

Information technology can dramatically cut down on the number of human processes in reservation, reconciliation and payment. What can electronic ticketing offer new low-cost airlines to get passengers onto their aircraft at the lowest possible cost? Robert Freedman reports.

# No-frills revenue and distribution systems

The airline industry has come through a period that has created an opportunity for new niche players to enter the market. The days of complicated brand management and marketing strategies have been overtaken by no-frills carriers. These airlines present a clear pricing strategy to the consumer. While the strategy and operational styles of these airlines have been examined, the most critical ingredient of success is how a new central reservation system (CRS) can bring passengers to planes in the quickest and cheapest way possible. Today's technology gives small to medium sized carriers the cost cutting and decision modelling advantages that in the past was only available to large carriers with healthy information technology budgets. The key is selecting an appropriate and economical system.

## Yield strategy

New airline owners and consumers are always looking for better prices and an easier way of purchasing products. The notion of yield management to consumers can be a little complicated since the vast majority of products that consumers purchase have fairly constant prices. For a new airline price discrimination and fare complexity should be kept to a minimum to gather consumer confidence. Simple marketing will attract passengers from other airlines and even stimulate new demand.

No-frills airlines have usually entered markets where there is reasonable origin and destination demand. This strategy

increases the prospect of success since the new entrant can capture existing market share. An airline can start with one or two flights a day without creating significant competition for incumbents servicing the route.

For instance easyJet in the UK offers London Luton to Edinburgh at a simple fare structure of four one-way fares between £29 (\$50) to £59 (\$100) in £10 (\$17) increments. This is simple and easy to remember. Most importantly the consumer knows the top price even before they pick up the phone.

EasyJet has a system where passengers book seats via the telephone with a credit card. Bookings can also be made via the internet through easyJet's web site. This is only possible because of the simple fare structure. As soon as the booking is made the funds are in easyJet's bank account. No tickets are issued and passengers are required to provide only a form of identity, usually a credit card, at check-in. All the booking information is stored on easyJet's computer and able to be called up by the check-in clerk.

EasyJet's yield management software works on a simple first-come first-serve basis. As the cheapest tickets are sold fares increase in £10 increments (\$17). The computer calculates the supply-demand situation by the rate at which the flight is selling. This determines how many tickets are available at each price level.

This system means easyJet, and all other airlines with a similar system, do not pay any travel agent commissions and avoid all the costs of issuing tickets and collecting revenue.



When looking at branded large carriers, a consumer could never hope to understand the number a fare types that exist, let alone make a purchase decision without feeling the fare they paid for had only been created when they called. Although there is always the threat that an incumbent carrier will match the pricing mechanism of the no-frills carriers, public perception still continues to look negatively on the incumbent airline. They are seen to adjust pricing to match no-frills airlines, rather than being price leaders. Also, the existing carrier will not want to erode its revenues from the route and lose high yield customers. What starts to occur is a mutual understanding between the new airline and its passengers that things are simple



Simple distribution systems used by no-frills airlines do away with issuing paper tickets. Passengers book tickets with a credit card via telephone and just turn up at for the flight.

and flying is as easy as riding the local bus to another town.

Simplicity of fare structure is the most important criterion in the successful start-up and growth of a no-frills airline. Many other factors contribute to how growth can be achieved. Building a loyal customer base is essential. Finding a cheap and simple distribution mechanism in the next step.

Competitive advantage for a new entrant must occur through a paradigm shift over ways airlines have traditionally done business. This is because aircraft leasing, fuel purchases and maintenance costs tend to be roughly the same, if not higher, for a new entrant. Some saving can be achieved in crewing but the only areas to achieve significant cost reductions these days are ticket marketing and distribution.

### Distribution methods

So what does all this mean? The traditional airline distribution and revenue model states that an airline sells through intermediaries. Strategic alliances that share revenue on code-share flights, pro-rate revenue on interline flights and handling passenger baggage numerous times between connecting flights of different airlines are the norm. The airlines list their flights on the global distribution systems such as Sabre, Galileo, Amadeus and Abacus paying costly segment fees in order for intermediaries to have the ability to sell tickets. Reconciliation of all this paperwork is then required.

The amount of human intervention required is mind boggling. From matching up ticket coupons to settlement with the various airline bank systems, typically 15-16 people handle a traditional ticket at some point. Before electronic ticketing, all airlines had the huge cost of processing and handling all the manual events that occurred just to get the paper ticket out, and wait for the revenue that in some cases took up to 90 days to collect. The majority of airlines still sell this way and approximately 80% of revenue generation comes from sales of third party agents such as travel agents wholesalers and consolidators.

Cashflow is king, and a new entrant receiving payments 90 days in arrears can be out of business before they begin. This archaic distribution model has prompted airlines to start anew and find an alternative approach. Airlines can now collect their revenues in advance of the actual flight.

### New world

Widespread use of internet and intranet database applications plays a very important role in being able to cut distribution costs. First, these database applications have the ability to provide a seamless environment for electronic tickets (E-tickets) which cut distribution costs by \$5-\$6 per passenger compared with conventional distribution systems. They also have the ability to create a unique data-warehouse of information related to the passengers entire booking history, while also allowing the airline an opportunity to build client and market profiles.

Database applications allow custom reports to be generated and updated continuously, giving management the ability to react quickly to changing market conditions. Fares can be changed easily to enhance revenue with an integrated yield management strategy.

#### DISTRIBUTION COSTS

Airline	Passengers carried (million)	Cost per passenger	Average fare	Cost per fare
Valujet (now Air Tran)	2.04	\$8.77	\$64	13.8%
Southwest	40.62	\$8.49	\$53	16.1%
American	66.88	\$27.48	\$136	20.1%
United	60.81	\$23.45	\$129	18.1%
Delta	80.57	\$24.93	\$111	22.5%
Continental	34.66	\$21.35	\$105	20.3%

source: US Department of Transportation 1994



Statistics can be compiled from sales information to accurately target marketing campaigns.

