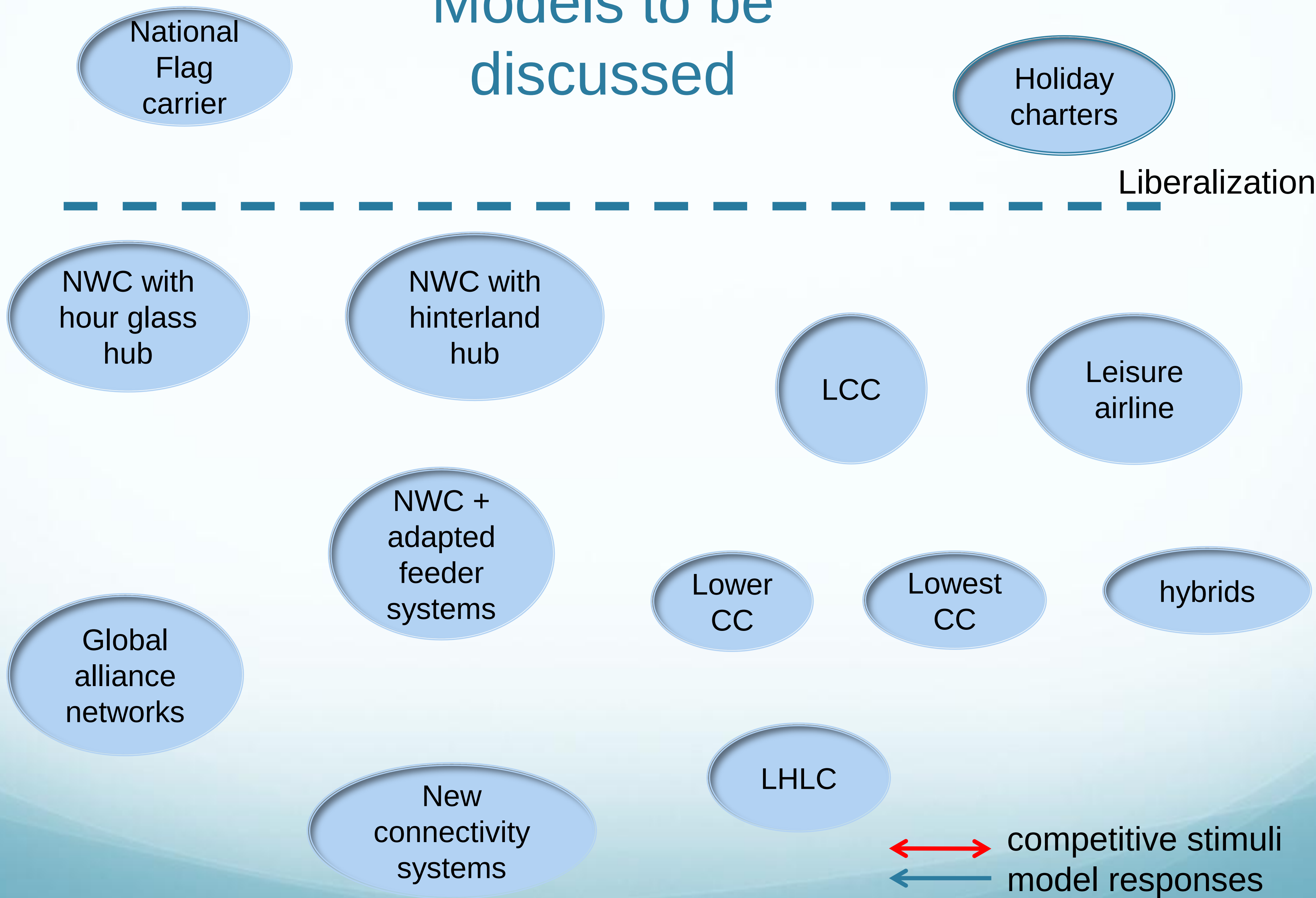
Mutating airline business models

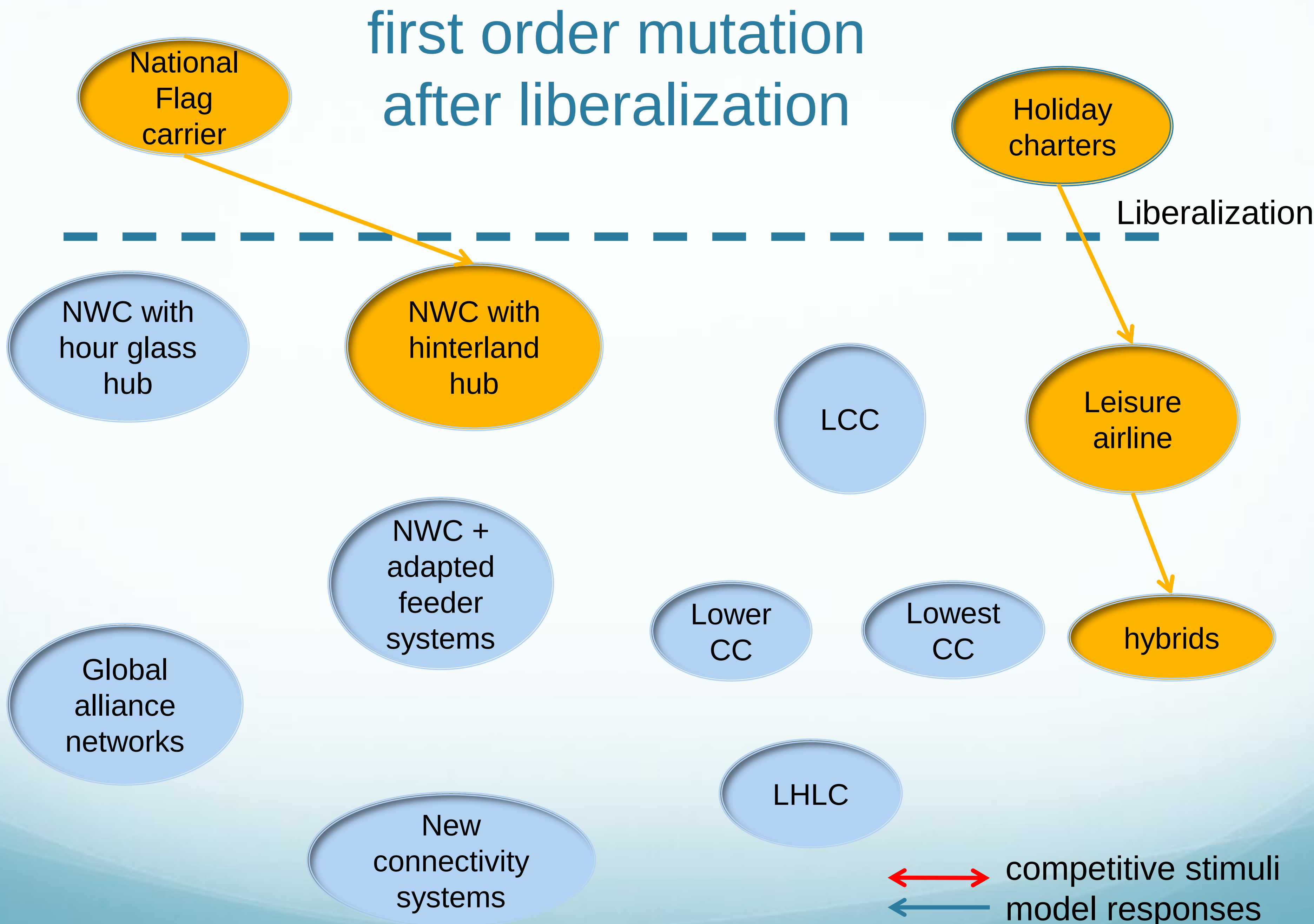
Air Transport Colloquium 2014

University of Antwerp

Prof. Jaap de Wit
UvA/Netherlands Institute for Transport Policy Analysis

Models to be discussed




first order mutation
after liberalization
National
Flag
carrier
Holiday
charters
Liberalization
NWC with
hour glass
hub
NWC with
hinterland
hub
LCC
Leisure
airline
NWC +
adapted
feeder
systems
Lower
CC
Lowest
CC
hybrids
Global
alliance
networks
LHLC
New
connectivity
systems
competitive stimuli
model responses

Two basic business models before liberalization: type 1

national flag carriers as the designated carriers to operate the bilateral traffic rights of their states

Two sub models

- Third/fourth freedom carriers
- Sixth freedom carriers (in case of a small home market: hidden hub)

Two basic business models: type 2

holiday charters

1. Point to point, leisure (sun/sea/sand)
2. Strong seasonal pattern (US: complementary carriers)
3. Series or ad hoc charters based on permits (not on traffic rights)
4. low unit costs due to high load factors, high aircraft utilization and limited inflight service
5. A delineated market:
   - Intra-European: IT only via tour operator
   - Transatlantic: ABC charters
6. Escape from rigidity: seat-only or “camping flights”

First order mutation 1. after liberalization: NWCs

1. From national flag carriers towards network carriers (NWCs)

- Open and growing internal market enabled national carriers to develop fully-fledged feeder systems and to improve connectivity at the home base through wave systems

