Burget airline travel

[Environment](), [Air]()

The Service Chosen For Discussion For This Asignment Is Burget Airline Travel From London To Other European Countries.

In recent years, the entry of low cost airlines has totally revolutionised the air passenger transportation industry. The low cost airline started full scale business in Europe in the early 1990. Since than Budget airline travel between London and other European countries has become very popular for holiday makers and businesses.

This will be used to answer the economics principles of the following questions.

(1)The three factors identified to affect demand for budget airlines between London and other European countries are price of substitute, price expectations and consumer income. Parkin, Powell and Mathews (2005, p55) stated the law of demand as ‘ other things remaining the same , the higher the price of a good, the smaller is the quantity demanded; and the lower the price of a good the greater is the quantity demanded’ (Ceteris Paribus)means all other things being equal

As the price falls consumers are willing to demand more units of the goods, for example , when the price above was £10 , consumers were demanding 10 units of the good and when the price falls to £5 , demand for the goods went to 20units.

Price Of Substitute

Substitute are products that compete with each other in the market to satisfy the same customers’ needs , they are said to be rivals in the same line of business . When Airline tickets become cheaper from London to Paris for example become cheap , customers who use the Train or Ferry to Paris will switch to travel by air and the quantity demanded for air ticket will raise , so demand will move to the right . In the other hand , if the price of ticket goes up and that of Trains or Ferry goes down, customers move to travel by either Train or Ferry and demand for airline tickets will fall forcing demand to shift to the left.

The above diagram will be used to explain the movement of demand due to other substitutes. When the price of Train tickets increased from London to Paris , demand for airline travel will move to the right from QD0 to QD1 and demand for Train Tickets will move to the left from QD0 to QD2.,

The second factor that influence demand for Budget Airline Travel is Price Expectations

Price Expectations

Budget Airline tickets are usually cheaper when you buy in advance and more expensive when you buy at last minutes. When consumers expect the price to increase, they will demand more now and wait if prices are expected to fall in the future. For example when Ryan air announced 1 pound ticket from London to Paris, within 48 hours, 1million seats were sold, this increased the demand for the ticket. Similarly, Ryan air announced they will reduce prices of tickets by end of December, consumers will wait and demand more when the prices are reduced, forcing demand at present to be decreased and demand to be increased at the reduce prices in the future.

In figure 2, if customers expect the price of Airline ticket to decrease/increase in the future , demand will move to the right from QD1 because you will bring your consumption forward and buy in advance. But your demand in the future will shift back to QD2

Consumer Income

This is the third factor of demand for budget airline travel. A rise in consumer ' s income will shift the demand curve to right for airline tickets indicating that more will be demanded as more people can afford to go on holiday and even send family members and friends. Airline tickets can be classified as normal service because increase in consumer income will increase the demand for more tickets and decrease consumer income or unemployment will reduce demand for tickets. A good example is the recent credit crunch when most employee income were cut and some were laid off , the airline industry was seriously hit and demand for air travel and holidays was dramatically been hit by the credit crunch so demand decreased.

In figure 2 above , when consumer income increase, the demand curve for airline Tickets shift from QD1 and shift to QD2 during the credit crunch.

How Elastic Is The Demand For Budget Airline Tickets.

Begg and Ward (2007) define ' elasticity is the measure of responsiveness to a change in price' Parkin, Powell and Mathews (2005 p91) indicated that the percentage decrease in the quantity demanded is less than the percentage increase in price, demand is inelastic . Demand for airline travel from London to other European countries is inelastic because an increase in price will only have small decrease in quantity demanded. So quantity demanded will be greater than zero but less than one.

There are number of factors for inelastic demand for airline travel within Europe, first of all, time is very important to business travellers and holiday makers. There is no substitute to travel to Europe faster than airline. For example the time taken to travel from London to Paris by air is about one and half hours and over three hours for other means of transport such as Ferry or Train. A change in the price of air tickets, will lead to a proportionately smaller change in quantity demanded due to time conscious travellers.

