

3. How do tourists travel?

Learning objectives

At the end of this chapter the reader will be able to:

- Describe the importance, ownership patterns, and market characteristics of airlines, rail, cruise and other ships, private cars, recreational vehicles, car rentals, and motor coaches.
- Describe the characteristics of economic and physical regulation in the transportation industry.
- Discuss the types of international air agreements common to the industry.
- Outline the major effects of airline deregulation.
- Show how the demand for and supply of transportation services leads to particular marketing strategies.
- Define and correctly use the following terms: scheduled air carrier, passenger load factor, charter air carrier, affinity charter, deregulation, rail support, cruise freighter/cargo liner, motor coach, Federal Aviation Authority, International Air Traffic Association, primary demand, demand elasticity, capital intensity, incremental cost, direct distribution, vertical integration, contribution theory, domestic trunk line, domestic regional line, public charter, single-entity charter, hub and spoke, Amtrak, car rental, Civil Aeronautics Board, bilateral agreement, derived demand, frequent-flyer program, income elasticity, sunk costs, lineal route structure, indirect distribution, differential pricing, incremental concept.

Modes of transportation

Introduction

Tourists travel by a variety of means. This chapter will explore the characteristics of the various modes of transportation and focus on two areas of particular importance: regulation and the marketing of transportation.

Air travel

Size and importance. The airlines of the world carry over 900 million passengers a year. This represents a passenger load factor, the relationship between seats occupied and seats available, of 66 per cent. That is, on average, passenger planes were two-thirds full. The US scheduled airlines carry over 40 per cent of total world passengers. Europe, on the other hand, accounts for 70 per cent of the world's charter traffic. This is because of the well-developed package holiday business in Europe. Overall the percentage of kilometers flown on charters worldwide has been declining steadily and now represents just over 3 per cent of total passenger kilometers flown. It is forecasted that air traffic will grow at an annual rate of over 6 per cent in Europe and in the United States and 8 to 10 per cent in Asia and the Pacific.

The largest IATAN-member (International Air Traffic Association) airlines in terms of revenue passenger kilometers (number of passengers times number of kilometers flown) in 1986 were:

- United Airlines
- American Airlines
- Eastern Air Lines
- Trans World Airlines (TWA)

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- British Airways
- Japan Air Lines
- Pan American
- Continental Airlines
- Air France
- Lufthansa

In the United States over 70 per cent of adult Americans have flown at least once in their lives. In any one year about one-third of American adults take an airline trip, just over half being for pleasure.

Ownership. More and more government-owned airlines (British Airways, Japan Air Lines, KLM (Royal Dutch Airlines), and Singapore Airlines, for example) are being offered for sale to the public. However, most foreign airlines are totally or partially owned by the government. In the United States, airlines are privately owned, and airline management is responsible to a board of directors to produce a return on investment. Airlines must operate accordingly in the prices they charge and the services they provide as they compete with each other, with foreign (often subsidized) airlines, and with other modes of transportation.

In the United States, eight major carriers account for approximately 90 per cent of revenue passenger miles. Texas Air, which took over Eastern Airlines, Continental, People Express, Frontier and New York Air, has 21 per cent of the market; United has about 16 per cent, and American has 13 per cent.

Support. The airways are federally owned. The federal government has also been actively involved in several areas that have encouraged development of the air transportation system. The government has been involved in the research and development of new aircraft, has helped provide terminals, has, through the payment of subsidies, helped defray some of the carriers' operating costs, and has taken a role in the training of personnel.

Market characteristics

Since 1981, US airlines have been classified on the basis of annual revenues. Majors are those with annual operating revenues of more than USD 1 billion; nationals have between USD 75 million and USD 1 billion a year; large regional is the term for companies that have annual operating revenues of between USD 10 million and USD 75 million; medium regionals are those with less than USD 10 million in annual operating revenues. However, the industry still commonly thinks of airlines on the basis of whether they are scheduled air carriers or charter air carriers. We will discuss these differences next.

Scheduled air carriers. In the US, scheduled air carriers are given a Certificate of Convenience and Necessity by the Civil Aeronautics Board (CAB) to provide service between various points on a regularly scheduled basis. They fall into one of several types. Domestic trunk lines operate the long-haul routes and serve large metropolitan areas and medium-sized cities. American, United, Eastern, TWA, Continental and Western are thought of as falling into this category.

International airlines are those that operate between the United States and foreign countries in addition to those that operate over international waters and US territories. While many airlines operate overseas, those regarded as international are Pan American, Northwest and TWA.

Aloha, Hawaiian, Alaska, and Wien Air Alaska are airlines operating primarily within the US states Alaska and Hawaii.

Domestic regional or local airlines connect smaller cities with regional centers. The system is known as the "hub and spoke". Trunk airlines designate certain cities as "hub" cities for them. Regional airlines form the spokes to transport passengers to regional centers where they are fed into the trunk airlines. With the advent of deregulation many regional carriers have expanded to provide service to local communities and even to fly overseas. Republic and US Air, for example, offer international flights.

Charter air carriers. Charter or supplemental airlines offer nonscheduled flights. They were originally started to provide lower air fares to people traveling as a group. As noted earlier, charters are more important in Europe than in North America. Within Europe, charter air services account for 60 per cent of all air travel.

A variety of complex regulations developed in the United States to ensure that the flight was a bona fide charter. In the deregulation of 1978 most of the categories were abolished and replaced with the term "public charter".

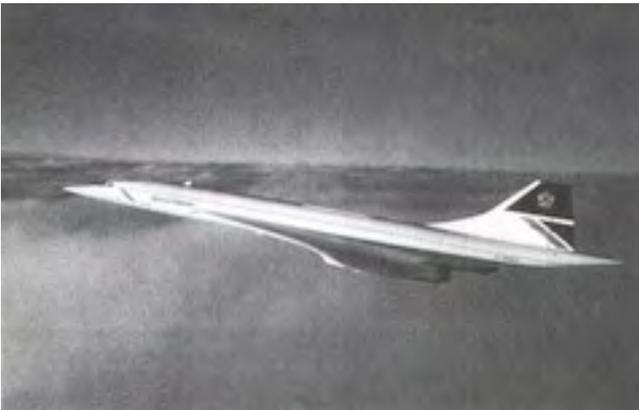


Exhibit 22: Concorde. (Courtesy Cunard.)

