

# Straight and Level: Practical Airline Economics

by Stephen Holloway

This book is made up of 4 parts. Due to the size of the book and interesting contents, I've decided to write the report in two parts. This section will cover Parts 1 and 2 of the Book.

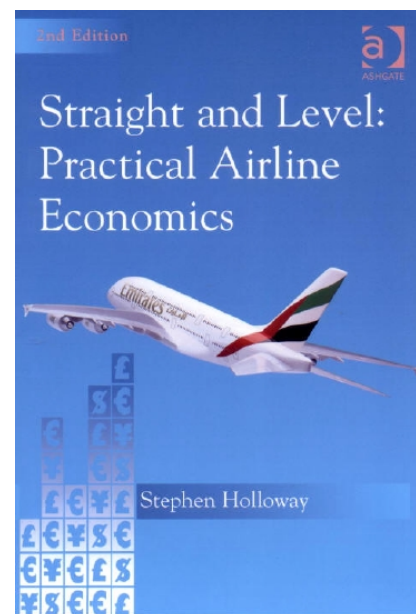
By Floris Boesveldt

Part 1, named Strategic Context, consists of only one chapter: *Economics and Strategy*. This first chapter outlines the strategic context in which costs are incurred and revenues are generated. But first, it starts with a general introduction and a description of economic science; alternative perspectives on the nature of organizations; the external environment; organizational objectives and so on. Then, the field of strategy is discussed. Holloway points out three fundamental issues: the boundaries of the firm ( i.e vertical scopes and horizontal scopes); the strategic position a company will occupy within its markets, together with the available resources; and, most importantly, the design of the organization, because it affects the implementation of the firm's strategies. These issues give the reader a good basic understanding of the strategy issues, that today's companies are dealing with. What I also like about the book, is that those issues are illustrated by actual examples from struggling airliners, as the focus of the book is on the air transport business. The next section of chapter one elaborates further on the second issue, which was positioning and resources, while it provides good background information for the discussion on industry economics that follows in parts 2 and 3 of the book.

Holloway discusses the concepts of customer value, along with some good examples of low-cost carriers and backs them up with customer-perceived value curves. Cost advantages and benefit advantages are discussed as well and, of course, Porter's Value Chain comes along. A chosen strategic position should be supported by an appropriate underlying resource profile and organizational structure (value chain). Together, these create the foundations for a competitive strategy, built on either cost advantages or benefit advantages, or both. And this link is worked out further in part 2 of the book: Operating Performance Drivers.

Part 2 of the book is structured around a model of performance at the operating level:  
 $TRAFFIC * YIELD > < OUTPUT * UNIT COST = OPERATING PERFORMANCE$  (i.e. PROFIT or LOSS)

Chapters 2 – 5 are about traffic, yield, output and cost respectively. These chapters build on chapter 1 by stressing the need for a focused, customer-oriented strategic framework, in which these critical variables are managed. Chapter 2 makes a distinction between demand and traffic. Demand is the quantity of a product that customers are willing and are able to purchase at a particular



price over a defined period of time. Traffic is the part of demand for air transport services, that has been satisfied by carrying passengers and cargo; it is different from demand that has not been satisfied. In the next section, Holloway looks at the particular characteristics of demand for air transport services and demand fluctuations in combination of pricing and capacity allocation. Demand functions and schedules, elasticity and modeling are being considered within the context of demand forecasting. At the end of the chapter, the importance of demand management to wider capacity management efforts in the short run, is stressed.

Demand is, of course, served by delivering a package to customers, that provides them with a range of benefits. Each package is part of a service-price offer. The downside of that offer – price – is the subject of chapter 3, which is called yield. Yield is revenues earned per RPM (revenue passenger-mile) or RPK (revenue passenger-kilometer, a measure of sold output) and is the element of the operating performance model, which this chapter will eventually focus on. But it begins with the discussion of price in the context of the airline industry by introducing different types of tariff structures for passengers and cargo and which elements influence them. Again, Holloway uses actual examples, which make the theory less

abstract. After this section, the question “What drives pricing?” is answered; cost, monopoly power and customer value are discussed. Next comes a very interesting part, entitled Tactical Pricing. The applications of introducing a fare change and responding to competitors’ pricing are among the topics of this section. Last but not least, the concept of yield is defined, describing recent yield trends and factors influencing yield – again, supported by actual examples.

Supply of output is the third – of four – elements in the operating performance model. That model is at the core of part 2 of the book and is also the title of chapter 4. That chapter begins with defining supply and looks briefly at supply economics. Hollloway also gives a good summary of the supply side characteristics of the airline industry, which are framed with reference to the passenger side of the industry, but can be extended to freight output. Holloway continues with discussing market structure, segmentation and competition policy. A good example of constraints, imposed by government policy and market entry, is discussed. Finally, a more operational perspective is presented, as in this section operating strategy, operations management and

capacity management (e.a. fleet management) are briefly discussed.

The last chapter of Part 2, chapter 5, discusses unit costs. Unit cost is the total operating cost divided by output. This chapter opens with a look at different definitions of cost and approaches to the accounting of costs. Holloway continues with a section of airline cost classification, concerning operating and non-operating costs, direct and indirect costs. The book continues with a good and brief review of the most significant cost drivers to airlines, but this section is less exiting to read in my opinion. The last section of the chapter discusses cost management. Costs are ‘escapable’ at each level, to the extent that they can be avoided by taking an alternative decision, but it all comes down to managing cost drivers. Holloway states, that cost management is not an easy task. The essence of cost management, however, is to ensure that customers get what they want and what they are prepared to pay for. Airlines thus spend as little as possible to provide them just that, at a level consistent with specified quality standards. In my opinion, that is a very crucial point. Considered in this way, cost

management can be a formidable competitive weapon.

#### **About the Author**

Stephen Holloway is a consultant to the air transport industry, specialized in both strategic and financial management. He has worked at a senior level in merchant banking, is a qualified pilot, and holds graduate degrees from Cranfield University, the University of Southern California and the London School of Economics. He’s also author of several other books.

#### **About the Reviewer**

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