The PRICING ADVISOR
A Professional Pricing Society Publication
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Profiting with the Post Recession Customer

Since, as a rule, the low price will win the business, the only way a commodity-based business can be profitable and provide good shareholder returns is by focusing on costs and operational efficiency. Unfortunately, as the author points out, the airline industry failed early on in its pricing models, contributed to its downward spiral and leading to more detrimental effects. Per Sjofors is the founder and Managing Partner of Atenga and the author of the Best Practice Pricing blog. He can be reached at info@atenga.com.

Most of the time I write in my blog about how a lack of pricing processes and/or discipline leads to underperforming businesses, and how a focus on pricing can rectify this. This time, the subject gets more serious.

In a commodity business, the product or service you provide is not valued by your customers more than any of your competitors, and your only way to compete is on price. Since the low price will win the business, the only way a commodity-based business can be profitable and provide good shareholder returns is by focusing on costs and operational efficiency. We all know this.

On February 12th, Continental flight 3407, operated by Cogan Air crashed on approach to Buffalo, NY, and killed all 49 passengers onboard and one person on the ground. In the aftermath is has come to light that it was pilot error which caused the crash. So what does this have to do with pricing? Nothing directly, but it has everything to do with commoditization.

Over the last 20-25 years the airlines have accepted, and even accelerated, a death spiral of commoditization; they failed to differentiate their offering and continued to detract value from their services by selling on price alone. They very quickly taught their customers to use the yield management systems (which coincidentally were once touted as the industry savior) to pay even less for their tickets. With revenues going south, and no efforts to fight commoditization, the whole industry had to cut costs. We've seen this through all the various bankruptcies and industry consolidation. Another strategy the airlines adopted was outsourcing, particularly on short haul commuter flights like flight 3407. The large incumbents cannot fly these routs profitably, but the likes of Cogan air can. Their operating cost is lower.

So let's introduce another concept: "You get what you pay for." We all know this. Sometimes what you "get" by paying more is tangible, and sometimes it's intangible. But in all cases, when you pay more, you pay more because you can defend the additional cost, at least for yourself.

When Cogan Air hired the pilots on the doomed flight 3407 they also got what they paid for:

- The captain, Marvin Renslow was 47 years old, had flunked 2 FAA flight certification tests, and earned a "whopping" $55,000 a year.
- The co-pilot, Rebecca Shaw was 24 years old, commuted back and forth from Seattle to New Jersey, and had, in fact arrived on a red-eye that day, and earned an even more "whopping" $16,300 a year. On top of that, she also had a second job to help support herself financially. Sleep deprived anyone?

The NTSB has concluded that neither of these two followed required practices, neither was well-trained or experienced on the aircraft type, and both were most likely fatigued as neither had the required sleep or quality rest period prior to that day. Unfortunately, this lack of quality ended up leading to dire consequences for the people in the back seat, who had trusted their lives to these individuals.

Keeping the belt tight on costs is all fine when your "commodity" is grain, sand, or oil. But if the service you provide ultimately affects people's lives, where staff mistakes can become fatal, should you allow your cost control focus to affect the quality of your staff? Piloting is a highly complex job, which requires years of training. Yet, Rebecca Shaw eared as much as a burger flipper. Marvin Renslow would have made more money as an Operations Supervisor at McDonalds. Where they the best in their profession? Probably not - as history unfortunately shows they were not even qualified to do their job.

So how does all of this tie back to price? It is the tremendous failure of the airlines to fight commoditization that ultimately is the cause of this tragic event.

- Their failure to differentiate their offerings
- Their failure to hold prices steady
- Their failure to understand that they were training their customers to use the yield management systems to their advantage
- Their failure to operate profitable businesses where they can afford to pay their most valuable and critical employees a reasonable wage, where they will attract "the best" staff, where employees can afford to live close to their base, and not commute sleeplessly across the country before going to a full day of work.
- There failure to have an industry where not meeting certification standards still allows an individual to be employed

With all of these failures, it's no surprise the airlines continue to find themselves in bankruptcy court, fighting to keep their companies afloat. **The saddest part about this story is that if more attention had been paid to pricing, they never would have found themselves in this mess.**