A public charter is characterized as follows: There is no requirement to purchase a ticket in advance; there is no minimum stay requirement; no restrictions are placed on discount pricing; there is no minimum group size, and travelers are allowed to buy one-way charters. Two additional classification were kept. Affinity charters are for members of organizations with a common purpose, such as social, professional or religious groups. Single-entity charters occur when a person, company or organization hires an aircraft for a specific trip. Scheduled airlines may also offer charters.

Ever since deregulation, the charter share of the market has declined. Much of the reason is that, as competition intensified, ticket prices dropped. Because charters arose to provide lower prices, as regular air fares dropped, charters lost their reason for being. It is estimated, for example, that about 86 per cent of revenue passenger miles are on discount fares with the average discount over 55 per cent of the posted fare.

Charter airlines must be certificated by the CAB and meet US Federal Aviation Administration (FAA) standards.

Other carriers. There are a variety of other carriers. Cargo air carriers carry freight rather than passengers. Commuter airlines operate small aircraft on a scheduled basis. They must meet FAA regulations but are non-certificated. Air taxi airlines operate only on a charter, contract or demand basis. In the US helicopters have been used successfully to provide transfers between Kennedy International Airport in Queens and downtown Manhattan.

The future. The future of air transportation is dependent upon several factors. Designers are considering the development of hypersonic aircraft capable of traveling at up to 6,437 kilometers an hour. This would mean that a flight from New York to London would take 2 hours; a flight from Los Angeles to Tokyo, 2 hours 18 minutes. At present the supersonic planes (SSTs) operated by Air France and British Airways travel between New York and

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Europe in just over 3 hours. The airlines have found the SSTs uneconomical, however. If manufacturers can come up with a hypersonic plane that can be operated economically it will undoubtedly stimulate international long-haul travel.

Air transportation is heavily dependent on the price and availability of petroleum. Most experts expect oil prices to remain reasonable in the short-run. At any time, however, problems could occur because of the volatility of the world situation.

Deregulation, covered in detail later, has spawned more competition and fare wars. A shakeout phase ended in 1986, and the industry has moved into a period of consolidation. While price wars still occur in certain very competitive markets, it is expected that a period of stability will ensue.

Tourism is becoming more international in scope. As more attractions and facilities are developed there will be more attempts to lure the international traveler. Air transportation will benefit.

A final caution has to be given because of the safety and convenience factors. Deregulation has also brought more flights and carriers into the air. Concern has been expressed about the crowded skies. While flying is still the safest way to travel, more and more people are concerned about the safety of the skies. Terrorist bombings have caused great concern among airline passengers. There is also the inconvenience of crowded airports. In some cases the time spent on the ground from plane to downtown is greater than the time spent in the air.

Rail travel

Size and importance. Travel by railroad steadily declined in the United States after World War II. This was due to several factors: construction of the interstate highway system; growth of the airline industry; the heavy fixed costs involved in developing and maintaining railroad equipment; disputes over the role of the private and public sectors in the railroad business; rising costs of operation because of union practices; a desire on the part of the public to travel faster in order to spend more time at the destination.

People often look to Europe and Japan and wonder why the United States cannot have a similar rail system. The population is more concentrated, distances shorter, and personal mobility less important than in the United States. In addition, the railroads are often heavily subsidized. A major problem as far as speed is concerned is the poor quality of the roadbed and rails. In the United States, heavy freight usage has slowed the speed of passenger trains using the same rails. Trains are available to travel faster; however, the roadbed cannot support faster trains.

Support. Railroad development was aided by massive government grants, primarily in the form of land, in the late nineteenth century. In return, railroads agreed to haul government passengers and freight at reduced rates. This reimbursement did not end until 1945. While public assistance of the railroads was justified on the basis of carrying passengers (settling the American West, drawing the nation together) railroads preferred to carry freight and often actively tried to dissuade passenger travel. Nevertheless, the system of rails in the United States is in great part the result of a desire to provide passenger transportation.



Exhibit 23: Traveling by train and barge. (Courtesy Britrail Travel International, Inc.)

Market characteristics

Amtrak. In 1981, Amtrak was formed to assume operation of all inter-city rail passenger service except for that of three railroads: The Southern Railway, Denver and Rio Grande Western, and the Rock Island and Pacific lines. These three, however, provide connections with Amtrak. Amtrak itself was organized by the US government as a quasi-public corporation with the intent of cutting down on the number of routes and points served and upgrading the remainder of the system.

Service is provided to 525 communities covering 24,000 route miles in 44 states. Amtrak carries over 20 million passengers a year traveling over 5 billion passenger miles. Significant government subsidy is needed as revenue pays only 60 per cent of the costs of operation.

International revenue from foreign visitors has been steadily increasing while the Florida Auto Train, which allows people from the Northeast to take their autos with them for a Florida vacation, has seen a large percentage increase in ridership.

The Official Railway Guide (ORG) lists fares, schedules and routes. Amtrak offers the coach or basic fare with additional charges for such things as a bedroom, slumber room or a drawing room; special fares for groups, families, travel agents, and the military, among others; and the USA Rail Pass, which gives unlimited train travel for a specified period of time.

In addition to carrying passengers, Amtrak has sold the right to lay fiber optic cables along the Northeast corridor to long-distance telephone companies. The line has also rescheduled east and westbound trains out of Chicago to compete with the trucking industry to carry second-class mail.

Charter train tours. It is possible for members of a group to charter a train. Tours include meals, bus excursions, accommodations and the services of guides. Activities are also planned on board the train. Private operators operate tours to various places in the United States.

The future. As the cost of owning and operating a car increases and the time required to go from downtown to downtown by plane expands, travel by train may be a viable alternative. It is likely, however, that rail transportation will play a relatively small part in pleasure travel.

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Because of the subsidies given to Amtrak, other carriers, particularly the bus lines, have complained vigorously. Subsidies will probably continue to support what has been called "the world's largest train set".

