Virgin atlantic market segmentation

ASSIGN BUSTER

Provide a hypothetical ROMI analysis if Virgin spent an extra £5m in marketing based on a 25% margin, 10% for costs, against £500m in sales, what is the break even on the £5m extra investment, provide the calculations and critical analysis.

INTRODUCTION

The marketing department is certainly at the heart of any organization, since it is responsible for setting, implementing, and evaluating marketing strategies to meet the customers' wants and needs, and to retain customers so as to build profit and sustain the business.

Smith and Rapin (2008) stated that marketing success is always driven by a thorough understanding of the market and a set of strong marketing strategies. They have advocated measuring the marketing performances of many companies in recent years. This trend of measuring marketing activities also was noted by McDonald and Mouncey (2009), who observed that increasingly, boards of directors and marketers desire to evaluate market performances to show how marketing boosts shareholder value and whether a firm is accomplishing its marketing objectives. There is a need to understand the business, to develop a framework, and to quantify the performance of marketing objectives and programmes.

Furthermore, Ambler (2003) defined the term " marketing metrics", which is a measure of the whole business's marketing performance, and suggested employing a portfolio of metrics to increase the accuracy of the results. Rust et al. (2004) found that a company employing market metrics to forecast future uncertainties and directions has enhanced resource allocation, since

better decisions can be made by drawing on lessons from the past. Therefore, measuring marketing performance, a company can improve its marketing efficiency and effectiveness, identify its strengths and weaknesses, establish precise insights between the investment in marketing activities and the financial value that investment generates, and so forth.

The purpose of this essay is to develop a practical framework of marketing metrics for Virgin Atlantic Airways to measure its marketing efforts and identify its challenges. The essay begins by (1) presenting the business model for Virgin Atlantic Airways, (2) identifying the correct marketing metrics for Virgin Atlantic and evaluating those, and (3) calculating the marketing performance by computing the return on marketing investment (ROMI) of the campaign spending and a break-even analysis of the airline's new offer.

PART I BUSINESS MODEL OF VIRGIN ATLANTIC AIRWAYS

Company Overview

Virgin Atlantic Airways Limited (Virgin Atlantic) is Britain's second largest long-haul international airline. Apart from scheduled services, Virgin Atlantic operates cargo transport services, flies to 31 destinations around the world using 37 aircraft, the average age of which is approximately six years (it has one of youngest fleets worldwide), carries nearly six million passengers each year, and employs nearly 9, 000 people currently (Civil Aviation Authority, 2009 a; Virgin Atlantic, 2009 c).

Virgin Atlantic is a subsidiary company and the best-known business in the Virgin Group Ltd. (Virgin Group), which possesses a 51% stake of it, with the remainder having been sold to Singapore Airlines so the two airlines could operate together as a strategic partnership (Virgin Atlantic, 2009 c).

Virgin Atlantic was founded in the U. K. in 1984. Its founder, Richard Branson, was motivated by three problems of the airline industry in that time: flights were expensive, companies lacked innovation, and long-haul flights were monotonous and uncomfortable (Twivy, 1986). Therefore, Richard established Virgin Atlantic and differentiated its brand with other airlines by positioning “ fun”, “ quality”, and “ innovation” as its core brand values. This can be seen from the airline’s vision statement: “ to provide the highest quality innovative service at excellent value for money for all classes of air travellers”. Its objective is “ to fly a profitable airline that people love to fly and where people love to work” (Virgin Atlantic, 2009 c).

Virgin Atlantic is a company setting a new standard for the industry. It was the first to break the cabin hierarchy from a three- to two-class system, to install individual televisions on the seat backs in economy class, to introduce a fully flat sleeping bed in upper class, and to fly using bio-fuel at 30, 000 feet (Twivy, 1986 & Virgin Atlantic, 2009 c). Its innovative and unique offerings are great contributing factors to its having won many business, customer service, and trade awards worldwide. To sum up, the offers and value that Virgin Atlantic gives were a marked revolution for the airline industry.

Business Map

The map above is created by summarising from the student information pack, “ Financial Information Press Kit & Full Press Information Kit 2009” at virgin-atlantic. com. (Notice: The customer section indicated above is only concerned with the passenger market). Appendixes A and B describe Virgin Atlantic’s current strategies and market segmentation.

Industry Highlights

The airline industry can be classified as either business logistics or passenger. Those that specialize in air-passenger transport can further divided into scheduled and non-scheduled services. In recent years, the low-cost carriers of the scheduled market have grown rapidly, while the high-cost carriers are continually struggling to grow (Manley, 2009).

Many airlines offer three flying classes for its passengers-first, business, and economy class-and they set different prices for the different segments. In terms of the consumer, the purchaser may not be the ultimate user of the service, so it is necessary for airlines to recognise the different needs of decision makers and users.

Recently, the industry has been suffering during the economy downturn. In such conditions, more companies tend to downgrade their travel policies, so first and business class flights are being decreased sharply (Shaw, 2007).

For airlines to maintain their business, they always have to pay for high operating and fixed expenditures (Civil Aviation Authority, 2009 b). Furthermore, economic, political, and legal changes, weather, and changes of fuel prices can have a significant impact on airlines (Manley, 2009).

Many airlines attempt to cooperate with other similar airlines to serve more destinations, to be more convenient for customers, and to retain customer by rewarding with frequent flyer miles.

(Appendix C describes Detailed Industry Overview)

SOWT Analysis

SWOT analysis is a tool that illustrates a company’s strengths and weaknesses (its internal environment) related to its competitors and what opportunities and threats it faces (its external environment) (Capon, 2009).

Virgin Atlantic’strengthsare its strong brand image, its innovation for setting a new industry standard, its excellent customer service products, its close interactions with its customers (Virgin Atlantic, 2009 a), and its strategic alliances with other quality airlines that offer more destinations (Virgin Atlantic, 2009 c).

Itsweaknessesare that it is too reliant on Branson (a sharp drop in sales occurred after Branson’s death), weak in the economy class-leisure market, and offers only limited destinations.

Itsopportunitiesare to target new segments of customers due to the aging of the population, to improve its service quality to become a five-star airline in Skytrax, and to reach more destinations to increase its market share.

It is vulnerable (threats)to losing its customers due to the open-skies agreement (less regulation of flights between the E. U. and the U. S.), to intense pressure from the rapid growth of low-cost carriers, recession, new industrial regulations, terrorist attacks, and soaring oil prices.

(Appendix D and Appendix E discuss PESTEL analysis of the airline industry and Competitors analysis for Virgin Atlantic)

PART II MARKETING METRICS FOR VIRGIN ATLANTIC AIRWAYS

After reviewing of Virgin Atlantic, I would recommend a number of crucial marketing metrics, which can be categorised into the following four performance aspects: financial-related (or shareholder), market-related, brand-related and customer-related. The following paragraphs explain why these were selected and discuss the measurement needs and impacts on the decision-making process of each metrics. Finally, recommendations and limitation of the framework are drawn.

Profit is the most important factor for a company to survive. Kerin and Sethuraman (1998) pointed out that marketers always monitor financial performance because increasing earnings and cash flow turnout increases shareholder values made, and all marketing activities are funding by it. Therefore it is need to measure the financial-related performance which at least three metrics can used to monitor Virgin's profit and cost how efficiency of Virgin spend and generate profit-return on marketing investment (ROMI), return on sales (or profit margin), and net sales contribution. Firstly, return on marketing investment is the percentage of net profit generated by marketing activities divided by total marketing expenditures. ROMI measures how marketing expenditures contribute to profits and is used to insight into the profitability of Virgin's marketing activities. Secondly, return on sales is the net profit as a percentage of the sales revenue, which measures how company efficiency generates profits

from sales turnovers and downplays spending, since net profits are equal to sales revenue minus total cost. Virgin Atlantic can use the above metrics to understand itself and the market by comparing these metrics against its key competitors or industries. Other important indictors related to financial performance include sales, gross profits, profit before taxes, and liquidity ratio, which do not require metrics since they can be easily obtained from the company's financial statements.

Ambler (2003) observed that managers always concern the financial performance, and ignore other non-financial activities, for instance, sales is driven by customers indeed. Therefore customer is definitely needed to measure. Before marketing department is responsible for attracting and retaining customers-without customers, identifying who target customers are is also important, how they generate profit to Virgin. So, retention and churn, customer profitability, customer lifetime value, and net sales contribution can include. Firstly, retention rate is the percentage of customers a company is able to retaining over time, which also measures customer loyalty, while churn measures the percentage of customers lost. If the retention rate is low, the company has to spend more effort to retain its customers since it costs less than attracting new customers. If it is high, marketers should investigate the profitability of its relationships; to measure this, customer profitability can be employed. Customer profitability is the profitability of customers based on the differences in customer revenue and cost, helps the company identify the most profitable customers. Farris et al (2006) suggest a process to calculating it: sorting customers' net profits, grouping customers by the customers' profits in 10 deciles, then it can show the

distribution of profit generated by each group. Normally, the profitability of the top group is between 150 to 300% (ibid). Fourthly, customer lifetime value is an estimation of the customer value in the number of years the customer is expected to purchase a given product, which measures the worth of a customer as a loyal purchaser of the company's products or services. It is important to be aware that metrics are rough estimations since input data is difficult to predict and may change over time. Fifthly, net sales contribution is the sales generated from a specific segment divided by total sales. It measures how well the segment performed within all segments and insights which segments contribute the most to sales. The metrics mentioned above are valuable to mangers to identify profitable customers and which marketing programs can be developed to reinforce the customer relationship with them (Davis, 2007). Other important indictors related to customer performance include purchase frequency, average amount per transaction or sales, and the number of customers or new customers from transaction support systems.

Market performance and trends directly link to financial result, and are indictors for manger since they would know how potential of the market. No surprising, the measurement of market-related aspects is also needed. The break-even analysis, market share and growth, and category share, can be included. Firstly, break-even analysis is a tool for projecting the use of a new product or service, which measures how many units will be required at a certain price to reach the break-even point. It can show how changes in price affect sales levels or how many years it will take to break even (Paek, 2000). Therefore, if the market size is not big enough, it is probably not to serve.

Secondly, market share is the percentage of Virgin's shares owned within the whole market which can calculate by the number of customers or sales value. Market growth is similar to market share but shows the percentage increase of this year compared with previous years. Thirdly, category share is the percentage of the number of customers who purchased an item of a specific brand divided by the number of customers who purchased an item under a specific category, measuring the popularity of a brand. Over time, market share, market growth, and category share provides marketers insight about Virgin's performance sales against its competitors by monitoring the growth of the company and its competitors and consumer trends within the market, but category share shows more details about category growth, for example, whether customers were acquired from competitors or if total users were gained under the same category.

According to McDonald, M. and Mouncey, P. (2009), brand account for at least 20 % of the company's asset, it helps customer to distinguish the company and its product among competitors, so it is indispensable to measure, but the challenges are many approaches available and difficult to qualify. The measurement of brand-related for Virgin can include brand awareness and loyalty, and customer satisfaction. Firstly, Brand Awareness measure the proportion of potential customers and consumers recognised the brand while brand loyalty is measured by usage, how was the frequency customers purchased a brand. Awareness, loyalty top of mind (the first brand in a customer mind within a given category), attitudes (the degree of customer belief towards a given brand) can simultaneously be measured by conducting a survey. Those can insight the brand location in the customer's

heart which influences customer purchasing behaviours and the sales. More importantly, recognizing consumer and non-consumer group is needed since results of them is always different (Gupta & Lehmann, 2005). Secondly, customer satisfaction is a rating to measure customers' experiences on specific aspects, also measured by a survey. It shows how well of their offers meets customers' expectations. However, the selection of survey respondent should be careful, high satisfaction may not mean all the customers are satisfied; some disappointed customers may simply leave from the company to competitors before the company noticed.

Measuring marketing metrics is a continuous process, which should be done regularly (Patterson, 2005). Over time, metrics can illustrate the effectiveness of marketing strategies and tactics and market changes. More importantly, the measurement methods of metrics also changes over time; methods currently employed are considered state-of-the-art.

Although Virgin can use the above models, still reminding other intangible factors cannot be measured, such as relationships, reputation and trust, culture and values, skills and competencies, knowledge, and processes and systems. These are important because of generating value for a company, and account for the majority of a company's assets (McDonald and Mouncey, 2009).

In conclusion, the metrics recommended to asses Virgin's marketing outcomes involve the following performances areas: financial-related (or shareholder), market-related, brand-related and customer-related. Working with these metrics Virgin can monitor its revenue and spending, identify and

retain the valuable customers, identify the chance expanding its market, insight customer perception towards the brand.

PART III MARKETING CAMPAIGN FOR VIRGIN ATLANTIC AIRWAYS

Marketing Challenge and Strategy

Virgin Atlantic feared that the E. U./U. S. Open Skies Agreement, introduced in March 2008 (Stewart, 2007), would have a negative impact for the future of its market share. Virgin Atlantic may lose part of its customers, since 40% of Virgin Atlantic’s business class-travel now is between the U. S. and Europe (Foresight, 2008). No doubt Virgin Atlantic needs to retain its customers or to expand into other new markets.

According to the World Tourism Organization, the route that serves the most passengers between the U. S. and London airports is between London and New York (ibid.). Virgin Atlantic plans to offer frequent business travellers an exclusive private luxury flight experience, operating a twice daily flight between London and New York, and pricing the ticket at £1000.

Virgin Atlantic also decided to initiate a marketing campaign by using TV commercials and outdoor advisements near the airports to raise Virgin Atlantic’s brand awareness among business travellers who fly often between New York and London. The target audiences are frequent flight business travellers or upscale leisure passengers (those who fly an average of ten times a year), male, aged 25 to 65, with more than £50, 000 income per year.

The following section employs two metrics, the break-even analysis and return on marketing investment, to forecast and measure Virgin Atlantic's marketing performance.

Assumptions:

- the objective profit margin for the campaign was expected to be 25 %;
- the 10% overhead on its sales generated;
- the extra sales generated by the campaign are £15 million;
- the operational and variable cost for " flights twice a daily" per year is £24 million;
- the extra marketing expenditure for the campaign is £ 2 million;
- the price of a flight is £1, 000;
- the average number of flights per consumer is ten per year;
- the net profit contribution is 24 %;
- the year of customer loyal and purchasing the tickets 10 times a year is 5 years.

Calculation of Break even for new business-classes flights

Customer Equity per year= price of flight * average flight times a year

= £1, 000 * 10= £ 10, 000

Customer Lifetime equity= Customer Equity per year * period of year remains as a frequent flight business travellers

= £ 10, 000*5 =£ 50, 000

Customer Lifetime net profit= Customer Lifetime equity * Net profit contribution

=£ 50, 000 * 0. 25=£ 12, 500

Number of customers need to Break-even= operational and variable cost for " flights twice a day" per year / Customer Lifetime net profit

=£ 24m / £12, 500 = 1, 920

If Virgin Atlantic can have 1, 920 frequent flight customers who purchase the flight for 5 years, and 10 times per year, then this project will reach break even points.

Calculation of ROMI

Campaign profits = assumed profit margin * extra sales generated

= 25% *£15 million =£3. 75 million

However, the campaign was overhead 10% in the £15 million sales,

Extra cost for campaign= overhead percentage * extra sales generated

= 10% *£15 million sales =£1. 5 million

Net profit generated from the campaign = Campaign profits -Extra cost for campaign

= £3. 75 million-£1. 5 million = £ 2. 25 million.

ROMI = (Net Profit generated from the campaign / Campaign cost) *100%

= (£ 2. 25 m / £ 2 m)*100% = 112. 5 %

The result of ROMI is positive which means that marketing spending is deemed.

As the extra cost £ 2 million is needed for the campaign, the break even point will be changed as follows:

Calculation of Post-Break even for new business-classes flights with extra cost in marketing.

Customer Equity per year= price of flight * average flight times a year

= £1, 000 * 10= £ 10, 000

Customer Lifetime equity= Customer Equity per year * period of year remains as a frequent flight business travellers

= £ 10, 000*5 =£ 50, 000

Customer Lifetime net profit= Customer Lifetime equity * Net profit contribution

=£ 50, 000 * 0. 25=£ 12, 500

Total cost for “ flights twice a day” per year = operational and variable cost for “ flights twice a day” per year + extra marketing cost

= £ 24 million +£ 2 million =£ 26 million

Number of customers need to Break-even= Total cost for “ flights twice a day” per year / Customer Lifetime net profit

=£ 26m / £12, 500 = 2, 080

The break-even analysis indicated that Virgin Atlantic will need 2, 080 frequent flight customers who will purchase the flight ten times per year for five years to reach the break-even point for the whole new route with the new marketing campaign in play. After reaching 2, 080 customers, the company will start to make a profit.

The break-even analysis is computed twice to show the different outcomes if extra marketing spending is added. In fact, as the costs increase, the number of customers needed increases as well. Therefore, if the managers believe it is easy to reach the break-even point, the airline is likely to launch this route. As the break-even analysis uses customer lifetime equity for the calculations, it is possible for that the break-even point may fail to be met in the short term, but for long-term outlooks and for retaining customers, it still can be profitable (Dwyer, 1999).

The positive ROMI indicates that the activity is healthy. If ROMI is equal to 100%, this means the marketing campaign will break even. To compute the ROMI, the cost is needed, as Amber (2003) mentioned that sales revenues may not increase immediately after advertising begins, and it is difficult to determine whether the costs belong to the marketing department. Furthermore, spending decreases can result in maximizing the ROMI, so balancing expenses with marketing expenses with ROMI is also important (Lenskold, 2004).

(3392 words)