The Right Price Model for Airlines

A Path to Profitability in the New Economy

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EMOTION ENGINEERING & DESIGN

Outline

Profitability – A Constant Challenge of the Airline Industry

Richard Branson, founder of Virgin Group famously quipped, “If you want to be a millionaire, start with a billion dollars and launch a new airline.” Although flying opened up the world for travelers and dissolved geographic barriers for business, the airline industry has always struggled with profitability. As the world emerges from the Covid-19 pandemic amidst new macro-economic variables like environmental sustainability and geo-political tensions in Eastern Europe, the airline industry grapples with even deeper challenges on profitability.

- **Dealing with debt** - Airlines borrowed huge sums of money to stay afloat during the Covid-19 crisis in the shape of commercial borrowing, shareholder contributions, and government aid. According to IATA (International Air Transport Association), despite cutting operating costs by 35% compared to pre-crisis levels, airlines amassed a debt burden of over $650 billion. McKinsey cautions that unless measures are taken, industry debt could exceed revenue by 2024. Recovering debt will have to be factored into ticket prices or absorbed into operational efficiencies, which directly impact profitability.

- **Rising costs** – Costs remain a challenge, with the price of fuel, maintenance, and infrastructure rising. In April 2021, IATA predicted higher fuel prices with jet at 68.9$/b, oil 64.2$/b (earlier jet at 49.5, oil 45.5). Non-fuel costs are also on the rise. Airports and air navigation service providers (ANSPs) looking to recover their losses seek to transfer USD 2.3 billion in charges to airlines. These critical essentials for the airline industry threaten to eat into already slim margins and profits.

- **Pressure on revenue streams** – International travel was the main source of revenue for airlines, but the pandemic saw both corporate and leisure travel come to a full stop. As vaccinations pick up pace world over, there is cautious optimism, but the road to recovery is slow. In 2021, overall travelers were only 47% of 2019 levels. Corporate travel will pick up, but the hybrid model of working is here to stay, so budgets will reduce. Leisure travel is encouraging, but travelers remain cautious. IATA expects travel to improve, recovering to 111% by 2025, but until then, airlines will find profitability a challenge, with multiple players competing for the smaller pool of travelers.

- **Challenges in supply and labor** – Airlines cut back on suppliers and staff to tide over the slump in demand caused by the pandemic. The recovery is in fits and starts, making it difficult for airlines to forecast supply and staff requirements and negotiate terms that favor them. To keep their staff, airlines must make investments in employee welfare or competitive salaries, another cost that chips at the bottom line.
- **Sustainability and carbon-neutrality** - With the global pressure to reduce carbon, most airlines are working towards NetZero goals by 2050. Although futuristic technologies like hydrogen and eVTOL (electric vertical take-off and landing) aircraft are in the wings, making a transition to bio-based sustainable aviation fuel (SAF) is the practical way for airlines to achieve these goals. The increased cost of SAF and investments in R&D will also need to be considered in the business model, and factored into the fight for profitability.