Secondly, substitutes, there is no other substitute that will give you comfort when travelling than airline, airport lounge is an example. For this reason many travellers will not change their way of travel even if the price is increased. A change in price will only have a smaller effect on the quantity that will be demanded because customers will not find the same comfort in other means of travel, such as Rail or Bus, so only a smaller number of customers would be lost or switch.

Q 2 Q1 QUANTITY

When the price move from P1 to P2, demand also moved from Q1 to Q2 but it has no much effect

How Is Price Discrimination Possible With Budget Airline Travel From London To European Countries? What Difficulties Can You Identify In Achieving Price Discrimination

Price discrimination is defined by Begg and Ward (2005 p44) as an act of charging different prices to different consumers for an identical good or service. Price discrimination is measured with the effect of ticket restrictions on airfare.

The large dispersion in airfares paid by passengers travelling on the same flight has been scrutinized by the press and consumer groups, who question the fairness of charging different prices for the same service in a seat on a given flight. However the variations in airfares can be justified by cost differences (i. e.., cost based) or discriminatory (i. e. .., demand based) The airlines price discriminate in two ways: first offering consumers a range of packages , or combinations of fares and restrictions attached to the tickets, secondly , by restricting the number of discounted seats on each flight . The first type of price discrimination is known as second – degree or self - selection price discrimination . Consumers choose their preferred version of version of the product based on their willingness to pay for a specific attributes of the good such as convenience, flexibility and time.(Lipsey and Chrystal 1999 pp161-164)

The second type is the case where carriers use a rationing device and limit the supply of the cheaper good. Travel restrictions attached to cheaper tickets make it costly for consumers to obtain discounts. In that way air carriers separate price sensitive consumers with relatively low disutility from travel restrictions from price inelastic with consumers with high disutility from tickets restrictions. For example, Saturday-night stay over and advance purchase requirements are designed to discourage price-inelastic consumers from buying cheaper tickets on given flight.

The difficulties identified with price discrimination of airline travel are that , there do not have market power to be able to charge prices above marginal cost, the population of consumers must be heterogeneous (otherwise the firm could not separate the market and the product resale must be impossible or costly, to prevent arbitrage .

Outline The Main Fixed And Varaible Costs That Are Assocaited With The Provission Of Budget Airline Travel.

Fixed costs are costs that are constant. They remain the same whatever the level of output. Variable costs in the other hand vary with the amount of production (Begg and Ward 2005 p50)

The provision of budget airline transport from London to other European countries certainly incur some costs

for the business to be operational, these are fixed and variable costs. The combination of fixed and variable equals to total cost. Fixed costs that are associated with airline travel are rent or purchase of buildings, lease payment, purchase of aircraft, insurance interest on loans . The buildings that an airline uses as offices are either owned or rented and the money that is paid towards that is fixed cost as rent may not change in the near future or the payment you made if you bought the buildings are all fixed costs. When you buy an aircraft to use for business, it becomes a fixed cost. Insurance is another fixed costs as the money you pay are not going to change in the interim . The interest you pay on loans are also example of fixed costs.

Variable costs are costs that change with the amount of output; examples are aircrew salaries, fuel, landing fees and passenger refreshments. The salaries paid to the aircrew may increase or decrease. When the number of passengers are increased and more aircraft are been used , more Cubin crew staff will be needed and more salaries will have to be paid out , however this will be reduced if passenger numbers fall and few aircraft are been used, so this type of costs are variable. Another good example is fuel , when more aircrafts are been used due to an increased in passenger numbers, more fuel will be consumed and the same way if the reduction in passenger numbers and less aircraft, there will be less fuel consumed and the costs associated to this costs are variable since the fluctuate with the level of passenger numbers. Landing fees are variable costs since more will be paid for more aircrafts landing and less for fewer aircraft landing due to passenger numbers.

Discuss The Extent To Which There Are Scale Econmies In Budget Airline Travel Within Europe.

