



The rationale for implementing a premium economy class in the long haul markets – Evidence from the transatlantic market



Cindy Hugon-Duprat ^a, John F. O'Connell ^{b,*}

^a Airbus, France

^b Centre for Air Transport Management, Martell House, Cranfield University, Bedfordshire MK43 0TR, UK

ARTICLE INFO

Article history:

Received 19 April 2014

Received in revised form

10 March 2015

Accepted 17 March 2015

Available online

Keywords:

Premium economy

Long haul routes

Operating costs

Operating revenues

ABSTRACT

The premium economy class is fast becoming an embedded and valued product that is being incorporated into the long haul fleets of the world's flag carriers. The premium economy unique proposition positions itself mid way between economy and business class with enhanced leg room as its primary attribute. It targets the price sensitive business traveller and the comfort seeking leisure passengers. This study contains an insight into the unit cost of production of economy, premium economy, business and first class seats and their potential to generate revenues on the lucrative London Heathrow to New York JFK route using a British Airways 747-400 aircraft. The main findings show that the rationale for implementing a premium economy seat is justified as it is only 1.6 times more expensive than an economy seat to produce, but it generates revenues that are 2.3 times higher than its cost of production - spawning the highest marginal returns from the four cabin hierarchy. The research reinforces the assumption that premium economy class cabins could very well become an embedded and sustainable product in the landscape of long haul travel in the near future.

© 2015 Elsevier Ltd. All rights reserved.

1. Introduction

The premium economy class was introduced in the early 90's and there are now 27 airlines offering this new seat class ([JP Airline Fleets, 2013](#)). The cabin is rapidly becoming a valued product on long haul aircraft. It is situated between the business and economy class and offers unique advantages that commonly include: increased seat pitch; enhanced seat width; more seat recline; additional Frequent Flyer points; supplementary baggage allowance; enhanced In-Flight Entertainment with wider screens; dedicated check-in counters; priority boarding; laptop power ports; wider variety of meals; dedicated toilets; welcome drinks and amenity kits. During the recent recession, many of the passengers that were previously travelling in business class downgraded to economy and some carriers expedited the introduction of the premium economy cabin onto their long range widebody aircraft, as a mechanism to stop business passengers downgrading, in order to sustain a higher yield. In addition, there are many leisure passengers who are unwilling to pay for business class, but would

be prepared to incur the additional charge to upgrade to premium economy as the tariff¹ is generally 30–50% higher than the economy fare, while the fares for business class can be up to 65% higher than premium economy.

There is now a distinct remodelling of the cabin configuration whereby first class is gradually being phased out, while premium economy is increasingly being installed to provide an enhanced differentiation between business and economy class. [Nita and Sholz \(2011\)](#) established that premium economy would enhance the airline reputation among travellers in standard economy and retain a base of loyal customers. It is widely perceived that many more airlines will introduce a premium economy cabin in the future on their long haul aircraft in order to target both the price sensitive business traveller and comfort seeking leisure passengers.

This study aims to research the rationale behind introducing a premium economy class. The three main developments to be considered are: a literature review of the underpinning reasons why airlines are installing this new cabin configuration; followed by a detailed analytical appraisal of the unit cost of each cabin

* Corresponding author.

E-mail addresses: cindy.hugon-duprat@airbus.com (C. Hugon-Duprat), frankie.oconnell@cranfield.ac.uk (J.F. O'Connell).

¹ British Airways premium economy flexible fares from London Heathrow to cities such as New York, Hong Kong and Johannesburg, for example, were around 25%–30% higher than the equivalent flexible fare in Economy ([UK CAA, 2011](#)).

configuration of a widebody aircraft; and concluding with an economic model to assess the financial viability of each cabin on a long haul commercial flight. These developments are used to test the robustness of the premium economy class in one of the most lucrative long haul markets in the world – London Heathrow to New York JFK. Doganis (2010) briefly evaluated the unit cost indexing of first, business and economy class and this research extrapolates and expands upon this earlier study by including premium economy whose outputs were subsequently validated by Doganis (2013). The financial viability of each cabin was then calculated through a Boeing cost model and endorsed by a Boeing cost expert.

The paper is structured as follows; firstly a detailed review of the history and current developments in premium economy class is undertaken, as well presenting the views of industry experts to depict the commercial viewpoints behind the rationale for airlines installing premium economy cabins. This is followed by an analysis of the different cabin economics which were evaluated through a simulation model to determine the ratio of cost:revenue of each cabin. The paper then concludes by stipulating whether the implementation of premium economy involves an economically viable cabin.

2. The pathway to premium economy class

The academic literature of cabin economics has largely focused on economy and business class, while in more recent years research into ancillary revenue drivers that the cabin can deliver, such as 'additional leg room', has layered the academic landscape. The commercial airline industry has argued the importance of the premium economy cabin for many years, while academic research has not kept pace with its commercial counterpart in any appreciable manner. Lee and Luengo-Prado (2004) were unique as they provided an academic insight into the core differences between United Airlines' Premium Economy and American Airlines' 'More Room Throughout Coach'. They used regression analysis on panel data from 1998 to 2004 for American Airlines and United and found that United's Premium Economy program helped it boost its average fare, while at the same time it was also effective in attracting passengers willing to pay higher fares for greater seat pitch, when offered a choice of otherwise comparable services among competing full service carriers in the US.

