The 2014 World Cup: Windfall or Worry for Airlines?

September 2014

It is estimated that close to 1 million tourists travelled to Brazil[i] to see the world cup this summer, creating a windfall for airlines. This should be great news for airlines but in the lead up to the event Latam Airlines' CEO Enrique Ceuto was quoted in a number of articles saying that the World Cup presented significant challenges for the airline[ii].

So, what was the impact of the World Cup on Airlines? To investigate this question we, at Air-Cube, conducted two analyses. First, we looked at how air fares changed over time for departures to Brazil in June 2014; this would tell us how airlines adjusted their fares to capture the maximum number of passengers. If air fares are too expensive, price sensitive passengers will stay away; if air fares are too low, airlines are leaving money on the table. Second, we looked at the volume of passengers to Brazil and how much they paid for their tickets. This would show us how successful airlines were in their attempts to use their fares to capture the maximum number of passengers.

In both cases we narrowed the analysis to two specific routes: Madrid (MAD) – São Paulo (GRU) and Santiago de Chile (SCL) – São Paulo (GRU) and compared fares, passengers and actual ticket prices between 2013 and 2014. This allowed us to isolate the impact of the World Cup and watch in detail how airlines tried to capitalize on the world cup.

Pricing analysis

The first analysis looks at how are airlines changed their fares to stimulate demand. To understand this we worked with INFARE who provided airlines' web-fares from Madrid to São Paulo.

In 2013, Brazil is a "substitutable" destination, because holidaymakers may choose a different destination if air fares are too expensive, so airlines must work harder to stimulate demand but launching special offers. In 2014 Brazil is a "non-substitutable" destination, because football fans can't travel anywhere else if they want to see the World Cup, so, in theory, airlines should be able to charge higher prices without affecting demand.

We looked at the median lowest fare offered each month from January to June, for flights departing in June 6th, just before the start of the World Cup. Imagine you recorded the cheapest fares offered on a route every day for a month, then put them in ascending order from the lowest to the highest. The median "cheapest" fare would be the one exactly in the middle; it is a form of average, which is less susceptible to single very low – or very high – fares. For example, if an airline offers fares for 1USD for a very short amount of time, the median is unaffected.

The median lowest fare is more expensive in each month of 2014 running up to the World Cup than in the same months of 2013. In fact, travelling from Spain to Brazil in 2014 cost in average USD 400 more than in the previous year.

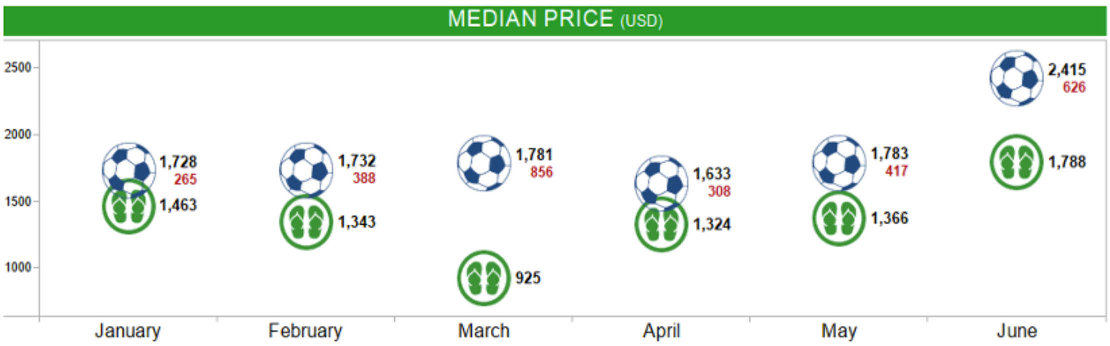

Chart 1: Median price 2013 versus 2014 (route MADGRU-direct flights-14 days stay duration)

Notice that in March 2013 the Median price dropped significantly, but in March 2014 the median price remains the same as in other months.

Lowest median price per month is a relatively blunt instrument; it is much more informative to look at how – and by how much – airlines changed their lowest prices throughout the month. We assume that airlines varied their lowest available prices in response to demand: when few people are making bookings, and therefore demand is low, the airline might launch a special offer; when demand is high, the airlines would close off the cheapest fare classes to ensure that passengers buy at a higher price. This reflects a form of price elasticity.

