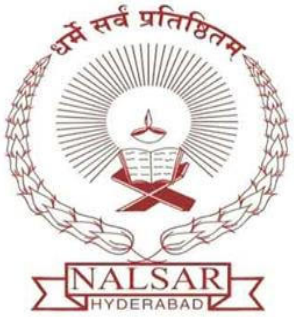

Centre for Aerospace & Defence Laws (CADL)

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Course Material

M.A. (AVIATION LAW AND AIR TRANSPORT MANAGEMENT)

2.3.12. AVIATION MARKETING

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MODULE I

FUNDAMENTALS OF MARKETING

WHAT IS MARKETING?

There is a popular misconception when the term "marketing" is defined – that it is not a very edifying activity. According to its critics, the marketing concept is about producing things that people don't really need and then tricking customers into buying them through deceitful advertising. Such views will be totally rejected in this book. Marketing describes a complete philosophy for running a business, based on the meeting of well-researched, well-understood and genuine customer requirements.

We will use the following definition of the subject: "*Marketing is the management process responsible for identifying, anticipating and satisfying customer requirements profitably."*

This definition, used by the UK Chartered Institute of Marketing, provides a valuable initial framework for the study of the subject. In particular, its use of the word "anticipating" emphasises the fact that marketing is a dynamic discipline, where customer requirements are in a constant state of evolution and change. This is especially the case in the airline industry, where successful airlines are likely to be those which anticipate change and are ready for it when it occurs. Unsuccessful carriers tend to be those which wait for change to happen and then try to catch up with it. This is a theme which will recur frequently in the book, and one which is well-illustrated by the difficulties which many so-called' Legacy' airlines have had in recent years in responding to the challenges which the rapid growth of Low Cost Carriers have brought to them.

Though the definition is useful, it is not sufficient to fully describe all the facets of marketing, nor to give a framework for this book. We need to break it down further.

A common initial way of doing so is to distinguish between "Consumer" and "Industrial" marketing. Consumer Marketing is marketing activity targeted at the individual or the family. Industrial Marketing is the term used to describe business-to-business or firm-to-firm marketing.

There are many differences between the two. One of the most important is that in Consumer Marketing, identifying the "Customer" for a particular product is usually quite straightforward. Market research studies could, for example, easily identify the demographic characteristics of the individuals who bought chocolate bars or ice-creams. With admittedly more difficulty, it would also be possible to carry out the attitude studies which would highlight the factors taken into account by these people in choosing between the different products on offer.

Industrial Marketing gives no such straightforward opportunities. When firms need to make purchasing decisions for major capital items, they will normally do so using a complex decision-making process. This process will often involve large numbers of people, each of whom will be working, at least partly, to their own agenda. Understanding of this process is one of the central skills required in Industrial Marketing and considerable space will be given to it in this book.

Airline marketing provides a particularly fascinating illustration of the application of marketing principles because it includes examples of both Industrial and Consumer Marketing. Marketing to the business air traveller, and of air freight services, both illustrate well the concept of Industrial Marketing. Leisure air travel marketing, on the other hand, if carried out correctly, increasingly exhibits the principles of Consumer Marketing.

The "*Marketing Mix*"

Though the distinction between "Industrial" and "Consumer" marketing is a useful one, it does not describe any of the activities which must be undertaken in order to apply marketing principles to business. The concept which does do so is known as the "Marketing Mix".

It is useful to describe marketing activity as encompassing the following "4Ps":

- Product
- Price
- Promotion
- Place

The word "Place" is somewhat confusing. In our study of airline marketing we shall take this word to describe the distribution channels employed by airlines.

The "4Ps" model tells us that the application of marketing principles will require decisions to be made about the Products which will be offered and the Prices which will be charged for them. Firms must also decide on the methods of marketing communication they will employ in order to persuade people to buy, and the distribution channels which will be used to provide the link between the customer and the product.

The concept is also valuable for another reason. It emphasises that marketing decisions cannot be made in isolation. Instead, all decisions are linked, with the ability to make tradeoffs between them in order to optimise the overall result for the firm an absolutely crucial skill.

Such tradeoffs are at their most obvious in the relationship between Product and Price. Clearly, no firm should invest money in product enhancement unless it expects to obtain a return in the form of a higher selling price or an improved share of better yielding markets. They are though, equally significant in other areas. For example, in making decisions about their distribution channels, firms must often decide whether or not they are to be a wholesaler or a retailer. As we shall see in the airline industry, so-called charter carriers have traditionally sold mostly in a wholesale basis (indeed, in some cases, notably so in Europe, they were restricted to such a role by government regulation). They produced planeloads of capacity in response to orders placed with them by Tour Operators. The Tour Operators in turn combined the aircraft seats with hotel or other accommodation to make up packaged holidays. In such a situation, the airline was merely the supplier of capacity. The Tour Operator took responsibility for reservations and retail selling. The airline's promotional spending needed only to encompass the costs of a field sales force which carried out sales negotiations.

In strong contrast, airlines focussing on the business travel market have tended to adopt a retailing philosophy. This has required them to keep in contact with travel agents, and to maintain a high promotional profile through such activities as media advertising, database marketing and the maintenance of an attractive Frequent Flyer Programme. All these tasks are costly ones, and need to be traded off against the undoubted advantages in terms of market control which retailing can bring.

Stages in the Application of Marketing Principles to Airline Management

The "4Ps" model is a powerful one, and describes much of what an airline must do if it is to apply the principles of marketing in order to achieve business success. It does not, though, give a complete description. In this book, it will be suggested that the application of marketing should consist of seven interlinked stages:

1. The Customer
   The cornerstone of successful marketing activity is that firms should obtain full knowledge of their current and potential customers. This knowledge needs to encompass information about market size, demographics, customer requirements and attitudes. There also needs to be an ability to forecast the future size of the market, and any possible future changes in customer needs. The processes whereby airlines seek this information will be those of market research and market analysis.
2. The Marketing Environment
   The nature of sound marketing policies will clearly vary according to the constraints and opportunities provided by the external environment. In analysing a firm's marketing environment it is usual to use the model known as PESTE analysis. This model categorises the factors in the marketing environment under the five headings of Political, Economic, Social, Technological and Environmental. The analyst's task is to isolate those factors in the external environment which will have a significant impact on the formulation of sound marketing policies and to assess their implications.
3. Strategy Formulation
   Clearly, it will not be possible to define marketing policies without the marketing input being a crucial one in the definition of a firm's overall strategic direction. This strategic direction must identify the firm's goals and objectives, the markets in which it will participate and the methods it will employ to ensure successful exploitation of market potential.
4. Product Design and Development
5. Pricing and Revenue Management
6. Distribution Channel Selection and Control
   Once an overall strategy has been selected, the next three stages should follow on logically. Today's aviation industry offers airlines many possible routes to success (and, interestingly, many different ways in which they can fail). What matters is that a clear strategy is selected and pursued steadily over the long-term. Each possible strategic option will result in a requirement for a linked set of Product, Pricing and Distribution decisions.
7. Selling, Advertising and Promotional Policies
   A common mistake is to assume that the words "Marketing" and "Selling" are synonymous. They are not. The term "Marketing", as we have seen, describes a total philosophy for running an entire business. "Selling" is the concluding stage of a correctly-applied Marketing process, whereby customers are persuaded to buy the firm's products.

"Marketing" ought to make "Selling" easier. It is likely to be a great deal easier to sell something to someone which is available in response to a well-researched and well-understood customer need. Indeed, one of the traditional faults of industry in the past has been a so-called Production Orientation whereby firms made what they liked making, or found it easiest to make, and then tried to persuade

reluctant customers through high pressure selling to buy these less-than-ideal products. It should not be thought, though, that "Marketing" will make the skills of Selling obsolete. In today's competitive markets, customers will usually have plenty of choice open to them. Persuading them to exercise this choice in a particular way will require the use of professional skills of a high order.

MARKET FOR AIR TRANSPORT SERVICES

An airline which is to apply the principles of marketing successfully needs a thorough knowledge of current and potential markets for its services.

This knowledge should encompass an understanding of the businesses in which they participate, and of the market research techniques they must apply in order to gain the knowledge they need about the marketplace.

They must be able to identify "Customers" and distinguish them from "Consumers". They must segment their markets and identify the requirements of Customers in each of the segments. Finally, and most importantly, they must examine their markets in a dynamic rather than a static sense and anticipate future changes in customer needs.

WHAT BUSINESS ARE WE IN?

To begin this work, any airline first has to answer the question as to which market or markets are to be studied. To do so, it must answer the fundamental question about the business or businesses in which it participates.

In doing so, there are two possibilities. The first and obvious way is to define business participation in terms of what the firm does. Thus it would be easy for an airline to say that it was a player in the aviation business.

There is a significant problem in doing so. It will result in a serious underestimation of both the extent and the nature of the competition that the airline faces. As a consequence, defining business participation in this way is often characterized by the term 'Marketing Myopia'. A far better way is to look at the question from the point-of-view of the needs that the firm is aiming to satisfy and the competition that it faces. A large combination airline will be working in at least the following areas:

Transportation

There is a clear economic, and, often, social need for transport. Those with this need will look for it to be satisfied in an optimum way. Whether use is made of air transport or a surface transport mode in order to do so will be less important to them. There are now many short-haul routes where surface transport can provide a level of service in terms of comfort and door-to-door journey times which is as good as or better than that available from airlines. In the future, this form of competition is likely to become more marked still, given the ambitious investment plans now in place in many countries for the improvement of surface, especially rail, transport.

Communication

Airlines have always assisted people to communicate, as travel allows opportunities for face-to-face meetings. It should not be assumed any longer, though, that travel is essential for such meetings to take place. The world is undergoing a revolution based on video-conferencing, conference calling and email. The future will see video-conferencing becoming even cheaper, of better quality (with the

spread of Broadband networks), and more widely available. More companies are now investing in videoconferencing suites for their staff. Also, increasing numbers of personal computers are being sold with in-built web cameras, allowing videoconferencing to come to the desk top. These are all indicators of the substantial amount of competition that airlines are already facing from the telecommunications industry. The degree of this competition will increase further in the future, especially during recessionary times when many firms are under acute pressure to save money. Its possible impact on the airline industry is further discussed in Section 3:5:1.

Leisure

Airlines today are increasingly involved in the intensely competitive leisure industry. Customers have to decide how they will use both their disposable income and disposable time. Disposable income can be used to purchase holidays. It can, though, also be used to buy a wide range of other consumer items. Disposable leisure time can be used for the taking of air-based holidays. Equally, it can be used for other leisure activities. It certainly will be if travelling by air becomes a tiresome experience through flight delays and more and more chaotic airport handling brought about by increasing congestion and growing security requirements.

Logistics

In the air freight industry, it is rarely possible for airlines to sell successfully against surface transport operators on the basis of price. Surface transport rates are almost always cheaper than those charged by the airlines. Commonly, surface rates are only a fraction of the air-based equivalent. As we shall see in Section 2:4:2, airlines are only able to succeed if they propose to the shipper a logistics concept based on fast transport, low inventories and limited investment in field warehousing.

They therefore compete in a Logistics business, with their rivals being the surface transport firms offering a different Logistics philosophy, as well as other airlines bidding for a share of the available air freight market.

Information

As a more minor, but still interesting issue, on the cargo side of their business, airlines certainly compete in businesses associated with the movement of information. For example, until the mid-1980s, many airlines had lucrative markets composed of moving urgent documents. Since then, this market has been progressively challenged by the electronic transmission of documents initially through fax machines and, more recently, e-mail.

Another example of competition for the airlines from electronic data transmission is in the field of newspaper publishing. Until recently, many airlines had profitable markets in the transport of newspapers. Newspapers were a classic air freight commodity in the sense that an out-of-date paper had no value and therefore speed was of the essence in getting them to their market quickly. The problem for airlines now is that newspaper publishers have realized that there are two ways of ensuring that this happens. They can, at great cost, ship printed newspapers. The alternative is to transmit the data contained in the newspaper very cheaply to satellite printing stations. The papers can then be printed near to where they will be sold and distributed by truck, at a far lower total cost.

Selling Services Running a successful airline requires numerous skills to be developed, and many carriers have an important revenue source from selling these skills to others who need them. Traditional skills which are sold are those associated with aircraft engineering, airport ground

handling and data processing and management.
As an overall summary, airlines participate in many businesses and must take a broad view when answering the question "What Business are we in?" If they do, they will be better placed to correctly identify their customers – the subject of the next section – and to take proper account of the extensive, and increasing, amounts of competition that they face.

WHO IS THE "CUSTOMER"?

Definitions

We now turn to the task of addressing one of the most fundamental and commonest mistakes made in airline marketing – failure to make a proper distinction between the "Consumer" and the "Customer".
To begin with definitions, "Consumers" are those people who actually travel. They are therefore easy to identify and analyze. They make their existence clear by reporting for flights and their requirements and preferences can be analyzed using questionnaires. They are therefore usually given a great deal of attention by those responsible for Marketing in the airline business. Unfortunately, they may not be decision-makers about the things that matter. In Marketing, such decision-makers are defined as "Customers".

There are at least four customer decisions which must be analyzed:

Will a trip be made at all?
For many firms today, the cost of travel is a major item of corporate expense. In a recessionary period, firms will attempt to reduce expenditure in order to minimise the effect of recession on corporate profitability or, in extreme cases, to stave off bankruptcy. In such a situation, executives might present a case to their boss that a business trip should be undertaken, only to find that the necessary expenditure is not sanctioned. Instead, they are told to use, say, the phone, email or video-conferencing as a way of conducting the business in question. In such a situation the true "Customer" for the airlines might be the firm's CEO or VP-Finance.

What mode of transport will be selected?
As was mentioned in the last section, it is likely that the future will see a significant increase in the amount of competition that airlines face from surface transport operators, especially railways. On short-haul routes, railways are capable of giving superior door-to-door journey times and, arguably, a better quality of service than airlines. Carriers will face a significant challenge for the business travel market, and may well have to target those who formulate corporate travel policies in order to minimize the adverse effect on their traffic.
For leisure travellers, the impact of surface transport competition is likely to be greater still. Besides competition on service quality, surface operators will be able to challenge airlines on price, with both train and bus services likely to become increasingly significant. The "Customer" in such a situation might be the family member who has most influence in travel decisions.

For air trips, what class of service will be purchased?
With many airlines, passengers have a choice of flying First Class (at least on long-haul routes),

Business Class and Economy or Coach Class. In the business travel market, the person who travels will have little or no say in the decision as to which class will be purchased. Almost all firms have a Corporate Travel Policy whereby very senior executives are allowed to travel First Class, those of middle rank in Business Class (at least on long-haul routes), whilst junior employees have to be satisfied with Economy Class. Interestingly, during recessionary periods, almost all firms have a downgrading policy in order to save money with, in particular, much First Class and Business Class travel being eliminated.

In order to maximize the amount of high yielding traffic available to them, carriers will have to target those who make decisions about Corporate Travel policies. They will, in particular, have to persuade these people that the benefits of buying travel in the premium cabins of the aircraft – for example, that these cabins allow better opportunities for sleep or work – outweigh the very substantially higher prices that are charged for access to them.

Which airline will be selected?

If it has been agreed that a particular journey will be made by air, the question of the choice of airline is clearly a crucial one. In the past, many business travellers did have the choice to make this decision themselves. It has been a major trend of the last ten years that this has become so in fewer and fewer cases. As we shall see in Section 2:2:4, during this time more and more companies have centralized travel purchasing in order to gain access to corporate discounts from airlines. Such policies narrowed the choice which the individual traveller could exercise, even if they were not restricted to using a single airline.

In leisure air travel, as will be discussed in Section 2.2.5, the market is still often a wholesale one. Many airlines still mainly confine themselves to selling blocks of seats to Tour Operators and Consolidators. The individuals who travel will therefore have very little say in the airlines that they fly with.

Given the importance of these four decisions, there is a crucial need to take account of them properly if effective marketing policies are to be established. In particular, the mistake of assuming that the "Customer" is the same person who boards the aircraft must be avoided.

"Apparent" and "True" Needs

In analysing customer decision-making, all firms need to understand the factors that their customers take into account in making up their minds. In order to do so, the obvious method is to ask them to describe the factors in a properly constructed and administered market research survey. The problem for the analyst is that what people say may not be the truth. Rather, it may perhaps reflect what they regard as an acceptable answer, rather than an accurate description of the factors they really take into account. This difference between the claim and the truth is known in Marketing as the difference between "Apparent" and "True" needs. To illustrate the point, a corporate business traveller asked to describe the factors that they take into account in choosing their airline might give a series of respectable answers, all reflecting the service features that permitted them to use their time as effectively as possible in their employer's interest. If they did, issues such as flight frequency (to allow for travel flexibility), punctuality and a roomy cabin (to permit working during flight) might figure prominently. The truth might be rather different. Today, many business travellers base their choice-of-

airline decisions on their wish to support an airline on as many occasions as possible because this will maximise the personal benefits available to them (bought using their employer's money) through that airline's Frequent Flyer Programme. These benefits will of course, feed the True Need of greed. As another example, almost all airlines attempting to exploit the business travel market find that, in order to do so, they must pander to the pride and ego of those who fly. Such features as separate reservations phone lines, a separate check-in desk (ideally with a piece of red carpet in front of it) and separate cabins on board the aircraft do, admittedly, sometimes have a practical purpose, of allowing the business traveller access to useful benefits. However, of equal, or probably greater, importance is that they massage the travellers' ego.

"True Needs" in marketing can cover other aspects as well. Some customers might, for example, be lazy and prefer to keep purchasing from an existing supplier rather than make the effort to change even if such a change might result in better value-for-money. Others might be risk-averse, preferring to stay with a tried-and-tested solution rather than an alternative which might be better but which also might go disastrously wrong.

"True Needs" are at the heart of successful marketing. In many ways they reflect the weaknesses of the human personality. They are also relatively constant in their importance through time. No-one who is concerned to make a success of an airline's marketing activities should make the mistake of assuming that a declared customer requirement is actually a true description of what is motivating purchasing decisions.

Industrial Buying Behavior

As was noted in Section 1:1:1, a major difference between "Consumer" and "Industrial" Marketing concerns the question of the ways in which decisions are made. In Consumer Marketing it is usually possible with confidence to target the individual or the family. In contrast, in Industrial Marketing, purchasing decisions will often be made in a complex way with different corporate executives interacting in different ways through a so-called Decision-Making Unit or DMU.

Because of its importance, there is now a substantial literature dealing with the workings of Decision-Making Units, and the ways in which those who wish to sell to the firm should approach the different DMU participants. This literature suggests that these participants should be divided into five categories, each of which will be working to their own agenda in terms of both "Apparent" and "True" needs.

These categories are as follows:

Deciders

These are the people who will make the final purchasing decision. They will, no doubt, have an Apparent Need of making the decision which will be in the best interest of the firm that employs them. There may, though, also be a hidden agenda. For example some Deciders may be looking for personal inducements through bribes or offers of corporate entertainment. Others, perhaps fearful of losing their job, may be looking for a safe, risk-free solution.

Gatekeepers

"Gatekeepers" are defined as those who control the flow of information into the Decision-Making Unit. Gatekeeping may take on a number of forms. The Decider's secretary or Personal Assistant will be taking on a Gatekeeping role if they opt to protect their boss from timewasting visits by what they believe will be unwelcome sales people. They will do so by declining to offer appointments to these sales executives when they phone.

The Market for Air Transport Services

Another form of Gatekeeping occurs when someone attempts to keep people away from the DMU who might show up their previous decision-making as having been mistaken. Once a decision has been made, there are almost always people with a vested interest in ensuring that it remains unchallenged. They will try to isolate people who might be able to prove that the firm would have done better to buy from another supplier. Anyone involved in Industrial Marketing will have to deal with Gatekeeping issues from time-to-time. There is a variety of methods open to them in doing so. They may try, for example, to by-pass the Gatekeeper. If the problem is a secretary who is refusing to offer an appointment, they could time their next phone call to ensure that it was after business hours when the secretary might have gone home but their boss is still in the office. If the boss answers the phone, an opportunity will present itself to attempt to persuade them that an appointment should be given. (If such attempts are successful, of course, they will invite a backlash from the secretary the next morning when they look at the diary. This may in turn result in them attempting to discredit the salesperson in the eyes of their boss).

A second method of addressing Gatekeeping problems will be through intimidation. Here, the sales person makes it clear to the Gatekeeper that they will offer a deal which will result in substantial benefits to the firm in question. These benefits cannot be given, though, if they have no opportunity to talk to the relevant decision-maker. It will reflect poorly against the Gatekeeper's judgement that their attitude is threatening to deny these benefits to the firm. It could even cause their job security to be brought into question if their attitude becomes more widely known – as the salesperson will ensure that it does unless they change their mind about their refusal to offer an appointment.

Whilst it may sometimes be necessary to use by-passing or intimidating tactics, they should be avoided if at all possible. The making of enemies seldom achieves the desired objective, in Industrial Marketing or anywhere else. By far the best tactic is to aim to convert the Gatekeeper so that they adopt an attitude of support rather than hostility. If the Gatekeeping problem is that of a secretary refusing to give an appointment then the offer of appropriate corporate entertainment may be sufficient. If the Gatekeeper is someone attempting to ensure that a previous decision they have made cannot be challenged, it is far better to address directly the root cause of the problem – the fact that they feel vulnerable and are worried about their status and job security. Reassurance that they will have an important future role to play if the decision is changed will be a way of calming these fears.

Users

Users are defined as those people who will actually use the product or service once it has been purchased. Because of this, they tend to be very concerned about the quality and utility of the product, and less worried about the cost of obtaining it.

In the next section, we shall be applying this model of Industrial Buying Behaviour to the situation where a firm is seeking to sign a corporate deal with airlines, whereby carriers will offer discounts in return for loyalty. In such a situation, the "Users" will be the business travellers who actually fly. They will lobby the "Decider" (commonly an executive with a job title such as Corporate Travel Manager) to deal only with airlines that offer extravagant service standards, a strong product reputation and an attractive Frequent Flyer Programme and with a prestigious brand position, even if these airlines do not offer such a good deal financially.

Buyers

Buyers are those who negotiate the final deal with the different suppliers. In a large firm, there will probably be a separate Purchasing function. In a small company, negotiations with suppliers may be the responsibility of the Finance Department.

In terms of true needs, those carrying out purchasing negotiations will certainly wish to protect their job security. They will probably conclude that the best way of doing so will be to demonstrate that their interventions save the company substantial amounts of money. To take account of this, salespeople will probably have to reserve the final concession that they are empowered to make until the last stages of a negotiation when the Purchasing Department is involved.

As a further aspect of saving money, those from the Purchasing Department are unlikely to share the enthusiasm of Users for extravagant product standards. They will probably favour more utilitarian solutions. For example, in the case of corporate dealing for business travel, those from the Purchasing function may well prefer deals with those so-called "Cost Leader"4 airlines which are able to deliver the product basics of safety, frequency and punctuality, but which do not offer the frills of luxurious seating and high levels of provision of food, drink and in-flight entertainment. The fares on offer from such airlines will probably be cheaper. Such fares will also address the natural prejudice of people who probably do not fly a great deal on business themselves and may regard those who do as a pampered and privileged minority.

Influencers

Influencers are those people who do not use a product, or become involved in detailed negotiations with suppliers, but who do influence the final outcome of the buying process.

Influencers can come from both outside and inside a firm. An example of an outside Influencer might be the Decider's partner, who had enjoyed some particularly pleasant corporate entertainment offered by one supplier involved in bidding for a piece of business. They then encourage their partner to continue to deal with this firm in order that further opportunities to accept hospitality might arise. A

further example would be a government minister or civil servant urging the firm to take account of the national interest in making its purchasing decisions by considering such issues as employment and the Balance of Payments.

Internal Influencers might exist as a result of internal corporate battles. For example, one unscrupulous executive might be trying to discredit another . They might well argue that the firm should change its source of supply for a product or service if this would help to embarrass the person who had selected the original supplier.

The "Customer" in the Business Air Travel Market

It is hoped that enough has now been said to show that correctly identifying and targeting "Customers" rather than mere "Consumers" is a cornerstone of successful marketing in the airline industry. This leads to the question of the identity of different customers and their "True Needs" which should be taken into account in order to ensure accurate targeting.

We have already seen that, in the business travel market, there will still be occasions when the person who travels has an absolute right to select the mode of transport they will use and, if it is to be an air-based journey, the airline with which they will fly. For example, someone running their own small business will presumably have this right, whilst even in large corporations there are still cases where companies leave these choices to individuals. We shall be further considering the question of the requirements of these people in Section 2:3:3.

Even where someone is able to claim that they have the right to choose the airline they fly with themselves, it may not actually be the case that they exercise this choice. For example, a busy business executive might trust their secretary to select airlines, and make the necessary bookings. There can be no doubt that executive secretaries make up an important group of "Customers" in the business air travel market.

In making a choice-of-airline decision, a secretary will presumably not select an airline which they know their boss hates. They will also takeaccount of requirements such as preferred departure airport, flight timings etc. However, from the point-of-view of Airline Marketing, there will presumably be occasions where two or more airlines both have a sound reputation, and offer an equivalent product in terms of timings. Here, the secretary will be able to exercise choice. As with all marketing decisions, they will have a set of True Needs which must be understood. For example, they will have understandable preference for the easy solution. It is unlikely that they will be prepared to wait for twenty minutes for an airline reservations department to answer the phone, when they know from experience that its rival will always respond instantly, or attempt to navigate a confusing website if other sites are easier to use. They will also get to know which airline is pleasant to deal with in terms of a warm and caring attitude from its customer contact staff.

Secretaries will also often have a True Need of greed, in that they may well prefer to deal with airlines that offer them an incentive. Thus many airlines have clubs for executive secretaries which provides a database to allow them to target secretaries with offers of corporate entertainment and discounted travel in return for loyalty.

Another example of a possible Customer in the business travel market is the travel agent. A business traveller may have the right to choose the airline they fly with themselves, but may leave the choice to their travel agent on the grounds that, perhaps, they are too busy to worry or that they regard the travel agent as an expert whose advice they should accept.

The role of the travel agent is still a controversial one in Airline Marketing and there will be repeated references to it throughout the book. It is easy to isolate the proportion of bookings which come through agents today. In some markets, still something over 70% of the bookings that traditional airlines receive come through agents, though the proportion is now generally declining. In terms of the subject of this section of the book, though, this does not mean that the travel agent is necessarily a "Customer" for them on such a high proportion of occasions. If someone specifies to the agent that one particular airline is the only one that is acceptable to them, the agent does not make a choice as a Customer, they merely take an order. The agent is a Customer, though, in any situation where, as described above, the person who travels leaves the choice-of-airline decision to them.

In terms of True Needs, senior agency managers will be motivated by greed, in that they will be predisposed to recommend the airline offering the highest rates of commission and certainly those which still pay commissions rather than those which do not. They do not have complete freedom to merely consider commissions, though, because if they recommend airlines that the person who travels finds unacceptable they run the risk that they will lose the account to a rival, and presumably more trustworthy, agency. There are, though, now a good number of respectable airlines where a recommendation for one giving better commissions would not arouse suspicion.

In the world of travel agency operations, airlines also have to take account of another set of customers. These are the travel clerks who actually make bookings and issue tickets. Generally, senior agency managers do not carry out this work. Equally, they rarely pass on to their staff the financial benefits of additional commission payments. In many countries, travel agency staff are poorly rewarded financially. Because of this, travel agency clerks often have true needs similar to those noted above for executive secretaries. They will prefer airlines that are easy and convenient to contact. They will also welcome the offer of incentives – particularly free travel opportunities on so-called educational or familiarisation visits arranged by airlines.

The final example of a "Customer" in the business air travel market has already been referred to in the last section. This is where a firm appoints someone to be responsible for corporate dealing with carriers. Under such an arrangement, freedom-of-action will be denied to the executives who actually fly. Instead, they will be required to choose from one or a small number of airlines. In turn carriers will be approached to offer substantial discounts in order to be one of the favoured airlines. In a large organisation, the management of business travel might be given to one executive with a job title such as Corporate Travel Manager. In a smaller one, it might be a task carried out by a senior manager from the Finance or Purchasing department.

As we have discussed, the growth of corporate dealing has been one of the major trends in business air travel marketing in recent years. In particular, recessionary conditions from 2001 until 2003 saw severe pressure being placed on travel budgets in many markets, and corporate dealing being

recognised as a valuable way of reducing costs. The possible renewal of such conditions in 2007 will again bring pressure on travel budgets.

Today, the question of correctly identifying and targeting "Customers" in the business air travel market is a vital one for airlines, and one that is causing increasing controversy. The problem is that it is very difficult to be certain exactly who is making the relevant decision. The normal expedient adopted by many airlines of simply asking the person who flies the question as to who was responsible for their choice-of-airline decision is unlikely to yield much enlightenment, striking as is does at the heart of questions about corporate status and privilege.

Because of this difficulty, many airlines today follow the policy of giving incentives to everyone, whether or not the person in question is actually able to influence the amount of business obtained. Thus, today almost all airlines offer individual travellers incentives through a Frequent Flyer Programme. They may also give the firms that these people work for substantial corporate discounts. Finally, the travel agents that these firms use are still sometimes rewarded by the offer of override commissions, though the extent of this practice has declined in recent years.

The results of such profligacy was that selling costs were for a long period the fastest rising cost of doing business for many traditional airlines. Indeed, the escalation of such costs stood in sharp contrast to carriers' success in reducing many other costs. It will be a major challenge in the future to better identify "Customers" and to ensure that promotional spending is more effectively targeted. This is especially so because failure to do so is a mistake most of the newer "Cost Leader" airlines have avoided.

The "Customer" in the Leisure Air Travel Market

Identifying the "Customer" is just as difficult, and just as important, in the leisure air travel market. They must also ensure that, if it is decided to spend time and money on a holiday, an air-based vacation will be selected. The airline must then ensure that the holiday is taken at a destination which it serves, and that people travel to the destination on its flights, rather than on those of a rival carrier.

In analyzing this complex set of decisions, it should first of all be born in mind that a great deal of holiday travel is undertaken in family groups. The question of how travel decisions are made within the family is thus a crucial one which should, for example, decide the creative content of advertising and promotional work, and the media buying decisions which are made.

Within the family, children can have an important influence on travel buying decisions made by their parents. For very young children, parents may deliberately choose an airline where they believe that facilities available for the care of babies are good. For older children, such factors as the availability of video games in an airline's in-flight entertainment system might be significant. For older children too, the choice of vacation destination may be made by their parents, but parents will take into account their children's preferences. This is something which is has been recognized in the creative strategies adopted by a number of vacation destinations, such as Disney resorts, in their advertising. Much of this appears to be designed to exploit so-called 'Pester Power'.

It is also a crucial issue as to whether or not men or women have a greater influence on holiday decision-making. Here, cultural influences assume great importance. Some societies are traditionally

matriarchal, where women are dominant in family life. Others are patriarchal, where men dominate. In the UK, it is recognized that women are extremely influential in holiday planning, and the creative strategies adopted by airlines and tour operators have increasingly reflected this.

With other possible "Customers" in the leisure air travel market, it must be recognised that the travel agent is important, being in fact more so than is the case for business travel. In the leisure market, the question of the destination for a vacation is a significant one, where people will often accept the advice of their travel agent. Of course, with business air travel the destination will have been decided prior to contact with the agent.

Another difference between business and leisure travel market is that, the business travel market is a concentrated one. It consists of a relatively small number of people who each travel a great deal. Indeed, the average number of air trips made per year by a business traveller averages more than ten in many markets. The leisure market, on the other hand, has fewer frequent travellers. Some leisure travellers are making their only trip of a lifetime. Many more take only one air trip a year, for their annual holiday. Given, therefore, that they are relatively inexperienced, they may have to turn to someone for advice on such aspects as the making of bookings, visa applications etc. The natural place for them to look is to their travel agent. The result is that it is possible to argue about the importance of the travel agent as a "Customer" for airlines in the business travel market. No such argument should occur with leisure travel. Travel agents are still important, and airlines must cultivate their loyalty if they are to obtain a proper share of this market. They will do so through the traditional so-called offline agents, but will increasingly have to sell over the Internet to the rapidly developing on-line travel agency industry.

A further feature of the leisure market as far as airlines are concerned is that, it is often still a wholesale market. Despite the use of on-line booking leading to an increasing presence in retailing, many airlines still wholesale blocks of seats to organizations known generically as Tour Operators (or Travel Organizers) and "Consolidators".

The difference between a Tour Operator and a Consolidator is becoming more and more difficult to define, given that many firms now combine both functions. In principle, though, the difference is that the

Tour Operators are aiming to be value-adders, in the sense that they take airline seats, accommodation, surface transfers and add-ons such as tours, sports opportunities etc to make up packaged holidays. A "Consolidator" is simply a dealer in discounted air tickets. More popularly known as "Bucket Shops", Consolidators provide an outlet whereby airlines can wholesale blocks of seats for a very low cost-of-sale. The problem, of course, is that because of the Consolidators' bargaining power, prices and yields can be extremely low.

In targeting the leisure air traveller, airlines must regard the senior managers and product managers of major Tour Operators as very important customers. They will have no hope of success in this market unless they can persuade Tour Operators to feature the destinations they serve in their brochures, and on their websites, and, when they do, to buy their seats to serve these destinations from the airline in question.

With the role of the Consolidator, airlines have difficult decisions to make. Reliance on them as a significant channel of distribution, will result in a straightforward selling task, in that an airline will be able to act purely as a wholesaler. There is a grave risk though, of the carrier losing control of its distribution channels, with potentially disastrous financial consequences. If, though, a decision is made to make significant use of the Consolidator channel, then the owners of the major consolidators must be regarded as highly significant "Customers".

The "Customer" in the Air Freight Market

The focus of this book is mainly on the passenger side of the airline business. A full study of the application of marketing principles to the air freight business is available elsewhere.5 It is nonetheless important that everyone who works for an airline should have an understanding of the air freight business, because the nature of the airline industry is such that frequent liaison will be necessary between passenger and freight departments. Air freight also gives another excellent illustration of the ways in which the application of marketing principles can make the difference between success and failure. No apology is therefore made for the inclusion of coverage of the air freight industry in this book.

In looking at the question of the "Customer" in the air freight market, it should first of all be born in mind that there are marked differences between the passenger and freight businesses.

In air freight, marketing intermediaries known as Air Freight Forwarders are extremely important to most airlines. Few carriers have a significant commitment to retail marketing. Instead, more than 90% of their traffic is typically provided by forwarders. There is every possible reason to regard the forwarder as a significant customer, more important still than the travel agent on the passenger side of the business. There seems to be a much greater degree of willingness on the part of freight customers to allow forwarders to make routeing and carrier selection decisions than is the case with travel agents. Also, a considerable proportion of air freight traffic is sent under the 'Consolidation' principle. Here, a forwarder will gather together a large number of small packages from individual shippers and present them to the airline as one large consignment. In return, the airline charges a much lower rate per kilo, and the forwarder passes on some of this saving to the shippers who generate the small consignments.

By definition, when shippers allow their consignments to be sent as part of a Consolidation, they are accepting that they will have no right to decide the airline that will be used to carry them. Instead, the decision as to which carrier will be given the traffic will be made by the senior management of the air freight forwarder, and all airlines must regard such managers as 'Customers'.

In the individual shipment, non-consolidated market, airlines will have another set of customers – the clerks who work for freight forwarding companies. A great deal of air freight moves at night, and is dealt with by an army of shift-working clerks. Also, as we shall see in Section 2:4:2, a considerable proportion of air freight moves as emergency shipments with no prior notice of the need to move goods being possible. In such a situation, routeing and carrier selection decisions will be made by clerks, late at night, when the senior managers of a forwarder are at home in bed. Airlines therefore have the task of building and maintaining a relationship with forwarder clerks as a significant customer group.

As has been noted above, many airlines only attempt to market their air freight services through air freight forwarders. For those that try and do more than this, a very much broader base of 'Customers' appears.

It should first of all be born in mind that in air freight there is a true 'retail' market of non-expert users. For example, a secretary may find that their boss tells them to send a small, urgent package of papers or samples. It is a major success of the so-called 'Integrators' that they have been able to simplify their processes to such an extent, and to design and administer a retail marketing organisation, so that their services are easily accessible to all customers. Away from the small shipment market, a limited number of airlines have taken this retail marketing philosophy in another direction, in that they have chosen to deal with the firms who produce freight, rather than merely rely on traffic offered to them by air freight forwarders. To say that such policies have proved controversial would be an understatement. For the moment, though, it is important to note that such a strategy requires a completely different view to be taken regarding the identity of the 'Customer'.

In bidding for business from the true originators of traffic, airlines will be facing two different situations. Firstly, they will have to attempt to obtain a good share of existing air freight flows. In order to do so, they will normally contact the Shipping Manager or some similarly-titled executive. Whether the correct person to approach is with the exporting firm or with the firm carrying out the importing activity will depend on the terms of trade under which a consignment is moving. Secondly, any cargo-orientated airline will also need to develop new air freight traffic by arguing that firms should use air freight in order to exploit new marketing opportunities, or to improve on the efficiency of existing logistics systems based on surface transport.

The exact arguments which should be used to do so are complex ones and are again covered in Section 2:4:2. For the moment, though, it should be noted that air freight can only be justified as part of a logistics philosophy in which higher transport expenses are traded off against cost savings and marketing benefits achieved elsewhere. In most firms, Shipping Managers are comparatively junior executives who do not have the authority to make these tradeoffs as they have no say over issues such as inventory and warehousing policy. In order to achieve a favorable outcome, airline salespeople will often need to target their message at a much higher level in the management hierarchy. In some firms, the Managing Director or President will be the right person to approach. In others, which take an integrated view of the management of the logistics function, there may be an Executive Vice-President or Board Director in place whose responsibilities include all the sub-functions of Logistics. If there is, this person should clearly be targeted in a sales campaign.

MARKET SEGMENTATION – AIR PASSENGER MARKET

The Concept

In Section 1:1, it was stated that the objective of a firm's marketing policies should be to meet the needs of its Customers, at a profit. We now have to deal with the problem that in one very real sense, this ideal objective is often unobtainable.

It is a truism to say that all Customers are different. If an airline was to carry out market research into the requirements of its Customers, the outcome would not be a uniform set of results. Rather, there

would be a spectrum of needs, and it would be quite impossible for the carrier to meet all these needs exactly whilst at the same time retaining sound production economics.

The problem is a common one in all areas of Marketing. For example, a car company might set out with the reasonable-sounding objective of giving all its customers exactly the colour of car that they would like. This would mean, though, producing some cars in wildly eccentric colours in order to satisfy the most unusual requests, with the result of very high production costs. Instead, car manufacturers usually produce cars in, say, eight or ten different colours. This gives them the benefit of much lower costs, but they have to accept that they will not be able to fully satisfy the requirements of all of their customers. Those with outlandish tastes will only be able to choose from cars which in no way give them the colour they are looking for. Even more conservative customers may find that a particular shade is too light or too dark.

The process of trading off customer requirements against production economics occurs in almost all industries – notably so amongst airlines. It is called 'Market Segmentation', and leads to the following definition of a 'Market Segment':

A market segment is a group of Customers who have sufficient in common that they form a viable basis for a product/price/promotion combination.

There are two possible mistakes which can be made when segmenting a market – those of under-segmentation and over-segmentation.

Under-segmentation occurs when Customers are grouped into segments which are too large, and where there is actually a high degree of difference in the requirements of those included in the segment. A finer segmentation might allow at least some of these differences to be incorporated in product, price and promotion policies without an undue cost penalty being incurred. Over-segmentation is the situation where too many segments are isolated, with the result that they give insufficient indicators with regard to policy development.

The correct segmentation does, of course, depend on the question of the use that will be made of it. With product planning, almost all airlines are handicapped by the fact that only two or three classes of service currently exist on board aircraft. Therefore, a broad segmentation must be used for product planning purposes. In contrast, if the objective is to provide the basis for a Database Marketing campaign, a much finer segmentation can and should be employed.

Segmentation Variables in the Air Passenger Market

Segmentation of the air passenger market has traditionally been based on the use of three variables: the purpose of the passenger's journey, the length of their journey and their country or culture of origin. Each of these variable remains important in Airline Marketing today, and we will examine them in turn.

Journey Purpose

Journey purpose has always been the fundamental segmentation variable in the air passenger market, with the essential division being between business and leisure travel.

In using such a division, it should not be assumed that all air trips can be placed in one of these two categories. Some are completely outside them. For example, many airlines have significant markets which consist of pilgrims visiting Islam's holiest places in Saudi Arabia. Such trips cannot be viewed as either business or leisure – they constitute an entirely separate market segment. Or again, airlines often find that they derive business from the medical market where someone who falls ill finds that the treatment they need is not available locally. They therefore travel by air to a destination where medical facilities are better. Again, the medical market should be viewed as a separate market segment.

Despite the clear existence of exceptions, the distinction between business and leisure remains a valuable one in Airline Marketing and there is no doubt that a usefully high proportion of trips can placed in one of these two categories.

In looking at the Journey Purpose variable, worthwhile sub-segments can be isolated, in both the business and leisure categories.

In business travel, a useful distinction is between Corporate and Independent business travellers. Corporate travellers are those who travel for a company, and who are able to put the price of their ticket and other business travel costs onto an expense account. They may adopt a more cavalier approach to the costs of the services they buy, placing importance instead on high product standards. Independent business travellers, on the other hand, are those who are self-employed or who work for small companies. These people feel to a much greater degree that the price of an air ticket is coming out of their own pocket. As we shall see in Section 2:3:3, some of their requirements are identical to those of the Corporate traveller. They do, for example, still regard a high frequency of flights and good punctuality as essentials. They are, however, often prepared to make sacrifices in terms of product frills – for example, by travelling in the rear cabin on board the aircraft rather than choosing costly First or Business Class products, or by using one of the so-called "Cost Leader" airlines. There are now many signs that the size of the Independent sub-segment of business travel demand is increasing relative to the size of the Corporate sub-segment.

In the leisure segment of demand, again, two sub-segments can be isolated – those of Holiday and Visiting-Friends-and-Relatives (VFR) travel. When someone is travelling by air on holiday, they still have to pay for their meals and accommodation at their destination. This restricts the size of the market to those who have relatively high disposable incomes. With VFR travel, on the other hand, meals and accommodation are normally provided free-of-charge. This allows airlines to develop new markets amongst people with lower disposable incomes, especially in situations where recent population migrations have left strong residual ethnic links between two communities.

Length of Journey

There are fundamental differences between the requirements of a short-haul traveller compared with someone who is flying a long-haul route. As we shall discuss further in the next section, on short-haul routes, the airport experience is an especially important one, whilst in-flight aspects such as seating comfort or food assume rather less significance. On long-haul routes, on the other hand, the in-flight experience is very important indeed in ensuring customer satisfaction.

An interesting debate is where the cut-off point between short-haul and long-haul services comes. No-one would presumably dispute that a flight of, say, forty-five minutes' duration should be regarded as short-haul and one of ten hours as long-haul. The difficult area is that of flights of, say, three or four hours. Here, for reasons of operational convenience most airlines continue to provide their short-haul product, despite the fact that passenger expectation is often for something substantially better. In particular, passengers will almost certainly respond unfavourably to being offered service in a single aisle aircraft with six abreast seating and a narrow seat pitch.

Country/Culture of Origin of the Traveller

In the airline industry in recent years there has been considerable discussion of the concept of 'global brands' and the possibility of truly global branding becoming a feature of Marketing in the aviation business. At the same time, with many airlines grouping together in large alliances, attention has been has been focused on the supposed need for seamless service concepts whereby wherever anyone flies, anywhere in the world, on the traffic system of the alliance, they should receive a comparable product.

Unfortunately, global branding and seamless service concepts in aviation come into conflict with the marked differences in customer requirements which occur between different cultures. For example, most people in north-west Europe or North America, would recognise a stereotype of the 'Business Traveller' as being someone who is middle-aged, and soberly dressed, carrying only a small amount of baggage. In contrast, in many third-world countries, 'Business Travel' takes on a quite different meaning. It largely consists of traders who fly to a destination where consumer goods are available cheaply. These goods are then purchased and flown to the developing country where they are in short supply and can therefore be sold at a premium. In strong contrast to the product standards that might be expected by a European business traveller, in many developing countries such standards are irrelevant. Instead, overwhelmingly the most important customer requirement is that the airline should offer a high free baggage allowance.

Even within the confines of market segments derived from developed countries, significant market-by-market differences in customer requirements occur. For example, different races often vary significantly in terms of height and weight, with people from many Far Eastern cultures often smaller on average than their European or North American counterparts. They may therefore regard seating comfort as being a rather lower priority. Or again, questions of appropriate food-and-drink to be offered will vary from market-to-market. A suitable 'breakfast' in France will be a different meal from what would be acceptable in the U.K.

All-in-all, the question of culture or country of origin of the person who is travelling must be seen as a highly significant segmentation variable in aviation marketing.

Customer Requirements – Business Travel Market

Given the segmentation of the air passenger market that we have been describing, it is useful to return to the definition of 'Marketing' given in Section 1:1. There it was stated that "Marketing is the management process responsible for identifying anticipating and satisfying customer requirements profitably". From this definition, it might be thought that our task is now a straightforward one. Having identified the main variables used to segment the market, we should now move on to discuss

the requirements of customers in each of the main market segments. Unfortunately, there is a significant complication. Despite our definition of marketing encompassing the concept of satisfying customer needs it is rarely possible to immediately satisfy all possible customer requirements. The reason is that to do so would require a degree of spending that would prove uneconomic. Instead, airlines have to prioritise needs so that what they are able to invest is focussed on their customers' most important requirements, on which their choice-of-airline decisions are most likely to depend. Customer Needs, therefore do not just have to be identified, they have to be prioritised as well.

If this is the case, it raises the question of how both the identification and prioritisation can take place. There are, of course, standard techniques of market research and analysis that airlines can use. Many carriers, for example, carry out in-flight surveys of their passengers. Often, such surveys include questions which ask passengers to list the factors they take into account in choosing their airlines. Unfortunately, in-flight surveys only allow carriers to sample the opinions of people who are flying with them already. They are potentially even more interested in the views of people who are at the moment choosing to fly with their competitors.

To remedy this problem, it is possible to engage firms of market research consultants and instruct them to carry out a survey of the whole of a market, rather than just amongst the airline's own customers. These surveys may be carried out by mail or email, by telephone or through individual or group interviews. Interview-based research at least should have the benefit of a better structure and more reliable answers, though at the penalty of a substantially increased cost. Even with such research, though, there are risks. In particular, respondents may give answers that they feel the questioner wants to hear, or which match up to their own, not necessarily accurate, view of their own importance. As was mentioned in the last section, these latter issues often arise especially over questions as to who is responsible for the person's choice-of-airline decisions. There is a natural wish to give the impression that they are important enough to make this decision themselves, even if they are in practice bound by a company travel policy that allows them little or no flexibility.

An alternative way of understanding customer needs is increasingly open to airlines as the forces of deregulation and liberalisation advance in the industry. It is one thing to ask people what their requirements are. It is often a more convincing policy to observe what they actually do when they are presented with a choice. Such situations often occur when new competitors arrive in a market, offering radically different service concepts from the incumbent carriers that they are challenging. If these new competitors immediately achieve a substantial market share, it allows the analyst an opportunity to change and adjust views about the nature of market requirements.

As an example of this, as we will discuss in Section 4:2:1, in many markets one of the major trends of recent years has been the rapid rise of airlines offering very low fares, and asking passengers to make carefully calculated sacrifices regarding frills in the product to obtain them. In the USA, by far the most successful of these carriers has been Southwest Airlines. Recent estimates have suggested that upwards of 25% of US air travellers are now choosing one of the no-frills airlines, and that a significant proportion of these people are business travellers rather than the back-packers one might have expected to make such a choice. In turn, this has led to a reappraisal of the priorities of customers, especially in those markets with only a short flight time of an hour or less. Similar

rethinking has been required in Europe as a result of the substantial growth achieved by, amongst others, Ryanair and Easyjet.

Having made these qualifications, it is now necessary to set out some opinions as to the nature of customer needs, starting with the business travel market. We shall divide our discussion between the Corporate and Independent sub-segments of business travel demand, and between short and long-haul routes. In turn, we shall begin with what the available evidence7 suggests are the high priority issues.

Frequency and Timings

In short-haul markets, frequency and timings are all important for the business traveller. Most business people find that their lives are extremely busy, and that their plans often change at short notice. If they do, an airline offering them a high frequency will have crucial advantage. Frequency will ensure that business travellers can fly out for a meeting shortly before it is due to begin and return to their offices or homes very soon after it has been completed. Because this is so, on almost all routes there will be a very strong correlation between the share of the frequency that an airline holds, and the share of the market it will obtain. Indeed, there is some evidence to suggest that this is an S-shaped relationship where the airline which dominates its competitors in terms of frequency will obtain an even higher share of the market than its frequency share would indicate.

Alongside the question of flight frequency, the timing of flights will also be a vital consideration. A high frequency of flights will be of no value if all the flights are concentrated at the weekend or during middle-of-the-day periods. It is essential that there should be extensive opportunities on short-haul routes for business travellers to make day-return trips. Flights will therefore need to be concentrated in the early morning and evening periods.

Punctuality

Punctuality of flights is of obvious, crucial, importance to the business traveller, with flight delays meaning inconvenience, missed appointments and, perhaps, the loss of customers. No airline can hope to obtain a large share of the available business travel market if it is saddled with the handicap of a poor punctuality reputation.

Airport Location and Access

On short-haul routes, passengers will prefer service from a local, easily accessible airport, rather than from a more distant hub. This rule may apply even if the service from the local airport is with a “No Frills” airline.

Seat Accessibility/Ticket Flexibility

“Seat Accessibility” is a piece of aviation jargon which refers to the probability of a passenger being able to book a seat on a flight shortly before it is due to depart. It is an important product need for the business traveller. Some business travel is undertaken in response to a sudden crisis, which requires someone to travel on a “next flight out” basis. In other situations, a flight may be booked well in advance, but at the last minute a change of plan means that the booking must be cancelled and a new one made on an earlier or later flight. This requires that the ticket held by the passenger should be a

flexible one, and that seats should be available near to flight departure time on the alternative service. Clearly, an airline can be giving a very high frequency on a route, but this frequency will be of no value to the business traveller if all the flights are fully booked days or weeks in advance. A further aspect of ticket flexibility is that many business travellers expect the right to no-show for a flight, and then to be re-booked on a later one, without any penalty being charged. Of course, because of this, airlines have difficult decisions to make about the extent to which they will overbook flights to take account of the likely extent of no-shows.

Frequent Flyer Benefits

Today, almost all airline operate their own Frequent Flyer Programme, or are partners in another carrier's programme. This whole, controversial, subject is dealt with in Section 9:3. In that Section, we shall be probing the question of the degree to which FFP benefits build market loyalty. It will be argued there that these benefits can be important in doing so, but that on short-haul routes their impact should not be exaggerated. For a short journey, the number of mileage points on offer will be quite small. It is true that the passenger will often happily take these by choosing the airline whose Frequent Flyer Programme they are currently supporting. However, what is uncertain is the extent to which they will actually change their behaviour and accept a less convenient option in terms of flight frequency, flight timings and departure airport in order to do so. The evidence is that on short-haul routes flights are chosen on the basis of an appropriate departure timing and the availability of a seat. If this is the case, then the offer of Frequent Flyer miles simply acts as a welcome bonus.

Airport Service

On a short flight, time spent at the airports at each end of the route may exceed the flight time. It is therefore not surprising that airport service should be a significant factor in choice-of-airline decisions. Business travellers will demand the opportunity to check in very late for a flight, by using a separate check-in desk to guard against the possibility of being delayed by a long line of less time-sensitive travellers. An online check-in facility may be even better. Today, they will expect expedited security and passport checks, and that a lounge should be available in which they can relax prior to a flight and make any last-minute phone calls or send emails. Finally, they will expect a premium baggage service. For many, this will mean that they do not check in baggage at all, but instead are able to carry their baggage on board with them. This requires airlines to provide large overhead baggage bins on their aircraft. When a larger amount of baggage is being carried and business travellers have to check it in, they expect an opportunity to retrieve bags very quickly at the destination airport.

Airport service provides a good illustration of the differences between 'Apparent' and 'True' needs discussed in Section 2:2:2. In all the factors mentioned above, the business traveller could make a good case for the service feature being as essential component of a product which will meet their air travel needs. For example, a late check-in will have a value in allowing them to maximize the time they spend in their office before leaving for an air trip. However, at the same time, the separate check-in desk also panders to True Needs associated with pride and ego and the need for recognition of status, something of great significance in terms of effective marketing to the business traveller.

In-Flight Service

On short-haul routes, the fact that flight times are short means that in-flight service often assumes a lower priority than frequency, punctuality and airport service in choice-of-airline decisions. Nonetheless, it can still be extremely important. As we shall see in Section 5:3:2, in competitive markets airlines usually have little choice but to match the frequency of their rivals and to closely mimic their flight timings. Also, it is sometimes difficult to achieve a Sustainable Competitive Advantage through airport service, at least in the large number of countries where airport terminal facilities are provided on a common user basis by airport operators. Because of these factors, the in-flight experience may be a crucial one for choice-of-airline decisions, even on routes where flight times are only three-quarters-of-an-hour or so.

In terms of the factors which will be taken into account in evaluating the in-flight experience, seating comfort in terms of seat pitch and seat width will be significant. Also, a separate Business Class cabin may be appreciated. This will satisfy a need for a working environment away from crying children etc., where important documents, say, can be read before a business meeting. It does, though, once again pander to the True Need for the recognition of status.

A final requirement in terms of in-flight service will be meals and drinks appropriate to the time of day. Here, it seems that breakfast, and an evening meal on after-business returning flights are especially welcome.

Having set down some of the fundamental requirements of the Corporate business traveller on short-haul, point-to-point journeys, we can now use this basic model to probe customer requirements in related, but significantly different, situations.

Here, a first interesting case is to examine the requirements of the Independent rather than the Corporate, business traveller. We saw in the last section that the Independent sub-segment of demand is growing relative to the Corporate one. With Independent business travellers, the fundamental needs remain exactly the same in terms of frequency, timings, safety, punctuality, seat accessibility and ticket flexibility. Price, though, assumes a greater significance than in the Corporate market. As we discussed, Independent business travellers feel that the ticket cost is coming out of their own pocket in the way that the Corporate traveller does not, with only the fact that the ticket cost is tax-deductible lessening its impact. The Independent traveller will therefore trade off cheaper ticket prices against product frills such as standards of seating comfort, free drinks, and in-flight meals. Interestingly, the willingness to do this makes the Independent business travellers' set of requirements one which can be well-satisfied by the "Cost Leader" airlines.

A further difference between Corporate and Independent travellers comes in their attitude to Frequent Flyer points. For the Corporate traveller, Frequent Flyer benefits are usually no more than an attractive perk of the job, providing opportunities for enjoyable free leisure flights. For the Independent traveller, on the other hand, free flights are much more commonly used for business travel purposes and provide a welcome opportunity to reduce expenditure on air tickets. One would therefore expect a greater focus still on obtaining mileage points.

A next important area where the requirements of the business traveller can differ is between the short-haul flights we have been considering and long-haul journeys. On long hauls, flight frequency and flight timings remain significant, but they take on a rather different meaning. On many long-haul routes, an adequate frequency is that an airline should give a daily flight. On denser routes, double daily flights may be appropriate, especially if they allow the airline to satisfy the need for both morning and evening arrivals at the destination. In few cases, though, will there be the need for the six or eight flights a day which may be required to provide adequate customer choice and to discourage entry by competitors on short routes. On long-haul routes today, a significant consideration alongside frequency is often that there should be direct, non-stop flights available. As aircraft manufacturers have innovated with aircraft having longer and longer ranges, so it has become possible to fly a greater and greater number of the world's air routes on a non-stop basis. As airlines have, in turn, exploited this opportunity by introducing non-stop services, so passenger expectations have changed. Today, it is difficult or impossible for an airline operating a stopping service to compete for high-yielding traffic with one which flies a route non-stop.

As aircraft ranges have increased in recent years, so it has also been possible for aircraft manufacturers to introduce cost-effective, smaller long-haul aircraft. Planes such as the Boeing 777-300ER, 777-200LR, and Airbus A330 and A340 all come into this category, as will the B787 and Airbus A350 when they are introduced. Such aircraft allow direct, non-stop services to be introduced on a secondary city to secondary city basis.

These services are removing from passengers the need to connect to hubs and are proving very attractive.

Another important difference between short and long-haul markets is in the attitudes to Frequent Flyer points. On a long-haul route, substantial numbers of points are at stake. Indeed, for many programmes, taking a long-haul flight with a particular airline, at least in First or Business Class, earns sufficient mileage for a short-haul flight on that airline's network to be taken free-of-charge. Because of this, there is a greater likelihood of a passenger on long-haul choosing the airlines whose FFP they are supporting, even if this means travelling earlier or later than they would ideally like.

As one would expect, there are differences in the attitudes towards airport and in-flight service on long-haul routes compared with short-haul. Seating comfort on board, a separate cabin to allow for sleep and work, meal quality and in-flight entertainment all figure prominently in the business traveller's-long haul expectations. An especially telling point may be the attitude of different airlines' customer contact staff. On a long-haul flight, passengers will be exposed to uncaring attitudes for many hours, with the likelihood of lasting damage being done to the airline's reputation.

Airport service may, correspondingly, be of rather less importance. Long-haul passenger tend to check in earlier than those on short trips, presumably because, with lower frequencies, the penalty of missing a flight will be greater. The offer of a very late check-in time may therefore be less important. In contrast, though, lounge facilities will be of greater significance.