Sea travel

Size and importance. There are about 130 cruise ships worldwide with a capacity of over 137,000 passengers and 57,700 cabins. About 80 ships serve the North American market. The Soviet Union operates 36 cruise ships in international waters. Although their rates are 20 per cent below most Western ships, Soviet ships are banned from US ports.

Over 2 million people a year take a cruise. Residents of the United States are the principal market segment, accounting for approximately 75 per cent of all cruise passengers. West Germany, the United Kingdom and Australia account for the majority of remaining passengers. Yet the surface has hardly been scratched. In the United States only one person in 20 has taken a cruise. California provides almost 20 per cent of these passengers, followed closely by Florida. Substantial numbers of passengers also come from New York, Illinois, Pennsylvania and Texas.

Support. Transportation by sea was the first major means of human travel. Countries with seacoasts were the explorers of the world. In the United States, waterways, harbors, and seaways have historically been owned and operated by the federal government. Federal involvement has continued with the building of canals, improvement of rivers and harbors, and the provision of navigational aids.

Market characteristics

The late 1960s marked the end of regularly scheduled travel by ships between two points. Cunard's QE2 is the only regularly scheduled passenger liner crossing the Atlantic today. Most all travel by sea today is in the form of a cruise.

Cruise ships. Cruises are sold on some combination of cost of the cruise, amount of time the cruise lasts and the ports of call visited. The shape of the cruise business has changed over recent years. Cruises have become shorter, appealing to those who have the money but not the time to travel.



Exhibit 24: (Courtesy Royal Caribbean.)

Three- and four-day cruises are a growing segment of the market. The most favored destinations are cruises to the Caribbean from Florida and Puerto Rico. One item that resulted in a number of lines moving from the Mediterranean to the Caribbean was the hijacking of the Achille Lauro by terrorists in 1985. There is also a strong summer demand for cruises from the West Coast to Alaska.

The profile of the "typical" passenger is also changing. Passengers are getting younger. For US passengers there is an equal proportion, about 37 per cent, of people in the 15 to 34 age group and in the 55-and-over age group. For British passengers the respective figures are 40 and 34 per cent. About 60 per cent of cruise ship passengers are female, almost two-thirds of all passengers are married, and about one-quarter are single. The remainder are separated, widowed or divorced. The average income is high. Over 50 per cent of US passengers have an annual income of over USD 25,000.

The major ports for US ships are, in descending order, Miami, New York City, San Juan, Port Everglades, Los Angeles, San Francisco and New Orleans.

Because of oversupply (or, as some prefer, underdemand) cruise lines have developed aggressive marketing strategies. Large price discounts were offered to passengers, and commissions far above normal were made available to travel agents, through whom most cruises are sold. On board as many as three different prices are charged, depending on the location of the cabin. Theme cruises with special celebrities are popular. Cruise lines have also teamed up with airlines to offer fly/cruise packages. In some cases the flight to the cruise port is "free" with purchase of the package. Stopover privileges have proved to be a successful sales strategy. Passengers can visit particular destinations either before or after the cruise. They may cruise some ports, stay a while, and fly back on a combination air/cruise/land package.

Freighter/cargo liner. A freighter or cargo liner is a vessel that operates primarily for carrying goods. However, these ships are licensed to carry up to 12 passengers on board. Passengers bring added income while adding little to the operating costs. The cabins may be equivalent to first class on a cruise ship while the cost to the passenger is much lower.

The "price" the passenger pays is that there is no medical service or entertainment on board. Moreover, schedules are dependent on the freight carried. Itineraries can be changed because of delays in loading or unloading of the freight. It has also been the case that, en route to one destination, the goods on board were sold and the destination changed! For some daring people this might be an attraction!

Charter yacht/sailing excursions. Some yacht owners charter their boats to help defray the high costs of ownership. A popular system in the Mediterranean and Caribbean is for people to buy yachts as an investment. A company controls a fleet of yachts, each individually owned. The company markets and maintains the yachts and shares the income generated with the yacht owners.

Riverboats. Riverboat travel is popular in Europe and, in North America, on such places as the Saint Lawrence Seaway and the Mississippi River. Boats may offer staterooms, restaurants, and entertainment.

Houseboat vacations are becoming more popular. They are rented by the week on various rivers and large lakes.

The future. Annual growth of 12 to 15 per cent is expected in the cruise industry. That growth will occur only if passengers will pay the rates necessitated by the high costs of construction and operation, which are steadily increasing. The QE2 was built in 1969 at a cost of USD 94 million; to replace her today would cost over USD 300 million. The average age of the cruise fleet is over 20 years, and many replacements will be needed soon. Some lines are looking at modular ships capable of carrying 1,000 passengers. The hull would be built and an engine installed.

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The stateroom would be pre-constructed and fastened into the hull in one piece. All staterooms would be the same size. As present, staterooms are built to fit the particular curvature of the ship, and first-class accommodations outsell the less expensive cabins. Can an all-first-class ship be built for which people will pay?

The cost of operating a ship is high. The principal costs are fuel and labor. A partial solution to the cost of fuel is to build longer ships. Long ships operate more efficiently than do shorter ones. Some lines have taken an existing ship, cut it in half, and added a new body section. This can result in the addition of up to 40 per cent more space at a cost one-third less than the construction cost of a new vessel.

Road travel

Size and Importance. Most travel in the world, domestic and international, is by the family car. In the United States over 80 per cent of all intercity travel is by automobile. Over the years the growth of international traveler arrivals has paralleled, but at a slightly higher rate, the growth of passenger car registrations. For example, between 1960 and 1973 international traveler arrivals worldwide increased at an average of 7.8 per cent a year while car registrations worldwide increased an average of 7 per cent per annum; from 1974 to 1984 the respective figures were 4.8 per cent and 4 per cent.

In fact, a useful method of forecasting international tourism is to project the growth of passenger car registrations.

Support. Highways, streets and bike paths are man-made and publicly owned. For pleasure travel the biggest boom has been the building of the interstate highway system. Properly titled the "National System of Interstate and Defense Highways", this network of roads has made much of the country more accessible to Americans. Typically, the federal government provides a portion of the funds to build and maintain the roads while state government owns, operates and actually maintains the highways. User fees on such items as tires, gasoline and vehicle-use pay much of the costs of building and maintaining the interstate system.