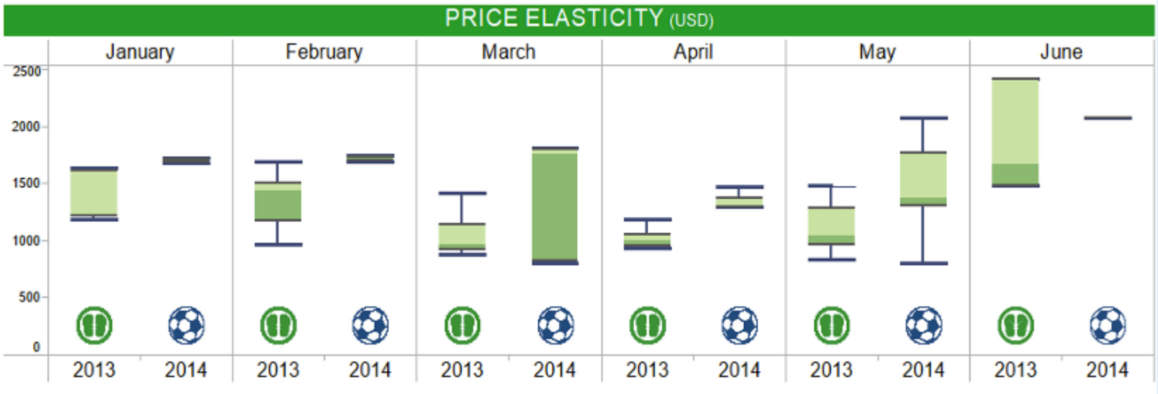

Chart 2: Price elasticity 2013 versus 2014 (route MADGRU-direct flights-14 days stay duration)

For example, in January 2013, the lowest available fare ranged from 1,188 US Dollars to 1,635 US Dollars depending on the day the booking was made. By contrast, in January 2014 airlines held their prices steady at 1700 USD. The demand is high and the product is "non-substitutable", reflecting a form of price inelasticity.

Let's turn now to the month of March. The median lowest price for the whole of the month of March 2013 was much lower than in March 2014. Looking at the price elasticity chart we see this in more detail. The absolute cheapest fares available in March 2013 were actually similar to the cheapest available in 2014. The difference lies in how many days those very cheap fares were available: the very lowest fares were only available for a short time in March 2014. Hence the median fare in March 2014 is very close to the highest fare offered in that month.

Now look the month of June. Remember, in this analysis the departure date is always 6 June; so this is showing us the price for flights booked within one week of departure. In June 2013 we see a wide range of prices on offer; even at such late notice it is possible to get a good deal on a flight to Brazil. In 2014, however, with the World Cup starting in less than a week, prices are fixed at 2,000 US Dollars.

Passenger volume and airline revenue

In the first analysis, we looked at how airlines changed their fares to stimulate demand and try to make the most of the large number of passengers travelling to the World Cup. In this analysis we will look at the results of that effort and try to answer the question - did it work? Was the World Cup a windfall or a worry for airlines?

In the first analysis, we looked at price variations on point-to-point routes between Madrid and São Paulo. In this analysis, using booking and coupon data provided by MILANAMOS, we will examine the volume of passengers, the price they paid for their ticket and which class they travelled in; we will look at direct routes between Madrid and São Paulo as well as connecting flights where Madrid and São Paulo are used as transit airports.

Overall, 3000 more passengers flew between Madrid and São Paulo in June 2014 compared with the previous year; that is an increase of 15%. The map view shows the first departure and ultimate destination of passengers travelling between Madrid-São Paulo; in the World Cup year, passengers on that route where much more cosmopolitan, having begun their journeys in 132 cities, compared with 96 origin cities a year earlier. This is a pattern typical of budget travellers – connecting flights tend to be cheaper than direct flights.

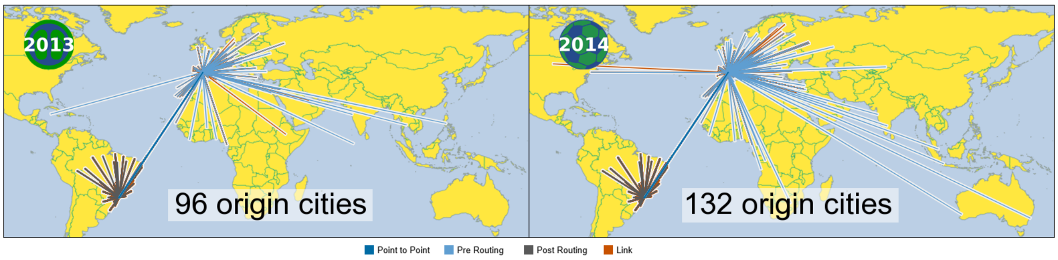

Chart 3: Routes with MAD-GRU leg, 2013 versus 2014 (point to point, pre-routing, post-routing and link)

