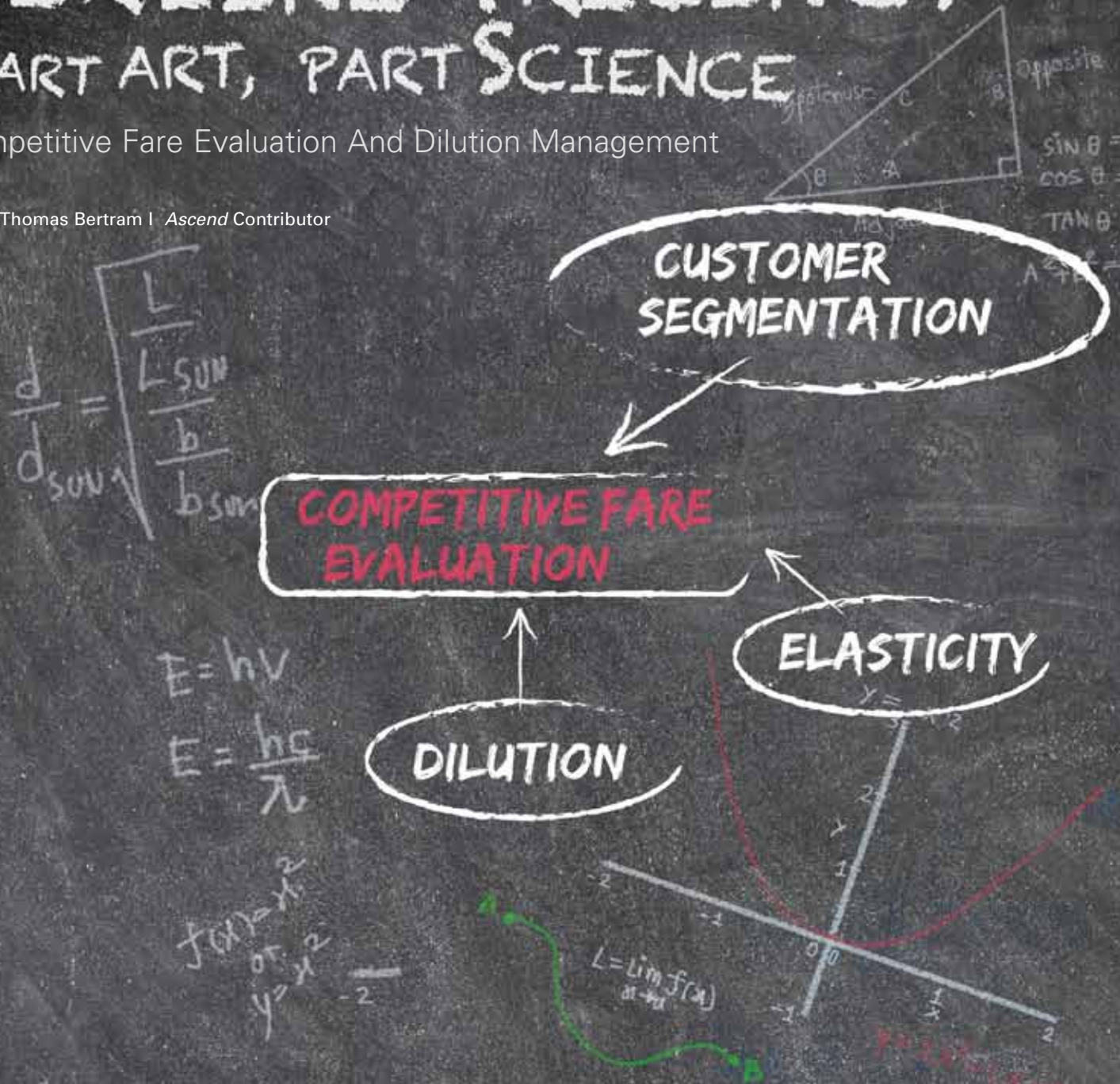


AIRLINE PRICING: PART ART, PART SCIENCE

Competitive Fare Evaluation And Dilution Management

By Thomas Bertram | Ascend Contributor



To respond to competitive pricing changes, airlines should tailor their pricing based on market segments, market strength and product comparison to reduce the risk of dilution and achieve competitive pricing.

From outside of the industry, airline pricing looks random and complicated. For those in airline pricing departments, it is a dynamic and highly competitive environment. Fares can be changed and distributed multiple times throughout the day. With so many pricing changes over multiple markets, quick and effective decision-making is imperative. So how does one determine how to react to a competitor's pricing?

