COST AND PRICE FOR ADVANTAGEOUS COMPETITION OF LOW-COST AIRLINES

ต้นทุนและราคากับการแข่งขันที่ได้เปรียบของสายการบินต้นทุนต่ำ

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Abstract

This paper aims to explore the benefit of cost and price of low-cost airlines that makes the advantageous competition in airline industry. Major low-cost airlines in USA, Europe and Asia utilize similar cost strategies and cost reduction to compete in fare price and services and increase their market share not only among low-cost airlines but also full service airlines. Several cost reductions and low fare offers with good promotion can compete in passengers in leisure segment which is much higher than in business segment.

Keywords : Low-Cost Airlines (LCA), Price Strategies, Cost Strategies, Competition

บทคัดย่อ

บทความนี้นำเสนอเพื่อสำรวจประโยชน์ด้านต้นทุนและราคาของสายการบินต้นทุนต่ำ ที่สามารถสร้างการแข่งขันในอุตสาหกรรมการบิน สายการบินต้นทุนต่ำสายหลักในอเมริกา ยุโรป และเอเชีย ใช้กลยุทธ์ต้นทุน การลดต้นทุนที่คล้ายคลึงกัน แข่งขันกันในด้านราคาและบริการ เพื่อเพิ่มส่วนแบ่งตลาด ไม่เพียงแต่เฉพาะในกลุ่มสายการบินต้นทุนต่ำด้วยกัน แต่ยังรวมถึงสายการบินที่ให้บริการเต็มรูปแบบอีก ด้วยวิธีการลดต้นทุนที่หลากหลาย และการเสนอขายราคาตั๋วถูก การส่งเสริมการขายที่สามารถสร้างการแข่งขันที่ได้เปรียบโดยเฉพาะในกลุ่มของผู้โดยสารที่เดินทางเพื่อพักผ่อนท่องเที่ยวที่มีสัดส่วนสูงกว่าการเดินทางเพื่อธุรกิจ

คำสำคัญ : สายการบินต้นทุนต่ำ กลยุทธ์ราคา กลยุทธ์ต้นทุน การแข่งขัน

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Introduction

Low-cost airlines which also known as budget, no-frill, discount or cheap airlines are obviously growing up fast and becoming popular among passengers both in domestics and overseas destinations. As the number of low-cost airlines has grown, these airlines have begun to compete with one another in addition to the full service airlines. Price is the weapon of choice for many low cost airlines in competition for market share. Price strategy has been assumed as an effective influence on customers' purchasing decision. However, Lewis & Booms (1983) claimed that prices are often set without an understanding of consumers' perception of price. Since decreasing ticket prices, the airlines may charge for extras like food, priority boarding, seat allocating and baggage in order to sustain their revenue and margins

The low-cost airlines revolution started in the 1970s as a pioneer, Southwest Airlines is a market leader of Low Cost Airlines and has JetBlue Airways as a typical competitor in the US. While in Europe Ryanair and Easyjet have had a very rapid growth ever since 1980s. In South East Asia, Malaysia's Air Asia growing up rapidly and generating rivals like Singapore's Tiger Airways and Australia's Qantas owned Jetstar have been competing aggressively with each other. Dresner, Lin & Windle (1996) found that full service airline's reacted to the entry of Southwest Airlines with a fall in their prices.

Operating Features and Cost Strategies

In Europe, all the low-cost airlines follow more or less the model of the most successful low fare airline in the United States: Southwest Airlines which includes

- Establishing a corporate ethos of ongoing and rigorous cost reduction
- Translating these savings into lower prices than competitors
- Growing existing markets through stimulating demand with the low prices
- Developing markets neglected by competitors such as secondary routes or visiting friends and relatives (Lawton, 1999)

The simple product such as travelling ticketless in one class without a seat reservation. There are no free drinks and meals on most flights and no business lounges at the airport. Added value like frequent flyer programs is not available. This simple product leads to cost savings which enables these airlines to offer cheap fares. As low-cost airlines offer fares 50-70 percent lower than normal scheduled fares, they have to maintain a sustainable cost advantage to survive in the long term. According to Doganis (2001), low-cost airlines have the following cost advantages at 59 percent compared to traditional airlines (Table 1).

