

1955

Shifting Fixed Costs in a Scheme of Promotional Fares

John P. Carter

Follow this and additional works at: <https://scholar.smu.edu/jalc>

Recommended Citation

John P. Carter, *Shifting Fixed Costs in a Scheme of Promotional Fares*, 22 J. AIR L. & COM. 283 (1955)
<https://scholar.smu.edu/jalc/vol22/iss3/3>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Journal of Air Law and Commerce by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

SHIFTING FIXED COSTS IN A SCHEME OF PROMOTIONAL FARES

BY JOHN P. CARTER

Associate Professor of Business Administration, University of California; A.B. Columbia; Ph.D. University of California.

EUROPEAN railways offer a great variety of concessions in their passenger fare structure. Some, such as excursion, commutation, school, military, and multiple ride tickets, are well known in this country. Others, such as fare concessions to parents with several children, are relatively recent innovations on this side of the Atlantic, and are often subject to numerous restrictions.

Still others, such as the regional or general *abonnement*, and the half fare *abonnement*, have had only very limited, if any, use in the United States. Such concessions, especially the latter, may offer possibilities for adaptation to air line use.

The general *abonnement* is a ticket which permits unlimited travel in the geographical area and during the time period stated. The area may range from only a pair of adjacent stations to the entire nation; the time period, from four days to a year. Because of the relatively long distances involved even in local air travel, the general *abonnement* may have only limited adaptability to air conditions. Even so, possibly some local service lines might find it worth consideration.

The general *abonnement* is essentially a technique for making transportation during the time period a fixed cost to the consumer. That may be compared with the calculations of an automobile owner. The automobile owner finds himself essentially faced with two kinds of cost: the costs of ownership and the costs of use. While there is some blending, the former are fixed in any one time period, and include obsolescence and insurance, and the latter vary with use and include gas, oil, lubrication, and tires. The ownership costs are substantial, and may often exceed the use costs. The result is to encourage the use of the automobile, since the additional costs of use per mile are less than average total costs per mile. The local service air line, whose principal competitor is often the passenger auto, is handicapped, because its uniform fares represent some attempt, however rough, to cover average total costs. Thus the incremental cost of any particular trip is likely to be less by automobile than by common carrier.

The general *abonnement* goes all the way in the other direction, making common carrier transportation during the validity of the ticket a fixed cost to the traveler. In European railway practice, the tickets are nominative and carry the photograph of the buyer. In Switzerland for a supplement of a third, the ticket may be made good for alternative use by two persons. That feature can be persuasive to commercial firms, especially for providing transportation for their salesmen.

But air travel is relatively expensive, per minute, and to guard against the enthusiast, who might want to spend every waking, and even sleeping, moment in the plane, the general *abonnement* price in this country might have to be discouragingly high. The half fare *abonnement* offers an intermediate solution, the exploration of which by our airlines might be fruitful.

The half fare *abonnement* is the European name for an identification card, sold for a substantial fee, which gives the purchaser the right to buy tickets at a reduction from the ordinary fare. In France and Switzerland the reduction is ordinarily 50%; in Italy only 40%. As with the general *abonnement*, half fare *abonnements* may be sold limited to fixed pairs of stations, or to regions, or to the entire nation. For example, in Switzerland, the half fare *abonnement* is sold for 65 francs for three months, and 200 francs for a year. The owner of the card may then buy at half fare one way or round trip tickets in the class of his choice anywhere in the country. The fare structure of the Swiss Federal railways is a tapered distance scale, with a basic rate of progression for the initial 155 kilometers (10.3 centimes per kilometer in third class), and lower rates for longer journeys (6.2 centimes per kilometer for the next 45 kilometers, and 4.2 centimes per kilometer for the distance beyond 200 kilometers). First, second, and third class fares are in the ratio 200: 140: 100. Round trip and circle trip fares are 150% of the one way fares. A different and usually higher fare structure often applies on the "private" railways, but the half fare *abonnement* also permits the purchase of half fare tickets on those lines.

Continuing the example, it is 289 kilometers between Geneva and Zürich, two major Swiss cities. The round trip fares are 33.80 francs in third class; 47.30 francs in second; and 67.60 francs in first. Thus the passenger who makes four round trips third class over that run (or equivalents) in three months would find it just worthwhile to buy a half fare *abonnement*, while the first class traveler would be on the margin if he went twice in the quarter. In either case, buying ordinary round trip tickets would cost 134.40 francs, but a half fare *abonnement* and half fare tickets would total only 132.60 francs. Thus half fare *abonnements* permit the traveler to make a calculation similar to that with his automobile. But to the carrier their big advantage is that, once he has bought the ticket (or car) and committed himself to a substantial expenditure independent of use, he is encouraged to expand his travel.

Of course, to the airline already operating at capacity, promotional fares are of no interest, at least not immediately. The purpose of promotional fares is to increase total revenue, and to increase it in such a way that expenses increase by a lesser amount. Net income, obviously, is thus improved. The conditions for such fares may exist, for example, at the ends of lines radiating from large cities. The plane may be fully utilized leaving the metropolis, and develop an increasing number of empty seats toward the end of the run. A "break of gauge,"

with the awkward and time-consuming transfer of passengers and cargo to a smaller aircraft, is not always feasible. Such a situation is ideal for the introduction of a promotional fare. The difficulty with many forms of promotional fares is that they tend to spread and to break down the structure in areas where no reduction is necessary. The half rate *abonnement* is not wholly without that disadvantage, but in addition to the possibility of geographical limitation it is limited personally to those who are regular customers (or pay as if they were).

Of course, if the passenger calculates correctly, he will not buy the half rate *abonnement* unless his unit transport costs are reduced: thus the carrier must expect a reduction of average revenue per passenger mile. Nevertheless, once the passenger has a half fare *abonnement* in hand, the fares to him appear proportionately reduced, and his travel is likely to increase.

Management necessarily faces a difficult problem in setting the price of the half fare *abonnement*. European railways apply varying formulas, so that the *abonnement* may become a worthwhile purchase for some who exceed 700 miles a year, while in other circumstances 3,000 miles or more a year may be necessary before the ticket becomes interesting. Much depends on the alternatives available to the traveler, and each country offers so many concessions in different forms that the optimum depends on the individual case. In the American context, any such experiments might well begin by setting the price of the *abonnement* somewhat higher than do the Europeans, since even the upper figure does not represent much travel either by American standards of mobility or in flying time.

To the air line, whose costs are usually more or less equally divided between those directly related to flying and ground and indirect costs, the half fare *abonnement* offers the promise of at least covering direct flying costs each time the passenger buys a flight ticket. The lump sum which he has paid in advance means that he is willing, at least for a limited time, to assume some fixed costs himself.

These are pricing techniques which air line management might profitably study. They are flexible, and adaptable to particular route segments and time periods. The great problem is to offer concessions to those whose demand for air transport is price elastic, thus expanding gross revenue from that part of the market, without reducing fares to those whose demand is inelastic. But there may be route segments, routes, or even whole companies where a half price *abonnement* might improve gross revenues without requiring higher costs.

The half fare *abonnement* represents a form of personal discrimination; it is difficult to know in advance whether it would meet with CAB approval. However, the *abonnement* could be purchased by anyone, while family plan fares, which seem by now to have obtained full acceptance, involve much greater discrimination. Yet for a bachelor to obtain family plan fares requires much more drastic steps on his part than the mere outlay of the fixed sum required for the purchase of a half fare *abonnement*.