

No-frills airlines have found a simple and easy to understand fare structure which has gained them customer confidence, market share and high unit yields.

Simplicity, the key to no-frills fare structures.

Although suffering adverse publicity from an accident and having to merge with another carrier, ValuJet managed to achieve very high unit revenues and a low seat-mile cost base. The adoption of a classic no-frills strategy and operation was an important factor in achieving low costs, but so was its pioneering use of ticketless travel.

This allowed it to realise one of the highest yields, despite charging fares a third the level of its major competitors. How do the fares, ticket distribution and marketing systems of other no-frills carriers compare, and is there more they can do to improve their distribution and profitability?

ValuJet yardstick

ValuJet's original success is worth examining in some detail. In 1994 ValuJet had the second highest yields in the US, which was 26% higher than Southwest's. This is with an average fare of \$65 across its network of 465nm routes from its Atlanta hub. Although ValuJet had fares \$100 lower than the average fare before it started operations it still managed to achieve the second highest unit yield in the US. How was this done?

The simplicity strategy ValuJet adopted meant that not only were costs lowered but revenues were also improved. Distribution costs were one of four major cost areas that could be kept low as a result of simplicity. This led to selling tickets outside the traditional computer reservation system (CRS) network and adopting a ticketless travel

system similar to the one developed by Morris Air.

To do this ValuJet created its own reservation software. The expense of printing tickets was not incurred, and was in fact unnecessary when all the required information was now stored on a computer system. The net result was that ValuJet achieved a cost of 0.7 cents per seat-mile for ticket marketing and distribution. ValuJet estimates that most US carriers spent 20% or more of their passenger revenue on ticket marketing and revenue collection. The ticketless travel system meant the reservation information and payment transactions could be combined.

ValuJet's strategy was so successful that similar systems were adopted by Southwest and United, travel agency commissions were capped by Delta and CRS agency fees reduced. ValuJet estimated most airlines were spending an average of \$25 distribution cost per fare while it was spending \$8.50 in 1995.

Southwest

Of all the no-frills carriers in the US and Europe, Southwest exemplifies the trend toward fares which are easy for the passenger to understand. "To begin with we had an extremely simplified fare structure," explains Keith Taylor, vice president of revenue management at Southwest Airlines. "The fares were the same for every seat and the only distinctions in fares were for time of day and weekend. This lasted from our inception until 1987 when American Airlines and Sabre, through their very

complicated yield management regime, undercut our fares with a few of their seats on each flight. This gave them the appearance of being a low cost airline and made it difficult for us to maintain our simple fare structure.

"We then implemented our 'fun fares'. There are three levels of higher cost fares. These are an unrestricted walk-up fare, a seven day advance round-trip with overnight stay fare, and a 14 day advance one-way fare. There is also a low seven day leisure fare.

"We have found when we enter new markets there are high starting fares (the lowest fares charged by the major carriers). For example, the Orlando-Fort Lauderdale route had a starting fare of \$190 one-way before we entered the market. We offered a \$59 unrestricted fare and a \$39 leisure fare. Our fares are now \$64 and \$39.

"The philosophy of our fare policy is to build and maintain a trust with our passengers. This means we have to remain a low cost and no-frills airline," says Taylor.

"The system we use to manage our revenue and yield is known as Prose, which is an acronym for Passenger Revenue Optimum System. More than 60 airlines use Prose software and it was developed by a company based in Houston. Southwest first used Prose 3.0, but now uses Prose 3.6, which is also adopted to do things internally. We use the SAAS system, which is part of Sabre (American Airlines' computer reservation system) for distribution. Passengers book seats by telephone or through Sabre on the internet.



The advent of electronic ticketing has reduced distribution and marketing costs from about \$25 per booking to less than \$5.

“Prose and revenue management is integrated into the distribution system. Revenue management works by determining the fare level when the ticket is sold. We issue some tickets and others through travel agents and Sabre, but this results in a full 10% commission. It is easier for passengers to book directly with ticketless travel and this now accounts for 50% of our passengers,” explains Taylor.