There are three key pricing concepts to keep in mind when talking about competitive fare evaluation:

- **Dilution** — Simply defined, dilution is the difference between how much customers are willing to pay and what they actually pay. Dilution risk is present with all types of fares, but is especially problematic for higher value business-type fares, and in markets that have restriction-free pricing. Effectively minimizing dilution is central to pricing success.
- **Customer segmentation** — Different customers have different travel needs. People traveling for business want more flexibility and less pricing restrictions. They are also willing to pay higher fares to meet their travel needs. Conversely, people traveling for vacations and visiting friends and relatives are willing to accept more travel restrictions (advance purchase, minimum stays) in return for lower fares. When evaluating a competitive fare, it is critical to know the type of market segment that is being targeted. There are many segments in the airline industry; the larger ones are business, independent travelers, tours, ethnic, labor and student.
- **Elasticity** — Elasticity measures the sensitivity between changes in price and quantity of demand. When a change in a fare results in a high change in quantity demand, it is elastic. It is inelastic when a change in price has little effect on quantity of demand. Because airline fares change frequently, it is difficult to calculate the exact elasticity of a fare change. That said, there are some general attributes to determine elastic or inelastic fares:
 - Business-type fares tend to be inelastic; lowering the fare does not result in an increase of demand to offset the discount.
 - Small and remote markets also tend to be inelastic because the traffic base is too small to stimulate significant demand.
 - Large cities, vacation destinations, visiting friends/relatives and student markets tend to be elastic. Lowering fares may spur more travel in general, and make some consumers shift between modes of transportation, such as from train to airplane.

Competitive pricing activity comes from a variety of sources. The primary source of published fare information is fare distributors such as ATPCO and SITA. ATPCO transmits international fares on scheduled intervals through most of the day, seven days a week. Fare

management tools, such as *Sabre® AirVision® Fares Manager*, provide information on analyzing fare changes.

Other sources of finding competitive fare changes include an airline's field sales staff, Web scraping of airline and online travel agency sites, and advertisements in the media. Time is of the essence when responding to a competitive fare, so the quicker a pricing change is identified, the more the impact will be limited.

When reviewing a competitor's fare, there is more to consider than just the price. Analyze the associated rules, restrictions and distribution as well. For example, say a competitor lowered a fare by 40 percent. If looking at the fare value only, this could have a significant impact on revenue. However, if this fare is only good on Tuesday travel between 10 a.m. and 2 p.m. with a 21-day advance purchase, the impact is much less. By ignoring information about the rules and restrictions, matching the competitor's fare would result in serious dilution.

Reviewing these fare rules and restrictions, an airline can identify which market segments the competitor's fare targets. Fares with multiple rules/restrictions generally aim at leisure travelers. Before responding to a competitor's price, know and understand all information about the fare.

Know Your Markets

The first step to evaluating competitive fares is to understand your market. Not all markets are created equally. One way to determine and quantify a market is by relative yield and market share. Relative yield is a measure of a market's actual yield compared to the yield of the market's highest fare. To determine overall market strength, look at market share as the absolute market share. Quantifying markets in this manner provides a methodology to define the type of competitive pricing response to use.

It is important to view the competitive fare evaluation through the type of market. Each type of market has a general market profile that shows the characteristics of the market. Market types include:

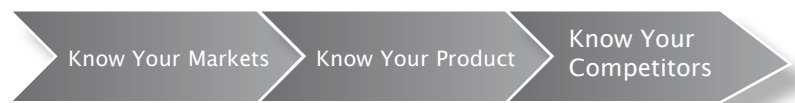
- High market share/high yield — Maintain market strength, improve yield and defend the market.
- High market share/low yield — Leverage market presence to improve yield.
- Low market share/high yield — Segment fare products to avoid dilution from higher fares.
- Low market share/low yield — Opportunistic pricing develops more demand.

High market share/high yield markets generally comprise a high component of business demand. Because most business customers are relatively inelastic, lowering prices does not usually generate any new revenue. In fact, it most likely will result in dilution. Therefore, an airline should tailor the competitive pricing response to protect high fares. It should match the competitor's price, but with additional restrictions such as advance purchase or minimum stays.

Conversely, in markets where the airline has low market share and low yield, the competitive position relative to the competitor airline allows an airline to be more aggressive on fares. At the very least, fares should be equal to the competitor. If the competitor has very strong market presence, there may also be an opportunity to undercut fares to drive additional market share.

