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Theory of product policy and practices in airlines

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Pricing and product policy in the airline industry is very complex and different from other industries, thus a successful airline has to manage its products and pricing perfectly, otherwise it will not succeed on the extremely competitive airlines market. This paper has two main goals, firstly to generally define product policy and secondly to show the product policy of airlines. Currently, airlines operate in a very competitive industry with little to no option to differentiate their product which leads to low profitability. New Distribution Capability and another new technology have the potential to increase airlines' revenue by better price discrimination and more personalization.

Słowa kluczowe: Product policy, product policy in airlines, pricing, product differentiation.

Wstęp

The world of airline industry is one of the most dynamic industries in the modern economy. In last 50 years the whole industry changed dramatically, flying became common and affordable for masses. Modern budget airlines made the world truly global.

Civil aviation is a specific industry with high barriers to entry, it is highly regulated with respect to any part of the industry. Aviation industry is highly competitive and only those companies that are flexible and adapt quickly to the market situation and future trends, can survive. In this essay I will analyze the concept of airlines product policy.

1. Definition of product policy

According to Kollar (2003), product policy is a key issue in a maintainable marketing plan and the enterprise's product policy is defined by changes in supply that come from developing new products, changing properties of existing products, or otherwise. Product policy is defined as a set of rules related to the production and growth of a product. These policies are usually decided by the top management. The product mix preparation is a long process, in the end of the process is client's satisfaction.

When a product is in introduction stage the business needs to decide upon its evaluation strategy, there are two options to choose from, diffusion pricing or scanning. To achieve quick breakeven the businesses, use skimming methods, otherwise they use diffusion to keep the rivalry out of the market. Emphasis should also be put on making alertness about the product and building the brand. A typical product policy for a factory-made product have to be able to manage the appearance of the product to its target market (consumers). (Kollar, 2003).

Kollar (2003) also pinpoints the main fields of product policy:

- development and marketing of new products,
- adapting the quantity of products according to the customer needs,
- working with the product,
- product lifecycle tracking

When a differentiation strategy is considered, the formation of a distinctive and exclusive product is in the forefront, which has a special appeal for the client when it comes to the perceived product changes (compared to competing products). This allows the realization of modest advantages. Such products with special topographies or physiognomies bring additional welfares to the customer and let product favorites grow. This enables higher additions on the product or service. For example, the extra benefit can be based on exclusive customer service or a high-performance product quality or design. The use of a differentiation plan can also influence and build up a product image by concentrated use of marketing activities or by highlighting certain unique performance-based differentiation features (Widmann, 2015).

Kollar (2003) summarizes the target of differentiation plans as a plan to reach client loyalty and to decrease the price resistance of the customer on the side of demand. The consequence is the entry into a quasi monopolistic value range, in which the company can ask higher prices for distinguished products than for undifferentiated products. However, a differentiation plan does not include only welfare but also risks and hazards. It might well happen that contestants imitate certain product mechanisms that decrease the effect of product differentiation.

Like stated in the differentiation plan there are also risks regarding the cost leadership strategy. For example, technical changes due to process novelties lead to new experience curves in the production of products and can also lead to a failure in value of the executed investments. Furthermore, a strong focus on cost structure includes the risk that product renewals might not be executed in time. It has to be noted that cost advantages might be lost if there are disproportionate increases of costs in the production process (Widmann, 2015). For example, Kolar (2003) includes in the costs of production process all reserves which are necessary for progress, production, marketing and distribution of a product.

Gilbert & Strebels (1987) defend their decision as follows. Income of a company is signified through the gap between procedure costs and perceived product price. Virtually all companies classify these two dimensions with admiration to the decision between cost management and differentiation. The change to Porter is that they are not seen as conflicting but complementary dimensions. It is vitally significant to be the first to achieve low prices and high perceived product value (in Button, 2004).

According to Gilbert and Strebels (1987), it is obvious to follow the favorite strategy for new products and service from the beginning. This is already reasoned that due to the fact of the novelty (of a product or service), a high advantage is mediated. At a later time of the competition a standard will be achieved on which the products of the contestants have to orientate. If a company succeeds to co-determine this standard, then it gains a temporary lead to realize cost reductions. The price rivalry which starts later can only be challenged effectively through targeted cost reduction (in Widmann, 2015).

