

## CASE STUDY 8.2W

## Yield management in budget airlines: The case of easyJet

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#### Introduction

The budget sector of the airline industry in both the UK and USA dates back to the 1950s and growth in demand for new holiday destinations, and the growth in air transportation. Initial budget airlines concentrated on the holiday market, offering charter flights. In Europe this meant Spain, France, Greece and the Balearic Islands in the summer and European ski resorts in the winter. Although this market still exists with specialist companies in the UK like Britannia Air, the start of low-cost flights began with 'the battle for the transatlantic business' as seen by Freddy Laker, with Laker Airways and The People's Express. The true budget airlines, however, took shape with deregulation in the United States. The most successful budget airline to develop in America was SouthWestern Airlines, while the main player in recent years in the UK has become easyJet. easyJet is probably following the SouthWestern formula in its operations and development of service and routes. The earliest European low-cost or budget airline still operating with significant passenger numbers and routes in the European market is the Irish carrier Ryanair. The basic premise of business in the budget airlines is of course similar to that of the major intercontinental air carriers. There are, however, major differences between the intercontinental carriers and the budget airlines in both the United States and Europe, which have knock-on effects throughout the budget airline operations. The major differences between the operating processes and cost base of both types of carriers, are outlined in Figure 8.1W. To be effective easyJet operates from low-cost airports (Luton and Liverpool) and flies to low-cost airports (the costs charged to the airline operators are lower at airports like Luton than major international centres like Heathrow or Gatwick). Additionally, it operates only one type of plane, the Boeing 737-500, which again helps to reduce operating and running costs. This has benefits for yield management as it means only one type of capacity, consisting of 159 seats or units.

Yield management within the airline industry may be a prerequisite, but in the budget airline sector it is still developing. Whether it is called yield management, revenue management or revenue maximization its aim or purpose is clear: to achieve the highest possible income from every single flight within an airline's portfolio of flights and routes. To investigate how budget airlines use and gain competitive advantage from this technique, easyJet is used as an example.

#### easyJet

easyJet began in November 1995, with two aircraft operating a three flights a day programme between Glasgow, Edinburgh and its base at Luton. Business was brisk and turnover rose from £25 million in 1996 to over £50 million

by the end of 1997. Routes began to expand and by 1998 these included Aberdeen, Edinburgh, Glasgow, Inverness and Belfast, complemented by Holland, Switzerland, Spain, France and Greece on mainland Europe, and adding Liverpool as a second English base. The company was conceived and run by a charismatic chairman, Stelios Haji-loannou, then a 31-year-old Greek graduate of the London School of Economics, who admits the idea came as a result of Virgin Airlines' first attempt to operate a franchise on the Athens to London route.

The company operates a no-frills airline, based on short-haul flights, aiming at maintaining a low-cost strategy and providing a quality low-price flight. In the autumn of 1997 Haji-loannou signed a \$500 million order for a number of brand new Boeing 737-500 planes, due to enter service by the end of 1999, to provide the needed capacity for the company's expansion up to six million passengers. Haji-loannou's declared ambition is for easyJet to be the 'McDonalds' of flying, and he is perhaps on course for this aim. The image easyJet is creating is one of simple efficient service, for quick easy use. From the attractively simple but functional black trousers or skirts with orange shirts of the in-flight crew, to the very effective and efficient online internet booking system which offers you a simple quick way to book your tickets (thus also providing a good view of a yield management system working minute by minute), easyJet has developed an effective and efficient operation, a single positive brand image and a successful marketing strategy. easyJet and Haji-loannou's commitment to Luton has probably done more in its first two years for Luton airport than any other single company or person, including Lorraine Chase and Campari! Future development plans for easyJet, to allow it to achieve its growth potential and fill the capacity created by the new plane acquisitions, include considering additional destinations, such as Munich, Copenhagen, Oslo, Hamburg, Berlin and Stockholm, along with plans to develop further the facilities at Luton airport. Complementary company developments include a chain of internet cafés and a low-cost car hire operation, both of which have implications for the use of yield management. Has easyJet been successful in its aims and objectives to date? By most methods of judgement, the answer must be yes. But perhaps British Airways' attitude is the best measure. In 1996, it described easyJet as the 'peanut airline' at the time of its launch, but just two short years later British Airways had announced the launch of its own low-cost airline, GO. Imitation, it is said, is the greatest of compliments. If you are uncertain of the success of easyJet the best answer is to try it for yourself. easyJet has seen an opportunity to develop direct marketing and sales of short-haul European flights and has used all the operational tools necessary to ensure its success, one of the main tools being the development of its own dedicated yield management programme.

## Yield management at easyJet

easyJet uses an automated yield management system based around maximizing the revenue on each flight, every day. The easyJet reservation system is somewhat different from those of most of its competitors in that all its bookings must be made directly with the airline reservations staff, via either the phone system or the internet, as no agency bookings are accepted. The yield management system, managed by the revenue manager, is one specifically developed for and by easyJet, and is modified on a regular basis and adjusted as operations mature. easyJet has developed the model to cover each flight route, for every flight and every day. The principal aim is maximization of revenue, while ensuring that the appropriate balance of passengers is met.

easyJet does not segment its customers. However, it does segment its flights into the following categories:

- 1 destination/route
  - business
  - leisure
- 2 flight time
  - morning and evening flights
  - daytime flights.

easyJet considers that there are, in its sector, two kinds of destination. The first is business destinations, like Glasgow, where the highest percentage of passengers are usually going for a short stay for business reasons. The second destination type is a non-business or leisure destination, like Palma, where the greatest percentage of passengers are going for non-business reasons with a longer stay over. The second segmentation is that of flight time, where the early morning, early evening, weekday flights tend to be regarded as business sector, while the middle day, late evening and weekend flights are non-business or leisure. Each segment/sector has differing booking patterns.

