Fare Basics Part 1– How Airlines determine what fare to charge on a flight (and how can you properly compare them)

This will be covered in two parts – the first dealing with Factors affecting pricing and the second dealing with Revenue Management – Fare classes, restrictions, overbooking etc.

First, let's start with the factors that determine ticket pricing. There are several of these – each with a varying level of importance depending on where you are. The main ones are as below:

Cost of Operations – At the most basic level, an airline needs to cover its costs (and hopefully thereafter make a profit.) So before any other considerations, an airline will price its tickets to cover the cost of operating the flight.
Sometimes there are unique elements that make travel to one place more expensive than to another, even if they are a similar distance apart. An example might be fuel price or airport taxes – one location might have a significantly higher fuel prices or airport taxes than another and the airline will need to factor that into their pricing. Another example might be the Alternate airport. On all flights the airline plans for a contingency where they might have to divert to an

alternative airport – e.g. if there is an issue with the destination airport. The plane will carry sufficient fuel to get to their destination plus an amount to get them to their alternate. If the only available alternate is very far away, then the airline must carry even more fuel than it would on another route. More fuel is more weight, more weight costs more money. SIDE NOTE: On all pricing the Airline has to factor in its indirect operating costs, i.e. it's overheads, costs of financing and the cost of ownership of the aircraft.

Route Product – Does the airline offer a direct flight or are there connections / stops to be made? The general preference for many travellers is to have a direct flight (as it always takes the shortest travel time) so airlines will charge a premium for it. What airport are you landing in? For example, you may fly from Nairobi to London, but there are six international airports in the London Metropolitan area (Heathrow, Gatwick, Stansted, Luton, City and Southend) each with varying desirability. Heathrow is the busiest and has the most connections so a premium might be charged for flights into Heathrow as opposed to say, Stansted.

Time of Day – This is another determinant of the ticket pricing but it's less straightforward in how it affects the price. It often depends on the type of traveller being targeted. Whereas Business Travellers tend to prefer night flights so they can maximise their daytime working hours, a VFR passenger – Visiting Friends and Relatives – might not be bothered about whether they travel at night or during the day. Another aspect of Time of day is convenience of Departure or Arrival Time. E.g. a flight that lands at a final destination at 2am will likely be less desirable than one that gets there at 7am and the airline might have to price lower in the first case to entice passengers. SIDE NOTE: In some cases, the airline might have little choice in the time of day it flies into a particular airport. The busiest airports have strict restrictions on take off and landing slots and the airlines do not have the option to deviate. Heathrow is a perfect example.

Day of Week – Like Time of Day, day of the week pricing is dependent on the traveller being targeted. E.g. on the Nairobi to Ukunda (South Coast of Kenya) route, most of the travel is leisure. Tickets for travel to Ukunda on Tuesday will likely be cheaper than tickets on Friday due to the number of travellers going on a weekend getaway.

Season – This one is more self explanatory, in certain seasons more travel is expected to certain destinations and so a premium is charged. For example travel to Mombasa or Kisumu from Nairobi on the 23rd/24th of December is going to be more expensive than travelling on the 26th/27th.

Competition – This may be the biggest determinant of price and it comes with the most different ways of affecting price. Actually, in many ways it encompasses aspects of all of the other factors. Does the airline have competition on the route? Naturally a premium will be charged if there is no competition. If there is competition, how does their route product compare? How about their timing? On what day of the week do they travel? Do they only travel seasonally? (Like charter operators)

In reality all of these factors will apply in varying degrees on a route by route basis. The airline must come up with a pricing strategy that balances all of the different factors while still trying to remain profitable. On some routes – when there’s a strategic benefit – the airline may have to accept losses when they can’t overcome the factors that drive their prices down. In such situations they hope that they can make more money on the other routes to compensate.

With all of this to consider, the airline must be smart about how it manages its revenues as there are many ways in which it can lose revenue or not get the right mix between the profitable and non-profitable routes. These will be explored in the second part of this lesson.

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