Market characteristics

Private cars. There are over 130 million private autos in the United States and over 145 million in Europe (both East and West). Domestic tourism in the United States is heavily dependent upon the desire of Americans to travel by auto. If the cost of owning and operating a car becomes prohibitive, tourism will suffer. There is no sign of that happening in the immediate future, but the one event that could dramatically change the situation is a shortage of gasoline, as occurred twice during the 1970s.

Recreational vehicles. A recreational vehicle (RV) is one that has wheels and living quarters. There are over 8 million RVs in the United States used by over 25 million people. Owners spend an average of 23 days a year in their vehicles, traveling an average of 5,900 miles. A number of dealers rent recreational vehicles.

Car rentals. Car rental companies operate over 700,000 cars in the United States. The major companies are Hertz, Avis, National and Budget. American companies produce USD 4 billion a year in revenues in the United States, another USD 1 billion in foreign markets.

About 70 per cent of car-rental customers rent at airports. The increase in air travel brought about by deregulation has helped stimulate the car-rental business.

Most customers are business travelers. Business customers are primarily concerned with how reliable the firm is and how convenient it is to rent the car. Most business occurs Monday through Friday. Because the industry operates on small profit margins, auto-rental firms have gone after the pleasure traveler, especially the weekend

traveler. This makes use of cars that would otherwise stand idle over the weekend. Pleasure travelers also rent the cars for a longer period. This reduces the costs involved in selling and servicing the vehicles. Because pleasure travelers put more miles on the car than do business travelers, companies are putting caps on their free mileage programs.

This means that car mileage is reduced and the resale value of the car is increased.

There is room for creative marketing in the car-rental business. Less than 10 per cent of the United States population has ever rented a car. Companies have teamed up with other sectors of the travel business to offer fly/drive and train/auto packages both domestically and internationally.



Exhibit 25: Tourists with rental car.

(Courtesy New Zealand Tourist & Publicity Office.)

Motor coach. The motor coach industry was deregulated in 1982. The immediate effect was to double the number of bus service companies from 1,500 to 3,000. Because of an increase in insurance rates ranging from USD 2,500 to USD 15,000 per vehicle, many of the smaller motor coach companies ceased to operate. The major companies in the business are Greyhound Lines and Continental Trailways. Bus companies serve 14,600 communities, including 9,000 localities not served by any other public mode of transportation.

Lower-income groups, the young, the elderly, and minorities tend to use regularly scheduled bus transportation more than most.

Charters and tours. Slightly less than one-third of the motor coach industry's revenue comes from charters and tours. Business growth has been slow but steady.

Most business is either a city package tour, an independent package tour, or an escorted tour. A city package tour includes accommodation and sightseeing in one city or its immediate area. An independent package tour consists of travel to a variety of places and includes accommodations and sightseeing. An escorted tour is scheduled during specific times of the year. Lasting from 5 to 30 days, this type of tour includes the services of an escort.

Ground transportation. Ground transportation is the term reserved for buses and limousines used for sightseeing at a destination and for carrying travelers between airports and hotels. In the United States, Gray Line

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and American Sightseeing International offer regularly scheduled sightseeing tours of most major cities. Other companies contract their buses for local services to a tour operator as part of a tour. Many hotels close to airports offer complimentary transfers between airport and hotel.



Exhibit 26: The Airbus connects downtown London and its airports. (Courtesy Britrail Travel International, Inc.)

Regulation

The past decade has seen sweeping changes in the regulation of the American transportation system. In order to understand the present environment it is necessary to review the past.

Goals of regulation

As the airline industry developed in the 1930s there was concern that unbridled growth could have negative consequences for industry and passengers alike. From this concern there developed a desire to control the growth of the airline industry through a variety of regulations.

The goals of regulation were twofold: to protect the public and to promote the best possible system of transportation. Because these goals can be contradictory, the result was a system that did neither one completely.

Types of regulation

There were two types of regulations: economic and physical. The Civil Aeronautics Board or CAB was formed in 1938. The board consists of five members who are independent of the executive branch but appointed by the US President with the consent of Congress. The CAB was primarily responsible for the economic aspects of regulation at the federal level.

Economic. Economically, control was exerted over rates, entry into and exit from the market, and the level of service provided. Economic regulations were intended to prevent a few airlines from controlling the market. The airlines were regarded as a public utility, and there was a fear that open competition might result in service to only the major markets; many communities would not receive airline service.

Control of the rates charged involved the concepts of "reasonableness" and "discrimination". Rates could be charged that would allow the carriers to earn a "reasonable" profit. The CAB ruled that airlines could earn a return of 10 to 12 per cent on the fair value of the airline. The Interstate Commerce Commission (ICC), which regulated the railroads, ruled that railroads might earn 6 per cent on fair value. In motor transportation, because of the difficulty of determining "fair value", commissions used the "operating ratio" approach to rates. The operating ratio is the operating expenses divided by the operating revenue multiplied by 100. A target of 92 would mean 92 cents out of every US dollar of revenue would go for operating expenses.

"Discrimination" in economic terms refers to the idea of charging a different price that is not reflected in a difference in costs. Railroads, for example, had been using a system of differential pricing. Railroads lowered rates when they were in a market where they were in competition; they raised prices when they had a monopoly between two points.



Exhibit 27: Hovercraft travel between England and France. (Courtesy Britrail Travel International, Inc.)

Transportation regulations prohibited "undue discrimination", and the board or commission defined "undue".

As a result of the ideas of "reasonableness" and "discrimination" the prices that carriers could charge had to be approved by the appropriate board or commission. The deregulation act of 1978, which affected the airline industry, established a "zone of reasonableness" around the standard fare level of the airline industry. Carriers could reduce fares by up to 50 per cent or raise them up to 5 per cent without formal approval. Now carriers can essentially charge whatever they like.

To enter the marketplace, carriers had to have a Certificate of Public Convenience and Necessity. They had to show that public convenience would be served and that a necessity for the service existed. Carriers also had to show that they were "fit, willing, and able" to offer the service. The principal concern in deciding whether or not to certify a new carrier was whether or not companies already doing business would be hurt economically.

Carriers were also required to apply for permission to add new routes. Today they can choose where to fly.