- Business model of the *scheduled national carrier* migrates towards the model of *network carrier* based on a H&S systems
  - Some created short haul/short haul Euro hubs: SAS-CPH, SN-BRU
  - Some created Euro-Euro + Euro-ICA hubs: LH-FRA, AF-CDG, KL-AMS, etc
  - Some remained lower connectivity hubs: BA-LHR/LGW, IB-MAD/BCN,SR-ZRH/GVA, AZ-FCO/MXP/LIN

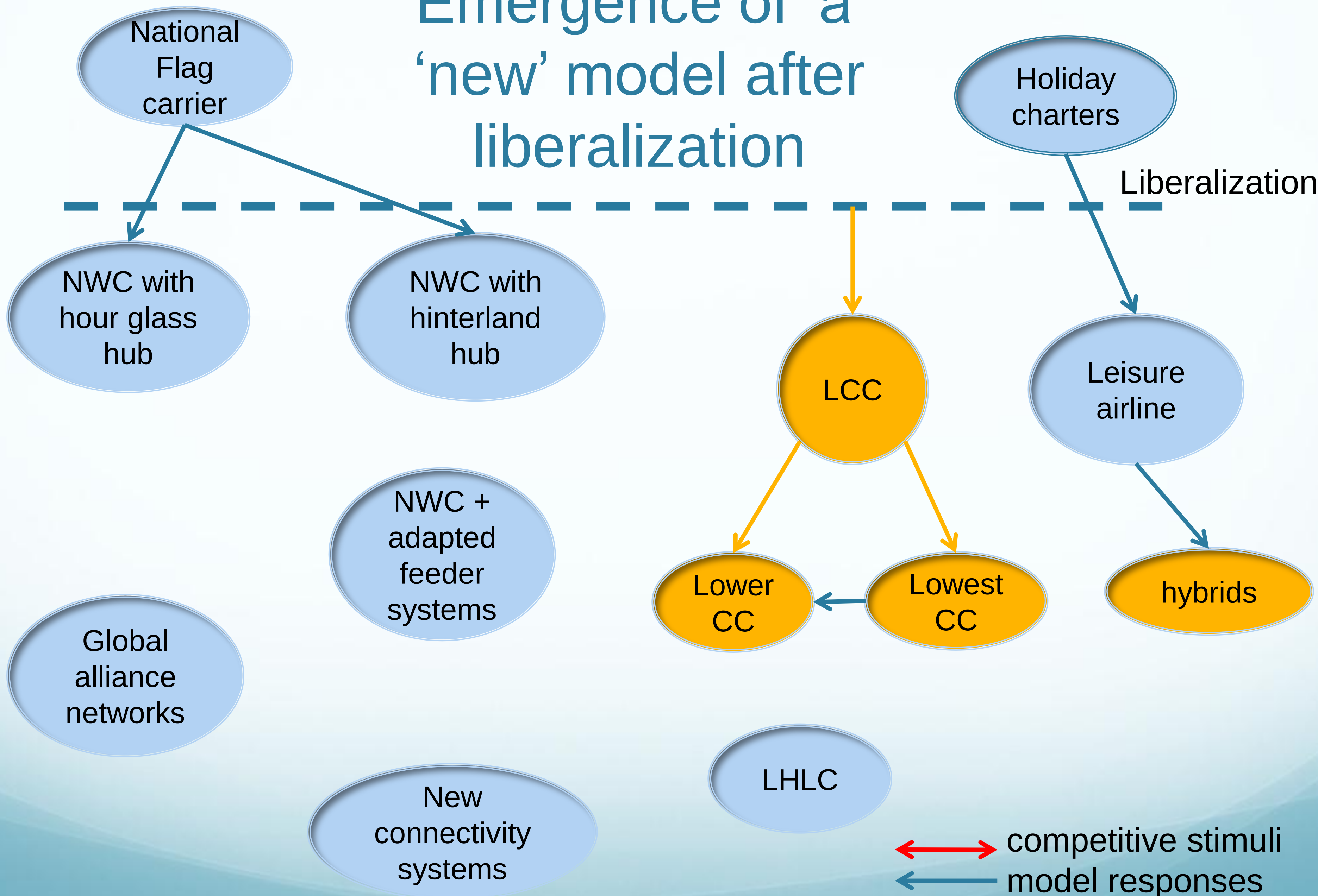
First order mutation 2. after liberalization: leisure airlines

2. From holiday charters towards leisure airlines

- Artificial market delineation of the holiday charters non existent anymore: no permits, no traffic rights inside the EU

- Holiday charters transform into *leisure airlines*
  - Strong horizontal and vertical concentration of tour operators and charter airlines
  - Mixture of IT, sold via tour operators and seat-only, via airline website
  - Semi-scheduled operations to the larger Mediterranean market enabling standard holiday durations (7, 10, 14 etc. days): resulting in hedgehog airports
  - Increasing number of long haul ICA-holiday destinations (Carribean, SE Asia, Africa)
  - point-to-point operations continued usually from several airports in an individual Northern country to many southern destinations
  - Increasing number of LCC features: hybrids

Emergence of ‘a’ ‘new’ model after liberalization



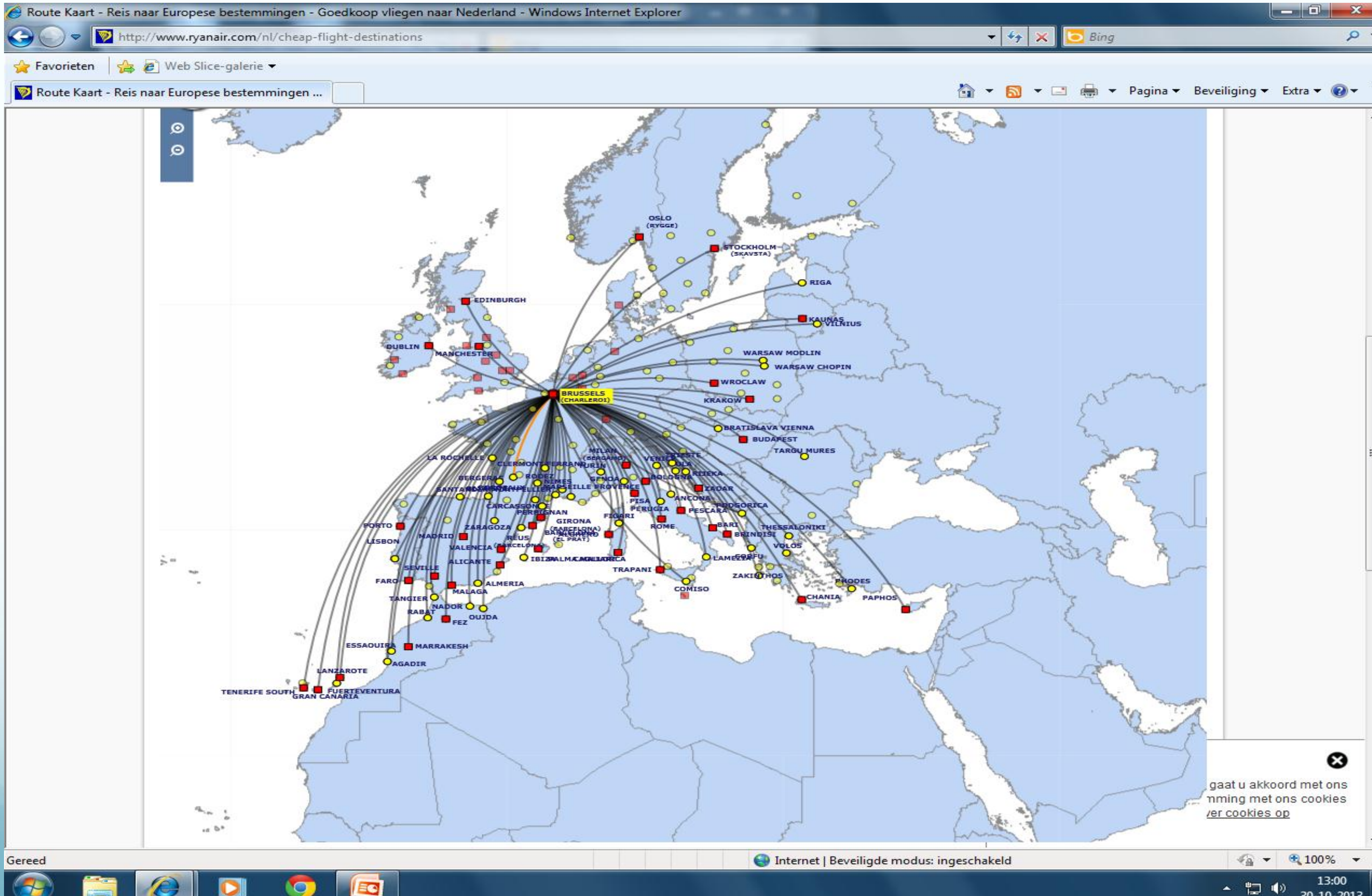
A new business model after liberalization: LCC

- Open internal market enabled introduction of a model copied from the US domestic market (not that new!)

