

Variety Is the Price of Flight

Airlines typically sell tickets at a variety of fares, as we saw at the beginning of the chapter with regard to United Airlines Flight 815. Third-degree price discrimination is one of the strategies airlines use to fill the plane with travelers in the most profitable way. Airlines often charge different prices for seats in the same class of service, such as coach class, even though the marginal cost of serving a passenger is about the same for all coach passengers. The reason is that different customers are willing to pay different amounts for tickets. For example, people traveling on vacation often can book their tickets weeks or months in advance of the flight, and they are willing to shop around for the best price. They may even choose their destinations based on the availability of relatively inexpensive airline tickets. Thus, vacation travelers are usually quite sensitive to price, especially if the vacation involves buying tickets for a whole family.

In contrast, passengers traveling on business are often much less sensitive to the price of the ticket. When business requires that a passenger be in London for an

important meeting on Monday morning at 8:00 A.M., the traveler will make the trip even if the fare is expensive.

An airline knows that its markets have different segments. It knows that business customers typically have relatively inelastic demands and that most vacation travelers have relatively elastic demands. Using the inverse elasticity pricing rule, an airline would like to charge a higher price for business travelers.

How does the airline implement price discrimination? As a way of screening passengers, it can impose restrictions on tickets sold at lower prices. For example, an airline knows that business travelers often do not know about the meeting in London far in advance, whereas the excursion traveler schedules a vacation months in advance. Business travelers often cannot stay at the destination over Saturday night, whereas vacation travelers will be willing to stay over Saturday night, especially if they can get a cheaper ticket by doing so. The airlines therefore limit lower-price tickets to people who purchase in advance and commit to staying over Saturday night, thereby screening for legitimate vacation travelers.

¹³There are surely other reasons to offer discounts to senior citizens and students. For example, regulators of urban mass transit systems may view a lower price for these consumers as a socially noble objective, perhaps as a means of creating more purchasing power for deserving sets of consumers.