With the questions of seat accessibility and ticket flexibility, these are of lower importance on long-haul routes. A long-haul trip will often require at least three days out of someone's diary. Finding such a gap will normally take a great deal more pre-planning in comparison with a short-haul flight which

can be carried out on a day-return basis. Therefore, the last-minute availability of a seat is of less importance on a long haul flight.

A last, interesting way in which the requirements of the business air traveller can be viewed concerns the needs of the connecting traveller. Some airlines make the mistake of assuming that everyone who flies on their short flights is a short-haul traveller. This is not so. Many of these passengers − upwards of 50% or more on very short routes – are connecting at hubs onto long-haul flights. They are therefore a long-haul passenger, on a short part of a long and tiring journey.

The requirements of the connecting passenger are, as one would expect, a mixture of those which prevail in the short-haul and long-haul point-to-point markets. The question of flight timings is an especially interesting one in this situation. The connecting passenger requires a high frequency of flights in exactly the same way as the point-to-point market does. The optimum flight timings, though, may be quite different. The point-to-point market has a requirement which peaks early and late in the business day. The connecting market, on the other hand, requires a spread of flights throughout the day, because long-haul flights depart from a hub at different times.

Punctuality assumes even greater importance for the connecting passenger. A delay of, say, an hour will certainly annoy the point-to-point traveller. It may not, though, destroy their entire itinerary. A delay of an hour, though, to a connecting passenger's flight into a hub may result in the long-haul flight being missed. This, in turn, may cause an actual delay of a day or more, on routes which are only served at a comparatively low frequency.

A further difficulty with the connecting passenger concerns the question of cabin comfort. It was argued earlier in this section that for the point-to-point short-haul traveller, cabin comfort was a relatively low priority, given that the person concerned will only be exposed to poor standards of comfort for a relatively short time. For connecting passengers, on the other hand, cabin comfort assumes great importance. This will be especially so on return flights when they may have spent many hours in a long-haul business class with very comfortable seating only to be faced, when exhausted, with completing their journey in a very cramped environment which airlines are basing on the needs of the point-to-point passenger.

Enough has been said in this section to demonstrate that, for all airlines, the business traveller is a demanding customer. There is no easy or cheap way of meeting the business traveller's needs, with carriers heavily dependent on the better yields obtainable from the business travel market to cover what will, inevitably, be higher production costs. Crucially, at the time of writing many airlines are still finding these better yields to be insufficient to ensure reasonable profitability.

The Business Travel Market− Demographics and Psychographics

In market segmentation exercises, the word "Demographics" is used to describe the physical and tangible characteristics of the members of the segment. "Psychographics" is the term used to describe the intangible attitudes, preferences and, perhaps, prejudices of the members of the segment. In terms of the Demographics of the business travel market, the traditional stereotype of the business traveller of being male and middle-aged still largely holds true. In Europe for example, still over 80% of business travellers are men, whilst the average age of those who travel on business is in the early

forties. In some markets, this situation is unlikely to change radically. In Japan, for example, the part played by women in business is still a limited one, whilst the "jobs for life" principle still followed by many Japanese firms means that people continue to be business travellers up to the official age of retirement. In Europe and North America, though, radical change is beginning to occur. Women are becoming much more important in business travel, with forecasts suggesting that by the year 2010 perhaps 25-30% of all business travel will be undertaken by women. At the same time, many firms are attempting to down-size and to reduce their labour costs. The expedient to do so is often to insist on early retirement. Where this is done, the age profile of the firm's employees will fall, with a corresponding effect on the average age of those who fly on business. The possible impact of these changes in the age and gender structure of the business travel market will be further discussed in Section 3:4.

Another important Demographic feature of the business travel market is that it is undertaken by relatively wealthy individuals, drawn from that small – often very small – proportion of a country's population where average income levels are high. The significance of this is that such people are fortunate to enjoy a lifestyle of comfort and affluence. They naturally expect the airline that they choose to reflect this.

A final, vital, Demographic characteristic of business travel is that it is a highly concentrated market. As has been previously mentioned, in all countries, it is undertaken by only a small number of individuals, each of whom on average travels a great deal. In the UK, the average number of air trips made per year by a member of the business travel community is more than ten.

A number of consequences stem from this high trip frequency. Business travellers become experts, familiar with the standards offered by different airlines, and able – and willing – to make comparisons between them. They also become extremely attractive to airlines, because the carrier which can establish and maintain their loyalty over a lifetime of business travel (which may extend for twenty years or more) will gain a large amount of revenue as a result. Finally, the fact that these so-called Lifetime Values are so high justifies substantial investment in the establishment and maintenance of databases, and in a Relationship Marketing strategy designed to encourage and reward loyalty. This, of course, leads us into the subject of Frequent Flyer Programmes which is fully covered in Section 9:3.

In terms of the Psychographics of business travellers, two characteristics stand out. Business travellers tend to have strong opinions, and are often prepared to communicate these opinions loudly and frequently, especially when they wish to complain about a particular airline. Carriers should not be surprised by this. Over a long period of time, almost all airlines have tried to encourage people to fly with them using advertising approaches which make unqualified promises of service excellence. If they do this, they should not be disappointed if people complain when the promises that have been made to them are not fulfilled.

A further important feature of the business traveller is that attitudes vary through time, with a pronounced Life Cycle effect often discernible. The young executive who is first promoted to a job which will require extensive international air travel will probably regard such travel as exciting, and will do all they can to ensure that as many trips as possible are undertaken. After a few years, though, attitudes can change dramatically. The person concerned realizes that travel is not all it is made out to

be, often consisting of long, tedious and boring journeys, repeated doses of jet lag, interrupted weekends, and often acute difficulties in maintaining social and personal relationships. From then onwards, instead of trying to find reasons why trips should take place, efforts may be focused on avoiding at least some of these journeys. Of course, it is at this stage of the Life Cycle that the possibility of using video conferencing and other forms of electronic communication to replace air travel will be at its most appealing.

As an overall summary of the characteristics of the business travel market it is true to say that many airlines have regarded the business traveller as being at the core of their marketing efforts. This is not surprising, bearing in mind the fact that yields per passenger-kilometer have generally been much higher than those obtainable from the leisure segment. It would be a mistake, though, to assume that high yield is the same thing as a high profit contribution. It is true that typically airlines obtain a high proportion of their revenue from business travellers. However, such travellers also account for a high proportion of airlines' costs. Besides the intrinsically high costs of meeting the product needs, in recent years the business travel market has become a bloodbath of costly competition. There have been successive rounds of innovation which have raised the product specification offered to the business traveller to higher and higher levels, without, sometimes, corresponding opportunities to raise fares in order to maintain profits.

At the same time as the costs of meeting needs and competing effectively in the business travel market have risen, so the proportion of air trips made up by business travel has progressively fallen due to the rapid growth of the leisure segment of demand. As has already been noted, though demand forecasting in air transport remains extremely difficult, all forecasters agree that this is a trend which will continue, with, if anything, the relative growth rates of business and leisure travel diverging even further as business growth slows and that of leisure accelerates. If this is the case it will lend further weight to the vital conclusion that today no airline is likely to be successful if it ignores the leisure segment. As we shall see in the next section, ensuring profitable exploitation of leisure demand is equally challenging, but the nature of the challenge is different from that in business travel due to the strong contrasts in the characteristics of business and leisure demand.

The Leisure Segment of Demand

The differences between business and leisure air travel begin with the Demographics of leisure travel. Unlike the domination by men of business travel, leisure travel consists of an approximate balance between males and females. Indeed, with leisure travel by older people – say, those over 65 – in many markets female travellers dominate because of their longer life expectancy.

In terms of age profiles, the situation is also very different. Business travel tends to be concentrated in the middle-aged 35-55 age group. Leisure travel, on the other hand, encompasses all ages. Children are important in leisure travel, whilst young adults, benefiting from reasonable incomes and few commitments, usually have an especially high propensity to fly. A period of lower disposable income then often follows, due to the costs associated with family life. Once children have left home, though, disposable income often rises and may remain at high levels until quite late in life if pension arrangements are good enough.

Average personal incomes in leisure travel are often in strong contrast to those in the business travel market. The days when air travel was only enjoyed by wealthy members of a so-called "jet-set" are long gone. Today, rising disposable incomes and even more the falls in the real cost of air travel which have taken place have broadened the base of the leisure market enormously, taking it well beyond the relative few who make up the segment of business travel demand.

Besides differences in demographic characteristics, there are also substantial contrasts in leisure customer requirements.

In leisure air travel, the dominant requirement is for a cheap air fare, for obvious, but vitally important, reasons. Unlike in at least the Corporate sub-segment of business travel demand, people are spending their own money, not their company's. Their spending is not tax deductible in the way that benefits someone who is an Independent business air traveller.

Often, too, leisure air travel is undertaken in a family group. If it is, the amount of cash payable will be multiplied several times over, making access to a low fare an even more important requirement. Finally, in the leisure market airlines suffer through being at the back of the queue in terms of people being willing to spend more. When a family travels on holiday a choice often has to be made between spending on a luxurious but expensive flight, or on a good quality hotel and meals in decent restaurants at the destination. Not surprisingly, the focus of spending tends to be on the destination, because people will only be on the aircraft for a few hours whereas they will be at their holiday destination for perhaps two weeks.

The overall effect of these factors tending towards price sensitivity is a clear one: the leisure air travel market is and always will be low-yielding. Revenue earned per passenger-kilometre is usually low, whilst decisive marketing advantage will always accrue to an airline able, through low costs, to charge and sustain fares lower than those of its rivals.

Despite the fact that yields tend to be low, it should not be assumed – as is often done – that involvement in the leisure market will necessarily result in airlines losing money. The leisure market has a number of characteristics which allow efficient airlines to meet their customers' requirements much more cheaply than is possible in the business travel market, in ways which may allow the leisure market to be a substantial, and welcome, source of profits.

Foremost amongst these characteristics is the fact that leisure travellers do not generally require frequent, on-demand service. This allows airlines to use relatively large aircraft to serve the leisure market, and gain the benefits of the lower seat-kilometre costs available from such aircraft. They can also operate at very high load factors – often in excess of 90% - because no last minute availability of a seat needs to be offered. This will minimise the difference between available and revenue seat-kilometre costs.

A further benefit of serving the leisure market is that its peaking patterns and timing needs are generally quite different from those which characterise business travel. It is true that leisure demand often shows pronounced seasonal peaking which increases the cost of serving it because of the need to provide costly peak-time resources which are poorly utilized at off-peak periods. This, though, is offset by the fact that flights for the leisure traveller can be spread throughout the day and, often, the

night as well because there is none of the marked peaking of demand during the early morning and after-business evening hours which characterises the business market, at least on short-haul routes. The result is that airlines serving leisure routes can achieve very high annual aircraft utilizations. The so-called charter airlines in Europe have often been able to achieve utilizations of 4,000 – 4,200 hours per year, in contrast to scheduled carriers carrying large numbers of business travellers which only usually reach 2,500 – 2,700 hours. Therefore their fixed costs of aircraft ownership or lease rentals are spread much more widely, with a correspondingly beneficial effect on unit costs.

A final, interesting, point of debate concerns the willingness of leisure passengers to sacrifice product features which, though desirable, can be traded off against the availability of cheaper fares. Some product features leisure travellers will clearly not sacrifice, safety being the clearest example. It is also clear that reasonable standards of punctuality performance are essential, at least if people are to make repeat flights with a particular airline. Amongst the product areas where people will, apparently, accept sacrifices are seating comfort, airport service and catering.

With seating comfort, many carriers serving the leisure market find that their passengers will accept lower standards in both seat pitch and seat width. This allows many more seats to be placed in a given aircraft type. For example, in an Airbus A330-200 series aircraft, a typical scheduled service seating configuration would be to equip the aircraft with 8-abreast seating at a 32 or 33 inch seat pitch. This allows just over 250 seats to be placed in the aircraft. A charter airline, on the other hand will use 9-abreast seating at a 28 or 29 inch seat pitch. This increases the number of seats to over 340, reducing seat-kilometre costs by more than 20%. (Concern over Deep Vein Thrombosis may reduce the ability of these airlines to use very low seat pitches in the future).

In the area of airport standards, leisure passengers will often accept longer minimum check-in times. This allows carriers to process a flight using a smaller number of check-in desks.

With in-flight service of meals and drinks, a considerable number of “no frills” airlines now offer no complementary meal or drinks service at all. Many others give a free meal – sometimes of a lower, cheaper, standard than that obtainable on a scheduled flight, but charge for drinks, at least for alcoholic ones. This provides a useful cost saving, and also turns drinks service into a revenue, rather than a cost item.

Overall, the leisure segment of demand now constitutes the dominant one in the air transport industry today and we shall make further reference to it throughout the book.

Segmentation of the Air Freight Market

For many years, air freight was the “poor relation” of the passenger business. Freight income made up only a small proportion of airline revenues, and it was consequently starved of both resources and management attention. It was often seen as no more than a by-product operation, to fill belly-hold space in passenger aircraft that would be available anyway.

Such attitudes are no longer acceptable. Some airlines are now able to specialise in carrying nothing but air freight, and to be highly profitable in doing so. For many others, freight now accounts for a highly significant and increasing proportion of profits. With the exception of 2001 – a poor year for air freight − average annual growth rates in the air freight business have exceeded those in the passenger

markets by two or three percentage points, for many years. This is a trend which is likely to continue, making freight's contribution through time greater still.

At the same time as freight revenues have increased, competition in the air freight market has grown steadily, and it is becoming less and less likely that airlines treating freight purely as a by-product will be successful. Professional marketing is therefore a prime requirement and it is essential that we should give proper attention to the marketing of air freight, beginning with the question of the segmentation of the air freight market.

Differences between the Air Passenger and Air Freight Markets

In order to do so it is first of all necessary to examine the principal differences between the air passenger and air freight markets. It is true to say that only the fact that aircraft are used to carry the demand coming forward links these two markets. In all other respects they are totally different.

A first area of contrast is that air freight travels only one way on a route. It is true that some passengers are emigrating. They therefore settle in the country they are flying to and do not return. A small number are unfortunate enough to die at their destination. However, almost all passengers who fly out on a route will also return on it. Therefore over a year most passenger markets end up approximately directionally balanced, even though there may be directional problems associated with particular seasonal traffic flows. On the freight side, a directional balance will be no more than a happy co-incidence. Directional imbalances will be most marked on routes to and from countries which are mainly primary producers. These countries, especially if they are relatively wealthy, such as Australia, may import many items which are suitable air freight commodities. However, a lower proportion of their exports will come into this category, consisting as they do largely of primary products. It is certainly possible to correct such a situation in the long-term by offering attractive low prices, in the weaker direction. Poor yields are, though, then being substituted for low load factors.

A further problem in air freight marketing is that freight is extremely heterogeneous. Passengers are homogenous in the sense that they each occupy a seat. Freight, on the other hand, varies in every possible way. Consignment sizes vary from small packages and letters weighing less than a kilo up to consignments of 30,000 kilos or more. Consignment density and "stowability" will also vary. Some commodity types – books are a good example – are both dense and easy to stow. Others – for example bicycles − are of low density and have poor stowing characteristics. Unless airlines keep a very close check on their pricing policies, carrying such commodities can easily become unprofitable.

A final area of variation is in the handling and stowage conditions that different commodities require. For example, some are fragile and need especially careful handling. Others are of high value, such as banknotes. Therefore, special security arrangements will be needed. A further, and increasingly common requirement is for the refrigeration of physically perishable goods.

The most important difference between the air passenger and air freight businesses concerns the nature of the competition that airlines face in these different markets.

On the passenger side, airlines are very fortunate that, on long-haul routes, almost all passengers who travel do so using air transport. With air freight, the situation is very different. Air transport faces intense competition from surface on all routes. This competition is especially difficult to meet because

it is based on low prices. It is true that in some cases air and surface rates are comparable due to the different charging methods that are adopted with respect to consignment density. Such situations are, though, rare. In almost all situations, air freight will be significantly more expensive than the surface transport alternative, if analysis is confined merely to a comparison of freight rates. These differentials can be extremely large, often reaching the level where air freight is ten times more expensive than surface transport.

The competitive situation makes the marketing of air freight an especial challenge. Airlines have to find and demonstrate arguments to justify the use of an apparently much more expensive mode of transport. These arguments form the basis for the segmentation of the air freight market.

Segmentation Variables – Air Freight Market

Market segmentation is as important in the air freight market as it is on the passenger side of the business. Only if markets are properly segmented can airlines find a basis for their product, price and promotional policies.

Using the criterion of the reasons why air freight rather than cheaper surface transport should be employed, a clear first segment of air freight demand is that consisting of Emergency traffic. Emergency situations occur when goods have to be moved by the fastest possible mode of transport, with the costs of achieving a fast transit a secondary consideration. In turn, Emergency situations may be divided into two types. An Operating Emergency occurs when a firm has to rectify an operational problem. For example, an oil company may find that one of its rigs has to cease production because of a breakdown. Every hour of lost production time will then have a substantial cost associated with it – a cost which can be minimised if air freight is used to ship the spare parts which are needed to enable production to resume. Another example of this type of emergency is an ironic one. Deep-sea shipping companies are air freight's biggest competitor on long-haul routes, yet these companies are major users of air freight. When a ship has to remain in port because spare parts are needed before a fault can be repaired, the shipping line operating it would be very foolish if it did not use air freight to move these parts. If it did not do so, the ship in question would be stranded in port for a much longer period than is necessary.

The second type of emergency situation is termed the Marketing Emergency. Such a situation occurs when a supplier is in danger of missing a deadline or one of its customers has expressed dissatisfaction with service levels. Then, again, air freight is the obvious choice, though the justification will be based on the maintenance of customer loyalty rather than cost reduction.

In terms of customer requirements, the Emergency segment has clear customer needs which airlines must satisfy if they are to compete in the market.

A first need is for the fastest possible door-to-door transit time. In order to be able to offer this to the shipper, an airline has first-of-all to give a high frequency of flights. Emergency situations do not give advanced notice of when they will occur. Therefore, a carriers with a high frequency will give the shipper the best likelihood that a flight will be available within a short time after the need to ship the goods has arisen.

Frequency, though important, will not be enough on its own. It must be accompanied by a capacity management policy ensuring that space will be available to shippers who need to book Emergency consignments shortly before a flight is due to depart. It is of no value to an Emergency shipper if an airline has a high flight frequency, but all its cargo space is fully booked days or weeks before flights are due to leave. Of course, once a booking has been offered it is important that freight should be flown on the flight on which it is booked and that it should benefit from safe and reliable ground handling.

A very important customer requirement in the Emergency traffic segment is that the selected airline should have the ability to track shipments at all times and be able to communicate accurate and timely information about the status of a consignment. It will also be important to provide a door-to-door collection and delivery service, so that the shipper feels that once a booking has been made, their troubles are over with someone taking responsibility for the entire transit.

The Emergency traffic segment presents airlines with both problems and opportunities. As will be discussed further in Section 5:6, meeting the needs of customers in this market presents a very demanding and costly task. It does, though, often provide them with very high yields, a factor which makes it an area where airlines compete intensively.

The Emergency segment of demand has always been, and remains, highly important to an airline's air freight business. It would be an unambitious airline, though, which sought to do no more than exploit the Emergency market. This would confine air freight to a comparatively small role in the international logistics industry. To avoid this, it has been necessary to develop arguments as to why air freight should be the preferred option for the Routine as well as the Emergency shipper. An area where it has been possible to do this constitutes the second major segment of air freight demand. It concerns traffic which is Routine-Perishable in nature − Routine as opposed to Emergency, and Perishable because the goods in question only remain saleable for a limited period of time.

Perishability in international logistics occurs for two reasons in particular. Physical Perishability describes situations where goods physically deteriorate. Cut flowers and soft fruits are good examples of this. With them, the argument for using air freight is clear. Producers of, say, cut flowers can always attempt to sell them in local markets close to where they have been grown. If they do so, prices will be low due to market saturation. A more profitable option might be to send the flowers to distant markets where they will have scarcity value. Then, though, air freight will have to be used in order to ensure that the goods reach the market in a saleable condition.

Economic Perishability is the second type. It occurs not when goods are prone to deteriorate physically, but when the Life Cycle within which they remain saleable is a short one. Newspapers have been such a commodity. Other examples include fashion clothing, children's toys, and pop music CDs. These goods can be sold in large quantities and at good prices if they reach the market when demand for them is still rising rapidly. Air freight often provides the only realistic way of ensuring that this happens, at least in long-haul markets.

In terms of customer requirements, the Routine Perishable market differs in some respects from the Emergency segment. At least for Physically Perishable goods, it may be possible to forecast further ahead when the need for shipment will occur. This is because many commodities which come into this

category have a pronounced seasonal pattern to their production. In turn, though, this gives problems to airlines attempting to exploit the market. Flows of Emergency shipments occur throughout the year, even though it will not be possible to forecast exactly when a particular emergency will occur. Perishable traffic, on the other hand, may only be offered seasonally. Airlines may therefore have surplus capacity at the off-season.

A further problem of Perishable traffic is that it tends to result in routes having marked directional imbalances. As we have already noted, this is because an area noted for production of perishable foodstuffs may not be one which attracts significant in-bound flows of commodities suitable for air freighting.

Besides the problems associated with capacity being available at the right time and place, Perishable freight often needs special handling. It may be fragile in nature, or need refrigeration, both of which force up airlines' handling costs. It will certainly require airlines to achieve high standards of regularity and punctuality, and to ensure that freight should always be carried on the flight on which it is booked. There also needs to be a comprehensive monitoring and control service in place, to make sure that if a mistake is made it is discovered in time for it to be rectified.

The question of the importance of price to the Routine Perishable shipper is an interesting one. High service quality will clearly be necessary if goods are to reach the market in time and in the right condition. Airlines may thus reasonably hope that customers will be prepared to pay more if this is the only way to obtain the required service, and that the market will be a relatively high yielding one. In practice, this may be true, but only in the short term. The economics of exporting Perishable goods by air are based on the premium price being obtained in the distant market being sufficient to cover the extra costs of air freight while still leaving a profit. The more air freight rates rise, the more such profits are threatened, leading to the possibility that the trade may have to be abandoned. Therefore, the lack of price-sensitivity in the Routine Perishable market should not be exaggerated.

Both the Emergency and the Routine Perishable markets are important in the modern air freight industry. Despite this, though, by far the greater part of the goods which move in international logistics cannot be placed in either of these categories. They must therefore be described as being Routine and Non-perishable. The air freight industry must be able to demonstrate the value of its services for shippers of this type of freight. If it cannot do so, then the industry will never achieve its full potential.

The industry's problem in developing this market is that shippers of Routine, Non-perishable freight usually have an alternative. They can use a surface transport instead of air freight and they will normally pay a substantially lower freight rate if they do. The task of air freight marketing is to demonstrate that if air freight is used rather than apparently-cheaper surface transport, significant advantages will accrue, advantages which will often be sufficient to outweigh the freight rate differential. Isolating these advantages and communicating them effectively has proved to be a major challenge. The customer must be persuaded to compare all the costs associated with using surface transport with the benefits of employing air freight.

In three relevant areas, a direct comparison will be possible:

- Packaging costs will generally be lower when air freight is employed. Air freight often allows less packaging to be used, due to its more favourable environment for carriage. Because of this, costs will be reduced both because of the lower cost of packaging materials, and because this cheaper packaging will result in a saving on freight costs due to each consignment having a lighter weight.
- Insurance costs will usually show a substantial saving in favour of air freight – again, a reflection of air transport's superior environment for carriage, and the shorter times for which goods are at risk.
- Air freight should bring important cash flow advantages. Most international trade is carried out on a credit basis. The consignor usually allows the consignee a period of time before they have to pay for goods that they have received. The credit period does not begin when the goods are dispatched but rather when the consignee takes delivery of them. If surface transport is used, the transit time on a long-haul route may be several weeks. During this time, the consignor will be incurring interest charges, because they will have invested money in producing the goods but will not have been paid for them. If, on the other hand, they dispatch the goods by air freight they should be received by the consignor in a matter of two or three days. If they are, cash flow will be several weeks faster and interest payments will be correspondingly reduced.

Defining the remaining advantages of air freight over slower surface transport is more difficult, because they depend on a comparison of different Logistics philosophies.

If a manufacturing company wishes to minimize its transport costs it will, of course, use surface transport modes. Surface transport will therefore be used to bring raw materials to its production points and then to move finished products to customers. Though low transport costs will be the result of such a policy, significant adverse consequences will also ensue. With regard to the supply of raw materials and components to production points, it will be necessary to hold large stocks. This is because surface transport cannot generally provide the high frequency of deliveries which air freight can, and which allow supply to take place under so-called "Just-in-Time" (JIT) principles. With surface transport usage, stocks of components must be held in sufficient quantities to allow production to continue in the intervals between deliveries.

With delivery of finished products to customers, again the use of surface transport will require extra stock to be held. For many products, demand will rise from time-to-time, in a way which cannot be precisely forecast. For example, demand for some products is weather-related, so precise demand forecasts cannot be prepared for them more than a few days in advance. If demand for a particular product does rise, it is extremely important that firms should be able to keep their wholesalers and retailers supplied with stock to sell. If they fail to do so, they risk losing the loyalty of these marketing intermediaries.

Ensuring continuity of supply given random and unforecastable fluctuations in demand requires companies to hold substantial amounts of so-called "Safety Stock". In order to distribute such stock, again surface transport can be used, and direct transport costs will be minimised as a result. However, many other logistics costs will be increased substantially.

To illustrate this point, let us take the case of a European firm exporting electrical consumer goods to a distant market such as Australia. If surface transport is used by the exporting company, it will be necessary to invest in substantial local warehousing. This is because, with surface transport transit times of perhaps six to eight weeks, customers will not be prepared to wait for goods to be dispatched and sent once an order has been placed. Instead, they will expect their goods to be available within a few days of ordering them. In the case of the Australian market, full coverage will probably require a warehouse in the East – perhaps in Sydney − and one in Western Australia.

The consequences of the need to invest in local warehousing will be substantial and costly. As stated earlier, stock will have to be held which is not only sufficient to cover day-to-day demand. There must also be considerable Safety Stock to prevent the collapse of service levels should a random and unpredictable increase in demand occur. This will mean investment in warehousing to hold the stock, and also in the capital costs of stockholding. For some items, there may be a risk too of deterioration or obsolescence, with falling demand meaning that the value of the stock falls while it is held.

Besides the cost of local warehousing, the need to invest in such warehousing results in a significant loss of marketing flexibility because it makes entering a new market a very slow process. Before the firm can begin selling in the new market, it will need to obtain warehousing capacity and ship out substantial quantities of stock so that adequate service levels can be offered to early customers. This will take time. As a result, when selling does finally begin, the market conditions which prompted the decision to enter may have changed. The initiative may then fail, with the result that the stock has to be withdrawn – a costly process in itself – and the new warehouses sold off.

The use of air freight avoids all of these problems. Instead of large amounts of field stockholding being necessary, local stocks can be reduced or eliminated. Most stock – especially Safety Stock – can be held at one central location – in the case we are looking at, in Europe. This means that aggregate amounts of Safety Stock can be reduced, because it becomes a reasonable proposition that demand fluctuations in the different market that the firm serves will to some extent to cancel one another out.

If local stockholding can be reduced or eliminated, marketing flexibility will also be greatly increased. Markets can be entered quickly when demand is strong. Should demand falter at a later stage, withdrawal from the market will be equally easy. Therefore, the company concerned can market its product on a world-wide basis, focusing attention always only on those countries where demand for the product is buoyant.

Though there can be no doubt about the power of the arguments relating to the use of air freight for Routine Non-perishable Traffic, it is important that those concerned with the marketing of air freight should also understand the limitations of the concept.

Foremost amongst these is that the air freight solution can be portrayed as a high risk one. It is based on firms keeping field inventories to a minimum, and supplying customers from central stockholding points after orders have been placed. If something happens to prevent the warehouses at these central points from working effectively – a strike, for example – or if there are delays in transport from them due to such factors as industrial action or bad weather, service to customers will be immediately and seriously affected. Such problems are, of course, avoided to a degree if local inventories are held. It is

therefore important that any logistics system based on low inventories and fast transportation should be a reliable one.

With the question of the use of air freight to minimize packaging and insurance costs, this argument only has weight if there are large differences between the so-called Environment for Carriage available from surface and from air transport. These differences are steadily being reduced through time as surface operators adopt the principles of containerisation and roll-on/roll-off. These allow goods to be sealed and protected from the beginning of a journey to its end, with a much reduced risk of damage.

Overall, this chapter should have made clear that a sound understanding of the marketplace is an absolutely essential building-block in the successful application of marketing principles to the airline industry. Without this building-block in place, all other aspects of marketing become pointless. It is therefore impossible to exaggerate its importance.

MODULE II

AIRLINE PRODUCTS AND SERVICES

GLOBAL AIRLINE PASSENGER MARKET

FIVE MEGATRENDS AND THEIR IMPLICATIONS FOR TALENT MANAGEMENT

Pressure on financial performance

While there will be no let-up in the pressure on airlines to enhance their operational efficiency, financial performance has become a much more critical success indicator. Airline shareholders – including governments – are increasingly demanding reasonable balance sheets and acceptable returns on investment. In fact, we believe that airlines need to become much more radical about which business to stay in and which routes to fly. This will require greater focus on the economics of the business and a willingness to embrace unconventional ideas, as well as greater flexibility and readiness to adapt their current business model to changing market needs.

Airline CEOs are therefore facing substantial expectations to transform their companies into sustainably profitable businesses with a robust, longer-term mission. One of the more tactical choices they are making is to further improve operational effectiveness and actively consolidate activities at local or regional levels in order to achieve critical mass and leverage synergies. Many of these choices are in fact strategic and game-changing and could lead to dramatic changes in industry structure. There will be winners and losers, with the game-changers having the advantage of being able to shape the future.

We believe that the need to master these challenges will drive up demand for state-of-the-art CFO, strategic and corporate finance competencies, restructuring capabilities and post-merger integration skills.

Continuing globalization and liberalization

The ongoing opening of travel and transportation markets – for investments, AOC, and transportation rights – has created both new business opportunities and new competitive threats for many airlines around the world, and there is more in store. The fact is that the industry is increasingly globalizing in many respects. New players have appeared on the scene, especially carriers that play the "sixth freedom" card, and are now reaching a critical mass. New network carrier hubs are emerging. New boundaries are being tested all the time. The airlines' centers of demand are tending to shift to Asia. Emerging markets, like Greater China, face significant mobility needs and offer huge growth potential in air travel. Although the current three global alliances seem to leave only a few white spots on the global map, additional partnerships might generate new roles for some of the airlines that have so far remained on the fringe. There will also be more industry-wide consolidation on a regional, continental, and global scale, giving rise to new classes of leaders and megacarriers.

CEOs need to respond strategically to these opportunities and challenges. For example, depending on an airline's size and market, CEOs will need to decide whether to enter into alliances, pursue niche strategies, or actively drive consolidation.

In view of these continuing trends, our hypothesis is that it is vital for airlines to evaluate and redefine the core competence-set that their extended leadership team must possess to heighten strategic

orientation and change management competencies in particular. We also believe that airlines will need to assess and upgrade their talent pool of strategists, M&A experts, out-of-the-box thinkers, and challengers, which might also result in taking on board additional smart people, potentially with cross-industry experience.

Evolving consumer expectations

From the standpoint of consumers, air travel has today become a commodity service offering a large array of flight options to many destinations, where favorable pricing and minimized product & service standards have become key buying criteria. In order to move forward, airlines have to search even harder for ways to set themselves apart from the competition and build customer loyalty.

CEOs therefore need to focus strongly on addressing the new commercial challenges ahead. In particular, they might consider fostering a corporate culture that is conducive to innovation and entrepreneurship, one that extracts maximum value by customer segment. For instance, special-purpose consumer travel often appears untapped by many leading, prestigious airlines. Marketing will also play a crucial role in emotionalizing airline brands and enhancing customer relationships. Other industries like consumer products or telecommunications can inform airlines on how this can be accomplished effectively.

We believe that airlines can differentiate strongly in the market by establishing commercial excellence which in many cases will require infusing senior ranks with people who bring skills and ideas from other industries.

IT technology will continue to emerge with greater frequency in leading changes in customer experiences through the use of new customer interfaces and social networks. With consumers increasingly using online channels from reservation through to ticketing, check-in and requests, airlines need to be up to speed in meeting today's requirements in managing a seamless passenger process that mass-customizes the travel experience. Technology will touch every part of an air-line's business and will increasingly be a competitive differentiator.

Superior technology capabilities and state-of-the-art CIO competencies will become mission critical differentiators for airlines to succeed in the market. We firmly believe that airlines need to further invest in their CIO organizations both from a talent and a technical perspective in order to stand out in the market.

Sustainability as a critical success factor

For the foreseeable future, the global airline industry will remain heavily dependent on fuel and their financial performance will continue to be strongly determined by variations in fuel price and consumption efficiency. Airlines are flying in the storm generated by the climate change and sustainability agenda. These are highly politicised issues that are starting to change legislation and industry practices. Simultaneously, consumer behaviour is being shaped by sustainability issues and this is affecting how people perceive and choose their airline. Sustainability is a clear and present issue and going forward, will represent a major influence in the airline industry.

Airline CEOs need to find effective ways to deal with sustainability requirements and expectations. We consider it critical for airlines to shift from what is today a rather reactive and tactical response to these matters, to a more proactive and forward looking approach to sustainability.

A successful response to sustainability may require a more integrated and cross-sector approach where all stakeholders in aviation – be it airlines, airports, air traffic control or aircraft manufacturers – jointly develop and implement sustainable solutions. Achieving this and communicating it properly might eventually turn what is currently considered a "sustainability burden" into a critical success factor for an airline.

Talent: from monoculture to diversity

In many parts of the world, the legacy of the industry is monocultural – generally home-grown, male and strongly aviation-industry experienced. While this may have been well-founded historically, today's fast-moving global context is challenging the status quo. We believe that diversity of talent – be it gender, geographic, cultural or cross-industry – is fast becoming a critical success factor for airlines to stay agile and ahead. There are examples from within the airline industry, but even more from outside.

Historically, the airline industry enjoyed a prestige and cosmopolitan flair that made it easy to attract and retain top talent. This may still be true, but for various reasons, many airlines are now widely considered ordinary employers – with relatively low compensation levels and comparably limited career paths.

CEOs need to rethink their people strategy and implement holistic talent management if they are to attract, develop, and retain the best and brightest. We believe that truly courageous leaders will be required to make a sustainable difference.

EVALUATION SERVICE MARKETING IN AVIATION INDUSTRY

> *"Competition [between airlines] has increased… Service is becoming more important is this competition. (Morrison and Winston, 1995)*

The airline industry has evolved rapidly in recent decades. It was a luxurious form of travel in the early of the last century but has become one of the most common methods of travel today. By 2003, there were 590 air million travellers in Europe alone (Eurostat News, 2005). Globally, world passenger traffic (measured in passenger-kilometres performed by scheduled airlines of ICAO contracting states) was estimated to have increased by a factor of 3 from 1,367 billion to 3,807 billion between 1985 and 2005 (Hanlon, 1999, p.14). There was a phase when most airlines were state-owned, followed by a period of oligopoly, before we entered a stage when competition is as intense as any other commodity goods (Shaw, 1999). Partly because of these changes, the service quality and marketing of the airline industry also changed rapidly. In the early days, airlines placed a heavy emphasis on service quality because it was a luxurious leisure pursuit. Then, it became a secondary focus when it entered the oligopoly stage. During this stage, price and price wars were the primary concern of the travellers and the airline companies. This tide shifted again during the 1990s, as some airlines started to reemphasise

and improve their service to attract travellers (Zeithaml and Bitner, 1996). However, the focus of existing studies is on the industry rather than the traveller.

The purpose and contribution of this research is to capture the essence of contemporary airline service marketing through 60 overseas student passengers and their evaluation of five world-classed airlines' performance on the Taipei-London route. There are existing studies on airline service performance and studies on travelling behaviour. The originality of the present study lies in its attempt to combine the two through a qualitative interpretive approach.

Despite the limitations, the findings reconfirm some existing literature on the issue, such as the importance of safety, but also produce some new suggestions about how airlines can improve customer satisfaction through understanding what passengers in the large and important student passenger market regard as a quality flying experience. In addition, the findings of this research can also bring new thoughts to other travel, tourism and hotel industries because the focus of this research is on marketing and service instead of aviation.

Airline service marketing and consumer decision making

Airline service marketing throws up some issues specific to the industry. Parasuraman, Zeithaml and Berry (1993) describe how an expectation of service in general can be divided into desired service and adequate service. Adequate service means the actual service that the customer received, while the desired service is the quality of service for which the customer wished. Palmer (1994) states that 'pure' services have characteristics of intangibility, inseparability, variability and perishability. Airline customers regard intangibles such as the service encounter and cabin crew friendliness and service performance levels as important, but they also place a high value on tangible aspects including food, seating and entertainment programmes (Rust, Zahork and Keiningham, 1996). The extent to which different customer segments place higher or lower values on different aspects of service depends to some extent on nationality.

Chiang (2003, p.149) suggests that "Passengers select different airlines based on service quality, travellers' socioeconomic characteristics and the purpose of the trip". Sultan and Simpson (2000, p.188) agreed and elaborated further by writing: "Major airline industry competitors, seeking to gain or expand market share globally or regionally, provide an opportunity to explore the service expectations and perceptions of customers of different nationalities".

The above scholars highlight the need to consider the consumer's background when assessing service quality and airline's performance during the service interaction (Natalisa and Subroto, 2003). Shaw (1999, pp12-14) emphasises consumers' personal characteristics and separates them into roles in the decision making process, such as deciders, gatekeepers, users, buyers and influencers. So consumer behaviour in airline choice is not entirely individual, it may be influenced by other members of their group. In the generic model of consumer behaviour there are five stages within the decision making process: problem recognition, the search for alternative solutions, the evaluation of alternatives, purchase and post-purchase use and the re-evaluation of the chosen alternative (Peter and Olson, 1999). This model is useful since it allows this research to examine individual consumers' mindsets

during different stages of consumption. Combining these two models of consumer behaviour will allow this research to have a dynamic view of how and why Taiwanese student passengers select airlines in the way they do.

Within the context of the airline industry, Kaynak and Kuchkemiroglu's (1993) found
that the reliability of the airline, consumers' their past experience with the airline, the price of the tickets, service quality and safety are the five most important factors when selecting airlines. Chen (2003) also identifies connection to the destination, price, emergency handling, services and special discount for frequent flyers as important choice criteria in European flight destinations.

The Unique Class (Elite Class) Offered by EVA Airways

A number of respondents refereed to a particular service offered by EVA Airways which has a specially designed configuration. This airline offers four classes of service, a unique differentiation among Taiwanese airlines (Shaw, 1999). The four classes are First, Business, Evergreen Deluxe (Elite class for Boeing 777 only) and Economy class. According to EVA airways, all EVA intercontinental services offer a unique class called the Evergreen Deluxe Class cabins or Elite Class. It offers a very high quality service and many enhancements that can only be found in other airlines' business class. For example, it has a large seat configuration and individual video systems. This class received massive praise from the passengers.

I always choose EVA because of its Elite class which was called Evergreen Deluxe in Boeing 747. I can enjoy the better facilities which are like Business Class offered by other airlines, but [at a] cheap price. (respondents AC)

However, not every participant who travelled with EVA bought an Elite Class ticket. Amount the 13 participants who collectively flew with EVA 22 times, only five mentioned they would always travel Elite Class. Others would travel in Elite Class after they accumulate enough mileage and received a free upgrade or were given it as a gift by someone else. The participants' feedback agreed with Calder's (2003) view that price is one of the most important attributes that passengers consider. However, it is still possible to charge a premium price through providing a better service mix. The impact of these favourable opinions and how they can be transformed to a positioning strategy will be discussed later.

The Web Service

With the progression of the technology and the emergence of the hyper-competitive environment, e-commerce and information systems play essential roles in the airline industry as well (Shaw, 1999). Web service is a key part of information systems. The companies applied these systems to enhance their competitiveness, such as improving product quality and customer services. In the airline industry, many airlines use internet services to attract more customers by making the transaction more customer-friendly. Laudon and Laudon (2002) point out that information systems are not only essential for management, but that most organisations also need it to prosper or even survive in today's competitive environment. In this research, passengers agreed that they will take an airline's web service into account while shopping for

and selecting airlines:

The convenient web service is the most important issue to me. I always choose Cathay Pacific Airways because of their online booking and checking-in service. I don't have to arrive at the airport two hours early to queue in front of the counter. It is quite time saving and convenient for me. (Respondents AF)

According to other participants, Cathay Pacific Airway's convenient web service, on some level, contributed to the user's favourable attitude. On the other hand, the web service's influence should not be overstated. Even though nearly all of the participants used the internet to search for alternatives, only a handful bought his/her ticket without the assistance of a travel agency. Chaffey et al (2003) proposed that a good internet service is not only a good source of marketing but also of relationship building which is essential in today's deregulated airline industry. With the high development of internet technology and communication facilities, the web service is becoming a necessity for airlines. At the same time, student passengers and other consumers who are already familiar with this instrument will expect the airlines to provide this service at some level.

In-flight Service

The unique class and web services certainly are important, but the in-flight service is the fundamental aspect that will be evaluated by the student passengers. They pointed out three main criteria: the flight attendant's service attitude, the food and the environment.

Flight attendant's service quality

Because of the booming service industry in recent years, corporations have started to provide additional and sometimes less noticeable services that were not available before (Berry and Parasuraman, 1991). In addition, the emphasis on marketing started to shift from the product itself to the overall impression that it gives to consumers (Parasuraman, Zeithaml, & Berry, 1985; Li, 2003). The following quote is one participant's view:

I choose Cathay Pacific Airways because of their good service. The flight attendants are all kind and polite. Even if I push the call button several times requiring water because I felt sick. They were still very patient. (Respondents AN)

From the passengers' perspective, they cared very much about the service they received
from the cabin attendants. Perhaps more importantly, sometimes it is not only the formality of the service, but whether the flight attendants were sensitive, caring and patient. Berry and Parasuraman (1991) assert that both service quality and customer satisfaction are positively correlated. Therefore, the quality of the flight attendants is crucial for airlines since they are the people who will have direct contact with the passengers.

Quality of food

In Chinese and perhaps some other Asian-Pacific cultures, dining has other social meanings apart from basic physical needs (Deng, 1997 in Li, 2002). In the Chinese saying, dining, clothing, living and travelling are four vital parts in people's lives. Hence, the quality of the food served during the flight can also be a unique selling proposition. A couple of respondents described their experience of the in-flight meals service and how much they cared about the food quality.

In my experience, many airlines do not care about the quality of the in-flight meals. However, Cathay Pacific Airways' in-flight meals are provided by Hyatt Hotel. Even though I am sitting in Economy Class, I still can enjoy high quality food from a five star hotel on the airplane. (Respondents AN)

Based on general observations during the interviews, although passengers cared about the quality of food, it was not the single most important issue. On the other hand, there are some who care about this a lot, based on the examination of their texts. If airlines intend to attract more Taiwanese or Chinese international students, these companies have to pay more attention to the quality and style of the in-flight food service, because it could affect customers' satisfaction and re-purchasing intention.

Environment: the type of aircraft, seating comfort, and entertainment system

The Skytrax magazine (2006) describes how the in-flight environment is an essential issue for long-haul flight passengers. The environment of the aircraft involves the comfort of the seats and the entertainment system. A number of participants gave a rather detailed description of the features of the cabin and the following comment was made by one participant:

I had used EVA AIR a few years ago when they used Boeing-747s, but that flight was awful because they didn't have a personal TV service. I can only choose a few music programmes during the flight. I haven't used EVA since then. However, since EVA uses Boeing-777s to fly from Taipei to London. I decided to try again. I find that the new type aircraft is good. They offer a 3-3-3 seat arrangement, so the space of the seats is wider. I also have a personalised movie channel, a music programme as well as video games. (Respondents BD)

According to these international students' views, they are concerned about and well-aware of the in-flight environment that the airlines offered. If the price is similar, they would choose the airline that can make them more comfortable, depending on their travel needs. During this research, food and seat comfort ranked the highest, while entertainment systems and service quality were rated slightly lower.

This once again suggested that price is not the only indicator for passengers but can be affected by multiple issues; therefore, airlines should make efforts to improve their offer since this is an effective way of building long-term relationships (Reichheld and Sasser, 1990).

Special Offers and Loyalty Programmes Targeted at Students

Kotler et al (2005, p.393) specify that segmentation is about adapting a company's offerings so that

they more closely match the needs of one or more market segments. The respondents mentioned a couple of offers that can attract their attention:

Being a student, I would like to choose the airlines which offer special discounts on student tickets. Some airlines offer very good prices to students. Otherwise, I also would consider the baggage allowance, because I may have to carry some necessary things from my home country. That is why I choose Royal Dutch Airlines because it offers a 30 kg baggage allowance which is also the best deal for students. (Respondents BG)

Due to the special needs of the students, they would like to choose the airlines which provide a tailor-made service for them. Student-fares and a baggage allowance are the two aspects that mostly concern student travellers. This information will allow airlines to form their targeting strategy if they wish to tag onto the student market.

Apart from the tailored offer, some other loyalty programmes can also offer additional incentives. Rust, Zahork and Keiningham (1996) explain that defensive marketing could help companies to maintain a long-term relationship with their customers, which is generally more cost-effective than pursuing new customers.

I always choose Cathay Pacific Airways or British Airways to London. The reason is that I can earn more miles based on the benefits of the Asian Mile system. No matter which I choose, I can accumlate the mileage and enjoy the upgrade service. This is an important issue to me because I also can have other benefits while booking a hotel or shopping using this Asian Mile system. Even when I want to travel to another country, if I choose the airline within this system, I still can accumulate the miles I fly. It's quite good. (Respondents AF)

From the passengers' point of view, they think that earning benefits by taking flights is attractive. They enjoy the services and benefits, such as upgrades, discounts and shopping, as long as they fly with airlines within this Asian Mile system. British Airways and Cathay Pacific Airways are also members of the oneworld alliance, and passengers who join the AsianMile programme also can have the benefits of the oneworld members' airlines. One observation made during the interviews was that loyalty programmes only attract those who travel most frequently. For less regular travellers, an immediate discount is sufficient. Airlines must consider their objectives and their consumer profile before deciding on which strategy to implement.

Good Connection to the Destination: the Number of Transfer Points

Long-haul flights can be a tiring experience regardless of the quality of the service; therefore, many passengers like to choose airlines that can take them to their destination fast (Shaw, 1999, p.124). At the moment, it is difficult drastically to decrease the flight duration due to technological reasons; however, too many transfer points and regular delays will be a disadvantage.

I will pick the flight which will let me arrive at my destination the quickest. I remember I have taken Royal Brunei Airlines once, because of a cheap ticket, however, it took me over 24 hours. I had to transfer four times to London. I almost went crazy during the trip. Since then, I do not like to spend too

much time on a flight which has too many transfer points even if the ticket is cheap. (Respondents AJ)

Long-haul flights certainly are not an experience they enjoyed, especially those who travelled often. Nearly all of those who travelled often tried to share a story about their painful encounters with delays and flight cancellations. So a long-haul flight is a negative purchase, like a new car tyre- consumers would not but if they didn't have to. Consequently, airlines and passengers have to come up with solutions that are acceptable to both sides.

Safety

Although it may sound obvious, passengers can accept a reasonable trade-off between airlines' offers, but safety is the most important feature that cannot be compromised:

Safety is the most important issue for me when selecting airlines, because life is precious. If I knew that China Airlines have had so many accidents in ten years, I would not ever take China Airlines! When I saw the number of fatalities, it frightened me seriously. I could not believe that I choose China Airlines just because of the cheap tickets. I think other services are not important compared to life. Nothing is more important than life itself. (Respondents AH)

Through the passengers' views, even though they think that good service is a necessity in their experience, nevertheless, the safety record is still a priority without dispute, and this can have a crucial impact on the passengers' decision-making process (Morrison and Winston, 1995).

From the above, it appears that safety is a priority as well as a bottom line that an airline has to provide. It is not only important to student travellers but most other travellers as well. Since 911, airlines are facing additional and sometimes very difficult challenges from within the industry and the macro-environment. All of the above topics are individual offers provided by airlines, but the last topic of the analysis section will look at the sum of these parts - brand image and reputation.

Brand Image and Reputation

Kotler et al (2005, p549) assert that brand includes a wide range of offers and that 'brand names tell the buyer something about product quality. Buyers who always buy the same brand know that they will get the same quality each time they buy'. In other words, all the different offer criteria discussed above could be summarised through brands and the meanings associated with brands. In the interviews, several respondents stated that they would buy tickets from certain airlines due to the recommendations of their friends. On the other hand, the importance of recommendation and word of mouth in travel and tourism industry although is confirmed in some studies, but it is not without debate. Some of the interviewees would actively advocate the airline with which they flew. For example, five respondents said that, when they saw or heard about EVA airways, they would think that it is the safest airline, while other respondents stated that Cathay Pacific Airways would remind them of the good service quality.

Cathay Pacific Airways always gives me a good impression because of their reputation. The majority of my friends also choose Cathay to travel. They told me that they choose Cathay Pacific Airways because that they saw some reports about the good service and safety provided by Cathay Pacific. I also agree with them due to the enjoyable flying experiences with Cathay. (Respondents AO)

Moreover, the fact that all of participants can remember which airline they travelled with last time and could name their favourite airline reconfirmed the importance of brand and branding to consumers as well as airline companies.

Summary of Main Findings

To summarize, the major themes which emerged as key to customer airline choice in this study were as follows. 1) having a fourth class with added benefits was perceived positively 2) an efficient and user-friendly web interface allowing ticket purchase was an important pre-requisite for many consumers 3) in-flight service quality was highly important, particularly the attitude and professionalism of cabin crew, the quality of food and the in-flight entertainment 4) special offers and loyalty programmes targeted at particular market segments were viewed very favourably 5) convenience in terms of proximity to end destination and transport links from the airport were also important 6) respondents were very aware of each airline's safety record and regarded it as a key factor 7) overall, respondents seemed to be very aware of brand reputation as a symbol of all these themes collectively.

Managerial Implications

In this section, the existing literature will be combined with some of the above findings to suggest how airline companies can improve their competitiveness in the short-, medium-and long-term. This research realises that there are many alternatives but here only presents those that were routinely pointed out by the participants.

Short-term improvement: the in-flight service

The first important lesson from this research relates to the kind of in-flight service that the airline provided. These are the areas where airlines can improve within a relatively short period of time. The first issue that concerns the respondents is the flight attendants' service. Some respondents worried about their language skills and chose EVA Airways, China Airlines and Cathay Pacific Airways, which have Chinese-speaking cabin crews. Another issue relates to the choice of food. Although other factors should not be undermined, however, airlines can add value to their services if they can appreciate their passengers' dining habits. This effort will be positively acknowledged by the passengers. The third factor concerning the interviewees is the in-flight entertainment programme. They care about that whether airlines can offer up-to-date and the newest movies, music as well as video games because long-haul journeys are long and tiresome, Additionally, the majority of the student participants are members of generation X (1965-1979), who are curious, adventurous, enjoy challenges and like to pursue fashionable things (Li, 2003).

Medium-term: the Inspirations from EVA Airway's Elite Class

During this research, the respondents' favourable attitude towards EVA's Elite Class confirmed the study by Johnson and Nunes (2002). They propose that there is a gap between the upper and the middle-class that was not recognised by the corporations.

The background of the students can be used to explain their purchase decisions and travelling preferences. These participants mainly are funded by their slightly above middle-class families at some level. They find business class too expensive and unnecessary, but also find economy class unattractive. Currently, only EVA has pioneered this type of in-between class and it seems quite successful in terms of capturing this marketing segment. Apart from EVA, only Virgin Atlantic Airways has a Premium Economy Class which is similar to EVA's Elite Class, but it is only offered on a limited scale. On the other hand, having an extra class will require a wide range of activities, such as new seating arrangements, service, marketing and financial obligations.

Long-term: Airlines' Safety and Branding Image

As mentioned in the previous chapter, safety cannot be replaced by any amount of service (Shaw, 1999). Therefore, it is essential for airline companies to be safe and have an image of being safe. Because airline's actual safety is more of an aviation safety subject, hence, this section will explore two suggestions about how airlines can use a service marketing strategy to acquire an image of being safe. As demonstrated by some of the participants in this research, they do have an existing belief about which airline is safer.

According to weak theory (Ehrenberg et al, 2002), airlines should not expect to alter the travellers' existing beliefs within a short period of time.

Airlines with a superior safety record, like EVA Airways and Cathay Pacific Airways, could stress their records in their promotional kits as a reinforcement and reminder to travellers. For airlines with inferior safety records, like China Airlines, one suggestion to improve their image is through public relations and endorsements by aviation specialists, especially through the channels of newspapers and specialised travel magazines. These channels can be perceived as credible due to their nature (Hackley, 2005). In Hsieh and Chang's (2005) study on the Taiwanese travellers, it confirms that advertising through endorsement can be an effective approach in hotel and hospitality industry. This research proposes it should also be effective when applied to airlines due to their nature are similar in many areas.

However, in another travel and tourism marketing study by Boo and Busser (2005), it demonstrated the essentialness of considering the affective image as well as its cognitive image. In other word, travel and tourism industry can not treat the consumers as naïve.

Concluding comments: limitations of this study and future research opportunities

This study, based on a representative and convenient sample of airline travellers and focussed on a single route, has limited generalizability. Nevertheless, it does generate insights which carry immediate implications for competitive strategy in the airline market. There are limitations as regards the data gathering and analytical method. Due to the number of respondents, it is difficult to establish a correlation between service attributes and behaviour. Furthermore, interview respondents' accounts of their behaviour are not always accurate. For example, one respondent initially claimed that she had bought an economy class ticket but later admitted that she flew business class because she did not want to be viewed as showing-off or different, despite the interviews being conducted individually and privately. However, in general, responses based on individual interviews tend to carry a high degree of integrity, especially when responses are probed in depth interviews lasting a considerable time period. The study could be extended and its findings deepened by adopting the same methodological approach to other typical students routes, and also by extending the study to other, non-student consumer segments.

ROLE OF PROMOTION IN MARKETING

Promotion **informs** consumers about the rest of the marketing mix. Without it, consumers do not know about the product, the price, or the place. Promotion is more than just advertising, and it includes several activities. It is crucial when you are selling in a mass market or you have a brand name. Promotion includes:

- **Advertisements:** They can take different forms, e.g. on TV, in newspapers.
- **Promotion:** e.g. Money off coupons.
- **Personal selling:** Sending out sales representatives to talk directly to the consumers.
- **Public relations:** Involves making the public aware of the company, e.g. creating publicity in the media.

The aims of promotion

- To inform people about particular issues.
- To introduce new products to the market.
- To compete with competitors products.
- To improve the company/brand image.
- To increase sales.

Advertising

The advertising process

- **Set objectives**: A business needs to determine the purpose of advertising.

Deciding the advertising budget: Set a limit on how much the business can spend on advertising. It can be decided based on:

A percentage of predicted sales revenue.

How much competitors are spending.

How much the business can afford.

- **Create an advertising campaign**: Decide on what advertising campaign to run. Can be determined based on:

Target audience.

Objectives.

- **Select the media**: Using the suitable media for advertising that is the most **cost effective**. E.g. TV, newspaper.

Evaluate the effectiveness of the campaign: Has the advertising met objectives?

Different types of advertising

- **Informative advertising**: Involves giving as much information about the product as possible. (e.g. computer)

Persuasive advertising: Involves persuading consumers that they **need** the product and should buy it. (e.g. perfume).

Different media of advertising

Media	Advantages	Disadvantages	Examples
Television	· Millions of people will see it. · The product can be presented in a very attractive way. · Easy to reach target audiences.	· Expensive	· Food · Cars · Household tools
Radio	· Cheaper than TV. · Uses song or tune which makes ads memorable.	· Cannot use visual message. · Expensive compared to others. · The advert has to be remembered. · Not as wide audience as TV	· Local services · Shops
Newspaper	· Can reach many people. · Cheap for local newspapers. · A lot of info can be put into the ad. · Adverts are permanent*.	· Not eye-catching if they are in black and white. · Does not grab reader's attention.	· Local products · Cars · Banks
Magazines	· Can use specialist magazines to reach **only** target audience. · Magazine ads are in colour and are more attractive.	· They are only published once per month/week. · More expensive then newspapers.	· Perfume · Golf equipment · Fashion clothes
Posters/billboards	· Permanent* · Cheap · Potentially seen by anyone who passes by them.	· Can easily be missed. · No detailed info can be included.	· Events · Products bought by a large section of the population
Cinemas	· Visual image shows product in a positive way. · Fairly cheap. · Effective if target audience goes to see particular films.	· Only seen by people who go to watch films.	· Toys for a children's film.

Leaflets	· *Cheap* · *Given to a wide range of people.* · *Delivered to people's houses.* · *May contain vouchers to encourage readers to keep the advert.* · *Permanent**	· May not be read.	· Local events. · Retail stores like Seven-Eleven
Internet	· Can be seen by anybody around the world. · Can store lots of info. · Orders can instantly be made.	· Internet searches may not highlight the website and it could be missed. · Internet access is limited in some countries. · Competition from other websites. · Security issues may discourage people from buying online.	· Virtual goods. · Services such as banking or insurance. · Virtually anything that is not too small.
Others (delivery vehicles or sides of bags)	· Cheap	· May not be seen by everyone.	· Shops put their names on plastic bags. · Coca cola use neon signs.

***Permanent:** adverts can be kept for future references.

Design of adverts

Businesses usually use the **AIDA** model:

- **Attention:** Informs consumers that the product exists.
- **Interest:** Consumers need to become interested in the product.
- **Desire:** Makes consumers want the product.

