Ryanair and british airways | fare comparison

Environment, Air

Introduction

This document reports the findings of a review of the economics and business literature on empirically-estimated own-price elasticity of demand for air travel for Ryan air and British Airways. It refers to the data on page two of the assignment handout to both above airlines to illustrate and explain the concepts of price elasticity of demand and income elasticity of demand.

The purpose of this study is to report on all or most of the economics and business literature dealing with empirically approximate demand functions for air travel and to collect a range of fare elasticity measures for air travel provide in the data on the second page of the assignment topic and provide some judgment as to which elasticity values would be more representative of the true values to be found in different airline such as Ryan air and British airways, furthermore will evaluate the achievement of cost savings of Ryan air through fixed costs and variable costs as well as writing a critical analysis the article on BAA Airports: ‘ Notice of release of interim undertaking’

1. Price Elasticity of Demand and Income elasticity of demand in the context of air travel demand: (Ryan air & British Airways)

This paragraph identifies two distinct prices for air travel which are price elasticity of demand and income elasticity of demand. Specifically, it is observed that studies of the demand for air travel demand should distinguish among prices for: Low cost carrier (LCC) example of Ryanair and Full Service Carrier (FSC’s) example of British Airways in this case study; business and leisure travel; long-haul and short-haul travel; and international and European long-haul travel. Accordingly, to examine the sensitivity of the demand for air travel to its price, separate estimates of the price elasticity of demand are gathered for each of these two distinct markets.

Price Elasticity of Demand ‘ Price Elasticity of Demand is a numerical value which describes the degree of responsiveness of demand to changes in prices’. (Andrew, D. 1988: 260)

The demand for a particular good or service depends on a variety of factors. Key influences include, the levels of consumer income, the price and quality of the services in question and especially services that are close substitutes (Sloman, 2005). In order to obtain useful estimates of the price sensitivity of demand for a product, we must carefully control for all the factors affecting the demand.

As a general rule, once other influences on demand stay unchanged, a higher price for a product leads in a lower quantity demanded. However, the price responsiveness of demand varies from one good to another and from one market to another (FitzRoy et al, 1998). Since the availability of alternative modes of transportation that are reasonably close substitutes for air transport diminishes with distance travelled, it is expected that the demand for air transport will be less elastic for longer flights typical example of British airways with is a FSC’s than for shorter flights typical example of Ryan air. Determine the demand and for the premium value the demand is low. means that for the different strategies the demand is price strategy, in al produEach price will lead to a different level of demand and therefore have a different impact on a company’s marketing objectives. The higher the prices are the lower the demand of the goods (Kotler 2002). British

Airways has two types of customers:

· Price sensitive customers (students, independent travelers, frequently travelers) who are looking for the cheapest prices and the best offers, and

· Low sensitive customers (business and executive customers) who are concerned more in the quality than the price.

Considering the three different pricing strategies of British Airways the demand curve will be as shown in the figure below. The price demand considers being elastic which means that for the different pricing strategies the demand is noticeable changing. For the low cost price the demand is high and for the premium value the demand is low.

2. 3. 3 Cost estimation

British Airways estimating the cost of the products in relation with the quality its one provide. The cost of the ticket includes:

· The price of the service

· The added value (extras)

· The airport fees, and

· The travel agents extra fees

However if someone book a ticket from the internet has at www. britishairways. com has a discount of â‚¤10.

2. 3. 4 Pricing method

Considering the three different types of customer, the three segments, British Airways has set a pricing method of perceived value. Perceived value is the value promised by company’s value proposition and the customer must perceive this value. British Airways perceived value is made up by the company’s brand mane and image, the customer’s image, the performance of the company and the quality of the product created by the company.

2. 4 Promotional pricing

British Airways has set some promotional prices on flights to some special occasion:

· Christmas gift voucher. The promotional offer for the Christmas known as British Airways escape ticket offers a perfect present. Flying to 14 travel zones from â,¤59 return on UK and Europe destinations and from â,¤269 return on the rest of the world.

· Domestic and European fares from â,¤49 return: Low fares to 135 destinations across Europe.

· Club World business class offer: When flying to club world business class you can upgrade to first class on a free one way ticket.

2. 5 Relation within the sector

The competition has increased since the introduction of the low cost airlines as easy jet and Raynair. Those airlines have achieved to sell chip tickets by eliminating all the unnecessary costs. They eliminated the intermediaries, the on board value and basically they eliminated completely the augmented product. They have concentrated just on the basic product which is the flight ticket from the on destination to

the other. They using a low cost low quality pricing strategy and set a market penetration objective in order to gain more market share. The have a method of value pricing of selling their tickets, the basic, in a greater value than their competitors.

