Airport connectivity and airline network dynamics in Europe

Dr. Guillaume Burghouwt
Head of section aviation economics

g.burghouwt@seo.nl

seo economic research

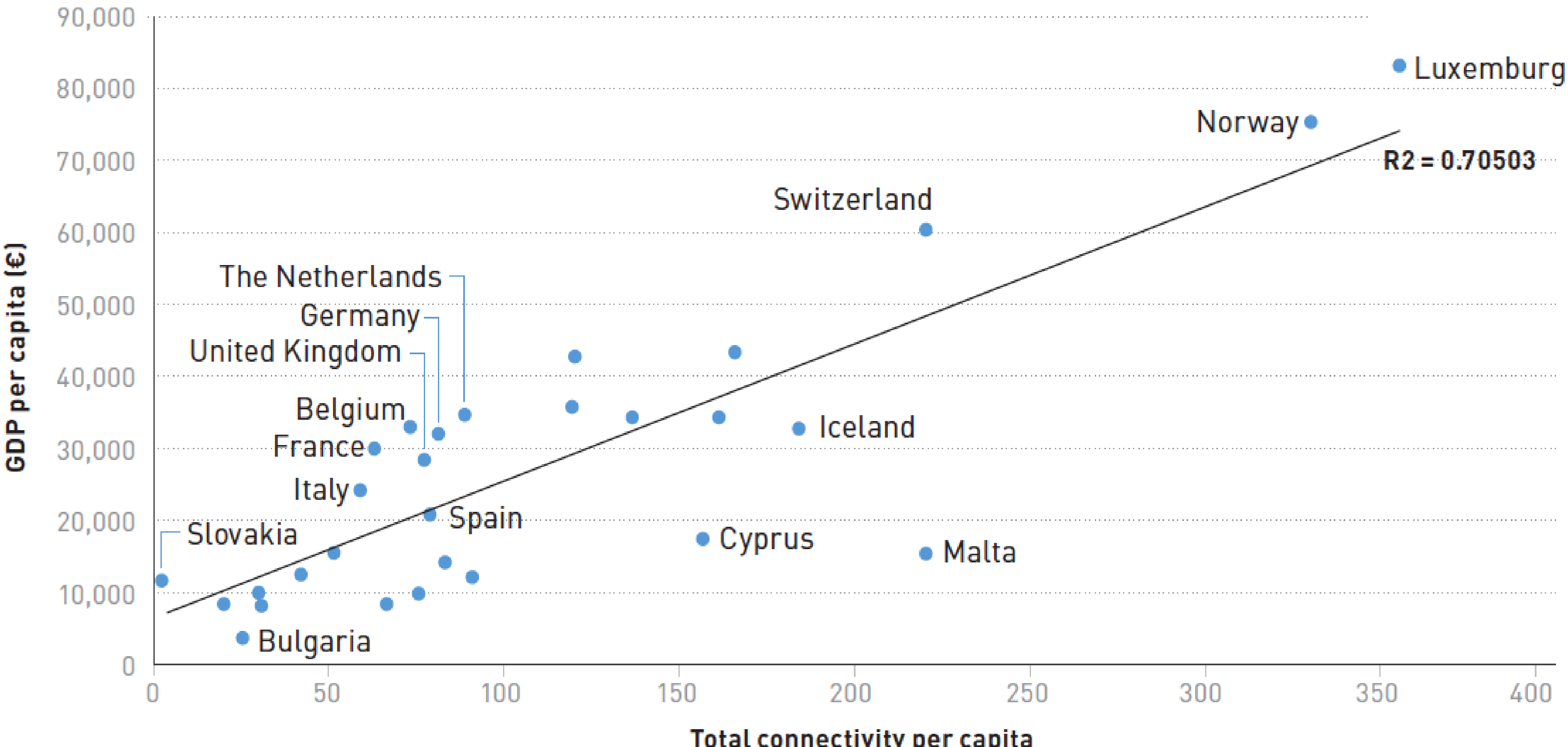
Take-aways

- Connectivity is key to competitiveness
- Connectivity growth at European airports
- European airline hubs key to connectivity

- Yet, European hub carriers under pressure
  - Cost levels
  - Exposure to low-cost competition
  - More and more traffic via non-EU & Gulf hubs

- Consolidation, rationalization, cost cutting, redefinition of hub models seo economic research