Indeed, in 2014 connecting traffic grew by 45% but point-to-point traffic suffered a significant drop of 40% fewer passengers. This is bad news for airlines. There is more bad news when we look at cabin class: in 2014 there were 30% fewer business class travellers than a year earlier. The drop in business class passengers was a double-whammy for airlines. Not only did volumes fall in 2014 but, as a consequence, so did fares. Business class revenue for airlines serving the Madrid-São Paulo route was half that of the previous year.

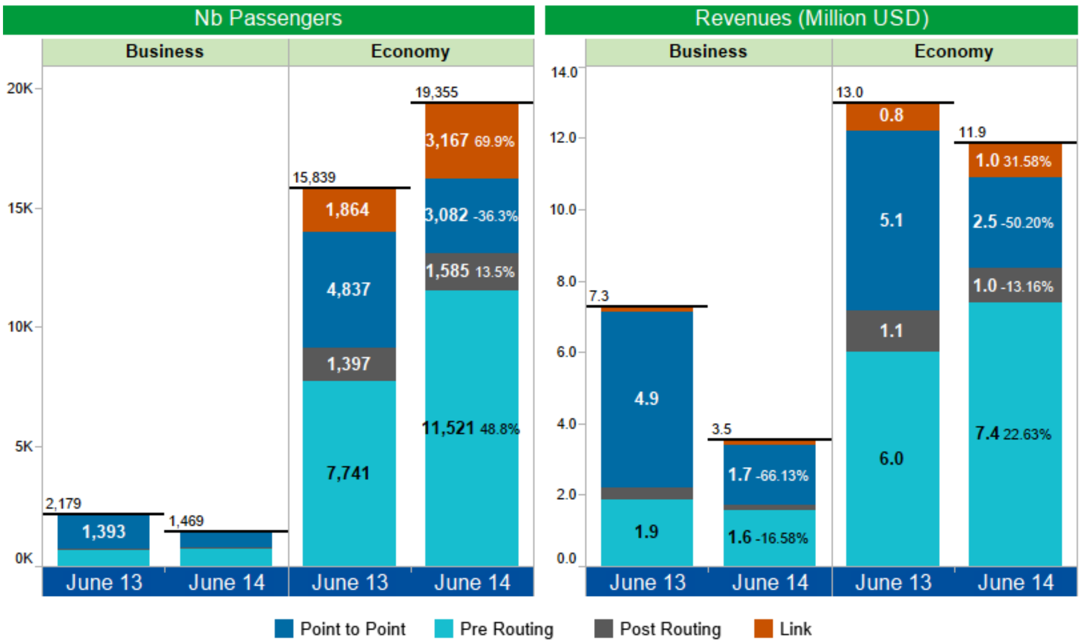

Chart 4: MAD-GRU bookings and revenues analysis MAD-GRU leg, 2013 versus 2014

So, despite the increase in passenger numbers, airlines made 25% less revenue in the World Cup Year of the World Cup than in the previous year. The effect of the World Cup, therefore, seems to have been to attract a high number of very price-sensitive customers but, crucially, to dissuade more profitable business-class customers from travelling at all.

Looking at a different route, Santiago de Chile to São Paulo, we see similar findings albeit slightly better news for airlines. In 2014, there were 15 additional routes, and a global increase of over 50%, or 13,000, more passengers. But the main difference in this case, is that revenues also grew, by 17%. Note that the revenue growth is not as spectacular than the growth in passengers; in that respect it is a similar finding to that on the route from Madrid: average ticket values dropped.

Looking at the routings, point-to-point passengers remain stable whereas connecting traffic all increase strongly.

Drilling down into the cabin class analysis the number of business class tickets increased slightly helping to maintain growth in overall revenue. In other words, by securing the level of business passengers, airlines secured their overall revenues.