- **Action:** Prompts consumers into buying the product.

The AIDA model is most effective on products that are not used regularly. It is less effective on products that are bought on a daily basis because people will know how good the quality really is.

Promotion

Different types of promotion

Promotion is usually used to **support** advertising and to encourage new or existing customers to buy the product. Its main function is to **boost sales** in the **short-term**, but not in the long term. It is used to attract **new customers** so that they can **try** out items with the hope that they will like it and continue to buy it after the promotion has ended. Here are some ways in which promotion is used:

- **Price reductions:** Involves sales or price reduction coupons.
- **Gifts:** Gifts are placed in the packaging of the product to encourage consumers to buy it. (e.g. toys in McDonald's happy meal).
- **Competitions:** A card may be put in the packaging allowing the consumer to enter contests such as the lottery.
- **Point-of sale displays and demonstrations:** Can be put near the window and displayed attractively. It could also encourage people to buy it if they can see how it works (demonstrated by sales staff)
- **After sales service:** e.g. warranty services. It reassures the customers that if the product has a problem then they can go and fix it for free. This make the product more attractive than others without warranty.
- **Free samples:** Encourages people to **try** the product. It can be included in other products as well. E.g. washing machine comes with free washing powder.

The advantages of promotion

- Can boost sales during the year when sales are traditionally low (encourage **off-season** purchases)
- Encourages people to **try** a product.
- Encourages people to buy a product or the product in **greater quantities**.
- Encourages people to buy a product instead of **competitors'** products.

Which type of promotion should be used?

When deciding on what type of promotion should be used, these points should be considered:

- **The stage of the product life cycle**: e.g. use informative advertisement in the introduction stage of the life cycle.
- **The nature of the product itself**: e.g. consumer goods use coupons but producer goods use discounts on bulk buying.
- **The advertising budget**: obviously the type of promotion depends on how much you can spend.
- **The cultural issues involved in international marketing** : businesses need to consider whether their type of advertising might offend the local people. They should also take into account things such as how many people own TV, literacy level, etc…
- **The nature of the target market**: Different markets require different media for advertising.

Personal selling

- Used when the **nature** of the product **varies**. e.g. housing
  - Price varies.
  - Quality varies.
  - Customer requirements vary.
- When customers need **advice** on what type of product is the most appropriate for their situation.
- When selling **expensive** products such as cars.
- When **negotiation** about price or products is needed. This is common for businesses that sell to other businesses. (e.g. discounts on bulk buying)
- When a business has a stand at a **trade fair**.**Public relations**
- Good for improving the brand/company's **image**.
- These activities raise **public awareness** of the company.
- Includes:
  - Sponsoring events such as football matches.
  - Giving products to charity.
  - Employees take part in an activity for a good cause.

Customer service

It is far more expensive to attract customers than to keep old customers, so one key objective for any business is to retain their old ones. In the international business environment, there are many competitors, so businesses need to raise the **value** of their products with **customer service**.

Good customer service is not only producing a good product but also means:

- **Giving advice about the product**: It is always good to give as much information about a product as possible so that the customers can be sure that they have purchased the product that meets their requirements.
- **Delivering goods for customers**: It becomes convenient for the customer which encourages the customer to buy products from the business since they do not have to go anywhere.
- **Providing credit facilities**: This means letting customers pay later or in monthly installments. This make products look cheaper and more affordable encouraging customers to buy them. Credit facilities are usually offered when people buy expensive products. You usually get interest as a result, but you could charge no interest for promotional purposes.
- **Providing product information**: This means giving information on how to use the product and offering help on customer service helplines.
- **After-sales service**: The aim is to show that you care about customers' **satisfaction**. Examples of after-sales service include:
  - Warranties.
  - Regular product checks.

  Giving refunds for faulty products.

AIRLINE SELLING, ADVERTISING AND PROMOTIONAL POLICIES

We are nearly at the end of our survey of marketing principles and their application to the airline industry, but one crucial step remains for discussion. The subjects addressed so far show how airlines can analyze their markets and their marketing environment, plot a sound strategy, and, following on from this, put in place correct product, branding, pricing and distribution policies. In order to be successful, though, they must convince and persuade potential customers to buy from them rather than from their rivals. The early stages of marketing should certainly make this process easier. It will always be more straightforward to persuade people to buy value-for-money products which will meet well-understood customer needs, rather than those which do not. In no sense, though, is the sales task an easy one, given the levels of competition which now prevail in the industry. A great deal of planning and hard work will be needed, and this
Chapter will discuss the necessary skills.

The Anatomy of a Sale

The AIDA Model and the SPIN Cycle

In order to understand the sales process as a whole, it is essential to look at some of the theoretical principles which underlie selling in any field. We will then apply these principles to the airline industry.

In all selling situations, it will first of all be necessary to identify the prospect and gain their Attention. This may be done using methods such as advertising, direct mail or the telephone. Once this has been achieved, sales can only result if the salesperson is successful in awakening the interest of the prospect.

It might be thought that the best way of arousing interest would be for them to launch into a long description of all the attractive features of their product. This is not so. Successful selling results from every effort being made to find out about the customer's problems and demonstrating the ways in which these problems can be solved.

Problem analysis in turn requires a systematic approach, based on a logical series of questions. The first questions should be so-called Situation questions, designed to isolate the prospect's present buying habits. A business traveller might, for example, be asked about the airlines they choose, the routes on which they fly, how often and in which class of service. All of these would be examples of Situation questioning. Next,

Problem questioning will be needed. These are the questions which are designed to make the prospect think of any areas where the present situation is unsatisfactory. The salesperson might ask about the prospect's experience of the punctuality record of one of the airlines they are choosing, if there is a suspicion that this airline is performing poorly.

Hopefully, the prospect will admit that they have been the victim of a number of flight delays. If they do, it will be time to move on to Implication questions. These build the significance of the problem in the prospect's mind. In the case of delayed flights, there is an almost limitless number of Implications. These can include cases where the prospect arrived late for an important meeting, or where they had to travel the previous evening – with extra costs in accommodation and time away from office or family – in order to be sure that they arrived at a morning meeting on time. Finally, there will be the requirement to ask so-called Need/Payoff questions. These put into the prospect's mind the idea that there might be a solution to their problem. Again, using the delayed flight example, this would be the point at which the salesperson would describe the – hopefully much better – punctuality performance of the airline they are representing.

Once proper questioning about needs has been undertaken, it will be safe to proceed to the point where the salesperson can move from the task of developing interest into that of converting interest into the Desire to make the purchase. This will involve presenting the solution to the customer's problem, and then moving on to the benefits of adopting the solution using a 'This Means That …' statement.

Promoting Desire may also involve the handling of Objections. The prospect may, for example, say that they do not believe the salesperson's claims, or that they regard the suggested solution as being too expensive.

Whatever the Objection, it must be handled professionally. The salesperson must ask as many questions as they need to do in order to understand the exact nature of the Objection. They must then make the Objection as specific as they can. It is not possible, for example, to manage an Objection well if the prospect merely says "X is a bad airline" or they don't fly X because the carrier is 'always late' Questioning should establish exactly what experiences have led to the view that the airline is a poor one, or that its punctuality performance is disappointing. Once this has been done, counterbalancing points can be given which address the precise concerns. These can often take the form of statements as to why the situation has improved since the unsatisfactory incidents took place.

The last stage of the AIDA model follows on from the nurturing of Desire. It is that of Action. Despite the importance of the earlier stages of the sale, nothing concrete has been achieved until the prospect has been persuaded to buy the product or service on offer. Salespeople must have the courage to risk rejection and ask for the deal, once the signs are there that the earlier stages of the sale have been completed successfully. These signs can be identified from the body language of the prospect, or by the fact that they start using so-called Verbal Buying Signals – for example, asking about the details of a deal rather than discussing whether the deal should be concluded or not.

In applying the general AIDA model to the specifics of the airline industry, two features stand out. Firstly, airline sales executives do not sell a tangible product in the way that, say, a second-hand car dealer does.

Rather, for the greater part of the time, their task is to sell a long-term relationship with customers such as travel agents or corporate travel buyers.

Therefore, the signing of an initial deal is always the beginning of the task of building a relationship, rather than the end of a process. Also, airline salespeople generally become involved in long sales campaigns. They can rarely expect to close a deal after merely one visit to the prospect. They therefore need skills in the managing of sales campaigns and in measuring progress through a campaign.

Sales Planning

Given the challenging and complex nature of the sales task in the airline industry, sound planning will be essential if it is to be accomplished successfully.

Such planning will need to take place at different levels. An overall sales and marketing plan will be needed for the airline as a whole, and preparing this will be the responsibility of the Executive Vice-president for Marketing working with the other senior managers of the company.

Amongst the crucial issues that this will settle is the total budget that will be available to underwrite the sales effort.

At a lower level, comparable sales and marketing plans will be needed for each sales region in the airline's network. These will, amongst other things, decide how the overall sales budget should be allocated between the regions, and how each region will spend the available funds. The latter will require decisions on the so-called 'Communications Mix', the ways in which the different forms of marketing communication are brought together to make up, hopefully, an integrated and successful policy.

Any form of budget-setting is likely to involve a difficult and contentious internal debate. Such debate, though, is likely to be especially intense when it involves decisions about the money to be spent on the sales and marketing effort. No-one, presumably, would dispute the point that some cash will be needed to support sales and marketing. The problem is that measuring the return obtained on such spending is notoriously difficult.

It also does not produce a tangible result in the way that spending the same money on a fixed asset such an aircraft would. It is therefore important that sales and marketing managers should be able to make the case for the money they need in a persuasive and credible way.

Traditionally, one can find three ways in which this case has been made. Two of these are

simple and straightforward, but unfortunately wrong. The third is much more difficult, but is the one most likely to lead to a positive outcome.

Of the incorrect methods, it still happens that budget requests are made using the so-called Percentage of Revenue method. This is where the request is made for a promotional budget based on a fixed percentage of the revenue which the sales and marketing team have achieved in the last year or which they will be expected to produce in the next one.

This concept certainly has the merit of speed and simplicity, but it is fundamentally incorrect. It ties spending to the prevailing market conditions. If the market is buoyant, revenue will rise naturally and promotional spending with it. If market conditions deteriorate, there is a risk that revenues will fall and that promotional spending will therefore follow. The worst possible situation could then result, with a downward spiral of falling revenue leading to a smaller promotional budget which will in turn cause a further loss of revenue.

The promotional budget should actually follow exactly the opposite pattern to the one which will result from the Percentage of Revenue concept. When the market is growing strongly, an airline operating in that market will be able to increase its own revenue in line with the market for only a small promotional spend. When the overall market is stagnant or declining, success for the individual firm can only come by it increasing its share of the market. Growth through increasing market share is notoriously difficult, and will only come about through a determined, and costly, marketing communications effort. The second common way for a promotional budget to be settled is for it to be based on what was agreed for the previous year with an adjustment for inflation. Whilst such an approach may be inevitable in the real world of corporate politics, it results in the promotional budget being at roughly the same level year after year without the necessary questions ever being asked as to whether it is correctly pitched or not.

This last point leads us on to the correct way to set a promotional budget, which is known as the Task-Based Method. Under this, the budget is set by first asking and then answering a series of questions about the money which will be needed if the target revenue and profit for the year is to be achieved. Whilst there can be no precise answer to these questions, the fact that they are asked at all means that a sound approach to sales budgeting is more likely.

Of these questions, the first has already been mentioned, but its influence on decision-making should be the reverse of that implied by the Percentage of Revenue concept. If a market is stagnant or declining this is an indicator that higher promotional spending will be needed.

It will also be necessary to take account of the spending of the airline's competitors. Whilst in principle it may not be necessary to exactly match the budget of a high-spending rival, there will at least need to be a reasonable relationship with the expenditure of others. If there isn't, the airline's efforts will simply be swamped.

The problem, of course, in the airline industry is that airlines have to compete both in their home market, where they should be dominant, and at the other end of the routes they fly, where the home airline is likely to be in a similarly strong position. Therefore, it is often the case that in overseas markets even airlines with a large promotional spend are being heavily outspent.

They therefore have a particular need to ensure that every dollar they have is made to work as hard as possible.

Besides the question of the promotional spending of competitors, the number and quality of these competitors will be of obvious importance. A carrier fortunate to have only a small

number of poor quality competitors in a particular market should not spend a great deal on persuading people to fly with it who will do so anyway. Instead, the money should be used in other, difficult markets or kept for the time when conditions become more challenging.

The nature of the marketing task in any particular year will also need to be considered. It may be a year in which new routes are to be launched, or when a major product upgrade is to take place. If it is, substantial extra\ cash will be needed to ensure that these new developments are explained and promoted to actual and potential customers.

A further, important question will be that of brand positioning. As we saw then, a case in point was the Canadian carrier Wardair which attempted – unsuccessfully – to change from being a leisure travel airline to one with a substantial presence in the business travel market. Something as ambitious as this will only stand any chance of being successful if it is underwritten by a substantial promotional budget.

Other airlines may not be attempting a major brand repositioning. They do, though, need to strengthen their brand. They may, for example, have carried out attitude studies which show that the airline is perceived in a poor light by potential customers in terms of such crucial issues as punctuality and customer service. If they have, some honest assessment of the situation will be required. It could be that these attitudes are a legacy of a time when the carrier thoroughly deserved a poor reputation, with today's situation much better. If they are, then investment in marketing communications will be justified because this can be used to persuade customers to give the airline another chance and to experience today's improved product standards. If, on the other hand, today's standards are as bad as ever, it is a delusion to think that marketing communications expenditure can rescue the situation. It will probably make things worse.

There will be a temptation to embark on a communications campaign aimed at getting people to try the airline again. When they do, and find that things are the same, they will feel betrayed and tricked by the messages that have been put out to them. In such a situation, any available funds should be spent on addressing the product and service weaknesses which are at the heart of its problems, with investment in marketing communications a much lower priority. Whatever is spent should be focussed on making noncontroversial, factual claims about such aspects as network and flight timings, rather than on the making of false claims about an improving product.

A final and inevitable factor will be the cost of the different forms of marketing communication. Generally, media buying costs have risen in recent years. In the future they may fall as the advent of, in particular, digital television increases competition in attracting advertising and promotional spend. The problem then will be that the fragmentation of the different media will make it harder and harder to reach a target audience effectively − indeed this is already the case. Overall, it is likely that the cost of marketing communications will rise at least as fast as the rate of inflation, and any bid for a promotional budget should reflect this.

The 'Communications Mix'

Once a budget has been obtained, the airline marketing manager's task is to decide how to spend the budget in the most effective way. In doing so, they have a clear problem: the number of ways in which money can be spent is now a bewildering one. Choosing between them will therefore require a great deal of thought and analysis. It is possible to spend money

on sponsorships, database marketing, media relations, trade entertaining, on various forms of advertising (including through the Internet) and through personal selling through investment in a field sales team.
Each of these will have different advantages and disadvantages. Our next task is to discuss them in turn, and also to consider the ways in which each technique should be used to ensure that it provides the best value-formoney. Once we have done so, it will become clearer as to how the different methods can be combined into an optimum Communications Mix.

Marketing Communication Techniques

Sponsorship Policy
The term 'Sponsorship' is used to describe a situation whereby a firm has its name associated with an event, a team or a competitor, in exchange for money.
In recent years, sponsorships have become increasingly important in marketing communication generally. They have certainly done so in the airline industry. It is not difficult to see why. A successful sponsorship can result in a firm's name becoming widely known, very quickly. This can be especially valuable for a new airline, or for an established operator opening a new route into a market area where it has had no previous presence.
Sponsorships can also help in building and reinforcing brand values. They can provide useful opportunities for corporate hospitality and trade entertaining. They can sometimes produce directly increments of new business, especially if an airline is nominated as the 'Official Carrier' for an event, as part of a deal to sponsor it. Lastly, they address problems associated with the fragmentation of media advertising opportunities which multi-channel broadcasting has caused.
Despite these advantages, the question of sponsorship remains a controversial one. It is notoriously difficult to measure and quantify the benefits obtained from sponsorships, and the suspicion will therefore always remain that a great deal of the resources put into them are wasted.
This is an especially serious point because airlines everywhere find that they are inundated with sponsorship requests. Many carriers are identified as national representatives, and many people in the countries where they are based see sponsorship activities as the airline's patriotic duty. Also, there is a perception that air tickets are available to airlines free-of-charge, and that giving away tickets in a barter deal associated with a sponsorship costs them nothing. The problem here is that when a carrier agrees to a sponsorship in return for free tickets, they have fewer seats left to sell to revenue passengers. They must accept that there will be a significant cost associated with a free ticket, if this results in a potential revenue passenger being denied a seat on the flight of their choice, and such tickets must therefore be seen as a form of currency. Only if such tickets are truly offered on a subject-to-load basis can they be seen as having a negligible cost.
There are a number of rules which must be followed to ensure a successful use of sponsorship. Crucial amongst these is that the airline must decide what are the values which underlie its brand, and must only undertake sponsorships which reinforce them.
For all airlines, the cornerstone of their brand is safety. The sponsorship rule which flows from this is absolutely clear. No airline should have anything to do with any event which is dangerous. The risks of a catastrophic accident giving as association between the airline's

name and danger and death is simply not worth taking. It is remarkable how many airlines have ignored this fundamental rule in recent years with, for example both Air Canada and Qantas sponsoring Formula One motor racing and Emirates having its name associated with power-boating.

For many airlines, a reputation for quality is also crucial to their brand development. They should not, therefore, sponsor downmarket events with a poor public image. They have to be very careful, too, to be perceived as a 'Winner'. This will help them in turn to penetrate the business travel market where people who are themselves successful will want to be seen to be travelling with the airline which is a market leader. It might be thought that the best way to be seen as a winner would be to get involved in sports sponsorship and to pick competitors and teams that do well – ideally to pick those that win the events in question. Whilst this is undoubtedly true in principle, it is also extremely risky. It may not matter a great deal if the selected teams or competitors do not win, but still perform well. It will certainly matter if they are humiliated. A more cautious, but much safer option is therefore to sponsor an entire event, rather than one of the individuals or teams in that event, and this is normally the policy which should be adopted.

A final, but important value underlying all airline brands is that of caring. Carriers should not get involved in any activities which have an adverse effect on the environment. They should at the same time be especially attracted by activities which are associated with charities and other good causes.

Once a decision has been made in principle as to the activities with which the airlines wishes to be associated, steps must be taken to ensure that the maximum value-for-money is obtained from them. Here, it is first of all important that the airline should if possible be the sole sponsor – certainly no other airlines should be involved. Too many sponsors can result in the identity of each individual firm being lost. Also, the event should be one where substantial media exposure can be guaranteed, exposure in which the sponsor's name will feature prominently.

In terms of assessing whether or not a sponsorship provides value-for money, its likely full costs should be should be quantified. This costing must include items such as any client hospitality provided, and any promotional back-up offered through special giveaways etc. Then, at least for a major sponsorship, research should be commissioned, related to its objectives. If the principal objective is to raise awareness, the research task will be an easy one. A study will be needed in the relevant market area of awareness levels before and after the sponsorship, with, hopefully, a significant positive change being the result. Where the objective is to improve the image and perception of the airline, the required research will be more complex and will almost certainly involve a quantitative study, and also some qualitative, focus group-based, research.

Database Marketing

Like sponsorship, Database Marketing has been increasing quickly in importance in airline marketing communication. Earlier, we discussed the role of Frequent Flyer Programmes in enabling airlines to produce effective databases. Today, storing and processing database information is cheaper than it has ever been. At the same time, carriers are seeking to make better contact with their retail customers as a component of their strategy to secure greater control of their distribution channels and they have seen database marketing as a way of doing

so. The subject remains, though, controversial and in this section we have to look at both the advantages and disadvantages which Database Marketing brings, and the decisions which will have to be made to ensure that it brings the best possible results.

With advantages, beyond question the main one is that, if it is properly applied, database marketing will allow for finer market segmentations and better targeting of marketing messages, in a way that media advertising, for example, cannot. We have now moved away from a proposition that airlines' markets can be divided into just 'business' and 'leisure' travellers.

In business travel, customers can be divided up by the routes they fly and the class of service which they (or their employer) choose. A tactical advertisement announcing, say, an increase in frequency on a particular route will be seen by many people who never fly that route. One which describes a re-launch of Business Class will be seen by many people – and may irritate them – who are forced to travel in Economy and who will merely learn what they are missing. Database marketing should avoid this problem.

In leisure air travel, there is an increasing need to recognise discreet market segments, especially amongst discerning, up-market travellers.

People vary, for example, in their stage-of-life and personal circumstances. Travel needs will also be distinctly different for families with young children compared with couples or singles. Preference may vary according to age. Also, hobbies and interests form an increasingly useful basis for market segmentation. People who travel, for example, for winter sports, golf, fishing etc all form distinct and potentially valuable market segments. Database Marketing allows for fine segmentations, and permits messages to be prepared and communicated which demonstrate an airline's ability to meet a precise set of needs. Traditional media advertising cannot offer the same opportunities.

Other features of Database Marketing are that it permits tactical messages to be communicated quickly, and only to those people that the airline wishes to tell. Buying advertising space may involve delay if the space has to be booked in advance. It will also mean that offers of, say, discounted fares become generally known, rather than knowledge of them being confined to those people whom it is in the airline's interest to approach.

Despite these very significant advantages, the use of database marketing in the airline industry remains controversial. If the selected medium for using a database is the telephone, many people still regard an unsolicited telephone call as an invasion of their privacy. The same may apply to a mailshot, fax or Email, albeit to a somewhat lesser degree. With these latter media, though, the problem is one of over-use. The modern remains, though, controversial and in this section we have to look at both the advantages and disadvantages which Database Marketing brings, and the decisions which will have to be made to ensure that it brings the best possible results.

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A further, important point with Database Marketing is that it must be viewed as an expensive form of marketing communication. The costs of a database marketing campaign might at first appear to be small in comparison with one based on, say, media advertising. The relevant cost, though, is not the total cost but a unit cost measure expressed in Cost-per- Thousand terms. Using such measures, database marketing can be a high cost solution.

Putting all these points together, the conclusion is clear. Database marketing campaigns must be executed with the utmost professionalism. If they aren't, the only result will be a costly waste of time and money. To achieve such professionalism, there are a number of rules which must be followed:

- Responsibilities and Timescales:
  Successful Database Marketing requires a proper definition of objectives and a sound action plan is which is properly formulated and communicated. This should be made the responsibility of one individual. "Integration" Database Marketing should never be implemented on its own, without proper consideration being given to its integration into the firm's wider marketing communication activities. At a narrow level, this may mean a simple, but very necessary co-ordination between the breaking of a media advertising campaign, and the sending out of a mailshot based on it. More broadly, though, it will be necessary to ensure that no contradictory messages are sent out. An

airline seeking to position itself as a premium brand, aiming mainly at the business air traveller, should not put out advertising targeted at that market segment whilst at the same time sending out mailing material of poor quality emphasizing the wide availability of cheap fares.

- Databases

  Sound information in a convenient-to-use form is absolutely essential for successful Database Marketing. A great deal of attention may be devoted to the production of attractive mailing material, but if this material is then sent to the wrong people, a campaign based on it has no chance of success. Indeed, poor material sent to exactly the right people will achieve more. In some senses, database management is now less of a problem that it once was, because computing power and the relevant software is now cheap and widely understood. However, problems associated with obtaining the necessary data and processing it are increasing through time rather than easing. In searching out database information, some fundamental divisions of the data can be made. Firstly, it will be necessary to obtain demographic details about the target audience for a campaign. This will obviously include names, addresses and titles. It is important that names should be correctly spelt and titles accurate. If a job title is to be used, this should reflect a person's status with the organisation they work for. A further requirement with demographic data is that it should be deduplicated. It might be thought that duplicates in a database are a minor problem, resulting in a small increase in mailing costs as the same communication is sent to one recipient twice. Duplicates are much more serious than this, because they give the impression that the company sending out the mailing is incompetent and inefficient. Few people will buy from a firm when this is their perception of it. Fortunately, modern database management software generally includes a de-duplication package and the use of this can eliminate many of the problems. In seeking out demographic information, by far the best sources are those based on situations where people volunteer to be included in a database. Besides addressing to a large degree invasion of privacy issues, cases where people offer their names voluntarily are generally much easier to deal with under the terms of the relevant data protection laws in different countries.

  Of potential sources of database information, attention has already been drawn in Section 9:3 to the value of a Frequent Flyer Programme. People can be asked when joining a programme to provide all necessary information about them. They will then keep this information up-to date for all the time that they are a programme member, because they will be anxious to ensure that their mileage statements and free tickets are sent to the right address. Another possible source of database information is to invite people to join a travel club. As we have already seen, the leisure travel market is changing, with significant numbers of people now searching for individually-tailored holidays, often centred around their hobbies and interests. They are also prepared to spend regularly and heavily to obtain these holidays. This development gives a classic opportunity for database marketing, and it may well be worthwhile to form a club which will enable database information to be collected and regular communication to be maintained with members.

  A final opportunity to obtain database information which people have volunteered

comes with the question of low fares offers. Many airlines invite people to volunteer their Email addresses. Once they have done so, they are regularly sent information about flights where there are substantial numbers of empty seats and where the airline is able to offer them particularly attractive low prices.

Despite the attractions of databases for which people have volunteered, it will often be necessary to go beyond them. In particular, "volunteer" databases can only include people who currently fly with the airline concerned, or who at least are reasonably well-disposed towards it. They do not give opportunities for increasing market share by enabling people to be reached who are currently flying with other carriers. Where the aim is to reach a competitor's customers, it will generally be necessary to buy in lists. Today, these lists are often based on geographical principles, with addresses being obtained from the Electoral Register and classified according to the neighbourhoods in which people live. The proposition is that people who live near to one another will have income levels and spending patterns that are to a significant degree similar. The problem with these lists is that they go out-of-date very quickly. The Electoral Register is only up-dated once a year, and by the time the information is in a form ready to be used in database marketing campaigns it may no longer be accurate enough. Much the same applies to magazine circulation lists and trade directories as sources of database information. In principle, these can be useful in business-travel orientated campaigns. Databases founded on them may, though, go out-of-date quickly, particularly those derived from lists for free-circulation trade papers.

Once the necessary demographic data has been obtained, this must then be combined with the relevant activity data. Airlines need to know where people fly, in what class of service and how often. They need also to be able to capture this data, and marry it to the demographic information they are carrying in their databases. Only then can they produce effectively targeted marketing campaigns.

A final requirement in database management is that the database should be properly integrated with an airline's Customer Relations activities. We have already seen in section 9:2:3 that someone who complains, with a justified grievance, provides carriers with an important opportunity. If the complaint is dealt with well, it can result in a strengthening, rather than a weakening of the relationship between that person and the airline. Having said this, it will be particularly annoying if someone complains, for example, about a delayed flight and then receives a mailshot shortly afterwards in which the airline boasts of its fine punctuality performance. They should not do so, if there is a proper integration between the marketing and customer relations databases.

Indeed, if there is, this may result in an important opportunity because someone who complains will also at the same time be providing information about themselves. If their complaint is handled sympathetically, they will then be well-disposed towards the airline in question and may respond to future database marketing messages.

Therefore, those who complain and express satisfaction at the way in which their complaint has been dealt with should be added to the airline's marketing database.

The subject of copywriting for Database Marketing remains extremely controversial. What is certainly true is that the investment made in building and maintaining a database can be leveraged substantially if is used well through the production of good

material.

With decisions about copywriting, the first requirement is clearly that a statement should be made as to the objectives which a particular campaign should meet. These objectives can vary substantially. It may be that the intention is simply to give information to an airline's existing customers on a particular route about, say, a change in flight timings. Another possible objective is that the campaign should encourage these existing customers to fly more through, for example, the offer of bonus Frequent Flyer miles or a move to a higher status in the airline's loyalty programme. A third, and much the most challenging, possible objective is that the campaign should be targeted at people who are currently flying with other airlines, with the objective being to change their choice-of-carrier decision. Alongside decisions about objectives, a choice will have to be made about the medium to be employed. A first possibility is that the database will be used for a telemarketing campaign, in which case the copywriter's task will be to help to prepare the script which those working the telephones will use. This will have the benefit of immediate impact, but as previously mentioned may be resented by those who are called. Secondly, the mail may be used. This will allow for the preparation of attractive mailing material but, as we have already seen, this material may be put into the waste paper bin without even being opened. Email provides a different choice, but it may be difficult to obtain a suitable database of Email addresses and emails are easily deleted without being read. Spam filters will also stop the delivery of a proportion of messages.

For the remainder of this section, we will mainly assume that the mail is the selected medium, as this is the one which provides especial challenges in copywriting.

With decisions made about objectives and medium, the copywriting process can begin. It should follow a series of easy-to-state, but difficult to apply, principles. The first of these follows the AIDA model already mentioned in Section 10:1:1. All material should aim to catch people's attention through a bold headline promising them a worthwhile benefit . It should interest them in the proposition to be made through showing an understanding of their problems. A solution should be presented in a persuasive and credible way, with every effort being made to anticipate possible objections and to deal with these. Finally, a course of action should be proposed, with clear information being presented as to how to follow this.

In using the AIDA model, there is a never-ending debate over the length of copy that should be employed. It is certainly the case that people are becoming busier and busier, and that their willingness to read long copy is lessening all the time. Because of this, communications which are designed simply to impart information should certainly be kept short and to-the-point. It is less clear, though, as to whether or not a 'short-is-best' conclusion will always be appropriate where the objective of a campaign is to radically change people's buying behaviour.

Here, it should be born in mind that any database, no matter how well prepared, will consist of two groups of people. The first are those who should not, in fact, be on it at all because they have no interest in the propositions being made and will never buy the products or services in question. In history, there has been no example of a perfectly-targeted database. The second group of people are those who do potentially have such

an interest.

In copywriting for Database Marketing, no time should be spent worrying over the fact that mailing material has not been read by people who will never buy the product anyway. The tragedy of the campaign will be if people with a genuine potential interest cannot be persuaded to act upon this and buy the product.

For these people, it is unlikely that a major change in their buying behaviour will be achieved by short copy. They have to be thoroughly convinced that the firm seeking their business has an understanding of their problems, and that it can solve these problems better than the existing firms from which they are currently buying. It is most unlikely that they will be so convinced by a few words.

If long copy needs to be employed – and there will be cases where it is essential – the style adopted can go a long way to ensuring that resistance to reading it is overcome. Short sentences and paragraphs will be needed broken up by frequent sub-headings. It will also be necessary to talk in plain, rather than flowery, language. "Correctly co-ordinated schedule" may put people off reading further whereas "right timings" will not.

A particularly useful tactic may be to employ a P.S. at the end of a letter. If this is well written, it can deal with any dissonance people may feel about carrying out the actions proposed in the main body of the letter.

It may also be the first thing that they see when looking at a letter and may persuade them to go back and read the earlier body-copy.

In terms of the style and quality of the material to be sent out, this should reflect the objectives of the campaign. An airline re-launching its Business Class service and seeking to persuade potential passengers that the new product is of the highest possible quality, will be unlikely to do so by the use of cheap and shoddy mailing material. On the other hand, a mailing may have the purely tactical purpose of informing customers about a forthcoming fares increase. If it has, it would be a mistake to dress up such a mailing with extravagant expenditure on high quality production.

A final, very important rule with copywriting is that, wherever possible, it should be made interactive. Effective campaigns are generally based on encouraging potential customers to respond to an attractive offer. This might be in order to obtain a free giveaway or to participate in a prize draw for free tickets or bonus Frequent Flyer miles. Making an offer may overcome people's dislike of the 'invasion of privacy' aspect of database marketing. It may also be a means of obtaining from them further, useful, database information about their travel patterns and service preferences.

- "Gatekeeping" Today, in most countries, the post is reasonably reliable and the services which back up fax and Email mostly very efficient. It is therefore possible to ensure that a database marketing message reaches the home or the office of the target recipient. This, though, is the beginning and not the end of the task, because it will be an altogether bigger challenge to ensure that a marketing message is read and acted upon. Many people will simply throw away what they perceive to be 'Junk Mail' into the waste paper basket without even bothering to open it, whilst in the office situation, a secretary may be told to throw away any direct mail items without even putting them

into their boss's in-tray. There is an active debate in the literature on direct mail as to how it is possible to ensure that an envelope will be opened and the contents read. In addressing the problem, there are two possible approaches. One is to employ subterfuge. In extreme form, this consists of writing 'Private and Confidential' on the outside of an envelope. This should at least ensure that the envelope is placed in the relevant in-tray. A similar approach, though less extreme, is to make a direct mailshot look exactly like an ordinary business letter. This at least ensures that the letter will be opened as the receiver will hope that there will be an important business communication inside or, better still, a cheque. As a general rule, deceit can be rejected as a way of getting envelopes opened. It is true that both these methods will succeed in a narrow sense, but they will fail to assist in getting the recipient to act on what they find inside the envelope once they have opened it. They will realise that they have been tricked – the so-called "Betrayal Factor" – and because they have been, they are unlikely to respond in a positive way. Similar issues arise with the question of giving emails a 'clever' title in the hope that this means that they will be opened rather than deleted.

The second approach to addressing Gatekeeping problems is much to be preferred. This consists of putting a message on the outside of the envelope saying to the recipient that there is a very good reason for them to open it and, if they do, they will be pleased with the offer contained inside. Preparing such a message should be easy. After all, if there is nothing inside the envelope which will make someone pleased they have opened it, why is it being sent in the first place?

Media Relations

It is impossible to over-estimate the importance of a sound approach to Media Relations in airline marketing communication. Air transport is regarded as immensely newsworthy by editors of newspapers, magazines and television and radio programmes. Because of this, an airline which fails to cultivate strong Media Relations can suffer a great deal of bad publicity when things go wrong. One which does will not only head off this kind of trouble. It will also be well-placed to obtain favourable coverage when positive things happen such as new route introductions or product and brand re-launches.

Sound media relationships require in turn a systematic approach to achieve them. Every effort must be made to foster the goodwill of journalists through trade entertainment and the offer of free travel on the airline's network. At the same time, helpful background information must be produced. This will include well-written press material, containing quotes from the airline's most senior management.

Poor Media Relations will result from any attempt to treat journalists with contempt − a sometimes-understandable emotion which must be firmly resisted. Cover-ups should also be avoided. If, for example, an airline has an emergency landing of one of its aircraft, nothing will be achieved by denying that such an incident has occurred. Instead, emphasis should be placed on the skill with which the airline's staff handled the situation, and the fact that the carrier has been able to maintain its strong safety record.

The Field Sales Team

Of all aspects of airline selling and sales planning, none generates greater controversy than

the question of the management of the airline field sales team. Disagreements occur over the role that field sales executives should play and the recruitment and motivation policies which should be employed. The purpose of this section is to address these issues.

The Role Until relatively recently, the role of an airline field sales executive was a straightforward one. The fact that competition in the industry was highly regulated meant that the pace of change was slow. Regulation also meant that all airlines charged the same fares. There was therefore no need for sales executives to seek out customers and negotiate deals with them.

Instead, the job was essentially a flag-waving one, with a heavy emphasis on trade entertainment and hospitality and – in many markets – on the consumption of large quantities of alcohol.

Today, the situation could not be more different. As deregulation has come about, so the pace of change in the industry has accelerated. In turn, sales executives now have to accept the challenge of keeping their knowledge up-to-date in a rapidly-changing marketplace. They also have to collect – and communicate to those who need to know – market intelligence data about the activities of competitors. Crucially, they have to negotiate deals with the business houses and travel agencies for which they are responsible. As was discussed in Section 2:2:4, the nature of marketing to the business air traveller has changed fundamentally over the last ten years. Instead of the 'Customer' being business travellers themselves, increasingly firms have sought to use their bargaining power to negotiate deals with airlines whereby discounts were demanded in return for loyalty.

Negotiation of these deals is today a normal part of the work of the airline field sales executive. Likewise, today travel agents remain important customers of airlines. Because of the urgent need for cost control, many airlines are requiring their field sales executives to retain the support of agents whilst ensuring that commissions are reduced or eliminated. The field sales executive will be expected to negotiate deals with them, and to monitor their performance, in the most difficult of circumstances.

Besides important market intelligence and sales negotiation roles, the airline field sales executive is today expected to carry out an important customer relations role. One of the challenges of their job is that they are not selling a tangible product. Rather, they have to sell a long-term relationship with a relatively small number of demanding clients. They can only do so if they work hard to support their clients in the jobs that they in turn have to do. Today, the supply of information is not usually the problem, in that modern Global Distribution Systems such as Galileo, SABRE and Amadeus make available almost limitless quantities of information about schedules and fares as do airline websites and the sites of on-line travel agents and search engines. Rather, the challenge is to use this information in a creative and imaginative way to build sales, and the sales executive must be prepared to work with their travel agency accounts in particular to ensure that this is done.

Recruitment Criteria

It is clear from the above that the airline sales executive is now required to do a professional selling job. The question of recruiting the right person is a crucial one which all airline sales managers will have to address from time-to-time.

There are, of course, a number of basic requirements. The person selected must be articulate and persuasive, something which can be tested at an interview. A person who cannot

convince an interviewing panel that the firm should take them on is unlikely to be able to persuade a travel agency to increase its sale of the airline's tickets. They should also be of a clean and tidy appearance, as scruffiness will be taken by clients as a sign of a cheapskate company. A current clean driving licence will also be needed.

A much more contentious question is the previous experience that should be required. Carriers have a number of possible recruitment sources for their field sales executives. They can aim to hire people with a proven selling track record, even it this has been obtained from outside the aviation industry. They can simply approach experienced airline sales executives who are currently working for other airlines. They can recruit from the travel agency industry or from those who work in corporate travel departments. Lastly, they can transfer people who already work for them, but in non-sales jobs.

Hiring people from other industries is an especially interesting option. It can certainly be argued that true salespeople are born and not made, and that the great sales success stories have often been achieved by insecure people who are driven to sell as they seek reassurance that they are likeable. In that sense, someone who has a proven selling track record is saying a great deal about themselves, despite their lack of airline industry experience. Even here, it can certainly be argued that, generally, airlines are likely to be better at training people in airline industry familiarization rather than in the skills of selling.

Despite this, the issue is not a clear-cut one. The problem is that, for reasons which will be discussed in the next section, airlines do not generally reward their sales people on a basic-plus-commission principle.

Instead, a reasonable salary is paid, together with perhaps a relatively small bonus if the annual target is reached. This therefore begs the question as to why someone who has achieved success in commission-based selling should want to come and work for an airline, where they certainly will not starve but neither will they have an opportunity to achieve very high earnings. The answer often is that they are burnt out and are looking for an easier life with a steady monthly salary. If they are, they should be rejected out-of-hand.

Hiring – or rather, poaching – fully trained and experienced sales executives from other airlines might seem in many ways to be the ideal solution. These people will have industry knowledge and – hopefully – proven selling skills. They will also have established industry contacts and perhaps will bring some useful inside information about a competitor.

In many situations, airline will have little choice but to use this recruitment source as they will not have the training budget available to spend on appropriate staff development. This will be especially the case for small airlines, or at the minor stations of larger carriers. The dangers of poaching, should, though, be emphasised. Someone who brings market intelligence with them may be disloyal enough to move in a year or two's time, giving away in turn the trade secrets of the airline they have joined.

Also, people who move from one airline to another in quick succession begin to lack credibility with their trade contacts, especially if the different carriers they work for are also competitors.

The travel agency industry may give some attractive recruitment opportunities. People with work experience as travel agents should have a good understanding of the travel business. They will also have seen airline sales executives at work, and will know of examples of the job being done badly.

With a final possible recruitment source, the airline's own staff should be looked at seriously.

There will almost certainly be people who are doing other customer contact jobs who have the qualities which will be needed to do well as a field sales executive. They will already have a knowledge of the airline, and can be expected to bring a greater degree of loyalty and commitment compared with those brought in from outside.
The ideal age for an airline sales executive is a final, interesting recruitment issue. The person hired has the difficult task of ensuring that they get on well with the young people who generally make up the clerks who work in travel agencies, whilst at the same time being able to present themselves as credible company negotiators with senior management both in travel agents and business houses. Because of the negotiation role, there is probably a minimum age of early to middle twenties – few people will warm to the idea of being asked to complete a deal with a child. At the same time, an older person applying for a job as a junior sales executive should be viewed carefully. They may have many qualities which will make them exactly right for the job, but one's concern would be that they lack ambition and are simply looking for an easy ride towards a well-deserved retirement.

Motivation of Airline Field Sales Executives

This is a very difficult question. In many industries money is used as the prime motivator for a sales team. Members of the team are paid a small retainer, and then a substantial commission on everything they sell.
Generally, airlines have found a basic-plus-commission reward structure difficult to devise and implement. Airline salespeople are not selling a specific product to a clearly identifiable customer in the way that, say, someone selling double-glazing is. Rather their task is to build a long-term relationship with a group of clients, and, in the case of relationships with travel agents, to encourage the agent to sell rather than doing the selling themselves. Also, there are complications in deciding who has been responsible for a sale being achieved. A common situation is for a business house to use a travel agent, but for different members of the airline sales team to be responsible for the relationship with the business house and the travel agent. If this is the case, both will claim any commission that might be available. The person responsible of the business house will argue that they have done all the persuading, with the travel agent being simply presented with a fait accompli with regard to choice-of-airline decisions.
The person calling on the travel agent is unlikely to see things in the same way.
The difficulties associated with commission-based reward structures mean that few airlines are able to use them. Instead, salespeople are generally paid a reasonable salary, with a relatively small bonus on offer if they reach their annual sales target. In turn, because of this, a wide rangeo f policies will be necessary to ensure the a high level of motivation in the members of the sales team, because the cutting-edge that commissions might provide will not be available to the sales manager.
Of these motivation methods, the annual salary on offer will be an obvious starting point. Here, it is important that the salary should be comparable to that paid to salespeople working for rival airlines. It is very de-motivating to realise that others are being paid more for doing exactly the same job. The annual bonus should also be a worthwhile one, with the salesperson involved in the setting of the targets which must be achieved in order to earn it.
Training will be an important part of the motivation process. The point was made in the last section that airline salespeople are now expected to take on a challenging, professional selling

role. They cannot do so successfully unless they are equipped with the necessary knowledge and skills. Training must therefore encompass both product knowledge and selling skills, and it must be on a continuous basis given the pace of change which is now characteristic of the industry.

Career progression and advancement will also be an important factor in maintaining the interest and commitment of the most capable people.

Providing a clear way ahead may be difficult or impossible for a small airline, or at an outstation of a major carrier. In other situations though, members of the team must feel that if they perform well the necessary training and development policies are in place to allow them to advance to sales management positions.

Questions of expenses and corporate hospitality are often a festering sore in many sales teams. What is important is that salespeople should be able to give their clients a comparable level of hospitality to that on offer from their competitors. It is de-motivating if only the basics can be given when rivals can offer generous treatment.

A very important general heading with sales force motivation is that of the tools to do the job. If a firm has high expectations, it should be prepared equally to invest heavily in resources. For airline salespeople, these resources will include a modern, reliable car and a management information system which allows them to be fully up-to-date both with what is going on within the airline and what business is being obtained from the accounts for which they are responsible. A final requirement is for there to be an adequate level of office back-up and support, with meeting rooms available when necessary.

The last, but perhaps the most contentious question in a motivation policy is the part to be played by fear. It is most certainly true that an element of fear must always be present. If the members of a sales team know that however poorly they perform and however lazy they are they will always have a job, it will be almost certainly impossible to obtain high levels of performance from them. At the same time, though, the role of fear should not be overdone, and it should not be seen as a substitute for other motivational methods. It may from time-to-time be necessary to fire people for laziness or dishonesty, but dismissing people for incompetence raises questions about who is incompetent and who therefore should be fired. A person who is dismissed because they cannot do the job may have been wrong for that job in the first place. In that case they should not have been hired and the incompetent person is the one who did the hiring. A second, still worse possibility is that they did have the potential to make a success of the difficult job of being an airline sales executive, but the manager responsible for them could not provide an environment in which they could give of their best. The necessary skills and qualities are relatively rare, and for an airline to lose someone with potential in these circumstances should be seen as a case of criminal negligence. It is their manager, and not them, who should be fired.

Airline Advertising

Advertising is, of course, no more than another marketing communication method available to airlines. It is, though, so important, and so controversial, that it needs a special section of its own. The purpose of this part of the book is to look at what advertising can and cannot do for airlines, and to discuss the decisions which have to be made in preparing and implementing an advertising policy.

The Functions of Advertising

No advertising campaign will be successful unless clear objectives are set for it, and the performance of the campaign monitored against these objectives. In turn, it is necessary to decide what advertising can and cannot do, so that any objectives which are set are achievable ones.

Clearly, advertising can be expected to promote corporate image and corporate brand values. It will also play a role in building sub-brands such as those which airlines have built around cabin classes or service concepts.

With shorter-term objectives, advertising can be used to provide tactical information about service changes such as the introduction of a new route or a new type of aircraft. It can also sell special offers such as those associated with discount fares or bonus Frequent Flyer miles.

More controversially, airlines may see advertising as a way of influencing policy-makers and opinion formers so that their policy objectives are achieved. No carrier can operate independently of the political process. They may rely on this process for favourable treatment with regard, for example, to the award of international route rights.

Increasingly, too, they have to lobby over environmental questions of noise and pollution in order to ensure that limitations on their freedom-of -action are kept to a minimum. Advertising may be able to play a subtle but useful role in positioning an airline as a good corporate citizen. A final function of advertising which some would claim and many dispute is that advertising can help in a staff motivation policy. Motivating customer contact staff to give outstanding service is a notoriously difficult task, especially in large mature airlines. The fact that staff members see their airline advertising in newspapers or on the television may help them to feel part of a team. If in these advertisements they see role models providing warm and friendly service to customers, this may in turn subtly affect their behaviour when dealing with customers in real life.

Unfortunately, this theory only works in situations where motivation is already high and service standards already good. Where morale is poor, using advertising as a form of brainwashing will only make matters worse, with the added problem that the airline's customers will see claims being made in the advertising which their experience of the product will not match. This will add significantly to their anger and disenchantment.

Advertising Decisions

Setting the Brief

All good advertising campaigns start with a clear decision about what the campaign should achieve. This in turn can only be decided in the context of an overall marketing communications policy, with a proper integration of any advertising which is undertaken with other forms of communication such as sponsorships or Database Marketing.

The brief itself should be as detailed as possible, and should include a statement of the objectives that a campaign should meet and the criteria which will be employed to decide whether it has succeeded or failed. It is also important that the brief should be agreed and signed by the airline's most senior management at the earliest possible stage. It is a peculiar, but vitally important feature of advertising that everyone regards themselves as an expert about it, especially CEO's. In practice, no campaign will be implemented without the Chief Executive's approval, and it is always a costly disappointment if a great deal of work is done, only for the resulting advertising to be vetoed shortly before it is launched. Such occurrences

can never be prevented entirely, but their frequency can be minimised by ensuring that the Chief Executive at least agrees with the brief before work begins.

Agency Selection

Choosing an advertising agency is a very important decision, where mistakes will prove very costly.

As a first point, advertising should be recognised as a professional discipline where outside help from a specialist agency will be needed. Some low fares airlines have in recent years attempted to produce their own advertising as a cost-saving measure, but the results have generally looked very amateurish. Also, even for cost-saving, the policy is of doubtful value, because agencies will be paid commission by the media where they buy advertising, whereas firms booking their advertising space themselves generally will not be.

Once it has been decided that an agency will be appointed, the question arises as to which one to choose. The good news here is that in the advertising industry, airline accounts are perceived as very attractive ones.

Besides being seen as fun to work on, they give an agency a great deal of prestige. Therefore, when it becomes known that an airline is seeking to appoint an agency, or to replace one they already have, there will be no shortage of firms willing to pitch for the account.

For many international airlines, a crucial question will be whether or not the agency can give a true global coverage. It is important that, in particular, brand-building advertising should be consistent across all markets. It may therefore be better to choose an agency with a large number of offices in different countries. This will, though, restrict choice to the comparatively small number of agencies which can credibly claim a global presence. If a smaller agency is selected, then it will have to be one which has well-established links with other agencies located in the overseas markets which the airline serves.

When choosing an agency, an overwhelming emphasis should be placed on its record of being able to produce original, imaginative and exciting work. Still, far too much airline advertising is hackneyed and stereotyped. It consists of pictures of blissfully happy passengers being served wonderful food by beautiful girls. If an agency's initial proposals include any variations around this tired theme, they should be shown the door with the utmost speed.

Once those agencies with the necessary creative skills have been isolated, other issues may come into play. There may be an attraction is the idea of appointing an agency which can supply a wide variety of services under one roof. These may include a media planning and media buying unit – most agencies would expect to provide this service. It may also be helpful if the agency can provide direct mail and sales promotion expertise and – increasingly important today – a unit able to deal with issues associated the airline's Internet presence.

Today, the fashion is rather away from this 'one-stop-shop' principle. An agency may be strong on one area and weak in others, and it may be better for clients to put together their own group of experts by calling in people from smaller, specialist agencies. This will, though, impose a major management task as the proper integration of the different forms of marketing communication will be a vital requirement. It would be a serious mistake if, for example, the firm's advertising was putting out different messages compared with its direct mail material.

One final point is that the appointment of an advertising agency should be seen as a strategic, long-term decision. Some firms may feel that it is a smart move to change their agency very frequently, because this keeps their current agency on its toes and also allows them to benefit

from a flow of new ideas every time a new agency is appointed. This view is a mistake.
Besides being very costly − substantial fees will be charged by each new agency to finance their initial work on the account – frequent changes of agency are unlikely to result in consistent and successful advertising. It will take time for the agency to fully understand their client's business and for the necessary personal relationships to be established. Also, as we saw in Section 8:2:1, the essence of brand-building is that the brand values which should underlie a firm's advertising must remain consistent on a long-term basis. Whilst a determined client might ensure such consistency when working with a succession of agencies, achieving it will be much easier if agreement can be reached with one agency at an early stage as to what these brand values are, with the same agency charged with communicating them over a long period of time.

Media Buying

Once an agency has been selected, there are then a large number of decisions which will be made using the agency's professional advice. It is important, though, that the airline should maintain an independence of thought, otherwise it risks merely becoming a slave to the agency's whims.
Media buying choices will decide where the airline's advertising will be seen, by whom, at what cost, and in what form advertising messages can be communicated. In making them, it will always be necessary to decide first on how best to spend the available budget. No airline will have the money to spend limitless amounts on advertising. Also, for carriers away from their home base, they will always be wrestling with the problem that locally-based airlines will be able to outspend them, often by a factor of several times. Their task will therefore be to make an impact against a competitor with far greater resources – always advertising's most difficult challenge.
In attempting to achieve this impact there are two possible approaches. Firstly, advertising expenditure may be spread evenly throughout the year. This ought to ensure that the airline will not be forgotten, but the difficulty will be in making a worthwhile impact. Secondly, advertising may be put out in short, concentrated bursts in the hope that, if it is memorable enough, this will carry the airline through the times when, because of budget limitations, it is doing no advertising at all. Of these two possibilities, the second is to be very much preferred. In today's world, it is hard enough to get noticed, given the proliferation of different advertising media and the way in which people are becoming increasingly bombarded with advertising messages. Making a strong investment, even if it has to be over a short time, is the best way of ensuring that you are.
Media buying choices will, of course, be decided by the objectives of a campaign, in terms of both its target audience and whether or not the campaign has a strategic or merely a tactical objective. To reach the business air traveller, there are now a well-established number of possible media choices. These will include business-orientated newspapers such as the Wall Street Journal and the Financial Times, and news magazines such as Newsweek and The Economist. In terms of television advertising, then commercial breaks in the main evening news programmes and some sporting events may bring a suitable audience profile.
With leisure air travel, weekend newspapers will prove useful, as will specialist magazines such as those aimed at enthusiasts for particular sports. The Internet, too, provides an increasingly exciting medium as it allows a destination to be sold in an attractive and

interesting way, alongside messages about the best way to reach the destination in terms of a choice of airline decision.

With questions of strategic campaigns, a long-term brand-building objective may well justify investment in the time and money to make TV commercials. These allow messages to be put across using sound and pictures in a way which print media cannot match. There may well, though, be a gap of months between an ad. being planned and it being ready to launch. This is often too long in the rapidly-changing world of today's deregulated aviation market. Newspaper advertisements, on the other hand, should be quick to produce and also usually can be placed at short notice with little or no advanced booking of space being required. They are often the most effective way of communicating messages about, say, a seat sale in a market which suddenly and unexpectedly turns down.

The cost of the different media will obviously be a crucial question when deciding between them. Here, it is important not to be misled by the up-front, invoiced costs. Rather, a Cost-per-Thousand (CPT) measure should be used. Thus, for example, the media buying costs of television advertising can appear very high. If, though, this expenditure allows a large audience to be reached in the right way at the right time, it can represent good value-for-money.

Creative Strategies

Successful creative strategies are, of course, at the heart of all worthwhile advertising. One is often tempted by a rule which states "There is only one rule – there are no rules". There are certainly examples of airline campaigns which seem to fly in the face of all logic yet appear to have been very successful, and others which looked soundly-based at the outset which have proved to be disastrous. Such a conclusion, though, is not helpful.

There have to be some basic guidelines, even if it will always be possible to quote exceptions to them.

For a start, all campaigns where the budget is sufficient should be research-based. Common sense, intuition and past experience are all important aspects in the evaluation of an agency's creative proposals. They cannot, though, always prevent mistakes being made. Advertising proposals should be researched through well-structured market studies using representative members of the campaign's target audience. Continuing research will also be needed as a campaign runs, research which should be related to its objectives and to measurement of the extent to which these objectives are being achieved.

Secondly, airlines should invest in decent quality-of-production of all their advertising, even if this means that within a given budget, less money will be available for media buying. All airlines have to base their appeal on the fundamental proposition that they are safe, whilst many are attempting to build brands which position them as quality up-market producers.

Cheapskate advertising will soon be associated in passenger's minds with a poor quality company. If there isn't the money available for reasonable production quality, it is better to do nothing.

As a further proposition, all airline advertising should be fundamentally honest. "If you cannot say it honestly, shut up and talk about something you can say honestly" is a sound dictum. Passengers – particularly regular business travellers – are not misled or fooled by

false claims in airline advertising. Rather, they are angered and alienated by them. Besides the problems the offending airline may run into with the bodies that regulate advertising content, it will also increase many times over the anger of those caught up in its service failings. People take a long time to forgive a firm if they feel that they have been tricked into buying its product through deceit.

In deciding on the creative content of their advertising, airlines and their advertising agencies are usually faced with a difficult dilemma.

Should they aim to include many arguments in an ad. as to why the airline should be chosen, or should they merely try to say one thing in a persuasive and convincing way?

The proposition in favour of including many arguments is, at first sight, easy to make. If an ad. succeeds in capturing somebody's attention, a prime selling opportunity is being lost unless a substantial number of arguments are put forward to persuade them to buy. The risk is, though, that no message is communicated effectively, in the enthusiasm to put across a great many. A better approach is to try to say one thing, using individual arguments to support a single proposition in a memorable way.

If this is done well (in the case of, say, a television commercial), only a relatively short one will be needed. Further commercials can then be made within a given budget, to make up an overall campaign in which all the required messages can be communicated.

The balance between long-term, corporate brand-building advertising and short-term tactical campaigns poses a significant, and increasing dilemma, in the airline industry. Deregulation, where it has occurred, has lead to instability, where tactical messages have often been needed to communicate changes in prices or product to customers. At the same time, airline sales managers have come under increasing pressure to achieve their end-of-year sales targets and they often worry that they will be fired if they fail to do so. They will always therefore be lobbying that a high proportion of advertising spend should be directed towards the tactical campaigns that they hope will help them. It is a great mistake, though, to merely consider tactical questions when setting advertising objectives. Section 8:2:2 looked at the importance of brands and showed how quickly a brand can die unless constant attention is given to maintaining and strengthening it. A significant amount of advertising expenditure must therefore be directed at the brand, and great care must be taken to ensure that frequent tactical messages − which are inevitable today – do not undermine fundamental brand values.

A final question with creative strategies is the difficult one of the balance between local and global advertising approaches. Perhaps more than in any other industry, airline brands need to be global, and it will be a problem if people travel around the world and see the airline they are flying with putting forward totally contradictory messages in different markets.

This might lead to a conclusion that all advertising should be controlled centrally, with creative work carried out by one agency in the airline's home country. This will also allow the advertising production budget to be spent in a concentrated way, with, in particular, quality work being done on expensive television commercials. The problem is, of course, that there are substantial market-by-market and culture-by-culture differences in what is acceptable and persuasive and what is not.

In a difficult area, the best approach is probably to appoint a lead agency, with overall responsibility for brand positioning and brand values in the airline's most important home-base market, and to in turn appoint sub-agencies in the airline's overseas markets. These agencies should then be given clear, but limited opportunities to adapt or change centrally

produced material in order to make it suitable for local markets.

Monitoring Success/Advertising Life Cycles

It is essential that thorough procedures are in place to decide whether or not an advertising campaign is meeting its objectives. No matter how well initial research is done, disasters do occur, and without a formal monitoring process, the fact that a campaign is failing may not be picked up. Even successful campaigns, though, eventually run out-of-steam because of Product Life Cycle effects. They then need to be replaced with new approaches. Deciding on the moment to do this will be difficult. Those with the task of doing so need to be helped by having available quantitative data from a monitoring programme.

The monitoring methods which should be used will vary with a campaign's objectives. The easiest case will be with advertising designed to make people respond to an offer. For example, an advertisement may offer a 'golden hello' of free miles in the airline's Frequent Flyer Programme for those applying to join the programme before a deadline date. If it also contains a cut-out coupon or special Freephone number, it will be possible to precisely measure the response, or the lack of it.