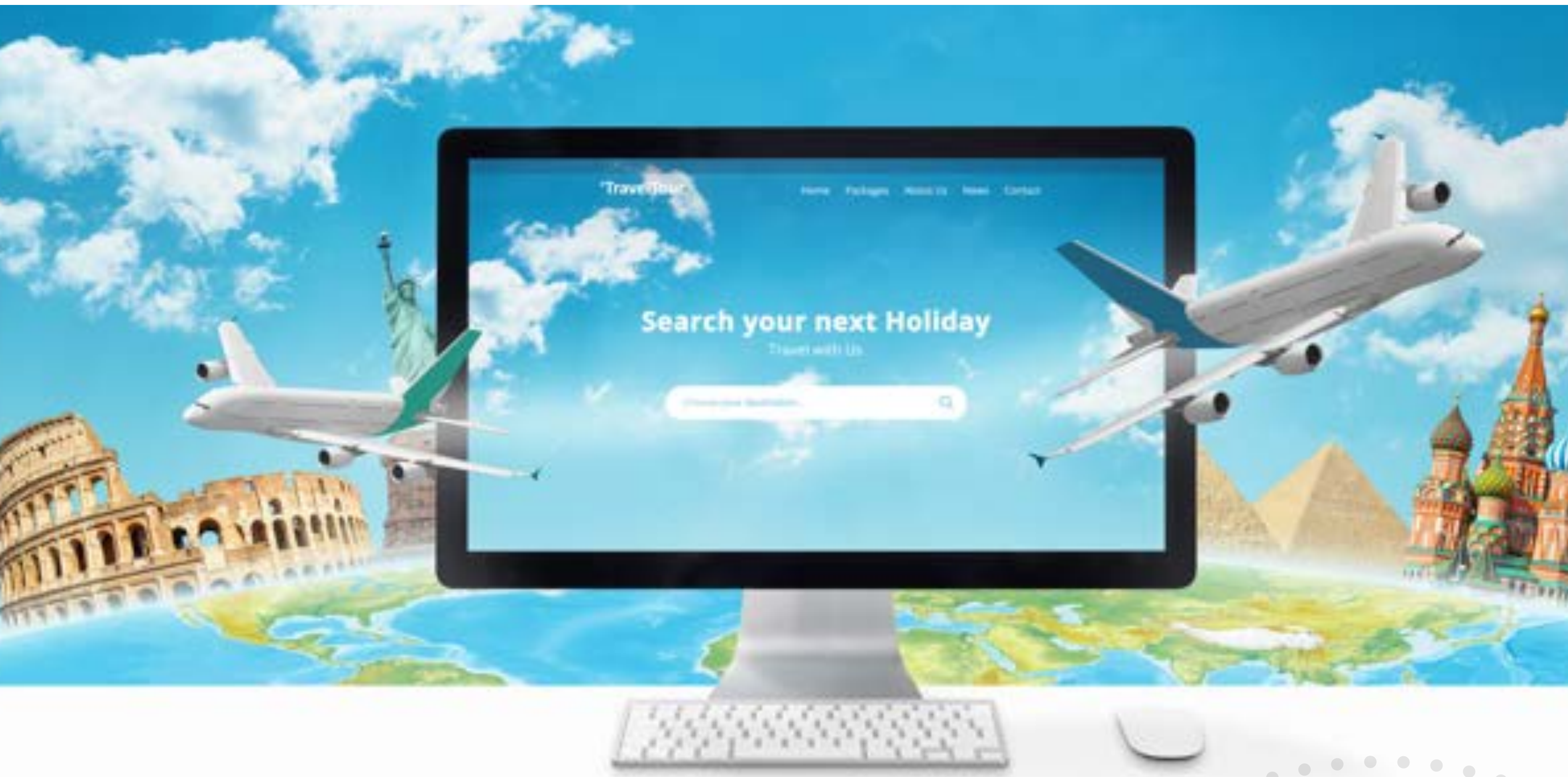
The Future of Airlines will Rely on New Business Models Enabled by Digitalization

Airlines need to re-visit flight economics and business models

To increase profitability, airlines must critically examine their business models. In the post-Covid-19 scenario where airlines are rebuilding their business, they can consider new models beyond the silos of low-cost, ultra-low-cost, and full service.

Full-service carriers (FSCs) like Lufthansa offer the comfort and luxury of a flying experience, targeting customers at the top of the pyramid. They charge a flat ticket price but include all the conveniences for passengers to enjoy the flying experience, such as hot meals, alcoholic and non-alcoholic beverages, syndicated entertainment, premium check-in spots at airports, etc. Of course, this comes at a price, and as such, they are 33% to 50% higher than low-cost carriers. To ensure that they are always offering the level of service and a luxe flying experience, FSCs invest in aircraft, materials, and staff that they need to maintain at all times, which increases operating costs.

Low-cost carriers (LCCs) or ultra-low-cost carriers (ULCCs) such as Southwest Airlines offer tickets at an affordable cost by reducing conveniences and lowering operating costs. While the cost of tickets is low, passengers pay for any other aspects such as carry-on luggage, choice of seating, meals, beverages, etc. In the case of ultra-low-cost carriers, even amenities like drinking water are charged additionally. However, this is at the cost of the convenience and comfort of the passengers. They find the exercise of declaring luggage, choosing seats, and other aspects at extra costs usually off-putting. Having to pay for luggage, food, and sometimes even water while aboard a flight compromises the passenger experience and may lead to negative reviews. Also, if passengers add up the cost of these ancillary services, they may conclude that they didn’t save as much as expected, compared to if they had chosen a more expensive FSC.