A low fare structure means all fares are non-refundable. This means the problem of no-show passengers is very small and so overbooking is a minor issue. “What we practice is a system where we compare the number booked with the number boarded after departure,” says Taylor. “This way we get historical data on what percentage of passengers do not show for flights – there is still a portion who fail to show despite non-refundable fares. Prose keeps all these records and looks 52 weeks behind to build a historical record of bookings versus boardings. With this data we can predict demand and boardings 52 weeks ahead and so determine by how many seats we can overbook on each flight, which is always a constant percentage. For every 10,000 bookings we have 14 denied boardings which puts us constantly in first or second place on this performance parameter in the US.”

Southwest’s fare structure is based on

stage length, rather than what the market will allow. Some other carriers charge fares for short sectors in remote parts of the US equal to what other airlines are charging for transcontinental sectors. “As an example of our consistency our highest unrestricted fare on the Baltimore-Los Angeles route is \$299, which compares with \$1,400 to \$1,900 on other airlines,” says Taylor. “We take the view that fares should be set to meet costs. Fares on shorter routes are correspondingly cheaper, such as \$49 to \$86 one way on the Dallas-Houston route. We could charge higher fares in areas where we have market dominance, but we don’t believe this is best for our long-term interests which are to maintain a trust with passengers. Yield management through Prose works by forecasting demand and maximising the number of highest fares. In 1997 our unit revenue per available seat-mile was 8.58 cents, while unit cost was 7.40 cents. This was achieved with an average fare of \$72.”

easyJet

EasyJet is the European no-frills airline with a fare structure and booking system closest to Southwest’s and ValuJet’s. EasyJet books 100% of its seats on a direct sale system with its passengers on the telephone, via the internet and at airport on check-in. This means easyJet cannot overbook and commissions to travel agents are avoided.

EasyJet adopted a reservation system where passengers book seats with a credit

card by telephoning the airline. No ticket is issued and passengers are issued with a boarding card at check-in. The system means revenue is transferred straight into easyJet’s bank account rather than having to reclaim it with a ticket coupon after the flight, which takes several months.

Seats are not allocated and there is no interlining or codesharing. EasyJet’s reservation system was bought off the shelf from Utah-based Open Skies. British Airways’s no-frills subsidiary Go and easyJet’s closest competitor did exactly the same and bought the Open Skies system and adopted the same reservation system.

EasyJet’s fare structure is based on six one-way fares which increase in £5 (\$8) and £10 (\$17) increments. The reservation system determines how fast seats are selling. The cheapest are sold first and sales’ speed determines availability of different fares as a system of revenue management and maximising yield. All fares are simple, non-refundable and have no restrictions.

EasyJet’s highest fares have increased, but the lowest have remained the same. Starting fares are £29 (\$49) one-way between London and cities in Scotland, Belfast and Amsterdam excluding airport tax on routes of about 300nm. Starting fares from London to Nice, Barcelona, Palma and Geneva are £49 (\$82) and £69 (\$117) to Athens. Airport tax has to be paid by the passenger.

Fare increments are £34 (\$58), £39 (\$66) and all the way in £10 (\$17) steps to £109 (\$185) for routes to Scotland, Belfast and Amsterdam and in £10 (\$17)



Ticketless travel means the only distribution costs incurred are for reservation computer hardware, software and staff.

increments to peak season highest fares of £119 (\$200) to Geneva and £129 (\$220) to Nice, Palma and Madrid.

Despite easyJet's top fares being high for a no-frills airline, its strategy is to have fares that are 50% the level of major airlines. Like Southwest and ValuJet, easyJet's distribution costs are tiny compared to others. Labour costs are £0.80 (\$1.36) per booking since it pays its sales staff on a commission basis only, and agents can work for as many hours as they like. Total marketing and distribution costs are estimated to be about £2 (\$3.40) per booked seat, including all overheads. EasyJet's highest return fare on its short-haul network is £220 (\$350) which is about twice the level of Southwest's highest fares on similar stage lengths. EasyJet only uses its highest fares when demand exceeds supply in peak periods.