Other advertising will have a longer-term, more strategic objective.

The airline may, for example, have gone through a difficult period with failing product standards. Its advertising might then be designed to persuade people that things are now improving and that the time has come to try the airline once again. If it is, a significant boost to bookings once the campaign has begun would be taken as an encouraging sign. Also, it might be possible to test people's attitude towards the airline by talking with members of its sales team who regularly meet travel agents and corporate customers.

For advertising with a brand-building objective, precise measurement of the results is notoriously difficult. It will be necessary to invest in initial market research designed to define levels of awareness of potential customers and the attitudes they adopt towards the airline. As the campaign is implemented and develops, more will have to be invested to repeat this research, and also to ask people if they remember seeing the airline's advertising and, if they do, what they recall about it. Successful campaigns will show a growing awareness, a positive move in attitudes and a high level of recall of the content of the advertising.

What are the Features of 'Good' Airline Advertising?

Of course, good research data will be particularly valuable in deciding whether advertising is working or whether it isn't. There will be many occasions, though, when such data is simply not available. This will especially be the case when Area Sales Managers have to decide whether or not centrally-produced advertising will be valuable in the market areas for which they are responsible. In such situations, a checklist will at least result in the right questions being asked prior to a decision being made.

The basis of such a checklist will be a judgement as to whether or not the ad. is likely to attract and hold attention. If it will, it must also be professionally produced, with no accusations being possible that it is a cheapskate effort. It must certainly be credible, as damage will result if it is not. It must also be persuasive, showing an understanding of the customer's True Needs, and demonstrating the ways in which the airline can meet these needs. The degree to which the ad. is likely to persuade will be increased if it can demonstrate that the airline can credibly offer a Unique Selling Proposition to the customer. (For example,

"First Flight of the Day" or "Only Airline Flying the A380"). Finally, it will be necessary to study the ad. very carefully to make sure that it is compatible with the airline's long term development of its brand values.

Selling in the Air Freight Market

With air freight consistently growing faster than the passenger side of the business, the question of effective marketing communication with its freight customers is one of growing important to many airlines. Some of the issues are the same as on the passenger side and some are unique to air freight.

The Sales Task in the Air Freight Market

One of the major differences between air freight and air passenger marketing is the degree of existing market penetration. It is true that on the passenger side, airlines face competition on short-haul routes from buses, private cars and especially from rail services. On medium and long-haul routes, though, their penetration is almost total. Virtually everyone who travels now flies, with surface transport restricted to the specialist market for cruising (even here, airlines often benefit by flying people to their port of embarkation).

With freight, things could not be more different. Surface transport provides formidable competition on all routes, either in the form of trucking and roll-on/roll-off ferries (in short-haul markets) or deep-sea container services on long-haul routes. This competition is especially difficult for airlines to deal with because it is almost always based on the proposition of cheaper freight rates than those which are available from air transport.

Given this competitive scene, the most straightforward selling task is that based on the need to secure a high share of the existing air freight market. Here, airlines mainly aim their efforts at the air freight forwarding industry. Still, a very high proportion of this traditional market (over 90% in many cases) passes through the hands of freight forwarders. Also, because much of the traffic consists of smaller consignments which are consolidated into larger consignments by forwarders, they, rather than the shippers who provide the original shipments, have the dominant role in deciding which airlines will be used. Marketing efforts, therefore, need to be concentrated on the senior management teams of large forwarding firms in pursuit of long-term relationships and also on the clerks in these firms who are responsible for routing and carrier-choice decisions for individual consignments.

A much more difficult, but more exciting, opportunity comes with the task of converting existing surface transport traffic flows into air freight.

Air freight's market penetration when calculated on a weight basis is still very low. On most routes, still only 2 or 3% of the goods that move do so by air. The remaining traffic is transported by much cheaper surface modes. This is not to suggest, of course, that all such traffic is potentially available to airlines – much of it is too low in value for air freight to make any sense. It is still true, though, that if air freight could double its market penetration from 2% to 4%, this would in turn double the size of the air freight market.

In carrying out this market development work, those airlines that attempt it have to use a fundamentally different approach. These is little point in approaching the forwarding industry. Most major forwarding firms have a substantial presence in both air and surface traffic.

Therefore, they are unlikely to see a worthwhile incentive to convert surface traffic into air freight, as this will often merely be moving traffic from one part of their business to another. Instead, approaches have to be made to the firms which are the originators of the traffic. These approaches have to be at a high level of management. The task of making the case for air freight is a challenging one. It involves arguing that there are tradeoffs to be made between the higher transport costs (brought about by the fact that air freight's rates are generally more expensive), and the savings that can be made in packaging, insurance, stockholding and warehousing costs. These tradeoffs can generally be made only by senior managers with a wide span of responsibility over all the relevant areas.

There is one final area of air freight marketing which is potentially the most interesting of all, because air freight gives opportunities for firms to do things which they simply cannot do if they employ slower surface transport. This is the most obvious in the case of perishable goods, which, if surface modes are used, can only be sold in local markets. These in turn will often be saturated with the product in question, with only low prices therefore on offer. Use of air freight allows them to be flown to much more distant markets where prices will be much higher and profits potentially greater.

Even for non-perishable goods, air freight may give firms the chance to open new markets. Use of air freight allows firms to begin to sell in overseas markets with the minimum of delay once they have made a decision to enter. They can do so without a large and inflexible investment in overseas warehouses. This is because the speed of air freight allows stock to be held in a single centralised warehouse and then to be shipped to customers once orders have been placed. In a very true sense, air freight allows marketing to be carried out on a global basis.

Because of the new opportunities which it gives, the most promising kind of air freight marketing consists of generating entirely new traffic flows by persuading firms to take advantage of them. This approach is in principle an especially appealing one because the resulting traffic will not be vulnerable to poaching by surface transport operators. It will, though, place high demands on an airline's field sales team, because it will require them to perform a consulting role with a firm's senior managers.

Marketing Communication Methods

For all the different tasks in the air freight market, personal selling by a team of freight sales executives is generally very important, and more so than is the case in the passenger business. This is especially the case for the many airlines which restrict their ambition to competing for their share of the existing air freight market. To do so, they will need a sales team which calls regularly on the major forwarding firms, both at their head offices and at regional branch offices.

They will need in turn to offer generous corporate hospitality, as well as opportunities for key decision-makers to travel on overseas familiarization trips. With advertising and promotion, most airlines see a role for some advertising, usually placed in the trade magazines which circulate amongst the forwarding community. This advertising usually merely describes the benefits of using one airline rather than another, with a dull and repetitious emphasis on the

quality of ground handling.
For the more challenging tasks of converting surface traffic into air freight and of building entirely new flows of air freight business, a personal selling approach will again be needed. It will, though, be of a very different kind. Airline salespeople will have to aim to make contact with high level managers, and be prepared to run a sales campaign which may take months or years to bring to fruition. During this time, they will have to carry out extensive studies to prove that airfreight can be a cost-effective way forward. Such studies will need to be backed up by advertising messages, with these placed in locations such as the Financial Times and Wall Street Journal which are read by senior management.

Successful Airlines ……

- Acknowledge that selling and sales management makes up a crucial, final stage in the marketing process.
- Define and distribute a sales budget using a Task-based method, rather than simplistic arguments based on a percentage of revenue philosophy.
- Make analytical decisions about a Communications Mix, so that the different methods of marketing communication are combined together in an optimum way.
- Spend money on each communication technique in a rigorously planned and strategic way.

ROLE OF SOCIAL MEDIA IN MARKETING

Social media is hot. Social Media is now the trend. And for businesses it represents a marketing opportunity that transcends the traditional middleman and connects companies directly with customers. This is why nearly every business on the planet—from giants like Starbucks and IBM to the local ice cream shop—are e xploring social media marketing initiatives. A year ago, businesses were uncertain about social media. Now it's here to stay and companies are rapidly adopting social media marketing. Much like email and websites first empowered businesses, social media is the next marketing wave.

Social media marketing is marketing using online communities, social networks, blog marketing and more. It's the latest "buzz" in marketing. India is probably among the first proponents of social media marketing. These days, the organizational cause has replaced the social cause as companies seek to engage with their audience via the online platforms.

The explosion of social media phenomenon is as mind boggling as that and the pace at which it is growing is maddening. Trust and goodwill are the basis of social networking, and by marketing in the realm of social media these fundamental notions need to be adhered. It is probably the only marketing platform that encourages fool proof communication and accountability among sellers as well as consumers. Global companies have recognized Social Media Marketing as a potential marketing platform, utilized them with innovations to power their advertising campaign with social media marketing.

Social media is engaging with consumers online. According to Wikipedia, social media is internet-based tools for sharing and discussing information among human beings. Social

media is all about networking and networking in a way that espouses trust among parties and communities involved. Any website which allows user to share their content, opinions, views and encourages interaction and community building can be classified as a social media. Some popular social media sites are: Facebook, YouTube, Twitter, Digg, MySpace, StumbleUpon, Delicious, Scribd, Flickr etc.

The meaning of the term 'social media' can be derived from two words which constitute it. Media generally refers to advertising and the communication of ideas or information through publications/channels. Social implies the interaction of individuals within a group or community.

Taken together, social media simply refers to communication/publication platforms which are generated and sustained by the interpersonal interaction of individuals through the specific medium or tool. Wikipedia has a general definition of the term: Social Media is the democratization of information, transforming people from content readers into content publishers. It is the shift from a broadcast mechanism to a many-to-many model, rooted in conversations between authors, people, and peers.
Social media uses the "wisdom of crowds" to connect information in a collaborative manner. Social media can take many different forms, including Internet forums, message boards, weblogs, wikis, podcasts, pictures, and video.
Social media is made up of user-driven websites that are usually centered on a specific focus (Digg = news) or feature (del.icio.us = bookmarking). Sometimes, the community itself is the main attraction (Facebook and Myspace = networking)

Social media are media for social interaction, using highly accessible and scalable publishing techniques. Social media uses web-based technologies to turn communication into interactive dialogues. Andreas Kaplan and Michael Haenlein define social media as "a group of Internet-based applications that build on the ideological and technological foundations of Web 2.0, which allows the creation and exchange of user-generated content."
Social media is the medium to socialize. They use web-based technology to quickly disseminate knowledge and information to a huge number of users. They allow creation and exchange of user-generated content. Facebook, Twitter, Hi5, Orkut and other social networking sites are collectively referred social media.
Social media represents low-cost tools that are used to combine technology and social interaction with the use of words. These tools are typically internet or mobile based like Twitter, Facebook, MySpace and YouTube.
There are two benefits of social media that are important to businesses, they include:

1. Cost reduction by decreasing staff time.
2. Increase of probability of revenue generation.

Social media enables companies to:

- Share their expertise and knowledge.
- Tap into the wisdom of their consumers.
- Enables customers helping customers.
- Engages prospects through customer evangelism.

Thus the benefits of social media include: brand reach and awareness, consumer interactions through transactions, referrals and reputation management.

Social media marketing:

Social media marketing consists of the attempt to use social media to persuade consumers that one's company, products and/or services are worthwhile. Social media marketing is marketing using online communities, social networks, blog marketing and more.

Lazer and Kelly's (1973) define social marketing as "concerned with the application of marketing knowledge, concepts, and techniques to enhance social as well as economic ends. It is also concerned with the analysis of the social consequences of marketing policies, decisions and activities."

Social media marketing is not merely about hitting the frontpage of Digg or any other social news website. It is a strategic and methodical process to establish the company's influence, reputation and brand within communities of potential customers, readers or supporters.

Growth of social media marketing:

A recent study, "The State of Small Business Report," sponsored by Network Solutions, LLC and the University of Maryland's Robert H. Smith School of Business, points to economic struggles as the catalyst for social media's rapid popularity. The study results show that social media usage by small business owners increased from 12% to 24% in just the last year, and almost 1 out of 5, actively uses social media as part of his or her marketing strategy. In 2009, only 23% of marketers were using social media for years. Now that number has grown to 31%.

Here's a breakdown of what the small businesses reported as the main uses of social media marketing:

- 75% have a company page on a social networking site.
- 69% post status updates or articles of interest on social media sites. 57% build a network through a site such as LinkedIn.
- 54% monitor feedback about the business. 39% maintain a blog.
- 26% tweet about areas of expertise. 16% use Twitter as a service channel.

According to the study, different industries are adopting social media marketing at different rates, and while many industries have started using social media marketing in their efforts to reach more customers, many still have not positioned it as their top priority.

A research shows that charitable organizations are still outpacing the business world and academia in their use of social media. In a study conducted in 2008, a remarkable eighty-nine percent of charitable organizations are using some form of social media including blogs, podcasts, message boards, social networking, video blogging and wikis. A majority (57%) of the organizations are blogging. Forty-five percent of those studied report social media is very important to their fundraising strategy. While these organizations are best known for their non-profit status and their fundraising campaigns, they demonstrate an acute, and still growing, awareness of the importance of Web 2.0 strategies in meeting their objectives.

In just the last few months, marketers have shifted their attitudes toward social media marketing spending. This was recently affirmed in the new study, "The CMO Survey", from

Duke University's Fuqua School of Business and the American Marketing Association. A key finding: Social media marketing budgets continue to rise. According to the results, businesses currently allocate 6% of their marketing budgets to social media, an allotment they expect to increase to 10% during the next year and 18% over the next 5 years.
Back in August 2009, marketers had already planned on devoting more money to social media. However, in February 2010, marketers reported that they plan to allocate one-fifth of their marketing budgets to social media marketing in the next 5 years. This is a definite increase from the 2009 projections. The study features the following comparison from August 2009 to February 2010:

Current marketing budget spending on social media:

- August 2009: 3.5%
- February 2010: 5.6%

Marketing budget spending on social media in the next 12 months:

- August 2009: 6.1%
- February 2010: 9.9%

Marketing budget spending on social media in the next 5 years:

- August 2009: 13.7%
- February 2010: 17.7%

It can be understood that even though many are still experimenting and learning how best to use social media tools, these results indicate that marketers think social media marketing is here to stay and will play an increasingly important role in their work in acquiring and retaining customers in the future.

Benefits of social media marketing:

Significantly different from conventional marketing strategies, Social Media Marketing (SMM) offers three distinct advantages. One, it provides a window to marketers to not only present products / services to customers but also to listen to customers' grievances and suggestions. Two, it makes it easy for marketers to identify various peer groups or influencers among various groups, who in turn can become brand evangelist and help in organic growth of a brand. And, three, all this is done at nearly zero cost (as compared to conventional customer outreach programmes) as most of the social networking sites are free.

Social media marketing helps in:

- Generating exposure to businesses.
- Increasing traffic/subscribers.
- Building new business partnerships.
- Rise in search engine rankings.
- Generating qualified leads due to better lead generation efforts.
- Selling more products and services.
- Reduction in overall marketing expenses.

Companies in the west are investing increasingly in SMM to get in touch with their customers. They are indulging in constant interaction with their prospects in order to understand their needs and hence make products better. It's the best way to learn from your

customers about their needs and your own shortcomings. However, SMM is a very personalized way of advertising and promotions can be targeted only to particular groups which are interested in a particular domain, quite unlike conventional advertising.

Understanding the Relevance of Social Media in Marketing:

The role of social media in marketing is to use it as a communication tool that makes the companies accessible to those interested in their product and makes them visible to those that don't know their product. It should be used as a tool that creates a personality behind their brand and creates relationships that they otherwise may never gain. This creates not only repeat-buyers, but customer loyalty. Fact is social media is so diversified that it can be used in whatever way best suits the interest and the needs of the business.

According to 2010 Social Media Marketing Industry Report 2010, a majority of marketers (56%) are using social media for 6 hours or more each week, and nearly one in three invest 11 or more hours weekly. Twitter, Facebook, LinkedIn and blogs were the top four social media tools used by marketers, in order. A significant 81% of marketers plan on increasing their use of blogs. A majority of the marketers are employing social media for marketing purposes and small businesses were slightly more likely to use social media. 76% of marketers are spending at least 4 hours each week on their social media marketing efforts.

In the present context, it is increasingly becoming pertinent for companies to (1) build a favorable base of consumers, and (2) involve them in decision making. According to Softpedia, during the last quarter of 2009, 86 percent of online retailers in US had a Facebook page. It was expected that this figure would reach 99 percent very soon. During this same period, e-marketer pointed that 65 percent of its surveyed online retailers were active on Twitter. Another 26 percent were planning to incorporate Twitter in their plans. E-marketer projects that by 2011, 91 percent of online retailers will be Twitter ready and all of them will have a Facebook page. Presently, greater than 700 thousands businesses have an active Facebook page. And around 80 thousand web portals are Facebook Connected presently.
Social media gives marketers a voice and a way to communicate with peers, customers and potential consumers. It personalizes the "brand" and helps you to spread the message in a relaxed and conversational way.
Adult beverage companies, exotic automobile manufacturers, pastry shops have been using social media tool. Pepsi Coke, Nokia and many of the top brands have effectively used social media for achieving their business objectives. Few companies that have become involved in social media are:

- Absolut Vodka - Online Video on YouTube and Using Facebook to house their Top Bartender fan page.
- BMW - Utilizing Facebook to promote their 1-Series Road Trip and they have created a Rampenfest Page for fans.
- Dunkin Donuts - They've found value in social media and have set up a microblogging Twitter account.
- General Motors - GM leverages the social media to improve the online equity of its

brand and make consumers feel more connected.

Until recent past, social media effectively served as another customer outreach activity of organizations – essentially building brand awareness and generating leads. However, trends are now changing towards utilizing social media for positively impacting sales. A mindset shift towards making social media a committed engagement channel is already underway. An analysis by Wetpaint and Altimeter – engagementdb.com, concurs that the most successful companies on social platforms were maintaining profiles on 7 or more channels.

The Pervasiveness of Social Media:

Social media is no more a fancy term; its popularity can be deduced from the findings of the latest PEW Research – as much as 70 percent of the economically active population is well entrenched in to the social media space. Similar statistics, albeit from a different source – eMarketer, further corroborates this notion; 46 percent of people in age group of 44 – 62 years and around 61 percent under category 27 to 43 years are socially networked.

Role of social media in marketing:

Social media is now increasingly becoming an ingrained aspect of political campaigns, national defense strategies, public policy, public relations, brand management and even intra company communication.

Since the major task of marketing as tool used to inform consumers about the company's products, who they are and what they offer, social marketing plays an important role in marketing.

- Social media can be used to provide an identity about the companies and the products or services that they offer.
- Social media helps in creating relationships with people who might not otherwise know about the products or service or what the companies represent.
- Social media makes companies "real" to consumers. If they want people to follow them they need not just talk about the latest product news, but share their personality with them.
- Social media can be used to associate themselves with their peers that may be serving the same target market.
- Social media can be used to communicate and provide the interaction that consumers look for.

Why businesses need to consider social media marketing services?

- Size: Facebook has over 250 million users globally. On an average, 70-100 tweets happen by the second. An average user on Facebook has 120 friends. This is the kind of enormity Social networking sites espouse and with this comes the license to communicate powerfully. But when such large numbers are involved, there is a danger of something going wrong and when it does, it happens in a big way. An expert should be hired to do what is best for business.
- Transparency: No cheat code involved. No black hat techniques allowed. Everything that happens in the social networking landscape is fool proof. Companies cannot fake authenticity in an attempt to get more people involved. Members can choose to associate with

the company or opt out. Opinions made on social networking platforms are taken seriously and the more authoritative the companies get, more seriously they are taken.

- Reach: It is possible to make mark globally and do it quickly using social networking sites.
- Boost website traffic: Social media is probably the fastest and easiest means of redirecting traffic to company's website. By simply placing their website URL in their profile, the company can have all their profile visitors check out their website and a percentage of traffic is sure to get converted in course of time. This is the virtual way version of "word-of mouth".
- Branding: Buying a candy may have been impulsive all your life, but if it is discussed on a social networking site, there is likely to get brand conscious even a candy. Social media is a smart way to build brands. Social media platforms are known to be one of the most powerful and fast means of branding. Some of the big brands like Coke, Ford, Dell, IBM, Burger King are some of the well known brands have powerfully used social media platforms to endorse themselves.

Barriers to Implementation of Social Media at companies:

On the other hand, social media use scenario is more encouraging at small businesses. According to the State of Small Business Report, social media usage by small businesses increased from 12 percent to 24 percent in the last year. Further, almost 20 percent of small businesses actively employ social media as an integral part of the marketing strategy. In fact small businesses are currently allocating 6% of their marketing budgets to social media. It is expected that this is expected to reach 10 percent by 2011 and further to around 18 percent over the next 5 years. Some of the findings from the survey are particularly encouraging from business via social media point of view, these include:

- 75 percent of small businesses have presence on a social networking site
- 54 percent are monitoring feedbacks
- 69 percent post updates or interesting articles on social media sites

Those are some mind boggling numbers, especially after the viewing the depth of social media penetration across big companies. But what is most striking from the two surveys is the fact that while nearly 70 percent of Fortune 100 companies are virtually inactive. However, a similar percentage of small businesses are buzzing with activity on social media. Nonetheless statistics aside, it is high time, that businesses, irrespective of their size have a social media plan that has 3 C's in it, viz (1) a Companywide engagement strategy that (2) ensures Conversations with consumers, and (3) Causes user loyalty across social networks.

Social Media Marketing in India - An Overview

India has 71 million active internet users. Social Media is really picking up new heights in India. According to the 2010 Regus Global Survey of business social networking, India tops the usage of social networking by business – it has the highest activity index, 127, far more than the US'97, and 52% of the Indian respondent companies said that they had acquired new customers using social networks while 35% American companies managed that. Many companies are coming big way for Social Media Optimization for their Product or Services nowadays. During Election 2009 Social Media was used for Influence Indian Voters. Social

Media Marketing in India is being undertaken by brands like Tata Docomo, MTV India, Channel V, Clear Trip, Tata Photon, Axe deodorants, Microsoft, Naukri, Shaadi and many more. Besides, numerous Indian celebrities are also using SMM platform to promote their movies, music and events via Twitter, Facebook and personalized blogs. Social Media Marketing is also boosting public relations business. Several PR agencies in India are undertaking brand building exercises for corporate organizations, brands and celebrities. However, to the delight of many among us, the biggest gainers from SMM till date have been the organizations from the Not-for-Profit sector. Several Campaigns like 'Bell Bajao'and 'Jaago Re' have been quite successful on Social Networking Sites. These campaigns have been spreading the word about their cause through blogs, Twitter and Facebook.

Social Media Marketing Strategies:

SMM is still in its infancy. Most of the online retailers though appreciate its positives fallouts on the brand awareness and promotion; they are still in the early stages of adoption. For an organization willing to invest in social media marketing, it is important to understand why SMM is an important marketing strategy and how it can help:

• This is the age of consumer satisfaction. It is not about selling it is more about interacting. There is a lot to learn from the customers. Using social media one can identify customers, listen to their feedback and use them to improve and innovate on products or services.

• SMM is not a mass advertising strategy. It can be used to identify peer groups and advertise to that particular group. Social Media can help in identifying influencers and through them one can guide a prospective customer into making a purchase.

• SMM calls for novel advertising methods as the attention span of online junta is very low. This is largely due to the multitasking phenomena. A person watching a video clip on YouTube might be simultaneously updating a blog, while reading another one and watching friend's photographs on Facebook. In order to garner their attention away from distractions the advertisement must be innovative and interesting to hold the imagination and attention of the prospect.

• At the same time the message must also provoke the recipient into action; like seeking a detailed description of the product/service, or suggesting to a friend, or initiating purchase. So, if the advertisement is trying to sell something then it should be conveniently placed with links so that the prospect can make a purchase with least effort.

• Similarly Social Media can be used to increase customer loyalty through customer support services and hence improve customer retention.

• Social Media Marketing can also be used by brands to ward off any negative publicity. But the brands will have to be cautious here as over doing it may further aggravate their customers / stakeholders.

Companies using traditional marketing methods (e.g. surveys, focus groups, test marketing) often spend millions to locate their target markets. Establishing a social media strategy will help them see where potential customers are hanging out. The companies can search for related groups and Fan Pages through Facebook, start accounts on social bookmarking sites such as Digg or StumbleUpon, and check on who is linking to your site to find out who's interested.

Social media gives businesses on small budgets the ability to find out what people are saying about them (and others) in their industry, without paying large sums on market research. With it's ear to the ground on social media, the company will be the first to know if its product is working or if changes need to be made.

To successfully implement one's SMM strategy the following points must be kept in mind:

- The company shouldn't just jump on to the bandwagon just because others are jumping into it. The market should be analyzed first to understand whether their brand would really benefit from SMM. It should try and find out whether SMM strategies fit its brand.
- The company shouldn't expect results over night. SMM is a long term strategy. It will not happen overnight. The results might become visible anywhere from three to six months.
- SMM is not a standalone tool for marketing. It has to be used along with all the other conventional marketing strategies.

There are many things that social media can do for business. Developing a strategy for using it means that the firms need to think about what they want to accomplish this year and determine how social media fits into the plan. One of the benefits of a social media strategy is the fact that the available tools can customized for their particular needs. The firms can choose to concentrate their efforts on the sites that seem to offer the best return on investment, while taking a "wait and see" stand on the others.

Conclusion:

There is no escaping social media these days, either for individuals or for businesses. Today, it is impossible to separate social media from the online world.

The social media conversation is no longer considered a Web 2.0 fad -- it is taking place in homes, small businesses and corporate boardrooms, and extending its reach into the nonprofit, education and health sectors. From feeling excitement, novelty, bewilderment, and overwhelmed, a growing number of people now speak of social media as simply another channel or tactic. Blogging can have a very positive effect on your Company's branding & growth. As per the Hubspot report, Customers with blogs gathered 68% more leads than customers without blogs. It is imperative to understand that today, social media have exponential potential. They are part of an ever-growing online network of people who discuss, comment, participate, share and create.

Whether you are an individual, a startup, small business or a large corporation, an online presence and an ongoing conversation with your constituents is a baseline requirement -- and will take time and expertise. Companies are diverting resources and rethinking their traditional outreach strategies. And as the social media wave dissipates into the vast ocean of connected experiences, the term itself will become an entry in dictionaries and encyclopedias and we will embark on a new era of knowledge, accessibility and experiences unbound by distance, time or physical walls. It is high time that every business adopts social media and takes it seriously.

MODULE III

AIRLINE BUSINESS: MARKETING ENVIRONMENT & STRATEGIES

AIRLINE BUSINESS-MARKETING ENVIRONMENT AND STRATEGIES

We have now completed our coverage of the essential building blocks in the application of marketing principles in the airline industry. No airline can hope to apply these principles successfully without the understanding of customer needs and the marketing environment. This Chapter deals with the crucial foundation: the Marketing Environment, or the background against which marketing strategies are developed. The Chapter look at the theoretical basis for the study of the Marketing Environment, applicable to any industry. Secondly, to analyze those factors from this environment which need to be considered by airlines. Thirdly, to discuss the specific impact which each of these issues should have on properly thought-out marketing policies.

Once such understanding is in place, the next requirement is the challenging one of the formulation of a sound strategy. In one sense, the news here is good in that in today's airline industry there is no single, unique strategy which must be followed if success is to be achieved. There is a range of possible strategies available. What *is* essential, though, is that one strategy must be selected from this range. It must then be implemented well and continued on a long-term basis. The aim of this Chapter is to set out and discuss the types of possible strategy, and their advantages and disadvantages

The Theoretical Basis – PESTE Analysis

The literature on marketing provides one, particularly useful, model for the study of a firm's Marketing Environment. This model proposes that the relevant factors should be divided into the categories of *P*olitical,
*E*conomic, *S*ocial, *T*echnological and *E*nvironmental.8 It should, of course, be born in mind that the categories are not mutually exclusive, and that it might be appropriate to discuss a particular issue under more than one heading. However, the model is still a powerful one, especially in the airline industry. Airlines cannot develop sound marketing policies independently of a range of political decisions. The industry has always been, and remains, intensely political. The fortunes of the world economy will also have a substantial impact, with marketing policies needing to ensure that favourable economic circumstances are exploited, and unfavourable ones countered. Social issues such as those relating to demographic trends will also be significant, especially at the present time. Technology provides both exciting opportunities and difficult challenges today, whilst problems associated with the environment may threaten the whole future of the industry.

Porter's "Five Forces" and their Application to the Airline Industry

In understanding these strategic options, a useful start can be made by looking at some of the ideas of the Harvard Professor, Michael Porter. Porter states that in different industries, strategic issues are coloured by the interplay of the Five Forces of the rivalry amongst existing firms, substitution, new entry, the power of customers and the power of suppliers. We will examine each of these in turn.

Rivalry amongst Existing Firms

Porter argues that, in many industries, often little of the true competition and the drive for change comes from long-established firms. These long established firms often resemble one another in terms of the strengths which they have, and in their problems and weaknesses. They therefore can only identify benefit from aggressive competition at the margins of their activities.

In the air transport industry, the policies of the long-established airlines of Europe illustrate this point only too well, especially in their short-haul markets. As we saw in the last Chapter, there are now no regulatory reasons which preclude intense competition between them. Since April 1997, the airlines of the European Union have competed in a Single Aviation Market where there have been only the very loosest controls over entry, capacity and fares. This represented a major change when it took place compared with the tight regulation characteristic of the previous system. Yet, one would hardly know that this change had occurred if one had merely looked at the reaction of the old-established airlines to it. They continued to fly mostly similar aircraft (usually drawn from the Airbus A320 family), and placed in them identical or near-identical seating configurations. Frequencies and timings remained very similar, with few airlines prepared to allow their competitors a frequency advantage. The onboard products were mostly comparable, and did not change. Finally and most tellingly, until recently these airlines pursued an almost identical pricing policy. Very high fares were charged for seats in Business Class, and for access to Economy tickets which allowed full flexibility. Lower fares were also on offer, but these had had tight restrictions attached to them, restrictions which were mainly designed to prevent business travellers using them. The result of such policies was that they made it much easier than it should have been for new Low Cost Carriers to grow in Europe, and for them to have a dramatic effect on the economics of the long-established firms. British Airways, for example, lost nearly £250 million on its intra- European network during its 2002/2003 financial year.

Substitution

Porter argues that disturbance to the competitive equilibrium set up by the long-established firms can come from two possible sources, the first of these being that of Substitution. Substitution occurs when firms in another industry find a new and better way of meeting the same customer needs as are being targeted by the existing players. There are a number of Substitution issues affecting airlines at the present time. Of these, potentially the most serious is the effect of electronic methods of communication on the market for business air travel. Virtual meetings, videoconferencing, teleconferencing and email all have the potential to mean that business travelers will travel less, and still satisfy their needs for effective communication. At the time of writing, there are worrying signs that this is exactly what is happening, an effect which is likely to increase still further during future downturns similar to the one which followed the September 11 attacks in 2001.

Surface transport, especially by rail, also raises important substitution issues. As we have seen, unlike airlines, railways can provide city-centre to city-centre travel, and have been shown to severely impact the business travel market once these city-centre to city-centre journey times can be brought down below three hours. The air freight industry is also being

affected by Substitution issues. Email is substantially reducing the market for the movement of urgent documents by air. Also, newspapers do not provide the lucrative air freight commodity they once did. They still lose their value completely soon after they have been published. The problem is, though, that today media publishers are increasingly reaching their readers through the Internet, or by setting up satellite printing stations which enable newspapers to be printed simultaneously in a large number of different markets. They therefore no longer have to make use of air freight.

New Entry

The second of the forces which may disturb the competitive equilibrium amongst the existing players is that of new entry. In some industries, new entry is difficult or impossible. In others, it is commonplace. In the modern aviation industry, the latter is very much the case, especially in short-haul, point-to-point markets. This is because of the many possible so-called "Barriers to Entry", most have become low or are now non-existent. A first possible barrier to entry may result from regulatory limitations. It is true that, there are still regulatory barriers to entry in many international markets, and airlines are constrained in their market entry policies by out-of-date and anachronistic limitations on ownership and control. However, it is now the case that many of the world's largest domestic markets, such as those of the United States and the European Union, now operate without any significant entry controls, apart from those applying to so-called Cabotage Rights.12 In others cases, *resources* may act as a Barrier-to-Entry. If vital resources are unavailable or very costly, entry will clearly be constrained. In the aviation industry, airport slots provide a classic resource barrier to entry. As long as airport slots continue to be awarded under the Grandfather Rights principle, it will be very difficult for new entrants to gain access to attractively-timed slots at congested hub airports.

Significant though slot constraints already are, with a likely worsening of them in the future, radical strategies are possible which find a way round them. In particular, Europe's vibrant low-fares scene - has largely grown free of airport slot constraints because of the willingness of the airlines to use uncongested airports, sometimes located a considerable distance from the cities they are designed to serve.

Slot constraints may provide some comfort to existing airlines in Europe today, but they can derive little more from the remaining possible resource constraints to entry. Especially during downturns such as the one experienced during 2002 and 2003, resources to underpin entry can actually be remarkably cheap and plentiful.

This is certainly the case with the question of the aircraft fleet that will be needed by a new entrant airline. In a recessionary period, aircraft manufacturers will be prepared to strike very attractive deals for the whitetailed

aircraft which sometimes result from order cancellations. Also, there will be large numbers of parked aircraft – many of them owned by leasing companies – where the owners will offer extremely low lease rates in order to get their idle aircraft flying once again. Staff resources – especially of pilots and mechanics – will also be important. Again, in a recessionary period many trained people will unfortunately lose their jobs, and may well be prepared to take new ones at relatively low salaries and wages in order to obtain employment. As a final, and, at

first sight, odd feature of resource constraints on entry in the aviation industry, it will always be possible for a new entrant to buy the support services, such as maintenance and ground handling that it needs. Many airlines have built subsidiary businesses offering such services and they will be prepared to sell these to a new entrant, even if the new entrant's business plan involves competing with them. They will reason that if they do not meet the need, this will not stop the new entrant. Instead, the required services will be bought elsewhere, denying the first airline some useful revenue.

Several more issues need to be covered in assessing the nature of barriers to entry in the airline business. Some industries are characterized by marked *Economies of Scale*, where lower unit costs can be obtained by large-scale producers. Many heavy industries such as steel, chemicals and car-making are like this. In them, existing firms are likely to be protected against entry because they will have been able to achieve a scale of production which is unlikely to be available to a new entrant.

In the airline business, there are some aspects where existing players are protected against new entry by scale economies. In particular, hubbing operations where short-haul passengers are collected together in order to feed long-haul services are increased in their effectiveness by being undertaken at a substantial scale. It is hard for small new entrants to break in. In point-to-point markets, however, no such protection for incumbents exists. Economies of Scale in areas like pilot training and maintenance quickly run out with increasing size, and are counterbalanced by the bureaucracy and poor staff morale often characteristic of large airlines.

In some industries, incumbents have a lot of protection against new entrants because of so-called *Learning Curve* effects. In them, mature firms achieve lower costs than new entrants because the intricacies of the production process mean that substantial experience is required before optimum cost levels can be achieved. Aircraft manufacturing and aeroengine production both illustrate this from within the aviation industry, with unit costs of production falling steadily as an airframe or engine family matures. Airlines, on the other hand, seem to show the opposite effect, with the concept of *Start-up Economics* a well-established one. Airlines often achieve their lowest costs of operation during the first five years of their existence. Later, costs tend to rise as more staff ascend seniority scales to higher rates of pay, and bureaucracy and declining staff morale start to impact on cost levels. The existence or start-up cost advantages does of course, make the task facing a new airline a significantly easier one.

One final issue with regard to entry into the airline industry is difficult to analyse, but very important. Over the last twenty years, the list of airlines which have entered the industry and then left it again through bankruptcy is a depressingly long one. All the evidence one could possibly require is there to illustrate the point that investing in and setting up a new airline is, at best, highly speculative, with an overwhelming likelihood of failure. From this, one might assume that new entry into the aviation industry would largely be a thing of the past,

especially given the depressed state of the industry in the early years of the new century. Nothing could be further from the truth, with the pressure of entry seemingly as strong, or stronger, than ever. One explanation for this apparent contradiction is that aviation is seen as a glamorous and exciting industry by many, and that the dream to set up and own one's own airline is a continuing one for those with large egos and deep pockets. Industries with dirty, unpleasant processes at their heart do not have the same appeal, despite the fact that profits and returns on capital may be much better within them. The English expression, "where there's muck there's brass" is a telling one.

As an overall conclusion to the question of entry, incumbent airlines must prepare themselves for a continuing challenge from new entrants, especially in their short-haul, point-to-point markets.

Power of Customers

Porter argues that the power of their customers will be a crucial determinant of profitability for the firms in any industry. In turn, customer power will be related to two variables: the number of customers a firm has, and the existence – or otherwise – of so-called *Switching Costs*.

In principle, the point about the number of customers is an obvious one. If a firm has many customers and some of these defect to the competition, there will still be a large number of customers remaining. If, on the other hand, the firm has only two or three customers, the loss of one of them will result in a third or more of its business being lost. In such a situation, customers will have extreme amounts of bargaining power. They will be able to cut deals on terms which are extremely favourable to them, holding down the profits of the companies from which they are buying.

Despite the unambiguous nature of this point, a series of industry trends during the 1990s suggested that airlines were ignoring it. They allowed the size of their customer base to decline steadily, with serious consequences for their profitability.

This decline resulted from at least three factors. Firstly, as we have seen, there was an increase in the extent to which firms in business travel were prepared to use their bargaining power to conclude corporate deals in which a degree of loyalty was traded for substantial price discounts. This changed the nature of the business travel market. Instead of the airline's 'Customers' being the business travellers who actually flew, they were increasingly negotiating with a relatively small number of finance and purchasing people who had been given the responsibility of negotiating corporate deals.

The structure of the travel agency industry also changed during the 1990s. In many countries, life became harder for the smaller, independent agent. Instead, an increasing share of the market was held by large, often multinational, agency chains, who achieved substantial power as a result of their ability – often exaggerated, but still significant – to switch passengers between airlines according the commissions they were being paid.

Such a trend did not arise by accident. Many airlines adopted a policy of paying so-called over-ride commissions to agents according to the volume of business delivered to them. In the short term, such a policy gained them the greatest amount of revenue. It did, though, give important advantages to large travel agents who could meet their revenue targets for over-rides. These agents were in turn able to use their higher commissions to fund market share battles against their smaller rivals, further cementing their domination.

A further issue regarding the size of the airline customer base concerned the selling of seats to price-sensitive leisure travellers. Again during the 1990s, many airlines tended to opt out of retail marketing of these seats. Instead, this job was increasingly left to so-called *Bucket Shops* and Consolidators, who treated the airlines as suppliers of cheap seats which in turn could be sold on, at a profit, through their own retail marketing outlets. Firms such as Trailfinders in the UK and Eupo-Air in the Far East achieved substantial dominance as a result. As they did so, they were progressively able to change their role from one of selling a small number of otherwise unsold seats, to one where they were able to dictate prices to carriers, negotiating deals which were very attractive to them, but which were much less so to the airlines supplying them.

As we shall see in section 7:2, the last five years have seen a revolution in the distribution channels used by airlines. The Internet has become a very important channel, and from the issues raised in this section, it is easy
to see why. The Internet allows carriers to begin the process of broadening their customer base once again, and to make better contact with the true sources of their revenue. They are therefore able to address the problems
of escalating commission costs and falling yields, which were a clear consequence of the mistaken polices of the 1990s.

A final question with the size of the airline customer base is in some senses the most worrying of all. Porter warns that if one, or a small number of the firm's customers become too big, they may take the view that it would be more cost-efficient to take on the resources to do the job themselves. If they do, a firm may lose all of the large amount of business currently being obtained from a single source. Worse still, the former customer may decide that there is actually money to be made in the new area of activity. If it does, it will not only cease to supply business to the firm in question, but will actively begin to compete with the firm for its remaining customers.

In the aviation industry, a common situation where a customer turns into a competitor occurs when a tour operator grows bigger and bigger, giving larger amounts of business to existing charter airlines. Often, a point arrives where it will make sense for the tour operator to buy its own aircraft, in order to set up an airline to carry its own passengers and perhaps also the compete in the open market for other airlines' passengers as well. The tax benefits associated with aircraft ownership can be an added incentive to do this, given that tour operators normally do not have significant capital assets to use to offset against their tax liabilities.

The subject of so-called *Integrated Carriers* is also an interesting one with regard to the question of customers becoming competitors. But, in summary, they are freight companies specialising in the movement of relatively small, urgent, packages. When they begin service on a new route, it is normal for them to offer substantial mounts of business to existing combination airlines. This helps the Integrators to grow their traffic. Unfortunately for the combination airlines, once they have done so, it has been common practice for them to then put on their own specialist freighter aircraft, cutting out of the equation the airlines that first helped them to grow.

The question of *Switching Costs* is an equally difficult one. In some industries, there are very substantial costs associated with switching from one supplier to another. Airline fleet planning illustrated this point very well. An airline only using, for example, Boeing aircraft will have built up a large investment in Boeing spare parts, Boeing-orientated flight simulators, and in the training of its staff to be familiar with Boeing products. There will therefore be a strong financial incentive to continue to buy from Boeing. If Airbus is to break the stranglehold of Boeing at such an airline, they will have to offer very large discounts on the purchase price of their aircraft, in order to effectively pay themselves for the Switching Costs of moving away from Boeing. They will probably have to offer many other incentives as well, such as large amounts of free pilot training.

The problem for airlines is that they do not have the Switching Cost protection which assists aircraft manufacturers in retaining their customer base. An airline may be getting a worthwhile amount of business from a major customer as a result of having a corporate deal with them. It will be a simple task, though, for another carrier to come along and offer the customer a more attractive level of discount, with the result that the corporate deal with the first airline is cancelled and transferred to the second. This will be easy, because little capital investment or training is required to work with one airline rather than with another.

Of course, the first airline will hope that its Frequent Flyer Programme will be of some value in fending off predatory attacks by its rivals, in that many people who actually travel for the firm in question will wish to continue to build their mileage balance, and retain their privileged status, within the programme. Even this, very limited, Switching Cost protection can be addressed by the predator by a 'Golden Hello' tactic of giving out a large number of free miles and Gold Cards in their programme to these people.

Overall, the question of the Power of their Customers is a very difficult one for airlines to address, and goes a long way towards explaining the poor profit performance of many carriers in recent years.

Power of Suppliers

This depressing conclusion is equally applicable to Porter's remaining point, that of the power of a firm's suppliers. Porter argues – again, the point is straightforward – that when a firm is totally dependent on monopoly suppliers of crucially-needed resources, these suppliers will be able to charge prices which ensure handsome profits for themselves, but which severely limit profits of the firms that they supply.

For airlines, the list of suppliers who either actually or potentially have this monopoly power is a depressingly long one. Most obviously, suppliers of Air Traffic Control and airport services may have it, with many airlines
having no choice but to pay whatever ATC and airport charges are levied on them. It is most noticeable that at the time of writing airline profits have been severely affected in a major industry downturn, but the pain of this is not being evenly distributed across the industry. Many airports are continuing to show strong financial returns, reflecting the monopoly power that many of them have. Often, it has been necessary to regulate landing fees in order to control the use of this power.

Sometimes, airlines' fleet planning can be affected by powerful supplier issues. The Boeing 747 was introduced into airline service in 1970, and was unchallenged by any other aircraft for the next 25 years. If a carrier's requirement was a long-range aircraft with 400+ seats, the 747 was the only option available to them. Not surprisingly, the aircraft became a very profitable project for Boeing. In the future, a similar situation may develop with the 555 seat Airbus A380, though Boeing's recent decision to launch a stretched version of the 747 – the so-called 747- 8 – will have been greeted with a sigh of relief by many airlines.

Perhaps the best, and most controversial, example of powerful suppliers in the aviation industry has concerned the so-called *Global Distribution Systems* (GDSs). Since their inception in the late 1980s, the GDSs have provided the switching technology which allows travel agents to make reservations with hundreds of different airlines, hotels, car rental companies and tour operators through a single computer keyboard.

Unlike airlines, the GDS business is one of immense scale economies. The capital costs of entering the business have been very high but running costs have been low. Large firms have therefore been able to spread their capital costs over greater volumes of output and achieve lower unit costs. As a result, there are only four significant players in the global GDS industry – the US based SABRE and Worldspan, and European-originating Galileo International and Amadeus. (In December 2006, a plan was announced for a merger between Galileo and Worldspan). All were first set up by airlines or consortia of airlines, though in recent years their ownership has become more diverse. (Very recently, some new entrants, using a different business model, have appeared in the GDS industry.)

Besides strongly concentrated patterns of ownership, the GDS industry has also shown a trend towards the establishment of geographical monopolies. For example, a high proportion of travel agents in the UK use Galileo. An equally high proportion in France and Germany are Amadeus customers. The GDS companies do not, of course, provide their services free. When they were first proposed, the plan was that the costs associated with them would be shared equally between travel agents and airlines. Travel agents would pay substantial rent to the company which supplied them with a GDS service, reflecting the fact that the GDS allowed them to substantially increase the productivity of their staff. Airlines and other travel firms would pay their contribution to GDS costs through a booking fee payable on each booking made in their reservation systems.

It has not worked out in this way. Because of the Economies of Scale involved, the GDS companies saw it as a major business objective to increase their market share in order to boost transaction volume. They did so by engaging in aggressive pricing, so aggressive in many cases that travel agents were given a GDS service free-of-charge if they switched from one firm to another, or even received incentive payments for doing so. The result of such a policy has been that the costs of GDS fell disproportionately on airlines, with the current level of booking fee they are paying being between $4 and $4.50 per passenger. This may seem a trivial amount, until it is multiplied by the hundreds of millions of passengers carried by the world's airlines each year. Not surprisingly, such a situation has been regarded as totally unsatisfactory by many airlines, particularly by those which have not benefited by having a shareholding in a GDS. Until recently, though, it has been difficult for many of them to do much about it. Some carriers, such as the UK firm Easyjet, have from the beginning adopted a radical policy of direct selling, completely by-passing the travel agency distribution system. Besides avoiding commission payments, this policy has also allowed the airline to save on GDS booking fees. This has been something of great importance to a low fares airline given that booking fees are levied on each booking made and thus potentially make up a disproportionate amount of cost for such an airline. For traditional carriers, the travel agency system has overwhelmingly been their main channel of distribution, with 85 – 90% of their bookings coming from this source. They have not, therefore, been able to refuse to pay GDS booking fees. Had they done so, the GDS firms would simply have removed the schedules and fares information of the recalcitrant airlines from their database, with the result that almost all the bookings they might have received from travel agents would have been lost. Therefore, in Porter terms, the GDS companies were monopoly suppliers of vital resources, and it should have come as no surprise that during the 1990s they were highly profitable. It should equally be of no surprise that as soon as the Internet offered a viable alternative distribution channel, airlines would embrace it enthusiastically.

"Disintermediation"

Sometimes, in the application of the Five Forces model, situations arise where relationships between firms change radically. This is especially likely when a particular player or group of players is not adding sufficient value to justify the prices that they are charging. An attempt may then be made to by-pass them, in a process which Porter describes as *Disintermediation*. Two examples, one actual and one potential, illustrate this process in the aviation industry. Returning to the example of the GDS firms given above, the recent rapid growth in the use of the internet as a distribution channel reflects a clear attempt by airlines to disintermediate the GDS companies, one which has already saved them substantial amounts in terms of booking fees.

Another interesting case comes from the freight side of the industry. In recent years, a number of companies have grown up which have specialized in providing so-called *wet-leasing* services for large freighter aircraft (mainly the Boeing 747F). The American firm Atlasair is the most notable of these. By using their services, an airline can offer its customers main deck freight capacity, without the costly overheads of owning and operating freighter aircraft themselves. In particular, they can save money because Atlasair crew salaries are

generally very much lower than the often stratospheric rates of pay given to 747 crews by traditional airlines.

The potential problem of such policies is, though, very clear, in that the airlines using wet-leased freighters are adding very little value. Mostly, they are taking pre-loaded Unit Load Devices (ULDs) from air freight forwarders, and loading these onto the wet-leased freighters. Sooner or later, the freight forwarders may decide that it will be more profitable for them to wet-lease the freighters themselves, and employ local handling agents to perform the simple task of dealing with the pre-loaded units.

Indeed, one forwarder, the Swiss-owned Panalpina, is already doing so. Each time they do is a classic case of Disintermediation. Overall, Porter's Five Forces model provides a valuable backcloth against which to view airline strategic decision-making. Any airline strategy, if it is to be successful, must deal with a complex interplay of often conflicting forces.

MODULE IV

AIRLINE PRICING & MARKETING

Of all the different facets of airline marketing, none has changed further or faster in recent years than the question of appropriate pricing policies. Today's airline managers are having to learn and apply skills which were either unknown or not needed by their predecessors, and where some of the fundamentals which have served the industry well in the past are being brought into question. It is also a high profile area, where mistakes can result in large losses in a very short time.

BUILDING BLOCKS IN AIRLINE PRICING POLICY

Pricing - A Part of the Marketing Mix

In studying the question of appropriate policies for airlines it is first of all necessary to emphasise that pricing decisions cannot be made in isolation – they can only be seen in the context of the Marketing Mix model presented in Section 1:1:2. In particular, product and pricing decisions must clearly be made together. In recent years, many airlines have invested large sums in improving the specification of their First and Business Class products, with costly investments having been made in such things as better (usually flat-bedded) seats, higher quality catering and greatly improved in-flight entertainment. At the same time they have generally − and correctly − raised the prices of First and Business Class tickets in real terms, to provide a return on the investment that has been made. As we have discussed, whether or not they will be able to maintain these higher prices and the same return when recessionary conditions re-assert themselves is another question.

Deregulation

Until recently, the question of government regulatory policy was a major constraint on airlines' pricing freedom in international aviation. Almost all intergovernmental Air Services Agreements were written in terms which were designed to stop airlines competing on price. The airlines designated under these agreements were required to meet together, agree on what the fares should be, and file these fares with their respective governments for approval. Assuming that this approval was forthcoming − and it normally was − the airlines in question would implement a fare structure based on the principle that all those on a route would change exactly the same fares. Even in domestic markets − notably so in the USA − government regulation was imposed to prevent price competition, presumably in the hope of maintaining a stable industry.

The situation today is totally different. Many domestic markets have been completely deregulated with regard to price, with airlines free to price as they choose. In some international markets, too, a virtual deregulation of pricing has taken place. This is notably so with respect to the so-called Single Aviation Market of the European Union.

Even in markets where the old facade of price regulation nominally remains, the situation today has still changed a great deal from that which prevailed only a few years ago. In these markets, it had been one of the functions of the International Air Transport Association (IATA) to run the Tariff Conferences at which fares have been agreed. The machinery of so-called Tariff Co-ordination has become more flexible. Airlines have gained the freedom to

innovate with their own promotional fares, with Tariff Co-ordination activity confined to the highest, interlinable fares. Even where fares still fall within the responsibility of the Traffic Conferences, it is an open secret that airlines have engaged in a great deal of under-the-counter tariff discounting, with IATA having discontinued what were described as its Compliance efforts. There were designed to ensure that carriers implemented the fares policies to which they had agreed.

It is impossible to exaggerate the significance of the moves towards less regulated pricing. They have allowed many airlines to develop a low cost/low fares philosophy, something which they could never have done under the old regulated pricing regimes. This in turn has challenged incumbents to become more efficient and innovative. At the same time, managers responsible for pricing policy have had to develop a completely new set of skills. Under the former regime, the skills required were those of attending often-interminable IATA Tariff Co-ordination meetings and engineering a compromise between supposed competitors. Today, the skills are those of forming an appropriate rapid response to the pricing initiatives of these competitors, and deciding when the airline should lead the market in a change of pricing policy.

Dissemination of Fares Information

Until relatively recently, the pace of change in airline fares was slow. Regulated competition meant that all prices were a compromise, and reaching such a compromise was usually a drawn-out affair. At the same time, the system for disseminating fares information precluded rapid changes. The method for such dissemination was a printed tariff manual. Preparing these manuals ready for a fares change would in itself take many weeks, as would distributing them to the travel agents who needed them. (The delivery of the tariff manuals to agents was a task generally undertaken by the airline's field sales executives). The effect of all these factors was that the fares were only changed once a year or once every two years.

Again, the situation today could not be more different. The development of Global Distribution Systems (see Section 7:3) has meant that almost all travel agents have instant access to a fares database which is up-dated (by the GDS firms) several times a day if necessary. At the same time, an increasing proportion of airline tickets are being sold through carriers' own websites, where the process of tariff updating can be even more rapid if necessary. The result of both these trends is that it the fare structure is now highly unstable at times of active price competition. Such competition will be especially prevalent during recessionary periods, when supply exceeds demand and airlines are fighting to fill otherwise empty seats. It will also break out in the autumn of each year on many routes as the summer peak period comes to an end and airlines compete for their share of the declining market.

At times such as these, millions of fares in the industry's main fares databases may change every day, challenging airline pricing managers not only to get their pricing decisions right, but to make these decisions quickly and under great pressure.

Revenue Management Systems

Clearly, the pricing environment today is a far more challenging one. There is, however, one major change which has made it much easier for airline managers to develop sound pricing policies − the advent of sophisticated systems for managing the sale of seats (and, increasingly, of cargo space).

In deciding on pricing policies which will optimise financial returns, carriers must decide on the number of seats they will sell, at what prices and in what currencies. They must also make often difficult decisions about traffic which will be accepted, and which refused on the grounds that the yield obtained from it is too low.

Twenty years ago, there were no tools that would allow this process to be controlled effectively. Today, there most certainly are. Modern airline reservations computers allow the capacity on board each aircraft to be divided up into a large number of booking classes − currently 26 in the more sophisticated systems with larger numbers than this likely to be possible in the future. Decisions can then be made about the number of seats to be allocated to each class, and the time at which these seats will be made available for sale. These decisions will reflect different patterns of demand. For example, for a flight leaving to a business destination on a Monday morning, few if any seats will be allocated to those classes allowing for early sale at low prices. Almost all of them will be in classes where sale will only be permitted at high fares, with many bookings only being made a relatively short time before flight departure. In contrast, a flight leaving to such a destination early on a Sunday morning will be given a completely different profile. Here, almost all the seats will be allocated to booking classes allowing for sale at low prices (or for their use by people redeeming Frequent Flyer Programme credits) as the airline attempts to obtain at least some revenue from seats which might otherwise remain empty.

A particular problem in airline revenue management at the moment concerns the question of connecting versus point-to-point traffic. Generally, airlines earn a better yield on short-haul routes from passengers who are only flying out and back on the route, rather than from those who are using the short sector to fly to a hub, from where they will connect onto a long-haul service. Unless a Revenue Management system is monitored carefully, there will be a tendency for long-haul connecting traffic to be turned away, and point-to-point passengers to be accepted. This will improve the apparent financial performance of the airline's short-haul routes whilst worsening the carrier's overall financial results because of the loss of so-called network revenue. In terms of the development of Revenue Management technology, many airlines are now attempting to produce the systems which will allow them to optimise revenue through taking account of the true origin and destination of passengers. This is, though, a challenging problem of software development.

"Uniform" and "Differential" Pricing

The Principles

Table 6:1 presents data which describes the present pricing structure of one of the airlines on the Heathrow − Toronto route. This route has not been selected on account of it having any

special features. The situation there is a typical one, replicated on thousands of different routes around the world.

Table 6:1 Fare Structure, Heathrow – Toronto, October 2005

Fare Type	Fare Level	Conditions
J	£4,163 RTN	Point-to-point only
S2	£1.171 RTN	Saturday night stay required
"World Offer"	£543 RTN	Mid-week travel only £50 fee to change reservation

The situation presented is one of considerable complexity. Prices vary enormously from the seemingly outrageous levels of Business Class fares down to the very low so-called "World Offer" fare. They also vary in terms of the conditions attached to each fare, with some fares − the more expensive ones − being fully flexible, and others having tightly restrictive limitations attached to their use.

To some degree, such wide differences in price levels are easy to explain and understand. In particular, the very high prices charged for seats in the First Class and Business Class cabins reflect substantial, tangible differences in the product supplied. As already discussed, a modern state-of-the-art First Class cabin will have seats which fold down into full-length beds. These will require a Seat Pitch of 70 inches or more. First Class passengers benefit from extravagant standards of in-flight service and entertainment. It is also generally the case that airlines operate their First Class cabins at low average load factors. Figures of only 40-50% are typical. Amongst the reasons for this is that First Class cabins are generally not overbooked as airlines regard the risk of having to off-load such commercially important people as unacceptable. It is clearly correct, though, that First Class passengers should pay both for the seat they occupy, and also for the empty seats in a low load-factor operation.

Though the specification of a typical Business Class is still somewhat lower than for First Class, it is still a very expensive one for airlines to provide. A typical Business Class seat pitch is now over 70", to permit the seat to be folded down into the flat bed that the state-of-the art requires should be made available. The passenger also benefits from better food, a higher ratio of cabin staff to passengers, and more choice in terms of in-flight entertainment.

Overall, whilst First Class and Business Class fare levels appear very high, it is at least possible for airlines to justify them in terms of differences in the product offered. It is much harder for them to do this for Economy Class fares. Here people paying very different prices will sit in the same part of the aircraft, in the same type of seat, and will experience exactly the same in-flight service and entertainment. Not surprisingly, there have been complaints that the existing fare structure is discriminatory. Those people who pay the higher fares argue that they are overcharged in order to subsidize the losses made on "below-cost" cheap fares.

It is possible to refute such arguments to a degree, but they should not be dismissed lightly. Both those who pay high fares and those who pay lower fares may benefit from a properly-

applied Differential fare structure. This is obvious in the case of low-fare passengers who are able to travel at a price they can afford. It is less obvious, but can still the case, that the high-fare payers also gain from Differential pricing.