Regulations were developed to outline the services that carriers could offer. The goal was to ensure that the public was offered good service. Since prices were regulated, carriers might cut back on services to save money. In return for the right to operate, carriers had to assume certain duties. They had to serve all comers and could not abandon service between two points without permission. Carriers are now free to leave unprofitable routes.

On December 31, 1985, the authority of the CAB was eliminated.

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Physical. The second type of US regulation relates to the physical aspects of safety and reliability. This was, and still is, the province of the Federal Aviation Authority (FAA). Established in 1958, the basic purpose of the FAA is to ensure air safety while promoting the growth of aviation. The agency is responsible for setting and enforcing safety standards; certifying the health and the skills of pilots; monitoring standards in developing, operating and maintaining aircraft; investigating air accidents; and controlling air traffic while helping to develop a national system of airports.

Freedoms of the air

The above aspects of regulation relate to domestic carriers. International travel requires the cooperation of nations. It has been accepted that it is not feasible to have an international system of air travel that is totally free. Some type of regulation is necessary. The foundation for such a system was laid down in the Chicago Convention of 1944 and the Bermuda Agreement of 1946. The notion of "Freedoms of the Air" was first discussed in Chicago, while the Bermuda Agreement focused on bilateral agreements to put into operation the various freedoms.

There are eight Freedoms of the Air, and they are illustrated in Exhibit 22. The first freedom refers to the right of an airline to fly over one country to get to another. The second freedom refers to the right of an airline to stop in another country for fuel or maintenance but not to pick up or drop off passengers. These first two freedoms are widely accepted. The next four freedoms are the subject of bilateral agreements. They are: the right of an airline to drop off, in a foreign country, traffic from the country in which it is registered to a separate country; the right of an airline to carry back passengers from a foreign country to the country in which it is registered; the right of an airline to carry passengers between two foreign countries as long as the flight originates or terminates in the country in which it is registered; the right of an airline to carry passengers to a gateway in the country in which it is registered then on to a foreign country, where neither the origin nor the ultimate destination is the country in which it is registered.

The final two freedoms, numbers seven and eight, are rarely allowed. These are the right of an airline to operate entirely outside of the country in which it is registered in carrying passengers between two other countries, and the right of an airline, registered in a foreign country, to carry passengers between two points in the same foreign country.

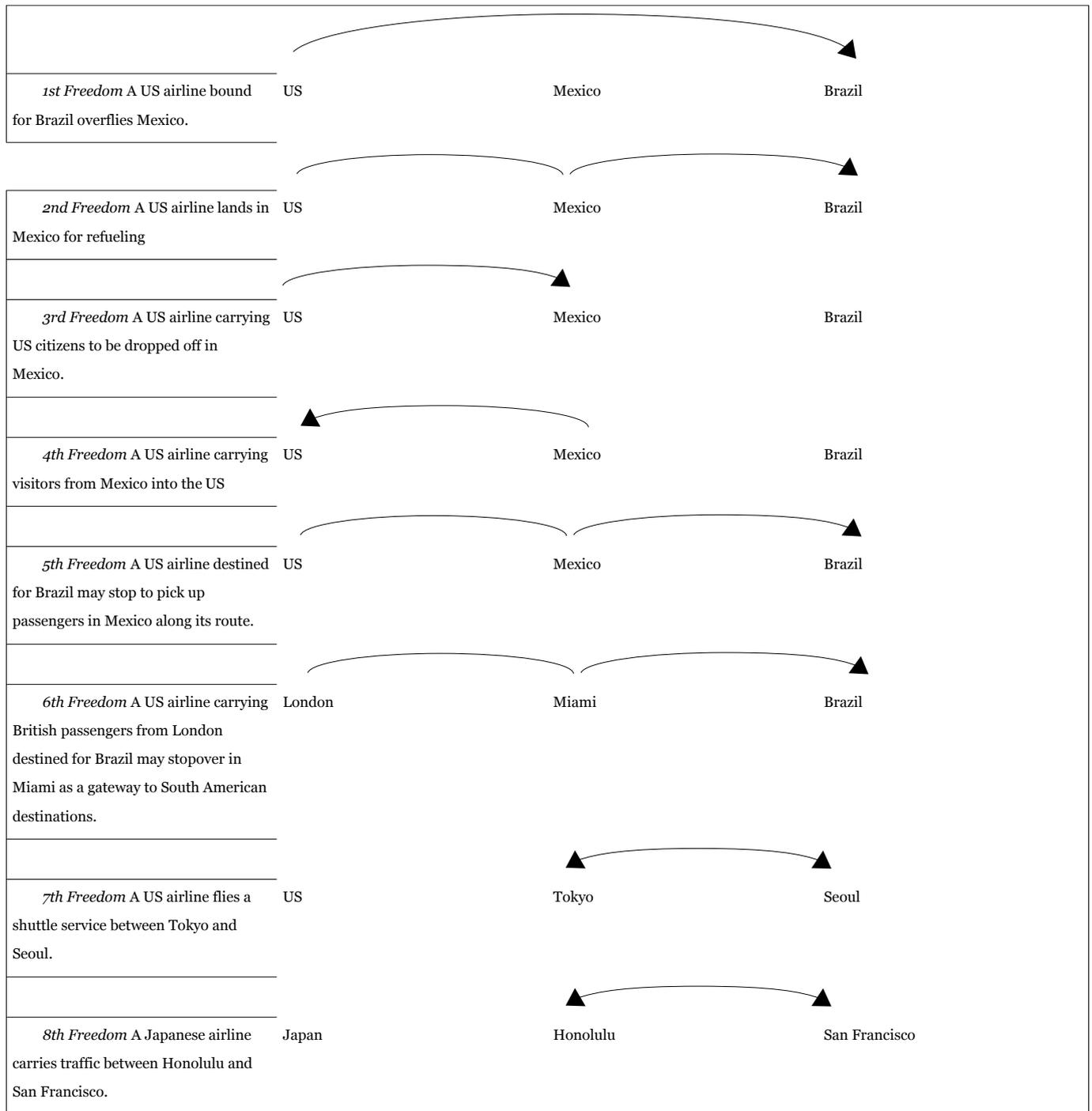


Exhibit 28: Examples of "Freedoms of the Air".