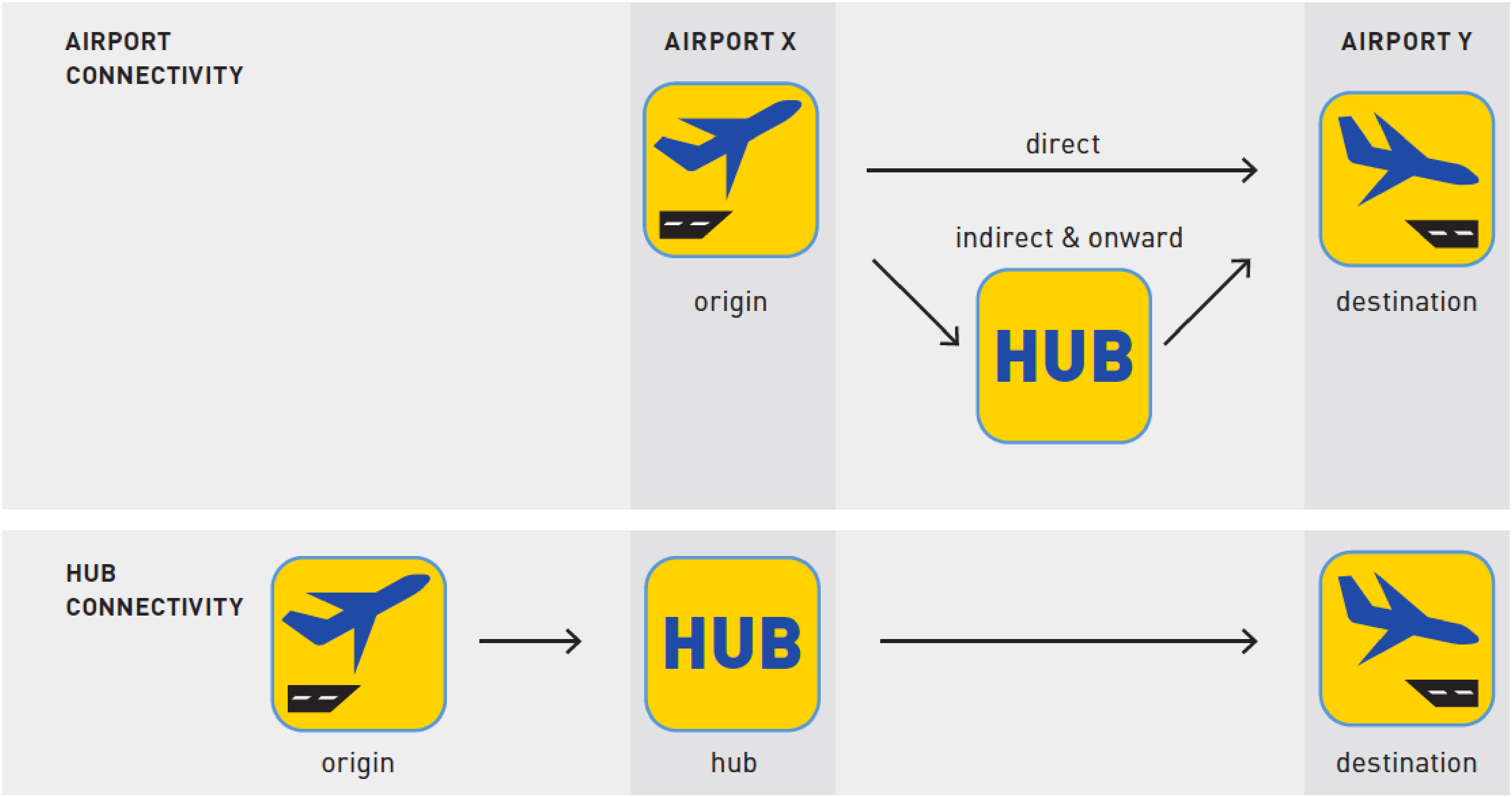
Connectivity is key to competitiveness



Increasing empirical evidence on (wider) economic benefits of connectivity by air

- **Connectivity growth reduces travel costs for consumers and results in consumer welfare gains**
- **Growth of 10% in long-haul connections results in 4% growth of international headquarters in European metropolitan regions (Bel & Fageda 2008)**
- **New routes improve regional Foreign Direct Investment (Redondi et al. 2011)**
- **Connectivity improvements stimulate R&D performance in German regions (Barrufaldi & Burghouwt 2014)**