The critic of differential fares might argue that airlines should instead adopt a uniform approach to pricing in the Economy cabin. For example, the data given in Table 6:1, stated that people in the Economy cabin could be paying a fare somewhere between £1,171 and £543 for a return ticket. A uniform approach to pricing would require that everyone should pay the same. The high fare would be lowered – perhaps to £700, and the lower fares would be raised to the same level.

Whilst such a situation might appear to be an ideal one, this might not be the case, for two reasons. Firstly, Economy passengers do not all have the same needs, despite the fact that they all sit in the same cabin. In particular, business travellers often have a requirement for flexibility which is absent in the typical product needs of the leisure traveller. Those flying on business may sometimes have a requirement to obtain a booking shortly before a flight departs, because of an unexpected business crisis arising. They may also need to cancel a booking once they have made it and re-book on another flight due to their plans changing. Leisure travellers, on the other hand will generally book weeks or months before they fly and will only need to alter or cancel a booking on rare occasions due to factors such as illness.

If an airline is to meet these two sets of needs effectively it must adopt a quite different philosophy for capacity management in the part of the aircraft given over to business travellers, compared to that occupied by leisure flyers. If business travellers are to be given the flexibility they need, a relatively low year-round load factor will be inevitable. This is because the pattern of demand from such people has a random, unforecastable component to it. If seats are to be available at the last minute for a high proportion of the people who need them, substantial numbers of seats will have to be kept back in the airline's capacity management system - a number well in excess of the average demand for such seats. This will, of course, result in empty seats at take-off on days when the actual demand is low.

Overall, an airline successfully offering last minute seats and full ticketing flexibility to those of its customers who need them will do well to achieve a year-round load factor of 65-70% in the part of the aircraft allocated to this segment of the market. In contrast, an airline not seeking to give an on-demand product will be able to operate at much higher load factors, often in excess of 90%. Indeed, the charter airlines in Europe which are certainly not in the "on-demand" business do achieve these very high load factors consistently.

These differences in load factor give a first, important clue as to why fares may need to vary in the Economy cabin, despite all the passengers there experiencing the same tangible product features. The tangible features are indeed the same, but the intangible one of flexibility is not. Prices can reflect the costs of providing these different degrees of flexibility.

Some of the arguments in favour of Differential pricing can thus be based on questions of costs. Others and ones of greater importance still, can be derived from the nature of airline market segmentation.

The advocate of a Uniform approach to pricing might argue that such an approach would be an optimal one because people currently paying high prices would pay substantially less. This, however, is a false view. They might actually in the long run end up paying more, for an inferior product.

If we return to the data given in Table 6:1, the suggestion is that Uniform pricing would see the fares charged to those paying the higher fare fall from the current level of nearly £1,200 down to, say, £700. They would no doubt be pleased by this, arguing that this represents the amount by which they are now being overcharged. The situation would be less happy, though, for those passengers who are currently paying the lower fares. The proposition for these people is that their fares would have to rise to the Uniform level, reflecting the end of the cross-subsidy of their fares by those currently paying higher prices.

In such a situation, it is most unlikely that the people concerned will simply pay the extra in order to continue travelling with the airline concerned. As discussed in Section 2:3:5, most leisure air travellers have a high price-elasticity, reflecting the fact that they are paying fares out of their own pocket. Because of this, a sudden steep increase in ticket prices would result in some not travelling at all. A much greater number will continue to travel, but will choose an airline which is continuing to offer attractive low fares as part of a Differential fare structure. Overall, an airline changing over from such a fare structure to one of Uniform pricing might easily find that the number of passengers it carried fell by 40 per cent or more.

The first reaction of business travellers to such a development might be to welcome it. They might argue that their air trips will be more enjoyable without revelling holidaymakers. They might also see it as a vindication of their arguments about cross-subsidy. Once the over-charging of business travellers to provide such cross-subsidy ceased, large numbers of leisure travellers could no longer afford to fly.

Such an attitude could be short-sighted. There is a synergy available to airlines which carry significant numbers of both business and leisure travellers, and the business flyer is a major beneficiary of this. In particular airlines which participate in both the business and leisure markets are able to maintain a much broader network, with a better flight frequency than those which do not. As shown in section 2:3:3, network and frequency are two of the prime product requirements of the business traveller. Also, such airlines are able to maintain frequencies whilst using larger aircraft. Aircraft show Economies of Scale whereby lower seat-kilometre costs can be obtained from larger planes. These cost advantages can in turn be passed on to passengers in the form of lower fares. Finally, all airlines have a proportion of their costs which must be regarded as fixed overheads. Expenses such as those associated with the reservation and revenue accounting systems, and brand-building advertising, come into this category. Larger and larger numbers of passengers permit these costs to be spread more widely, again allowing fares to be lowered. On the other hand, a substantial fall in the numbers of passengers carried would almost certainly not be followed by a pro-rata fall in overheads. If passenger numbers fell by 40%, an airline might do very well to reduce overheads by, say, 20%. The result would be that the remaining passengers would each have to cover a higher proportion of overhead costs if the airline is to achieve a profit. This will in turn lead to higher, rather than lower, fares. Overall, the risk is that Uniform pricing might

result in business travellers paying still higher prices for a worse product than they currently receive. It is not in their interests that such a pricing policy should be adopted, despite its superficial attractions.

The situation regarding air services across the Atlantic between the UK and the USA helps make the case for the advantages of Differential pricing. Twenty years ago, there were only a small number of gateway points in the USA for travellers from Britain. Direct services were available from the UK only to New York, Washington, Boston, Chicago, Miami and Los Angeles. Any passenger whose final destination was away from these cities had to take a tiring and time-consuming domestic flight in the USA. In addition, flight frequencies were sometimes poor, with some of the gateways served only on an inconvenient less-than-daily basis.

The situation today is substantially better. The number of gateways receiving direct service has increased to over 20, with almost all of them served with frequency of a daily flight or better.

The reason for the improvement is that during this time, the market has grown, by a factor of more than 4 times. Some of the growth has admittedly come from increased amounts of business travel, but a far greater proportion has been the result of a rapid growth in leisure air travel. This has in turn been stimulated by an increasing availability of low fares as airlines have adopted a Differential pricing policy and have refined their ability to control the resulting low fares through more sophisticated Revenue Management systems.

We have now made the case that airlines should base their pricing policies on the Differential principle. Despite all these potential advantages, though, an airline decision to adopt a Differential pricing system should not be taken lightly. Indeed, competitive conditions in the industry today suggest that in the past, Differential pricing has been applied in too extreme a form, and that many of the problems being experienced by today's 'Legacy' airlines result from the fact that this has been done. We will now look at some of the counter-arguments.

The first drawback of Differential pricing is that, inevitably it leads to tariff structures that are very complex. The watchword adopted by the revenue manager is often that they should 'Capture the Value' available in the market – in other words, that each segment of the market should be charged a fare which is as near as possible to its willingness-to-pay. This will mean many different fares, reflecting the varying demand elasticities of the different segments. Worse still, as we shall discuss in the next section, in this mix of fares, all the lower fares will need to have restrictive conditions associated with them. If these are not in place, people with a higher willingness-to-pay may take advantage of lower prices aimed at more elastic segments.

It is almost impossible to exaggerate the drawbacks that a complex tariff brings. Airlines will be faced with a very costly training task. The typical time taking to train a new reservations and ticketing agent joining a 'Legacy' airline in the past has been a matter of several weeks, all needed to explain to the new recruit how to use reservations, ticketing and pricing concepts the airlines themselves have dreamed up. Once they have been trained for such a

long time, these people rarely stay for more than a year or so, such is the boring and repetitive nature of the work they are asked to do.

Tariff complexity also gives airlines a very difficult selling task. When someone wishes to buy a ticket, they will presumably seek out the best value-for money. In trying to find out which fare will give them this, they will have to assess not only the level of prices, but also the availability of reservations and the extent to which they can meet the fare conditions applying to each of the different prices which are available. This will mean either a time-consuming phone call, or the need to navigate an airline' website. The latter is a notoriously difficult thing to do when each of the cheaper fares on offer may have a page or more of restrictive conditions associated with it.

In such circumstances, it is hardly surprising that in the past many people have decided that the effort is just not worthwhile. Instead, they have turned to a travel agent to do the hard work for them. In the past, this will generally have been an off-line agent, but increasingly today (as we will discuss in the next chapter) there are a large number of on-line agents which can be used. In both cases, the customer can expect a 'best-buy' recommendation, based on a survey of the whole market. From the airline viewpoint, though, such activity can only lead to an increase in the cost-of-sale as incentives have to be offered to the travel agents and search engine firms to ensure that the 'best buy' proposition goes in their favour.

It is instructive to look at the approaches to pricing that have generally been taken by Low Cost Carriers, in comparison to those adopted by their Legacy competitors. LCC's certainly vary their fares over time. In order to gain access to the cheapest prices − certainly to the prices which these airlines publicize in their media advertising − a passenger will probably have to book weeks or even months before the flight that they want departs. Near to flight depart time, these carriers may be low cost, but their fares are often surprisingly expensive. There is, though, one crucial difference in their approach. At the time someone looks at the airline's website to ascertain how much it will cost them to travel on a particular flight, there will only be one price available. The customer can therefore make a simple 'take-it-or-leave-it' choice. This is in strong contrast to the situation of looking at the site of an airline attempting to take full advantage of the 'charge-at-the-willingness-to-pay' principle which has underpinned Revenue Management approaches at so many Legacy airlines for so long. It is not coincidence that the whole basis of the business model of the Low Cost Carriers has been an almost exclusive concentration on on-line sales, which have in turn resulted in enormous savings in commissions and booking fees. It is an example of where there has been a close interplay and tradeoff between pricing policies and distribution strategies.

Important though the arguments about training and distribution costs are, they are not the most important reason why in today's very competitive industry environment, Differential pricing in its extreme form must be used with a great deal of caution.

As we have seen, the assumption of revenue managers in the past has been that pricing at the willingness-to-pay of different segments of the market will produce an optimum revenue situation for the airline. Such arguments now appear dangerously out-of-date. They will work well in any situation − at least in the short-term − where entry into the market is highly

regulated, as of course it was during long periods of the industry's evolution. They will continue to do so even when entry controls are relaxed, providing all the carriers in the market follow the same pricing policies. They are likely to do so if they all have similar high costs, where the yield premium of charging high prices to supposedly price inelastic segments will be valuable for all of them.

The situation changes when new entrant carriers appear, with much lower costs. For them, the use of Differential pricing by Legacy airlines presents an irresistible target. They can take advantage of the fact that past 'Legacy' views of Revenue Management have been based on one fatally-flawed building block. The assumption has always been that some segments of the market − those mostly made up by business travellers − have a very high willingness-to-pay. They often don't have. Instead, their using of high fares has reflected the fact that they have had no choice. All the airlines in the market have adopted the same policies of charging very high prices for flexible tickets of the kind that business travellers often need, and have limited the value of lower priced tickets by such expedients as the length-of-stay rules and cancellation penalties which we discuss in the next section.

It is now clear that the use of extreme forms of Differential pricing by Legacy airlines has had the effect of building up a great deal of resentment amongst business travellers who have been forced to pay very high prices under a Differential pricing policy. Most would accept that there is a pricing premium to be paid if a flexible ticket is needed very near to the departure time of a flight. What has angered them is that if they have booked far in advance − and for many business commitments such as regular board meetings advanced booking is certainly possible – they have paid very much more than a leisure passenger would pay who had booked on the same day, simply because of what they regard as absurd and discriminatory conditions being placed on the lower fares on offer.

Once such levels of resentment have been established, the task of Low Cost Carriers seeking to invade the markets of the Legacy airlines becomes a very easy one. They offer choice, which passengers are only too ready to exercise given their anger at past pricing policies.

The early months of 2005 saw some interesting developments in the pricing policies of the Major airlines in the United States. The period before this had, of course, been one of incredible financial bloodletting by once strong and confident airlines. In January 2005, one troubled carrier, Delta, announced a radical reform of its pricing policies. There were actually several facets to this reform, but the most notable change was that Delta announced a unilateral reduction in most of its highest domestic fares, and an ending of the length-of-stay restrictions on many of its cheaper tickets.

The Delta move was widely attacked by other US Legacy airlines. Delta's Legacy competitors all accepted that they would have to respond to its move, and they argued that it would significantly lower their yields in what was already a disastrous revenue situation. However, there can be little doubt that Delta's policy was sound, and that its new concept represented its 'least bad' option. It was under severe attack from new entrant Low Cost Carriers, notably so from the very aggressive Jetblue Airways. Jetblue was already finding it easy to appeal to former Delta passengers, who were attracted by fully flexible fares which

were a fraction of those available from Delta. Worse still, the continuing existence of very high prices on routes where Delta did not yet face Low Cost Carrier competition meant that in many cases it was only a matter of time before it did. The abandonment of extreme forms of Differential pricing was therefore an essential defensive measure.

This has been a long, involved, but necessary discussion on the merits or otherwise of Differential approaches to airline pricing policy. It will always be necessary for airlines to vary their fares over time, to even out variations in demand and to ensure that they fill as high a proportion of their seats as possible. Some efforts to take advantage of varying demand elasticities between market segments are also justified – we will continue with the theme of how this can best be done in the next section. However, it is now clear that in the past, Legacy carriers have taken these measures too far. They have done so because extreme Differential pricing offered them the advantage of the maximisation of short-term revenues, something which they needed because of the fundamental weakness of their position – as 'Legacy' airlines their costs were too high. They are now having to accept that their cost problem must be addressed directly, and that it cannot be hidden by the fig leaf of suitably high yields gouged out by Differential pricing.

Management of Discount Fares

If, at least to a degree, a Differential pricing policy is to be employed, it needs to be managed and controlled properly. If it isn't, excessive amounts of so-called 'revenue dilution' will occur when too many people use the lowest fares in the range, and too few the higher prices.

Decisions about price levels must be made in an increasingly deregulated market, where airlines must both respond to the pricing initiatives of their competitors and decide when they should lead the market by a pricing initiative.

Control of discount fares is exercised in two ways. Firstly, and to an increasing degree, the Revenue Management system is used to decide on the number of low-fare seats which are available on different flights. As was discussed in Section 6:1, on off-peak flights, a large number of seats will be made available at low prices, reflecting the low marginal costs of filling seats which would otherwise be flown empty. On peak-time flights, however, few if any low fares will be offered, forcing people who need to travel on these flights to pay higher prices.

The second way in which control should be exercised is through the setting of restrictive conditions on discount fares. With these conditions, the best of them do not aim to simply make a fare unusable by business travellers whom in the past airlines have assumed would then pay them more. Instead, they should make a fare available to all who are prepared and able to meet the condition, and ensure that, if the correct cost allocation methods are used, that the passenger who pays a lower price is carried at a genuinely lower cost We now move on to discuss some of the more common conditions associated with discount fares, in the light of this requirement.

Minimum Stay Conditions

Many discount fares in the past have required passengers to spend a minimum amount of time at their destination. On short-haul routes, a Saturday night stay has often been specified. This has meant that passengers could not make return journeys earlier than the Sunday morning following their outbound trip. On longer routes, a minimum period of days−usually seven− which must be spent at the destination was sometimes defined. In both cases, passengers could return early if they wished to do so. However, they would have to pay the full fare.

These conditions, whether set as a Saturday night stay or a period of days, all had the same purpose. They were designed to restrict the business travellers' freedom of action. The Saturday night stay condition meant that they had to use the full fare to spend the weekend at home. Also, business trips usually last for only a few days in any one place. Indeed, a salesperson on a sales tour may visit several countries on a two or three week business trip. The Minimum Stay Conditions on the cheaper fares ensured that they had to buy a full fare ticket in order to obtain the flexibility they needed.

To some degree, length-of-stay conditions met the criterion set down in the last paragraph, of being cost-related. In particular, A 'Saturday Night Stay' rule could be said to do so. Most airlines find that their flights on the evening before the weekend begins are very full, but on Sundays generally loads are much lower. Therefore, a condition which encourages at least some passengers to delay their return may have the beneficial effect of lessening the extent of a peak, whilst lower prices may generate additional trips at off-peak times which will fill otherwise empty seats at lower, but still profitable, yields.

Generally, Minimum Stay rules are amongst the most effective of the conditions designed to protect airlines' high yielding traffic, providing they are strictly applied.

Maximum Stay Conditions

Maximum Stay Conditions define a maximum length of time that passengers can stay at their destinations and still return home using a cheaper discounted fare. If they stay longer than the stipulated maximum − 45 or 60 day periods are often allowed − they will have to pay the full fare to return.

Generally, Maximum Stay Conditions are a less effective way of controlling discount fares and their usage by airlines has declined in recent years. They may, though, have some effect in controlling dilution in that sometimes someone who is travelling to a destination and staying for several months may not be on holiday. Instead, they may be travelling on a business contract, in which case their employer will be paying the fare. They may be able to pay a higher price as a result.

Advanced Purchase

Advanced purchase rules are still sometimes applied to discount fares. They mean that passengers must book and pay for their ticket a defined minimum period in advance. They must also accept that there will be a substantial penalty if they wish to alter or cancel their booking once they have made it. Advanced Purchase conditions bring airlines a number of

advantages. They improve cash flow. They also ease the task of capacity management in that they force low yielding demand to come forward at an early stage. Their most telling advantage, though is again that they make it difficult for the business traveller to use a lower fare. Many business trips arise in response to last-minute emergencies and cannot be planned far in advance. Even where they can be, business executives often cannot accept the limits on their flexibility that a cancellation or rebooking penalty will cause.

Standby

Standby fares can be booked at any time. They do not, though, guarantee the passenger a seat on a particular flight. Instead, the passenger must report for a flight and wait. If there is an empty seat, they will travel. If there isn't, because the flight is full with higher yielding demand, the Standby passenger will not be given a seat. Instead, they will have their money refunded, or will have to wait for a later flight.

Standby fares bring a number of advantages. They are a genuinely cost-related lower fare, in that they are profitable as long as the fare paid exceeds the passenger-related costs of filling an otherwise empty seat. Also, they are often sold at the airport or at an airline's downtown ticket offices. Therefore, no commission has to be paid on them. They permit airlines to exploit a market for last minute, unplanned leisure travel decisions. Advanced booking requirements do not allow this. Of most importance, though, is the fact that, if properly managed, Standby fares protect airlines from revenue dilution. Except in the circumstances discussed below, a business traveller who has to attend an important meeting is unlikely to use a Standby fare to reach it, in view of the uncertainty involved.

Despite these advantages, the use of Standby fares remains controversial, and many airlines have backed away from them in recent years. They are certainly unpopular with airport operators, because of the risk they carry that airport terminals will become crowded with people holding Standby tickets waiting for many hours − perhaps days − for flights on which they can be offered a seat. Also, a passenger holding a Standby ticket for a particular flight has an incentive to phone the airline to make extra bookings using false names, addresses and contact phone numbers. Finally, business travellers may find it surprisingly easy to take advantage of a Standby ticket. All they need to do is to buy a full Economy ticket in advance of their flight. On arrival at the airport they check to see if the flight is fully booked. If it isn't, they then buy a Standby, fully confident that they will be offered a seat. The full-fare ticket is, of course, refundable. They would merely keep this ticket to claim their refund at a later date. Had they found the flight full, they would have used their full-fare ticket in order to get on it. A final point about Standby fares is a particularly important one. Airlines should not offer Standby fares on their off-peak flights. This is an apparent contradiction. Off-peak flights are those with the greatest number of empty seats, which the Standby fare can help to fill. If, though, Standbys are allowed on off-peak flights, the dilutionary effects of doing so will be severe. Passengers who need to take the flight in question will still have a very high probability of getting it, despite the fact that they only hold a Standby ticket. In contrast, Standbys bought at the peak season will carry with them a significant risk that a seat will not be available. Business travellers in particular may not therefore be able to use them.

"Preferential" Fares

Airlines today still offer many types of cheaper fare which are only available to named groups of passengers. These fares can be divided into two types. First, what are known as stage-of-life fares. Examples include the special low fares offered to children, young people and to senior citizens. Second, airlines offer many occupation-related cheaper fares. Special fares are, for example, often given to seamen, to military personnel and to diplomats.

These "Preferential" fares (they are sometimes, and better, described as "Discriminatory" fares) give preference to named groups. Unfortunately, it is impossible to support them as a form of pricing for airlines. Those carriers that use them often find that they are offering an increasing number of discounts to a wider and wider range of their passengers. The reason is, of course, that once a discriminatory discount has been offered to one group, there are no reasons of principle to deny it to others. Airlines will therefore be subject to constant lobbying, to some of which they may eventually have to give way. Also, after a discriminatory discount has been introduced, it will be very difficult for airlines to withdraw it. Once a particular group has known the privilege of cheaper fares on a preferential basis, they will fight hard to retain this right.

Fares Only Available as Part of a Tour Package

These conditions limit the sale of fares to wholesalers, who are then supposed to add in the accommodation and other features which make up a packaged holiday. Only these complete holidays should then be retailed. If these rules are complied with, again the proposition becomes an unattractive one to the business traveller.

Pricing Response and Pricing Initiatives

Today, in price-competitive markets, pricing managers will be constantly faced with situations where they have to decide whether or not to respond to the pricing initiatives of their rivals. This may involve questions of responding – or not doing so – to the fares discounts that a competitor introduces. There may also be opportunities to lead the market either in terms of discounts, or in the raising of prices to improve yields.

In all these situations, it can, of course, be argued that every case is unique. Whilst this is undoubtedly true in principle, it is an unhelpful proposition in terms of airlines deciding on what their pricing policy should be. Instead, it can be argued that there is a series of questions which should always be asked. The answers to these questions will ensure that there is at least a consistency in an airline's pricing philosophy.

If we begin with the situation of a rival airline coming into a market with discounted fares, the most fundamental question of all is to decide why they are doing so. There is a wide variety of possible reasons for an airline to offer discounts, reasons which will explain whether or not the initiative may be limited and short-term − in which case it may be possible to ignore it − or substantial and long-term, demanding action from competitors.

In terms of possible reasons for lowering fares, by far and away the most common is that the airline is suffering from an overcapacity problem. It may have taken delivery of an aircraft

type which is too big for the prevailing demand, or over-ordered in terms of the number of planes entering its fleet. Such mistakes may be exacerbated by the Trade Cycle entering a downswing, so that forecast increases in demand − which might have filled the new capacity − do not materialise.

In such a situation, other airlines will have little alternative but to respond to the challenge with which they are being faced. By responding, they will risk running into a loss-making situation. By not doing so, though, the fall in their market share may cause even worse problems.

Closely related to price discounting caused by overcapacity is the situation where an airline cuts fares in order to raise cash in the short term. A carrier on the edge of bankruptcy will need to find the cash in order to pay off its most demanding creditors. If it cannot do so, these creditors may insist on the liquidation of the company, seeing this as the best hope of securing at least some of the money they are owed.

This type of pricing is often characterized as the "Dash-for-Cash". It poses an awkward problem for other airlines challenged by it. Their first reaction might be to respond fully by matching or even undercutting the lower prices of the failing airline. By doing so, they would hope to speed its decline into bankruptcy, resulting eventually in the removal of the competitor from the market altogether.

Today, such a reaction might be over-hasty. If an airline disappears, it will certainly be replaced by another, probably stronger, carrier. The long-term result of a weak airline going into bankruptcy may therefore be that a favourable competitive situation is replaced by an unfavourable one. It is often better to allow a weak airline to raise sufficient cash to stay in business, by not fully responding to any desperate pricing initiatives it may undertake. Such a conclusion may be especially true in the USA where Chapter 11 of the bankruptcy code may allow an insolvent airline to survive for a considerable time using the expedient of court protection from its creditors. Whilst it does so, it may be able to price in a cavalier and destructive fashion because it knows that only its short-term creditors (in order to persuade them to continue to forward necessary supplies) rather than its long-term creditors will need to be paid.

There are other reasons why an airline may offer lower prices. A start-up airline may do so, in order to gain useful publicity and to persuade people to try its services. Equally, a mature airline might do so when launching a new route serving a market where it is not well-known. In both cases, established players will have difficult decisions to make. If they match, or even undercut the newcomer they will undoubtedly make life very difficult. They will, though also dilute the yield obtained from the large number of passengers who would have continued to fly with them anyway, despite the newcomer's presence. They may also (within the European Union at least) risk court action being taken against them, with the accusation that they have abused a dominant position under the terms of Article 82 of the Treaty of Rome.

Once a view has been taken as to why a competitor is engaging in fare discounting, other questions then come into play.

The question of appropriate action will be very different in the situation where the price leader is a dominant player rather than a minor market participant. A large airline in its home market will have sufficient power to ensure that whatever pricing initiatives it takes, these will almost certainly have to be followed by its rivals. A minor player, though, may well be left alone if its overall impact on the market is small.

A further question is that of the number of seats made available at discounted prices. Modern Revenue Management systems allow a precise control to be kept not only on the prices which are offered, but also of the number of seats available at each price in an airline's Differential pricing structure. There have been accusations from time to time that some carriers use advertisements describing attractive offers of lower prices in an unscrupulous way. These offers are designed to encourage people to contact the airline seeking the very low prices described in the advertisements. In fact, the airline ensures that very few seats are available for sale at these prices. Those making enquires are told that all the very low-priced seats have already been sold, but that seats are still available at a significantly higher fare. The aim is to "bait and switch" these people into buying higher priced tickets.

Whilst the morality of such tactics is open to question, their implications for pricing policy are clear. Rival airlines should not over-react to the prices placed in newspaper advertisements. Rather, they should base their reaction on the number of seats being made available at the different fares. This can easily be checked by calling the airline in question or visiting its website and making enquiries about seat availability.

A final issue with the question of response to a discounting competitor is the need to study past situations where price discounting has occurred in a particular market. Such discounting often has a seasonal component to it. It commonly breaks out at the end of the summer peak season as airlines position themselves for the quieter winter period. Careful study of the effect on market share and yield of past decisions to match or not to match rival's fare initiatives will certainly have a bearing on the question of appropriate responses to any current challenges being laid down by competitors.

The other major question airlines need to address in managing pricing is when they should take the risk of leading the market in terms of a price increase.

Sometimes, it will be possible to do this in consultation with rival airlines. In some international markets, it is still possible for competitor carriers to meet together at the Traffic Conferences organised by IATA These conferences can be used to discuss the levels of the higher, fully flexible, fares with hopefully (from the airline's point-of-view) agreement being reached that these fares should be raised in tandem. In other situations, all the different airlines serving a market may unite in a so-called Yield Improvement Programme (YIP), with again the questions of reduced availability of discount fares and fare increases on the agenda.

Today, the evidence is that such multi-airline approaches to tariffs management are only effective in situations where capacity and demand are in some sort of equilibrium. When they are not, one or two airlines will always break ranks in pursuit of their own commercial objectives. Once they have done so, any agreement will quickly break down due to the pressures of market forces. Of course, too, airlines must be very careful not to discuss raising

prices in any situation where this will break applicable competition laws. British Airways was reminded of this in the summer of 2006 when investigations were begun to decide if it had colluded with its competitors over the question of fuel surcharges.

In a situation where airlines are under pressure to raise their prices, it will often be the case that the requirement to do so is dictated by poor profitability. In turn, low profits or losses may be caused by cost increases. If they are, it will be vital to decide whether these increases are in "Controllable" or "Uncontrollable" costs.

"Uncontrollable" costs are those which airlines can do little or nothing to influence. Examples are the price of aircraft fuel and the level of landing fees. If these rise, they will affect all airlines more-or-less equally. Presumably all carriers will then welcome the opportunity to raise prices on order to, hopefully, allow their financial position to recover. At the time of writing, this is happening as carriers attempt to respond to rapid increases in oil prices.

"Controllable" costs are those which are within the control of airline management. By far the largest component of them for almost all airlines is that of labour costs. Typically, 30 percent of a carrier's total costs will be made up of these costs. In pricing terms a very worrying situation is that where an airline fails to control its labour costs effectively by conceding an over-generous wage and salary settlement, or by allowing changes in work rules which damage productivity. Then, rival, better-managed carriers will not be affected to the same degree. They may in turn see competitive advantage in not matching any fare increases which might be put in place to cover higher costs, instead seeking to improve market shares on the basis of sustainable cheaper prices. Beyond any question, in a market where active price-competition is taking place, effective management of these controllable costs is one if the central tasks which management must address.

Other factors to be taken into account in deciding whether or not to lead the market with a price increase, are the questions of the stage of the Trade Cycle, and the degree of market dominance which a carrier has. Generally, it is possible to raise prices much more easily in the up-swing period of the Trade Cycle when demand is recovering and deliveries of new aircraft comparatively small (due to airlines only ordering small numbers of planes during the preceding recession).

This was well-illustrated by the upswing period in the mid-1990's when many airlines were successful in raising prices. They were able to do so to such a degree that yields improved in real terms for the first time in many years. Something similar has occurred during the period of buoyant growth in the world economy during 2004 and 2005.

With regard to market dominance, generally it is a strong airline in its home market that will decide when prices will rise in such a market. Smaller players will often have little choice but to follow the initiatives taken by their stronger rival.

All-in-all, the questions of pricing response and pricing initiatives illustrate the enormous changes which have come about in the skills required to manage pricing in the airline industry. Today, it is a question of judging, quickly, the pricing decisions which need to be made, in the ever-present knowledge that mistakes will result in large financial losses.

THE STRUCTURE OF AIR FREIGHT PRICING

Pricing policy for air freight is just as controversial as that on the passenger side of the industry. It is also an area where considerable, and long-overdue, change has come about in recent years.

Air freight pricing policy has in principle to encompass almost all of the problems which occur on the passenger side of the business. In addition, a way must be found to taking account of significant differences which are unique to air freight. For example, air freight shipments vary in size from very small packages to consignments of 30,000 kilos or more. Costs, though, do not vary in the same way. Many costs, such as those of documentation and customs clearance are fixed irrespective of consignment size. Also, commodity types vary, often with an impact on cost levels. Some commodities may need extra security. Perishable goods will need refrigeration, whilst especially fragile items may need special handling. Pricing policy must as far as possible reflect these differences. A further problem is that of density. Airlines must charge shippers of low density freight on a volumetric basis. If they do not, they run the risk that they will attract excessive amounts of low density cargo which will fill the volumetric capacity of aircraft without their payload potential being fully exploited.

All these issues are important in air freight pricing. Perhaps the most difficult problem, though, is to find a cost base for pricing in a situation where airlines are using different types of capacity to carry freight.

Where freight is carried in a pure freighter aircraft, the appropriate cost base is clear. Airlines must aim to recover all the costs of operation including such items as depreciation, maintenance, crew salaries and landing fees. When the belly-hold of a passenger aircraft is used the situation is by no means as obvious. Then, some of the costs will clearly be attributable to freight, such as those of freight handling and selling, and the costs of extra fuel burnt as a result of the weight of freight carried. Many costs of these flights will, though, be joint costs. This will be the case, for example, with costs such as those for crew salaries, maintenance and landing fees.

Many airlines now attempt to apportion these costs between the passenger and freight output of a particular flight. This may make some sense at peak times for freight, and on long-haul routes, where it might be argued that the use of belly-hold space saves the costs of the airline's freight department from operating pure freighters. It does not do so at off-peak times, or on routes with little freight demand. Then, the freight department would not operate services at all if it was free to make its own commercial decisions.

In seeking a cost base for pricing, airlines must clearly never offer prices which fall below the level of the marginal costs of freight handling and selling. They must, though, aim to do a great deal better then this. Freight must make a significant contribution to the total costs of flights where a substantial proportion of the aircraft's potential payload consists of belly-hold freight capacity. This will especially be the case if the airline is also operating freighter aircraft. Prices based merely on marginal belly-hold costs will come nowhere near the levels necessary to cover the operating costs of a freighter.

Given these various constraints, it should not be surprising that the subject of air freight pricing has been a controversial one.

In the past, it was possible to divide freight pricing into two distinct parts. Firstly, airlines offered so-called General Cargo Rates. These were pitched at a very high level, with an even higher Minimum Charge for the smallest shipments. Discounts were then offered for larger consignments, to reflect lower documentation and handling costs. The highest rates applied only to shipments weighing 45 kilos or less.

The second part of the traditional air freight rate structure was much more controversial. In addition to General Cargo Rates carriers offered a range of lower so-called Specific Commodity Rates. These were usually available only for larger consignments. Also, they could only be used for specific, named types of freight. IATA set up a complex system to allow its member airlines to define the commodities which would, and would not, be charged a lower rate.

The Specific Commodity Rate system was fundamentally in error. It was based on the principle, comparable to that used on the passenger side of the industry, that if price-sensitive users could be brought into the market, the size of the total market could be expanded with benefits to all customers. The mistake was to equate price sensitivity to commodity type, rather than to the urgency of the shipment. By using commodity type, airlines were faced with insoluble problems of commodity definition, problems that made the industry a laughing stock. For example, should a Specific Commodity Rate covering "footwear" allow socks, bandages or indeed anything else that might be worn on feet to be set at the concessionary rate, in addition to shoes? Also, the system produced a classic problem, encountered in many discriminatory pricing systems. Once a concessionary rate had been offered for one type of commodity, there were few arguments of principle to deny them to shippers of other types of freight. As a result, the role of Specific Commodity Rates changed. They were originally intended to provide a supplement to the General Cargo Rate system. Instead, on some routes (notably the North Atlantic), they came to dominate the rate structure with a high proportion of all cargo moving under them. The implications for average yields then became significant.

In recent years, the emphasis of airline's freight pricing policy has altered. The introduction of the so-called Bulk Unitization Programme was dealt with in Section 5:6. It largely changed the basis of air freight pricing from one of discrimination by commodity type to Freight-of-all-Kinds (FAK) instead. Bulk Unitization rates were available for any type of freight, provided it was pre-loaded into an aircraft Unit Load Device (usually a container), or stowed onto a pallet. They were therefore fairer, and much simpler to administer. The problem with them was that they gave excessive power to the air freight forwarding industry, because it was only the largest shipments (which the forwarders could provide through their consolidation activities) which qualified. They also did not differentiate between shipments in terms of urgency.

Today, most airlines by-pass the old, cumbersome structure of air freight rates. Rates are set through negotiation between customer and airline, with rates rising and falling in recognition of the balance between supply and demand in the market. Substantial discounts are generally

offered to customers willing to accept deferred delivery, because this often allows airlines to fly their goods during the off-peak period at the beginning of the working week rather than at the busy time at the end of it when there may be shortages of capacity.

In the so-called "Express" market of small, urgent shipments, pricing policies have been led by the integrated carriers such as UPS, Federal Express, DHL and TNT. As was discussed in Section 4:2:6., these firms have not relied on the air freight forwarding industry for their traffic. Instead, they have invested in building strong brands, and promoting these heavily to the retail market. The brands have been divided between those which offer guaranteed next-morning delivery at a premium price, and ones which give a slower, but still time-definite, delivery. Again, this allows carriage to be delayed from peak into an off-peak period.

Such a product-based approach to pricing is simple to administer and essentially fair between different types of customer. Not surprisingly it has been followed by many combination airlines which have launched their own branded products in an attempt to compete with the Integrators. Generally, though, these have been offered on an airport-to-airport basis with the ground transportation provided by air freight forwarders who have been encouraged to sell the products on a commissionable basis.

All-in-all, the field of pricing is one of the most rapidly changing and most challenging in the whole area of airline marketing activity. Only by a flexible adherence to a set of clear principles can costly mistakes be avoided.

REVENUE MANAGEMENT

When is its Use Appropriate?

Revenue Management is an economic discipline appropriate to many service industries in which "market segment pricing" is combined with statistical analysis to expand the market for the service and increase the revenue "revenue" per unit of available capacity. The intelligent use of revenue management principles can be used to increase top line revenue a bottom line profitability in any service industry possessing the following characteristics[2]:

- Demand for the service can be divided into clear market segments and sensitivity to prices varies among the market segments.
- The firm's capacity is relatively fixed; it is expensive or impractical to add or subtract inventory in the short run, though there may be some ability to shift it.
- There is a time dimension to the provision of the service – once that time has passed, the inventory loses all of its value.
- The cost of selling an additional unit of the existing capacity is low relative to the price of the service.
- There is an opportunity to evaluate and accept or reject order requests in advance of the performance of the service, or

There is considerable flexibility to adjust prices quickly to reflect variations in the balance of supply and demand.

- There are definite peaks and valleys in demand, which can be predicted, but not with a high degree of certainty.

The most familiar and well revenue management in practice is the Airline industry where:

- Segmented Markets
  Demand is segmented into business and leisure market segments using discount fare restrictions. Relatively price insensitive business travelers are charged higher fares than more price sensitive leisure travelers.
- Fixed Capacity
  The number of seats on a flight is fixed once schedules are set.
- Perishable Inventory
  Once a flight has departed, the unsold seat inventory has no value.
- Low Marginal Servicing Costs
  The out-of-pocket cost of adding a passenger to a flight is very low. (Meals and servicing expenses of less than $10.)
- Advance Sales
  Booking requests are tendered in advance of departure and can be evaluated using logic programmed into the computerized reservation system. Fares can be changed on short notice.
- Uncertain Demand Forecasts
  Passenger demand varies by season, day-of-week, and time-of-day and can be forecast by flight and fare category, but not precisely.

Airlines that practice revenue management well have found that they have added as much as five to ten percent to their bottom line revenues. Airlines consider their revenue management systems to be strategic systems and they continue to invest heavily in them.
Revenue management has also taken hold widely throughout the rest of the Travel industry as well. Almost all major Hotel, Car Rental Agencies, Cruise Lines and Passenger Railroad firms have, or are developing, revenue management systems. Other industries that appear ripe for the application of revenue management concepts include Golf Courses, Freight Transportation, Health Care, Utilities, Television Broadcast, Spa Resorts, Advertising, Telecommunications, Ticketing, Restaurants and Web Conferencing. Let us go through the checklist to see if revenue management is applicable to your industry. Are some or all of the following characteristics applicable to your business?

- Perishable inventory
- Relatively fixed capacity
- High fixed costs, low variable costs
- Advance reservations
- Time variable demand
- Appropriate cost and pricing structure
- Segmentable markets

SOME INDUSTRIES THAT MEET CRITERIA FOR APPLICATION OF REVENUE MANAGEMENT

REVENUE MANAGEMENT CRITERION	**Industry:** ***AIRLINES***	***HOTELS***	***CAR RENTAL***	***FREIGHT TRANSPOR-TATION***	***HEALTH CARE***	***BROAD-CASTING***	***TELEPHONE***	***GOLF***
Market Segmentation	Market is segmented between business and leisure travel using Discount Fare Restrictions	Can pursue airline strategy	Can pursue airline strategy	Market is segmented by type of commodity to be transported	Time Sensitive Care vs. Postponable Care, Clinical Care vs. Surgical Care	Guaranteed Spots vs. Preemptable Spots vs. Rotatable Spots	Businesses vs. Residences Wire or Landline vs. Wireless or Satellite	Member vs. Guest or Walk In Senior vs. Adult vs. Child
Unit of Fixed Capacity	Flight	Hotel	Car Fleet	Truck, Train	Hospital	Television Show	Phone Network	Golf Course
Unit of Perishable Inventory	Departing Seat	Room Night	Car Day	Trailer/Boxcar Departure Labor	OR Room Hour/ Bed Night	Advertising Second or Minute	Line Minute vs. Airtime	Tee Time
Low Marginal Costs for Incremental Sales	Passenger Meals, Processing	Order Processing, Room Cleaning	Order Processing, Car Cleaning	Order Processing, Freight Handling Gas	Order Processing, Meals, Supplies	Order Processing Distribution Channel	None?	Order Processing
Bookings Taken in Advance	Yes (up to a year)	Yes	Yes	Yes, but often close to departure	Yes, for elective procedures	Yes	Not usually	Yes
Demand Forecasting Cycles:								
Seasonal	Yes	Yes	Yes	Yes	?	Yes	Yes	Yes
Day-of-Week	Yes	Yes	Yes	Yes	?	Yes	Yes	Yes
Time-of-Day	Yes	Not usually	Sometimes	Sometimes	?	Yes	Yes	Yes
Other	-	-	-	-	?	Popularity of show	-	

SOME INDUSTRIES THAT MEET CRITERIA FOR APPLICATION OF REVENUE MANAGEMENT

REVENUE MANAGEMENT CRITERION	*RETAIL*	*PASSENGER RAILROAD*	*ELECTRIC POWER UTILITIES*					
Market Segmentation	Store/Demographic based market segmentation, multiple stores in multiple locations	Low Fares on Price Sensitive Segments, Fare Restrictions and Discount Allocations, Optimizing Mix of Short versus Long Haul	Pricing Peak versus Non-Peak Hours, Peak versus Non-peak Seasons, Residential versus Commercial versus Industrial Customers					
Unit of Fixed Capacity	SKU	Maximizing Profit by Optimal Capacity Utilization	Central Plant or Distributed Generation					
Unit of Perishable Inventory	Maximizing Supplier Deals with Distribution and Clearance Optimization	Seat/Track Network Oriented Traffic Mix Optimization	Lost Energy					
Low Marginal Costs for Incremental Sales	Base Price Optimization, Promotion Optimization, Clearance Optimization and Category Management	Order Processing	Pricing based on Demand & Supply, Load and Distribution Management					

REVENUE MANAGEMENT CRITERION	*RETAIL*	*PASSENGER RAILROAD*	*ELECTRIC POWER UTILITIES*					
Bookings Taken in Advance	Not usually	Yes but usually with very Short Booking Lead Times	Energy Storage					
Demand Forecasting Cycles: **Seasonal** **Day-of-Week** **Time-of-Day** **Other**	 Yes Yes Yes Yes Store Based and Cross Shopping Patterns	 Yes Yes Yes Yes Network Oriented Traffic Mix Forecasting and Optimization	 Yes Yes Yes Yes Balancing of Demand and Supply					

How Does It Work?

Market Segment Pricing

The first step in a revenue management program is to define the various segments of the market for your service. Then you can design ways in which you can charge different prices to the different market segments, a practice which economists refer to as economic price discrimination. The objective is to expand your market and increase your revenue potential by charging higher prices to those market segments which are not responsive to changes in price level and lower prices to those market segments which will respond to a price reduction by increasing their purchases by a large enough amount to more than offset the revenue reduction occasioned by the discount.

In the travel industries, the business travel segment of the market is less sensitive to price levels than the leisure segment. Service providers offer discounts to the leisure segment of the market. Business travelers are largely precluded from taking advantage of these discounts through the imposition of advance purchase and length-of-stay requirements. Travel companies know that these restrictions do not suit normal business travel characteristics.

CHARACTERISTICS	BUSINESS TRAVEL	LEISURE TRAVEL
Advance Booking	Booked close to departure.	Booked well in advance of departure.
Stay at Destination	Rarely includes a weekend.	Usually includes a weekend.

Obviously these types of devices will not work in other service industries; however, it is likely that there is some way, often more direct, to segment the market in most industries:

INDUSTRY	METHOD OF MARKET SEGMENTATION
Freight Transportation	Vary rates by commodity being shipped.
Health Care	Time sensitive care vs. postponable care.
Broadcasting	Guaranteed spots vs. preemptable spots vs. rotatable spots.
Utilities	Urgent, non-discretionary service vs. non-urgent, interruptible service.

The reduced price offered to the price sensitive segment of the market may also be associated with the grade or class of service or reduced cost of delivering the service, but this is not necessary when employing market segment pricing.

Peak/Off-Peak Pricing

Quite often, a time element is added to the pricing of a service. Demand for a service is managed by raising prices during periods of peak demand and discounting prices during periods of slack demand[6]. Some examples of this in various industries include:

INDUSTRY	TYPE OF DISCOUNT
Air Travel	Night Coach fares.
Car Rental/Hotel	Weekend discounts in major cities (not resorts).
Telephone Companies	Reduced long distance rates on nights and weekends.
Theaters	Discounted Matinees.
Golf	Discounted off peak tee times.

Peak/Off-Peak Pricing is complimentary to other revenue management techniques that will be discussed in later sections. There are often practical limitations on the application of peak/off-peak pricing which are posed by the limited ability of service consumers to digest rate schedule complexity. These limitations do not seem to be as severe for the forms of revenue management that employ inventory rationing, which we will discuss next. Advanced revenue management techniques such as those designed by IDeaS can provide precise feedback for the fine-tuning of peak/off-peak pricing strategies.

Forecasting Demand

Once the market has been segmented and the initial rate structure has been put into place, the other elements of revenue management come into play. The first of these is the Demand Forecasting process.

In most service industries, demand for the product exhibits one or more regular patterns – either cyclic in nature (such as time -of-day, day-of-week or season-of-year), or trends (growth in demand due to growth in the economy at large), which can be projected forward in order to estimate future demand in each market segment. The forecasts that can be produced by analyzing these patterns are seldom precise.

~~The most that one can us~~ually say is that we are 99% confident that the demand for the service on a particular future day and/or time will be “50” plus or minus “25” percent. Or that we feel that there is an “80” percent probability that demand will be at least “40.”

It is this uncertainty about the future demand for the service that gives revenue management its revenue advantage and makes it a challenge. It is the management of this uncertainty that is the essence of revenue management. The uncertainty is managed by:

- Minimizing the uncertainty by producing the best possible forecast of demand and its degree of unpredictable variation.
- Acknowledging the uncertainty and reflecting it in the decision analysis process.

When we make decisions about pricing our service as if we could know with certainty that we will be offered a specific level of demand when, in fact, there is only some probability that it may materialize, we make many bad decisions which, over time, are sure to cost us money.

Inventory Allocation Basics

The objective of revenue management is to allocate inventory among price levels/market segments to maximize total expected revenue or profits in the face of uncertain levels of demand for your service.

If we reserve a unit of capacity (an airline seat or a hotel room or 30 seconds of television advertising time) for the exclusive use of a potential customer who has a 70 percent probability of wanting it and is in a market segment with a price of $100 per unit, then the expected revenue for that unit is $70 *($100 x 70%)*. Faced with this situation 10 times, we would expect that 7 times the customer would appear and pay us $100 and 3 times he would fail to materialize and we would get nothing. We would collect a total of $700 for the 10 units of capacity or an average of $70 per unit.

Suppose another customer appeared and offered us $60 for the unit, in cash, on the spot. Should we accept his offer? No, because as long as we are able to keep a long-term perspective, we know that a 100 percent probability of getting $60 gives us expected revenue of only $60. Over 10 occurrences we would only get $600 following the "bird in the hand" strategy.

Now, what if instead the customer in front of us was offering $80 cash for the unit. Is this offer acceptable to us? Yes; because his expected revenue *(100% x $80 = $80)* is greater than that of the potential passenger "in the bush". Over 10 occurrences, we would get $800 in this situation or $80 per unit.

If the person offers exactly $70 cash we would be indifferent about selling him the unit because the expected revenue from him is equal to that of the potential customer *(100% x $70 = 70% x $100 = $70)*. The bottom line is that $70 is the lowest price that we should accept from a customer standing in front of us. If someone offers us more than $70, we sell, otherwise we do not. This is one of the key concepts of Revenue Management.

> *We should never sell a unit of capacity for less than we expect to receive for it from another customer, but if we can get more for it, the extra revenue goes right to the bottom line.*

What would have happened in this case if we had incorrectly assumed that we "knew" with certainty that the potential $100 customer would show up (after all, he usually does!). We would have turned away the guy who was willing to pay us $80 per unit and at the end of 10 occurrences, we would have $700 instead of $800.

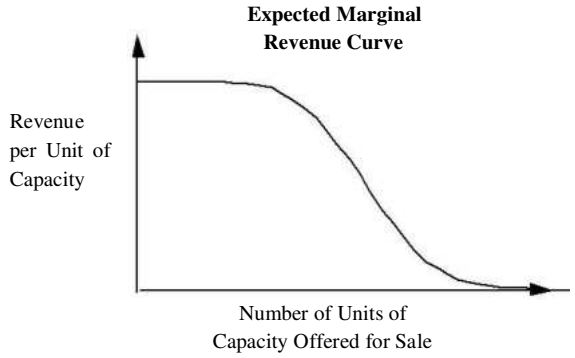
Thus we can see that by either ignoring uncertainty and assuming that what usually happens will always happen, or by always taking "the bird in the hand" because we are afraid to acknowledge and manage everyday risk and uncertainty as a normal part of doing business, we lose money.

Estimating Expected Revenue

The key to effective revenue management is the accurate estimation of the expected revenue of each unit of capacity for each available sale date. How is this number calculated?

One of the key principles of revenue management is that as the level of available capacity increases, the marginal expected revenue from each additional unit of capacity declines. If you offer only one unit of capacity for sale the probability of selling it is very high and it is very unlikely that you will have to offer a discount in order to sell it. Thus, the expected revenue estimate for that first unit will be quite high. However, with each additional unit of capacity that you offer for sale, the probability that it will be sold to a customer goes down a little (and the pressure to discount it goes up) until you reach the point where you are offering so much capacity that the probability of selling the last additional unit is close to zero, even if you practically give it away. At this point the expected revenue estimate for that seat is close to zero ($0 *x 0% = $0).*

Economists call this phenomenon the Expected Marginal Revenue Curve, which looks something like this:



The exact shape of the curve is determined from the probabilities of achieving each level of demand (which is estimated in the forecasting process) and the rate structure[7].

Note that EMR values can also be interpreted as the "Opportunity Costs" of the marginal units of inventory. They represent the alternative revenue opportunities that are foregone when we sell the marginal unit of inventory. It may be useful to think of the EMR value in

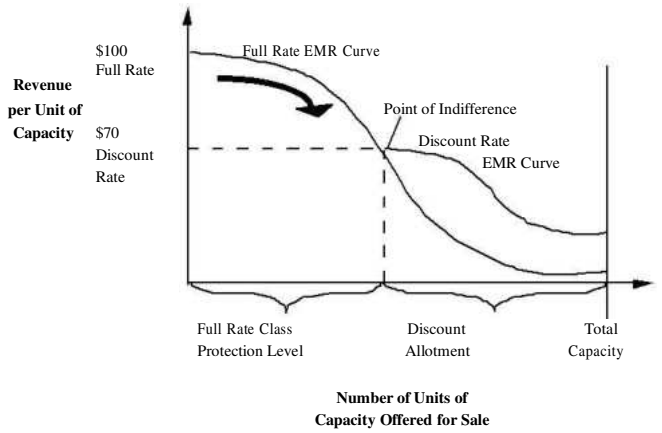
these terms as you read the next sections.

Applying the Expected Marginal Revenue Principal

Once the EMR curve has been calculated for all of the available units of capacity offered for sale together (e.g., all of the seats on one airline flight, all of the rooms available for rent at a hotel for one night, or all of the advertising minutes available on one episode of a television show), the information stored in the curve can be used in one of two different ways.

The first way is to use the curve to ration units of capacity between market segments/rate classes. In this method, which has historically been used in the Airline industry; the EMR curve is employed as follows.

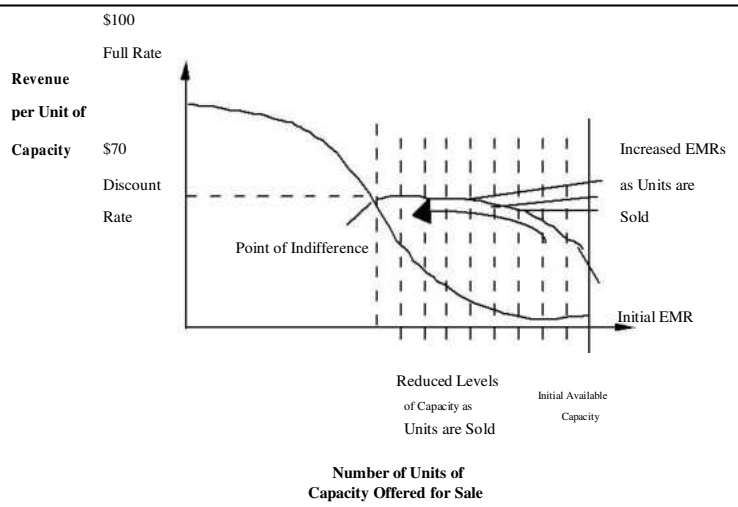
Units of capacity (e.g., seats) are reserved incrementally for customers in the highest rate class, one at a time, until the Expected Marginal Revenue for the next unit, if reserved for a customer in this rate category, is equal to or less than the next lower rate. Going back to our earlier example, if the full rate is $100 and our discount rate is $70, we would continue to reserve units for the exclusive use of customers in the $100 rate class until the probability of selling one more unit to such customers dropped to 70 percent. If that point was reached after reserving 10 units for the exclusive use of customers in the $100 rate class, we would say that the "protection level" for the first rate class was 10 units. The remaining units could be sold to customers in either rate class on a first come first served basis. In essence, with this approach you start on the left end of the EMR curve and move down to the right, reserving seats until you reach the point of indifference.



This is the typical way airlines currently determine discount seat allotments.

The second more direct and preferable way to apply the EMR principle to revenue management is a new approach championed by IDeaS and referred to as the "Bid Price" approach. In the Bid Price approach, the EMR value of the last (marginal) unit of capacity is

applied directly to define the lowest acceptable price (the Bid Price) for the next unit to be sold. As long as the rate requested is above the EMR Bid Price, the sale is permitted. Each time a unit is sold the number of available units shrinks by one and the EMR increases. In essence, you start at the right end of the EMR curve and move up and to the left, selling units at discount and shrinking the amount of capacity remaining available until the EMR for the remaining units of capacity reaches the point of indifference. At that point, you would stop selling units at the discount rate.



In our simple example, the result would be the same under either the rationing or Bid Price approach. You will end up selling the same number of Full Rate and Discount Rate units under either approach and the resulting revenue will be identical. The Bid Price approach is preferable because the complexities of real life revenue management situations can be much more simply, directly and intuitively incorporated into practical revenue management systems under the Bid Price approach[9].

These examples have been oversimplified in order to illustrate a single principle. They would only be literally true for a very limited scenario in which there were only two fare classes and all of the discount booking requests were tendered first and in a single transaction. In the real world, there are usually several fare classes and bookings in each class come in gradually over time. There are frequent opportunities to reforecast demand and recalculate EMR values. At each such revision point, what is forecast is the remaining orders to come, and the relevant inventory for which EMR values are recalculated is the inventory which remains available for sale. Past orders and inventory that has already been ordered are irrelevant[10]. In general, more frequent revisions result in greater revenue (though there is a point of diminishing returns).

Rate Management

Pricing

When rate structures are flexible, the EMR values produced by the revenue management

model itself can provide invaluable feedback to the rate setting process itself.
When EMR values are consistently higher than your published rates, it is a clear sign that your rates are too low and should be raised to at least the EMR value. The implementation of your revenue management program should prevent the sale of units at these uneconomic rates anyway, but why risk alienating your customers by posting a price that is never available?

As long as discount pricing can be successfully limited to truly price sensitive market segments, price reductions which move a rate downward towards a low EMR will result in increased revenue. Where high price sensitivity can be combined with the flexibility to pursue involved peak/off-peak pricing strategies with numerous variations in prices by time period, revenues will be maximized by setting prices right at the level of the EMR.

In the most extreme case where prices can be set on the spot rather than being pre-set in a rate schedule, the EMR value would tell your firm's negotiator what the lowest acceptable price would be for a particular unit of inventory at that point in time.

Several operators in the travel distribution channel are attempting to establish a shadow market in airline seats wherein potential customers would submit bid solicitations to be carried from one city to another within a given time frame. The customer would submit a proposed price with his request and participating carriers would decide to accept or reject the bid by comparing it to the EMR values on qualifying flights. The first airline to accept the bid would get the booking.

Contract/Promotion Evaluation

The EMR values produced by the Revenue Management system are also an essential ingredient in the proper evaluation of corporate contracts and other marketing promotions. Each time a unit is sold pursuant to a corporate contract or other marketing promotion, record both the EMR value of the unit that was sold and the actual revenue received from the sale. The difference represents the "economic profit" derived from the sale – the difference between the opportunity cost of the unit and the actual revenue received. If you then sum these "profits" (or losses) for all of the bookings made pursuant to a particular contract (or program) you'll know at the end whether or not the contract or program generated more revenue than it displaced from other existing sources of business. If it did not, then clearly the contract or program cannot have been profitable, even if one assumes that in the absence of the contract, all of that customer's business would be lost to a competitor.

Sometimes competitive pressures will force you to enter into a contract in which the customer is guaranteed access to any available seats regardless of discount availability. While these "last unit availability agreements" erode the effectiveness of a revenue management program and should be avoided if at all possible, there are ways to minimize their damage if you're stuck with them or if they were put in place to generate other revenue streams or business reason. Similarly sometimes service providers offer guaranteed availability that again is not a good yield management practice. If you must offer guaranteed availability, you can minimize the damage as follows: Forecast the demand for seats pursuant to these contracts and remove

an equivalent amount of available seats from inventory before valuing the remaining capacity and establishing allocations or bid prices. In essence, you remove this class of demand from the equation and optimize the remainder. Contracts with a last unit availability clause are much less likely to turn an economic profit than "capacity controlled" contracts.

The second key question which needs to be answered in order to judge the success of a contract or program is: Did the contract or program generate enough new customers at the reduced price to more than offset the discount offered and result in more total net revenue than before, considering the additional cost of conducting the program and servicing the extra customers. The answer to this question is usually found by statistical analysis or passenger surveys.

A contract or program cannot be judged a success unless *both* of these calculations have a positive result.