Table 1 Cost advantages of low cost airlines on short-haul routes (Doganis, R., 2001)

	Cost reduction
Operation advantages	
Higher seating density	-16%
Higher aircraft utilization	-3%
Lower flight and cabin crew salaries	-3%
Use of cheaper secondary airports	-6%
Outsourcing maintenance/single aircraft type	-2%
Product/service features	
Minimal station cost/outsourced handling	-10%
No free in-flight catering	-6%
Marketing differences	
No agents commissions	-8%
Reduced sales/reservation costs	-3%
Other advantages	
Smaller administration costs	-2%
Total Cost Advantage	-59%

Binggeli & Pompeo (2002) calculated that through lower cost and higher seat-load factors low cost airlines can offer fares 50 to 70 percent lower than those of the incumbents. In addition to cost saving advantages low-cost airlines have revenue advantages as well. Like full service airlines, they need a high load factor to break even and they have to apply successful yield management. Pender & Baum (2000) defined as passenger-kilometers flown per available seat-kilometers at that the average 75% and that an example the break-even load factor of Easyjet lies between 50-55%.

Unlike the traditional seat booking with the agent, low-cost airlines sell direct to the customers without using agent. Once booking via the airline websites, passengers must pay by credit card. No reservation is possible without paying, this means that they generate their cash before delivering the product service. This facilitates the low cost airlines' cash flow and enables them to generate interest from their cash deposits (Doganis, 2001).

It is clear that low-cost airlines are able to exploit several cost advantages on short-haul routes (Graham, 1995). First, low-cost airlines are able to achieve a high utilization of the plane and its crew. Second, they have a simpler management model. This is attributed to the fact that they focus on point-to-point services, use just one type of plane, operate a single fare-class, and provide no fare on-board frills. Some low-cost airlines such as Southwest, Ryanair and Air-Asia enjoy lower charges from their use of secondary airports

In Asia, Air Asia, established in 1993 the first low-cost airline in Southeast Asia, utilize e-ticketing and bypass traditional travel agents by no issuing physical ticket which estimated at US$10 per ticket, eliminating the need for large and expensive booking/reservation systems and no agents' commissions. In 2004, internet booking has increased from 5% in 2002 to approximately 50% in 2004. Additionally, Air Asia subsequently made its tickets available via post offices and designed bank Automated Teller Machines (ATM), increasing accessibility to consumers while having lower distribution costs, gaining more market share in the process. In addition, Air Asia managed to achieve cost per average seat per kilometer of 2.13 US cents which is the lowest for any airline in the world. This efficiency enabled Air Asia to utilize the capacity by increasing its load factor (passenger carrying capacity) from 0.62 in 2000 to 0.75 in 2005 (Singh, Pangarkar & Heracleous, 2007).

Price and Customers Concentration

Since low-cost airlines have reshaped the airline industry competitive environment within liberalized markets and have made significant impacts in the world's domestic passengers markets which had previously been largely controlled by full service network airlines (O'Connell & Williams, 2005) Therefore, their marketing strategies have to capture and maintain the passenger need and impulse them with strong marketing strategies. Every firm needs strategy to make its product acceptable by the consumers at the right time. Marketers need marketing mix to produce desired response from the market (Wikipedia, 2012). Price is the only element of marketing mix that directly produces revenue (Lovelock, 1996). Though some airlines respond to low cost competition by reducing prices, however their revenue often does not cover costs and economic problems are growing.

The low-cost airlines always offer a simpler fare quote with discounts and free tickets in promotion but typically fares increase as the plane fills up, which rewards early reservations. Furthermore, some of low-cost airlines operators try to differentiate themselves with offering in-flight entertainment, satellite radio or even mood lighting. Obviously, the low-cost airlines fly to smaller, less congested secondary airports and/or fly to airports in off-peak hours to avoid air traffic delays and taking advantage of lower landing fees, and some low-cost airlines asking passengers to board the aircraft by shuttle bus or walk from the terminal to the aircraft at the ramp. The airlines tend to offload service and re-load the aircraft in shorter time period, allowing maximum utilization of aircraft. Some low-cost airlines operate only single passenger class and most operate just a single type of aircraft. In the past, low-cost airlines tended to operate older or second-hand aircraft, such as the McDonnell Douglas DC-9 or Boeing 737. Since 2000, fleets generally consist of smaller, newer, more fuel efficient aircraft, commonly the Airbus 320 or older models of Boeing 737 families, reducing training and servicing costs (Wikipedia, 2012).

The low-cost airline which describes itself as cheap airlines also has the dynamic price policy with discounts and tickets in promotion. However, prices steadily rise thereafter to the point where they can be comparable or more expensive than a flight on a full service airline.

In the past, airline booking service was somewhat delivered by the airline agent. Telling requirements over the phone needed much interaction and time. Consequently information technology has globalized the role of the internet and enable the low-cost passengers to engage in online booking by themselves. That becomes easier and faster wherever they are.