Three types of connectivity

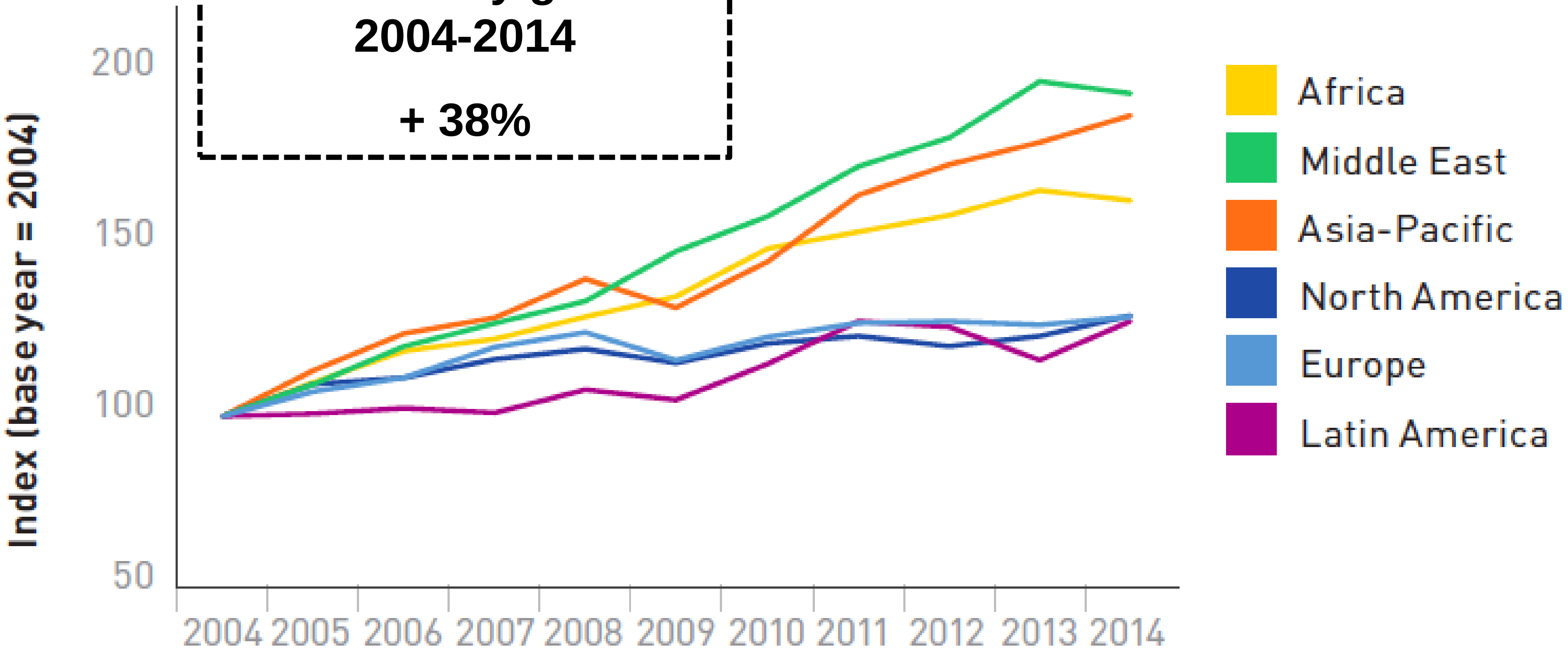


Source: SEO

Substantial European airport connectivity growth during last decade

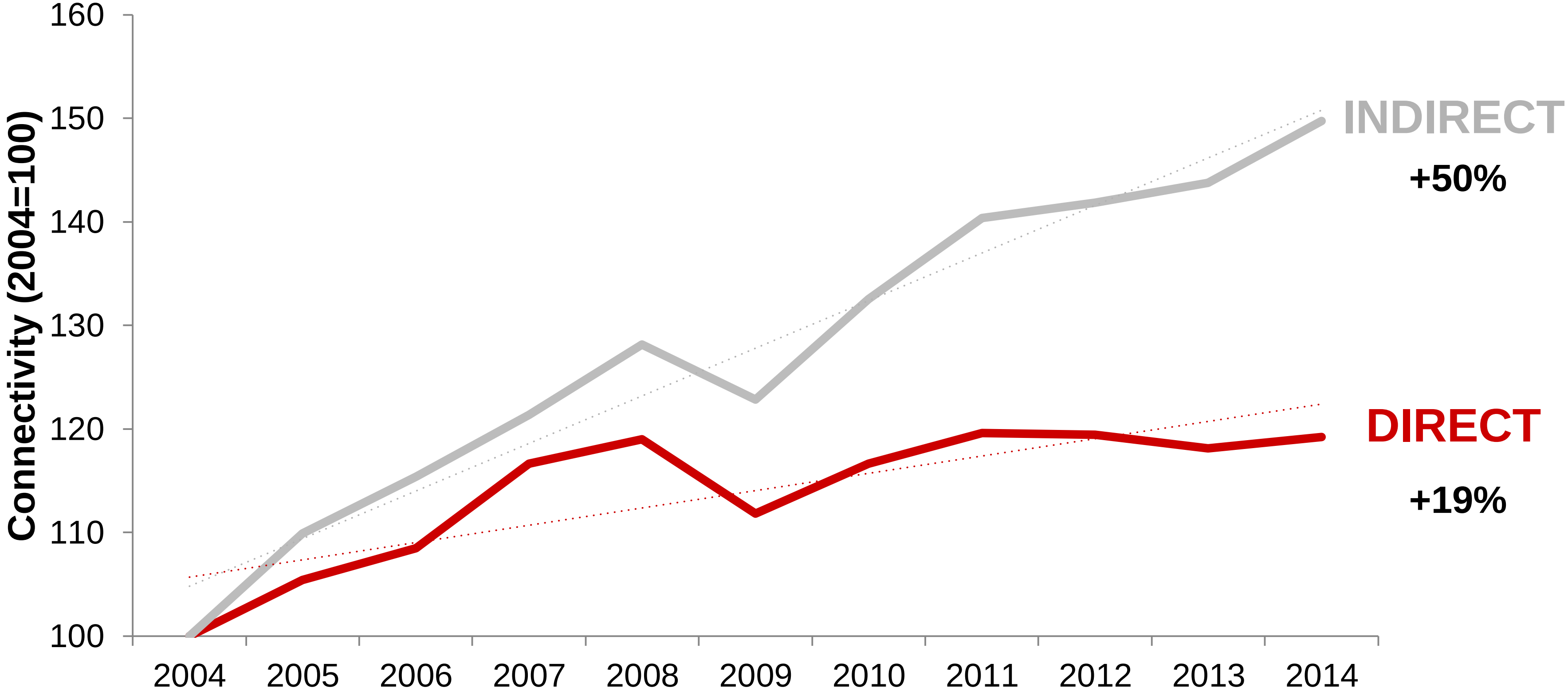
Total airport connectivity growth 2004-2014