- Marketing & pricing innovation (later also copied by NWCs)
  - Unbundled airline product *)
  - Simplified distribution channels: internet or call center bookings *)
  - Extra ancillary revenues through e-selling *)
  - Simplified revenue management systems *)

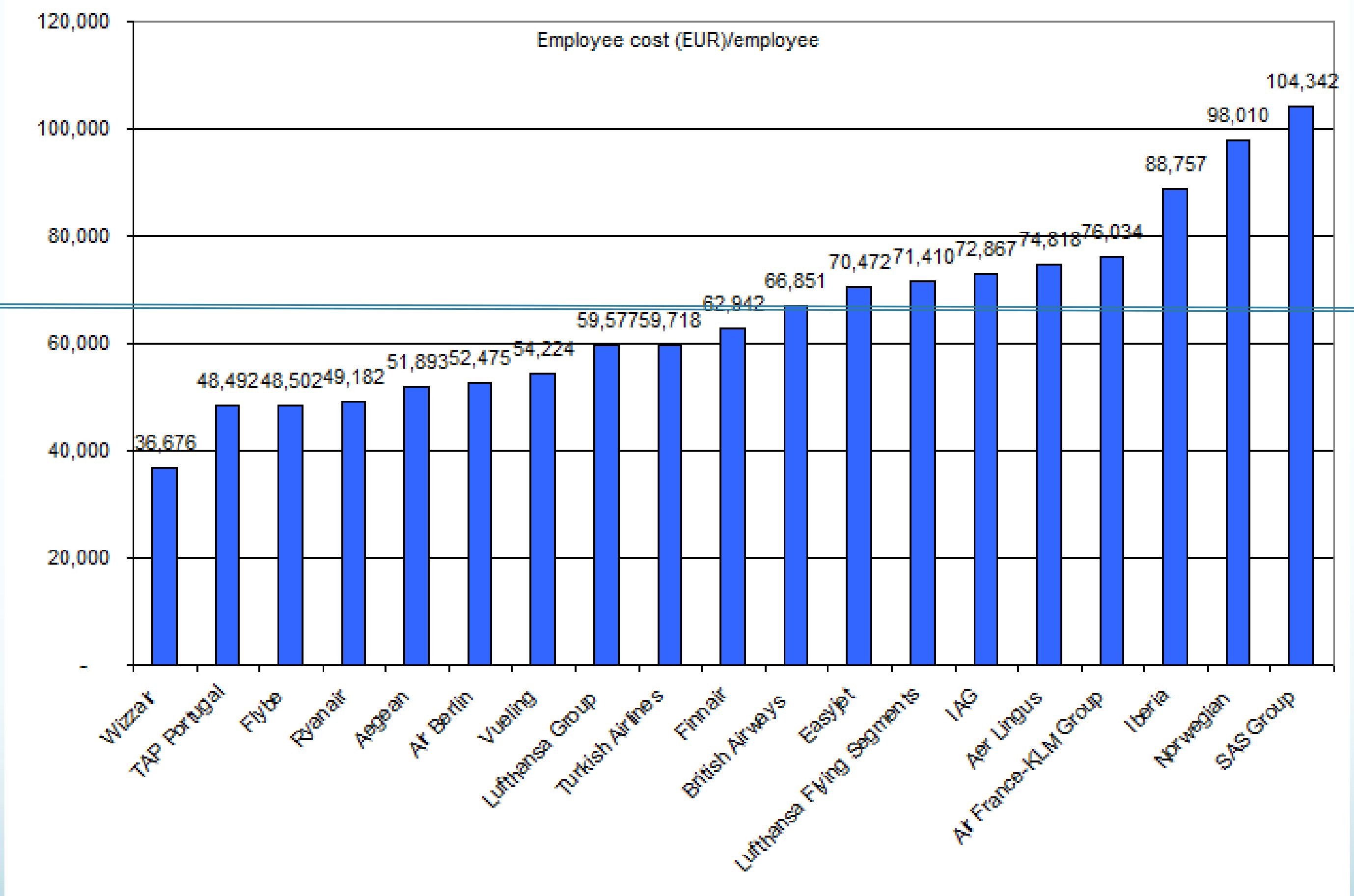
- Operational and network innovations (not copied by NWCs)
  - fleet commonality
  - Fast rotations at less busy airports
  - Seasonality absorbed by grounding part of the fleet
  - Rigorous labour policies (see next slides)
  - Point-to-point without costly transfers, often less than daily frequencies
  - Focus on cheaper regional airports: difference between lowest and lower
  - Multiple aircraft and crew bases (see next slide)

Multiple aircraft and crew bases



Labour costs of NWCs and LCCs

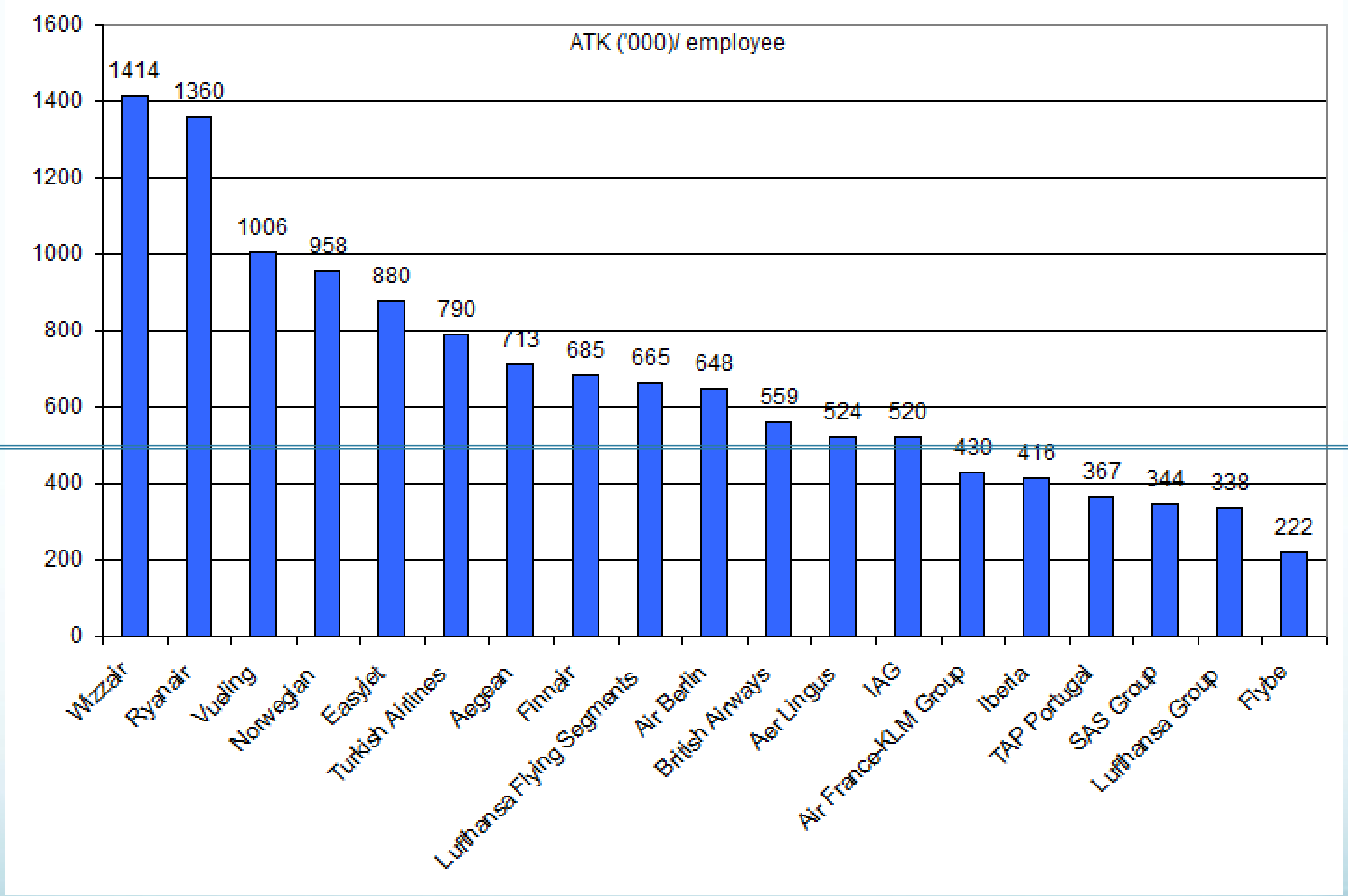
Overall average European carriers: € 68.871