Figures 8.2W–8.7W show different patterns of bookings. Figure 8.2W shows non-business customers, and Figure 8.3W business customers, with Figure 8.4W combining them into a yield booking pattern. The prices can then be established around these expected patterns. The cheapest are available until, say, 25 seats are sold, then the next price bracket until 65, then 80, when the almost full price becomes available. The full price opens approximately ten days from take-off, when the majority of business segment fliers can be expected. Figure 8.5W shows actual bookings received as well as the yield plan.

Figures 8.6W and 8.7W indicate the yield plan for non-business/leisure flights, or weekend flights, together with an actual booking flow.

Figure 8.8W shows a flight yield pattern with the actual bookings received, along with the sales book-out price levels. This indicates that if the bookings received exceed 40 by or before 45 days from take-off, then the rate increases, and if it exceeds 60 seats sold by or before 35 days before take-off, the price increases to the next level, and so on.

Figure 8.9W highlights a similar booking pattern, but with late demand (business sector), and shows the price levels closing later and reopening again as the take-off date comes nearer, in the aim of increasing demand by offering a lower-cost seat.

Why is yield so important to easyJet?

- 1 Unlike the major airlines, easyJet has a price structure with only a small degree of flexibility: the range in price available for any destination at easyJet is low. For example, Nice starts off at a low of £35 per seat, extending up to £129 depending upon level of bookings and number of days out from take-off. At BA, for a similar flight, the prices range from £284 standard fare, to £351 for business class, and the reduction can be very wide nearer take-off, depending upon source, e.g. bucket shop, travel agents' special late offers. This gives the major airlines a larger range of discounting opportunities, and more chance of a contribution to their fixed costs. (Both examples of prices are current at time of writing and one way.)
- 2 easyJet offers no agency bookings, and passengers can only book or inquire directly via the telephone sales staff and the internet. Therefore it is essential to have an easy and quick reservation system that shuts out and opens the various pricing levels as the take-off date nears, and the booking pattern becomes clearer. Any problems or delays within the computer yield management booking system could result in:
  - a staff giving different rates
  - b lower rates than are necessary being given, and therefore loss of revenue occurring
  - c staff being able to differentiate prices as a personal choice
  - d customers receiving unequal treatment, and thus becoming dissatisfied.
- 3 A system which instils confidence in the operation for management, sales staff and customers.
- 4 This system permits the staff to achieve a high level of operator efficiency, due to certainty, accuracy and simplicity, which is important to the company, and the operators who are paid on results (bookings achieved).
- 5 The easyJet internet system is only possible with the use of a real-time yield management system. This system has proved so successful that during November 1999 it set a world record for airline bookings achieved via the net, 60 per cent of all bookings for a specific day.

How does this system vary from the traditional yield system operated by the major carriers?

- 1 The major carriers have interconnecting flights, which means that yield management can be used to maximize the income over more than one flight. The use of low-cost flights encourages use of other flights, usually more profitable ones. easyJet does not have interconnecting flights or arrangements with other carriers.

- 2 easyJet does not have cancellations, whereas the major carriers offer this opportunity, with varying complexity.
- 3 easyJet does not use travel agents, or any form of agency bookings, and this makes the reservations system easier and fully centralized.
- 4 easyJet does not operate tickets, thus making last-minute bookings easier to operate.
- 5 easyJet operates from fewer airports, has only one central reservations base and has only a limited number of destinations.

Other major differences between easyJet and the majority of other airlines include:

- 1 easyJet runs only one type of plane, the Boeing 737-500, which makes operations and reservations much simpler.
- 2 easyJet offers few onboard services, no duty-free and only limited catering service, which is outsourced.
- 3 easyJet operates without a ticket and has no actual boarding cards.
- 4 easyJet runs with very few ground handling crew, and an extremely sales-orientated central head office.
- 5 New plane purchases have been made and fit into the easyJet model, i.e. Boeing 737-500s.
- 6 No external sales offices, or airport sales offices, are operated by easyJet. It has no linked or joint sales.
- 7 Pricing is based strictly upon a revenue maximization process that matches the aims and objectives of yield management.

All these factors help the company to maintain a low variable cost, a key component in any successful yield management system, and provide an opportunity for leverage against its major competitors.

### Why do airlines pay so much attention to yield?

Airlines operate in a highly competitive market, and the low-cost operators, by the nature of this, are fiercely competitive. The environment in which they operate is one of high fixed costs, fixed capacity in the short term, a perishable product and seasonal variable demand. According to Arthur Andersen (1997), easyJet fulfils all the established criteria for the effective use of yield management. Dr Scot Hornick of Andersen Consulting has identified five 'functional aspects of yield management', as outlined below:

- 1 *Market segmentation*: an area that easyJet feels is inappropriate, only segmenting by destination and flight time.
- 2 *Price management*: systematically offering different prices to different customer segments in response to demand, the main issues for easyJet.
- 3 *Demand forecasting*: forecasting future demand on the basis of past sales and known future events. Initially easyJet has obvious problems, as past history was short and demand was increasing. It was through good

forecasting of future events that yield management was successful. Now easyJet's historic records are becoming more useful, as it is becoming more established. But, with each new route easyJet opens, problems restart.