Like Southwest, easyJet wants to maintain an image of being a low fare airline, however it has to contend with severe infrastructure congestion, higher user charges and high passenger taxes.

Virgin Express

Another European no-frills operator which has successfully adopted a distribution and booking system like

ValuJet and Southwest is Brussels based Virgin Express.

"Our booking system is our own internal system and is the one developed by Open Skies. This is used by Go, easyJet, Vanguard and AirTran," explains Gus Carbonell, director of marketing at Virgin Express. "We have 100% electronic ticketing and all seats are booked without issuing a ticket. We have 100 people in the reservation centre and an internet site which interfaces with the booking system. We are currently booking about 5% of our seats through the internet.

"The distribution cost is based on a combination of a basic salary and incentive commission to reservation staff. This is the only distribution cost. The minimum amount we save compared to a conventional booking system is £10 (\$17) per booking. The fare structure is a simple one-way basis and the only restricted fare we have is a 21 day advance purchase. The number of other fares available depends on the speed of sale and we sell the cheapest first. All are non-refundable and we generally do not overbook since we experience less than 1% no-show rate.

"Our fare policy is to be a market leader and to stimulate traffic with the lowest fares relative to other airlines. Our fares are based on a mileage formula, taking particular airport landing fees and user charges into account. Fares do not include airport taxes which are paid by the passengers. We have five fares on each

route which are arrived at from our formula," says Carbonell.

One-way fares on London routes start at \$43 and rise in steps of about \$6 and \$15 to a maximum of \$89. One-way fares on longer routes to Milan, Nice and Copenhagen start at \$58 and rise in steps of about \$15 to \$139 or \$151. Virgin Express has more fares available than easyJet but Virgin Express's highest fares are lower.

AirTran

Since merging with ValuJet, AirTran has changed its strategy from being a pure no-frills airline. "We market our product through a number of distribution channels including travel agencies," says Jeff McKinney, senior vice president of marketing and planning at AirTran. "This means we have a far wider distribution outlet than ValuJet ever did. We distribute through CRS systems, travel agencies and the internet. We do issue paper tickets but still also book a vast number of seats through electronic ticketing."

So why did AirTran go back to paper tickets? "Paper tickets made our product available at more outlets and the percentage of our traffic sold by agencies has increased from 10% to 40%. This additional revenue more than offsets the cost of distributing tickets in this way," explains McKinney.

AirTran's product has also changed. "We have introduced a business class and have advance booking and reservations. The business class is equivalent to a US domestic first class, but we call it business class because we charge much cheaper first class fares than the majors. The enhanced product has to be more attractive to business travellers, and this means we have to distribute through traditional channels. We have still kept the positive aspects of low cost distribution.

"Our fare structure is still relatively simple. There are five or six fares on each route, including business class fares. This compares with four fares in ValuJet's old system. Our philosophy still works on the premise of making fares affordable, and we have kept the simple one-way fare structures. All tickets are non-refundable, except for first class. This means we do not have to worry about overbooking in economy class and no-shows are kept to a minimum. We track the percentage of seats used compared to those booked, and so do slightly overbook. Our rate of overbooking is still much smaller than major airlines.

AirTran's route structure is a hub and spoke network from Atlanta serving 29 cities with a daily frequency of about four flights on each route. The schedule is flown every day and stage lengths vary

from 300nm to 700nm.

The five fares available on each route start with a 14 day advance purchase, followed by a seven day and then three day advance purchase and end with a walk up fare. Examples of 14 day advance purchases are \$47 for Dulles-Boston, \$57 for Dulles-Midway, \$67 for Atlanta-Dulles and \$97 for Atlanta-La Guardia.