Balcombe et al. (2009) applied a Bayesian method to estimate a mixed logit specification and found that in principle passengers are willing to pay a relatively large amount for enhanced service quality that includes seat comfort, which encompasses enlarged pitch and width. Espino, (2008) conducted a multinomial logit model on passenger stated preferences between the Canary Islands archipelago with the Iberian Peninsula and found that travellers were willing to pay almost €34 more than the basic fare for additional legroom for this short haul flight, which indicates that they could be prepared to pay significantly more on long-haul sectors. Garrow et al. (2012) disagreed with Espino's research by establishing that the customers of Delta Air Lines were unwilling to pay for the extra leg room on short flights. However when applied to international markets, passengers welcomed the product and were very willing to purchase it, which further endorses the concept that demand exists for a roomier cabin priced slightly higher than economy class.

Claussen and O'Higgins (2010) developed a consumer choice model and found that price-sensitive business class passengers and comfort minded leisure passengers were prepared to pay moderate surcharges for premium travel. Daft and Albers (2012) found that passengers now pay on average around €30 per flight for an exit seat in economy class because of its comfort. Vink et al. (2012) showed that there was a clear correlation between comfort and

attributes such as legroom, wider seats and personal space, while their study of more than 10,000 internet trip reports and 153 passenger interviews concluded that a high comfort rating is related to higher 'fly again' values. Research conducted by Mintel (2012) and Nita and Sholz (2011) also concluded that passengers give greater importance to extra legroom on long-haul flights than to other amenities, which ultimately favours the premium economy cabin, which offers more comfort than the economy class in addition to its enhanced services.

Business travel, which is closely correlated to a trio of economic prosperity, world trade and business confidence, fell sharply during the recent economic down-cycle. IATA data showed this trend by indicating that premium traffic represented 9.5% of total passenger traffic in mid 2007 but this fell sharply to 7.6% by mid 2009. As global economies began to recover, parallel gains were immediately evident in business travel as it accounted for 8.1% of total passenger traffic by mid 2013 (IATA, 2013). However this overall reduction of premium traffic (from 9.5% in 2007 to around 8.1% by 2013) has had a significant impact on the industry as it represents an overall shrinkage of 15% of premium traffic during this period, and an even larger contraction of global revenues (Airline leader, 2013). Cathay Pacific reported that its 83% fall in profit for 2012 to \$118 million was largely attributed by declining yields as a result of a tightening of corporate travel policies that discouraged employees from choosing business class, while its premium economy class was aimed at recovering some of this passenger leakage to higher yielding business cabins (Flightglobal, 2013). The UK CAA (2011) reported that first and business class passengers at British Airways represent less than 15% of the airline's total passengers but generate approximately 50% of the total revenues – so premium economy could further bolster its overall yields by enticing economy passengers to upgrade into an enriching value adding cabin.

Interviews with industry experts showed that it is believed that premium economy is an effective mechanism to improve overall yields (Bisignani, 2013; Doganis, 2013; Tarry, 2013). However Tarry and Doganis also stated that there are risks involved as the new cabin with enhanced features could cannibalise business class traffic, especially if carriers begin to scale up the seat configuration. In addition some corporations now have an opportunity to reduce their travel budgets by changing the terms and conditions of their corporate contracts, by requiring that executives travelling for business purposes must book cheaper premium economy tickets on flights lasting up to 6 h in duration. This would apply to many flights serving the lucrative US East coast and the British Isles, potentially deteriorating the fragility of such profits. The cabin also adds complexity and cost as the enhanced products and services keep it differentiated from the economy class, while transferring passengers from the business class of a partner airline could find it unattractive and they may avoid carriers offering such a cabin in the future.

The fare for economy seats are at a disproportionately low level compared to premium cabins. These fare differences are reflected in the cabin classes profitability and yield per RPK. O'Connell (2011) found that the yield measured in US cents per RPKs for first class, business, and economy class was 24 cents, 19.6 cents, and 5.8 cents respectively; while Claussen and O'Higgins (2010) found that the proportion of passengers in each class was 0.7%, 31.4% and 67.9%. Clearly there is potential for airlines to install a new cabin between the business and economy cabin as the yield gap between the two cabins is so wide. O'Connell (2011) established that the yield measured in US cents per RPK for premium economy was between 8.5 and 9.5 cents, which favourably prices the cabin towards leisure passengers who seek additional comfort. IATA data indicates that 58.7% of business travellers will chose economy class on short-haul, whereas 23% are choosing economy class for long-haul, which

Download English Version:

<https://daneshyari.com/en/article/7435676>

Download Persian Version:

<https://daneshyari.com/article/7435676>

[Daneshyari.com](https://daneshyari.com)