- 4 *Availability and/or capacity management*: limiting or shifting the availability of certain products or services according to customer demand. This is the main backbone of yield management in the airline sector. The capacity in terms of seats at easyJet is fixed, and is managed by good pricing to maximize the use of the limited seat capacity to obtain the maximum sales volume and to satisfy customer demand.
- 5 *Reservation/negotiation*: in some sectors, management can achieve better yield with the management of price and availability, through the 'up-selling' of specific areas to higher more expensive products or 'cross-selling' to alternative products, so ensuring an even spread of sales. Here easyJet is restricted as it operates a single class product, and the pricing is fixed irrespective of the type or segment of customer. The price offered will be dictated by the yield management system, related to the seat availability and the closeness of take-off date.

Preconditions for yield management are:

- 1 *Perishable inventory/or seasonal demand*: seats on an aircraft are extremely perishable, for if easyJet fails to sell seats on say the 7.00 a.m. flight to Glasgow, those seats sales are lost for ever.
- 2 *High fixed costs or sunk costs*: thus resulting in a low or relatively low marginal cost of selling one extra unit. Here the cost of a Boeing 737-500 is a very high fixed cost, while easyJet's marginal cost of selling one extra seat on, for example, the 7.00 a.m. flight to Glasgow is very low.
- 3 *Fixed capacity either overall or in the short term*: easyJet operates a fixed seat capacity throughout the fleet, on all routes and flights.
- 4 *Advance purchase of service/product*: easyJet will only accept pre-booked flights.

The use of a yield management system has enabled easyJet to operate its low-price policy successfully from its conception. The main skills needed are developing a good forecasting plan and history to permit the yield system to be successfully developed. The differences between the levels of yield management within the industry are based upon the level of sophistication and actual understanding of the techniques and markets. Lack of systemization, improper use or lack of understanding of the system can lead to erroneous results and decisions. easyJet ensures successful operation through simple systematic operations, and constant modification of the system as the market continues to develop.

### Obstacles and success factors

The barriers to the use of yield management in the airline industry are few, but the level of operation and sophistication

will depend upon the complexity of the flight programmes and price structures. Table 8.4W summarizes them.

Kimes (1989a) identifies seven key techniques necessary for the success of a yield management system.

- 1 **Ability to segment:** easyJet has identified two major segments within its operations.
- 2 **Perishability of inventory:** clearly airline seats, like hotel rooms, are a highly perishable commodity.
- 3 **Product sold in advance of use:** easyJet, more than most airlines, insists on 100 per cent sales and payment in advance, and offers no in-airport sales desks.
- 4 **Fluctuation in demand:** clearly with a number of destination and a number of flights at different times per day each day of the week, the demand for the product is subject to considerable variation.
- 5 **High fixed costs:** again, the cost of a 737-500 airline is relatively high compared to the ticket price.
- 6 **Low marginal sales costs:** here easyJet has a competitive advantage over most of its competitors, having very low variable costs.
- 7 **High marginal production:** here all airlines have a high marginal production cost. If the plane is full, and an extra seat is required for a customer, they are unable simply to produce one more seat and must decline, upgrade, provide an additional plane or compensate. It is here that easyJet, which operates a full-plane policy, with no standby and no interconnecting flights that can cause problems, has a cost advantage.

Kimes (1989b) also identifies five core requirements for the operation of a yield management system.

- 1 **Booking patterns:** yield management systems require information on how the reservations are made for a specific date. It is from this information that the system tracks and creates a picture of the booking process in the future, and from the past for the future. It is through this process that easyJet is able to: (a) operate its online live reservation system, and (b) create the necessary historic bookings profiles.
- 2 **Knowledge of the demand patterns by market segments:** as stated above, easyJet has identified, and operates with, two specific flight segments.
- 3 **An overbooking policy:** most airlines operate an overbooking policy, which when it goes wrong results in upgrades and stand-down discounts. easyJet works with very tight margins, without the back-up of business or first-class upgrades to cover this situation, hence it operates to a pre-booked full-seat capacity.
- 4 **Knowledge of the effect of price changes:** the team in charge of yield management need to know how changes in price will affect their customers, their occupancy and profitability. The major airlines change prices thousands of times a day, mainly in response to competitive pressure (Kimes 1989b). Clearly this level of yield management system is sophisticated beyond the current needs of easyJet.

- 5 **A good information system:** to match all the requirements of a successful yield management system, the operator requires a great deal of accurate information. It is in this area that the company has its greatest problem, since it is very young, and therefore lacks the in-depth history of a company like British Airways. Additionally, the capturing of such data is very costly, in terms of both the methods used and staff time. This has resulted in easyJet only capturing information on actual bookings. The history on denied bookings is not recorded, an item which most writers (e.g. Orkin 1988; Kimes 1989a, 1989b; Jones and Hamilton 1992; Leiberman 1993) suggest is a prerequisite for successful yield management. However, it is an area in which the company acknowledges information is desirable, and hence this is more a question of the cost of collection and the time involved. The collection would need to be undertaken by sales staff, whose job is designed to be as time efficient as possible to help to maximize both the company's and the employees' income.

### **How does this system fit in with senior management plans?**

Clearly easyJet is focusing on Michael Porter's (1985) low-cost strategy, and its version of yield management helps it along this path. However, without top management commitment the process would fail. To this end, one person, the revenue manager, has full responsibility for the development and management of the system. The system is designed to be user friendly, very simple in operation and adaptable to any changes brought about by internal or external factors.