2. Product policy in airlines

In the previous section of this paper I have outlined the product policy from a broader perspective. Product policy of airlines is a special case and very interesting and complex one. There is a broad

spectrum of literature analyzing airlines product policy from any angle possible, management, marketing, micro economics etc. In the following paragraphs the most important views on product policy will be summarized.

Liberal air transport policy has created completely new conditions. Airline companies have previously worked in a highly regulated environment and suddenly have to compete in the open market. Therefore, they need to go beyond full market marketing behavior without unnecessary hesitation, which entails the need for a tangible change in both internal and external corporate culture.

According to Belobaba et al. (2017) the airline's objective in establishing a differentiated fare structure is to offer a wide enough range of fare product options with different price levels to capture as much potential revenue as possible, while targeting each fare product to specific demand segments with different levels of willingness to pay. At higher price levels, the airline might offer enhanced service amenities that recover the attractiveness of the fare products to travelers who are not price sensitive. And, at low price levels, prices low enough to stimulate new request for low fare travel are offered to fill empty seats that would otherwise remain empty. The challenge is to find instruments to prevent the diversion of consumers with higher willingness to pay (who were expected to buy the higher fare products) to the lower fare products.

The basic objective of the airline should be to seek the highest possible loyalty and customer satisfaction. This can be achieved only by offering a product that matches their needs. Therefore, the main part of the strategy should focus primarily on identifying the risks and the environment for the company's activity and consequently on defining, creating, realizing and distributing the product that will correspond to the expectations of the selected segments of the market, potential customers.

The sophistication of the fare quote procedure continued to evolve, starting with the creation of automated airline rule data feeds by ATPCO (The Airline Tariff Publishing Company) in the 1980s and 1990s. These data feeds have over 10,000 data elements that can be used to describe how a fare may be used for a particular flight leg, O&D and the total passenger journey. These elements reflect the many business rules used to content the tax, regulatory, currency, segmentation, product differentiation, and ultimate fare use requirements. The ability of fare quote systems to mechanically load this data and apply these rules to each transaction has allowed for accurate price calculation from the simplest to most complex passenger journeys (Belobaba et al. 2017).

Given that competition has been shown to have the greatest impact on the fare structure and price levels in an O-D market, it should not be a surprise that airlines pay a great deal of consideration to the fare structures of their competitors. In the vast majority of cases, airlines will compete the fare offerings of their competitors, typically their lowest-price competitors. The decision to match a competitor's fare can include both the specific price levels associated with each fare product and their specific rules and restrictions (Belobaba et al. 2017).

Lehman (2003) has noted that the change to widespread ticket delivery on the Internet has intensified meaningfully this practice of fare matching. As consumers brand use of air fare search engines to find the lowest likely fares for a future trip, even price changes of a dollar or two between the fare product offerings of airline contestants can relegate the higher-priced choices to lower ranked locations on the web page and lead to important booking loss.

Some fresh developments in airline valuing suggest a return to the fundamentals of fare product differentiation, including the move to "branded fare families." The fare family approach to valuing and demand division involves sets or families of fare crops, each defined

by significant differences in limitations and/or amenities. Within a fare family, there are no differences in the appearances of the fare creation, but there can exist multiple value points for that fare product (Naylor & Frank, 2001).

The use of product differentiation among families assists to reduce the risk of revenue diversion. At the same time, business travelers wishing to buy a fare family product with fewer restrictions and improved amenities early in the booking process can obtain substantially lower fares than the "full Y fare" of the traditional limited fare structure, stimulating new business travel demand and contributing to higher revenues and load factors (Belobaba et al. 2017).

The pricing policy of some carriers can be very dynamic, offering stock tickets at promotional prices, or at no cost. In the European Union, airline companies are required to indicate the price of tickets, including all mandatory charges, so for a ticket that is promoted for 20 euros the passenger will pay 20 euros (without optional surcharges such as card payment, luggage, etc.), this regulation blocks aggressive marketing strategies that are seen in other industries.

Emerging technologies provide airlines new platforms to improve their capabilities for reaching higher revenues, to sell additional services related to travel. Modern technologies offer greater flexibility to set up and manage business rules and high-margin ancillary products and more varied fare options. Airlines can then personalize offers base on frequent flyer information such as status, flyer profile, past behavior and so on. The new possibilities are summarized in the following picture by PwC (in Borgogna, 2016).

The New Distribution Capability (NDC) presently under development as a new global standard for airline distribution enables airlines to communicate all of the features of each fare product offering, not just its price and limits. By providing a standardized way of communicating the offers, it could also bring the airlines closer to "dynamic pricing" and even "customized pricing", where diverse types of requests or even individual customers could receive different price/product offerings based on the airline's assessment of their potential total revenue contribution (Belobaba et al. 2017).