Source:CAPA

Labour productivity of NWCs and LCCs

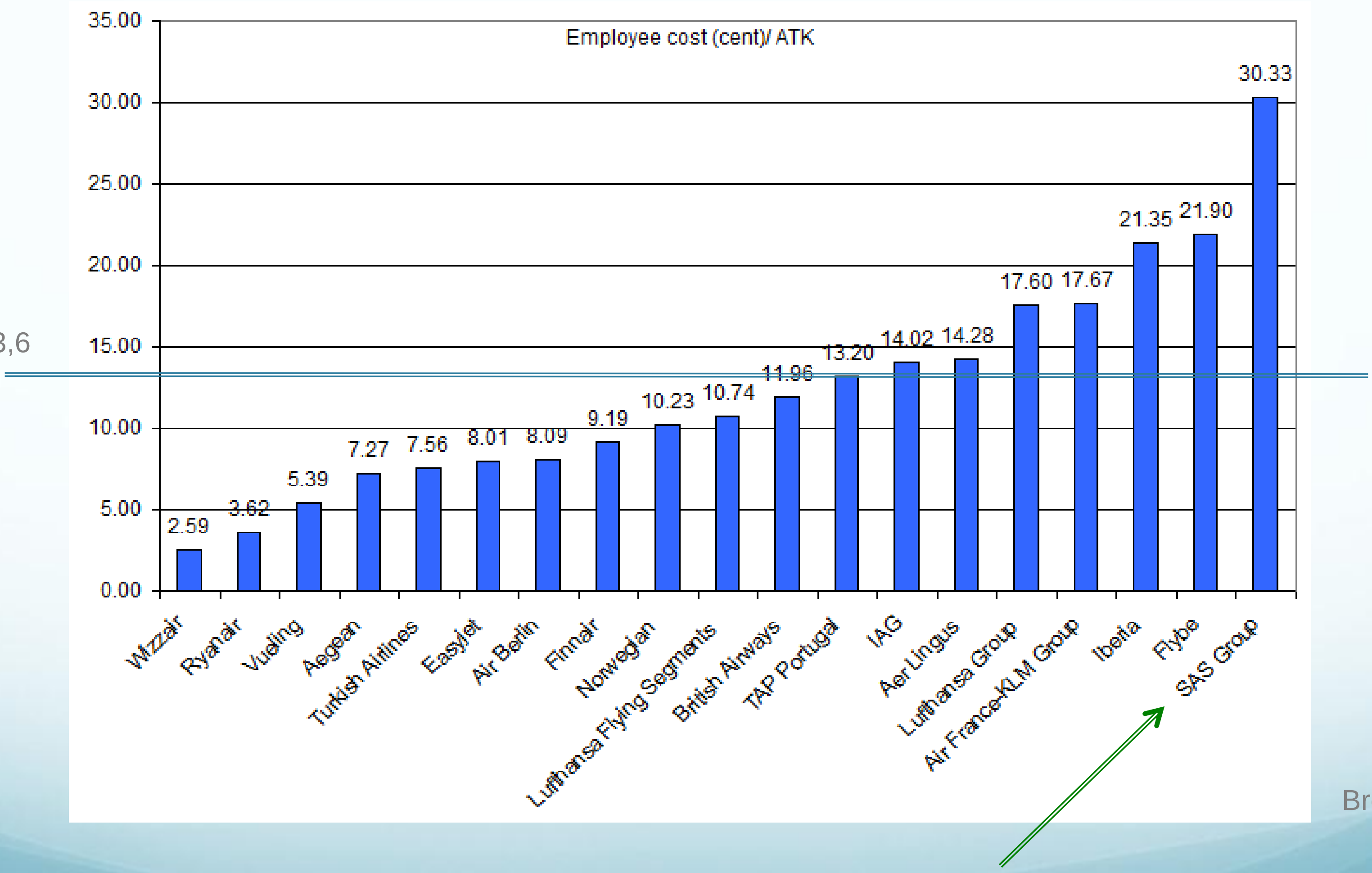
Average ATKs/empl: 507.000



Bron:CAPA

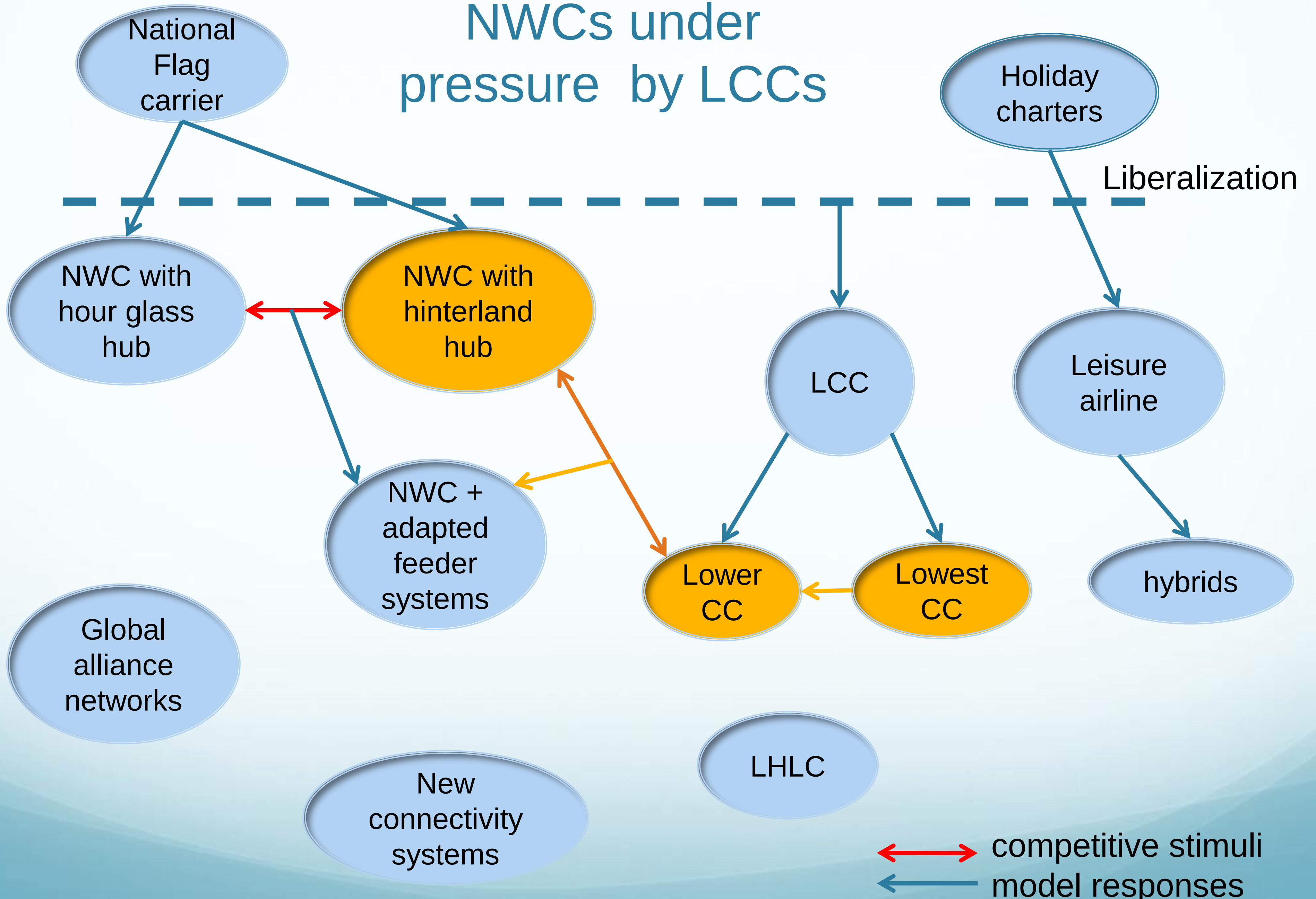
Result: labour costs per ATK

Average: 13,6 ct



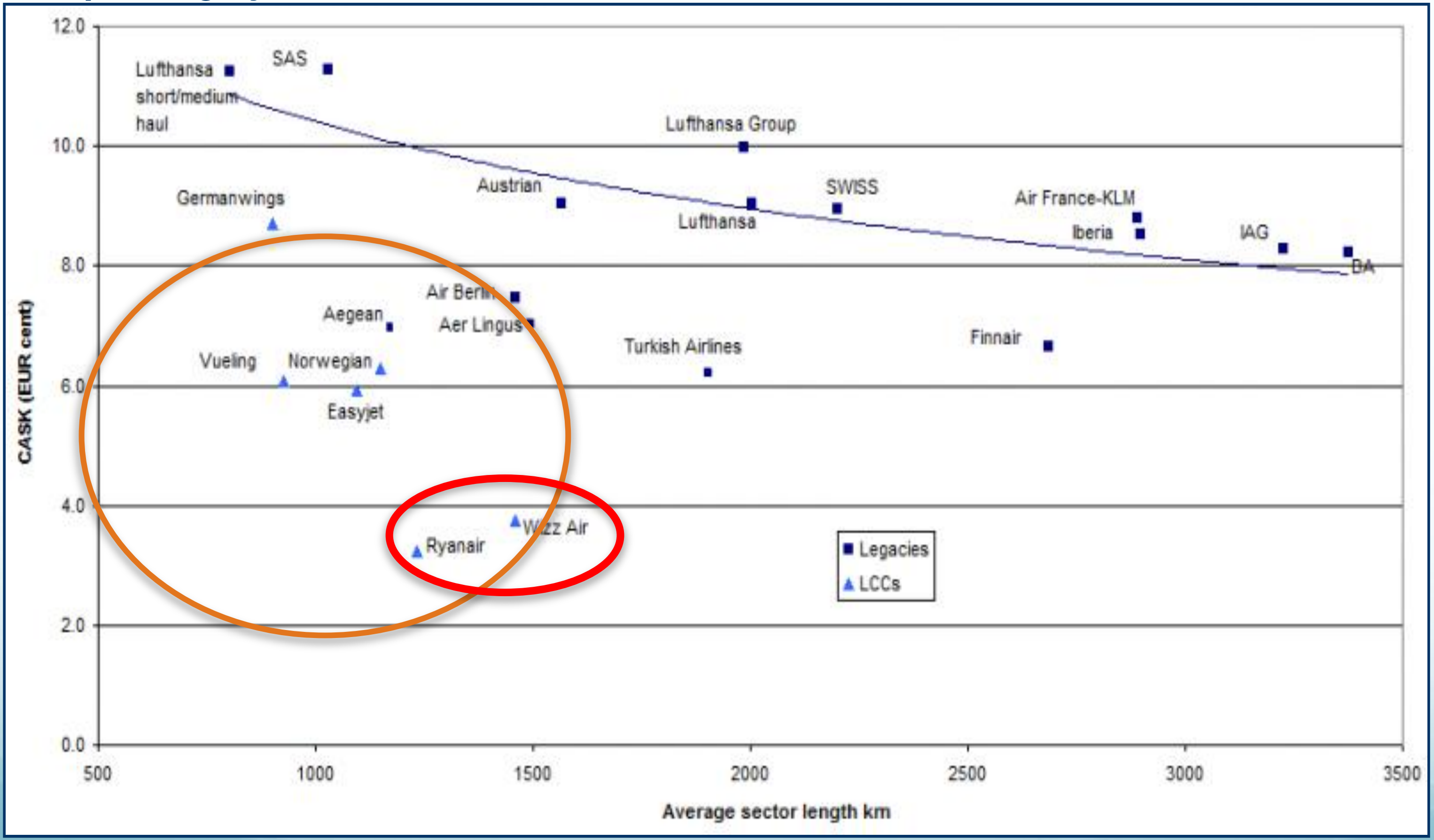
Bron:CAPA

NWCs under pressure by LCCs



Competitiveness of NWCs and LCCs: unit costs

Unit costs (cost per available seat kilometre, EUR cent) and average sector length for selected European legacy and low-cost carriers: 2012*



*Financial year ends as follows: Germanwings Dec-11, Aegean Airlines, Air Berlin, Turkish Airlines, Lufthansa, Aer Lingus, IAG, Iberia, BA, Air France-KLM, Finnair, Norwegian, Vueling Dec-2012; SAS Oct-2012; easyJet Sep-2012; Wizz Air, Ryanair Mar-2012.

Source: CAPA analysis of company accounts and traffic data

NWC model under pressure of LCCs

- Very substantial inroads of LCCs in the European market: Dobruszkes: 31% of European ASK (based on OAG Jan 2013), Doganis 47% (based on OAG August 2013). Explanation?
- Increasing direct competition of *Lower*CCs such as EZY on AMS-Geneva
- Increasing indirect competition of *Lowest*CCs such as Ryanair on EIN-Rome Ciampino versus KLM on AMS-Rome Fiumicino) (US: 'Southwest effect')
