THE FUTURE OF LOW-COST AIR TRAVEL

Dorota Liptakova, Edina Jencova, Juraj Vagner

Abstract

The aviation market changed over the course of half a century. Important milestones shaping todays face of this industry were deregulation as well as development of low cost business model. Clearly distinctive in the past, today the low cost product is becoming of interest for traditional carriers. What course of action can the low cost carriers take in order to keep their competitive advantage? The article summarizes historical background as well as latest development and expected trends in low cost air transportation.

Keywords: *airline, alliance, low cost, no-frills, self-connect*

1 INTRODUCTION

Air transport has evolved over the course of a century, from the first attempts of dreamers and adventurers to put fragile and unstable machines into air, into today´s state when at any moment more than 10,000 aircraft carry as many as 1,500,000 people worldwide. In addition, air transport has never been more accessible. State regulation of aviation in the mid-20th century ensured the development of aviation in the nation´s interest. Deregulation of the market in the 1980s and 1990s led to the liberalization of relations and the development of competition. Nowadays, lower-income groups can also afford flying usually by low cost companies. Is the low cost model really sustainable and what will be the future development of the air transport market?

2 THE FORMATION OF LOW COST COMPANIES

An important factor in creating low cost transport was the enforcement of deregulation on the individual air transport markets, together with the adoption and ratification of new liberalizing international treaties. From the beginning low cost carriers have been clear in offering air transport at lower prices in exchange for less comfort. The whole concept originated in the United States of America and subsequently spread to the entire world.

Pioneers in “cheap” air transport were Rolling King and Herby Kelleher, who in 1967 decided to set up the American airline named South West CO. It was not until 1971 that the company changed its name to SouthWest Airlines, which operates until today. The company was created in Texas, thereby avoiding the federal regulation of the aviation in the United States. The first scheduled flights began in 1971 within the state of Texas. The deregulation act in 1978 was a strong growth impulse when the company began to operate flights between other US federal states. At present, this company is one of the largest players in low-cost transport across the US market, but also in the world market when it comes to the number of passengers transported in one year. [8]

Following the South West success other low-cost carriers came to existence. In the US the most significant carriers were for example Spirit, