

Targeting leisure and business passengers with unsegmented pricing[☆]



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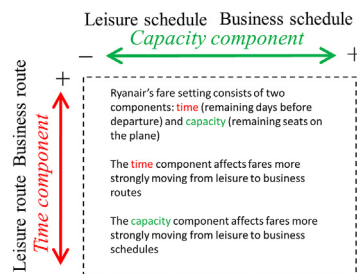
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HIGHLIGHTS

- Ryanair's fare setting is much more sophisticated than it looks.
- It consists of two components: time (remaining days before departure) and capacity (remaining seats on the plane).
- The time component becomes stronger moving from leisure to business routes.
- The capacity component becomes stronger moving from leisure to business schedules.

GRAPHICAL ABSTRACT



ARTICLE INFO

Article history:

Received 21 April 2015

Received in revised form

26 December 2015

Accepted 27 December 2015

Available online xxx

JEL Classification:

D22

L11

L93

Keywords:

Dynamic pricing

Unsegmented pricing

Market segmentation

Ryanair

ABSTRACT

We analyse the fare setting strategy of a leading European low-cost carrier, Ryanair, which, until recently, adopted an unsegmented pricing policy (all tickets belong to a single fare class). We show that, to account for different demand characteristics, the company adjusts the two main components governing the dynamics of posted fares, namely *time* (the number of days before departure) and *capacity* (the current number of available seats). We find that: 1) in routes with a strong presence of leisure (business) traffic, fares are set to be less (more) responsive to the time component; 2) in schedules more suitable for leisure (business) travellers, fares are set to be less (more) responsive to the capacity component.

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[☆] We wish to thank Paul Dobson, Carmine Garzia, Gerardo Patriotta, and Federico Visconti for their valuable comments. Piga gratefully acknowledges financial support from the Leverhulme Trust Research Grant RPG-051.

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1. Introduction

Since their appearance in North America and European countries, low-cost carriers have challenged traditional airline companies, by proposing a business model that is based on a cost leadership strategy. Such an approach has become a marketing

lever that credibly promotes a brand image based on the strong adherence to the low-cost concept, which implies that the firm strives to be never knowingly undersold by its competitors.

As a cost advantage normally derives from the exploitation of scale economies and learning effects, a cost leader company usually sells a “standardized, no-frills product” (Porter, 1985: 13). The most obvious limitation of standardization is that the firm may not be able to attract those demand segments with a high willingness to pay for a differentiated product or a personalized service. Nonetheless, there is evidence that an increasing number of business travellers choose low-cost carriers, an aspect that raises the question as to whether the intrinsic simplicity of the pricing strategy associated to the standard low-cost business model is suited to the task of taking full advantage of the opportunities offered by the business demand segment. While it is true that in recent years some of these companies have innovated their original pricing approach based on an unsegmented pricing policy (i.e., charging a single-fare class where all seats carry the same characteristics) by embracing a segmented pricing strategy (i.e., charging multiple-fare classes), in this paper we show that even before they did so, low-cost carriers were able to target business travellers by exploiting some crucial features of their Revenue Management (RM) system. Indeed, RM constitutes a central organizational function in companies that have to set the prices of highly perishable services under uncertainty (McGill & van Ryzin, 1999). It encompasses a set of processes and techniques that are ultimately responsible for the price offered to the final consumers, and in this sense it can be used to target different segments of demand.

In this study we propose an in-depth analysis of the Revenue Management (RM) system implemented by the leading European low-cost airline, Ryanair. Since its inception in the 1980s, this carrier has been recognized to be the most adherent to a pure cost leadership strategy which has been tightly associated to an exclusive application of an unsegmented pricing approach (Klophaus, Conrady, & Fichert, 2012); however, in mid-2014, Ryanair started offering a business-class fare, which, relative to the basic-class, includes a bundle of additional services each carrying a fixed price to be added to the basic-class fare. Because RM is responsible for the definition of the latter fare, even if our analysis is based on data collected before the introduction of the business-class fare, it can provide insights into how the company fine-tunes its fares depending on specific routes and flights characteristics.