- **NEW!** Direct competition of *Lowest*CC: Alitalia at Rome Fiumicino and Brussels Airlines under attack by Ryanair (see next slide)
- Intra-European O-D passengers in the NWC feeder systems creamed of by the LCC.
- Lower yield of the intra-European O-D pax segment urges NWCs to redesign their feeder systems

Also lowest cost carriers in direct competition with NWCs?

Recent messages in the media

- **Anna-aero:**

Ryanair network re-invention begins with bases at main Brussels and Rome airports

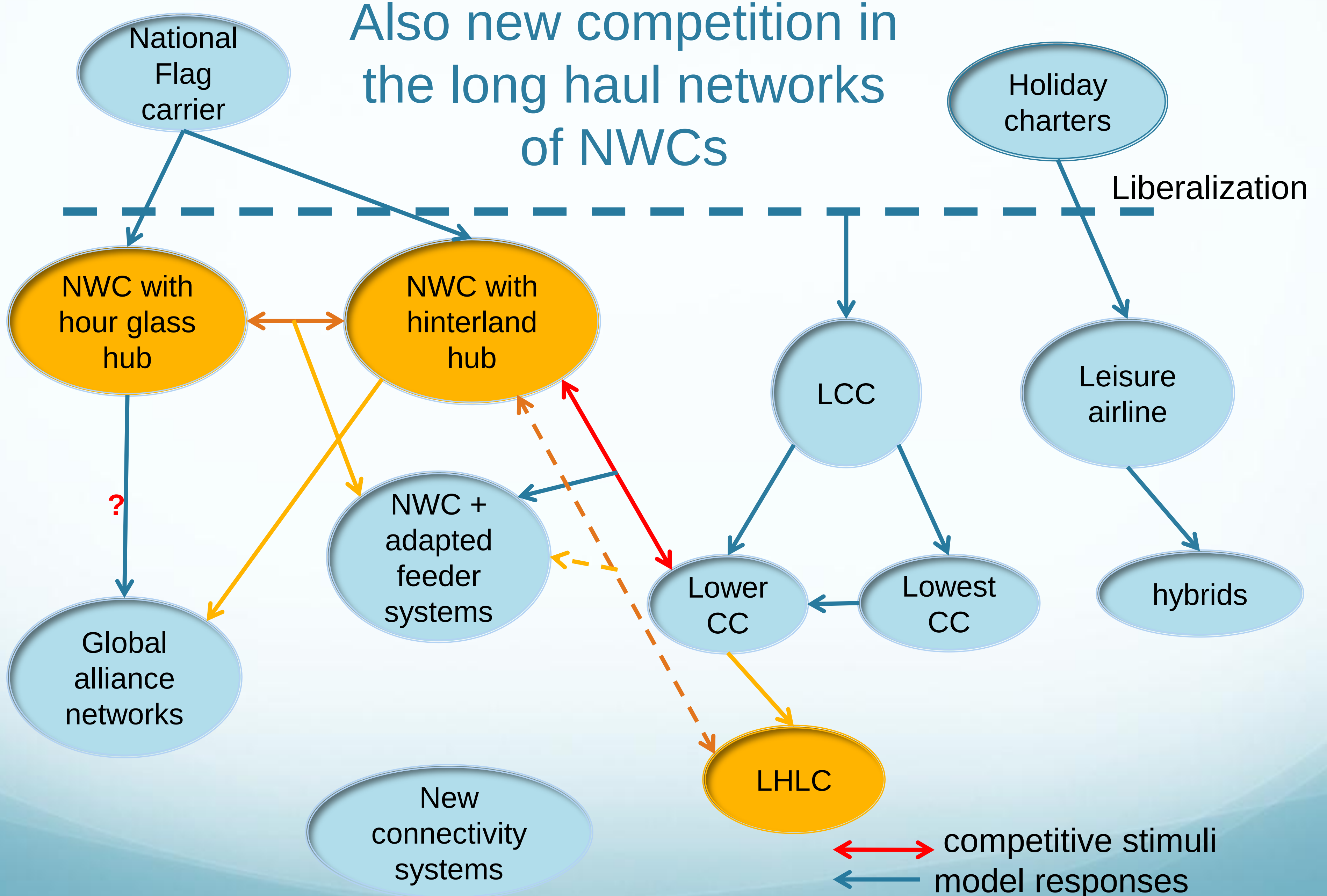
- **CAPA:**

Ryanair announced (27-Nov-2013) it will open its second Belgian base at Brussels Airport in Feb-2014, with four based aircraft and ten new routes.

The carrier expects the new base will add 1.5 million passengers p/a, as well as creating 1500 new jobs in Brussels. Ryanair CEO Michael O'Leary said: "Ryanair is delighted to announce Brussels Zaventem as our second base in **Belgium** in addition to Brussels Charleroi. These 10 new routes with daily or multiple daily frequencies to Alicante, Barcelona, Ibiza, Lisbon, Malaga, Palma, Porto, Rome, Valencia and Venice, are ideal for business passengers or families booking getaways from summer 2014, who can also enjoy Ryanair's recently announced customer service improvements."