+ 38%



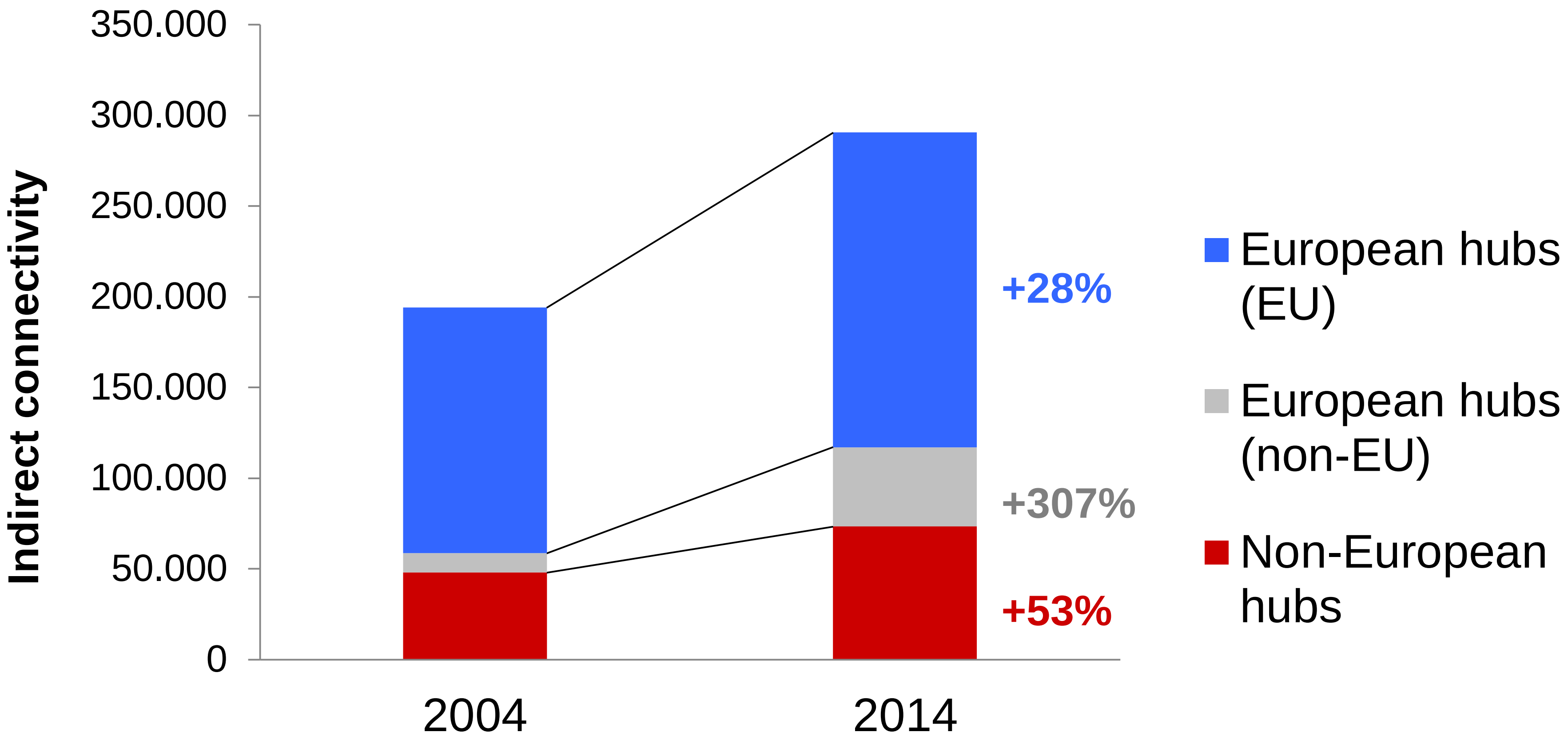
Source: ACI Europe & SEO 2014

Majority of connectivity growth comes from the growth in indirect connections via other hubs