### **Conclusion**

Theoretically yield management as a management tool in the airline industry has an enormous potential to increase the financial performance of the airline. Sir Colin Marshall (1992) attributed BA's success to cost cutting and sophisticated yield management. However, for a newcomer and a low-price airline, it is not going to be easy. However, easyJet has created a successful system within a short time. It first flew in November 1995, and has seen its market share grow from 0 per cent in June 1996 to 29 per cent by December 1997 on the UK-Nice market (Nice Airport 1997). There are many lessons that companies, not just in the airline sector, can learn from easyJet's dedication and belief in the systems, which were necessary if it was to become truly successful. The findings presented here show how with determination and belief companies operating in a number of sectors could create and use a yield management system, suited to their specific needs to help create more successful operations. The system developed by easyJet perhaps has more in common with some hotel operations than many of its airline competitors, and certainly a number of them could learn from the easyJet experience. As Porter (1985) has pointed out, success comes from innovative products and service, often introduced by a competitor new to the industry.

Source: Ingold, A., Yeoman, I. and Leask, A. (2000) *Yield Management: Strategies for the Service Industries*. London: Thomson Learning, pp. 198–210.

### References

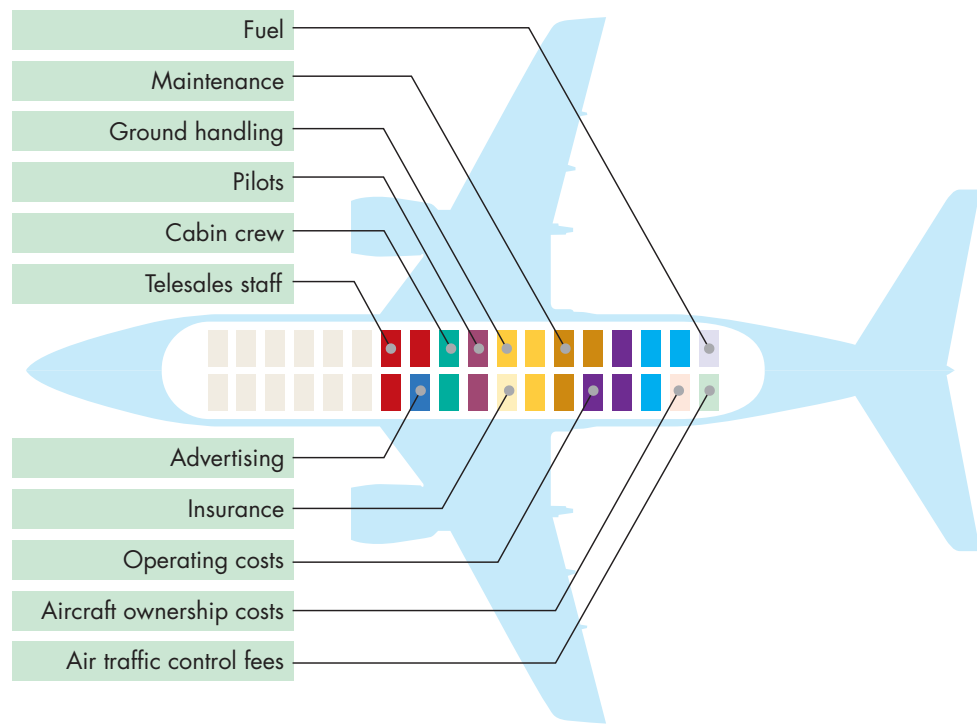
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**TABLE 8.4W** Barriers to yield management