Markets that have low market share and high yield might have a high percentage of business demand. Even though market share is low, protecting the higher business fares from discounting helps reduce the risk of dilution. Because market share is low, there could be an opportunity for selective pricing reductions in the lower fare ranges to attract incremental demand.

Evaluating Competitive Pricing Actions



Effective Competitive Pricing To determine competitive pricing actions, an airline must know its markets, product and competitors.

Finally, high share and low yield markets present an opportunity to leverage market strength to take small premiums against a competitor, especially if the fare is in the lower part of the fare hierarchy.

Know Your Product

Once the market type is identified, another factor in the competitive analysis is how the airline product compares with the competitor. Many factors go into the airline purchase decision, and understanding these factors can affect how to price. Key factors include:

- **Schedule** — This is one of the most important factors to consider, especially in markets with a high component of business traffic. An airline should analyze how its schedule lines up with competitors. Airlines that have higher frequency than their competitors and well-timed departures might be able to take small premiums on the higher business fares.
- **Load factor** — If markets are running a high load factor, there is little incentive to lower or undercut fares. If load factors are extremely high, implement small pricing increases. If pricing cannot be increased, work with the revenue management staff to reduce inventory in the lower reservations booking designator (RBDs) on high load-factor flights.
- **Loyalty/alliances** — Loyalty programs provide incentives for frequent travelers to fly with a specific airline or global alliance. Some customers are willing to pay a pricing premium to accrue miles on their chosen airline/alliance. If an airline has a strong program, it has an opportunity to

take pricing premiums versus a competitor. Airlines without a strong program may need to undercut the competitor's fare to entice customers to change their travel habits.

- **Airport/in-flight service** — While schedule and price are the two key drivers in selecting a flight, an airline's service can impact pricing. Airlines with poor service will not be able to extract a pricing premium versus a competitor that offers great service. Some airlines have legendary reputation for customer service, and their prices reflect that reputation.

Unfortunately, there is no magic formula on how to weigh the above items, but it is easy to look at each of these factors and determine if an airline is better or worse than its competitor. If an airline is superior to its competitor in all items, it may be able to take pricing premiums in the market. On the other end, if the airline lags behind its competitor in all four factors, at best it can match competitor fares.

Know Your Competitors

The final component to consider is understanding a competitor's pricing behavior. A good, experienced pricing analyst learns how a competitor airline will react to a pricing change. For example, if a fare is reduced and the competitor has a strategy to have the lowest price available, any decrease in fares will be matched. No advantage will be gained and it will cause dilution. If an airline has demonstrated it will not match a small undercutting of a fare, then taking small fare

reductions might move some small market share and revenue gains.

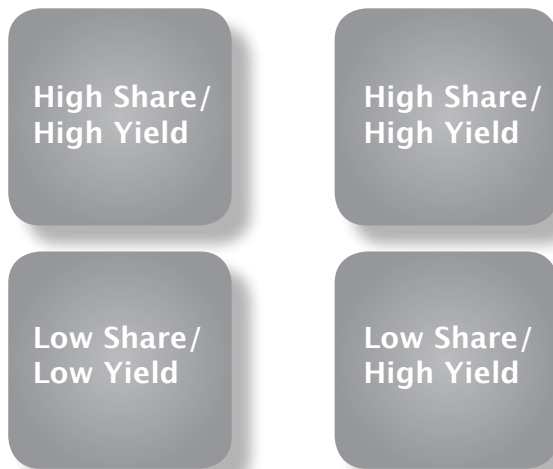
Before a fare change is launched against a competitor, an airline must assess how the competitor will react to the pricing action. It becomes like a chess match where players not only think about their next move but their opponent's next move, and then respond to that move. Anticipating the potential result in advance will reduce pricing churn.

When taking a competitive pricing action, it is important to measure the impact of the pricing change. One of the simplest and most immediate measures is reviewing advance bookings. Analyze both the total and bookings by RBD to see if there is an increase in demand, or if demand is just shifting between RBDs. If the competitive pricing response was to increase market share, then analyze market share data to see if the share did shift.

Finally, analyzing revenue accounting data can determine yield changes. If the data is available at the fare-basis code level, measure the impact of a specific fare. Based on the result of these analyses, adjust competitive pricing changes accordingly.

Airline pricing is one part art and one part science. Blindly matching a competitor's fare does not take into account the type of market, the market segment, or the airline's advantages and disadvantages. Tailoring pricing based on market segments, market strength and product comparison positions competitive pricing appropriately and helps reduce the risk of dilution. **F**

Market Types



Airline Pricing Video



Sabre AirVision Fares Manager



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