Source: ACI Europe & SEO 2014

An increasing share of European connectivity channeled through non-EU hubs



Source: ACI Europe & SEO 2014

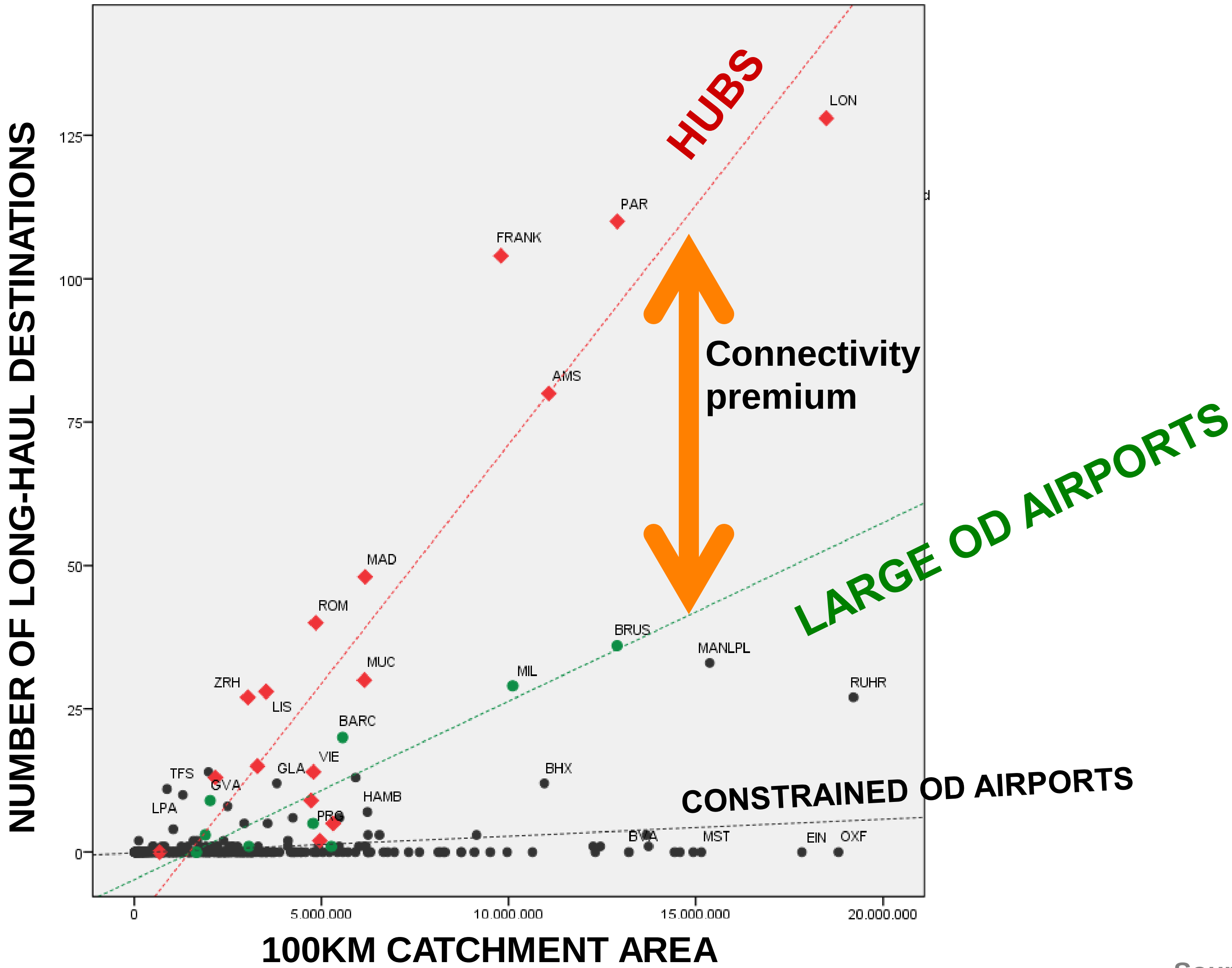
Hubs are key to connectivity

- Airline hubs give European metropolitan areas a connectivity premium: hubs allow metropolitan areas to grow their network far beyond what their local market can support

- Airline hubs are the smaller cities' one-stop gateways to the world

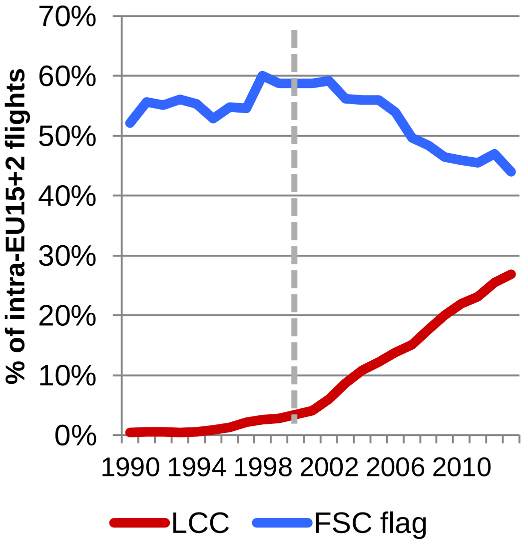
- Indirect travel options through hubs add competition and choice for the consumer on directly served markets