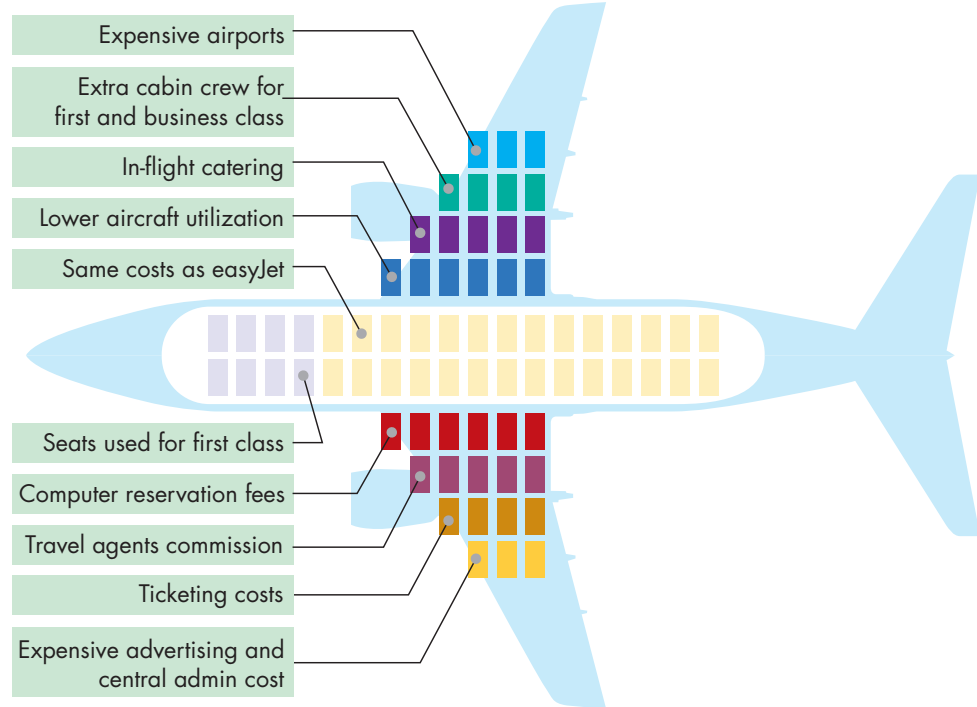
| Business-internal<br>(Features of the business itself which interfere with yield management)                   |  | Environmental<br>(Features of the environment in which the business operates)                               |  |
|--|--|---|--|
| Attitudinal<br>(Features of business philosophy, attitudes towards pricing, understanding of yield management) | Operational<br>(Aspects of the way a business operates)        | Infrastructural<br>(Factors in the business environment which impede the effectiveness of yield management) | Regulatory<br>(Governmental restrictions on a business's ability to practice yield management) |
| No awareness of YM.  | Cost of technology.  | Insufficient supporting infrastructure.   | Governmental price restrictions.   |
| Insufficient management skills; incompatible business philosophy.  | Dependence on contract business with fixed prices.             | Appropriate off-the shelf computer YM technology not readily available.                                     |  |
| Resistance to formalizing information.   | Insufficient information.<br><br>High staff turnover.          | Rigid seasonality of demand.  |  |
| Negative misperceptions or scepticism towards YM.  | Undifferentiated commodity product.                            |   |  |
| No clear profit motive.<br><i>As applied to easyJet</i>  | Capacity too small.  |   |  |
| Clearly fully aware.   | Developed own technology; cost low compared to start-up costs. | New operation real issue.   | High risk of governmental restrictions removed, thus opening way for easyJet type operations.  |
| Management skills acquired.  |  | High cost, so developed own model.  |  |
| New organization and staff, so no problems.  | Lack of information a clear early problem.                     |   |  |
| Very clear profit and financial incentives.  | Staff new, constant training, ease of operations.              |   |  |

Source: Arthur Andersen (1997)

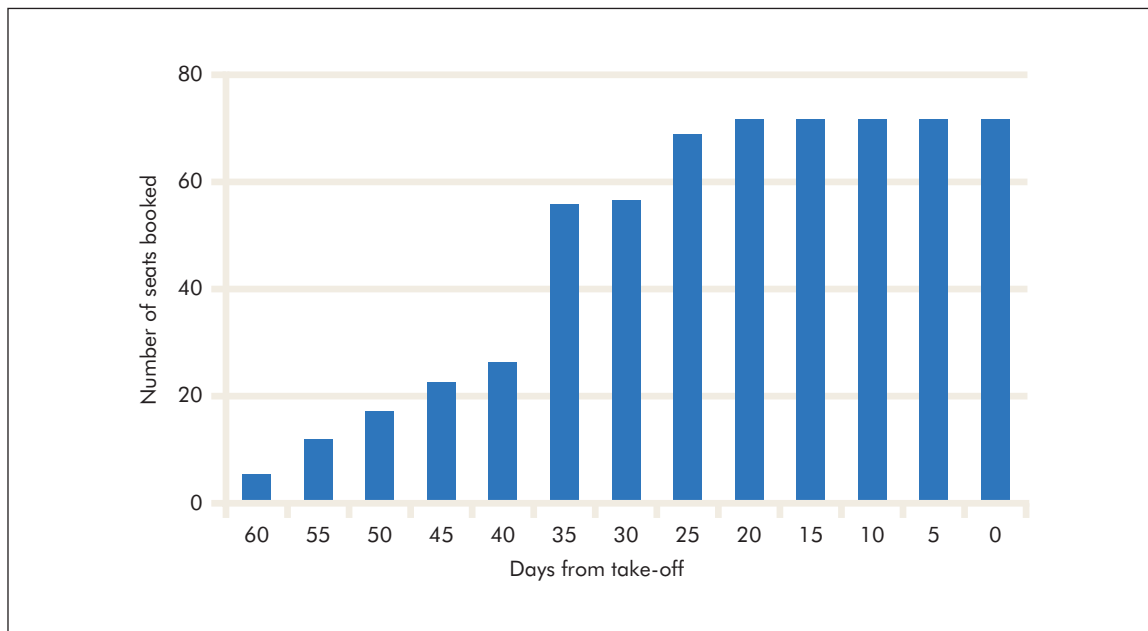
The costing of running a budget airline – based on easyJet