Bilateral agreements

A bilateral agreement refers to an agreement between two countries to offer airline service between them. Bilateral agreements are intended to protect the rights of both countries in three areas: to allow carriers of both nations to participate in the marketplace; to control the frequency of flights so that profitable load factors can be generated; to control prices to prevent discount fares in prime markets. This latter practice is referred to as predatory pricing. Many small nations felt they needed bilateral agreements to protect their national airline. A national airline of a small country may be subsidized by the government. The airline may be operated because of

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national pride or a fear of being dependent on foreign carriers for bringing in tourists or exporting other products. On the other hand, countries where the airlines must operate on a profit-making basis are concerned that a foreign subsidized airline could offer cut-rate prices, the losses being picked up by the government.

Because bilateral agreements were not sufficient to bring together the interests of for-profit and nonprofit airlines, the International Air Traffic Association (IATA) to bring about cooperation between international airlines was established. The functions of the IATA are covered in the next chapter. Both the IATA and the concept of bilateral agreements have come under increasing attack. Competition is greater; there is overcapacity on a number of routes, while the role of unscheduled airlines and the increasingly important part wholesalers, who are outside the regulatory framework, play in selling discount package tours have caused confusion and disagreement. Several countries have dropped the membership in the IATA. International travel will still require some type of agreement structure between nations, but at the moment the IATA and bilateral agreements seem to be it.

Deregulation

Although there is disagreement as to whether or not deregulation has been better for the airline industry and the air traveler, it appears that the following effects have occurred:

- There are more carriers in the sky. Small commuter lines have moved into many of the smaller markets vacated by the majors. As more carriers offer more flights there have been concerns over safety.
- There is a greater number of fares available to the public. As airlines practice free-market pricing they are able to adjust prices relative to market segment, time of day or week, and degree of competition. This has meant that there are bargain opportunities for certain people in certain geographic areas. It may, however, mean that two people flying on the same plane might be paying vastly different amounts for their tickets.
- The consumer departing from major metropolitan airports probably has more flights to choose from and an increased opportunity for better prices; those who fly from small or medium-sized airports probably have less of each.

Marketing of passenger transportation

Transportation marketing seeks to satisfy the needs and wants of the traveler by providing the right mix of services. To appreciate the difficulties involved it is necessary to consider the characteristics of supply of, and demand for, passenger transportation.

Characteristics of demand

The demand for passenger transportation has a number of characteristics, all of which affect the way a company markets. First, demand is instantaneous. For carriers there is great uncertainty as to what the demand will be on a particular day at a particular time between two points.



Exhibit 29: Tourists with campervan. (Courtesy New Zealand Tourist & Publicity Office.)

While past trends are useful they cannot be totally reliable. When demand is greater than supply, travelers are unhappy. By the time adjustments are made to supply more capacity, customers may have changed carriers or found an alternate means of transportation. The tendency, then, would be to provide more capacity than is needed. Overcapacity shows up in the load factor. In a perfect match of supply and demand, load factor would be 100 per cent. Anything less indicates the measure of overcapacity. The challenge in marketing is to create programs to fill each plane, train, ship or bus on each trip.

Overcapacity is the result not only of instantaneous demand but also of the variability of demand. Demand for transportation is not the same each hour of each day of each month. It shows what is known as "peaks and valleys". At certain times of the day or week or month there is great demand; at other times the demand is light. Yet sufficient planes, boats, trains, buses and terminal facilities have to be provided to cover peak demand. The result is that excess capital has to be invested, and this means that operating costs are increased. How should demand be priced? Should the peak traveler pay more than the off-peak traveler? Peak-load pricing states that those traveling at peak times should pay more for the extra capacity provided to meet peak demand. Some off-peak pricing is found in the airline industry and with passenger trains. Reduced midweek and night fares are an attempt at peak pricing.

Another characteristic of demand is that there is, in fact, more than one type or segment of demand for transportation. In its simplest terms, demand is either business demand or pleasure demand. The motivations, frequencies, and response to price are different. The motivation for the business traveler is derived; that is, the demand for travel exists because of the desire to do business in a particular territory. Demand for pleasure travel is primary; the motivation is to travel to a vacation spot. The distinction is important because derived demand tends to be affected more by factors external to the transportation industry. No matter how good the service between New York and Detroit, if business is bad in Detroit, travel demand may go down. A reduction in fares, for example, may affect primary demand but may not affect derived demand.

The business traveler travels more frequently than does the pleasure traveler. This makes this person very valuable to the airline. Frequent-flyer programs, which offer rewards based on miles traveled, have been targeted toward the business travel in an attempt to capture customer loyalty.

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As mentioned above, derived demand may not be affected by changes in price. The company may absorb a fare increase as a cost of doing business. The business traveler may choose a more convenient, but more expensive, flight since the company and not the individual is paying for it.

In some situations people can substitute one mode of transportation for another (train for plane; bus for train, etc.). This affects the way transportation is marketed. Elasticity is the economic term for the sensitivity of travelers to changes in price and service. An elastic demand is sensitive to substitution; an inelastic demand is not. The extent of elasticity is dependent upon the price of the other mode of transportation and the type of demand. Pleasure travel is more price-elastic than is business travel; primary demand is more price-elastic than is derived demand. When people choose how to travel, the decision is made on the basis of price, prestige, comfort, speed and convenience. Amtrak could successfully compete with the plane on certain distances on the basis of several of these factors.

Competition also exists within one mode between carriers. Generally, prices and the speed of the journey are the same or similar amongst competing carriers. Carriers must then market on the basis of the factors mentioned above: prestige, comfort, and convenience. Often a small change in departure time can capture a significant number of passengers. This explains much of the congestion at airports at certain times; everyone wants to offer flights at what are believed to be the most convenient times for the traveler.

Still another aspect of demand is that some transportation modes offer more than one type of service. Passengers can fly economy, business class or first class; trains also offer various classes of service. The different types of service are in competition with each other. Airlines, for example, have to decide the proportions of first-class, business-class and economy- or tourist-class seats to offer on a plane. They then decide what additional services are necessary to justify the price differential (more leg room, better meals, free drinks, etc.).