- See also: "the growth limits of the LCC model" in JATM

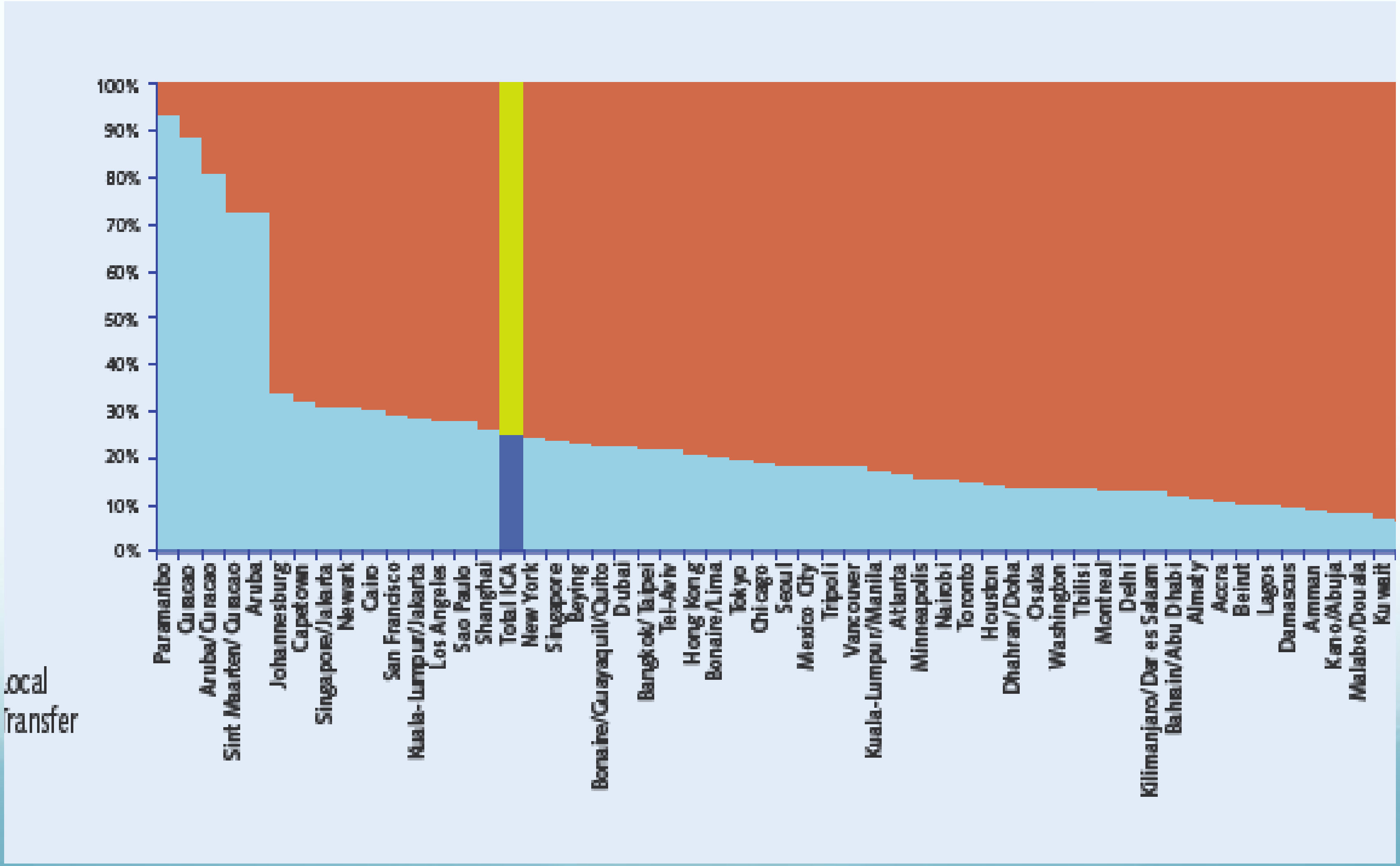
Also new competition in the long haul networks of NWCs



Threat of a ‘new’ NWC model

- **European NWCs with hinterland hubs** connect loss making short haul operations and profit making long haul operations (see KLM transfer shares on ICA destinations)
- **Gulf NWCs with hour glass hubs** connect long haul operations only, such as SIA, Etihad and Emirates
- Competitive impact larger than arche type SIA due to hub locations
- Unit costs of NWCs with hour glass hubs much lower due to
  - technological economies of scale of long haul wide bodies only (see next slide)
  - Distance related decreasing costs per ASK: see next slide

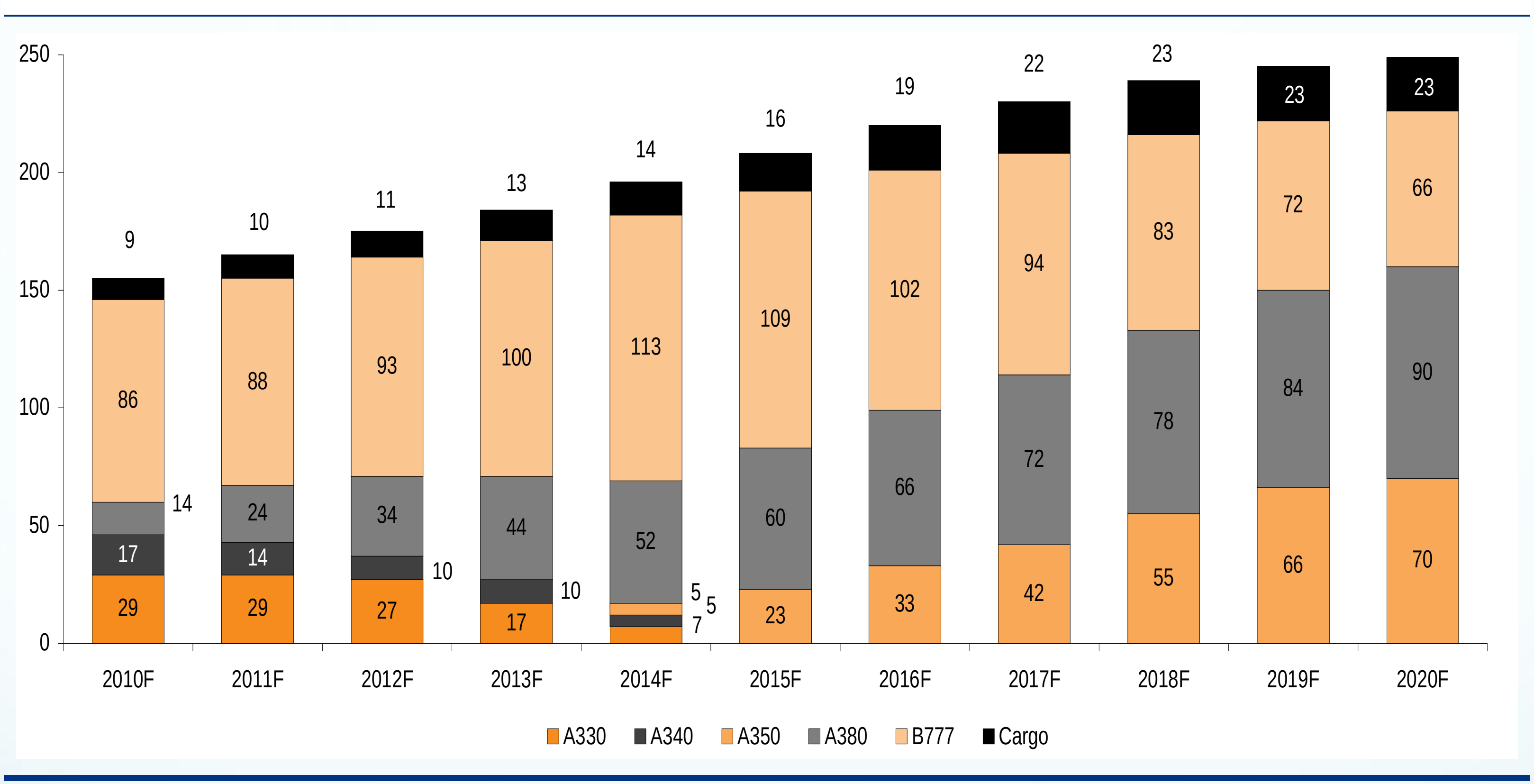
Transfer shares at a hinterland hub: KLM at AMS



Hinterland hub NWC also under pressure of hour glass hub NWCs

Airline	**Average distance flown per pax (in round km)**	**CASK in euro cents**	**Type of FSC**
Singapore Airlines	5150 km	5.4	Hour glass hub long haul
Emirates	4800 km	6.2	Hour glass hub long haul
BA	3350 km	7.9	Semi hub with limited short haul network
AF-KLM 2)	2900 km	7.2	Hinterland hubs
Lufthansa 3)	2000 km	9.3	Hinterland hubs
SAS	1000 km	12.4	Euro hub