Low-cost carriers are counting on price-by-side revenues such as revenue from ticket sales. These are in particular different booking fees, which are not part of the ticket price, and revenue from sales on board. These secondary revenues make a significant part of total revenues for low-cost carriers.

NDC will also give the airline the capability to produce an "offer" consisting of not simply a published ticket fare, but one that includes additional amenities and services. In contrast to the static dissemination of seat availability by flight and booking class, real-time interactive communications between customers (or their agents) and the airline will enable dynamic packaging and pricing of flight, price and product combinations. The new capabilities will also license airlines to give their customers the choice of different ancillary product options and build a shopping cart before checking out (Belobaba et al. 2017). According to Widmann (2015) the product formation process occurs prior to value selection and could range from pre-constructing proprietary fare products to dynamically bundling or packaging numerous ancillary services into product offerings. The product formation process itself is not included in our price assortment framework.

The price selection process, according to Beloba et al. (2017) could be managed through business rules that govern when or how specific price points are made available. For instance, a particular price point may only be accessible if purchased far in advance, if the product cannot be returned or refunded, or if the customer is a senior citizen. Along with simple business rules like these, a firm

could also use a mathematical optimization model to regulate which price point to display at a given time, as a function of a demand forecast and the amount of inventory remaining. Mechanically, continuous pricing could coexist with existing fare filing processes if airlines filed a distinct fare product for each unit of currency in the range of allowable values. Airlines could then use a continuous pricing engine to choose which precise price to make available. This could be a cumbersome process, as the sheer amount of possible currency values would require significant improvements to the capabilities of existing RBDs.

Alternatively, the development of the New Distribution Capability means that airlines may not unavoidably need to retain pre-filed fare structures when practicing continuous pricing. With next-generation distribution technologies, airlines could potentially select prices freely from a range of possible values without a traditional fare filing related with that value. Airlines implementing continuous pricing may select to use either a traditional fare product structure or a NDC-style mechanism for implementation. (Belobaba et al. 2017).

Note that dynamic offer generation could combine incessant pricing with transactional product selection. Each search request could result in a customized offer with a combination of pertinent ancillary products and a price that is selected in real time from a continuous range. It is also possible for airlines to pre-construct a small number of possible offers, and then choose which of these options to display to each customer. These pre-constructed offers could also be dynamically priced (Belobaba et al. 2017).

Conclusion

The pricing in the airline industry is highly affected by the fact that the marginal costs of additional passenger are almost zero. A plane with 100 passengers or 100 + 1 passengers on board is affecting the total cost of the flight to a very little degree. This leads airline companies to very aggressive ticket pricing, because even the marginal benefit of a marginal passenger who pays lower fare can make the difference between profit and loss.

Situation of many airlines is critical, however a light in the end of tunnel is NDC that can give airlines the ability to distribute all their content through third parties. NDC will allow better product differentiation and secure airlines that will be able to take advantage of it a new stream of revenues.

Future research should focus on low-cost airlines and their impact on the whole market, especially on the future of product policy and pricing. The New Distribution Capability together with the rise of low-cost carriers can significantly change the market and revenues of airlines, airports and other stakeholders.

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Teoria polityki produktowej oraz ich praktyka w liniach lotniczych

Polityka cenowa i produktowa w branży lotniczej jest bardzo złożona i różni się od innych branż, w związku z czym, odnoszące sukcesy linie lotnicze muszą doskonale zarządzać swoimi produktami i cenami, w przeciwnym razie nie odniesie sukcesu na niezwykle konkurencyjnym rynku linii lotniczych. Artykuł ma dwa główne cele: po pierwsze, aby ogólnie zdefiniować politykę produktową a po drugie, aby pokazać politykę produktową linii lotniczych. Obecnie linie lotnicze działają w bardzo konkurencyjnym przemyśle, z niewielką lub żadną opcją, aby odróżnić swój produkt, co prowadzi do niskiej rentowności. Nowa funkcja dystrybucji i kolejna nowa technologia mogą zwiększyć przychody linii lotniczych dzięki lepszej dyskryminacji cenowej i większej personalizacji.

Słowa kluczowe: Polityka produktowa, polityka produktowa w liniach lotniczych, ceny, zróżnicowanie produktów

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