Demand for transportation is also affected by the relationship between the price charged and the income level of the traveler. Pleasure travel is income-elastic; that is, the demand for travel is affected by changes in the traveler's income. Economists say that demand is elastic when a reduction in price results in more demand that will result in more revenue. (Revenue equals price times number demanded.) The company gains revenue because the increased demand brought about by a drop in price makes up for the reduced price. Similarly, an inelastic demand is one where a reduction in price results in less revenue generated. More passengers may be attracted but not in sufficient numbers to offset the loss of revenue brought about by the reduction in price. Pleasure travel is discretionary; that is, the traveler has a choice of whether or not to travel. An increase in price may mean the traveler will postpone the vacation.

Business travel is also influenced by the income of the corporation. Much business travel is essential; but some is discretionary. Businesses may turn to teleconferencing as a way of reducing the travel bill if costs increase too much.

Finally, the demand for travel makes itself felt in a demand for non-price items. The frequency of departures, the condition of the equipment, the service of the employees, on-time performance: the entire package is often more important than the price. Companies have to find out what is important to the different segments of the market they are going after (the list will be different for each) and seek to provide it.

Supply characteristics

Just as the marketing of transportation is affected by the characteristics of demand, so too is it influenced by the supply characteristics.

The supply of transportation is unique in several distinct ways. First, the transportation industry is a capital-intensive industry. Terminals and equipment cost a great deal of money. The costs are also "indivisible", airlines cannot put "half a plane" in the air if the plane is only half full. Because the industry is capital-intensive and because much of the capital is borrowed, most of the costs of running a transportation company are fixed; for example, interest on the debt must be paid in full regardless of the number of passengers and revenue. This puts a great deal of pressure on management to fill seats that would otherwise be empty. This may affect both promotional and pricing decisions.



Exhibit 30: Traveling by train in Great Britain. (Courtesy Britrail Travel International, Inc.)

Related to this previous point is the fact that transportation costs are "sunk" with few alternatives. This means that the cost of a plane is "sunk" in that the company has incurred the cost of buying it. It is up to the company to generate revenue to pay for the aircraft. It is not like a light that can be turned off, thereby saving money. The plane also has few alternative uses. It can fly; it might be possible to sell it as a unique type of restaurant, but essentially all a company can do with an airplane is fly it. This puts additional pressure on the company to use the resource (the plane) rather than have it sit idle. Hence, the large amounts of sunk costs also mean that there is a tendency to use old equipment rather than invest in more modern (and more expensive) equipment.

Another characteristic of transportation supply is that, although demand is instantaneous, supply is not. There is a long time between planning for a piece of equipment and placing the order for it; between placing the order and receiving it; and between putting it into service and scrapping it. Thus, while demand can shift very quickly, it takes a great deal of time to adjust supply. A company must live with its mistakes for a very long time.

Because of the high level of fixed costs, the incremental costs of operation are small. Incremental cost is the cost of adding one more unit. The running cost of adding another passenger car to a train, another bus to a route, or even a plane between two points is small compared to the cost of the actual piece of equipment. If a plane is scheduled to fly anyway, the cost of an additional passenger is incredibly small with the mere charges of an extra meal and some services. This means that, above a certain point, it makes economic sense to reduce the price

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charged in order to get some revenue coming in. This is the rationale behind discount fares. Airlines can predict, based on past records, how many seats on a particular flight will sell within a week before the flight. People who book within a week before a flight are usually business people. Assume, for example, that on a particular flight 80 per cent of the seats will be bought at the regular fare in the last week before the flight. This means that the airline can sell up to 20 per cent of the seats at a discount for people who will book and pay more than seven days before the flight departs.

Still another characteristic of transportation supply is that it cannot be stored for future use. A grocery store can sell a can of dog food today or tomorrow or next week. Every seat on a plane or train or bus must be sold only on that trip. The sale that is lost today is lost forever. This puts additional pressure on management to sell, sell, sell.

Transportation services must be available on a continuous basis. Travelers expect the same level of service whether it is day or night, summer or winter, whether the plane is full or almost empty. Because transportation is expected to be reliable on a continuous basis there is little opportunity to cut costs for inferior service at odd hours. This adds to the cost of providing the service.

Finally, there is the problem of labor. In transporting people the company takes on a great responsibility. Often the service, whether in operations or in maintenance, is offered 24 hours a day. Employees must be equally alert no matter what the time. Strict rules regulate the amount of time that pilots, drivers or operators can be on duty at any one stretch. The FAA limits pilots to 30 hours of flying in any seven-day period. Airline pilots are also paid well for their skills. Thus, although the operating costs are small compared to the sunk costs, they can still be considerable. A further complication is that there is little opportunity for the substitution of capital for labor. This is, after all, a service business.

Marketing has the task of ensuring that there is sufficient demand to utilize fully the supply of equipment and facilities. It must also ensure that there is enough of the right kind of supply to meet the demands of the passengers. Just as demand influences supply, so too does supply influence demand. The demand for vacations to Jamaica will influence a decision to operate flights to Jamaica; however, the existence of flights to Jamaica at times and prices appropriate to the market will stimulate demand. Marketing brings supply and demand together.

Marketing strategies

In marketing, the offerings of the company are known as the four p's: product, promotion, place and price. In tourism it is appropriate to change the "product" to "service" and "place" to "distribution".

Service. Service refers to getting the ideal mix of services to satisfy existing or potential customers. This means offering transportation at the right times, in the right kinds of equipment, while giving a level of service before, during, and after the journey that will meet the needs of the customer, while making a profit.

Most carriers use a linear route structure; that is, the equipment travels from one point to another, turns around, and travels back. In the airline industry most fuel is used at takeoff and landing. Also, the speed of travel by plane is only appreciated on longer flights. Thus, for reasons of cost and customer benefit, jet aircraft operate in the most efficient manner when they fly on long hauls. A piece of equipment may, however, make an intermediate stop. While this increases the time and fuel costs, it can add significant additional revenue.

The airlines also operate what is known as a hub-spoke concept. Airlines have identified several major cities that serve as hubs (as in hub of a wheel) for them. Smaller towns serve as the spokes of a wheel connected to these hubs. Airlines attempt to have passengers fly into their hub city on a smaller or commuter plane for connection to a larger

plane for travel to their ultimate destination. Colorado Springs, Colorado in the US is a spoke for the Denver hub (on Continental), which is itself a spoke city for St Louis, Missouri which is a spoke (on TWA) for London.