Hubs allow metropolitan areas to grow far beyond the size of their local market

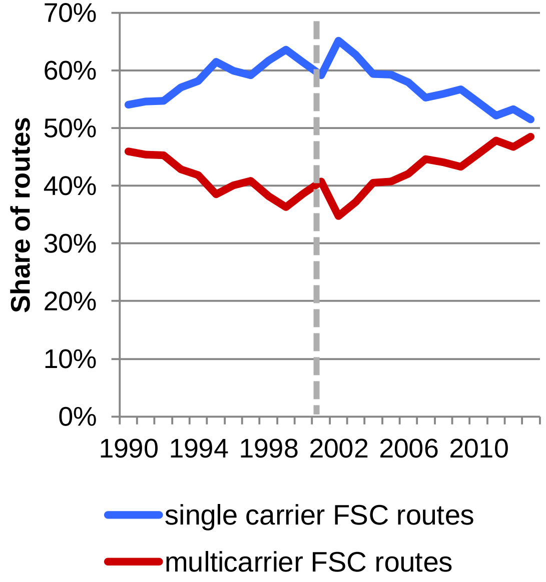


Source: OAG; SEO catchment area database

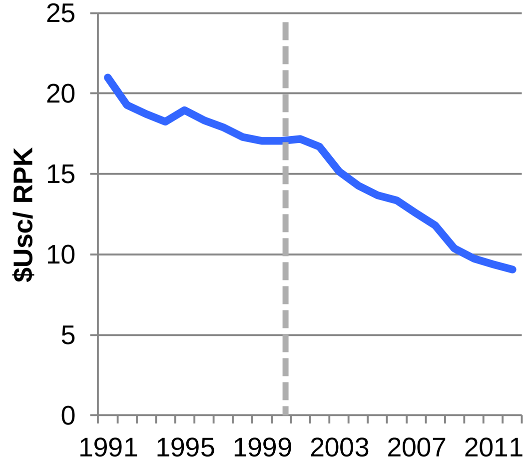
EU market share down



Exposure to competition at EU route level up

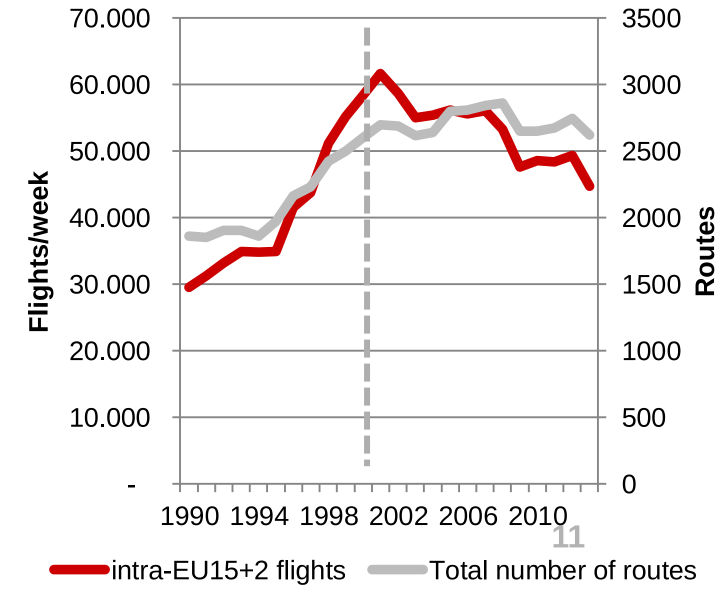


Real yields down



European hub carriers under pressure since 2000s

Flight/route growth stagnating



The market environment for European hub carriers is tough

From within

- High cost levels of Europe's legacy carriers

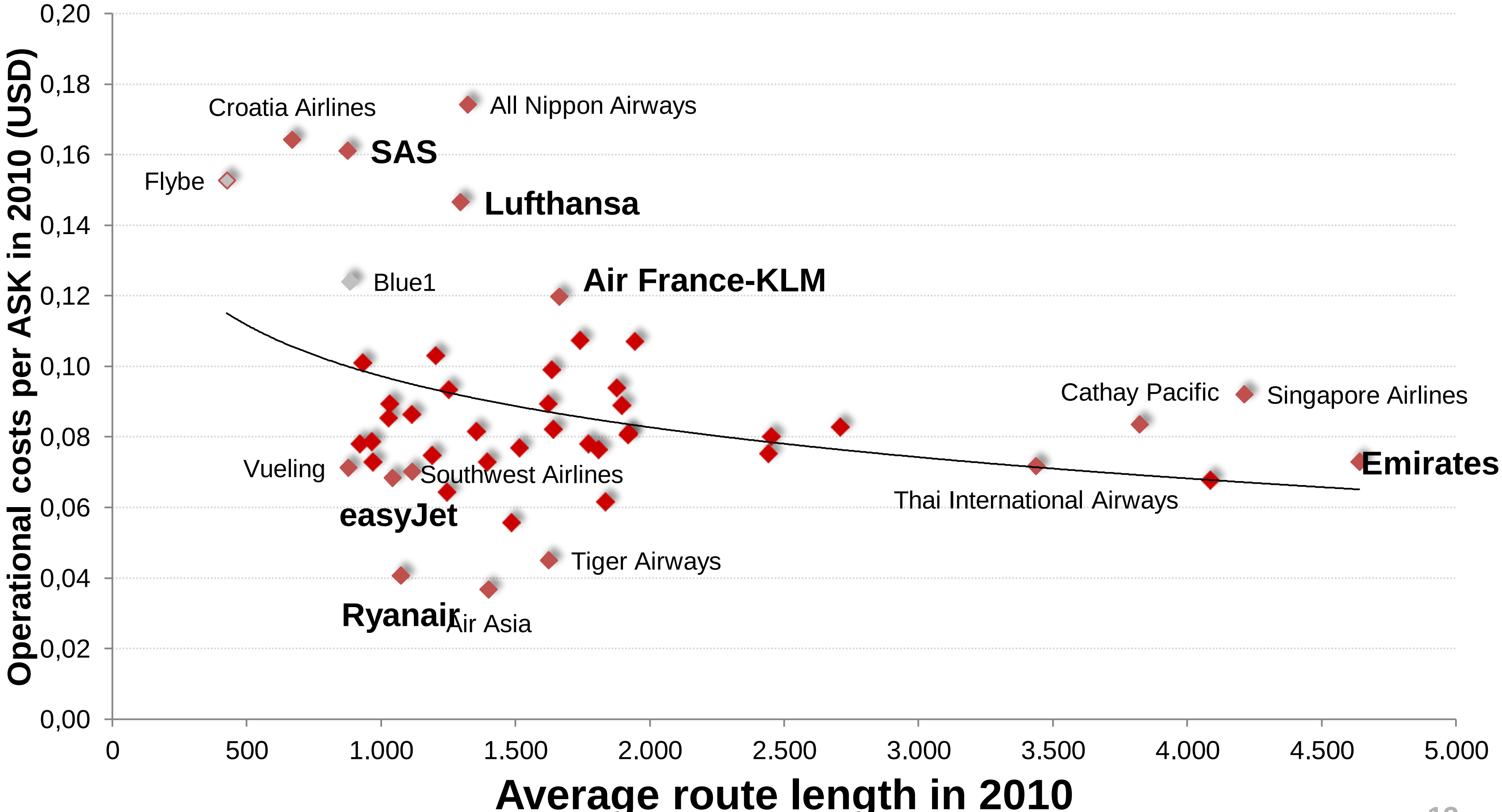
