

Application 07: The Pricing Policy of Airlines

The concept of elasticity and the pricing policy of the airline industry

For example, business travelers have an inelastic demand for air travel, so an increase in business fares tends to raise revenue. By contrast, leisure travelers have much more elastic demand for air travel, because they have much more choice about where and when they are travelling. As a result, raising leisure fares tends to decrease revenue.

Example: Fly the financial skies of “Elasticity Air”

Understanding the demand elasticities of their passengers’ travel is worth billions of dollars each year to U.S. airlines. Ideally, airlines would like to charge the highest price they can to business travelers, while charging a low-enough price for leisure passengers to fill up all their empty seats. That is how they would maximize revenue and profits.

But if they charge low-elasticity business travelers one price and high-elasticity leisure passengers a lower price, the airlines have a big problem – keeping the two classes of passengers separate. How can they stop the low-elasticity business travelers from buying up the cheap tickets meant for the leisure traveler, while not letting high-elasticity leisure flyers take up seats that businesspeople would have been willing to use? The airlines have solved their problem with amazingly complicated schemes for pricing tickets. Many discount tickets, for example, require a stay over Saturday night, which is designed to discourage business travelers who would like to get home for the weekend. On the other hand, on any flight the number of available discount seats is strictly controlled by sophisticated computer programs. That is why many people have had the frustrating experience of finding out that an advertised cheap fare has sold out.

Source: Samuelson, Paul A.; Nordhaus, William D.: Economics, 15th edition, McGraw-Hill, 1995, pp. 62 – 63.

Exercise:

Your enterprise organizes a 3-day conference in Chicago in late February / early March 2023. Many important suppliers of your company will attend this meeting that will take place from Tuesday to Thursday of that week (Feb 28 – March 2, 2023).

As you will be working in your company’s purchasing department during your first practical training, your boss thinks it would be worthwhile for you to participate in this seminar. However, she insists that you will be back in time for the start of the second theoretical semester at the DHBW in Bad Mergentheim on the following Monday.

Conduct an online search:

Find an inexpensive, non-stop return flight from Frankfurt/Main to Chicago and back to Frankfurt/Main – leaving Frankfurt on Monday (Feb 27) and departing from Chicago on Friday (March 3). 862 [niedrigere Elastizität --> nachfrage bleibt bei erhöhungen ungefähr gleich](#)
Compare your result to a flight also leaving Frankfurt on Monday (Feb 27) but departing from Chicago on Sunday (March 5) i.e. taking you back to Frankfurt/Main on Monday of the following week i.e. March 6, 2023 (but that you cannot choose because you would miss the first day of lectures). 500