The Pricing Conundrum of FSC vs LCC

Is low cost travel being misinterpreted as a low price? In reality, cost and price should be considered separately.

LCCs work with frills and conveniences as levers to reduce the price. A lower price resulting from reduced frills and conveniences actually is an inconvenience to the passenger and back-fires in realizing the benefits of being a low cost carrier. FSCs have a higher price to accommodate the services they offer. If they want to hold on to their edge of offering a luxury experience, they need to manage their costs.

Lower cost should be an outcome of reimagined business processes, and increased efficiencies across the operations. Digital technologies hold the promise of lowering cost.

Arriving at the pricing should be a judicious assessment of the most commonly required facilities and conveniences.

Most commonly used conveniences should be maintained as standard inclusions- sufficient data is available to help determine what these standard inclusions could be. For instance, one can determine the most commonly carried number of bags on each sector, whether passengers have seat preferences on that sector, and other such commonly required facilities and conveniences. If the analysis of data reveals that a larger percentage of flyers carry two pieces of luggage on a particular sector, this can be factored into the price for that sector. The airline gains nothing by continuing to permit only one bag, subjecting majority passengers to inconveniences related to the additional bag. Similarly data can assist decisions related to seat selection, meals and other pricing parameters. Keeping customer experience as the prime factor in pricing decisions will result in better customer stickiness and make it the first choice of airline.

With changing passenger preferences and the potential of technology, is there a new model that can lower costs on one hand, and arrive at the right pricing on the other? Is there a Right Price Model?

A New Model Emerges – The Right Price Model

For LCC and ULCC operators, while passengers appreciate low ticket prices, they ultimately still want a certain level of convenience. Despite the fact that they accept low prices, having to pay for every additional frill is an inconvenient experience that negatively impacts the airline's reputation.

On the other hand, for FSCs, a delightful customer experience is the differentiating factor, so they endeavor to keep everyone happy, but at a cost.

Today, with data widely available, and digital technologies that simplify operations, a new model can emerge – one that is flexible and allows the airline to plan their pricing models based customized to passengers preferences.

It's time for airlines to take an outside-in approach

The current airline business models, both FSC and LCC, evolved from the need to keep airlines profitable, based on two categories of passengers - those who preferred luxuries and those who wanted to fly at the lowest ticket price. These models were inside-out - they defined what airlines want to be from the perspective and profit goals of the airline.

In fact, today, it's no longer about low cost or full-service, but about what is right for the passenger. The new business model - The Right Price Model - lets the passenger define what they want the airline to be.

The Right Price Carrier (RPC)

The way forward for airlines is to price for the customer experience and streamline the operations to support the experience.   The right priced carrier, leading with customer experience, has three pillars to create profitability in the airline industry – Revenue, Passenger experience, and Cost.

The Right Price Model for Airlines

RPC for RPC

Revenue, Price and Cost for Right Price Carriers

Revenue

Broaden strategic focus to adjacent areas of customer convenience in the first and last mile

Add new service lines beyond the regular focus

Use data to determine customer preferences and factor those into the pricing

Passengers

Design digital experiences that engage passengers and create stickiness

Enable networking through on-fight gaming creating business or interest-based communities

Customize experiences based on purpose of travel

Leverage digital for superior end to end experience

Cost

Re-imagine processes and leverage digital technologies to reduce costs

Data-riven decisions on flying slot selection to optimize costs

Contactless boarding and automated touchpoints reduce staff costs

Digital maintenance for reduced cost and downtime and quality workmanship

REVENUE

Digital technologies can open up new avenues of revenue generation as well as new ways of offering current services to generate an alpha on the revenue. Some examples include:

- **Broaden strategic focus to adjacent areas of customer convenience in the first and last mile**
  - Provide first mile and last mile services such as taxi or food services on the way to the airport: There are platforms for route planning that enable plugging in local services such as taxis, food delivery, parking, etc. Such an extended set of services will not only generate additional revenue but will also create customer stickiness resulting in becoming the first choice of airline.

