



Airlines Flex Pricing Power With Fare Hikes

By Jay Boehmer

AUGUST 14, 2006 -- With capacity and demand on their side, domestic carriers have pushed through a series of fare increases this year—with two in the past three weeks alone. In addition to published fares that have grown by double-digit percentages in the past year, buyers face resistance among carriers on striking contracts that mitigate the increases.

United Airlines led the most recent, spurring other legacy carriers to match the \$5 to \$10 increases on one-way fares.

"The increase was more orientated towards business fares," Calyon Securities analyst Ray Neidl said in a research note, adding that JetBlue in certain markets matched, yet other low-cost carriers did not. Prior to that, Delta in late July initiated a \$5 increase on most domestic one-way fares and other carriers since have chimed in. Delta said the increase is to offset surging fuel costs.

Citing data from the first week in August, Harrell Associates airfare consultant Bob Harrell last week said, "Both leisure and business were up double digits. Business fares were up year over year 19 percent and have been up quite a bit more during most of the second quarter."

Since the beginning of the year, fares have been growing. The Department of Transportation's Bureau of Transportation Statistics late last month released its Air Travel Price Index, showing fares rose 10.3 percent in the first quarter of 2006 from the same period last year, representing the largest year-over-year increase since the index began in 1995. The rising-fare trend continued through the second quarter as domestic carriers pointed to higher yields as a factor to posting quarterly profits ([BTN, July 31](#)).

With the busy summer travel season nearing its end, Calyon Securities' Neidl offered some short-term comfort for buyers who have faced steadily increasing fares throughout the year. "There may now be a lull in future fare increases for the short-term as carriers evaluate demand post-Labor Day as we head into a shoulder season for travel," he said. "However, as long as demand stays strong, load factors will remain high, leaving room for eventual, additional fare increases, in our opinion. Needless to say, this would be an industry positive."

"Just recently, there was wide fare sale announced for fall travel," said American Express Advisory Services senior practice manager for air Mitch Cwanger, "but they were all geared toward advance purchase, leisure-type fares. The business fares, which the majority of our clients are buying, continue to see increases. When the summer travel season comes to a close in a couple of weeks, you'll see some reductions in fares, but it won't be long-term because the airlines can't sustain the profitability that they saw in the second quarter with fuel prices the way they are."

Airlines contend that fare increases have not completely mitigated fuel costs. While he couldn't comment on pricing specifically, John Caldwell, Northwest Airlines managing director of corporate and agency sales, said, "We'd love to pass on all our costs of doing business as other industries do, but it's so competitive, it's difficult to add a surcharge or raise a fare."

Average domestic airfares beginning early last year have inched upward each quarter and represent the highest year-over-year growth in the past five years, yet averages to date still fall well below those charged earlier this decade. BCD Travel in a benchmarking study of 181 clients showed that average domestic ticket price is tracking 8 percent below levels in 2001. "However, the 2006 average airfare has started an upward trend and is expected to continue to rise as fuel costs impact profitability of major carriers and low-cost carriers alike," the survey notes. As such, BCD said high passenger traffic, tight capacity and a rising fare market could push fares at or above 2001 levels.

Bob Brindley, vice president of BCD Travel Consulting, said, "Corporate buyers are going to have to get more assertive over the next two years to realize any air program savings. Expect to see airfares rise as much as 6 percent to 10 percent this year—a trend that will continue for the remainder of 2006 and 2007."

The same pricing environment that allowed carriers to push through broad-based fare increases throughout the year is allowing domestic airlines to further pressure corporate travel buyers and be more selective about whom they contact.

Procurement consultants with BCD Travel and American Express said carriers have been much more aggressive on corporate contracting. Cwanger said carriers favor high-volume, high-yielding companies with a demonstrated ability to deliver on contracted promises and move marketshare. "Their seats are full, so their thinking is, 'Why should we give a discount to a company that's not going to support us?'" he said. "They have a degree of pricing power that they have not had since 2001, or even before that, and they have better tools in their back pocket as far as measuring how companies are doing."

BCD noted, "Corporate air program performance review has been targeted as a savings item for further cost control by carriers. Survey respondents continue to report cancellations of contract discounts due to lack of volume performance or the inability to meet marketshare requirements."

Brindley noted that carriers are scaling back some discounts and canceling contracts they deem to be underperforming.

Perhaps no major carrier has exhibited this more than US Airways ([BTN, May 15](#)). While one corporate travel airline analyst said US Airways has reduced the number of negotiated contracts by the thousands, US Airways asserted it is not adopting the model of some low-cost carriers that foregoes corporate negotiations.

Bank of America travel manager Elizabeth Caligiuri Sullivan, at last month's National Business Travel Association conference in Chicago, said, "Airlines have gotten much stricter in recent years."

When asked if volume or marketshare is more important to carriers, Brindley said, "It's both." Sullivan added, "It's about yield as well. The airlines work with you if you're a high-yielding customer."

"Airline pricing is all about supply and demand. It's not about costs or miles flown," said Continental director of national sales Kelly Hart.

"There are no economies of scale in corporate programs," Hart said. "It's not like buying office furniture. It's like you're buying 2,000 chairs on separate days, each with an individual invoice and then say, 'I want them all to be different colors.'"



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