Other companies with same objectives as British Airways like Lufthansa and Virgin have followed the same pricing strategies and policy. They set different price rates in relation with value added and looking after how to gain a bigger piece of the market pie.

3. Conclusion

Considering the increased competition in the flying industry which is rising people expect that companies will reduce cost by providing less quality products. That is partly true considering what easy jet and

Raynair has succeeded. However this is only one part of the true. Companies like British Airways fight the competition with different methods like introduction of low cost ticket where customer can still enjoy a good quality product in a low affordable price. Just considering an example where Ryanair (a low cost airline) flight’s to Milan from £49. 99 return and British Airways from £628 return. The problem though with Ryanair is that you can find this cheap ticket if you book it about it well in advance. But if you try to book it on the same day before your journey the price has gone up

at £179. 99 return when British Airways price will be still remaining the same until a week before your journey. So does it really worth flying with the low cost airlines which offer just a ticket with no allocated seat, no food or drinks and from unfrequented airports when you have a company like British Airways with so much extra for almost the same price? That’s a question that each of as has to answer on his own. Further, international travel tends to be widen over more time than domestic travel, so that the airfare is a smaller proportion of overall trip costs, which makes international travel less sensitive to changes in ticket prices. In addition, leisure travellers are more likely to postpone trips to specific locations in response to higher fares, or to shop around for those locations offering more affordable fares. Consequently, it is expected that the demand for air transport for leisure reasons will be more elastic than business travel who usually travel with FSC’s. According to Anthony et al (2000) Ryan air prices management is systematically offering different prices to different customer segments in response to demand whereas (Kimes, 1989) suggests that the team in charge of yield management need to identify how changes in price will affect their customers. Within the airline industries customer demand may be higher on week ends, during Summer months, or at particular times of a day, (Belobaba, 1987). Managers must be able to forecast time-related demand so that they can make effective pricing and allocation decision to manage the shoulder periods around high demand period. However the corporate business traveller during the week becomes a leisure traveller when on holiday or at week-ends. Different occasion find the same consumer having different expectation and needs, (Buttle, 1986). Such a concept is termed elasticity of demand.

According to the Data downloaded from Ryan air website giving on page two of the assignment topic the price of the flight on the day it been downloaded is far more higher than the price of the flight on other following days of the week day. However, when approaching the end of the week-end or school holiday, there is a huge demand and the increased demand drives the price up again as customer are returning from their vacation or family are going on holiday. Closer to the date and time of the scheduled service, the price rises, on the simple justification that consumer's demand for a flight becomes more inelastic the nearer to the time of the service. The low cost airlines such as Ryan air follow the pricing strategy outlined above. Customers booking early with carriers such as Ryan air will normally come across lower prices if they are ready to commit themselves to a flight by booking early. This gives the airline the plus of important how full their flights are likely to be and a source of cash-flow in the weeks and months prior to the service being provided. People who book late often regard travel to their planned destination as a need and they are therefore likely to be prepared and able to pay a much higher price very close to departure. Airlines call this price discrimination yield management – but despite the consider name, at the heart of this pricing strategy is the straightforward but important concept price elasticity of demand.

Ryanair has a seat pricing policy that causes fares to rise as a flight fills up (Ryanair. com, 2010). Following theory of supply and demand, if customer wants a seat so badly, they will pay more for it than otherwise.

Income Elasticity of Demand

It is defined as numerical values which describe the responsiveness of demand to a change in consumer incomes. (Sloman, 2005)

Because of the recession, demand for low cost flights grew rapidly as family with higher income who were travelling with FSC’s before would prefer low cost than traditional airlines and some current low cost customer with low income may prefer domestic flight or would just prefer not to travel by air.

However, since elasticity is measuring proportionate change, elasticity values will change along almost all demand functions, including linear demand curves. Estimation of elasticity values is therefore most useful for predicting demand responses in the vicinity of the observed price changes. As a related issue, we recognize that in markets where price discrimination is possible comprehensive data will not allow for accurate predictions of demand responses in the relevant market segments. In air travel, FSC’s are essentially joint products consisting of differentiated service bundles that are identified by fare classes. However the yield management systems employed by FSC’s also create a complex form of inter-temporal price discrimination, in which some fares (typically economy class) decline and some increase (typically full-fare business class) as the departure date draws closer. This implies that ideally, empirical studies of air travel demand should separate business and leisure travellers or at least be able to include some information on booking times in order to account for this price discrimination, and that price data should be calibrated for inter-temporal price discrimination: for example, the use of full-fare economy class ticket prices as data will overestimate the absolute value of the price elasticity coefficient. Within the set of differentiated service bundles that comprise each (joint product) flight, the relative prices are important in explaining the relative ease of substitution between service classes. Given the nature of inter-temporal price discrimination for flights, the relative price could also change significantly in the time period prior to a departure time.