- **Providing a category of services that generates an alpha over the regular set of services**
  - Help passengers plan future trips and provide proactive notifications to encourage flying.
  - Redefine business class: There is always a set of passengers that appreciate the differentiation of a business class. The challenge, however, is to fill up the business class, as unsold seats result in a loss. Towards this, can digital technology be leveraged to create a configurable business class? Based on the demand, available seats may be released for economy class, or in fact added to the business class. Physical differentiators on board can be created by moving the separators. The notion of business class can be redefined with digital and personalized services such as lounge access, priority boarding, SMS luggage tracking and alerts and other similar digitally enabled services. The provision of a flexible business class permits higher revenue from the same set of seats and other expenses.

- **Use data to determine customer preferences and factor those into the pricing**
    - Use past data to determine the conveniences availed by the majority of passengers and factor those into the pricing. Those who avail the conveniences will be thrilled, while those not availing the conveniences will generate profit. The highlighted conveniences will be sufficient to offset the perceived higher price. Only the exceptionally used services should be priced separately (maybe at a premium) to ensure only those desiring it have to go through the effort of requesting it.

PASSENGER EXPERIENCE

Adopting a passenger-centric approach helps to create a competitive edge, and strengthen the brand, establishing strong emotional connections with the passenger. This is the power of a thoughtfully designed customer experience. A digital-first approach to building passenger experiences must reflect in the experiential design. A pleasant look and feel, and easy discoverability helps overcome key emotional inhibitors, and short and easy booking journeys help convert users. Loyalty is then a given.

- The flying experience can be enhanced into a networking experience using digital technologies. Digital multi-player games can be made available, wherein passengers seated anywhere can participate. The game conclusion can permit exchange of contact information, which could result in establishing business associations or long lasting friendships. An ongoing blog permitting passengers to share their views on key topics will engage them. The ability to network and to socialize could be a differentiator that will make it an airline of first choice.

- Passengers are always looking for ways to utilize flying time gainfully. Access to updated articles guiding passengers on investment possibilities, goal calculators or wealth planning could be extremely engaging and passengers would appreciate the experience.

- The time slot chosen for each sector has an inherent decision to cater to business travel or leisure as a primary target. Customized experience can be built based on the profile of passengers.

- Experience can be enhanced by reducing the booking effort for repeat trips, end to end journey planning including the first mile and last mile, automatic data filling and so on.

- User studies help identify common challenges faced during travel and designing customer journeys to alleviate the challenges can make it a joyful journey.

- Systems can be developed, in conjunction with airport authorities, to send notifications once the bags are loaded on the carousel.

Many airlines are already experimenting with creating digital experiences

Diversifying Revenue from a Super App	Owning the Tourist Experience	Differentiators for Business Class
AirAsia has set a goal of attaining 50% of revenue from non-flight-related streams. To do this they are becoming a digital lifestyle brand by creating a unified e-commerce platform, powered by technology and data. The carrier's commercial strategy focuses on three main pillars – travel, e-commerce, and fintech.	Singapore Airlines is trying to win customers over a new e-commerce subsidiary called Pelago. The platform curates experiences for the curious traveler. Over 200 curated experiences are listed, from attractions and city tours to local hidden gems	Panasonic's waterfront suite concept features a full privacy door, giving an uber-luxurious experience. Passengers have full control over their experience through their smartphone or from a tablet. From adjusting their seat, ordering food, controlling the in-flight entertainment, it's anything at a click.

Design thinking is critical for airlines to adopt the outside-in approach and start with customer-first. A design thinking approach to customer experiences helps elicit emotional considerations that will cause greater emotional connect and stickiness. It involves a detailed understanding of customer touchpoints, with the chance to convert the pain at any touchpoint into joy. This will simplify the journey, and increase probability of journey completion.

COSTS

Airlines need to optimize their operations to be lean, agile and efficient. For this, they can rely on digitalization of operations and automation of customer touchpoints using state-of-the art technologies like RPA, AI, ML, as well as interactive technology such as biometrics, virtual reality and apps. Not only does digitalization connect carriers to the customer's expectations, it is also the secret weapon behind the efficiency of operations. From ticket booking to route optimization, aircraft maintenance, or fleet management digitalization can help implement a lean operation resulting in cost savings, accuracy, and safety.