Gone are the days of building extensive legacy databases and paying large integration and support fees to make the information technology work. New entrants now have the ability to concentrate on running their airline, rather than operating a sophisticated information technology (IT) department.

They can take advantage of the new airline technology commerce tools that provide cheap distribution and high return on investment for the backbone technology needed to run the organisation.

### Distribution costs

Let's take a look at some recent examples of how new technology has helped no frills carriers cut costs. The table (see page 26) shows distribution costs for several US carriers in 1994. Air Tran, the new name for ValuJet, has similar distribution costs to Southwest. Air Tran and Southwest have distribution costs which reap substantial savings compared to the other major carriers. It almost seems the larger the airline the greater the distribution costs. Or perhaps the older operations have greater problems adopting new technology that lowers distribution costs.

### Electronic ticketing

So how do Air Tran and Southwest manage to achieve these low costs? Information technology is at the heart of a very effective E-ticket operation that dramatically cuts down on the number of human processes of reservation, reconciliation and payment. Reductions in one area lead to reciprocal savings in the others. Ultimately a system can give a reservation agent the ability to handle all elements of the process from credit card payment and verification to an electronic E-ticket, that only needs to be recalled once the passenger arrives at the airport.

All carriers are implementing, or have already, E-ticket type operations. However, older established airlines have large legacy computer systems which make it difficult to integrate new technology. Applications have to be written to interface with the existing software, staff have to be trained in a new customised application and support has to be provided to the users.

A new airline just wants to be an effective competitor. It wants to be inventive, but often finds itself needing a vice president of information technology. Traditional market suppliers for distribution software have geared to very large organisations with sophisticated products and corresponding purchase and support costs. A no-frills carrier wants simply to sell seats effectively at the lowest possible cost.

The traditional suppliers of reservation and information systems have tended to be large global companies such as Sabre, Unisys and Siemens Nixdorf. Traditionally these companies have sold tools or applications to what can be defined as enterprise level customers. A no-frills carrier resembles more the start-up company looking for out-of-the-box solutions. They require solutions which can get a passenger call centre and a revenue management system running with a minimum of time and expense.

One company, Open Skies, has pre-packaged several central reservation and yield management software solutions. These applications have been built from the ground up to be specifically designed for the small to medium sized airline. They have been designed by ex-Morris



*Simple and dependable fare structures adopted by low-cost airlines means they have effectively created a transport service with can be likened to a bus with wings.*



Air employees with a wealth of experience, David and Brett Evans. Modules available include yield management, airport kiosks, an internet booking system and easy movement of data and crew scheduling. An 'open architecture' allows various PC based applications to access this data using an industry standard interface.

Open Skies has also formed a partnership with Hewlett Packard (HP) to run several data centres around the world where airlines can have their software hosted on HP mini computers. All software and data are hosted on the server and the airline connects to the systems via a dedicated data line or dial up from both the call centre and airport check-in areas. Open Skies also prices its software on a transaction basis, so an airline can effectively rent the application based on a boarded passenger (RPB) fee schedule. Typical fees are tend to average at less than \$1 per RPB.

Gone are the days of having variable distribution costs based on cancellations, no shows and price per query. The Open Skies model simplifies the whole process. An airline pays a small fee for people who actually board the aircraft. Variable costs tend to focus more on call centre activity than on the ticketing solution. The predictable costs of this system are particularly important for budget conscious no-frills operators.

An operator can start with the core reservation system and then add modules as it grows. This is important because they can concentrate on a simple fare

structure in the beginning, then build customer loyalty and straighten out operational problems. Once these problems are solved, the functionality of the system can be upgraded by implementing a yield management package. This will reap further rewards of up to 5%-15% revenue gain on existing routes and would more than pay for any increased costs associated with the higher level of technology.

Open Skies currently has a data centre in Utah in the US and two others opening shortly in the United Kingdom and Japan. The company has been successful in selling its systems to numerous no-frills carriers such as WestJet of Canada, easyJet of the UK and Virgin Express of Belgium. Most recently the new no-frills start-up, British Airways subsidiary, Go purchased a solution that will be hosted on a central HP 3000 mini computer at a data centre in London.

British Airways reportedly learned about the Open Sky system on a Monday. At this stage British Airways had been considering its subsidiary, Speedbird, to provide the yield management service for Go. BA arrived in Utah three days later on the Thursday and had signed a contract by the following Tuesday.

It would seem that the Open Skies systems has significant cost advantages and can be run more efficiently than solutions provided by British Airways' own IT department. An airline can outsource the operation cheaper than doing it in-house and still maintain control. The system is rented rather than

*All low-cost airline distribution strategies are based on Southwest's KISS principle (Keep It Simple Stupid).*

building a custom application and siphoning off value capital resources? The airline gets the entire set of applications and pays for the use of the service based on passengers boarded. Communication with the server from the call centre will be via dedicated data lines while outstations can use the internet as medium to communicate with the host server. Whether it be obtaining a credit card number, closing sales on the telephone or printing out a passenger manifest, the tools are all available at a cost that can be budgeted based on projected passenger volumes.

If you think the new technology is bringing about a new paradigm shift, it is. Airlines can concentrate on marketing and revenue management rather than information technology. The tools exist today. With thousands of airlines flying around the world and only about 100 utilising yield management, the landscape of revenue maximisation and distribution cost reductions has only just begun to be explored.

The bonanza of electronic ticketing is too good to be ignored by the major airlines. Because their current costs are so high, it is inevitable that they will adopt the new technology even though its implementation is costly and complex. The effort will be rewarded in a short space of time.

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