Walk-up one-way fares, or full economy fares, are \$108 for Dulles-Boston and Dulles-Midway, \$149 for Atlanta-Dulles, and \$189 for Atlanta-La Guardia. Business class one-way fares are \$55 to \$65 higher than walk-up fares. First class fares on Delta Airlines on the same routes are \$379, \$793, \$572 and \$486.

AirTran's low fare structure means major airlines' fares are low where there is competition. AirTran still operates the same electronic ticketing as ValuJet did, and the same telephone booking system used by easyJet. "We also distribute tickets and make bookings through the internet," says McKinney. "The internet is a viable channel and we have a similar booking level to the major airlines. The internet is in fact exceeding all expectations and the level of internet reservations should continue to increase as passenger awareness improves. It definitely stimulates traffic, and we have only been using it for three weeks."

Ryanair

Irish carrier Ryanair is probably the no-frills airline which has continued to use traditional ticket distribution methods more than any other no-frills airline.

"We keep lowering fares to stimulate traffic," says Michael Cawley, chief financial officer at Ryanair. "We are now offering a £20 (\$34) one-way fare between Dublin and London and this is a permanent fare, not a temporary offer. Fares from London to the European continent start at £17 (\$29) which include a £10 (\$17) tax.

"Our fare strategy is to have a small number of fares and distribute 40% of our bookings directly through the airline and 60% through travel agents. As an example of our fares, a one-way restricted fare between Ireland and the UK is £19 (\$29), a mid-week return is £60 (\$102) with fares rising to a £70 (\$120) return and £109 (\$185) day return," explains Cawley. "We bought the British Airways booking system from BA and also operate a telephone credit card booking system. Our fares are 70% to 75% lower than existing airlines on the same routes and our strategy is to keep our fares permanently low. Our fares are now 10% lower than they were in 1997."

Ryanair does not use ticketless travel because it does not have the software to support such a system. "We are looking into ticketless travel," says Cawley. "We would have to buy someone else's system rather than develop our own." Like all other no-frills airlines Ryanair has a very low overbooking percentage because its fares are non-refundable. The airline only overbooks where it operates a very high frequency service so that denied passengers can be put on the next available flight after a short wait.



Low fare structures means tickets are non-refundable. This almost eliminates the complication of no-shows and overbooking and can provide an opportunity to achieve high load factors.

Contrast

All no-frills carriers have adopted the same basic policy of selling the cheapest fares first. This is a reverse situation of the traditional system used by major airlines of selling the most expensive first and only making cheap fares available closer to the flight. This clearly works well for no-frills carriers since some record respectable unit yields. AirTran and Ryanair, which issue tickets through traditional channels, make the cheapest available first but regulate their availability with fixed date controls rather than speed of sale like the other carriers.

No-frills carriers all differ slightly in the distribution channels they use, and only easyJet and Virgin Express have 100% ticketless travel. The benefits of ticketless travel are the obvious savings made from very low booking costs,

elimination of paper tickets and commissions, and the flexibility to implement pricing based on speed of sale. As Southwest and AirTran find, however, traditional distribution channels make their product more available to the public and generate more traffic without having to result in a complicated fare structure. Whether the internet will be able to substitute for traditional channels is a major issue; not just for no-frills airlines.

The one common feature of all no-frills airlines is that their fare structures

are simple to understand, and only involve four or five fares on each route. The other common feature is that tickets are non-refundable. This almost eliminates the complication of no-shows and overbooking and can also provide greater opportunity to achieve high load factors which contribute to high unit yields.

Contrast this with a major airline running a traditional paper ticketing system. Although their costs are much higher, they are able to offer a greater range of services to their customers such as interlining and distribution through a wide number of outlets. Their complex fare structure also allows the airline to maximise the price charged to each of their customers, depending on the elasticity of demand at that fare point.

Regardless, it is clear that a simple fare structure works well. It stimulates traffic by presenting a clear image to the public, avoids many costs of distribution, side-steps overbooking complications and allows high load factors to be achieved. These all contribute to generating some of the highest unit yields seen in the industry.

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