opted for simpler pricing structure

Pricing of LCCs

- Use price differentiation
 - Different prices at different times of booking
 - Not always low-fare if booked close to departure

BUT

- **Only one price available at any time**

Pricing of LCCs

Ryanair

Price breakdown	
Flights	
London (STN) to Rome (CIA)	
Fri 15th Apr 06:25 - 09:55 FR 2672	
1 x Adult fare	£ 167.99
Rome (CIA) to London (STN)	
Sun 17th Apr 11:45 - 13:30 FR 3073	
1 x Adult fare	£ 206.99
+ Redeem a voucher / reward	
Total to pay	£ 374.98

That's about 1,500 TRY!

Last-minute deals

- Low marginal costs
 - i.e. the costs of selling one more seat are minimal (meal, handling, duties...)
 - Incentive to sell seats before departure at very low costs
 - Problem: slippage, diversion of more price inelastic segments

Conclusion

- Many FSNCs have changed their marketing mix
- Many LCCs have changed their marketing mix
- → hybridisation of business models
- Defining business models by their marketing mix is more and more difficult