Competitive threat illustrated by EK



Source: RBS forecasts

Bron: RBS

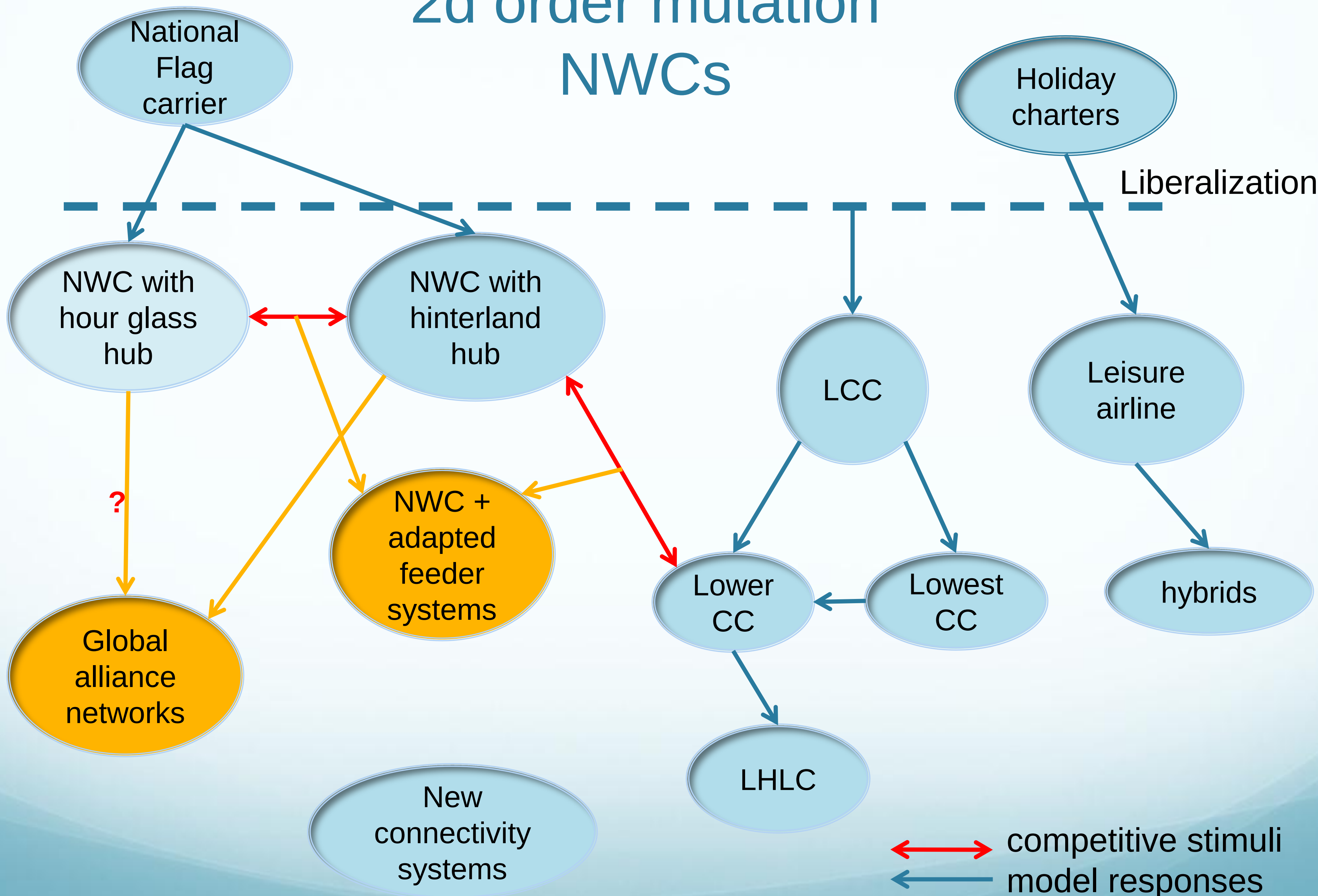
10 jaar vlootuitbreiding en schaalvergroting:

- van 155 naar 249 wide body vliegtuigen
- van 14 naar 90 A380s en van 86 naar 66 B777s!
- Van 46 A330/340s naar 70 A350s
- Dubai Air Show nov. 2013: 50 A380s extra (75% replacement, 150 B777X)

Second order mutation of LCC model: long haul low cost

- Long haul, Low cost: an old story (Freddie Laker in the 70s)
- A famous graveyard of initiatives: Zoom, EOS, Oasis, MAXjet, OpenSkies
- Reasons for failure: LCC cost advantages shrink on long haul, but B787 may become a new challenge for this model mutation
- Viable alternatives in SE Asia: AirAsiaX and Jetstar
- New European intiative: Norwegian
  - Oslo/Stockholm: Bangkok, Fort Launderdale and JFK. Gatwick: JFK, Fort Launderdale, LAX. (no feeder system, no daily frequency, B787, half the NWC price)
- Consequence: NWC also under pressure in their frontyard by LCCs

2d order mutation NWCs



Competition for European NWCs from two sides

- More competition in backward connectivity
  - For example KLs MAN-AMS-SIN service now contested by EK's MAN-DXB-SIN (twice daily A380 service)
  - A greater need for cost reduction in the feeder system
  - Aggravated by LCC inroads in the European O-D market
- More competition in the forward connectivity
  - For example KL's AMS-BKK now contested by EK's AMS-DXB-BKK
  - The need to improve accessibility to new intercontinental markets via alliances and codesharing
  - For example: KL/AF-Etihad codeshare agreement to gain acces to Indian market

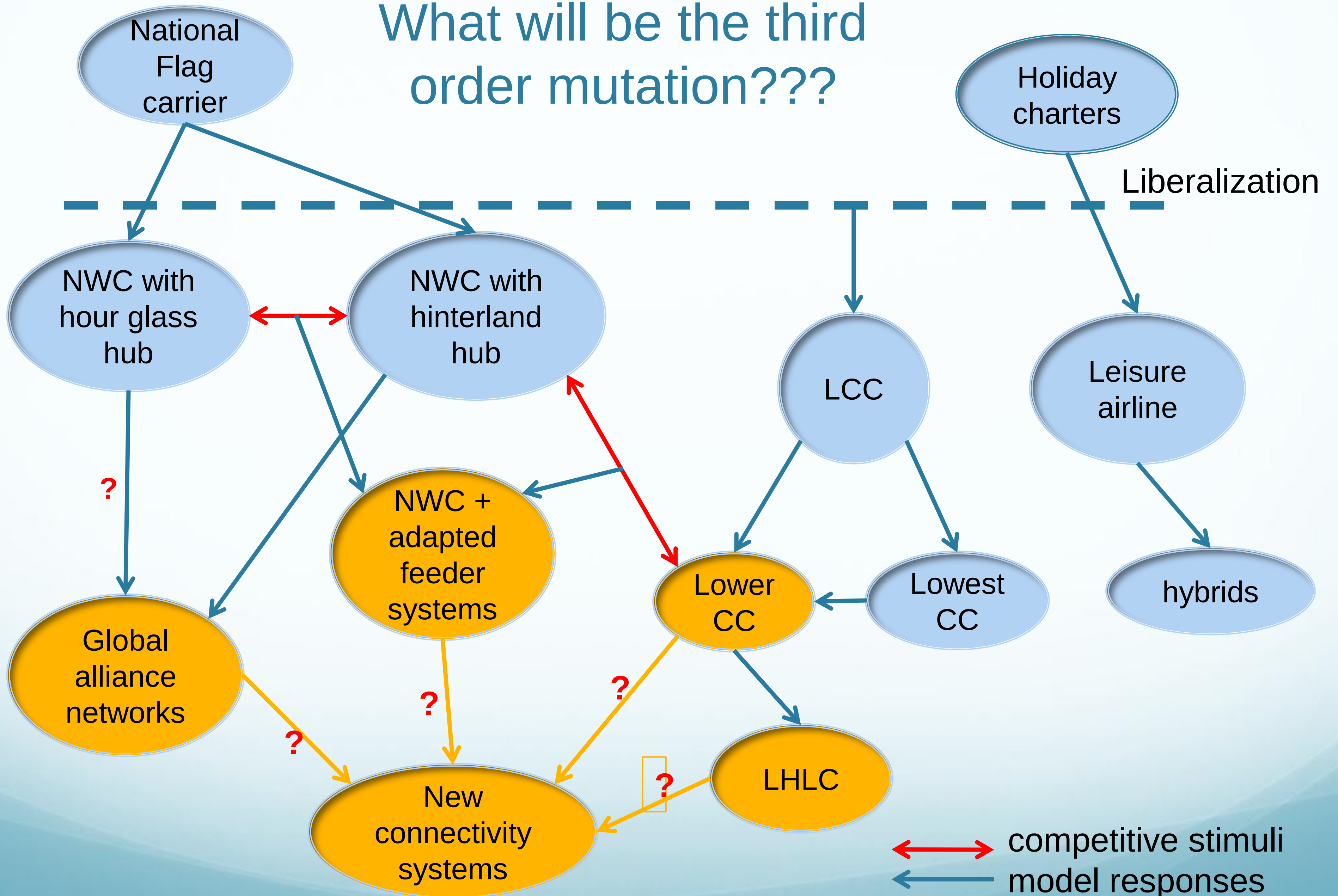
second order NWC response 1: adapting feeder systems

- At the home base
  - IB at MAD: IB Express and Vueling as feeders
  - LH: non-hub operations to Eurowings (relatively cheaper)
  - AF: regionals bases and HOP! ????
  - KLM: all European flights under Cityhopper labour conditions?
- Barriers for LCC feeder systems at the home base:
  - Cost increase due to lower aircraft utilization in a wave system
  - Pro-rating tariffs for transfer pax
- LCC feeders at ICA airports elsewhere
  - KLM: Pegasus, Westjet, Gol
  - Emirates at MXP: easyJet
  - LH at JFK: JetBlue

Second order NWC response 2: codesharing and alliances

- Focus of first open skies agreement *plus ATI*: connecting hubs of KL and NW to stimulate behind and beyond traffic in two continents by metal neutral operations in a joint venture
- Different levels of cooperation to stimulate economies of scope in coupled intercontinental H&S networks
  - Full alliance partners (marketing, FFPs, revenu sharing, metal neutral etc.)
  - Network specific codesharing agreements
  - Route specific codesharing agreements
- How to encapsulate New NWCs: Emirates as a major problem of European NWCs.