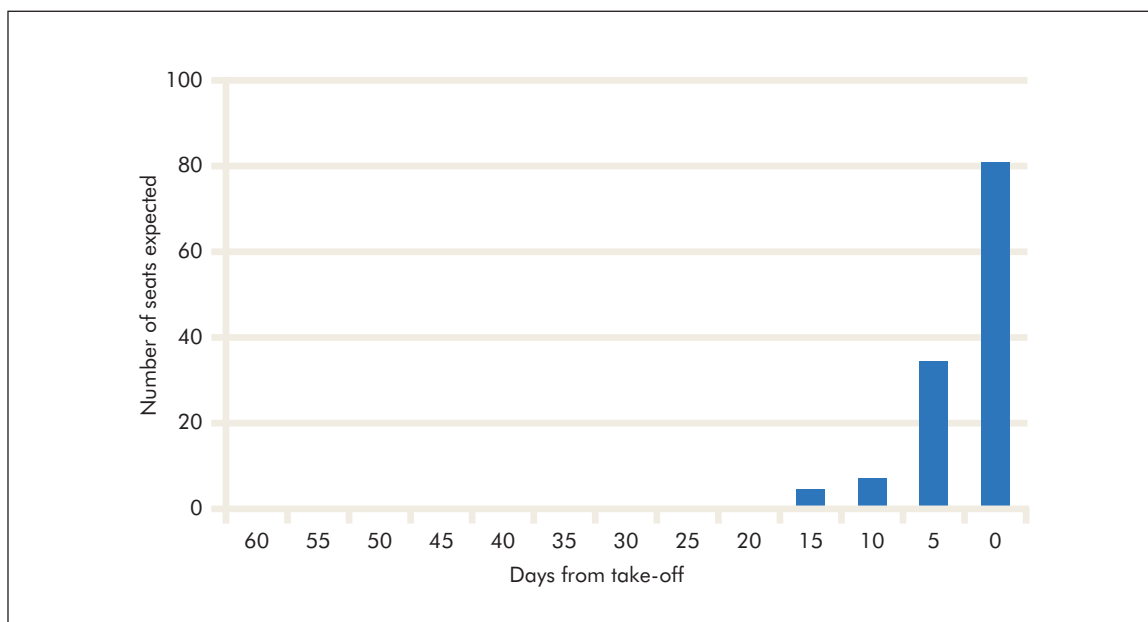
Inter-continental airline costs



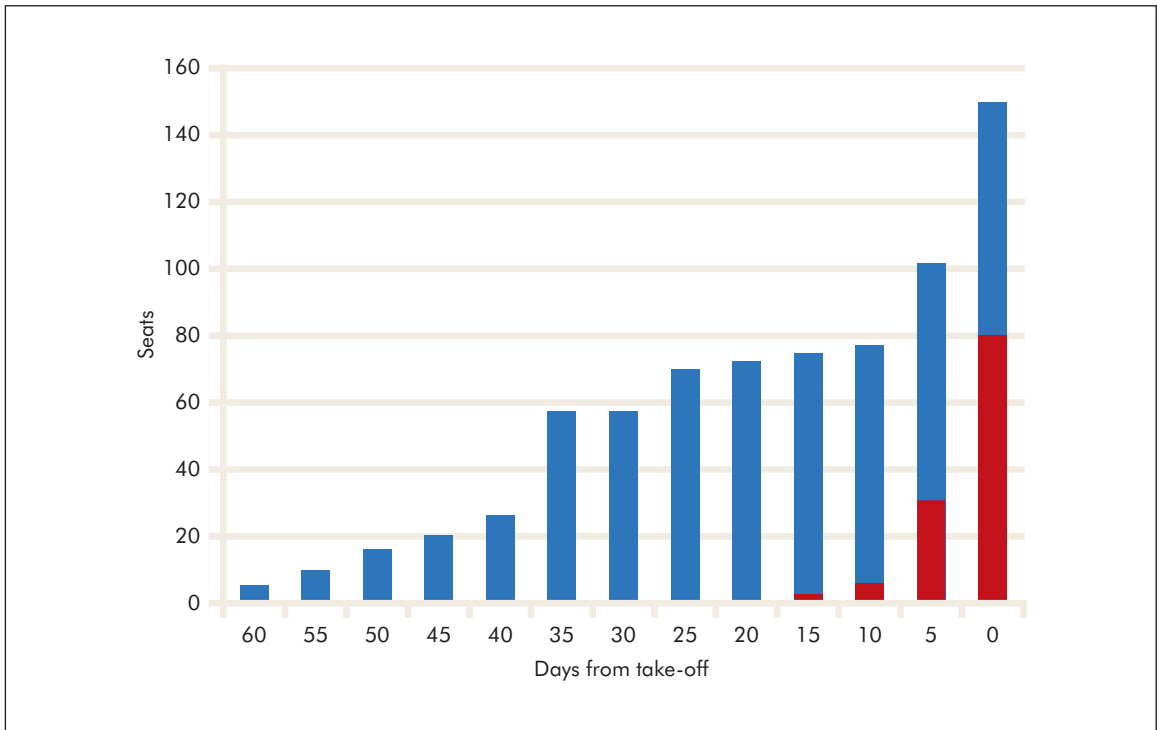
**FIGURE 8.1W** Intercontinental airline costs