In particular changes in real income and the prices of substitutes or complements will affect demand. Alternative transportation modes (road and rail) are important variables for short-haul flights, while income effects should be measured for both short and long-haul.

Oum et al. (1992) provide valuable tools that occur when evaluating the demand models. Air travel demand can be affected by changes in the prices and service quality of other modes. For short-haul routes (markets) the relative price and service attributes of auto and train would need to be included in any model; particularly for short-haul markets such as low cost airline. Failure to include the price and service attributes of substitutes will bias the elasticity. For example, if airfares increase and auto costs are also increasing, the airfare elasticity would be overestimated if auto costs were excluded.

The entry of low cost carriers leads to lower fares for a subset of traffic and competitors will offer a supply of seats to match these fares. Lower average fares should lead to lower demand elasticity estimates, while increases in the number of competitors in the market will lead to higher demand elasticity estimates.

2. How ' low cost carriers' such as Ryan air able to achieve cost savings? Fixed Costs and Variable Costs.

Ryan air's business model is focus around its general low cost philosophy. That is Ryan air attempts to cut all non value adding activities as it strives to drive costs down to the total minimum. Below are typical examples how it drives it's downwards which include selling directly to its customer over the internet or over the phone rather than via agents and middlemen, thus saving commission cost and administrative cost. Ryan air is a ticketless as most of it customer buy over the internet, in return for a booking reference that is exchanged at the checking counter at the airport for a boarding pass.

The airline has no in flight meals which is a cost saving measure that cannot be much inconvenience to its customer since all Ryan air flights are short haul. Nevertheless has subcontracted catering services on its flights where customer can buy an in flight meal and drink should they wish which is another way of driving price. Cabin crew double up as cleaner and this helps Ryan air to promise a turnaround time at any airport of 30 min rather than 45-60 min that has FSC's been the norm.

Another cost cutting device, is the typical example of the UK smaller airports such as London Luton, cheaper to fly to from than bigger airports such as Heathrow which it is use at least as its base as they are less congestion and facilitate turnaround times for aircraft to be a lot shorter.

Fixed Costs

Fixed Costs are defined as the Total costs that do not vary with the amount of output produced (John, S. 2005: 82)

Ryan air as a LCC operate in the environment of high fixed cost, fixed capacity in the short term, a perishable product and seasonal demand. Virtually all of airline's costs can be considered fixed. The cost of the capital tied up in the plane, the fuel it take to fly the route, the crew it will take to staff the ground and flight operations insurance, rent, etc… All these cost are fixed once the company decides to fly a particular route and the variable costs associated with serving another passenger on the flight are figure lively peanuts.

Ryan air generates sufficient revenue through ancillary services such as car rentals, accommodation, currency, travel insurance, transactions, refreshments, to cover variable costs and offset at least some fixed cost. Management believes that providing these services through the internet allows Ryan air to increase sales, while at the same time reducing costs on a per unit basis.

Variable Costs

Variable Costs are defined as the total costs that do vary with the amount of output produced (Sloman, 2005: 82)

The relatively low variable costs associated with many capacity- constrained Ryan air allow for some pricing flexibility and give operators the options of reducing pricing during low demand times.

Ryan air always seeks for low variable costs. Below are factors that help Ryanair to maintain a low variable cost:

* One type of aircraft, management believes that its strategy of limiting its fleet primarily to three variants of a single type of aircraft from a single manufacturer enables it to limit the costs associated with personnel training, maintenance and the purchase and storage of spare parts, as well as affording greater flexibility in the scheduling of crews and equipment.

* Pricing is based strictly upon revenue maximization process that matches the aims and objectives of prices elasticity of demand

* Internet booking which cut paper and administrative costs

* No airport sales offices/ no cancellations

* Charging a surplus for excessive baggage

* Maximization of seat capacity per plane

Use of less expensive airport as ‘ Ryan air been offered incentives is a controversial one’ Ryan air director of communications. Ryan air further endeavours to reduce its airport charges by opting, when practicable, for less expensive gate locations as well as outdoor boarding stairs rather than more expensive jet ways. Ryan air has entered into in agreements on competitive terms with third party contractors at certain airports for traveller and aircraft handling, ticketing and other services that management believes can be more cost resourcefully provided by third parties. Management attempts to obtain competitive rates for such services by negotiating multiyear contracts at prices that are fixed or subject only to periodic increases related to inflation. One of the typical example is the price of aviation fuel which is directly related to the cost of oil but Ryan air control this through hedging.

All these factors listed above contributed to a low variable cost of Ryan air, a key component in any successful yield management system and provide an opportunity for leverage against its major competitors.

3. Critical analysis of the issues involved in the following article: ‘ BAA Airports: Notice of release of interim undertaking’

Bibliography