- **Choosing flying slots intelligently to reduce costs per sector**
  Choosing the flying slot for each sector requires balancing airport costs and anticipated business during that time. However, some unusual flying slots may be available that provide perfect connection to certain international flights. These could provide the passenger load with lower airport costs. Digital analytics can help with identifying such possibilities. Code share partnerships can be established to provide the domestic first-mile or last-mile for international flights and slots can be selected to align with these. This allows airlines to increase utilization and reduce airport costs.

Reimagine operations to reduce costs

- With self-service already popular, passenger-facing experiences can be automated, reducing the need for staff at many points of the check-in and boarding experience. Booking is already completely digital, and web check-ins and e-boarding passes only require a baggage drop counter. Turnstiles can be provided at the boarding which scan the QR code and ascertain passengers to flight match, reducing staff costs.
- Contactless boarding from parking, luggage tagging, security checks, notifications on boarding gates and all other touchpoints can become one single, seamless digital experience. These also lower the reliance on staff, reducing costs.
- Requirements for meals to exact amount of fuel required, (since excess fuel has its own weight), can be estimated based on ticket sales, checked-in baggage, to optimize the operational costs.

- **Digital maintenance for reduced cost**
  - Digital twins can allow carriers to simulate wear and tear and aircraft performance, predicting maintenance requirements to carry out aircraft maintenance efficiently and increasing safety. Drones can be used to improve inspection detail and quality and effectively reduce total time for maintenance and making airplanes available early.

While the challenges of the LCC and FSC model remain, the right price model leverages digital technologies to provide a configurable, delightful and sustainable business model.

The Right Price Carrier (RPC) uncovers additional revenue streams while increasing revenues per seat using the conveniences and configurability of digital technology.

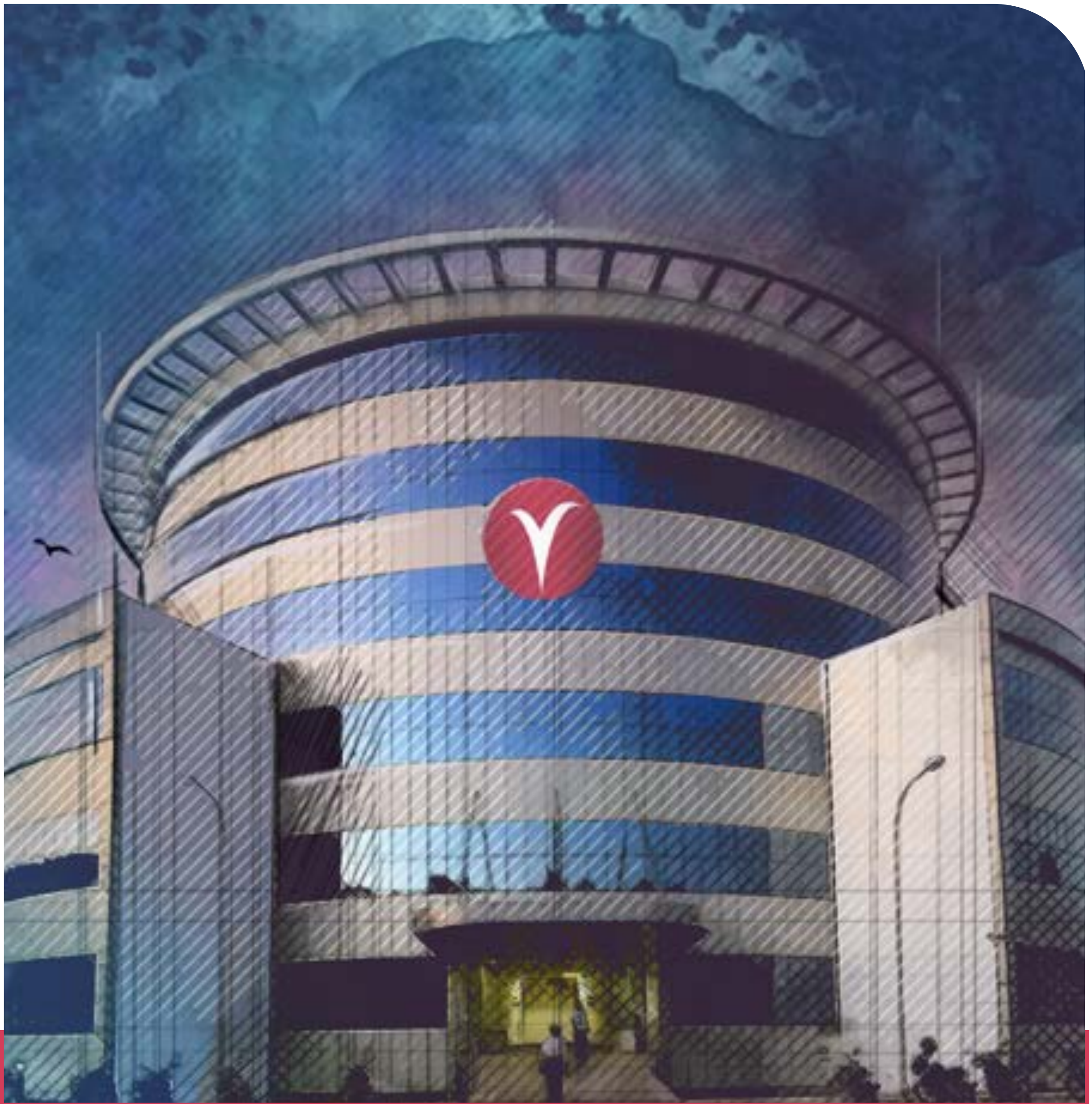
Airline carriers must explore how digitalization can enable the Right Price Model – on all pillars of revenue, passenger, and cost.