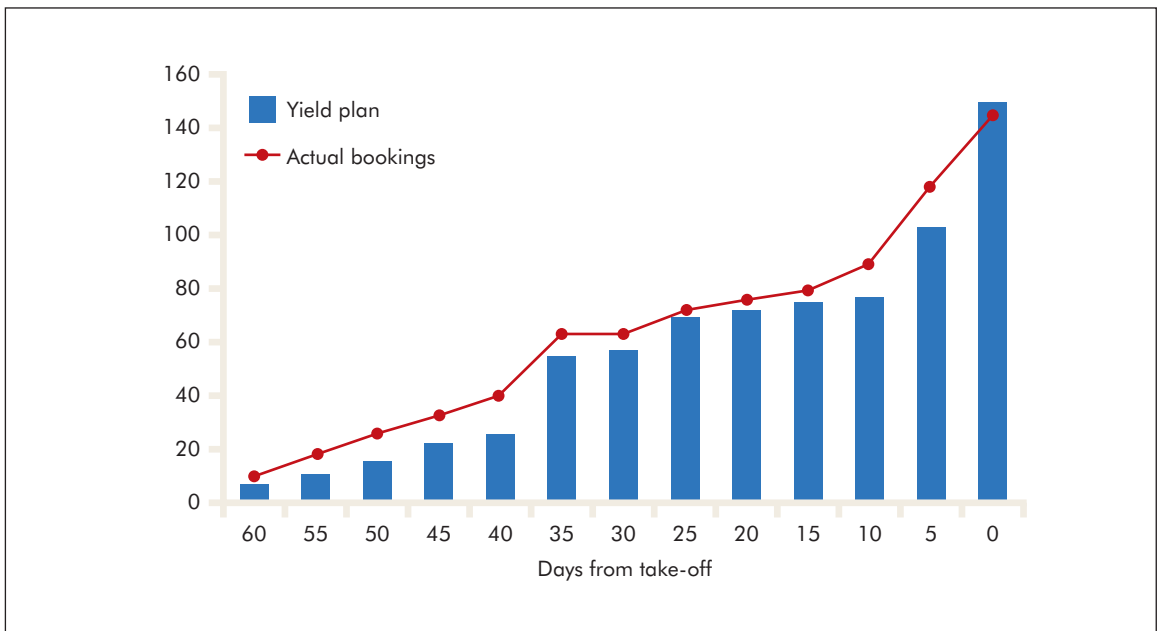
**FIGURE 8.2W** Airline booking patterns – leisure segments