Service must be provided on the right kind of equipment. Equipment has two facets that must be matched: identifying the operating costs of one piece of equipment over another while offering equipment that will attract the traveler. One example is the Concorde. While this supersonic aircraft could draw passengers because of its speed and unique shape, the operating costs are so high that the potential market is relatively small.

Scheduling is a major marketing weapon for carriers. Traveling from point A to point B leaves little opportunity for differentiating one company or carrier from another. Offering departures at times most convenient for the passenger is one way to do this. Unfortunately, everyone wants to do this. The result, certainly in the airline industry, is severe congestion at the most popular times. Generally speaking, the demand for business travel peaks on Monday mornings and Friday afternoons. It is also heavy during the morning and early evening hours during the week, Monday through Thursday. The demand for pleasure travel peaks on Friday evenings, Sunday afternoons, and early evenings.

Service can also be altered by such things as upgrading the quality of the interior of the vehicle. Tie-ins with other modes are possible, such as fly/cruise or rail/drive.

Promotion. The subject of promotion will be dealt with in greater detail toward the end of the book. However, several points can be made now. Promotion can be seen as the communications link between carrier and passenger.



Exhibit 31: Street ferries as a form of transport in Tai O. (Courtesy Hong Kong Tourist Association.)

It is the responsibility of the carrier to communicate its message effectively. If the passenger has not understood the message, it is the fault of the carrier. To this end, it is important that clear promotional objectives be defined. These objectives should identify which target markets are to be reached, what tasks have to be done to reach the markets, who is to perform the tasks, and when they have to be completed. It is vital that the promotional theme be synchronized with the marketing plan, which, in turn, must be consistent with the overall objectives of the carrier. Carriers may, for example, feel that in order to meet their financial targets they must emphasize "quality" and "service". Thus, the way to reach the target is to stress quality and service. These concepts become the essence of the marketing campaign. As part of that plan, communicating the ideas of "service" and "quality" to the public becomes the promotional objective.

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Distribution. Distribution involves the mechanisms by which passengers can obtain the information they need to make a trip choice and, having made that choice, that they can make the necessary reservations. *Direct* distribution occurs when passengers get in touch with the carriers directly. *Indirect* distribution is when the sale is made through an intermediary.

This latter procedure takes four forms. First is the emergence of independent companies to handle all aspects of travel. It might involve a wholesaler who arranges the specifics of a tour, for example; or it might be a retail travel agent who serves as an independent distributor for a wholesaler or carrier; it may even be a wholesaler-retailer who packages its own tours or who buys packages from other wholesalers for distribution.

A second method of distribution is the marketing of tourism either regionally or nationally. Countries, provinces and states promote travel to their particular destination. This effort supplements the marketing plans of the carriers. In some cases the marketing effort of the carrier can dovetail with that of the destination.

A third method is the coordination of marketing plans by various private-sector companies. Tie-ins between airlines and hotels, or bus lines and various attractions, are becoming more prevalent.

Finally, there is the movement toward vertical integration. Airlines have moved in to take control of hotels and car-rental agencies. This has been an attempt to develop a "one-stop travel shop" experience for the traveler. The strategy recently backfired for United Airlines, which formed Allegis, an amalgamation of airline, hotel and car-rental companies. Under stockholder pressure, United was forced to divest itself of the non-airline parts of the company. This subject will also be dealt with in greater depth later.

Price. When the majority of airline passengers once consisted of people traveling on business and those who were rather wealthy, the airlines felt that the demand for travel was inelastic. That is, if prices were reduced, any increase in number of passengers would not produce more revenue. Because of this and a fear that open pricing would lead to price wars that might result in bankruptcy for smaller airlines, airline pricing was closely controlled. Pricing was a reflection of operating costs. The average costs of carriers serving particular markets were calculated and a reasonable return on investment added to come up with the price that could be charged. With deregulation a new era has come to pricing in transportation in general and in the airline industry in particular.

Three economic concepts are important when looking at pricing alternatives. These are the ideas of "differential pricing", the "contribution theory", and the "incremental concept". Differential pricing is the concept that there is not one but many demand curves. A separate demand exists for coach than does for first-class; separate demands exist for travel from Denver to New York than from New York to Denver. As such, carriers can calculate how price-sensitive demand is in one particular class or on one particular route and price accordingly. The demand for business travel, for example, is probably less sensitive to price changes than the demand for pleasure travel on that same route at that same time. A higher price can be charged where demand is inelastic.

The idea of contribution theory is that prices should be set at the level that contributes most to paying off fixed costs while still allowing traffic to move. The fare charged might be low on a route where the demand is elastic; higher where demand is inelastic. In effect, segments of the market that are price-inelastic are subsidizing others that are price-elastic. How low should the price be? Low enough to ensure the passenger travels while contributing as much as possible to paying off fixed costs.

Tied to the ideas above is the incremental concept. Incremental costs are those incurred by running an additional service. The operating costs of a particular plane or train are its incremental costs. Each fare should

cover its incremental costs while contributing as much as possible to fixed costs and also ensuring that the traffic moves. It is up to management to analyze each route and each segment of the market and set prices accordingly.

Study questions

- What are the major market characteristics of air travel?
- How does government support travel by air, rail, sea and road?
- How did deregulation affect charters in the United States?
- What factors affect the future of air travel?
- Why did rail travel suffer a decline after World War II?
- List the three factors on which cruises are sold.
- What are the two goals of regulation?
- What have been the effects of deregulation?
- What are the characteristics of travel demand and supply?
- In what ways do transportation companies compete in the marketing of their services?

Discussion questions

- Discuss the importance to tourism of the following: airlines; rail; cruise and other ships; private cars; recreational vehicles; car rentals; motor coaches.
- What actions have been taken to protect the traveling public while promoting the best possible system of transportation?
- What have the effects of deregulation been on (a) the airline industry and (b) the traveling public?
- In what ways do the characteristics of demand for, and supply of, transportation affect the way it is marketed?