A sample "Contract/Program Effectiveness Statement" follows which describes one possible structured framework for answering these questions. In the statement, your "Baseline" figures represent your best estimate of what would happen without the contract or program while your "Actual" represents your actual experience with the contract or program. (A pro-forma statement could be produced before the contract or program became effective in order to evaluate program profitability under various scenarios.)

Sample Contract/Program Effectiveness Statement

BASELINE	PER CUSTOMER	TOTAL
Customers		5,000
Customer Revenue	$300	$1,500,000
Opportunity Costs (EMR Values)	$100	$500,000
Revenue Related Costs	$24 (8%)	$120,000
Customer Related Costs	$10	$50,000
Program Related Costs (promotion, administration)	-	-
NET PROFIT	$166	$830,000

ACTUAL	PER CUSTOMER	TOTAL
Customers		8,000
Customer Revenue	$200	$1,600,000
Opportunity Costs (EMR Values)	$100	$800,000
Revenue Related Costs	$16 (8%)	$128,000
Customer Related Cost	$10	$80,000
Program Related Costs (promotion, administration)	$5	$40,000
NET PROFIT	$69	$552,000

CHANGE	PER CUSTOMER	TOTAL
Customers		3,000
Customer Revenue	($100)	$100,000
Opportunity Costs (EMR Values)	n.c.	$300,000
Revenue Related Costs	($8)	$8,000
Customer Related Cost	n.c.	$30,000
Program Related Costs (promotion, administration)	$5	$40,000
NET PROFIT	($97)	($278,000)

Common Complicating Factors

Of course, the real world is never as "tidy" as the world inhabited by theoreticians, and the real world of revenue management is no exception. There are a number of practical complexities that overlay the basic framework that must be solved before a revenue management program can be successfully instituted. Many of these issues have parallels in ~~most, or all, of the service~~ industries susceptible to the practice of revenue management. The solutions to these common problems can be modeled in a similar fashion in each industry.

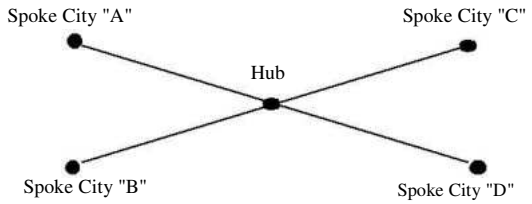
Network Effects

Sometimes it is necessary to jointly consume more than one unit of inventory in order to provide the desired service. For example, in order to route a telephone call from Milwaukee to Los Angeles, time may be consumed on one cable running from Milwaukee to Minneapolis and simultaneously consumed on a second cable running from Minneapolis to Los Angeles. The capacity available on each cable can alternatively be used to help satisfy demand in a number of other city pairs (e.g., Milwaukee-Seattle or Los Angeles-Duluth) and possibly in other rate classes in combination with other cables (the Minneapolis-Seattle and Minneapolis-Duluth cables). In addition, it may be possible to route Milwaukee-Los Angeles calls via Chicago or via a satellite circling the earth.

These "network effects" exist in one form or another in almost all of the revenue management target industries, and they greatly complicate the task of finding the true EMR value of the marginal unit of inventory in each of them.

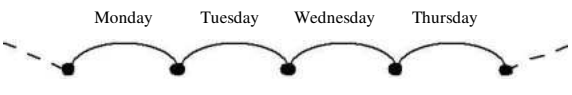
Network effects are obvious in the transportation and communications industries where the existence of transfer hubs is common. In the above example you could substitute the word "flight" for the word "cable" and you would have a clear description of the same phenomenon in the Airline industry.

A Simple Transportation/Communication Network



However, analogous "networks" also exist in the other target industries as well. When a Hotel or Car Rental customer requests a room or a car for three days/nights starting Monday, the room/car he uses on Monday could have been sold to other customers requesting to occupy the unit for any combination of days from one day to two (or more) weeks and in any number of rate classes.

A Simple Hospitality Industry "Network"



Let us take a simple Hotel industry example to illustrate this aspect of the revenue management equation. Consider a typical hotel catering to business travelers in a major city. As is common for such a hotel, it's down to its last two rooms for this coming Monday and Tuesday, but there are plenty of rooms available the rest of the week.

Four customers arrive at the front desk simultaneously to request a booking. *Customer A* needs a room for Monday night and would pay the full rate of $100 per night. *Customer B* needs a room for Tuesday night and would also pay the full rate. *Customer C* wants a room both Monday and Tuesday and qualifies for a two-day package rate of $150 ($75 per night). *Customer D* would stay all week and pay the weekly rate of $350 ($50 per night).

Which combination of bookings should be accepted to produce the highest revenue? The answer is: Customers A, B and D, which would produce a total revenue of $550 dollars. Can you find a better combination? Can you figure out a rule that could be used to find the right combination? Can you imagine trying to find the best solution for an airline hub network where 40 arriving flights connecting to 40 departing flights create 1,600 different city pair combinations, each of which may have 10 fare classes for a total of 16,000 possible city pair/class combinations to evaluate?

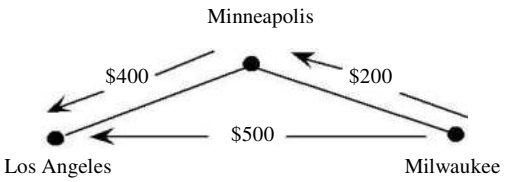
Believe it or not, there are rules and it is possible to solve this problem. A couple of simple rules: To the extent that you can sell an equal number of single, full rate units on all parts of your "network," you should generally do so. To the extent that demand for single full rate units is unbalanced across the network you are generally better off making discounted multi-unit sales instead. These rules assume that the multi-unit rate is greater than the single unit rate in absolute terms, but less in rate per unit terms.

For example, to the extent that a flight from Milwaukee to Minneapolis to Los Angeles can be filled with full fare passenger

Angeles for $400 *(total = $600)*, you should do so rather than accepting Milwaukee-Los Angeles passengers for $500.

However, to the extent that Minneapolis-Los Angeles demand ($400) exceeds Milwaukee-Minneapolis demand, the excess should be turned away to accommodate Milwaukee-Los Angeles passengers ($500) instead.

A Two Flight Airline Network



If total demand exceeds supply on the Minneapolis-Los Angeles leg of the flight but not on the Milwaukee-Minneapolis leg, then higher revenue will be produced by allocating scarce Minneapolis -Los Angeles seats to $500 Milwaukee-Los Angeles passengers.

If total demand exceeds supply on both legs of the flight, then higher revenue

will be produced by allotting seats to a combination of Milwaukee-Minneapolis and Minneapolis-Los Angeles passengers ($200 + $400 = $600) and denying seats to $500 Milwaukee -Los Angeles customers.

The mathematics involved in finding networked revenue management solutions is extremely challenging. This is the current "frontier" in airline revenue management research. The problem bears a superficial resemblance to other transportation logistics problems that are commonly solved using traditional linear programming techniques. However, the revenue management problem is essentially statistical in nature because of the necessity of working with probabilities (not certainties) of achieving different levels of demand for your service, and the traditional linear programming models are incapable of incorporating uncertainty. Hybrid statistical linear programming models that have been developed require too much computer power to be practical or cost effective in everyday commercial use.

In our earlier Hotel example, the Network EMR value for the last rooms on both Monday and Tuesday would be $100. It would be close to zero on the other days that never fill up. These "Bid Prices" would cause you to accept each of the single day Customers A and B since their $100 rate is equal to the $100 Bid Price; reject Customer C because his $150 two day rate is less than the combination of Monday's and Tuesday's Bid Prices *($100 + $100 = $200)*; and accept Customer D because his $350 weekly rate exceeds the sum of the week's Bid Prices *($100 + $100 + $0 + $0 ... = $200)*. As we said earlier, this is the correct choice of bookings to accept. It turns out that for every network, no matter how large or complicated, there is a unique set of Network EMR values, whic h, if applied as Bid Prices, will cause you to accept the unique set of customers that will revenue you the most revenue. The IDeaS software will find these Network EMR values for your networked revenue management problem.

The software can also be used to determine discrete inventory allotments for use in an inventory "rationing" revenue management approach, but in most cases the output is much more difficult, if not totally impractical, to successfully implement. Each network combination (e.g., an airline city pair/fare class/flight itinerary combination or a hotel day of arrival/length of stay/rate class combination) requires its own discrete inventory allotment. In the airline example, the resulting unit allotment for a city pair/fare class/itinerary combination with a low demand forecast may be one unit (or less, which is impossible to implement). What happens if the next several booking requests for this combination are all for parties of two?

If you move to group the many small allotments, or "nest" the lower revenue inventory allotments within the higher revenue allotments to make the output more manageable, the resulting compromise solution may produce less revenue than the uncompromised Bid Price solution.

Multiple Unit Orders

Not all order requests are for single units of inventory. In the travel industries, booking requests may be tendered for individuals, couples, families, or entire busloads of tourists. In order to evaluate an order for multiple units of inventory you should calcula te and sum the EMRs for the next "N" marginal units of inventory, where *N* is the number of units requested. If the sum of the revenue you would receive from the order request exceeds this amount, you should accept the order.

In the Bid Price control approach this is exactly what you would actually do. You would either a) precalculate and store the next several EMR values for future use, or b) precalculate a simple formula that would allow you to closely estimate the next several EMR values[13].

In the inventory rationing approach your rate class order limits are precalculated. However, a problem comes in when, for example, your order limit is three units and the next order request is for four units. The finite order limit may be precluding you from accepting an order that, on closer analysis, you find you should take.

When a significant proportion of the total demand comes in the form of large clumps which are tendered on an irregular basis, like airline tour groups, it can also make the demand forecasting problem much more difficult.

Marginal Cost Considerations

In most of the target service industries for revenue management, the marginal out-of-pocket cost of accommodating an additional customer using existing inventory is quite small. However, in some cases, such as travel agency commissions in the travel industries, it is important enough to incorporate into the model. It is handled quite simply by deducting these expenses from the gross revenue received from the customer and using the remaining net revenue per customer as the rate level input to the inventory allocation process.

In international markets commission expenses and net revenue after currency conversion may vary widely depending on the source of the order. These variations should also be factored into the evaluation process in the same manner.

Ancillary Revenue And Profit Considerations

Sometimes the opposite is true, that is to say that sometimes the acceptance of a customer booking for the basic service may result in additional revenues being indirectly generated to the firm, such as from the sale of meals, drinks, tickets and tee times to hotel customers. The expected profit per customer *(price of product – cost of product* x *probability of purchase)* from ancillary services should be added to the net revenue per customer used as the rate level input to the inventory allocation process. Sometimes the level
of expected ancillary profit varies by customer market segment. For example, persons attending a meeting at the hotel are more likely to take their meals there than are independent

vacation travelers.

Reflecting Subjective Value

A revenue management system should have some mechanism that allows the revenue manager to explicitly evaluate subjective or 'difficult to quantify' considerations in an informed manner in reaching decisions about when to sell or not sell a unit of inventory. Suppose the system is flashing a "don't sell" signal but the manager knows that this is an important client whose continued goodwill is worth a considerable amount of money down the road? To account for these cases the system should be designed to quantify the immediate negative revenue implications of accepting the sale so that it can be balanced against future revenue considerations. For example, if the system can tell the revenue manager that accepting this sale will cause an expected revenue loss of $200 (the price requested is $300 while the EMR for the requested unit of inventory is $500) the manager is now in a much better position to make an informed decision. (Is this customer's good will worth at least $200 in future sales?)

You would follow up on this decision by tracking the customer's future purchases. Ideally, you would want to capture the EMR value associated with each sale and compare it to the revenue actually received from the sale. The higher the cumulative "profit" (actual revenue less the EMR value of the inventory consumed) the more valuable the customer. In this manner you may find that you have lower volume customers that pay high prices for low value inventory that are adding much more to your bottom line than are other high volume customers that always pay low prices for high value inventory.

A firm could also measure the total revenue displacement occasioned by the use of free frequent customer vouchers in this manner and thereby conduct a much more rigorous evaluation of the economics of their frequent customer program. The "profits" from the qualifying purchases that were made to earn the award could be balanced against this "loss".

Multiple Rate Categories

The examples used to introduce the EMR principle in earlier sections were oversimplified for purposes of illustration. When there are more than two rate classifications (it is common to have *many* more in the Travel industry) the calculation of the correct EMR value becomes considerably more complex. Published mathematical formulas, which correctly calculate the EMR value when there are multiple rate classes require too much computer processing power to be of practical use.

Multiple Product Categories

In many cases in the target industries there may be multiple quality levels to the basic service product offering. Examples include First Class and Coach air travel, concierge, and standard floors in hotels, the various classes of rental cars, private vs. semi-private rooms in hospitals, etc. While demand should be forecast and inventory allocations produced for each product line, it is necessary to recognize that in some circumstances it is possible to substitute one

product line for another by "upgrading" the customer from an inferior product line to a superior one at no extra charge.

It will sometimes be the case that forecast demand for the superior product category is so low that the EMR value for the marginal units in the category will fall to a level below the EMR value for the marginal inventory units in an inferior product category with high forecasted demand. For example, there may only be a 25 percent probability that anyone will rent the last Cadillac for $100 per day *(EMR = $25)* while there is a 75 percent probability that someone will want the last Chevrolet at $60 per day *(EMR = $45)*. When this is the case, inventory units in the superior category should be artificially transferred to the inferior category (i.e., pretend that Cadillac's are Chevrolets) until the EMR value of the last unit to be transferred is the same whether it is sold as a superior class unit or an inferior class unit. Customers are unlikely to mind if the Chevrolet they reserved turns out to be a Cadillac.

If the firm is willing to accept the associated customer ill will, it can apply the same concept in reverse and occasionally downgrade a customer against his will. If this practice is to be pursued, the expected "cost" of ill will should be factored into the equation.

The astute reader will have observed that, in this case, the revenue management system is providing important feedback to the capacity planner. If the system consistently turns Cadillac's into Chevrolets (figuratively), it is telling the fleet buyer that the next time he buys cars, he should buy fewer Cadillac's and more Chevrolets.

Ability to Fine Tune Capacity

While we earlier noted that the inability to adjust capacity in the immediate term is a common characteristic of the revenue management target industries, in several of them it is possible to at least fine tune capacity over a slightly longer planning horizon. The assignment of aircraft to flights in an airline schedule can be juggled, cars can be shifted from one rental location to another, and trucks, ships, and rail cars can be moved around, all without changing the firm's overall level of productive capacity. In certain hotel environments that also offer timeshare it is possible to fine tune capacity.

To the extent that it is practical to shift capacity in this manner, the guiding principle is this: Shift inventory from low EMR locations to higher EMR locations until EMR values are equalized for all locations, taking into account any marginal out of pocket expenses involved in shifting the capacity. As long as the EMR value for this unit at location *B* exceeds its EMR value at location *A* over some period of time by more than the cost of moving it from *A* to B, you should make this move. Airlines are currently evaluating a concept known as "Demand Driven Dispatch". In this concept the airline would generically schedule a set of roundtrip flights departing and returning to a hub city at about the same time to be operated with "737" equipment. As the day of departure approached and the level of demand for each flight became more certain, a specific model of 737 would be assigned to each flight in the set so as to equalize the EMR values of each flight.

Over an even longer planning horizon it is possible to buy and sell incremental units of production in these industries in order to further fine-tune the level of availa ble inventory. The guiding principle is this: You should buy more (or larger) units of capacity as long as the (sum of) EMR value(s) of the incremental units of inventory that can be produced exceeds the marginal cost of operating the additional (or larger) capacity by an amount sufficient to warrant the capital investment.

For example, the fleet buyer should continue to buy Chevrolets for a location as long as the EMR value for one more Chevrolet exceeds the cost of servicing the car by an amount equal to the net capital cost of the car after resale over its expected service life with the firm.

It is common for capacity planners in these industries to base their capital investment decisions on easily calculated average revenue values per customer and simple rules of thumb about the amount of demand that is turned away at varying levels of capacity utilization at the company level. By providing the capacity planner with an accurate source of information about the marginal revenue contribution of incremental units of capacity, the revenue management system can provide a side benefit of enormous value in these capital-intensive industries. The untapped value of the potential improvements in the quality of capital investment planning and capacity level planning that the revenue management perspective can provide may be greater than the direct value of revenue management itself.

Sell-Up Potential

There is usually some probability that a customer, when denied a booking at a lower rate class, will agree to buy the requested service at the applicable rate for a higher rate class. For example, if the "ultra saver" airfare of $200 is "sold out," he may be willing to buy the $250 "super saver" airfare in order to ride on the flight of his choice. This possibility also needs to be factored into the EMR formula. To do this one need merely to reflect the fact that the expected revenue from a turned away potential "ultra saver" passenger isn't zero, it's the $250 "super saver" rate times the probability that he will opt to pay that higher fare. Sales process can be developed to proactively steer demand .

To see how this affects the inventory allocation process, let us take the example of a hypothetical airline flight with very low demand such that the EMR value for the marginal seats on this flight is near zero. The only decision facing the revenue manager for this flight is "should we go for the $200 'bird in the hand' from this customer or should we try for the $250 'bird in the bush.'" The decision the revenue manager makes will depend on his perception of the probability that the customer will accept the $250 rate instead of booking with another airline. In order to go for the $250 bird in the bush he has to believe that there is at least an 80 percent probability that the customer will accept the higher rate because: *$250 x 80% = $200 x 100% = $200*. Since the actual probability of successful "sell up" is unlikely to be anywhere near 80 percent for an Airline industry discount fare shopper, the best course of action for the revenue manager will be to accept the customer at the lower $200 rate.

In the above example, the application of sell up rates is simple and straightforward. Let us consider a slightly more complicated case where sell up potential tips the balance in a marginal situation. In this example, there is one unit of inventory remaining available for sale. There is a 40 percent probability that a $100 full rate customer will ultimately order this last unit. There is a customer standing in front of you who is willing to buy it right now for $50, however, there is also a 25 percent probability that he will pay the full $100 rate if you tell him that he can't buy it for $50. Should you sell him the unit for $50? If you do you will get an expected revenue of $50 *(100% x $50 = $50)*. If you do not your expected revenue will be $65 *(40% x $100 = $40* from the potential future customer, *plus 25% x $100 = $25* from the guy standing in front of you) so you should *not* sell the unit for $50.

In the early ye ars of airline revenue management it was widely misperceived that the primary revenue benefit from the application of revenue management would come from mining "sell up" potential through
bait and switch sales tactics. However, early attempts to practice this strategy were such dismal financial failures that the consideration of sell up potential was quickly put into its proper perspective. Suppose that in the first example the actual probability of successful sell up was a more realistic 40 percent (half the "breakeven" rate). If this was the case, he would *lose* an average of $100 per prospective passenger each time he held out for the higher fare because *$250 x 40% = $100* while *$200 x 100% = $200*.

The over optimistic assessment of sell up potential is one of the greatest potential dangers in a revenue management program. The overzealous application of bait and switch strategies can result in a revenue management program that *loses* money for the firm. In a properly designed revenue management program, the appropriate reflection of sell up potential in the system has a relatively minor impact on inventory allocations and bottom line revenue.

Most people are surprised to learn that the proper application of revenue management often results in significantly higher sales and revenue per unit of capacity, but *lower* revenue per customer.

Spill Recapture Potential

In several target industries there will be some probability that a customer, when denied a booking in his requested rate category at his preferred time, will choose to purchase the same product in the requested rate category from your firm but at a different time period. For example, an airline customer who is unable to secure a booking at the super saver rate on the 5 PM flight may elect to book at the super saver rate on the 7 PM flight as his second choice. We say that this customer has been "spilled" from the 5 PM flight to the 7 PM flight. The probability that this may occur has an impact on the inventory allocation process that is similar to that of the sell up concept and is handled in a similar manner in the valuation model.

Overbooking

The travel industries in particular are plagued by the problem of "no-shows" – people who book inventory and then do not show up to use it (or pay for it). The attachment of cancellation penalties to airline discount fares and the spread of "guaranteed reservations" programs in the Hotel industry are attempts to mitigate this problem which have met with some success.

To compensate for no-shows, travel firms "overbook" their capacity, trading off the possibility of empty units if they don't overbook enough against the ill will and out-of-pocket compensation to customers that occurs when customers are "bumped" (airlines) or "walked" (hotels).

This tradeoff should be considered in the following manner. First, the probabilities of incurring various no-show rates must be forecasted in much the same manner that demand is forecasted. In the Travel industry, no-show rates often vary by rate class/market segment and time period. The "cost" of failing to honor a customer's booking, including both out of pocket costs such as cash compensation to "bumped" airline passengers and a consideration of the potential loss of future revenue from the disgruntled customers, must also be calculated. (Airlines attempt to minimize customer ill will by compensating passengers who voluntarily relinquish their reservations with free tickets.)

With this information the expected oversale cost (probable number of oversales times the total cost per oversale) can be calculated for any level of overbooking above the actual number of inventory units available for sale.

REVENUE MANAGEMENT CHALLENGES BY INDUSTRY

INVENTORY ALLOCATION CHALLENGES	**Industry:** *AIRLINES*	*HOTELS*	*CAR RENTAL*	*FREIGHT TRANSPOR-TATION*	*HEALTH CARE*	*BROAD-CASTING*	*TELEPHONE*	*GOLF*
Network Effects	Multiple Flight Itineraries	Multiple Night Stays	Multiple Day Rentals	Multiple Segment Itineraries	Multiple Night Stays	Bundled Program Packages	Multiple Line Routings	Number of holes 9 vs. 18 holes
Marginal Costs	Commissions, Currency Exchange, Meals, Passenger Processing	Commissions, Room Cleaning	Commissions, Car Cleaning	Commissions	Meals, Room Servicing Care			Golf Course Maintenance
Ancillary Revenues	In-flight Sales	Meals, Drinks	Collision Damage Waiver	Insurance	Diagnostic Services F&B			Caddy Club House
Multiple Rates	Numerous Fare Categories	Numerous Published & Negotiated Rates	Numerous Published & Negotiated Rates	Numerous Specific Commodity Rates	Numerous Negotiated Rates	Numerous Negotiated Rates	Several Rate Tariffs	Several Rates Seasonal and Time of Day
Multiple Products	First Class/ Business Class/ Coach	Multiple Room Categories	Multiple Car Size Categories	Multiple Delivery Time Categories (e.g., Overnight vs. 2nd Day)	Private vs. Semi-Private	Program Popularity & Demo-graphics	WATS, Private Lines, etc.	9 vs. 18 holes
Spill Recapture	From One Flight to Another	From One Location in a City to Another	From One Location in a City to Another	To a Later Departure	To a Later Date (Elective)	To Another Show	To an Alternative Line	
Sell Up Potential	Yes	Yes	Yes	Yes	Yes	Yes		
Capacity Fine Tuning	Reassignment of Aircraft Sizes to Flights	No	Reassignment of Cars to Rental Locations	Deadheading Trailers, Boxcars to Alternate Pick Up Points	No	No	No	
No-Shows	Yes	Yes	Yes	Limited	Limited	Limited	Unused minutes	Yes

INVENTORY ALLOCATION CHALLENGES	**Industry: *AIRLINES***	***HOTELS***	***CAR RENTAL***	***FREIGHT TRANSPOR-TATION***	***HEALTH CARE***	***BROAD-CASTING***	***TELEPHONE***	***GOLF***
Multiple Unit Orders	Yes	Yes	No	Yes	No		No	Yes
Subjective Values	Yes	Yes	Yes	Yes	Yes	Yes		

Demand Forecasting Challenge

Good demand forecasting is an essential aspect of revenue management. Improvements in the demand forecasts used as inputs to the inventory allocation process translate directly into increased revenue in the form of higher average rates per customer, without a loss in orders. This is because the more confident you are that a high rate class customer will materialize, the lower the risk entailed in reserving a unit of capacity for him. Consequently, the search for improved forecasting techniques continues to attract a considerable and ongoing level of investment, even among airlines with relatively mature revenue management programs. A demand-forecasting model is unlikely to ever be considered truly "finished".

The demand forecasting process should also be considered the focal point of all human intervention in the revenue management process. While human oversight over the forecasting process is essential, it is often counterproductive in other stages of the process.

A potential side benefit of developing a good demand forecasting capability for revenue management is that the resulting customer volume forecasts can often be put to good use elsewhere in the firm as well. Functions such as supply ordering and staffing can often be more optimally planned with access to the detailed customer forecasts produced by a revenue management system.

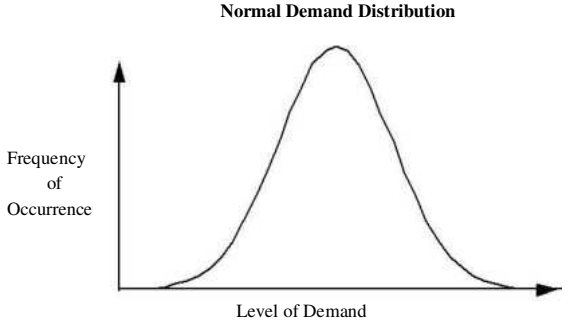
Forecasting demand for the revenue management process entails a few unique challenges, which must be addressed in a successful program.

Estimating Unconstrained Demand

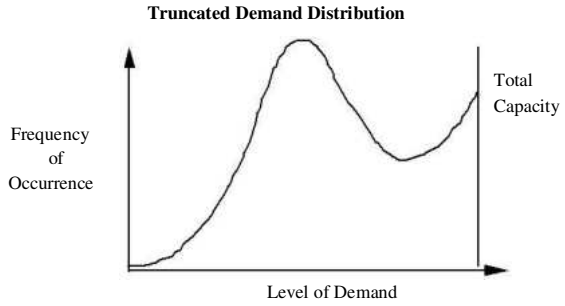
In order to correctly estimate EMR values it is necessary to know the estimated total demand for the service, not just the observed demand. This is a problem in those industries where the number of rejected orders cannot be directly measured. For example, in the travel industries it is common for services to be sold from an automated display of available inventory. Flights or properties that are already sold out on the requested date do not even make the display. How can we know how many customers would have requested those services had they been available for sale?

In order to illustrate this issue, we will first introduce it in an oversimplified manner. In an ideal world, you would notice that once the cycles and trends in your data are properly adjusted for, the distribution of the level of demand for the service would be randomly clustered around the average level of demand for the

service, with most cases being closer to the average. The plot of this distribution would approximate the "familiar bell shaped curve".



However, when the level of observed demand is constrained because of occasional shortages in capacity, the distribution would look more like this:



If the real world problem were this simple, it would be relatively easy to extrapolate an estimate of the true "unconstrained" distribution of demand and its standard deviation using textbook mathematical techniques. Most vendors of revenue management software use such techniques to estimate unconstrained demand in their forecasting models.

However, IDeaS has discovered that the real problem is not this simple. The distributions of demand that we observe in actual leg level airline data are actually combinations of several distributions of Origin, Destination and Fare Class level data. These distributions may have ~~hidden constraints on conne~~cting legs that are not under scrutiny and the constraints may vary as unit allocation/bid prices are adjusted from week to week

When these individual distributions of demand are rolled up into a single distribution, the combined distribution may appear to be normal and not constrained although many of the component distributions clearly *are* constrained. Consequently, IDeaS has concluded that the accurate estimation of the mean and standard deviation of the true unconstrained demand cannot be done with out reference to the manner in which the inventory evaluation strategy actually employed would have influenced the observed distribution of bookings. In other worlds, the process of inventory evaluation and unconstrained demand estimation are inextricably linked. We believe that we are the only vendor of revenue management software to address the issue in this manner.

The consequence of failing to properly identify instances of constrained demand in higher revenue classes is that the inventory optimization process will fail to protect adequate inventory for passengers in those revenue classes.

No-Show Forecasting

In addition to forecasting bookings, it is also necessary to forecast no-show rates (and standard deviations) in order for the Inventory Optimization model to determine appropriate levels of overbooking.

Like demand forecasts, no-show rates may vary by flight, time-of-day, day-of-week, or season. They are also influenced by variations in the mix of bookings by rate or customer type. In general, speculative bookings made many months in advance tend to exhibit higher no-show rates than bookings made closer tin. No-show rates tend to increase during peak seasons as customers make multiple bookings in order to preserve their options during these periods of scarce supply.

Group bookings tend to exhibit very low no-show rates because they have usually been "firmed" up several times. However, the group firming process, in which the group organizer is called at several "checkpoints" in the booking profile to obtain actual customer names and to obtain the release of inventory, which the group organizer cannot sell, can contribute significantly to the *booking countdown* effect, which is often seen.

Booking Countdown is a phenomenon in which total bookings rise up to a particular point in the booking profile and then decline as the number of new bookings is exceeded by the number of cancellations of existing bookings. In the airline industry this effect is common in long haul, leisure markets with high load factors because both individual passengers and travel distributors tend to book more reservations than they will use in order to preserve their options on flights where seats are scarce. As departure date approaches and their needs become more certain, they cancel the reservations they will not use causing the booking countdown effect.

This effect can be dealt with as if these cancellations represented a kind of advance no-shows in the Inventory Optimization Model, provided that any firming activity which is performed (either group or individual) is consistently performed at the same revision point in the booking profile. A "no-show rate" at each point in the booking profile can then be reliably calculated and used to vary overbooking levels at different points in the profile. It is very important to perform firming very consistently, or not at all. The object of firming is not to reduce the no-show rate. The object of firming is to make the no-show rate more consistent and predictable (i.e., to reduce its standard deviation) so that a more accurate overbooking level can be set, regardless of the expected no-show rate itself. Sporadic firming is actually counterproductive because it makes the no-show rate more unpredictable.

Estimating Low Levels of Demand

Very low levels of demand also create difficult forecasting challenges. In some of the target industrie s like the telephone or airline industries, demand may be "high" in the aggregate but very "low" at the disaggregate level at which it must be forecasted in order to capture any "network effects" that exist. In these industries demand must be forecast by city pair, rate class and time period. At this level of detail the average demand for the service may be one call/passenger per day or less in smaller markets. The degree of random variation in demand will necessarily be small in absolute terms but very large in relative terms. Saying that forecast demand is 2 plus or minus 1 is like saying that forecast demand is 100 plus or minus 50. In order to produce meaningful forecasts of demand in such cases, a certain amount of re-aggregation of the demand data may be necessary. Any such re-aggregation of the data will

improve the quality of the demand forecast, but will simultaneously sacrifice the capture of some of the potential network effect revenues in the process. This tradeoff between the measurable revenue gains which can be achieved through more accurate forecasting and the measurable revenue losses that will occur as the ability to discern and capture network effects is blurred needs to be addressed explicitly, as it is in the approach to revenue management.

Measurable Influences on Demand

In addition to the predictable cycles and trends that can usually be detected in the historical ~~demand data, demand for~~ the service is often directly affected (sometimes dramatically) by changes in price levels, in conditions of sale, in levels of capacity or other factors such as strikes, transportation constraints and economic changes. You or your competitor may instigate these changes. It is important to analyze the effect of these changes when they occur so that when they next reoccur you are in a position to promptly make the appropriate adjustments to your forecasts.

Human Intervention in the Forecasting Process

More than one ambitious revenue management project has failed to gain the acceptance of those charged with running the completed program because the demand-forecasting module of the system did not produce credible estimates for input into the inventory valuation module. In these cases, it is common for the revenue managers to adjust or disregard the recommended inventory allocations produced by the system, when the more appropriate corrective action would be to make appropriate adjustments to the demand forecasts instead.

Forecasting will always be part art, part science, because there will always be unprecedented events which will significantly effect demand for the service which cannot be easily assimilated by a computer program. It is difficult for a computer to recognize the potential impact of extraordinary influences on the demand as would be occasioned by a war or a major fare or schedule change. However, human beings can assimilate the consequences of these phenomena, and it is entirely necessary and appropriate that they should intervene in the forecasting process when they know that such events are likely to occur. It is essential that the forecasting module of the revenue management system be designed to facilitate this intervention. One of the necessary features of the forecasting module is a *threshold reporting* facility, which automatically identifies flights/markets where deviations from the expected booking profile are signaling that such an event may be occurring. The criteria used by this facility should be objective and should minimize the volume of unnecessary “flags” raised for analyst review.

Adjustments made by the analysts to the demand and no-show forecasts produced by the system should be tracked, and management reports should be generated indicating each analyst’s skill at improving upon the base forecasts produced by the system. This information could be expressed in terms of approximate revenue impact. These reports should be the primary basis for evaluating the job performance of the revenue managers.

From a psychological point of view it is critical to the success of the revenue management program for the revenue management professionals who will run the system to accept ownership of the forecasting process and accept responsibility for the quality of the forecasts that it produces. To achieve acceptance of this responsibility, the revenue manager must understand and accept the basic forecasting methodology.

Just as important, he must have the proper tools at his disposal that allows him to monitor and intervene in the process when appropriate. In a properly developed revenue management program, the revenue manager is primarily a forecaster; his intervention in other phases of the process, especially the inventory valuation process, will usually be counterproductive because the human mind is incapable of assimila ting the volumes of data and complexities of calculation that are involved in those steps. The importance of this point cannot be overemphasized.

In addition, managers usually feel comfortable making subjective judgments about the quality of demand forecasts based on intuition. However, they are typically more reticent about criticizing the output of the mathematically complex "black box" which "magically" produces recommended inventory allocations or bid prices. Consequently, the forecasting process often becomes the focal point for the normal resistance to change that is associated with the introduction of any major new process to a firm. In dealing with this issue it is important to get across to the skeptics the point that the impossibility of forecasting demand with perfect prescience is acknowledged; that this uncertainty about the level of demand is, in fact, an intrinsic part of the concept which must be expressly addressed in the process; and that rather than invalidating the revenue management concept, the existence of this uncertainty reinforces its value.

FORECASTING CHALLENGES BY INDUSTRY

FORECASTING CHALLENGES	**Industry:** ***AIRLINES***	***HOTELS***	***CAR RENTAL***	***FREIGHT TRANSPOR-TATION***	***HEALTH CARE***	***BROAD-CASTING***	***TELEPHONE***	***GOLF***
Constrained Demand	Yes	Yes	Yes	Yes		Yes		Yes
Low Demand	Yes			Yes			Yes	Yes
Measurable Influences	Competitive Fares, Capacity	Competitive Rates	Competitive Rates, Capacity	Competitive Rates, Capacity	Competitive Rates	Competitive Rates, Program Ratings	Competitive Rates	Competitive Rates
Special Events	Conventions, Sports Events, Acts of God	Conventions, Sports Events, Acts of God	Conventions, Sports Events, Acts of God	Acts of God	Acts of God	Acts of God	Acts of God	Holidays, Convention, Acts of God

Practical Pre-requisites

In order to implement a revenue management program there are a number of practical prerequisites that must first be met.

Access to Data

In order to forecast demand and allocate inventory, current and historical information must be available at the level of detail at which the inventory is to be controlled concerning:

1) Demand
   a. Orders/Sales
   b. No-Shows
2) Capacity
3) Rates

This data is commonly extracted from the order taking system (e.g., a Travel industry reservations system) and the rate quotation or revenue accounting systems.

The assembly of the necessary databases in order to perform forecasting research and business modeling is usually the first order of business in the development of a revenue management system.

Order Processing System

Frequently an order taking system must be built from scratch or modified significantly in order to efficiently incorporate revenue management into the order taking process. In the Travel industry, it has been common for reservations system modifications in order to accommodate new revenue management strategies to demand a majority of the project resources. Order system design should be taken up early in the project, as it is likely to be a "critical path" item. Limits in the architecture of the order taking system may pose serious constraints on the choice of revenue management strategies to be pursued. For example, in order to pursue a "Bid Price" strategy, rate information must be stored within (or accessible to) the order taking system for reference. IDeaS believes that it will usually be cheaper and more effective to capture "network effects" through an order taking system built around the bid price approach, especially if the order taking system is being built from scratch.

In the software development process, the order taking, data extraction, storage, and decision support capabilities should be designed and built as a set if possible.

taking system for reference. IDeaS believes that it will usually be cheaper and more effective to capture "network effects" through an order taking system built around the bid price approach, especially if the order taking system is being built from scratch.

How To Sell A Revenue Management Program

The development of a revenue management program is likely to be an ambitious and costly process. Unless the discipline is already established in your industry, convincing senior management of the strategic necessity of investing in revenue management technology is likely to initially be a tough sell, although the economics are very compelling.

Investments in revenue management generally have a very short payback period because almost all of the revenue increases generated goes straight to the bottom line. A $10 million investment in revenue management that revenues only a 2 percent revenue improvement on a revenue base of $1 billion would pay for itself in six months. The hard part is to convince senior management that the two percent *is really there*. The problem is that in order to precisely quantify the revenue improvement you may first have to spend the money and build the system – catch 22!

To get around this problem a considerable amount of research has gone into the design of mathematical simulation models which can estimate the revenue impact of pursuing various revenue management strategies (or no revenue management strategy at all). It may be possible to develop a credible benefits estimate for your firm from such a simulation. Before relying on the results of a simulation to justify your project be careful to closely examine the underlying assumptions, which are incorporated into the model. It is common for mathematicians to make "simplifying assumptions" to cut down on the amount of computer power needed to run the simulation. If these assumptions are not valid, they can throw off the results considerably. A simulation is valid only to the extent that it mimics the reality of your particular economic environment. IDeaS are quite proud of its own simulation models. With the appropriate capacity, demand, and rate information from your firm, IDeaS is confident that it can produce a realistic and credible estimate of the value of revenue management to your firm.

The degree of revenue management leverage obtainable by your firm will depend on the size and complexity of your firm and the degree to which each of the various principles and complicating factors of revenue management apply. However, on the basis of actual experience in the Airline and Hotel

industries it is likely that your revenue improvement will be on the order of five percent plus or minus three percentage points. When circumstances are such that there are also opportunities to refine pricing and capacity planning through application of revenue management principles the potential benefits are likely to be considerably larger.
When you design your revenue management system be sure to build a benefits measurement capability so that you can claim the proper credit when the system is installed and revenues improve!
As a practical matter it is usually the case that the easiest way to persuade key decision makers that a major investment in systems development is necessary is to convince them that your competitors are already doing it and you're going to be competitively disadvantaged if you don't. This is an easy sell to make in the Airline industry where Donald Burr, founder of People's Express, has publicly stated that the failure of his firm to adopt revenue management was the primary cause of the demise of this company. The sophisticated revenue manage ment programs of his larger competitors gave them a decisive competitive advantage, which more than offset People's Express' significant cost advantage.
Revenue management will eventually come to be viewed as a strategic necessity in all of the target service industries. It is rapidly reaching that point in the Hotel and Car Rental industries already. Those firms in each industry, which take the lead in developing revenue management programs, will earn "the innovator's profits" for as long as they maintain their lead, ala American Airlines. Those firms, which fail to embrace revenue management, will wither and die, ala People's Express.

How to Keep Your Senior Management Support

Once you have senior management support for your revenue management project, how do you keep it? Failure to address the following obstacles and pitfalls will undermine support for your project and greatly reduce your chances for success.

Make Continuous And Visible Progress In The Development Of The System

Because of the cost of developing a revenue management system, you should expect pressure from senior management to produce revenue benefits quickly. It will not be easy to meet these expectations and you should be careful to not promise too much, too fast.

Building a complex decision support system to support a new business process is much more difficult than modeling an existing, well documented administrative process. Traditional software development methodologies are unlikely to be suited to the task. We believe that the best approach is to undertake a short high level conceptual design effort to identify synergies and interdependencies between system components followed by a staged iterative design of individual program modules in order to be able to deliver the first phases of the system (usually the databases and data analysis tools) quickly.

Be careful about how you choose to phase your project, however. While you should definitely keep the 80/20 rule in mind (80 percent of the benefits can usually be realized with 20 percent of the effort), you should be careful not to foreclose the possibility of getting that last 20 percent of the benefits down the road. It is likely to still be worth going after at a later time.

Also, be careful about the selection of which "complicating factors" will be included and excluded from early releases to the system. It is, in fact, possible to build a revenue management system that will actually lose money for your firm in some cases if you oversimplify the modeling of your true economic circumstances.

It is important not to overextend either the depth or the breadth of the information systems development resources that can realistically be brought to bear on the project. Be careful to allow time for hiring and training of new project me mbers in your project plans or due dates will be missed. This is especially true because it is possible, if not likely, that expertise in technologies that are new to the firm will need to be developed or hired. (Most commercial revenue management programs are now developed in C/UNIX to be run on scientific workstations.)

Any firm that embarks on a revenue management project should seriously consider incorporating commercially available revenue management software into their new system as a means of shortcutting the development process and producing revenue benefits more quickly.

Overcome Normal Resistance to Change

The revenue management innovator should expect to meet a normal amount of resistance to change to the new concept and should be prepared to deal with it in a constructive manner. As with any new process, the people who will resist the innovation are those who are concerned that their existing skills and corporate status may be devalued by the new procedures, and/or those who find that the innovation creates new obstacles to the achievement of their existing goals.

Your sales force is likely to fall into the latter category. The first time that a salesperson has a "bird in the hand" order rejected by a revenue manager looking for a more profitable "bird in the bush" he is likely to begin seeing the revenue management department as an "enemy" that's keeping him from meeting his sales quota.

This contention should be deflected by reorienting the sales department's goals away from gross sales targets towards cumulative "economic profit". Each time a salesperson makes a sale, record both the EMR value of the units of inventory sold, and the actual revenue received from the sale. The difference is the "economic profit" of the sale. If the sales force is rewarded for maximizing this number they will make every effort to direct sales towards inventory with a low EMR value and the revenue management program will be reinforced rather than undermined.

It may also be useful to get across the point that while the sales force may initially see the revenue managers as adversaries, in reality they are merely arbitrators between salespersons who are competing to sell the same inventory. They ensure that the salesperson that can get the best price makes the sale instead of the person who merely sells faster.

The second possible category of resisters is composed of your current order takers and order evaluators. These are the people who are most likely to feel threatened by the potential devaluation of their skills. Some of them are likely to have developed their own rules of thumb for evaluating the profitability of order requests, and these people may fear that the

new system will supplant their expertise and render them unimportant or even superfluous.

It is also common for these people to fear that they may not be smart enough or well educated enough to manage this economically and mathematically "sophisticated" new process. This fear is generally groundless and can be overcome by coaching as explained later.

You do not have to be a rocket scientist to do day to day revenue management work. Anyone who can understand the basic revenue management concepts at the level at which they are presented in this paper is qualified to become a revenue manager. Indeed, airlines that have attempted to staff their revenue management programs with MBAs or persons with advanced degrees in mathematics find that they have a high rate of staff turnover. These people tend to move on to more challenging positions within the company relatively quickly. A revenue management program often becomes an analytical training ground serving the entire firm. At the other extreme, Hotel revenue management is usually the responsibility of the on-site property manager. It is common for this responsibility to be delegated to a back office reservations clerk with no more than a high school education and an average tenure on the job of about three months. With the proper training and tools, such a person can be an effective revenue manager.

The key to successfully overcoming this source of resistance to change is to convince your order evaluators that they are capable of making the progression to revenue manager, and that this change will enhance the importance and visibility of their role within the company. The leaders among the current order evaluators should be given prominent roles in the development and introduction of the new program to secure their support.

> *Insufficient education is not a serious obstacle to effective revenue management.* Fear *of insufficient education* is.

In order to overcome this fear, the "basic training" for a new revenue manager should include an unthreatening and non-technical introduction to the basic economic and statistical principals described in this paper so that they gain a fundamental, intuitive understanding of what's going on in the "black box" that values the inventory. The bulk of revenue management training should deal with the management of the demand forecasting process. Forecasting oversight will be the revenue manager's primary responsibility and, as already noted, is likely to be the focal point for expressions of discontent with the system.

For the same reason, the design of the user interface through which the revenue manager interacts with the forecasting system is as important to its ultimate success as all of the mathematical sophistication of its economic models. No effort should be spared to develop a window into the system that makes the revenue managers feel at home and in control. Allow for the development of the interface to be a time consuming and iterative process.

If insufficient emphasis is placed on these human aspects of a revenue management program, "passive resistance" to the program may emerge among order evaluators. While they will go through the motions of employing the new revenue management system, in reality they will

go on making decisions the way they always have, and none of the potential benefits will be realized. It is not uncommon for airline revenue managers to ignore the recommendations produced by their "sophisticated" revenue management systems and set unit authorizations based on their individual rules of thumb.

This possibility increases the importance of building an objective method of evaluating revenue manager performance into your system. The evaluation process should be based on either their effectiveness at improving upon the base demand forecasts produced by the forecasting module of the system, upon the percentage of theoretically obtainable revenues actually achieved, or both.

Avoid Pitfalls In The Application Of Revenue Management

Once the revenue management system is up and running, there are two main pitfalls to be avoided in applying revenue management principles. The first, which has already been discussed, is the overzealous use of "bait and switch" sales tactics to exploit "sell up" potential. It is important to downplay the significance of this aspect of revenue management in the course of selling the concept to senior management. Otherwise, there will always be the danger than an uninformed policy position emphasizing the practice may be promulgated at any time in response to inadequate profit margins. The normal consequence of such a dictate is marginally higher average rates, plummeting sales and alienated customers.

The second major risk is that once the revenue management program is in place, the firm may become sloppy about its pricing practices. An attitude can develop that the improved inventory allocation process will provide a safety net if the rate structure becomes uneconomic.

A clear sign that this dangerous form of complacency is setting in is when one begins to hear things like "so what if the prices are too low; we just won't sell any inventory at those price levels!" The problem is that the competitors probably will be selling inventory at those price levels, so if you do not, your market share and revenues will evaporate. Despite the best efforts of firms in the target industries to differentiate their service products based on quality or features, brand preferences tend to be weak. By and large, consumers view these services as commodities and they will freely substitute one brand for another on the basis of small price differentials. The implementation of a revenue management program does not eliminate this competitive reality. Just as a competitive price premium is almost impossible to maintain in a commodity industry, it is also impossible to accomplish the same result through arbitrary restrictions on the supply of low price inventory.

Rather than viewing the implementation of a revenue management program as an opportunity to relax pricing vigilance, you should view it as an opportunity to strengthen your pricing program as well. As previously mentioned, the revenue management system will provide the rate setter with important feedback concerning minimum acceptable price levels and opportunities to improve revenues through selective discounts on low EMR value inventory. The trend in the Airline industry is to combine the demand forecasting, pricing, and revenue

management functions into a single job to take advantage of these synergies. (The person performs all three functions for a particular route area.) This is an organizational model that we strongly recommend to anyone establishing a revenue management program for the first time.

Summary

Revenue Management is a proven discipline with a track record of significant revenue improvement in various sectors of the Travel industry. Its potential applicability extends to a number of other service industries with similar economic characteristics. It is not the dark, mysterious art that it is sometimes portrayed to be. Rather it represents the application of a number of straightforward economic and statistical principles that anyone can understand. A well-developed Revenue Management program is already a strategic necessity in the Airline industry. In the coming years it is likely to become necessary to corporate survival in the other service industries as well.

DISTRIBUTION OF AVIATION PRODUCTS AND SERVICES

After products are produced and priced, they must be distributed to the marketplace.

All organizations perform a distribution function. Del Monte products are distributed in supermarkets and convenience stores across the United States. Public libraries use bookmobiles to distribute their services to residents in outlying areas and to others who cannot get to the library.

The distribution function is vital to the economic well-being of society because it provides the goods and services desired by the consumer. Economists often describe the value of distribution in terms of ownership, place, and time utility. The marketer contributes to the product's value by getting it to the right place at the time the consumer wants to buy it and by providing the mechanism for transferring ownership. Firms that do not perform the distribution function effectively usually fail.

Distribution also provides employment opportunities. Salespeople, warehouse managers, truck drivers, stevedores, and forklift operators are all involved in distribution. Others service the products provided through a distribution network.

Most people involved in distribution are classified as service personnel: Their role is to provide service to some other sector of the economy.

This chapter explores the two major components of an organization's distribution strategy: distribution channels and physical distribution. Distribution channels are the paths that goods—and title to them—follow from producer to consumer. They are the means by which all organizations distribute the goods and services they are producing and marketing.

The second major component of distribution strategy, physical distribution, is the actual movement of goods and services from the producer to the user. Physical distribution covers a broad range of activities. These tasks include customer service, transportation, inventory control, materials handling, order processing, and warehousing.

Distribution Channels

Distribution channels are composed of marketing intermediaries, the persons or firms that

operate between the producer and the consumer or industrial user. The two main categories of marketing intermediaries are wholesalers and retailers.

Wholesaling intermediaries are people and firms that sell primarily to retailers and other wholesalers or industrial users. They do not sell significant amounts to ultimate consumers. Sysco is a food-service wholesaler that buys more than 100,000 food products from manufacturers and resells them to some 150,000 restaurants, hotels, schools, hospitals, and other institutions. Sysco also distributes frozen food products to supermarkets, other retail stores, and military commissaries.

Retailers, by contrast, are persons or firms that sell goods and services to individuals for their own use rather than for resale. Retailers are the marketing intermediaries that consumers are most familiar with. The typical consumer buys food, clothing, personal-care items, furniture, and appliances from some type of retailer.

The Functions of Marketing Intermediaries

Marketing intermediaries perform various functions that assist in the operation of the distribution channel. These functions include buying, selling, storing, and transporting. Some intermediaries also sort and grade bulk products. Wholesalers of fresh produce, for example, receive bulk shipments of fruits and vegetables from growers; sort the produce according to a standardized grade, size, color, and degree of ripeness; and then repack it in smaller quantities for their customers, grocery stores, and restaurants. Intermediaries often provide other channel members with important marketing information. Many wholesalers and retailers use scanners and computer technology to measure the movement of producers' goods.

By buying a manufacturer's output, intermediaries provide the necessary cash flow for the producer to pay workers and buy new equipment. By selling, they provide consumers and other intermediaries with want-satisfying goods and services. The buying/selling function of intermediaries brings efficiency to the distribution channel. Intermediaries facilitate the exchange process because they reduce the number of transactions needed between the producer and the consumer. If each of four manufacturers sold directly to four customers, transactions would be required. With an intermediary, the number of transactions is cut to eight.

Marketing intermediaries enter a channel of distribution that direct products from producers to ultimate consumers. Sometimes their efficiency wanes and they must be replaced, but someone in the channel must perform the vital distribution functions.

Major Marketing Channels

Hundreds of channels are used to distribute the output of U.S. production, processing, manufacturing and service industries. Canned food products usually pass through wholesalers and retailers to reach the consumer. Some vacuum cleaners and encyclopedias are sold directly to the consumer. Numerous variations exist: Channel selection depends on the circumstances of the market and on consumer needs.

Channels for reaching the consumer may vary over time. For example, the channel for distributing beer has changed from taverns to supermarkets. Channels shift, and effective marketers must be aware of consumer needs so they can keep their distribution methods up to date.

The first four channels are typically used to distribute consumer goods and services, while the last two are commonly used for industrial goods and services.

Channels to Consumer Products

- Producer to Consumer. A direct channel from producer to consumer is used for most services but relatively few products. An artist who sells their creations at an art show is an example of this distribution channel. Other users include Avon, Amway, Fuller Brush, Electrolux, Kirby, some encyclopedia publishers, and farmer roadside stands.
- Producer to Retailer to Consumer. Some food processors and manufacturers distribute their products directly to retailers. The apparel industry has many producers that sell directly to retailers through their own sales forces. Some manufacturers set up retail outlets in order to maintain better control over their channels. Agricultural processors, like S & W canned foods, Diamond Walnuts sell directly to retailers through their sales staff.
- Producer to Wholesaler to Retailer to Consumer. The traditional channel for consumer goods, distribution to wholesalers, is used by thousands of small manufacturers that cannot afford to maintain an extensive field sales force to reach the retailing sector. Some of these manufacturers employ technical advisors to assist retailers and to secure marketing information, but they are not directly involved in the selling effort.
- Producer to Wholesaler to Wholesaler to Retailer to Consumer. Several wholesalers are common in the distribution of agricultural (canned and frozen foods and cotton) and petroleum products (gasoline). An extra wholesaling level is required to divide, sort, and distribute bulky items.
- Producer to Industrial User. The direct channel from producer to user is the most common approach to distributing industrial goods and services. FMC corporation selling conveyoring equipment to a factory. This channel is used for nearly all industrial products except accessory equipment and operating supplies.
- Producer to Wholesaler to Industrial User. The indirect channel from producer to wholesaler to user is used for some industrial items. It is also used for small accessory equipment and operating supplies that are produced in large lots but sold in small quantities. John Deere, Ford and Case tractors sell to wholesalers who in turn sell to industrial users.
- Selecting a Distribution Channel
  The selection of a distribution channel depends on several factors: the market, the product, the producer, and the competition. These factors are often interrelated.
- Market Factors. The most important consideration in choosing a distribution channel is that market segment the producer wants to reach. Changes in consumer buying behavior may influence a channel decision. For example, an increasing number of service firms are satisfying consumers' desire for convenience by providing home delivery. Diet-conscious shoppers can choose from an array of low-calorie, microwavable meals sold at the supermarket. But Doorstep Diets in San Diego offers the ultimate in convenience by delivering fresh, low-calorie meals directly to homes and offices. The service is especially appealing to two-income households and older people.
  If the product can be marketed to more than one segment, multiple distribution

channels may be required. In fact, multiple channels have become increasingly popular in recent years. Bowater Inc. uses multiple channels to distribute its stock computer paper. For years, Bowater salespeople have been selling computer paper directly to large-volume users such as corporations, banks, insurance companies, and government agencies. Today, individuals and small businesses are the fastest-growing segments for computer paper. To reach these markets, Bowater uses a variety of channels, including business forms distributors, paper merchants, office product dealers, and computer retail stores.

- Product Factors. In general, products that are complex, expensive, custom-made, and perishable move through shorter distribution channels. Boeing sells its 747 jet aircraft directly to British Airways and other commercial airlines. Each of the $100 million aircraft brings in about $25 million in gross profits.2 Inexpensive and standardized products are typically sold through longer channels.
- Producer Factors. Producers that offer a broad product line and have the financial and marketing resources to distribute and promote their products are more likely to use a shorter channel of distribution. American Greetings Corporation, for example, bypasses wholesaling intermediaries and sells directly to some 90,000 retail outlets worldwide. American Greetings produces 6 million greeting cards each day while also marketin gift wrap and ribbon, party goods, candles, stationery, calendars, and gift items. The company has the financial resources to conduct marketing research studies and to maintain its own network of distribution centers.

In addition to a large sales force, American Greetings employs 12,000 part-time merchandisers who service retail customers on a weekly basis.

Vertical Marketing Systems

In some instances, the efficiency of the distribution channel is disrupted because of conflicts among channel members. Conflict can occur between manufacturers and wholesaling intermediaries, such as the problems Campbell Soup had with Japanese distributors. Conflicts also develop between producers and retailers. World of Wonder Inc., marketer of Teddy Ruxpin, Lazer Tag, and other high-tech toys, alienated some of its key retail customers because it failed to deliver products when promised. By not receiving shipments of Lazer Tag guns in time for pre-Christmas selling, some retailers not only lost sales but also were left holding large inventories of the guns when they arrived after the Christmas holidays.

Efforts to reduce conflict and improve the efficiency of the distribution channels resulted in the development of vertical marketing systems. A **vertical marketing system (VMS)** is when two or more stages of a distribution channel are combined and managed by one firm. Vertical marketing systems have become a popular method of organizing a distribution channel. The three types of vertical marketing systems are administered, contractual, and corporate.

Administered VMS

An administered vertical marketing system is a distribution system dominated by one channel member. This channel member, often called the **channel captain,** can be a manufacturer, a wholesaler, or a retailer. Traditionally, the channel captain has been the manufacturer that provides the promotional budget to support a brand.

In recent years, however, an increasing number of retailers and wholesalers are assuming the role of channel captain.

Ernest & Julio Gallo Winery is an example of a dominant channel member. The California wine maker exercises considerable power over company-owned and independent distributors. One independent distributor describes it this way: "I sometimes feel like an Olympic runner who gets mad at his coach. Gallo pushes so hard you end up working more than you want." Gallo believes its success in selling wine is tied directly to wholesalers' performance with retailers. It encourages distributors to hire a separate sales force to sell to and service retail customers. It requires distributors to provide exceptional customer service, from setting up floor displays to dusting bottles on store shelves. Distributors are expected to follow detailed instructions set forth in a 300-page manual that covers everything from selling techniques to how much shelf space Gallo wines should occupy. Distributors benefit from Gallo's strong brand-name recognition and aggressive promotional support. They cooperate with Gallo because of the effective working relationship. In fact, most distributors owe their success to the winery's dominance of the channel.

Contractual VMS

Contractual vertical marketing systems have had the greatest impact on distribution strategy. In such a system, the members are bound by a contractual agreement. Franchises such as Burger King, Baskin Robbins, and Century 21 are contractual Vertical Marketing Systems.

Another contractual system is the wholesaler-sponsored voluntary chain of retail stores. Under this agreement, a wholesaler provides marketing programs, merchandise selection, and other services to independent retailers that agree to purchase the wholesaler's products. McKesson Corporation, the nation's largest wholesale distributor of pharmaceuticals, established Valu-Rite, a voluntary chain of 2,500 pharmacies. McKesson provides Valu-Rite members with advertising circulars to generate store traffic and a private-label line of 170 products including vitamins, shampoos, and toothpaste. Other wholesaler-sponsored chains are Sentry Hardware and IGA Food Stores. This system helps independent retailers compete with mass merchandisers and retail chains.

A third type of contractual VMS is the retail cooperative, in which retailers set up their own wholesaling operation. The retailers agree to buy a certain amount of merchandise from the wholesaling operation, but may choose a common store name and develop their own private-label line of goods. Retail cooperatives, such as Associated Grocers, are common in the grocery industry. Like the wholesaler-sponsored system, retail cooperatives help independent retailers compete with mass merchandise and large retail chains.