Price Promotion often known as price-off deal [Belch & Belch, 2007; Solomon, Marshall & Stuart, 2009; Wells, et al., 2007) is a promotional strategy in which consumers receive a temporary reduction from product's normal price. Low-cost airlines sell low price but it's necessary to have marketing promotion to increase sale volume and earn more margins. According to Graham (1995), price–off deal is a very frank marketing technique as it offers special packages that may reduce consumer spending. One of the most obvious effects of the liberalization of the airline industry has been the decrease in airfares due to increased competition. In this regard, the relationship between airfares and competition has received a great deal of attention in the empirical literature on air transport.

Meghan (2002) conducted that a price war is a period in which a firm in an industry or market set price that are significantly below the usually prevailing price. A price war occurs because a firm cannot observe its competitors' prices therefore it interprets a fall in demand for its own output as a sign that one of the competitors' has offered customers a secret price cut.

Ryanair has got into the position of leader in its strategy "to establish itself as Europe's leading low- cost carrier ever enhancing and expanding its range of low cost services". Ryanair's objective is to offer low fares that generate increased passenger volumes while maintaining focus on cost containment and operational efficiency. While Air Asia's slogan "Now Everyone Can Fly" emphasized its aggressive marketing by offering free-seat price that attracted publicity and interest from travelers. As a result of massive advertising and sales of the part of tickets at very low prices, it has succeeded along with its followers and competitors in attracting millions of customers to the air transport who would not have flown otherwise. This trend on the one hand, has generated a large volume of new passengers on the other hand, and led to the problems of the full service airlines who have found themselves under pressure from the price war. Their response to this situation is different. In diverse way, some airlines reduce prices, however their revenue does not cover costs and economic problems are growing. If such a carrier reduces the quality and range of services on board which is close to the low cost, it often loses business clients who generate a significant proportion of revenues. So the airlines are trying to differentiate themselves from low-cost competitors.

Recommendation however, airline operators have to focus on customer price satisfaction. The recent researchers have concluded that price should be conceptualized as a multiple dimensional construct (O'Guinn & Semenik, 2006; Meghan, 2002; Matzler, Renzel & Faullant, 2007; Giovanna & Bruno, 2005). Price satisfaction dimensions are consisted of Price Transparency that customer can easily get a clear, comprehensive, current and effortless overview about a company's quoted prices Airlines have undergone a domestic transformation towards increased transparency and internet pricing enable the customers to easily compare prices across airlines' websites, Price Confidence that Anton (2007) stressed that trust and commitment are positively related customers' retention. Airlines implemented price promotion to stimulate demand and it associated with commitment and provides sustainable competitive advantages with the reliability in low cost brand, Price Quality that is not merely a support mechanism but viable competitive strategy. Lewis & Booms (1983) suggested that in the service industry definition and service quality tends to focus on meeting customers' needs and how well the service delivered meets their expectation, Price Reliability that customer will perceive high price reliability if prices do not change unexpectedly. In the airline industry, customers perceive high reliability if there are no hidden cost. Matzler, Renzel & Faullant (2007) found that dynamic pricing method is generally unfair for customers and this technique is harmful for trust building and induce unfair price competition, Price Fairness that Meghan (2002) noted that fairness of price can be defined as the consumer's judgement of whether the actual price is just compared to the assessment of the economic value that the supplier has captured from the exchange relationship with customers. In marketing, the airline product has certain unique characteristics. The service (product) cannot be kept in inventory to match fluctuations in demand. The revenue lost as a result of an unfilled seat when the aircraft departs is lost forever, and Price Security that is cited as one of the determinant factors of the customers' online trust, customers' online purchase intention, online satisfaction and online loyalty (Kim, Tao & Shin, 2001). Therefore, customers' perceptions of the security features of a website play a critical role in their online behavior and purchasing decision making process.

The growth of low-cost airlines has shown that they can successfully compete with full service airlines (FSA), particularly in the price-sensitive leisure market on passengers' decision making and satisfaction Fourie & Lubbe (2006) and Hanlon (1999) described that leisure travel has been growing more rapidly than travel on business. This is something that affects the aggregate price elasticity of demand. The demand for leisure travel is price elasticity but the demand for business travel is price inelasticity. Across the world the leisure/business breakdown is now approximately 80/20. Mason (2000) analyzed that business passengers using low-cost airlines are small and medium sized companies. Long term growth would require low-cost airlines to gain market share from full service airlines. There are powerful travel groups and alliances members in Europe which are able to block inroads into leisure and business travel segments. The low-cost airlines will have to fight with structural limitations and competitive challenges (Binggeli & Pompeo, 2002).

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