Economies of scale arise when a firm is able to enjoy substantial cost reductions due to an expansion in size. It can be classified into internal and external economies of scale. Internal economies of scale are results of an expansion in a firm’s productive capacity while external economies of scale refers to the cost savings accrued due to an expansion in the size of the industry as a whole. Example of internal economies of scale includes managerial, financial, technical and marketing economies of scale. External economies of scale include economies of concentration.(Parkin, Powell and Mathews2005 pp194-196)

The airline industry is affected by economies of scale since fixed cost is extremely high; there is the need for expansion. The airlines expand by increasing their route and going into merger with each other thereby specialisation can take place and reduce fixed costs. When two companies merge, there is scale of economies because technical knowhow will be much better such as Pilots and engineers bring their expertise. Example of such merge is BA and IBERA in recent months , IBERA specialise in south American routes and BA specialised in north American , Africa , middle east and both of these companies coming together would form one of the largers airline company on the planet.

Managerial economies of scale in an airline industry is a form of division of labour where doing the same type of job for example Pilots and Cubin crew may specialise on the job that there do all the time and may be able to manage the equipments increase productivity and thereby reduce unit costs.

Financial economies of scale, airlines are classified as large firms and may be able to raise credit facilities because of the credit worthiness of the firm and also negotiate low interest rate from lenders.

Diseconomies Of Scale

(Begg and Ward 2007 P64) defined diseconomies of scale as the long- run average costs eventually begin to rise. There is a diseconomy of scale in an airline industry because as the firm get bigger and expanded to different countries and routes, it become difficult or expensive to control and monitor, in that instances managers find it difficult to monitor the performance of the workforce and decreasing return to scale set in.

Identify The Market Structure Of Budget Airline Travel Within Europe

There are three main types of markets; these are perfect competition, oligopoly and monopoly

Perfect competition arises when there are many firms that sell an identical product, many buyers and no restrictions on the entry of new firms into the industry. The many firms and buyers are all well informed about the prices of the products of each firm in the industry. (Parkin, Powell and Matthews 2005 p190). Examples of such markets is financial markets and agriculture products.

Characteristics of perfect competition such as free entry and exit to industry, large number of buyers and sellers, perfect information, homogenous products and firms have no market power will be explored .

Free entry and exit, this means that companies can move economic resources into the industry when they believe that profit can be maximise. In the same way there may move the resources out of the industry if they think the market is no longer profitable.

Large number of buyers and sellers, this will prevent any firm or buyer to have control of the market. There is no market power for any particular firm or indeed any buyer.

Since airline travel from London to Europe do not meet the above characteristics of perfect competition and do not fall in the category of monopoly where one firm supplies and control the market, it certainly an oligopoly. This is a market structure in which small number of large firms controls the market. An airline is very good example of oligopoly because there are few large firms in an airline business, such as ryanair, easy jet Thomas cook, thomsonfly, air Berlin etc. These types of companies provide identical service to their customers.

What Are The Main Barriers To Entry Into Airline Market In Europe?

Barriers to entry are legal or natural constraints that protect a firm from potential competitors. The legal regulations by government intervention is one of the barriers to entry into an airline market , in this case the government controls the number of flights that may land in their airport due to few run ways that may be available for more airlines to use those run ways. Another barrier is huge insurance cost, to enter into an airline market, you need to have comprehensive insurance and employer liability insurance , these types of insurance are very expensive and new business may find it difficult to buy , so it become an entry barrier to the new firm.

Huge start up cost, to enter into full airline service, high level of fixed and variable costs will have to be met in order to establish and maintain air services: labour. fuel, airplanes, engines , spares and parts . IT services and networks, airport equipments , aviation insurance and other costs are the capital that will be a barrier to entry into this market. Airport security checks can also be a barrier because staff will have to be fully checked and these can take long time before staffs are cleared to pass through the airport.

In conclusion, airline travel is an integral part of businesses of today . The service they render to transport people from one location to the other bring economics benefits as most businesses are operating internationally, and managers have to travel to other locations of their businesses in limited time frame and airline travel is the answer .

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