**FIGURE 8.3W** Airline booking pattern – business segment

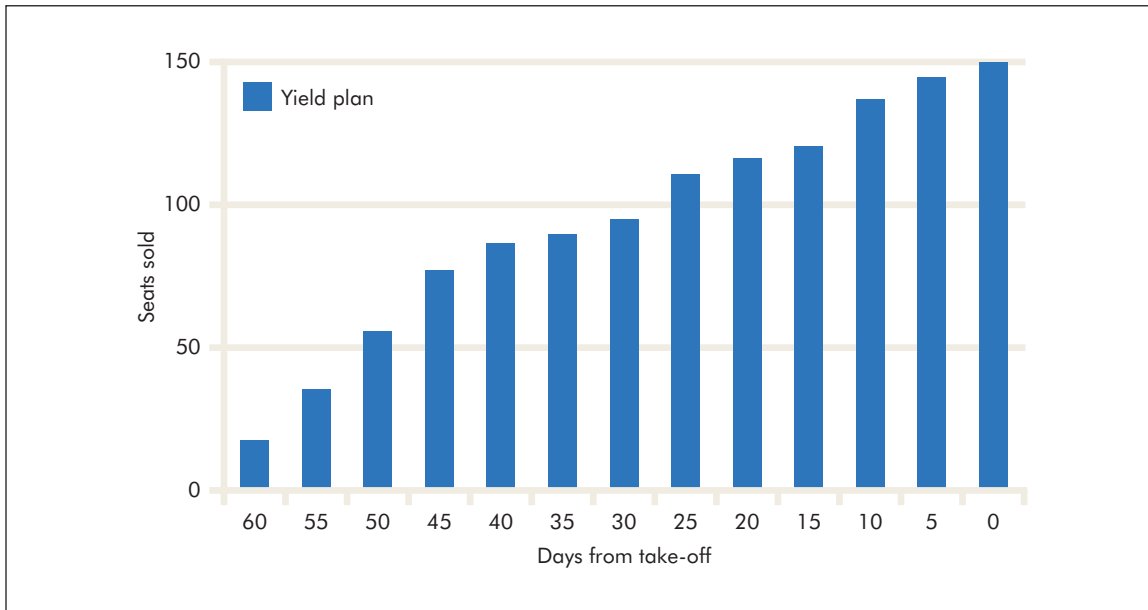


**FIGURE 8.4W** Combined booking pattern (date, time, destination)

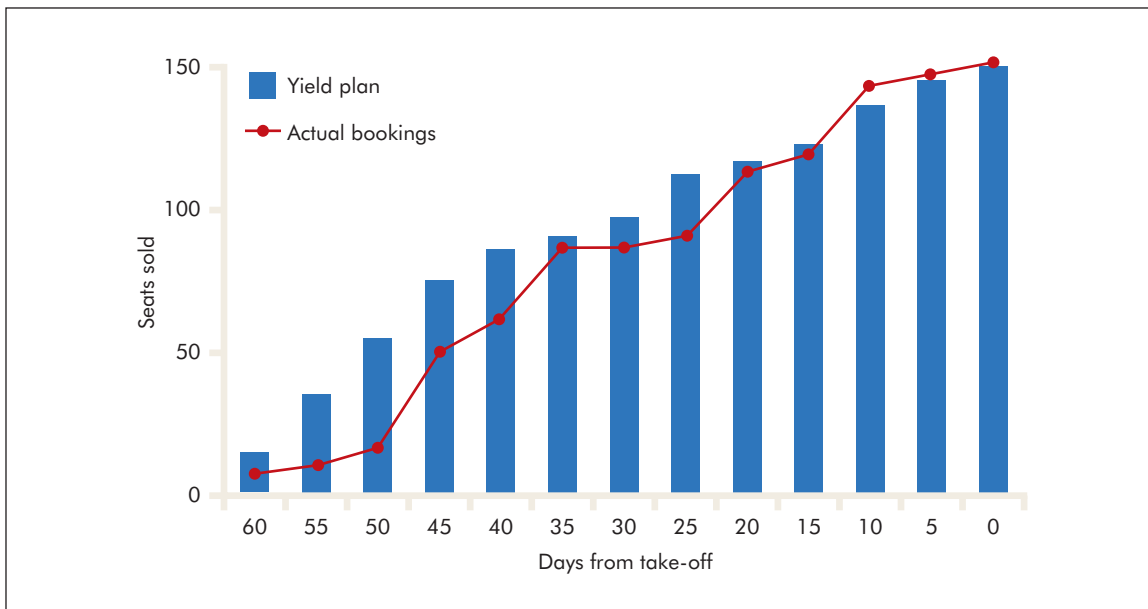


**FIGURE 8.5W** Booking plan showing yield forecast and actual (date, time, destination)

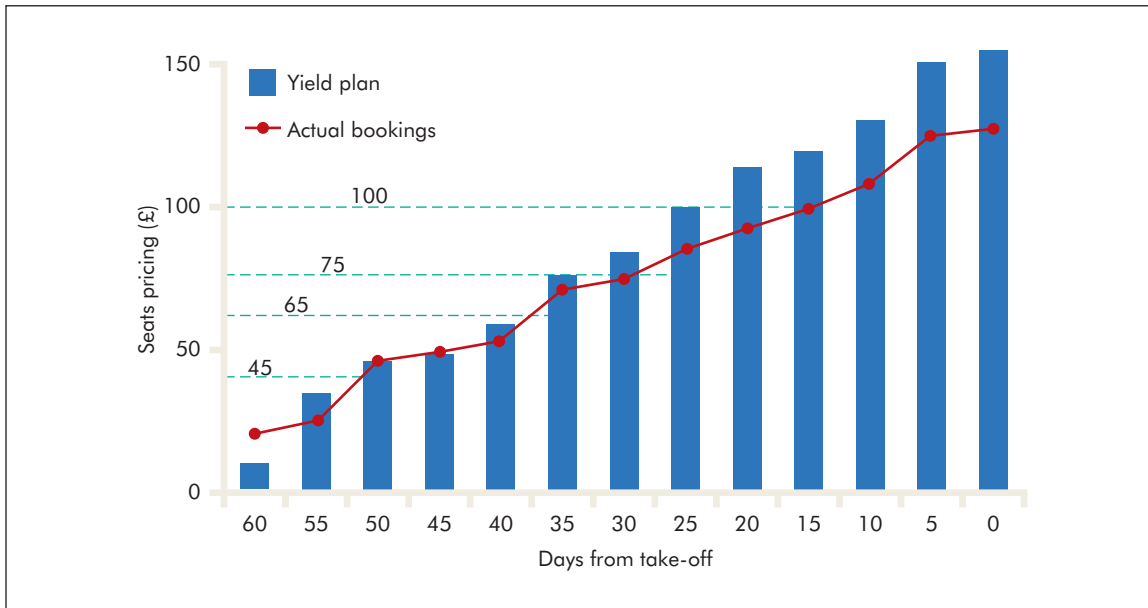




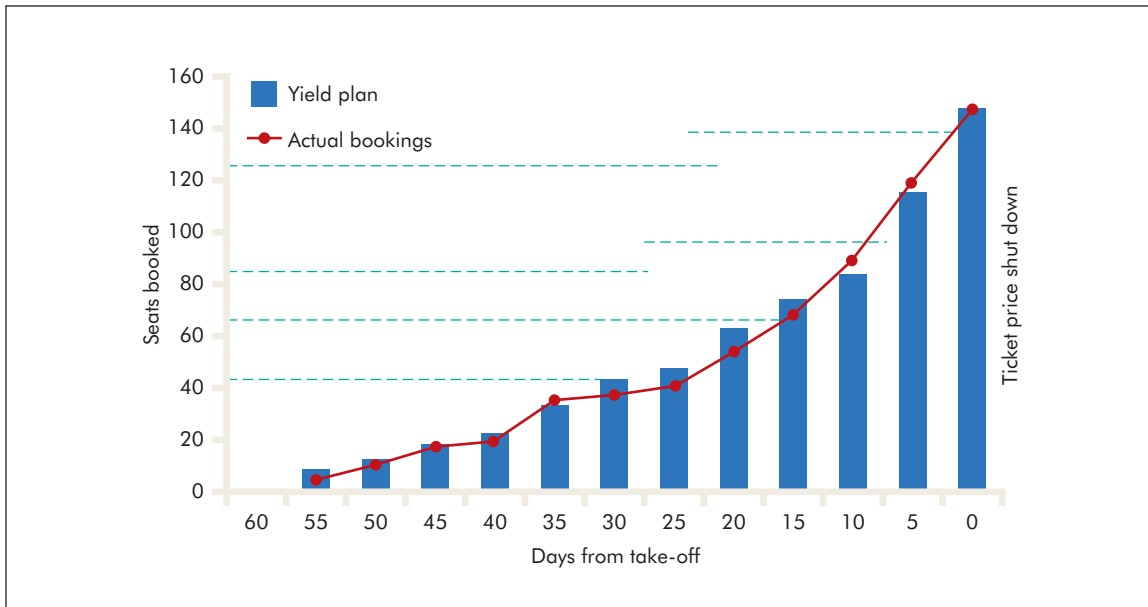
**FIGURE 8.6W** Yield plan for non-business destination



**FIGURE 8.7W** Actual booking chart – non-business destination (date, time, destination)



**FIGURE 8.8W** Yield pattern of actual bookings received and sales bookout price levels



**FIGURE 8.9W** Booking pattern for late demand