What will be the third order mutation???



Third order mutation of business models near?

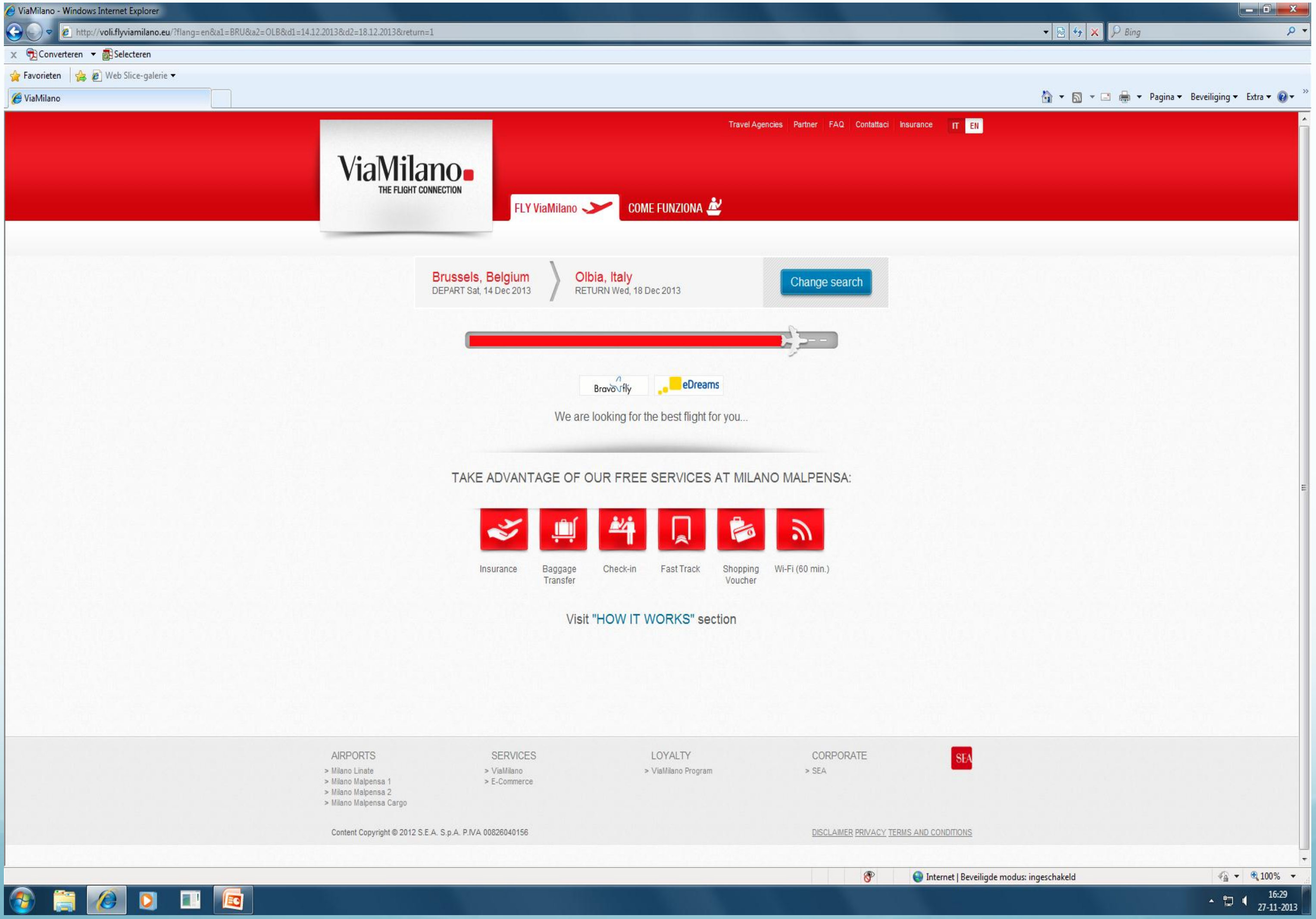
- Re-inventing the hub & spoke model?
  - The case of SWA (see next slide)
  - Is such a model viable in Europe (average travel distance)
- Is there a new role for the airport in network connectivity?
  - First mover Cologne
  - New movers:
    - LGW (U2-U2 en U2-Norwegian)
    - Singapore airport Changi
    - MXP: ViaMilano: http://www.flyviamilano.eu/en (see next slides)

Self-connecting pax of SW

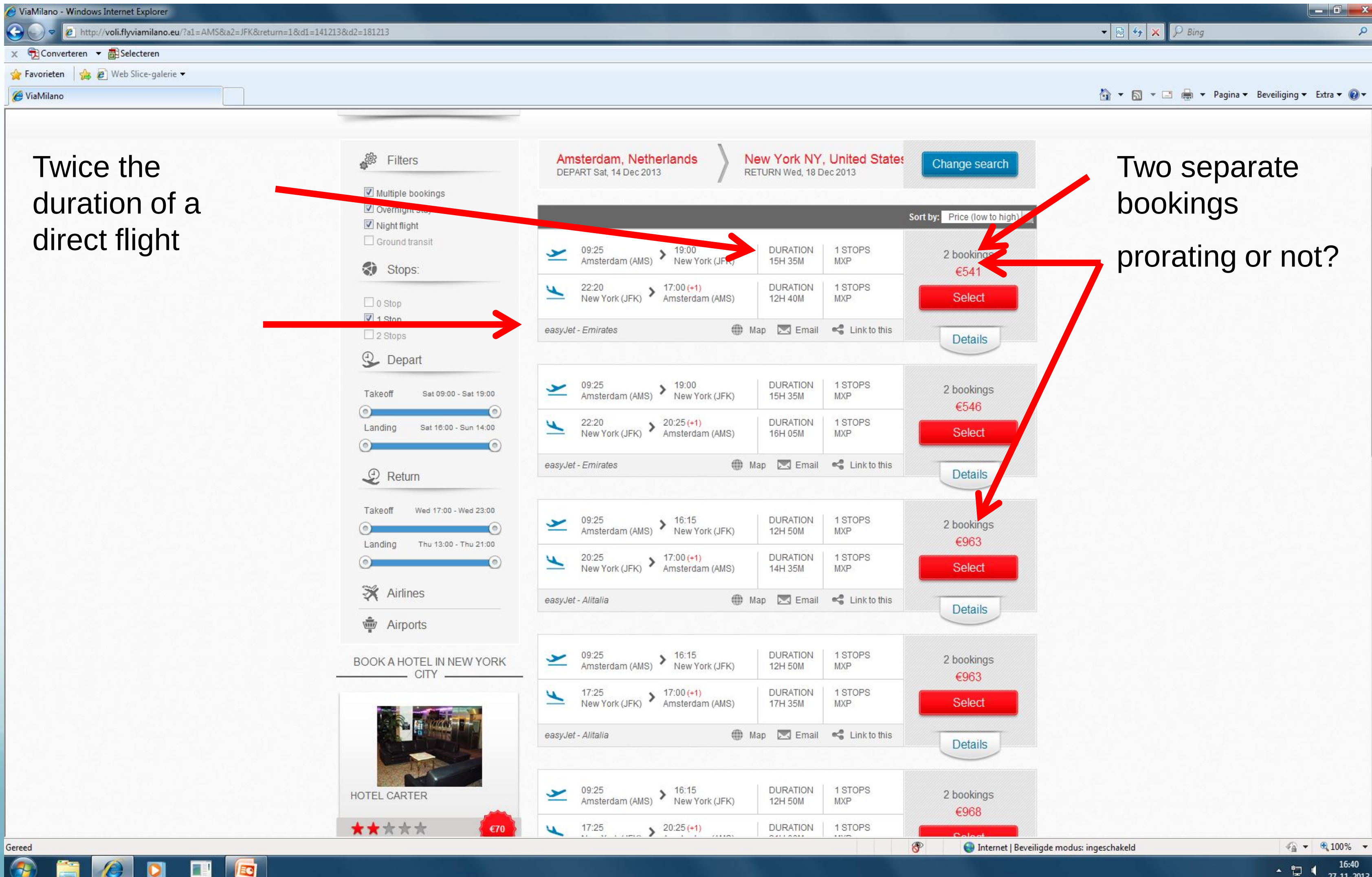
Airport	**Non local passengers on board**	**Share of non local passengers**
Chicago Midway(MDW)	1,446,217	43.2%
Houston Hobby (HOU)	731,461	37.0%
Baltimore (BWI)	906,573	36.6%
Nashville (BNA)	422,578	35.8%
Dallas Love Field (DAL)	625,128	33.4%
Denver (DEN)	645,809	31,9%
Saint Louis (STL)	341,286	30.2%
Phoenix (PHX)	860,513	28.8%
Las Vegas (LAS)	1,060,372	27.9%
Kansas City (MCI)	211,382	20.9%
Total	*7,251,319*	**33.2%**

Source: Boyd group 2010

Connectivity provided by the airport



How to create new connections with independent carriers?



Final question

- What is the likely outcome of all these changing business models for Europe in the next ten years?

- Thank you for your attention!