Technology can enable profitability and new business models

The past few years saw airlines increase their confidence in technology, with contactless passenger processes from parking to check-in and luggage drop, tech-led security, and document processing. SITA's 2021 Air Transport IT Insights reports that CIOs are betting on technology to support the recovery, with planned IT spending on mobile-based services such as automating vaccination and health verifications, self-service, unassisted check-in, luggage tracking, boarding gate notifications, etc. For airlines, digitalization is a path that has solutions on every aspect of the business, whether on cost optimization, passenger experience, or pricing and route planning. Digitalization can address multiple issues such as automating passenger experiences to reduce the dependency on staff, streamline airline operations and reduce costs. Artificial intelligence (AI) and machine learning (ML) can play a strong role in determining pricing strategies, and with an agile operation, these strategies can also support changes in travel preferences. Airlines can also deploy technology to fulfill sustainability goals, to arrive at data-driven flight paths and fuel efficiency.   Digitalization offers airline carriers the sought-after promise of cost reduction, on one hand, combined with superior customer engagement and retention on the other.

About Robosoft

Robosoft is a full-service digital transformation company with a vision to Simplify Lives. A subsidiary of TechnoPro Holdings, Japan, we offer end-to-end solutions in Product Advisory, Design, Engineering and Analytics. We craft intuitive digital experiences that drive brand preference for enterprises. Our industry experience is diverse including Banking & Financial Services, E-commerce & Retail, Media & Entertainment, Healthcare & Pharma. We have played an active role in the ever-changing world of digital products — from app development to emerging technologies.



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With officers in New York, San Francisco, Los Angeles, Tokyo, Mumbai, Bangalore, Pune, Udupi we partner with several prestigious brands across the globe including Discovery, ESPN, HP, McDonald's India, Paytm, NDTV, Viacom18, Disney, BSI and more. We have crafted over 2000 digital experiences and our apps have garnered over a billion downloads. Our clients are spread across diverse domains - Banking & Financial Services, E-commerce & Retail, Media & Entertainment, Healthcare & Pharma to name a few.

Voted 'Mobile App Development Company of the Year' at the Amazon Mobility Awards, our other prestigious awards include Top Wearable App Developers, Best UX Design Agency 2020, 'Products, Upgrades, and Innovation of the Year' at CEO World Awards, Best of App Store, Apple Design Award, BAFTA, Stevie Gold Winner at American Business Awards to name a few.

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