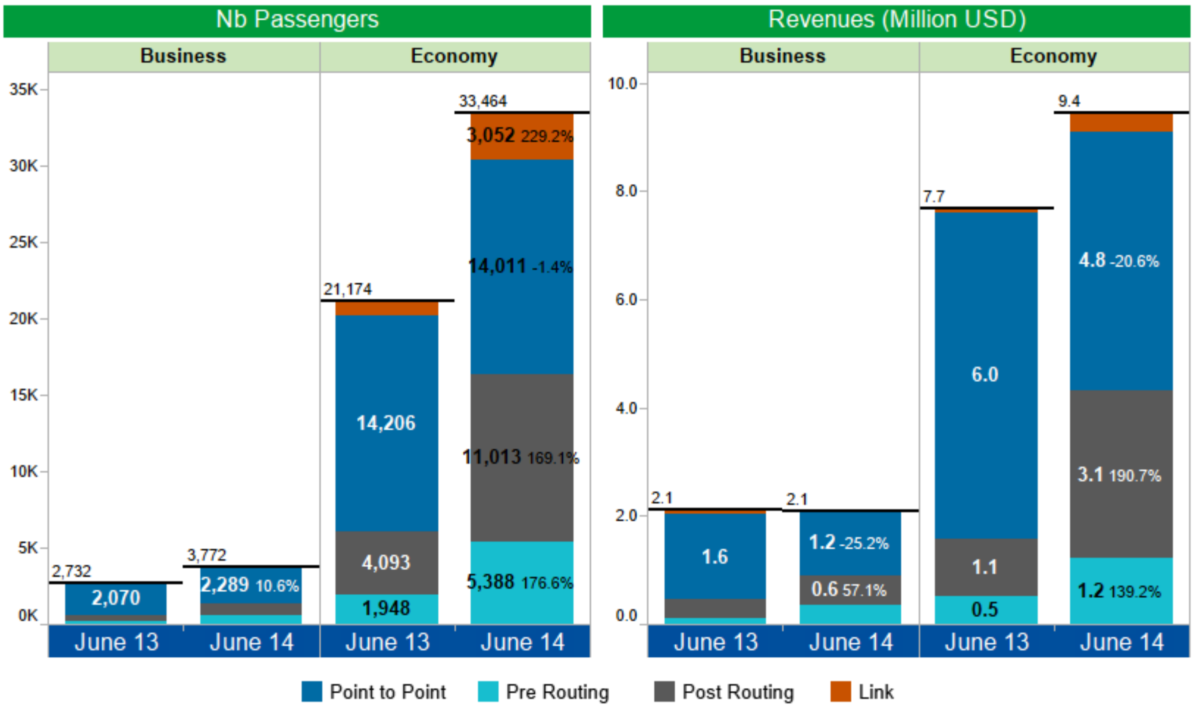

Chart 5: SCL-GRU bookings and revenues analysis MAD-GRU leg, 2013 versus 2014

Conclusion

At first sight, the conclusions of the two analyses above are contradictory – how is it that charging higher fares has resulted in generating less revenue for airlines even as they carried more passengers?

There is a key difference between the two analyses. The pricing analysis, which looked at the range of lowest fares available, was in a way a forward-looking analysis. It looked at the fares airlines published before the World Cup, at a time when they still didn't know with any certainty how many people would fly, how much they would pay and what the competition would charge. To overcome this uncertainty airlines publish hundreds of thousands – if not millions – of fares, many of which may never actually be bought by a passenger. The analysis we conducted, analyzing the lowest fares, is exactly the kind of barometer, which airlines use to monitor each other.

By contrast, the revenue analysis looked at the results after the event; it analysed only those fares which were bought by a customer. Airline revenues are driven by many more factors than price and volume; cabin class, routing (direct or connecting) and competition all play a part.

The difference between the analysis of fares, which looked positive for airlines, and the passenger analysis which showed revenues falling, is the difference between what airlines wanted to achieve and what they actually achieved. Or as Yogi Berra, a baseball player, once said, "In theory there is no difference between theory and practice. In practice there is."

For more information:

http://www.air-cube.com/#showcases

https://m.youtube.com/channel/UCtsXi_rYbE2pEbkUhuyJvJQ

email: info@air-cube.com

Data sources:

www.infare.com

www.milanamos.com

Other sources:

http://blogs.wsj.com/dailyfix/2014/07/15/brazil-welcomes-one-million-world-cup-tourists/
http://online.wsj.com/news/articles/SB10001424052702304157204579473903915971312
http://www.flightglobal.com/news/articles/iata-latam-will-lose-money-during-world-cup-399914/