Corporate VMS

A corporate vertical marketing system is one in which channel members are owned by one enterprise. AT&T selected a corporate VMS by opening 450 AT&T Phone Centers to sell its telephone products to consumers. Liz Claiborne Inc. chose a corporate system to distribute a new line of sportswear under the First Issue label.

Made by Liz Claiborne, the sportswear collection is sold at company-owned First Issue retail stores. Other well-known corporate systems are Firestone and Sherwin-Williams.

Market Coverage

Distribution strategy must be concerned with market coverage. There is probably only one Chevrolet dealer in your immediate area, but there may be several retail outlets that sell General Electric products. Coca-Cola can be found everywhere—in supermarkets, neighborhood convenience stores, service stations, vending machines, restaurants, and coffee shops. Different types of products require different kinds of distribution coverage. Three categories of marketing coverage exist: intensive distribution, exclusive distribution, and selective distribution.

Intensive Distribution:

Coca Cola's goal is to have their product within 100 feet of every consumer. The intensive distribution strategy is used by the marketer who tries to place a product in nearly every available outlet. Tobacco products, chewing gum, newspapers, soft drinks, popular magazines, and other low-priced convenience products are available in numerous locations convenient to the purchaser. This kind of saturation market coverage requires the use of wholesalers to achieve a maximum distribution effort.

The distribution of USA Today illustrates the concept of intensive distribution.

The national daily newspaper is sold at hundreds of newsstands, newspaper vending machines, and retail outlets throughout the country to saturate the market and provide maximum convenience for the paper's 5.5 million readers. The ultimate form of convenience is the provision of time and place utility by direct delivery to the consumer's residence.

Exclusive Distribution:

The opposite of intensive distribution, exclusive distribution occurs when the manufacturer gives a retailer or wholesaler the exclusive right to sell its products in a specific geographic area. Automobile companies probably provide the best examples of exclusive distribution in domestic markets. However McDonalds fast food restaurants are set up on this basis also.

Manufacturers sometimes set up effective distribution systems in foreign markets by granting resident firms the exclusive license to import or manufacture their products.

An exclusive distribution contract allows the retailer to carry an adequate inventory and provide the service facilities that might not be possible if competitive dealers existed in the area. Because the dealer has a guaranteed sales area, they are likely to make expensive investments in the business. In return, the manufacturer helps the dealer develop a quality image and promote its products effectively.

Selective Distribution: A degree of market coverage somewhere between intensive distribution and exclusive distribution, **selective distribution** occurs when a limited number of retailers are selected to distribute the firm's product lines.

Television and electrical appliances are often handled in this manner. Manufacturers hope to develop a close working relationship with their dealers and often split advertising expenses with them. Extensive servicing and training facilities are usually maintained by the manufacturer to help the retailer do a good job of distributing the product.

Wholesaling

Wholesaling is crucial in the distribution channel for many products, particularly consumer goods. As we explained earlier in the chapter, wholesaling intermediaries are marketing intermediaries that sell to retailers, industrial purchasers, and to other wholesalers, but do not sell directly to the ultimate consumer. The traditional customer of the wholesaling intermediary is the retailer. Some wholesaling intermediaries, referred to as **industrial distributors,** sell to industrial users. Others sell to other wholesaling intermediaries.

Wholesaling intermediaries can be classified on the basis of ownership. Some are owned by manufacturers, some by retailers, and others are independent organizations. Figure 15.2 outlines the various categories of wholesaling intermediaries.

Manufacturer-Owned Wholesaling Intermediaries

Manufacturers may decide to market their products through company-owned sales branches and sales offices for a number of reasons. Producers of perishable products may operate their own distribution centers to speed the delivery of products directly to retailers. Complex products requiring installation and servicing and intensely competitive products requiring considerable promotional efforts are often distributed through company-owned channels. USG Corporation, marketers of gypsum board, acoustical ceiling tile, and other building products, established a network of 140 distribution centers to provide specialized service to construction contractors. The centers have boom-mounted trucks and other special lifting equipment to facilitate delivery of products not only to job sites but also to rooms on any level of a building under construction.

Sales branches stock the products they distribute and process orders from their inventory. They are common in the chemical, petroleum products, motor vehicle, and machine and equipment industries. Snap-On Tool Corporation has 55 sales branches that warehouse hand tools and other equipment that independent dealers sell to professional mechanics. Snap-On also maintains four large distribution centers that supply products to sales branches.

A **sales office** is exactly what it seems: an office for salespeople. Unlike sales branches, sales offices do not perform a storage function or warehouse any inventory. Manufacturers set up sales offices in various regions to provide a localized selling effort and to improve customer service.

Independent Wholesaling Intermediaries

Most of the wholesaling organizations in the United States are independent wholesalers. They account for about two-thirds of all wholesale trade. Independent wholesalers can be classified as either merchant wholesalers or agent wholesalers.

A **merchant wholesaler** takes legal title to the goods it handles. This type of independent wholesaler can be broken down by the functions it performs. A merchant wholesaler that provides a complete assortment of services for retailers or industrial buyers is referred to as a **full-function merchant wholesaler.** An example is Fleming, a food wholesaler that offers more than 100 services to its retail customers. Among these services are store planning and development, financing, advertising, counseling and training for store managers and employees, consumer-oriented nutrition and health education programs, and an insurance

program. Fleming also developed computer software programs that retailers can use for direct store delivery, accounts payable, labor scheduling, and shelf labeling. To help retailers computerize their store operations, Fleming formed a special computer support department that provides retailers with consultation, installation, and training.

Another type of full-function merchant wholesaler is a rack jobber, a person who sets up and services a particular section of a retail store, such as bread, snack foods, paperback books, magazines, or toys. A rack jobber supplies the racks, sets up the display, stocks the merchandise, handles the pricing, and completely services the space, which is rented from a retailer on a commission basis.

A merchant wholesaler that also takes legal title to the goods handled but provides fewer services is a limited-function merchant wholesaler. These wholesalers may, for example, warehouse goods but not deliver them to customers. Others may warehouse and deliver goods but not provide financing. The ultimate example of a limited-function merchant wholesaler is a drop shipper. This wholesaler forwards orders directly to the producer for shipment to customers. Drop shippers that operate in industries like lumber and coal never physically handle the products, although they do hold legal title.

The second major category of independent wholesaling intermediaries— agents and brokers—never take title to the goods they handle, although they may or may not take possession of the goods. Agents and brokers bring buyers and sellers together and generally perform fewer services than merchant wholesalers.

Boston Computer Exchange is a broker that brings buyers and sellers together for used personal computers. The firm's electronic network lists businesses and individuals that have purchased new computers and want to sell their older models, and firms that are interested in buying used models. Boston Computer Exchange receives a fee on every transaction, but it does not take title to or possession of the computers.

Because most computer makers do not participate in the sale of used models, the broker serves as an important intermediary in the used personal computer market. Other examples of agent wholesalers include real estate brokers; sales agents of various types; manufacturers' agents, who sell noncompeting lines of several producers on a commission basis; commission merchants, who sell agricultural products for farmers; and auction houses.

Retailer-Owned Wholesaling Intermediaries

Some retailers have joined to form their own wholesaling organizations, either buying groups or cooperatives. The objective is to reduce costs or to provide some special service not readily available in the marketplace. To achieve cost savings through quantity purchases, independent retailers may form a buying group. Others may band together to form a cooperative, described in an earlier section as a contractual vertical marketing system.

Retailing

Retailers are the final link in the distribution channel. Because they are normally the only channel members with direct customer contact, it is essential that they operate with the times and within the environment in which they exist. Retailers are part of one of business's most dynamic settings, and special vigilance is required of them if they are to remain competitive. Kmart is an example of a successful retailing company, and its successes are to be admired, but much can also be learned from the study of retailing failures.

In the early 1960s, the S. S. Kresge and W. T. Grant retailing chains were about the same size. Both faced the problem of deciding what direction to take in the years ahead. Kresge President Harry B. Cunningham decided to take his firm down the discount path and changed the name to Kmart, now the third leading retailer in the United States.

Meanwhile, W. T. Grant watched and then moved to open larger stores and position itself somewhere between discounting and general merchandising. Grant began to promote big-ticket items such as furniture and major appliances, in contrast to its traditional soft goods and clothing. It stimulated sales of the big-ticket items by issuing credit cards. The consumer's image of Grant became confused, and the chain lost $177 million in 1975. New management reversed many of the earlier decisions, but it was too late. W. T. Grant declared bankruptcy a year later.

The Wheel of Retailing

Institutions are subject to constant change as new stores replace older establishments. This process, called the wheel of retailing, suggests the retail structure is continually evolving as new retailers enter the market by offering lower prices through reductions in service. Supermarkets and discount houses, for example, gained their initial market footholds through low-price, limited-service appeals. The new entries gradually add services as they grow, and then become targets for competitive assault. Today's attractive Kmart stores, for instance, offer good lighting, wide aisles, adequate paved parking, and services such as credit-card purchasing. They are unlike those early discounters that often operated from

Wal-Mart is the nation's largest retailer with sales of almost $94 billion. Each of the ten largest retailers in the United States, listed in Table 15.1, has sales exceeding $15 billion. About one-fifth of all retail stores are part of a chain, a group of two or more stores that are centrally owned and managed and handle the same product lines. The chain organization is common among shoe stores, department stores, supermarkets, and clothing stores. The Limited, The Gap, Foot Locker, and Safeway are examples of chain-store operations.

Types of Retailers

While most retailing activity is done in stores, about 10 percent of total retail sales occurs in a nonstore environment. Thus, retailers can be grouped into two broad categories: store and nonstore.

The major types of store retailers include department stores, specialty stores, variety stores, convenience stores, discount stores, off-price stores, factory outlets,

MODULE V

AIRPORT MARKETING

STRUCTURE OF AIRPORT-AIRLINE RELATIONSHIP

Most texts approach this subject by focusing on the *vehicle* used by airport administrations to document their relationship to other parties, for example, a contract. This chapter instead focuses on the *relationship itself*, a reality that is not always readily apparent to industry newcomers.

Frequently, we make sense of something new by comparing it to something already known. In the case of airports, we find a large facility wherein portions are leased to various companies; thus a newcomer comes to believe that the airport manager is primarily a landlord, and all other parties at the airport are tenants. Although true to a point, this over-simplification is misleading and can lead decision-makers to consider airport issues in an inappropriate manner.

As a further example, people with a military background will frequently compare an airport to an air force base since they certainly *seem* alike in many respects. Unfortunately, this mental model may lead a newcomer to assume the airport manager commands most of the personnel at the airport. In reality, the airport manager's direct employees account for a minority of the total persons employed at the facility.

Even though his direct workforce is relatively small, the manager is still responsible for the smooth operation of the airport as a whole, and must therefore maintain multiple relationships with the members of the airport population and other segments of the air transportation network. This chapter will trace a brief overview the key features of the airport manager's relationships with the major airport user groups.

Airlines

Recalling the air+air+air equation from the first chapter, it's apparent that airlines are more than just tenants to airports. Airports and airlines are really partners who must work together to produce the final product: air transportation for the customer. In a sense, airports are the wholesalers of ground infrastructure, and airlines use this input to produce the final retail product.

Although the term partner is used when describing this relationship, it must be emphasized that the partnership operates at an arm's length. Airports and airlines are frequently on opposing sides of an issue, and the partnership is often based on mutual needs rather than mutual interests.

Historically, airlines have been the partner that initiates change and airports react to these changes. Airlines purchased jets and jumbos and established hub-and-spoke systems; airports responded to these changes by enlarging facilities and reacting to the consequences. Recent discussions about wayports and cargo hubs seek to change this relationship by setting the airport as the initiator of change and expecting the airlines to

react favorably. Whether or not these grand plans are workable is yet to be seen.

The most common financial mechanisms used to obtain a revenue stream from airlines include a square footage charge for rented space and a landing fee based on aircraft weight (usually established as an amount per 1000 pounds of Maximum Gross Landing Weight). These amounts may be calculated in such a fashion to (1) recover the airport's specific costs for providing facilities to the airlines, or (2) balance the airport's overall budget after revenues from non- airline sources are subtracted from total expense. This latter method is referred to as the residual method and is part of a more tightly-woven contractual relationship between airport and airlines.

Selection of the airline rate -making philosophy is a central feature of an airport's financial strategy. Purely compensatory rate methods leave the airport owner with greater flexibility to control future plans and pursue new opportunities. On the other hand, a residual contract shares decision- making authority with the airlines in return for their commitment to pay adequate fees to balance the airport's budget (in the simplest example, all non-airline revenue is subtracted from total airport expense -this residual amount is charged to the airlines; thus, the airport operates at the break-even point).

Both methods are common throughout the industry, and many airports use both by establishing different cost centers and selecting the appropriate method for each. Which strategy best suits an individual airport depends on its financial situation, negotiating posture, and overall management philosophy. In Northwest Airlines vs. County of Kent (92-97), the U.S. Supreme Court reaffirmed the right of airport owners to pursue either ratemaking strategy provided the final calculation produces reasonable airline fees and charges (The U.S. Department of Transportation holds authority to review such fees for reasonableness.).

In any event, in the deregulated era it has become obvious that airport rents and fees from airlines are not guaranteed cash flows. If passengers don't board an airline, the airline leaves town, and the airport doesn't get paid. In this sense, the airline fees received by the airport are best viewed as a percentage of the passenger fare originally paid to the airline. Thinking of the cash stream in this manner helps to overcome the landlord-tenant mentality and focuses attention on the true market viability of the airport's air trade area.

How can airports attract more airline service? Like all businesses, airlines seek to increase their revenues and decrease their costs. Concerning revenue, it is doubtful that airport management can have a meaningful impact on the size of the local market for air travel demand. Any particular airport will serve an air trade area, and this area will have (1) population, (2) disposable income, and (3) an economic profile. For the average U.S. city, these items combine in such a way that the airport will enplane a certain factor times the air trade area's population during a year (1.5 is a common

number), and airport management's actions cannot alter this relationship in a significant way.

Concerning airline expenses, labor, fuel, and travel agents' commissions account for approximately two -thirds of the total; payments to U.S. airports usually amount to about 5%. Although some airport managements have attempted to attract new airlines by offering special pricing incentives, airport fees are such a minor cost factor that special incentives have little power to alter the airlines' fortunes in an appreciable way (though it should be noted that some communities have attempted to overcome this impediment by combining incentives on airport fees, labor costs, advertising, and taxes). Airport fees can be a deciding factor if an airline must choose between airports that are otherwise judged to have equally attractive markets. A cautionary note is in order at this point: any form of subsidy, whether a fee reduction or outright offer of cash assistance, should be made available to all airlines on an equitable basis, otherwise, an airport sponsor is open to a charge of economic discrimination, an event that can trigger a D.O.T. investigation.

Regardless of these hurdles, an airport's leadership can be proactive by thoroughly studying its own air travel market and communicating useful information to those airline companies that are best positioned to profit from it. If

(1) a particular airline is expanding its route system toward an airport and (2) the airport staff has market data indicating the local citizens wish to travel on the new airline's routes, it's not difficult to communicate this information to the airline's management. In doing so, the airport management hasn't attempted to alter the size of the local market nor the expense profile of the airline; rather, it has altered the timing of an event that may now take place sooner rather than later.

Concessionaires

If you wish to open a restaurant and sell hamburgers, you are free to do so, but if you wish to place golden arches in the front and call your restaurant McDonald's, you must pay a franchise fee for this privilege. Someone else spent a great deal of time and money to create the McDonald's image, and you may not profit from it unless you pay back a return on that investment.

Airports that have spent large sums of money to create an air transport facility have also created a marketplace in the process. If an entrepreneur wishes to enter that market, she owes a franchise fee to the airport that initially created this opportunity. This is the correct mental model for understanding an airport's relationship to its concessionaires. Once again, there is a larger dimension to this relationship than the simple landlord-tenant model that meets the eye.

The customary financial mechanisms include a square footage charge for rented space and/or a percentage of gross revenues. Frequently, a contract that specifies a

percentage of gross revenue payment to the airport will also establish a minimum annual guarantee to be paid regardless of business conditions.

At larger airports, the airport owner may employ a master contractor who operates one of the major concessions (e.g. food and beverage) and subcontracts other business opportunities to other companies. Alternately, some airports have employed the concept of a master developer who likewise subleases and oversees all the concession opportunities but is specifically prohibited from operating any itself.

An alternate relationship is established in a management contract wherein the airport essentially retains ownership of the concession and contracts with an outside company to provide competent management of the service. With this arrangement, the airport usually retains control over the strategic issues (pricing, product offering, total service hours) while the operator is given latitude to exercise tactical judgment about the actual operation (employee scheduling, product display, etc.) Although financial incentives for the operator may be included in the management contract, risk and reward primarily accrue to the airport.

When should an airport operate a particular concession with its own employees? The simple answer is when (1) the airport has a natural advantage over outside concessionaires and (2) it desires to do so. For example, an airport parking lot will be staffed with employees drawn from the local labor market, and airport management can attract employees from the local area as well as (or better than) a concessionaire whose headquarters is located several states away. If the local airport management already has a competent personnel management structure and efficient work rules, its leaders may decide to use these strengths to its advantage. Operating the parking lot without a middleman can result in a greater net return to the airport.

On the other hand, if the airport must abide by strict civil service rules or if it is currently engaged in labor troubles, it may be more prudent to recognize that an outside operator can better serve the situation, whether employed as a concessionaire or a management contractor. Each concession opportunity at each airport requires a specific assessment; no generalized answer can be given.

General Aviation

General aviation is such a broad category of activity that it is not surprising our airports have developed a wide variety of relationships with this segment of the flying public. To the extent there is a standard, it is to lease ground space to a Fixed Base Operator (FBO), which then builds facilities and offers customer services to the GA public. In a sense, this portion of the airport is routinely privatized, although the airport may require certain product offerings that would not otherwise be supported by strict market economics.

Alternately, the airport may wish to provide these services directly to the flying public without the FBO middleman. This method is less common than the previous and many times exists because of a peculiar situation in the local GA market rather than a preferred strategy by the airport's leaders. A variation of this strategy is to employ an experienced company to provide these services under a management contract, an approach that is gaining popularity.

Finally, at very small airports it is not uncommon to find the FBO actually acting as airport manager. A small county that owns an airport may not have the resources to hire a professional airport manager and staff. The county may then lease airport space to a FBO and further require the FBO to mow the grass, inspect the runway, and otherwise provide some minimum maintenance services in the guise of "airport manager". The potential for conflict of interest is obvious; however, many times there is simply no other economically viable solution.

In all cases, these points must be kept in mind when considering the relationship of airports to general aviation:

- The airport may not grant one FBO a monopoly; however, the airport owner may grant monopoly status to itself if it provides aeronautical services directly to the flying public. In either case, the FAA will exercise its oversight responsibility to ensure no members of the flying public suffer "unjust economic discrimination".

- If an airport has two or more FBOs on the field, it must treat them fairly, without unjust discrimination toward any. Easy to state in theory, this is sometimes difficult to apply in real life situations.

- FAA doesn't have as much regulatory control over general aviation as many of its employees would like. Sometimes the FAA forces the airport to act as a regulator, a role many are not pleased to acquire (Example: Requiring some airports to inspect GA fuel farms; requiring some airports to establish traffic patterns for ultralights).

In all cases, it is prudent for an airport's governing body to understand its local GA market and determine (by policy) its strategy for serving this flying segment. The alternative is to invent a strategy after the fact by negotiating with the various entrepreneurs that pass through the airport manager's office.

Customary financial mechanisms include a square footage charge for space leased (or per acre for raw land leased) and a fuel flowage fee. The fuel flowage fee is usually expressed in terms of cents/gallon although some airports establish it as a percentage

of the retail price. A wide variety of other financial mechanisms can be found at different airports around the country; however, fuel is usually the predominant revenue source for an FBO and the fuel flowage fee is frequently the central GA revenue source for the airport.

How can the local general aviation market be quantified? As a starting point, there are approximately 200,000 general aviation aircraft in our country. Dividing this by the total population (280,000,000) yields a ratio of about 1 airplane for each 1400 people; thus, if a particular community has 500,000 citizens and 450 locally-owned aircraft, it has a general aviation market that appears to be larger than average. Beyond sheer numbers, it is important to examine the type of aircraft. In the example above, if those 450 aircraft were all single- engine piston-powered aircraft (no turbojets, no twin-engine aircraft), this would be unusual and warrant further study. Finally, beyond the market of locally-based aircraft, an airport serves itinerant aircraft. A small rural airport may only serve two dozen local owners, yet sell over 250,000 gallons of jet fuel every year to the itinerant aircraft which deliver their owners to a nearby resort.

After measuring the size and composition of the locally-based and the itinerant markets, it is useful to classify the aircraft operators in these categories:

- How many aircraft are used to make money?
- How many aircraft are used to save money?
- How many aircraft are used to spend money?

Making money (e.g. air ambulance, crop dusting) and saving money (corporate travel) are economically viable uses of an aircraft and produce the majority of positive economic impacts associated with general aviation. Spending money (recreational flying) becomes more and more difficult as the cost of aircraft ownership increases. If a local airport serves a general aviation market that is (1) smaller than average, (2) primarily composed of lighter piston-powered aircraft and (3) serving recreational users entirely, the airport manager has to entertain concerns about the long term viability of the market.

State Aeronautics Agencies

Due to the interstate nature of air commerce, most government involvement with aviation is focused at the national level; however, practically every state has a bureau, department, or agency that oversees intrastate aeronautics. The size of these agencies and the breadth of their responsibilities varies greatly from small offices offering little more than expert advice to larger organizations involved in financial assistance, accident investigation, airport licensing, and statewide airport system planning. Because of this wide diversity, no clear generalization can be given about the customary relationship between airports and their respective state aeronautics agencies.

AIRPORT COMMERCIAL & RETAIL MANAGEMENT

Principles of Commercial Management

The following are the principles to manage airports commercially.

a) Understand the Customer
b) Determine What They Will Buy
c) Create a Shopping Environment
d) Motivate Shopping Behavior
e) Make it Easy to Buy

Key Actions to Maximize Commercial Revenues at Airports

a) Bring Commercial Planning Expertise to the decision making table as early as possible
b) Work to Better Understand Customer Needs and experiences
c) Immerse yourself in their mindset and align your retail offer to their needs
d) Create mechanics to encourage loyalty through reward programs
e) Create pre-awareness of what the airport has to offer through E-Commerce and strong website followed by handheld communication and airport way finding
f) Keep up to date with retail trends and anticipate passenger needs
g) Sweat the Space through innovation and creativity.
h) Bring "uniqueness" and point of differentiation to the end result that is consistent with the airport's image and rand.
i) Minimize any negative impact that increasing the concession space may have on airport and airline operations.
j) Airports and Retailers Need to Have a Clear Business Strategy which is jointly "owned".
k) Bring new concepts to market quickly – be fleet of foot.
l) Create the right economic conditions which attract the best operators through more equitable share of risk and reward.

Limiting Factors to Optimizing Commercial Revenues

a) Lack of investment in customer insight
b) Poor design at the development stage
c) Poor customer service – Service Level Agreements
d) Poor performance monitoring
e) Un-willingness of concessions to invest in commercial assets
f) Lack of close working relationship with retailers
g) Lack of innovation and flexibility to change.

Airport Retail Business Model

1. After five years of strong growth, prospects for airport retail in the mid-term remain positive even if forecasting seems to be a risky exercise in this current climate. Arthur D. Little forecasts duty-free sales will be 6 points above traffic forecasts for the period 2008-2012 (using IATA December 2008 forecasts of +2%, we estimate duty-free sales could grow by up to 9% over the period): duty-free sales should be one of the key drivers to compensate for the effects of the downturn for airports.

2. To sustain growth and outperform the market in the coming years, airports and operators will need to focus on five key success factors:

a) Developing the density of the retail surface to maximize performance (sales per departing passenger).
b) Adapting the offer to reflect the passenger profile.
c) Using a range of approaches to convert browsers into buyers, and to increase time spent shopping.
d) Extending their price advantage over city-center retailers.
e) Expanding customer target groups to include non-travelers and arrival passengers, and diversifying distribution channels.

3. As part of their drive to optimize performance, airports are applying new criteria in their assessment of operators tendering for concession contracts. Operators' local know-how and the way they leverage it to propose the highest concession fees is no longer as important as it has been; airports are increasingly looking for operators who can demonstrate financial robustness, strong offer flexibility, international know-how and high-quality operational performance. These changes in airports' expectations reinforce global operators' competitive advantage. Indeed, the trend among operators towards internationalization and consolidation helps them reach a critical size, allowing them to improve their professionalism, increase their buying power, extend their brand portfolio and offer very competitive and robust concession fees. In order to survive, local operators are repositioning themselves in niche categories or at regional airports or entering joint ventures with global operators. In the long term, however, these smaller operators are strongly exposed. These developments however do not guarantee a monopoly for global operators in future.

4. Airports are increasingly seeking out new business models in order to optimize their revenues and Arthur D. Little expects to see international airports claiming a greater stake in the value chain through the development of joint ventures between airports and global operators. Ultimately, it is the ability of airports and operators to collaborate effectively that will determine their success in realizing the potential of the airport retail market.

a) Perfumes & Cosmetics remains the must-have category for airports, with strong growth prospects driven mainly by a growing demand for cosmetics (skin care

and make-up) and an optimum "profitability vs. space allocated" ratio, guaranteeing high concession fees to the airports.

b) Fashion & Accessories has been a strong growth driver for the past five years thanks to an enlargement of airports' offer (space dedicated to this category, brand portfolio, etc.), a development of brands' direct operations and an upgrading of shops' merchandising and concepts. Although the economic slowdown will have the greatest impact on this category (especially luxury products) in the short term, Arthur D. Little forecasts very positive growth in the mid-term due to current segment immaturity.

c) Confectionary & Fine Food is the new growth driver benefiting from an increasing demand for local destination products (gift items) and the improvement in delicatessen concepts.

d) Two traditional categories, Alcohol and Tobacco, have lost market share (from 29% of duty-free sales in 2002 to 24% in 2008) compared with the other categories, suffering from a shift in consumption habits (health awareness) and toughening regulation (on liquids, on smoking, on advertising, etc.). However, growth prospects remain stable-to-positive thanks to the development of high-end products (single malt whisky, cigars, etc.).

5. Historically, airport retail has been dominated by local operators (incumbents), with the renewal of concession contracts with these operators being based on their local know-how, their knowledge of the airport's constraints and management, and their capacity to leverage other on-site concessions.

6. However, a number of factors have led to a change in expectations on the part of the airports. These factors include:

a) The internationalization of passengers.
b) The upgrading of airport retail standards driven by "best in class" Middle East and Asia Pacific airports.
c) Poor experience with some local operators (limited offer renewal, overbidding resulting in systematic guaranteed
minimum payment).

As a result, airports are now adapting their selection criteria leading to a possible reshuffling of competitive positioning.

Financial expectations: a new focus on financial robustness

7. The concession fees level remains a major selection criterion for airports. However, the growing pressure on retail operators to achieve higher targets and invest in offer renewal and shop concepts means airports are being more careful in assessing the robustness of the operator's business plan (through deep analysis of both the top

and bottom line) and the capacity of the operator to fulfill the plan's objectives. The operator's overall buying power and proposed brand performance benchmarks are key factors for the airports in this regard.

Optimizing passenger footfall

8. Two key objectives for airports are to increase the conversion rate and to increase time spent shopping. Airports need to:

a) Position "must-buy" products (core business categories) immediately after security checkpoints to ensure passengers complete their pre-planned buying first and therefore feel more comfortable when entering the second group of boutiques (diversification categories).

b) Capture those passengers that spend less time airside (business travelers, for example) by positioning last minute offers for top-selling brands in core categories near boarding gates, as seen in the "Vizzit" concept at Schiphol Airport.

c) Develop walk-through shops, as planned in Sydney where 3,500m2 of walk-through will be developed.

d) Secure "time to gate" communication to reduce pressure on passengers and maximize time spent shopping

(e.g. introduction of flight information panels inside the shops).

Promoting price advantage over city-center retailers

9. In order to compete with city-center retailers, airports andoperators have recently introduced innovative pricing policies, securing communication around their price advantage airside (lowest price guarantee) and proposing, when permitted, a unique pricing policy airside for both Schengen and non-Schengen passengers (Copenhagen Airport, Belgian Sky Shops, etc.).

The Disadvantages of Local Operators

10. With their smaller brand portfolio, limited negotiating power and, in many cases, lack of international perspective on demand/supply trends, local operators will find it increasingly difficult to compete with global ones. In the short to mid term, local players tend to survive by repositioning themselves in one of three ways:

a) In niche categories, such as local gastronomy and souvenirs, where local know-how is a key competitive advantage.
b) At regional airports, where the concessions surface is not yet sufficiently attractive to global players and where local operators can use their knowledge

of domestic passengers and local operations to secure their competitive position temporarily.

c) In core categories at major hubs, through joint ventures with global operators, in order to safeguard their historical position.

11. Joint venture with local operators is part of global operators' market entry strategy, especially in emerging markets (India, South America, etc): the local player provides understanding of local regulation and customs and a relationship with local authorities, local brands and local operations (logistics warehouse, staff, etc.) while the global operator secures purchasing efficiency and up-to-date concept set-up. Due to its joint venture with Aldeasa, for example, former state monopoly India Tourism Development Corp. (ITDC) succeeded in maintaining its incumbent position at Mumbai International Airport by winning a contract renewal in 2007. In the long term, however, local operators are strongly exposed the situation that once global players have acquired local know-how, they will compete independently for hubs' tender offers (without their local JV partner) and will also compete for regional airport concessions in order to optimize and amortize their national logistics and purchasing structure.

No guarantee of monopoly for global operators

12. Developments in the competitive environment mean that global players cannot necessarily expect to establish a monopoly at the major hubs; in fact, to a certain extent, global operators' objectives are at odds with the airports' current priorities.

13. Global operators are concerned mainly with optimizing margins and less with developing turnover. As a result, they are reluctant to take risks to increase turnover, such as introducing new brands or new concepts for which they will negotiate lower margins. By contrast, airports are paid according to turnover fees and have increasing expectations in terms of revenue optimization.

14. Thus success in airport retail relies on the ability of operators and airports to optimize their interface; both parties need to agree on turnover risk levels and margin targets, and to participate jointly in establishing an action plan to optimize turnover.

New business models emerge as airports seek to optimize revenues

15. As a result of the current inability of global and local operators to propose optimized interfaces with airports and properly integrate revenue optimization at the expense of their margins, new business models have emerged where airports have taken a greater role in order to impose their vision and optimize revenues.

16. The two main Airport Retail Business models that are becoming increasingly common are :

a) **A joint venture between the airport and a global operator.** A joint venture between an airport and a global operator imposes de facto collaboration

through a risk-sharing model. A local dedicated organization and governance bodies covering both sets of shareholders makes sharing information easier. By defining strategy (brand selection, investments, etc.) jointly through these governance bodies, the airport and the operator can balance margin and revenue optimization. The success of this model recently saw Milan airports (Malpensa and Linate) extending the concession contract with their joint venture with Dufry from 2020 to 2041.

b) **Direct operation of the retail space by the airport.** Direct operation, where the airport bypasses operators to deal with brands and operate shops itself, remains embryonic and tends to be implemented in airports with critical mass and established retail operations (staff, logistics, etc.), such as Dubai, Amsterdam Schiphol and Rome Fiumiccino. Direct operation gives airports complete control over the offer and the concepts and because there are no turnover fees squeezing margins, allows the airports to maintain competitive prices.

18. In their move to Mastering Airport Retail, airports should address the successive questions:

a) How is the airport's retail performance with regards to best practices (gap analysis) and what revenue optimization is at stake?
b) Which concession management model should be targeted taking into account the local context and the optimization at stake?
c) How can airports mobilize the different competencies in order to design and set the new operating model?

19. Whatever the Airport Retail Business model, the ability of players in the value chain to work closely together will determine their success in meeting the challenges ahead. Effective collaboration will be vital in order to develop the offer, optimize concept quality and improve performance, all of which will help players to realize market potential and resist value chain turbulence.

20. Setting these different levers, however, remains a complex challenge for both airports and operators. Key success factors identified through best practices may enable players to establish a better understanding of the areas they need to address, but customizing the levers and applying them to improve retail performance effectively on a given platform is very difficult.

21. Moreover, these key levers encompass a wide range of functional competencies (infrastructure, purchase, logistics, legal, marketing, etc.), which makes setting them even more challenging for airports and operators who find themselves having to involve and co-ordinate a wide range of different resources.

MODULE VI

FUTURE OF AVIATION MARKETING

AVIATION MARKETING: CHALLENGES AHEAD

This module has been prepared against a backdrop of what is still an industry facing rapid change and continuing financial problems. Two years of terrorism and war fears which began on September 11 2001 had a very serious and continuing effect on demand, an effect which, in an unstable world, may recur at any time. We have also seen that in aviation it is a dangerous statement to say that, "Things can't possibly get any worse". People were indeed saying this in 2003, when things did get worse with a rapid increase in the price of aviation fuel which has continued up to the present time.

Given the extent of the gloom which still prevails, it is difficult, but very important, to keep a sense of perspective. The industry has endured turbulent times before – admittedly at a reduced scale compared with today – and has come through them. Travel still has a great hold on many members of the world's population, and rapid economic growth in China and India is seeing the emergence of very large new markets Also, despite all the problems, some airlines are continuing to be very successful, as new business models emerge which seem capable of dealing with today's situation. More widely, a healthier and better industry may be the result of today's difficulties. In many ways, traffic growth has acted as a drug providing a fix which has allowed the industry to survive despite poor standards of management.

So what does the future hold over, say, the next ten years? Airlines will certainly have a substantial demand for their product, though in this writer's opinion at least, it will be a long time before we see a return to the inflated levels of demand growth seen in the boom years of the late 1990s.

A substantial, though declining, proportion of this demand will be in the business travel sector. This sector will be very different from the one to which airlines have become accustomed, in that it will be much more price sensitive and volatile. Leisure traffic will make up an even greater proportion of demand than at present, and it will be even lower-yielding than it is today. Only airlines with the keenest levels of operating costs will be able to carry it profitably. One bright spot will be continuing growth of the air freight market, the one market which airlines have which is not vulnerable to wars and the threat of terrorist attack. The problem for traditional airlines will be that most of this traffic will be carried by the small number of giant global Integrators rather than by them.

The marketing environment of the airline industry will certainly remain volatile and difficult. The established trends towards deregulation and liberalisation will continue, and, at least towards the end of a ten-year timescale, may encompass the long-overdue changes in ownership and control rules which will allow aviation to finally take its place amongst other global industries. Airport slot allocation will almost certainly come to be based on market principles, though the question of who should keep the proceeds from slot sales will always be a difficult one. Environmental issues will become even more important, and carriers will face justified limits on their growth and freedom of action unless they can demonstrate that they are taking al possible steps to minimise the environmental impact of their activities, even if these steps involve

substantial costs. As we have seen, only a supreme optimist would now suggest that airlines won't have to deal with the consequences of an unstable world political scene, and the ups and downs of a volatile world economy. They will have to address social change, with the ageing of the population and the changing nature of the world of work likely to have a particularly significant impact.

Technology will also affect airlines. In particular, ways of using electronic forms of communication to reduce the amount of business travel an executive has to undertake will continue to develop, and will significantly worsen airline's vulnerability to downswing periods. Also, new aircraft technology will give important opportunities which must be embraced.

Environmental questions will result in continuing – probably worsening – problems in expanding infrastructure capacity alongside demand. Taxation on airlines will also increase as governments follow a "polluter pays" policy.

In response to this difficult industry environment, the question of airline strategies will see revolutionary change. Around the world, we will see short-haul and medium-haul routes transformed by the principles currently being employed by the so-called "Cost Leader" airlines. The successful carriers will be well-managed "Cost Leader" players, and those threatened Differentiation airlines which are able to re-model their ways of working to get within striking distance of the cost levels of the Cost Leaders. Those that fail to do so will disappear as significant competitors in these markets. On long-haul routes, there will be less radical change, and the better-managed of today's Differentiation airlines have a good chance of survival and prosperity.

Given these strategic changes, the airline product scene will also see a considerable transformation. First Class service will have disappeared on all but a small number of routes, even in long-haul markets. Its replacement will be enhanced Business Class products, and perhaps, to a small degree, dedicated Business-Class-only products using 737BBJ and A319CJ aircraft. On short-haul routes, in contrast, there seems to be little hope that Business Class will survive at all. Instead, the emphasis will be on value-for-money offerings on single class aircraft. Everywhere, there will be an increase in point-to-point services and a decreased emphasis on hubbing, though A380 and 747-8 aircraft will find employment on the densest routes.

With pricing policy, the future is unlikely to see greater stability in airline pricing structures. The continuation of the well-established deregulation process and growing airline skills in storing, manipulating and communicating fares data, are likely to lead to instability, as airlines battle to match prices to the price elasticities of the different sub-segments of the market and to fill in the trough and even out the peaks in demand. Again this will place an absolute premium on speedy decision-making. Pressures will also increase for a simplification of airline pricing policies, to reduced overheads costs and to ease the selling task.

The area of distribution policy will see some of the greatest changes in the future. Over the next ten years, there will be a further fall in the proportion of tickets sold by travel agents, from the present industry average of around 70% to 50% or even less. This change will be brought about by an emphasis on electronic means for airlines to deal directly with their customers, and will bring about both a valuable further reduction in

commission costs and a necessary increase in airlines' ability to control their distribution channels effectively. It will not, though, be an easy change to manage, because of the adverse reaction of traditional travel agents to it and because of the setting up of increasingly powerful on-line travels agencies. The entry of very powerful search engines into travel retailing may turn out to be a particularly worrying development.

In terms of those Differentiation airlines that are successful, one of the most important characteristics will be that they are successful in identifying their most important customers, and establishing a warm, deep and longterm relationship with them. In doing so, they will still make use of Frequent Flyer Programmes, though, in a saturated marketplace, the role of FFPs will be more to provide a source of data for airlines so that they can target individuals with attractive offers, rather than them being the broad-brush incentive programmes they have tended to be in the past. With the question of marketing communication, brand building and brand maintenance will become crucial. The airline business has been slower to adopt these concepts than many Fast-Moving Consumer Goods firms. The reason is probably that up until now there has had to be a great focus on operational questions such as those associated with safety and punctuality. In the future, though the ability to build and maintain strong brands will be a necessary requirement for success. If it is, it will require marketing communication spending which is substantial, well-thought out and seen in a strategic, long-term way rather than as a tactical exercise which can be reduced or ditched as soon as times become difficult. All in all, the future will be an exciting and challenging one. Working in the airline industry will be stressful – dealing with an accelerating pace of change always is – but it will provide tremendous opportunities for those privileged to make their living from this still dynamic and fascinating industry.

AIRPORT MANAGEMENT: TRENDS and DEVELOPMENTS

Airports are evolving to play different roles in the wider ecosystem of the communities they serve. Driven by the complexity of shifting needs, the airport industry is adapting by developing different models, each meeting a different combination of needs. Some travelers wish to experience the airport almost as a destination unto itself, with many options for leisure and entertainment, dining, fitness and shopping. Others want a more minimalist experience, moving as quickly as possible through the airport before and after their flight. Still others may need extra assistance to navigate through an airport. The challenge for the airport is to deliver the experience that each type of passenger wants, consistently and cost-effectively, despite the inherent complexity in meeting a wide variety of needs. The magnitude of this challenge will increase over time as passenger volumes continue to rise.

We believe that airports will evolve along the lines of three models that will all have to meet the passenger experience needs. The airport city is a fully-featured international gateway and destination catering to the needs of both travelers and visitors from the local community. The regional travel and transportation hub is an arm of the local

economy focused on moving passengers and freight efficiently. The local, self-service terminal is a streamlined entity where most of a traveler's airport processes are conducted through self-service, focusing on speeding passengers efficiently from curb to aircraft with minimal human assistance.

Regardless of the type of facility, airport executives face a common set of management challenges. These challenges stem from the amount, variety and speed of information flowing from the major management domains in any airport, as depicted in Figure 1. The six domains shown in the figure are linked to management outcomes, which enable the business outcomes central to the airport as an enterprise.

Underlying the management domains and their associated outcomes, efficient data processing is critical to ensuring that managers can understand, predict and direct events, processes and assets to achieve the outcomes. Business intelligence and analysis has taken hold in airports and the airline industry, focusing primarily on analyzing specific, single domain issues.7 For instance, most airports today can determine if a flight arrived on time or was delayed and often know why, but most cannot analyze and respond in real time to the root cause (e.g., delayed catering truck, slow fueling, etc.). For airports to be able to meet their challenges and imperatives while remaining agile enough to accommodate evolutions in the industry, they must move beyond using analytics to simply producing reports in single domains to using them

to produce instant insights across all domains. This means that airport executives and CIOs must elevate the strategic importance of the digital infrastructure to manage informational complexity and produce successful outcomes.

Managing Information Complexity In Airports

As airports evolve, the amount of information and data generated will increase, driven by increasing numbers of subsystems, people, technology platforms and the interconnections between them, creating massive complexity for airport managers. Typical airport management systems using information technology (IT) are designed around discrete, single-purpose systems, such as passenger management, which sit within organizational silos. This results in a complicated and inflexible system that is difficult to administer and expensive to maintain and power. Worse still, these legacy systems segregate information that should be shared between domains and cannot easily adapt to changing requirements placed on them. Moreover, as the volume and complexity of information increases, these legacy systems can be overwhelmed, degrading managers' ability to run the facility.

A better approach to managing information complexity is to implement an overarching system integrating all of the domain subsystems and enabling cooperation between them. Under this approach, aviation operations, security, energy and physical assets would all coordinate during a snowstorm, for instance, to accommodate sudden changes in air traffic patterns while ensuring positive passenger experiences. Using

current management systems, this level of coordinated activity is difficult and costly, as managers manually abstract relevant information from multiple sources and then try to combine it in the moment. The integrated management system approach builds business value by reducing administration costs, improving process efficiencies and generating higher, supervisory-level insight. Moreover, an integrated management system extends managers' visibility across all domains, increases control and balances between them, promoting continuous improvement holistically.

Smarter Airport Management

The digital infrastructure for an integrated airport management framework is based on ingesting, processing and sharing data from the many subsystems throughout the airport domains. This supports a method of smarter airport management through visibility, control and continuous improvement capabilities.

Holistic Management Systems

The heart of smarter airport management is a holistic management system that integrates an airport's stand-alone systems. Because many airports will have substantial investments in these legacy systems, the holistic application is able to incorporate the stand-alone systems without having to replace them. The holistic system works by obtaining operational data from each separate system and then creating a single view of all the data. This also allows interconnection between the separate systems and promotes collaboration between domains through shared sources of information.

Holistic management systems support smarter airport management by:

a) Giving security officers the ability to detect a threat, such as an unauthorized intrusion into a secure area, evaluate its implications and direct the appropriate personnel and resources to neutralize the threat without disrupting airport operations or inconveniencing passengers

b) Enabling maintenance managers to schedule work during low traffic periods while retaining the flexibility to rapidly reschedule physical assets and personnel in the event of a weather emergency to accommodate the unexpected surge of passengers

c) Allowing airport real estate managers to use consumer forecasting to evaluate the impact of a new entertainment center on energy consumption, security needs and terminal traffic patterns to drive increased passenger spending

CHANGING FACES OF AIRPORT

Privatization of Airlines

Privatisation of State owned airline has been one of the prominent transformations in international air transport, where airlines in all but a handful of States had been government owned until recent times. The motives for privatisation have been highly discussed, ranging from few purely economic considerations to improving operating efficiency and competitiveness, to a more pragmatic desire to reduce the heavy financial burden for governments for financing capital investment in new equipment. Since 1985, about 140 governments announced privatisation plans or expressed their intentions of privatisation for approximately 180 State- owned airlines.

Low- Cost Airlines

Another recent development in the airline sector is the introduction of 'Low – cost business model'. Low-cost carrier also known as no-frills or discount carrier is an airline that offers low fares but eliminates most traditional passenger services. The common features of this business model are, a single type of aircraft reducing training and servicing costs ,point to point network focusing on short-haul routes, high frequencies, simple low –fare structures, high density single class with no seat assignment, simple in-flight services, staffing flexibility and minimal overheads, and intense use of electronic commerce for marketing and distribution. They also use less-congested cheaper secondary airports to ensure short turn rounds and high on-time performance.

The first successful low-cost carrier was Pacific Southwest Airlines in the US, which pioneered the concept when their first flight took off on 6 May 1949.Southwest Airlines followed the trend in 1971. With the advent of aviation deregulation the model spread to Europe as well, the most notable being Ireland's Ryan air, which began its low cost operations in 1991 and Easy Jet followed it in 1995. Many traditional carriers also followed this model such as KLM's Buzz, British Air's Go Fly and United's Ted. Some of them found it difficult to run both the traditional and low-cost models together. Notwithstanding, the low-cost models are on the increase. As per Mercer Management Consulting report of 2002, a comparison of costs per seat/mile reveals unit cost advantage of 20 to 40% for South West low –cost airlines over US airlines. Low-cost airlines are overtaking established carriers in market capitalization on the stock exchanges. Ryan air by and large remains the low-cost pioneer in Europe and pursuing this business model in its pure form. It is forecast that low-cost airlines will expand their European market share from the present less than 10% to 25% by 2010.

The low-cost formula is likely to spread to other regions and increasingly to international services where market conditions and regulatory arrangements permit. The low-cost model 'airline –within an airline' strategy by major airlines tries to combine the ingredients of low cost carriers approach with the reputation and quality of their own brand. While only purely 'low-cost' airlines will survive as major players,

this model can also compete with railways by way of inter modal transportation offerings (Rail &Fly) offering affordable prices for long distance rail tickets. The low-cost model provides immense opportunities for regional airports and medium sized airports including military bases for growth. The user profile being that flexible holiday and private travelers and price-conscious business passengers preferring low – cost airlines for short routes, while the big network carriers focusing on inter-continental/inter-regional business passengers, the stage is set for the growth of low-cost airlines and in turn cheaper secondary airports.

Airline forecast points to almost a 2.7 fold increase in passenger traffic, and of doubling of aircraft movements by the year 2020. These forecasts are predicted on the assumption that sufficient system infrastructure and capacity will be available to handle the demand. It is relatively easier for the airline to meet the growing passenger flows by moving to higher capacity aircraft where as airport sector is a different ball game.

Capacity Constraints

Capacity constraint is one of the bottlenecks in air transport growth. At their meeting on 28 January 2000, Ministers of Transport from 38 European States estimated that cumulatively flights experienced over 27 million minutes delay in Europe alone due to airport and air space congestion. Traffic patterns based on the underlying demand for air services and air carrier practices influence the use of available capacity.

Airport slot is different from the air traffic control (ATC) slot, which is the take-off or landing time of an aircraft which is assigned by the relevant air traffic control unit to make optimum use of available capacity at points en-route or at the destination airport. With the assignment of airport slot, airlines build their schedule taking into account time to taxi out and the customary en-route duration, on the assumption that an ATC slot will be available. This factor therefore underlines the importance of close coordination between the airport slots and ATC slots. Generally, the airport capacity is never fully utilised throughout the day. It undergoes peak and lull periods. There are seasonal peaks as well.

When we talk of airport capacity, it is a combination of runway and terminal capacity. The runway capacity is determined by the regulatory authorities, usually in terms of the number of movements (landing or take-off which can safely be performed per hour) taking into account such factors as the physical characteristics of the runway and the surrounding area, types of aircraft involved and air traffic control capabilities. Whereas, terminal capacity is the amount of passengers and cargo which the airport can accommodate in a given period of time sometimes referred to as passenger or cargo throughput. Type of passengers or passenger mix can influence the rate of passenger throughput. Aircraft size is another factor that can affect terminal capacity. Airport capacity can also be adversely affected by external factors such as environmental restrictions and air traffic control capabilities.

When the air carrier demand at an airport exceeds the availability of slots, the airport can then be considered capacity constrained. To a great extent capacity constraints are eased out through International Air Transport Association (IATA), schedule coordination conferences, in which well over 260 airlines participate and schedules are adjusted through bilateral discussions. Capacity is essentially controlled through regulatory framework within which slot allocation mechanisms are employed at global, regional and at national levels.

The ability of an airline to exercise the market access/ traffic rights granted under relevant air services agreement is closely linked to the availability of slots (designated times for an aircraft to take off or land) at the specified airports for which the traffic right was granted. Shortage of airport slots by and large is an important physical constraint on market access. Some of the airports resort to auctioning of slots or price the slots to control the demands.

One may ask, why not expand the airport and build new runways? Here again, there are considerable constraints to the development of new airports or even the expansion of existing facilities. Environmental and physical constraints are formidable. Past experience in the UK, Japan and Germany where local resistance to the construction of a second runway or new airport explains the point. Japan was forced to build an offshore airport (Kansai) in a man-made island in Osaka Bay. Hong Kong and Macau have both built new airports on reclaimed land in their in- shore waters, and Incheon airport in the republic of South Korea built partly on reclaimed land between two islands. Even in the USA, Denver is the only new airport that has been constructed in the past over 10 years. Liberal air services agreements with multiple designation and gradual removal of capacity restriction have enabled increases in the number of air carries and air services, thereby putting additional pressure on existing airport capacity and it would continue to challenge the airports.

Consumer Interests

Growing dissatisfaction with the conduct of airlines staff and similar concern on quality of service such as facilitation at the airports are matters of increasing passenger concern. In USA and Europe, certain measures are in place aimed at reinforcing the rights of air passengers, proposing new voluntary commitments and enforcement legislation. As for voluntary commitments, airlines and airports in the member States of the European Civil Aviation Conference (ECAC) developed two codes. The Airline Passenger Services Commitment and the Airport Voluntary Commitment on Air Passenger Services. These two codes became effective in February 2002. Governments in other regions have also been considering some legal measures. IATA also adopted a global customer services framework in June 2000 intended as a guide for member airlines in developing their own voluntary commitments.

The point to remember is that consumer interest issues are gaining momentum and they need to be carefully examined to make sure that the service quality has adequately

been dealt with by the current commercial practices by airlines and airports. There will be a need for the States to strike the right balance between voluntary commitments and airport infrastructure

Change of Airport Ownership

Majority of airports world over were constructed pre-post World War II and in any case prior to mid 1960s. Airport ownership then was reviewed as strategically important and as such most of them came under government ownership. A further shift in ownership began in early 1970s when a number of countries created airport corporations under public ownership and it provided access to private/external capital market. A second shift occurred in the mid 1980s and a number of countries began to turn the private sector for direct financing of airport investment and to further improve the managerial efficiency. A large number of publicly owned and operated airports are generally not rated well equipped due to limited government funding. Hong Kong and Singapore airports are exception to the rule. In the 1990s many of the public airports became privatised. The privatisation model included outright sale of asset through stock market, long-term leases, joint ventures/equity flotation etc. Private sector participation in Asia has reveled primarily around green field projects. In the current economic climate, there is an increasing pressure to reduce or re-direct government spending and that makes it more and more difficult for public involvement in airport infrastructure. Therefore, there is an increasing trend in the airport ownership by way of leasing and private participation,

Airports have been moving away from the government ownership to commercial and private ownership. British Airports Authority (BAA) was among the first to privatize in 1987 and it remains a paradigm for airport management. Aer Rainta and Schiphol are examples of airport companies which although State owned, operate as commercial enterprises. New airports in Asia including India is based on a concept of Public-Private Partnership (PPP), instituted through a Special Purpose Vehicle (SPV). All the Greenfield airports in India are based on this model.

Traditionally, governments were cautious to take part in airport privatisation barring few like British Airports Authority (BAA). Long-term lease holds of Australian Government in Brisbane, Melbourne, Perth, Sydney etc have provided the lead for other governments to come out of their traditional outlook.

Involvement of local authorities, concession for the management, Inter-airport shareholdings are encouraging trend in airport ownership. Aeroport DI Roma has 20% (US4 130 million) shareholding in Airports Company of South Africa(ACSA). Copenhagen airport has a 25.5 percent stake in a consortium to develop and operate nine airports in South Eastern Mexico. The management of Djibouti airport was awarded to Dubai Ports International Authority, Bamako airport in Mali transferred to a private concessionaire, Tehran airport to an independent airport authority and similarly, Beirut airport to a commercial entity to operate.

China has embarked, on a trial basis, a substantial airport management reform – under the scheme, hub airports will focus on strategic initiatives to fulfill their development potential, while major regional airports would specialise and strengthen links with their regions. Similar airports are expected to peruse innovative approaches to become more financially sustainable.

What is interesting to observe is that aimed at reducing the financial outlay and improving the efficiency of government owned airports, more and more airports around the world are transforming into autonomous authorities and subsequently moving towards private sector participation. Common technique for private participation involves Build –Own - Transfer (BOT), Build – Own Operate – Transfer (BOOT), Lease – Develop-Operate-management Contract (LDC). The limited past experiences of airport privatisation, however, does not confirm to any single model with a single definition as yet. Financing of airport projects however continues to be the critical constraint and a major challenge for the airport sector.

Change Management- Challenges

The first task for the airport management therefore, is to cope with the transformation from being largely state owned/ supported entities to more and more commercial and competitive entities with private participation. Airports are therefore challenged to re-organise themselves and cope with the organisational stress in the wake of this ownership changes. Additionally, airports will have to face the conflicting demands from airlines for increased capacity due to the changes in their own business models and high service expectations of customers and stakeholders, at the same time there is a mounting pressure from environmentalist seeking to ensure that progress will not be made at the expense of environment. Regional and local planning authorities expect increased social and economic activity in the form of employment and new business opportunities. From the technological point of view, airports are beginning to face the waves of advanced Information Communication Technology (ICT) and it certainly calls for a comprehensive airport management system.

There is yet another area that is likely to involve airport operations and that is the on-going efforts to form air traffic alliances. Euro control is talking about such an alliance, the re-organisation of air space focused on efficiency and cost-effectiveness from Iceland to Turkey. As the ICAO initiated CNS/ATM gets its way, several such advanced measures including reorganisation of airspace would have to be introduced despite the likely political uncertainties. Nevertheless, airports have to be on board in all such new ventures. In order to achieve the financial viability, airports have also been diversifying their business- direct operation in ground handling, management involvement at other airports (BAA, Schiphol, Frankfurt etc.), providing training or consulting services (Montreal, Airports de-Paris, Singapore Etc.), airline partnerships and diversification into non-aviation activities(real estate, production of aviation related items such as fire fighting equipment etc.)

Faced with the emerging changes, airports in most parts of the world have been forced to re-examine their operational capability and managerial style. A new buzz word " World Class" has emerged and quite a few airports/Department of Civil Aviations/Civil Aviation Authorities have also duly filed their flight plan to destination 'World Class' and are now obsessed with 'VISION', 'MISSION', 'VALUES' and 'STRATEGIC OBJECTIVES' to reach their destination.

Interestingly, most of the VISION /MISSION statement reads "to be a world class airport", "to be a world leader ", "to be a world class airport in the region", and so on. They all want to be world class players. Apparently, both the management and staff are being sensitised to go through the strategic management path, a clear shift towards commercial management philosophy.

PRIVATIZATION OF AIRPORTS

INTRODUCTION

Since 1987 airport privatization has become a worldwide trend. As of early 1994, privatizing airports was on the agenda of more than 50 sell all or a partial interest in existing airports or airport authorities. In developing countries, where the principal need is major expansion and modernization, the usual pattern is for government to use a long-term franchise to have the countries. In developed countries, the general pattern is for the government to private sector finance and develops new terminals or entire new airports. A major factor in the growing interest in airport privatization is government fiscal stress. Developing countries often lack the resources to develop new airport capacity, so they turn to private capital and expertise to get the job done. Governments in developed countries increasingly view airports both as assets and as businesses. A commercial airport is an asset which often fails to produce a commercial rate of return, as operated by government. And as "reinventing government" becomes the guiding philosophy, airports are often seen as non-core functions that can better be managed as businesses, by a private-sector business enterprise. In part, the move to airport privatization reflects a changed paradigm of what an airport is supposed to be. The traditional paradigm views an airport as essentially a public service whose objective ought to be simply to enable aircraft and their users to arrive and depart while just covering its costs. The airport-as-enterprise paradigm views an airport as an entrepreneurial business, whose objective is to identify and meet the needs of a diverse clientele: not only airlines and private pilots but passengers, meters-and-greeters, airport staff, airport neighbors, and airport tenants, among others. Airport privatization is much further along overseas than in the United States. Developed countries generally seek to reduce or eliminate their need to invest scarce resources in airports, which can be commercially financed and operated. Developing countries seek world-class expertise, as well as capital, to ensure modern and efficient airports. Airport sales have taken place in four countries, and another seven have announced plans to sell major airports (with the issue under study in eight more). Franchises for new airport capacity projects are under way in 17 countries and under study in 14 others. In this country, the principal factor leading to interest in airport privatization is the growing

trend toward reinventing government, seeking to replace monopoly government agencies with the competitive forces of the private sector. All U.S. air-carrier airports are owned by governments, and less than a dozen are currently leased or managed by private firms. However, since 1989 public officials in a number of cities have proposed the sale or lease of air-carrier airports, including Atlanta, Baltimore, Boston, Indianapolis, Los Angeles, New York, Philadelphia, Rochester, San Francisco, Syracuse, and Worcester. A number of jurisdictions are considering contracting out the management of general-aviation (GA) airports, including DuPage, Illinois; the state of Rhode Island, and San Diego County, California. The purpose of this guide is to explain how airport privatization applies in the U.S. context, so that public officials can consider their options for ensuring high-quality airport services.