Our analysis hinges on the collection of primary price data taken from the Ryanair website over an 18 months' period, containing information on posted fares and available seats retrieved on a selection of days before departure, and covering scheduled flights for 42 international routes with one endpoint in the UK. This is complemented by secondary data based on official statistics on market characteristics coming from the International Passenger Survey (IPS), which provides route information on the composition of passengers in terms of their travel motivation. For each flight in the sample, we also identify the time and the day of departure, and, from the IPS, the (quarterly average) share of business travellers carried by all companies on the city-pair. We use the latter variables to stratify data according to two dimensions. Flights operated on routes where the share of business passengers is below or above the median of the sample, are respectively labelled as “leisure routes” and “business routes”. Flights leaving in early morning or late afternoon during weekdays are assigned to the “business hours” category, the remaining flights to the “leisure hours” category.

We report evidence indicating that Ryanair adapts its RM techniques to the market's characteristics, thus effectively carrying out a segmentation strategy. In practice, the two main components governing the dynamic of posted fares, namely *time* (the number of days before departure) and *capacity* (the current number of

available seats), are adjusted to account for different compositions in demand characteristics. We find that: 1) in leisure (business) routes, fares are set to be less (more) responsive to the time component; 2) in leisure (business) hours, fares are set to be less (more) responsive to the capacity component.

Our paper is mainly related to that of Salanti, Malighetti, and Redondi (2012), who study the pricing behaviour of Ryanair. Indeed, our findings confirm their result that the time component is less prominent on leisure routes than on business routes. However, there is no existing evidence exploring the simultaneous use of capacity and time components to manage different consumer segments. Other papers have highlighted, through econometric techniques, that LCCs adjust their pricing policy to market conditions. Bilotkach, Gaggero, and Piga (2015) find that yield management interventions are less effective in routes with predominantly leisure traffic, while the degree of competition does not produce any substantial difference. Alderighi, Nicolini, and Piga (2015), applying a similar methodology to ours, show that route length, competitive pressure, market volatility, seasonality and time schedule affect both time and capacity components. Malighetti, Paleari, and Redondi (2009, 2010) mainly focus on the time component of the pricing policy of EasyJet and find that route length, route frequency and airport dominance play a significant role, while competitive conditions are less relevant. Finally, some works base their analysis on a case study investigation of LCC behaviour. Forsyth (2003) recognized that LCCs may target business travellers through the use of multiple fares. Other studies in this stream of research show that LCCs have followed different ways in order to attract business travellers including some forms of hybridization (Lawton and Solomko, 2005) and the use of multiple fares (Fageda, Suau-Sanchez, & Mason, 2015).

The rest of the paper is organized as follows. In Sections 2 and 3 we briefly review the airline literature on revenue management and we provide the main hypotheses to be evaluated. Section 4 offers a brief description of Ryanair's business model and strategic positioning. Section 5 describes the data and Section 6 presents the methodology. Section 7 provides some descriptive results and the econometric evidence. Section 8 concludes the paper.

2. Revenue management in theory and practice

McGill and van Ryzin (1999) identify four key areas for RM in the airline sector: forecasting, overbooking, seat inventory control and pricing. Forecasting plays a critical role in predicting the probability of different states of demand but it is an antecedent process that is largely reflected in the implementation of the other three components; overbooking is the practice of selling a number of tickets larger than the available seats accounting for the fact that some passengers do not show up for the flight. It is more often employed by Full-Service Carriers (henceforth, FSCs) than LCCs. The two remaining components are paramount in this work, since they are closely examined in the empirical section.

Seat inventory control defines the availability of seats for different booking classes. Even if the airline adopts unsegmented pricing and sells only one fare class with tickets of the same homogenous characteristics, it is still possible for the airline to pre-assign seats with different fare levels to distinct ‘buckets’, each denoting a group of consecutive seats that the airline wants to sell at a given price. In line with the work by Talluri and van Ryzin (2004), the airline decides the buckets' size (i.e., the number of seats in a bucket) as well as their fare level ex-ante when a flight is first put on sale, based on its demand forecast. The outcome is a full pricing plan for all seats on sale, detailing how the fare will change as the plane fills up. Based on the theoretical model in Dana (1999a), the optimal pricing plan is monotonically increasing because the cost of a seat

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