Internal

- Increasing exposure to head-to-head competition by low-cost carriers

External

- Intensifying hub competition due to rise of Middle East and Turkey hubs

High unit costs of European network carriers



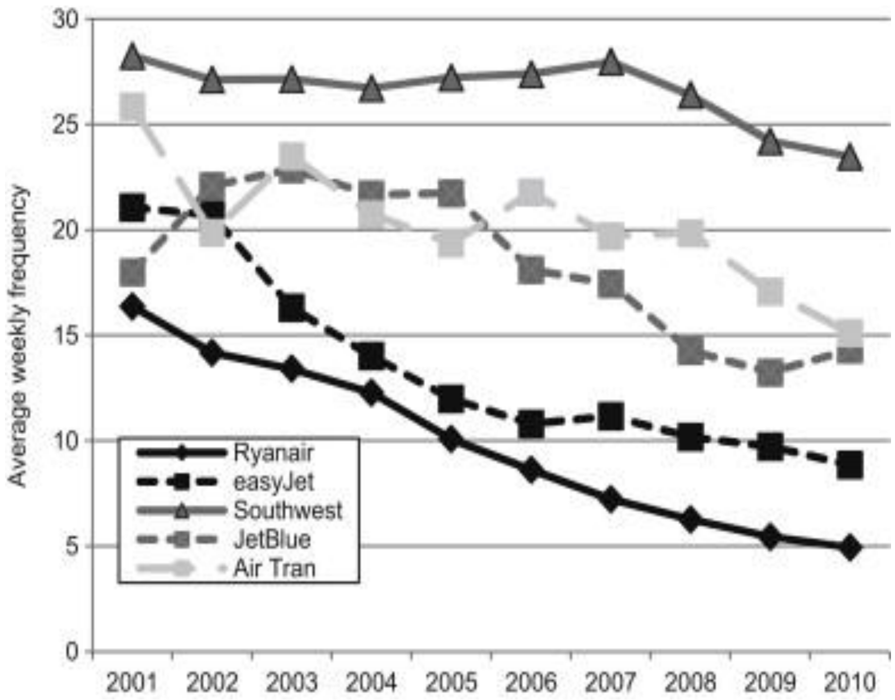
Source: airline annual reports

Traditional low-cost markets in Western Europe reach saturation

- Low-cost carriers in search of new markets as low hanging fruit has been 'consumed'
  - Longer routes
  - More low frequent routes
  - Connecting traffic
  - More route churn
  - Entry of ultra LCC's to primary airports