PRIVATIZATION MODES

Existing Airports

There are three principal alternatives for making use of privatization in the context of an existing airport. In order of increasing reliance on the private sector, they are:

- contract management
- long-term lease
- sale

Contract Management

Many types of municipal facilities are being turned over to private contractors on relatively short-term (five years or less) management contracts. Convention centers, data-processing centers, golf courses, jails, sports arenas, and wastewater plants are among the facilities now routinely contracted out by city, county, and sometimes state governments. Governments use the competitive process to stimulate greater efficiency in the operation of these facilities, since a firm must rethink the way it does business in order to be competitive in winning an operating contract. Typically, in a facility management contract, the operating budget is proposed by the contractor and approved by the government; funds needed for budgeted items are appropriated by the government and passed through to the contractor. Fees and charges are paid by users to the government agency, not to the contractor. The contractor receives a management fee from the government agency, which may be based in part on the contractor's performance. The facility's employees and managers work for the contractor, not the government. Contract management can be used for airports of all sizes and economic conditions, though it is generally most applicable where an airport has been losing money. If an airport is inherently unprofitable (i.e. its costs are very much more than its current and likely future revenue potential), the motivation for contract management is usually to reduce costs and increase revenues, thereby reducing the extent of the airport's deficit. A nearly break even airport can potentially become profitable under contract management. A number of U.S. airports are operated by contractors. Table 1 lists the four air-carrier airports under contract management as of mid-1994. Also

listed are a number of general-aviation airports also managed by contractors, including the five general-aviation airports in Los Angeles County.

Long-Term Lease

A long-term lease is quite different from a management contract. Generally, a lease is used in preference to a contract where significant airport development is anticipated. The aim is to shift a significant portion of the risk of development away from the taxpayers and to the private-sector lessee. The term of the lease is often related to the length of time needed by the private operator to recover its investment in new facilities. A lease arrangement transfers the principal responsibility for airport operations and development to the private lessee. Hence, unlike the management-contract case, in lease situation airport users pay fees and charges directly to the lessee, and the lessee must cover its operating and capital costs out of those revenues (and hope to have enough money left over to show a profit). The typical lease agreement provides for a lease payment to the government based, in part, on a percentage of the airport's gross revenue. This gives the government an incentive to work cooperatively with the lessee, since the government will share in the proceeds. But this arrangement also gives the lessee an incentive to minimize costs, so that it can maximize the difference between gross revenue and costs. And since the lessee is responsible for capital investment in the airport, it will have strong incentives to add only that amount of runway or terminal capacity that will produce an acceptable return on its investment. Several small air-carrier and large general-aviation airports in the United States are currently leased to private firms, as noted in the number of other airports have been leased by municipal governments to independent public authorities; a principal example is the lease by the cities of New York and Newark of Kennedy, LaGuardia, and Newark airports to the Port Authority of New York and New Jersey.

Sale

Worldwide, the most common mode of airport privatization is the sale of either a part-interest or the entire airport. Full divestiture (sale) is the mode of choice when the airport is profitable but may not be maximizing its entrepreneurial possibilities under government ownership and management. Governments generally sell entire airports as part of an overall program of divesting themselves of noncore businesses, using the proceeds either to reduce outstanding debt or for investment in other needed infrastructure. This was the motivation for the British government's 1987 sale of the British Airports Authority and the planned sale of the airports belonging to Australia's Federal Airports Corporation. In some cases, governments sell only a majority interest, retaining some fraction of ownership and therefore a direct voice in airport management. Liverpool, England sold a 76-percent interest in its airport to a single strategic investor, British Aerospace. Several other British cities are planning similar sales of majority interests. Some other countries are thus far selling only minority interests. Austria sold 27 percent of Vienna International in 1992 and plans to sell another 18 percent in 1994; the proceeds are being used for airport expansion. Denmark sold 25 percent of the Copenhagen Airport in 1994, and airport authorities in

several other European countries are considering similar sales of minority stakes. Table 3 summarizes the status of airport sales worldwide as of mid-1994.

New Airport Capacity

New airport capacity may be developed privately in two ways. The more conventional is via the government granting of a long-term franchise (called a "concession" in most other countries), at the end of which the airport (or terminal) reverts to government ownership. This type of transaction (which sometimes involves some financial participation by the government) is a kind of public-private partnership. The other approach is for the private sector to develop an airport entirely on its own, subject only to the planning permissions required (airspace approval by the national aviation authority, local land-use regulations, etc.). In effect, the airport company has what amounts to a perpetual franchise, though there may not be an actual agreement to that effect (any more than there is for an investor-owned steel mill).

Long-Term Franchise (BOT or LDO)

Around the world, long-term franchises for infrastructure facilities are usually referred to as BOT projects, because under this type of contractual agreement the private sector builds, operates, and eventually transfers to government the facility in question. When a lease of the underlying land is involved, this type of arrangement is sometimes called Lease-Develop-Operate (LDO); in this case the "transfer" back to government is implicit, since the lease has a fixed number of years. The BOT approach is widely used for several reasons. First, it taps into a different pool of capital than is normally available for public infrastructure projects, thereby expanding the range of potential funding sources. Second, private consortia are often able to design and build large facilities in significantly less time than is possible via traditional government procurement methods. Third, both the up-front cost and the operating costs may be lower in a facility that is designed, built, and operated by a single team interested in long-term profitability. Fourth, BOT is a way of shifting many of the risks of project development from the public sector to the private sector. For these reasons, airport BOT projects have proliferated in recent years. As of early 1994, there were 15 airport BOT terminal or runway projects under way worldwide, and another five projects to develop entire new airports. In addition, another 18 such projects were under study. No outright airport BOT project has yet occurred in the United States, but Transport Canada used this process to develop the successful international terminal (Terminal 3) at Toronto (as will be discussed in the next section). Many U.S. airports have used something resembling an LDO process to develop new terminals sponsored by either one or a group of airlines, which gain exclusive control of the gates in that terminal. But this type of project raises important competition and access issues that do not arise when the developer/operator is an independent third party which relates to all airlines equally as users (as is the case with BOT terminal projects worldwide).

Perpetual Franchise

The number of fully private air-carrier airports (as opposed to small general-aviation fields) is quite small. Among those currently in operation are the London City Airport (a short/medium-haul airport in the Docklands area near the financial district), the Freeport airport on Grand Bahama island in the Caribbean, and the Punta Cana airport serving a resort area in the Dominican Republic. Hawaiian Airlines built and operated a small commercial airport in West Maui, HI in the 1980s, but turned it over to the state as unprofitable several years later. Several entrepreneurial private airport proposals have been made in the United States, several of them as potential "wayports"—freestanding hub airports aimed primarily at transferring passengers from one flight to another (and therefore not linked to a city's origin/destination market). One of the best-known is the proposed Aeroplex, planned to occupy 22,500 acres in northwest Martin County, on the east coast of Florida. Its developer received airspace clearance from the Federal Aviation dministration in 1991, but as of 1994 development had not begun.

Military Base Conversions

Over 100 major military bases are expected to be closed during the 1990s. Many of these are airfields, and quite a few are in or near urban areas. The general procedure for federal disposal of unneeded bases is that if no other federal agency needs the property, the local government has first claim on it; under certain conditions, the municipality may be able to obtain it at no charge. In the case of air fields, if the Federal Aviation Administration recommends the site for airport use, the property may be given to the local government for that purpose. Without such arecommendation, the municipality may buy the base or arrange for a private firm to purchase it. A number of military bases have been or are being converted to civilian airport use. Orlando International Airport is the former Strategic Air Command McCoy Air Force Base, converted in 1974. In New Hampshire, the former Pease AFB became a civilian airport, Pease International Tradeport, in 1991. Scott AFB, 15 miles east of St. Louis, is becoming Mid-America Airport. And in Austin, Texas, officials abandoned a Greenfield site for the city's new airport when Bergstrom AFB became available; the base is now being redeveloped as the replacement for Austin's outmoded air-carrier airport. The long-term franchise mode of privatization is the one most applicable to converting a military airfield to a civilian airport. Instead of attempting the complex task of developing, financing, and managing the airport project itself, the base-redevelopment authority can seek competitive proposals from private-sector consortia. In this way, not only can greater professional expertise be brought to bear, but much of the risk involved in new-airport development can be shifted from taxpayers to investors.

POTENTIAL BENEFITS OF AIRPORT PRIVATIZATION

Increased Operating Efficiency

One of the most common benefits of substituting a private operator for a government department is greater efficiency in operations. In part this is due to the different

incentives at work in the two sectors. Private-sector managers are generally evaluated and compensated in part based on the economic performance of the enterprise; this is very seldom the case in the public sector. Second, the public sector is hampered by such constraints as civil service (which makes it difficult to fire incompetent staff or to reward outstanding performance), cumbersome government procurement regulations (which stretch out the time and increase the cost of purchasing supplies and equipment), and micromanagement from higher levels (either departmental or political). The private sector may also benefit from economies of scale. A firm that owns and/or operates multiple airports may be able to purchase supplies in bulk, operate centralized accounting, personnel, and other support services to serve all the airports, and take advantage of other economic benefits of larger size. In addition, the private sector is likely to be less constrained and more willing to contract out functions that can be performed more cost-effectively by other firms. For example, airport fire and rescue service at privately managed Burbank (CA) Airport is contracted out to a private firm. Thus, the single decision to privatize the airport (via management contract, lease, or sale) can serve to depoliticize a potential host of smaller-scale contracting-out decisions, each of which might have involved a political wrangle if it had to be made by a government department.

Additional Operating Revenues

It is increasingly being recognized that airports are economic enterprises able to generate more kinds and larger amounts of revenue than traditionally imagined. For smaller, currently unprofitable airports, privatization offers the potential of turning a loss-maker into a profit center. For larger airports which may already be operating in the black, the greater revenue potential under private management can lead to increased returns to the current governmental owner, either via lease payments or sale proceeds. For general-aviation airports, increased revenues may be derived from instituting landing fees (if none exist), better enforcement of fee payment, encouraging fixed-base operators (FBOs) to develop expanded offerings of goods and services (a percentage of whose proceeds flow to the airport-management company), and more intensively developing airport real estate. For air-carrier airports, the revenue opportunities are even greater. In some cases, landing fees and/or rental charges may be out of date and below market; likewise for current agreements with concessionaires. Perhaps more important, a privatized airport firm will typically adopt a more expansive retail approach involving a much broader array of goods and services aimed not only at passengers but also at airport and airline employees and airport neighbors. New business opportunities also include providing business services, conference facilities, hotel accommodations (both short-term and longer-term), as well as more intensively developing airport real estate. It is sometimes noted that there is nothing in the preceding list that is uniquely known to the private sector, which is correct. However, most of these activities require specialized knowledge and an entrepreneurial corporate culture which may not be present in the public sector. There is a higher risk of failure in seeking to convert civil servants into entrepreneurs than in hiring genuine entrepreneurs to do these things. In addition, the competitive process may well

generate innovative new ideas for cutting costs or increasing revenues; ideas which would not otherwise have been brought to bear.

Improved Customer Amenities

The most dramatic difference which privatization can bring about is a new approach to airport retail activities. Air travelers who have used London's Heathrow or Gatwick airports (privatized via sale in 1987), the new international Terminal 3 at Toronto (developed via BOT/LDO and opened in 1991), or the new Pittsburgh terminal (whose concessions are managed privately by BAA under a 15-year lease) will have experienced airport retail that differs dramatically from other U.S. airports in three respects: 1) the amount of retail space is several times as much as in other terminals of comparable size; 2) the retailers include numerous national and international brand-name outlets; and 3) the prices charged are not high "airport prices" but are the same as one would find in the local shopping mall. The new privatized retail approach produces a situation in which all parties are better off. Air travelers like the lower prices and greater variety of goods and services, as proven by per-passenger sales two to three times higher than in traditional terminals. The airport operator is happy, because the higher sales volume produces higher net revenues. And the airlines are happy because concession revenues cover a higher fraction of total airport costs.

Reduced Risk of White Elephants

A principal reason why the World Bank is now urging privatization of major infrastructure (including airports) in developing countries is to minimize the risk of unwise investment, leading to "white elephant" projects which cost several times what they can generate in revenues. In this country, airlines have grown weary of being faced with grandiose plans for architectural monuments (often referred to as Taj Mahals) posing as new airport terminals. Recent cases in point include the (now-canceled) JFK 2000 project to build a new central terminal at New York's Kennedy International airport, the large new terminal at Washington National airport, and the very costly new Denver International airport. How and why does privatization make a difference in new-project development? Privatization of airport capital project development (whether by sale, long-term lease, or BOT) shifts many of the risks from the taxpayers to private investors. This, in turn, forces a high degree of "due diligence" in reviewing the design and cost of the project, and especially an insistence on "investment-grade" traffic and revenue forecasts. Privatization helps to ensure that project decisions are made on economic and financial grounds, not on political grounds.

Lease or Sale Proceeds

Under contract management, a city or county may be able to reduce or eliminate an airport's operating loss, thereby ending a drain on the taxpayers. But this type of short-term privatization may not produce net revenue for the municipality. That is because federal airport grant legislation makes it illegal for a city to "divert airport revenue" to municipal coffers. All revenues generated by the airport must be used solely for airport purposes, if the airport is to retain eligibility for federal grants. The only legal way

around this restriction is for the municipality to cease being the airport operator. By selling or leasing the airport, the city or county can recover its investment of land (and capital, if any) in the airport, via the lease payments or sale proceeds. The private airport lessee or owner may choose to remain eligible for airport grants, working out its fee schedules and payment arrangements so as to obtain FAA approval, or it may opt to forego federal grants and operate free of FAA economic restrictions. (In the latter case, it may have to pay back the depreciated value of the facilities purchased with the grants.)

PROJECT PROFILES

Air Carrier Airport/Contract Management (Westchester)

The White Plains/Westchester County Airport is an 800-acre facility surrounded by affluent suburbs and office parks. In addition to scheduled airline service by four major airlines and several commuter carriers, the airport is the home base for numerous corporate jets and turboprops. Activist anti-noise groups made up of affluent homeowners have succeeded, via litigation in limiting the extent of growth in airline passengers over the years. Turned over to Westchester County by the federal government after World War II, the airport was operated by the airport's fuel supplier for 30 years. In 1977, faced with large operating losses (up to $250,000/year) at the airport, the county government decided to bid out airport management on a five-year contract basis. Pan Am World Services won the initial contract, and it and its successor company, Johnson Controls World Services, have won renewals every five years since then. Under contract management, the airport has become solidly profitable, with net income of up to $3 million per year. The company has achieved these gains by reducing operating expenses (e.g., by cross-training personnel so that fewer people are required), increasing revenues (e.g., by renegotiating ground leases to market levels and instituting paid parking in 1981), and fostering real-estate development. For example, there are now five fixed-base operators (FBOs) compared with three in 1977, as well as additional hangars and related facilities. Despite community-imposed growth limits, major airlines have been attracted to Westchester, compared with the mostly commuter airlines that provided service prior to 1977. The transition to contract operation was relatively smooth. The county requested the company to offer jobs to all the current airport employees, and all but two accepted such offers. After many years of political wrangling, a badly needed new terminal building is under construction and set for opening in the summer of 1995, funded by county-issued bonds. A parking structure and service building opened in summer 1994. The county is pleased with contract management because it insulates public officials from community complaints. Though the county retains all policy-making authority, it can cite and rely on the company's professional advice, thereby depoliticizing many decisions. In addition, of course, the airport's former operating loss has been turned into an operating profit.

General Aviation Airport/Concession Management (L.A. County)

Between 1958 and 1970 Los Angeles County acquired five general-aviation airports which their developers were unable or unwilling to maintain. Due to concerns about high operating costs and net low revenues, the county decided in 1990 to contract out these airports as a group. What evolved was a hybrid between contract management and a long-term lease. The 20-year agreement (with two five-year extension options) does not grant the firm a leasehold interest, but it operates financially like a long-term lease rather than a management contract. In other words, users and tenants pay fees to the contractor, out of which the contractor must pay all operating expenses and turn over a guaranteed minimum annual amount to the county. Prior to the award of the contract to COMARCO, there was strong opposition from GA pilots, airport employees, and some airport tenants. By the contract's second anniversary, privatization had "gained acceptance by most pilots and proved worth celebrating for some," according to a local newspaper account. Board of Supervisors chairman Ed Edelman, who had voted against the contract in January 1991, wrote aletter of endorsement in January 1993, praising the success of the arrangement. Financially, during the first two years, COMARCO paid the county $2.7 million per year, compared to the County's net income of $2.2 million when it operated the airports itself. The increase was made possible by improved marketing of airport facilities, reduced operating costs, and a computerized revenue control system. Despite opponents' fears, there were no increases in user fees for the first two years of the contract. All fee increases must be approved by the county. COMARCO splits the airports' net income with the county according to a pre-arranged formula; the county puts all these revenues in its Aviation Division budget and uses them for capital improvements at the airports. COMARCO was required to offer jobs to all 56 county airport workers. Of these workers, two assistant managers and eight service workers went to COMARCO, five stayed with the Aviation Division, one resigned, one retired, and the others were transferred to other positions within the county's public works department. None were laid off.

Air Carrier Airport/Sale

The largest airport privatization to date was the British government's public share offering of the former British Airports Authority in 1987. At the time, BAA was the owner/operator of the three main London airports and the four principal Scottish airports (one of which, Prestwick, it subsequently sold). The initial share offering valued the company at $2.5 billion. Three years later, in 1990, the market value had grown to $4 billion, and by early 1994 to over $8 billion. What difference has privatization made to BAA's operations? A Reason Foundation study in 1990 addressed five indicators: capital investment, productivity and efficiency, pricing and revenues, noise mitigation, and customer satisfaction, and found positive results in all five.

As a public authority, BAA had limited access to capital; essentially, it was permitted to borrow only from the British Treasury, and the Treasury set stringent annual limits on borrowing by state-owned companies. In the first three years following

privatization, BAA capital spending more than doubled. Terminal expansion at all three London airports accounted for the majority of the initial investment; in addition, on-airport hotels were added at all three. Furthermore, plans were drawn up for construction of Heathrow Express, a high-speed rail line connecting Heathrow with central London (in a joint venture with British Rail). Thus, a capital-short enterprise was able to increase capital spending on productive projects as a result of being privatized. Economic theory predicts that a privatized enterprise would have strong incentives to operate more efficiently. Data from BAA showed a steady upward trend from 1983 (as BAA began gearing up for privatization) to 1990 (the year of the study) in labor productivity, as measured by operating revenue generated per employee and by passengers handled per employee. In addition, BAA's unit labor costs (in terms of £ of expense per passenger) trended steadily downward. Airlines typically express concern that landing fees must increase as a consequence of airport privatization. Airports that possess monopoly power (such as BAA's London airports) might be able to increase landing fees above market levels. Because of this, the act authorizing BAA's privatization provided for regulation of airside charges. Rather than controlling individual charges, however, the price-cap regulation (RPI minus X, where RPI is the retail price index) applies to each year's airside revenue per unit of aircraft operation. In other words, the formula requires that the average unit charge on the airside increase by less than the rate of inflation. (The value of X is set by the regulator for each five-year period.) Thus, in real, inflation-adjusted terms, airside charges have steadily decreased at BAA's London airports. This flexible form of regulation permits the pricing structure to be based on market principles. Thus, at Heathrow and Gatwick, where significant airside congestion exists at certain hours and certain seasons, peak landing charges are much higher than those off-peak. In addition, BAA has abandoned the traditional weight based approach to landing fees, recognizing that the cost of handling the landing or takeoff of an aircraft bears little relation to its weight. Further, BAA makes use of noise-related surcharges and rebates to promote a shift toward quieter aircraft. With its airside revenues somewhat constrained by price-cap regulation, BAA has had strong incentives to increase revenues on the landside. Data show that while airside revenues made up 54 percent of BAA operating revenues in 1983, that fraction had declined to only 42 percent by 1990 (while overall revenues more than doubled). BAA accomplished this by aggressive expansion of the type and quantity of retail concessions in its terminals. Focusing on brand-name retailers and instituting a well-publicized guarantee that prices at airport shops would be no higher than in the same shops elsewhere, BAA developed the Heathrow and Gatwick terminals into the equivalent of shopping malls. BAA's airports remained subject to the same noise regulations before and after privatization, and the data showed continued downward movement in the figures for the amount of land impacted by various levels of airport noise. Finally, data from BAA's regular surveys of customer satisfaction (on such matters as catering, baggage-cart availability, cleanliness, and staff) showed either no change or slight improvements in the first three years following privatization.

Air Carrier Airport/Build-Operate-Transfer

In the mid-1980s Transport Canada, the federal agency that until recently owned and operated virtually all of Canada's major airports, decided that a new international terminal was needed at Toronto's Pearson International Airport. Its initial conceptual design called for a facility of 15 to 17 gates. Following the agency's normal development procedures, Transport Canada estimated that this facility would take seven years to develop, at a cost of C$1 billion. Instead of pursuing the traditional approach, the agency opted for a BOT project. The resulting terminal, which opened in 1991, has 24 gates (plus five in a satellite terminal for Canadian Airlines). From drawing board to opening day, it took just 33 months, rather than the seven years projected by Transport Canada, and cost only C$700 million rather than C$1 billion. In addition, it operates with 25-percent fewer people than in Transport Canada's plans. Terminal 3 was developed and is operated by a Canadian/U.S. joint venture, of which Lockheed Air Terminal is the U.S. member. Their 40-year concession (franchise) includes a land lease on 130 acres (with a 20-year option). The project included the 1.2 million sq. ft. terminal building, a 3,300-car parking garage, a 500-room hotel, and five miles of access roads with six overpasses. The terminal was designed with extensive retail space, including a mini shopping mall. Terminal 3 incorporates several innovations, including the first airport shopping mall in North America and the first cash-and-carry duty-free operation in Canada. Unlike typical U.S. practice, the airport terminal company retains control of all gates (i.e., they are not leased to individual airlines) and controls the arrival and dispatch of all aircraft onto the terminal's apron areas. It also controls the flight-information (closed-circuit TV) system, the public address system, and the baggage systems, rather than delegating some or all of these to individual airlines.

LEGAL ISSUES

Federal Grant Eligibility

Under the Airport & Airway Improvement Act of 1982 and subsequent amendments, the Federal Aviation Administration (FAA) makes grants to air-carrier and general-aviation airports. Air-carrier airports receive entitlement grants based on a formula related to annual enplanements. They and other airports may also apply for discretionary grants for specific projects, in competition with other airports. Airports accepting federal airport grants (generally known as AIP grants, meaning Airport Improvement Program grants) must sign contractual grant agreements with the FAA. Under the terms of those agreements, the recipient (the airport “sponsor”) must provide assurances that the airport be open to all users on a nondiscriminatory basis, that airport charges be fair and reasonable, and that “all revenues generated by the airport” must be used only for airport (or airport-system) purposes. It is well-established in federal law that the FAA's control over such economic issues as airport access and charges stems from the grant agreements. If an airport did not make use of federal grants, the FAA's jurisdiction would be limited to safety and air Traffic control issues only. How does privatization affect grant eligibility? Under contract management, the government which owns the airport remains the sponsor, and the airport remains

eligible for the same types of grants for which it was eligible when managed directly by the municipality. Likewise, under most forms of long-term leases and BOT arrangements, the government which remains the airport owner would remain the airport sponsor, so grant eligibility would be unchanged. With respect to an airport sale, post-1982 federal law permits discretionary and noise-related grants to be made to privately owned airports, but entitlement grants are not permitted. Thus, an airport can be owned by the private sector and operated by it for profit and still receive federal grants for capital projects (though it must compete for such grants against other airports). To sum up, general-aviation airports can make use of any form of privatization without any impact on their grant status, since they do not receive entitlement grants (which are based on passenger enplanements) to begin with. Air-carrier airports can receive discretionary and noise related grants under any form of privatization, but if privately owned, cannot receive entitlement grants. Entitlement grants are a relatively small component of the revenue of large and medium airports, but can be significant for smaller air-carrier airports.

Lease or Sale Proceeds

In Section III it was claimed that a municipality could legally obtain a return on its investment in its airport, despite the federal prohibition on "diverting" airport revenue, by either leasing the airport (and receiving lease payments, not profits) or one-time sale proceeds. How strong are the legal arguments for this position? This question has been examined by several legal experts, each of whom has concluded that it is legally sound. These include former U.S. Transportation Secretary Jim Burnley5 and former FAA Chief Counsel E. Tazewell Ellett.6 One of the most detailed assessments was carried out by the law firm of Skadden, Arps, Slate, Meagher & Flom for the City of Los Angeles in 1992.7 The Skadden, Arps assessment concludes that current federal law permits the sale or lease of a municipal airport to a private firm, and that a privatized airport would be eligible to receive federal grants, as outlined in the previous subsection. What about the proceeds from such a transaction? With respect to a sale, Skadden, Arps concluded that a municipality would be able to use sale proceeds for general purposes because the term "airport revenues" asused in the 1982 Act (and amendments) refers to operating revenues, not the one-time proceeds from an asset transaction. This would be consistent with: 1) the legislative history of the 1982 Act; 2) accounting definitions; and 3) the FAA's own AIP handbook, which states that "Airport revenue does not include proceeds from the sale of real property owned by the sponsor." With respect to lease payments, Skadden, Arps notes that the FAA Compliance Manual already provides for the lease of entire airports. Not noted by Skadden, Arps is the fact that lease payments being made by private lessees in the case of airports such as Atlantic City are going "off the airport" today, to the general funds of the underlying government owners. The memorandum also notes a 1991 Department of Justice opinion regarding the proposed lease of Albany Airport, in which DOJ assumed that the lease payments were "airport revenues" but could still be used for general-fund purposes to the extent that they represented a recovery of the local government's original investment in the airport. But it notes that a 1992

Executive Order may supersede this opinion. President Bush's Executive Order No. 12803 (April 1992) was intended to remove federal barriers to the lease or sale of federally aided infrastructure facilities, including airports, by state and local governments. It directs the federal agencies which have made such grants (e.g., the FAA) to approve such requests. The only conditions attached to such transactions are that: 1) the proceeds from the sale or lease be used in accordance with the provisions spelled out in the Order (and with pre-existing federal law); and 2) that some sort of for its original purpose and that user charges will be structured so as to protect users from abuse. E.O. 12803 calls for the sale or lease proceeds to be used as follows. The first claim on the proceeds is for the government owner to recover its original investment in the facility, including any transaction costs. These funds may be put into its general fund. If there are funds remaining, the second claimant is the federal government, which may be entitled to recoup a portion of the previous federal grants to the facility (the full amount less accumulated depreciation, based on IRS accelerated depreciation tables). If there are still funds remaining, the final portion must be used only for investment in other infrastructure or for reducing debt or taxes. In 1994 President Clinton issued Executive Order 12893 on Principles for Federal Infrastructure Investment. It specifically directs each agency with responsibility for transportation, water, energy, and environmental facilities to "seek private-sector participation in infrastructure investment and management" and seek to work with state and local governments to "minimize legal and regulatory barriers to private-sector participation." It also endorses market pricing for infrastructure and sound cost-benefit analysis. E.O. 12893 supplements and reinforces E.O. 12803; it does not supersede it.

Existing Bonds/Tax-Exemption

A change in the ownership (sale) or de-facto ownership (long-term lease) may affect the status of existing bonds used to construct a portion of the airport. In most cases, these bonds will have been issued by the municipality on a tax-exempt basis. Most airport bonds are revenue bonds (secured solely by airport revenues), though some may be general-obligation bonds (secured by the general taxing powers of the issuing government). Three factors must be looked at in connection with these bonds. First, the bonds themselves must be reviewed to determine if there are any provisions that restrict the use of revenues or require the bonds to be defeased or redeemed in the event of a sale or lease. Even in the absence of such provisions, the bond language may require that the bonds satisfy IRS requirements as to taxexemption. Second, state law must likewise be reviewed to see if there are any comparable provisions. Having to defease or redeem the bonds may not prevent a sale or lease from taking place, but may affect its cost and therefore its financial feasibility. The third factor to consider is the IRS itself. Thanks to a recent change in its procedures, the IRS is now able to consider requests to retain the tax-exempt status of bonds when the facility which they have financed is sold or leased. In 1993 the agency issued Revenue Procedure 93-17, which allows interest on outstanding bonds to continue to be tax-exempt when the facility is sold or leased, if certain other conditions are met. The most important of these is that the disposition proceeds (i.e., the lease or sale payments) must be used in

an alternative manner that would have qualified for tax-exempt status. Devoting the proceeds to other public works investment, for example, would be one such purpose. In addition, the facility must continue to be used for its original purpose for at least five years, and the new owner or lessee must transact business with the original government owner on an arms-length basis and for fair-market value. Hence, provided that neither state law nor the bond covenants prevent it, existing tax-exempt airport bonds may remain in existence (and tax-exempt) following the sale or long-term lease of an airport.

Access to Future Tax-Exempt Bonds

The difference in interest rates between taxable and tax-exempt bonds is in the vicinity of 200 basis points (e.g. two percentage points). In financing airport expansions, that difference in interest costs can lead to major differences in debt-service expenses. Thus, airport users would benefit from the availability of less expensive debt, other things being equal. Under contract management, capital expansions are the responsibility of the government owner of the airport, making use of tax-exempt bonds. Under BOT and long-term lease arrangements, it is generally possible for the government owner to issue tax-exempt revenue bonds on behalf of the private lessee or franchise-holder, with project revenues earmarked for debt service. (This is simply a variant on the common method of financing airline maintenance facilities and terminal buildings, in which the municipality or airport authority issues revenue bonds on behalf of the airline(s) committing to use the facility for a long-term period.) Under current federal and state tax law, it appears difficult or impossible for tax-exempt bonds to be issued for an airport which is owned and operated by the private sector. As a matter of public policy, this lack of a "level playing field" between public and private ownership is likely to skew the choice between public and private ownership, though it might not prevent full private ownership in certain cases of high profit potential.

POLICY ISSUES

Loss of Public Control

Airports are valuable community resources, providing a needed public service. Thus, it is to be expected that privatization, especially via sale or long-term lease, raises concerns about potential loss of public control. There are a number of mechanisms that can protect the public interest, while still retaining the benefits of private-sector operation. Under a management contract, the contract itself spells out the requirements and constraints under which the firm must operate. Although the more constrained the conditions, the less scope there may be for innovation and efficiency gains, the contract can potentially include any provisions desired. One particular benefit of contracting out is that measurable performance requirements can be specified, with appropriate penalties for failure to meet them (e.g., financial penalties and even termination of the contract). This is often a greater degree of real accountability for results than exists when the airport is operated by a government department that will remain in place regardless. A lease or franchise agreement, though much onger-term

in nature, offers similar potential for including explicit provisions to protect the public interest and require achievement of certain performance targets. The temptation to micromanage the firms's operations via lease provisions should be resisted, however. Because far more of a financial commitment (and hence risk) by the private sector is involved in a lease than in a management contract, economic incentives will accomplish far more than detailed prescriptions in such arrangements. If an existing airport is sold, or if a new airport is built from the start as a private venture, how can the public interest be protected? With a sale, government can condition the sale on several factors. A deed restriction can be included, guaranteeing that the property continue to be used for airport purposes for, say, 99 years. Government may wish, as in Britain and some other countries, to retain a single share of ownership (the British call this a golden share), with special voting rights designed to protect specific public-interest concerns (e.g., foreign ownership in the case of BAA airports). For either a new airport or an airport sale, government could grant a perpetual franchise, administered by a municipal entity such as an airport commission. Under such an arrangement, the private firm would hold title to the airport in perpetuity, subject to compliance with the terms of the franchise. The commission would be able to revoke the franchise if the firm violated its explicit terms.

Economic Regulation

Airports are often referred to as a municipal utility, like electricity, gas, telephones, or water. Although an airport is very capital-intensive, like those utilities, the key question is whether or not it possesses monopoly power. If it does, then the issue becomes the most appropriate way of dealing with that power.

The first question is to what extent monopoly power exists, and for what set of customers. In most cases, the airport's land-side services (restaurants, car-rentals, etc.) are subject to competition from off-airport suppliers; no airport user is forced to deal with them. So these services generally will not be candidates for regulation.

On the airside, many cities have at least one general-aviation airport in addition to their air-carrier airport. Thus, GA users do not face a monopoly situation. Airline passengers may have the option of driving 50 or 75 miles to another location with airline service, in which case they are not really victims of a monopoly even with only one air-carrier airport in the city. And many urban areas (e.g., New York, Chicago, Detroit, Dallas, Houston, Los Angeles, San Francisco) have multiple air-carrier airports, such that privatizing one of them would not create a monopoly situation. Only selling an urban area's entire set of airports to a single firm (as the British did by privatizing BAA, rather then selling Heathrow, Gatwick, and Stansted separately) would lead to monopoly conditions.

But suppose that some degree of airside monopoly does exist under privatization. What are the possible remedies? First, if the airport continues to receive federal grants, its pricing must meet the FAA's definition of fair and reasonable, in compliance with the grant agreements. Second, unlike the public sector, privately owned airports would be subject to federal and state antitrust laws, which prohibit both price discrimination and

price gouging. Third, international air service is subject to bilateral treaties which protect airlines (and hence passengers) from discriminatory pricing.

Given the protections offered by these three mechanisms, it is not clear that any further regulation would be necessary. But if it were, several choices are available. One would be to subject the airport to traditional public utility regulation, administered by the state public utilities commission (PUC). Given that in all likelihood only a portion of airside services would exhibit monopoly aspects, the costly and time-consuming PUC regulatory process would not be appropriate.

Two more-flexible alternatives are British-type price-cap regulation and franchise-based rate-of-return ceilings. Under the former, BAA's airside charges are limited each year to increase by less than the rate of inflation, as noted in Section IV, via the RPI minus X formula. All the recently privatized British utilities are regulated in this way. The alternative, as used in California's BOT franchises for private toll roads, is for the franchise agreement to set a ceiling on the annual rate of return the company can realize. This permits its pricing to respond to market conditions, but requires that any profits earned above the ceiling amount go into the state transportation fund.

As a general rule, any form of explicit economic regulation imposes costs and will reduce the attractiveness of an airport to potential investors. Thus, careful tradeoffs must be made to determine the extent of likely monopoly problems and the least-restrictive way of dealing with them.

IMPLEMENTATION

Once a municipality (or airport authority or state transportation agency) has determined that privatization might be applicable to an airport which it owns, what steps must be taken to move forward? Most or all of the following steps will apply in most cases.

Request for Information/Strategies

In order to ascertain the private sector's degree of interest, the agency can publish and publicize a request for private firms to submit expressions of interest in private management, operations, and/or development of the airport. If the agency is not sure which mode of privatization would be most suitable, this process can obtain expert opinions from airport professionals at very little cost to the agency. In 1994 Indianapolis received eight responses to such a request, from domestic as well as overseas firms. The Dupage, Illinois airport authority received 11 responses to its request for privatization ideas for its general-aviation airport.

Consultant Assistance

If the agency has already decided upon a privatization mode (contract management, lease, sale, BOT, etc.), its first step should be to retain a consultant knowledgeable about both airports and privatization to review its financial and operational data and assist with designing the competitive process and the required documents (RFQ, RFP, etc.). If the first step has been a request for strategies, the consultant can be of great

help in assessing the (most likely) varied responses and helping the agency decide which mode of privatization makes the most sense, given the agency's objectives. Legal advice may also be advisable at this step, especially in the case of large airports and/or long-term modes of privatization (lease, sale, BOT).

Request for Qualifications

In the case of large, long-term privatization competitions, many governments make use of a two-step procurement process. The first step is to weed out those firms or consortia that are judged to be unlikely to succeed in meeting the requirements for operating, managing, and/or developing the facility. Hence, in this step the firms are asked to document in some detail their experience and qualifications. It is generally wise to spell out in some detail in the Request for Qualifications (RFQ) what factors will be used to evaluate the responses. This leads to some degree of self-selection, as clearly unqualified firms will be able to conclude that they have little hope of being judged qualified. Another way to discourage clearly unqualified firms is to require a filing fee large enough that only serious contenders will pay. Making the requirements and selection criteria as clear as possible may also serve to minimize the likelihood of legal challenges by firms which do not make the grade.

Request for Proposals

The next step is to issue a formal request for proposals to those firms which constitute the "short list," by virtue of having survived the RFQ process. For large procurements, the agency may be well-advised to hold a bidders' conference for these firms prior to finalizing the RFP, at which it presents an early draft of the document and seeks feedback and suggestions from them. This kind of interaction can lead to a more realistic RFP, which will lead to more responsive proposals and should make the subsequent negotiations with the winning firm go more smoothly. Given that airport privatization is at an early stage in the United States (there is still no clear-cut policy guidance on the subject from the FAA or its parent, the U.S. Department of Transportation), an important element in the RFP should be for the bidder to document its plan for obtaining DOT approval of the transaction (which will be required in most cases, if the airport is to continue to receive federal AIP grants). This will involve demonstrating to the various stakeholders, especially the airlines serving the airport, that the privatization will not harm their interests. E. Proposal Evaluation Depending on the size and complexity of the privatization, bidders should be given from two to six months to prepare and submit their proposals. Rigorous evaluation should then be carried out by senior officials, possibly with consultant assistance. Here again, it is important that the evaluation process be as objective and "transparent" as possible, with detailed evaluation criteria having been spelled out in advance in the RFP. In addition, the scoring of proposals against these criteria should be documented and be made public following the completion of the process. The objective is to guard against subjective or biased decisions, as well as to minimize the likelihood of legal challenges by losing bidders.

Airport privatization is relatively new to the United States, but is rapidly becoming the model for airport operations around the world. Depending on the economic and political circumstances, contract management, a long-term franchise for new facilities, a long-term lease, or outright sale can offer benefits to taxpayers and airport users alike. The appropriate mode of privatization depends on the specifics of each case, and must be the subject of careful analysis. Done well, privatization can provide net benefits for all parties by adding value to the airport's operations. Airlines can receive assurances of cost controls; air travelers can obtain a higher level of service; the airport agency can obtain some new revenues; and the new airport operator a new source of business.

The fundamental choice in the privatization process appears to be how the government should exercise its control to sustain the public interest in open access to and fair rates for airport services. The major alternatives are between:

- Government regulation, an inherently adversarial process; or
- Government ownership and partnership in the development of airports, a more collaborative

approach. On balance, the partnership approach as practiced by numerous airport authorities throughout the United States seems most suitable for both assuring the public interest in fair operations and, most importantly, in assuring that the local community can express its desire for sufficient airport capacity for its purposes. The exact way that privatization should be accomplished, and the right balance of public and private involvement in the development of airport properties would seem to depend on the precise context of the project, the potential users, the region and the moment in time.

GREENFIELD AIRPORTS: Overview of India's Legislative Policy

There are strong growth prospects for airport privatization given the steady air transport expansion, the need for adequate return on social investments and the dwindling government finances. Similar models have been proposed to develop Mumbai and Delhi airports. Though private participation in airport development and operation is an accepted concept world over and `airport privatization' is now part of the industry vocabulary, it would be premature to dub the concept a `success'. According to the World Bank, during the 1990s, private sponsors in 22 developing countries were involved in 89 airport projects, with investment adding up to $5.4 billion. Private participation in airports has attracted less investment than privately-sponsored projects in other transport segments. Airport assets are viewed as strategic for national security, and, therefore, outright privatization of airports is often met with political resistance.

Against this backdrop of airport privatization, it is noteworthy that Greenfield airport projects, such as the Bangalore International Airport, account for just 10 per cent of global investment in private airport facilities. A Greenfield project is one where a private entity or a public-private joint venture builds and operates a new facility,

entering into Build-Own-Transfer (BOT) or Build-Own-Operate (BOO) contracts for this purpose.

Other typical airport project types include `Operations and management contracts' covering leases; `Operations and management contracts with major capital expenditure' by private investors contributing 70 per cent of all private investment; and `Divestitures' (20 per cent) where a private entity holds equity stake in the state-owned airport, with or without management responsibilities. It is against this global backdrop that financial closure has been reached in the greenfield airport project for Bangalore. As is characteristic of such project financing, the 23 per cent equity component is shared by multiple contributors Siemens (40 per cent), Unique Zurich and Larsen and Toubro with 17 per cent apiece, and the local and Central governments investing 13 per cent each.

Private participation in public infrastructure pre-supposes an environment different from that was when governments exclusively owned and operated the facility. While many government- controlled airports may not have recovered their operating costs, the use of private capital dictates that a reasonable return on investment is generated. The need for private investors to achieve stipulated levels of financial performance translates into developing systems to identify and manage risks inherent in these projects.

Greenfield airport privatisation projects carry risks for all parties involved. The private investors consortium, entering into the concession agreement with the host government faces construction and completion risks. Thereafter, operational and market risks could impact the expected cash flows. The host government runs the risk of project sponsors being unable to generate sufficient returns to carry the project through the concession period, or having to make substantial capital investment for upgradation after the concession period. The project company's highly leveraged capital structure implies that any development impairing expected cash flows or project assets would directly hit the debt service capacity of the project and the lenders' bottomline.

Past experience with airport privatisations in various countries suggests that risks have generally been underestimated, especially in terms of capital costs for project construction, and forecasts of revenues from operations. Some of the `practices' noticed in earlier privatisation projects are alarming:

- Private bidders prepare optimistic forecasts, leading to an over-estimation of revenue, or under-estimation of capital costs.
- Natural features of the terrain jeopardise aircraft safety in the Wellington airport privatisation, significant risk arose from the runway area extending on to narrow land, surrounded by sea.
- Violation of international safety standards the bidders' profit motive could cause airport designers to adopt a minimalist approach to reduce capital cost.

- Most problems arise due to design incompatiablitywith the needs of the airport beyond the concession period.
- Site expandability problems were noticed in airport privatisations in Europe and New Zealand.
- Changes in aircraft mix and airline alliances altered risk dimensions for a privatised airport in Canada.
- Over-estimated airport traffic and revenue due to oversimplified assumptions was seen in Manila's Terminal 3. All charges and rates were forecasted to increase by 10 per cent over the 25-year concession period, which growth could hardly be sustained in the economy.

One dominant partner influences the bids. If this partner is also a developer, attempts to minimise costs using substandard material may ensue, as was the case in Toronto. Government policy changes and environmental impact were risk factors in many projects. In the absence of government's detailed development plans, bidders determined the project's form and scale that met the profit objective of the private investor, but conflicted with traffic needs or government's plans, as in the case of the Manila airport. The onus is, therefore, largely on the government in privatising substantial and sensitive infrastructure such as airports.

Contracts work best when risks are identifiable, outcomes verifiable and contracts enforceable. Since risks would be allocated to various parties through contracts, it is imperative that the government institutes a sound legal framework to ensure proper risk management. Insurance is a powerful risk mitigating mechanism in large projects. The government should take steps to deepen the insurance market to guard stakeholders against all insurable risks, including force majeure and political risks. The project's terms of reference should be specified with absolute clarity without which the government may lose control over the vital infrastructure.

Due diligence is typically carried out by bankers and the government at the time of financing. At this juncture, some drawbacks may be rectified at huge cost or may be beyond rectification. The government will, therefore, have to carry out financial and technical reviews periodically, right from the project planning stage. Users of privatised retail facilities, such as airports or toll roads, should be educated on the need for and advantages of paying user charges.

The markets should be able to generate public interest in subscribing to airport bonds. Structures resembling General Airport Revenue Bonds (GARBS) in the US could be introduced. The rating agencies should be equipped to handle increased demands. The banking sector should prepare to assess risks unique to airport projects and finance the projects through innovative instruments. Growth in high risk-high return financing has to be supported by a strong securitization framework. The country is `crying for infrastructure'. At this juncture, airport privatization is a bold move by the government with far reaching implications.

PPPs work well in a conducive business and legal environment. It is to the government's and the investors' advantage if such an environment can be created without delay.

Greenfield Airport Policy of India

1. Introduction / Context

1.1 India is presently on a high economic growth trajectory with GDP growth reaching 9% since 2005-06. This is also manifested in a phenomenal growth in air traffic that has been enabled by liberalized policies. Since 2002 the growth rate of passenger traffic has steadily increased crossing 20% in 2004-05. Expansion of air services in a competitive environment has brought it within the reach of large numbers that were hitherto not using air travel as their preferred mode of travel. This rapid growth in passenger traffic has put enormous pressure on airport infrastructure causing severe congestion at major airports. Airport services at non-metro airports are also not geared for handling this increased flow of traffic

1.2 In the past, government policy relating to greenfield airports was restrictive and aimed at protecting the financial viability of the existing airports. However, the spurt in traffic suggests a liberalized approach towards setting up of greenfield airports with a view to bridging the growing deficit in airport infrastructure. The anticipated investment in airport development during the Eleventh Plan is over Rs 40,000 crores, both from public and private sources, including for greenfield airports. It is, therefore, necessary to lay down the policy guidelines that would govern proposals for setting up greenfield airports, other than defense airports.

2. Legal framework

2.1 The Constitution includes aerodromes in item 29 of the Union List, which implies that the Central Government alone has the legislative and executive powers relating to airports. The primary responsibility for development of airports rests with the Central Government. The Union alone has competence to legislate in respect of:

"Airways, aircraft and air navigation; provision of aerodromes; regulation and organization of air traffic and of aerodromes; provision for aeronautical education and training and regulation of such education and training provided by States and other agencies"

2.2 The Aircraft Act, 1934 (the "Aircraft Act") and the Rules made thereunder by the Central Government govern the development, maintenance and operation of all airports, including greenfield airports. Under the Act, Central Government has the sole right to grant a license for setting an airport, and the operations of the airport would be subject to its licensing conditions (Rule 78 of the Aircraft Rules).

2.3 Airports Authority Act (the "AAI Act") was enacted by the Central Government in 1994, which stated that all government airports are to be developed, financed, operated and maintained by Airport Authority of India ("AAI"). However, the AAI Act enables AAI to grant a concession to a private entity for financing, development, operation and maintenance of an airport being managed by AAI. As such, greenfield airports to be developed by the Central Government could adopt the concession route if private participation is envisaged.

2.4 Airports other than those managed by AAI are governed by the provisions of the Aircraft Act and the Rules made thereunder. An entity other than AAI (hereinafter referred to as an "Airport Company") can set up an airport. The Airport Company must function under a license from DGCA to be issued under the Aircraft Act. Such a license can be granted only to the following (Rule 79 of the Aircraft Rules):

(a) A citizen of India; or

(b) A Company or a body corporate either in the Central sector, State sector or the private sector registered under the Companies Act, 1956 subject to the following conditions:

(i) it is registered and having its principal place of business in India
(ii) it meets the equity holding criteria specified by the Central Government from time to time; or

(c) the Central Government or a State government or any company or any corporation owned or controlled by either of the said Governments; or

(d) a Society registered under the Societies Registration Act, 1860

2.5 Thus an airport can be developed and operated either by AAI or by an Airport Company that has been given a license by DGCA as per its license conditions. The Rules also allow the Central Government or a State Government to obtain a license.

3. Operations of airports

3.1 Airports managed by AAI must be operated according to the provisions of the AAI Act as well as the Aircraft Act. All other airports would have to be operated under the provisions of the Aircraft Act and the conditions of license.

4. Regulation of Airports

(i) Safety Regulation

4.1 The process to regulate the technical and safety standards of all airports are vested in DGCA under the provisions of the Aircraft Act. AAI airport as well as those owned by Airport Companies must, therefore, conform to the technical and safety standards laid down by DGCA under the Aircraft Act.

(ii) Economic Regulation

4.2 Economic Regulation of all airports would be governed by the proposed Airport Economic Regulatory Authority (AERA) as and when enacted.

5. Development and Financing of Greenfield Airports

(i) AAI Airports

5.1 Greenfield airports to be set up by AAI would be preferably constructed through Public Private Partnership (PPP) and such airports would be financed substantially through PPP concessions. However, land for such airports would have to be provided by AAI. Further, financing gaps, if any, can be bridged through the Viability Gap Funding scheme, which provides for a capital grant of upto 20% of the project cost. The concessions for development of greenfield airports would be awarded through open competitive bidding based on model bidding documents. In the north eastern areas where it may not be feasible to follow the PPP route, AAI could set up greenfield airports by itself, as may be approved by the Government on a case to case basis.

(ii) Other Airports

5.2 Financing and development of any other airport would be the responsibility of the Airport Company seeking the license. Land for this purpose may be acquired by the Airport Company either through direct purchase or through acquisition by the State Government as per extant policy.

5.3 In case a State Government wishes to promote the setting up of airports in the State, it could either:

(a) apply to DGCA for a license itself, in which event the State Government would be responsible for development and operation of the airport; or
(b) an entity of the State Government could apply for a license to DGCA, in which event such entity would be responsible for development and operation of the airport; or
(c) the State Government or its corporation may select a private entity and form a Joint Venture Company (JVC) in the private sector and in such an event, the JVC would be responsible for development and operation of the airport under a license from DGCA; or
(d) Allot land to a private Airport Company for development and operation of an airport under a license from DGCA.

5.4 In case a State Government wishes to facilitate setting up of the airport, it could provide the following incentives to an Airport Company:

(a) land, concessional or otherwise;
(b) real estate development rights in and around the airports;

(c) airport connectivity; rail, road;

(d) fiscal incentives by way of exemptions from State taxes; and

(e) any other assistance that the State Government deem fit.

5.5 State Governments may evolve their respective policies for providing any or all of the aforesaid incentives to an Airport Company. If the selection of a private entity or JVC partner is to be made by the State Government or its entity it shall be done through open competitive bidding. While granting land and other benefits, the State Government may, if it deems fit, stipulate the rights and obligations of the Airport Company as conditions of such grant.

5.6 State Governments cannot enter into any concession agreement with the Airport Company as they do not have the powers to grant airport concessions under the Constitution. As noted above, the powers to grant a license for operating an airport rests solely with the Central Government under the provisions of the Aircraft Act, 1934. However, the State Governments can provide any or all of the incentives/assistance stated in para 5.4 above.

5.7 State Governments can also provide land to AAI for development of greenfield airports through concessions to be granted to private entities in accordance with the provisions of the AAI Act. States may also provide any of the above concessions to AAI for facilitating the development of airports in their respective States. All such airports would be developed as PPP projects.

6. Reserved activities

6.1 On any greenfield airport to be developed under these Policy Guidelines, activities relating to Air Traffic Services (ATS), security, customs and immigration would be reserved for central government agencies. Provision of these services would be governed by the policy to be laid down by the Central Government from time to time. Prior to grant of license, an applicant for license shall procure the following clearances:

(a) Defence clearance: An applicant seeking a license would need prior clearance from the Ministry of Defence. Guidelines for this purpose would be issued by the Ministry of Defence from time to time.

(b) Air Traffic Services (ATS): Functions related to ATS are being discharged by AAI. The applicant will have to enter into a CNS/ATM Agreement with AAI for the provision of ATS services at the proposed airport. ATS would be provided on a cost recovery basis and AAI would publish a standard agreement for this purpose. The Airport Company would also provide the required infrastructure to AAI free of cost for provision of ATS.

(c) Security: The applicant will have to enter into an agreement for provision of security by the concerned authority. The cost of providing security will have to be borne by the Airport Company. Guidelines for this purpose would be issued by the Ministry of Civil Aviation from time to time.

(d) Customs: In case of an international airport, the applicant will obtain clearance from the Department of Revenue for provision of Custom services. The cost of providing these services will have to be borne by the Airport Company. Ministry of Finance would issue the necessary guidelines from time to time.

(e) MHA Clearance: The applicant seeking a license would need prior clearance from the Ministry of Home Affairs regarding location of the airport, acquisition and installation of security equipment and verification of credentials of the developers.

(f) Immigration: In case of an international airport, the applicant will procure clearance from the Ministry of Home Affairs for provision of immigration services. The cost of providing these services will have to be borne by the Airport Company. Ministry of Home Affairs would issue the necessary guidelines from time to time.

(g) BCAS Clearance: The applicant seeking a license would need prior clearance from BCAS regarding location of the airport and acquisition and installation of security equipment.

(h) Airport Meteorological Services: The applicant will have to enter into a CNS/ATN agreement with IMD for provision of meteorological services at the proposed airport to be provided by India Meteorological Department (IMD). The meteorological services would be provided on a cost recovery basis and IMD would publish a standard agreement for this purpose. The airport company would also provide the required infrastructure to IMD free of cost for provision of meteorological services.

6.2 A memorandum of understanding would be entered into between the Airport Company and each GOI agency/department providing the following Reserved Activities, setting out the terms and conditions on which the said services shall be provided by the relevant GOI agencies/departments:

(i) Customs Control;
(ii) Immigration Services;
(iii) Health Services;
(iv) Plant Quarantine Services; and
(v) Animal Quarantine Services

6.3 The memorandum of understanding would be issued and revised from time to time by the Ministry of Civil Aviation.

7. Conditions of license

7.1 As a condition of license, the licensee would be required to:

(a) make available its airport services, free of charge and to the extent necessary, for meeting exigencies such as war, natural disaster/calamities, internal disturbances etc. in accordance with the provisions of the Union War Book;

(b) provide uninterrupted landing and parking facilities for defence and other para-military aircrafts, free of landing and parking charges, and also provide the infrastructure facilities and equipment required for defence operations;

(c) make available to the security agencies access to the airport for periodic and surprise inspections;

(d) obtain approval of the relevant agencies for hiring of foreign nationals for senior decision making positions in the management of the private airports;

(e) adhere to the security measures laid down by the BCAS and DGCA;

(f) obtain prior verification of the credentials of foreign firms to be engaged for construction, ground handling or other important activities at the airport;

(g) obtain clearance relating to the FDI limits in the construction/development of private airports from relevant authorities. Any change in the control or ownership shall be subject to security clearance from national security angle;

(h) ensure the requisite infrastructure for handling international passengers and crew who must pass through immigration and customs; and

(i) ensure appropriate arrangements for health services and plant quarantine at international airports.

7.2 The authorities noted above shall, on a best endeavour basis, provide their response to the applications within 60 days.

8. Guidelines of Central Government to DGCA

8.1 The Central Government may from, time to time, notify guidelines to be followed by DGCA for grant of license to operate a greenfield airport. While granting a license, DGCA would keep these guidelines in view. For the present, the following conditions shall be kept in view by DGCA while granting a license.

(a) No greenfield airport would be allowed within an aerial distance of 150 Km of an existing civilian airport.

(b) In case a greenfield airport is proposed to be set up within 150 Km of an existing civilian airport, the impact on the existing airport would be examined. Such cases would be decided by the Government on a case to case basis.

9. Procedure for Approval of a Greenfield Airport

9.1 A greenfield airport to be set up by AAI or an Airport Company ["Airport Company" would have the meaning as given in Para 2.4] that is in compliance of the above guidelines and is beyond 150 km of an existing civilian airport would not require prior approval of the Central Government. DGCA would be competent to grant license for operation as per the extant Rules and Notifications.

9.2 A greenfield airport to be set up by AAI or an Airport Company that is beyond 150 km of an existing civilian airport but seeks exemption/relaxation from any of the other guidelines or extant Rules and Policies, would be considered by the Steering Committee constituted under paragraph 10. The Committee's recommendations would be forwarded to the Ministry of Civil Aviation. If the Steering Committee is unable to reach a consensus, the proposal would be placed before the competent authority (Union Cabinet) for a decision. DGCA would consider such proposals for grant of license only after the approval of the Central Government is conveyed.

9.3 In case of an application by the AAI or an Airport Company to set up an airport within 150 km of an existing civilian airport, the application shall be considered first by the Steering Committee. The Steering Committee shall consider all relevant facts and circumstances including contractual liabilities, if any. The Steering Committee shall also take into account whether the applicant has obtained the approvals required under the applicable laws from the authorities concerned. After considering the application, the Steering Committee shall make a suitable recommendation to the Central Government (Ministry of Civil Aviation). The Central Government (Ministry of Civil Aviation) shall consider the recommendation and decide whether approval for the airport project should be granted or not. DGCA shall consider a proposal for grant of a license to the applicant only after approval has been granted by the Central Government (Ministry of Civil Aviation).

9.4 Where an application to set up a greenfield airport attracts paragraph 8.1(b) (within 150 kms) and also seeks exemption/relaxation from any extant Rules and Policies, the application shall be considered first by the Steering Committee. The Steering Committee shall consider all relevant facts and circumstances including contractual liabilities, if any. The Steering Committee shall also take into account whether the applicant has obtained the approvals required under the applicable laws from the authorities concerned. After considering the application, the Steering Committee shall make a suitable recommendation to the Central Government (Ministry of Civil Aviation). The Ministry of Civil Aviation shall place the matter before Union Cabinet for its consideration. DGCA would consider such proposals for grant of license only after the approval of the Central Government is conveyed

9.5 Airports for cargo and/or non-scheduled flights and for heliports need not be submitted for approval of the Ministry of Civil Aviation and these cases may be considered and decided at the level of DGCA, subject to applicable laws.

10. Constitution of a Steering Committee

10.1 Since the grant of a license for a greenfield airport involves several agencies, a Steering Committee would be set up under the chairmanship of Secretary (Civil Aviation) to coordinate and monitor the various clearances required for setting up of an airport. The Committee would consist of the following:

(a) Secretary, Civil Aviation - Chairman
(b) Secretary, Ministry of Home Affairs, or his representative not below the rank of Additional Secretary;
(c) Secretary, Ministry of Defence, or his representative not below the rank of Additional Secretary;
(d) Secretary, Department of Economic Affairs, or his representative not below the rank of Additional Secretary;
(e) Secretary, Department of Revenue, or his representative not below the rank of Additional Secretary;
(f) Secretary, Planning Commission, or his representative not below the rank of Additional Secretary;
(g) Director General, India Meteorological Department;
(h) Chairman, Airports Authority of India;
(i) Director General of Civil Aviation; and

10.2 Ministry of Civil Aviation would convene a meeting of the Committee once every 3 months in case applications for grant of clearances/licenses are pending.