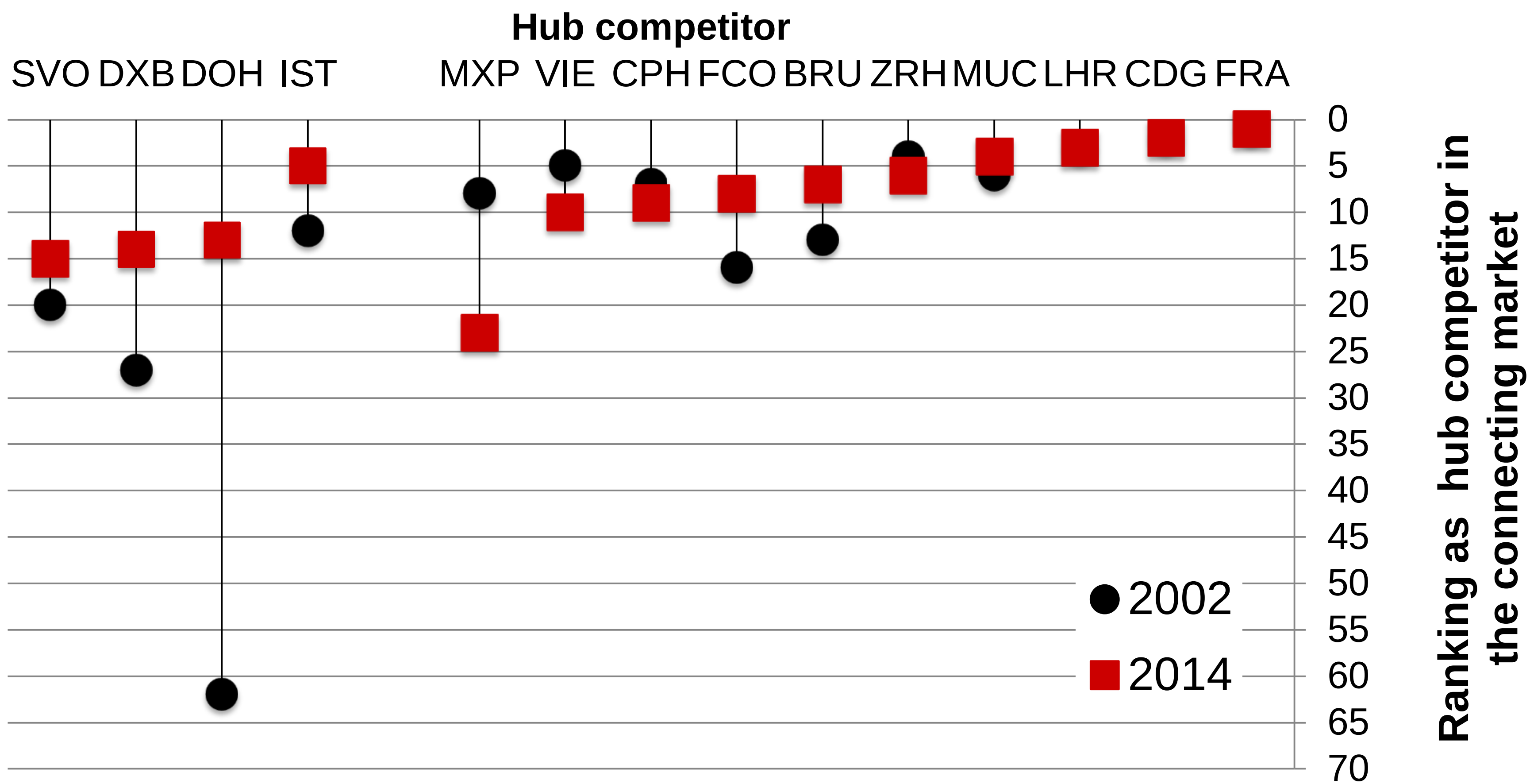
➢ **Increasing route overlap between hub carriers and low-cost carriers**

Average route frequency down



Source: De Wit & Zuidberg 2012

Increasing competition in connecting market from outside the EU



The case of AMS

Source: SEO Netscan

As exposure to competition on short and long-haul is likely to increase further, we expect:

- Continuing pressure on cost level
- Ongoing industry consolidation
  - Bankruptcies
  - Mergers to achieve cost synergies and a more attractive network
- Network rationalization
- Redefinition of the hub carrier business model

The rise and rationalisation of EU hubs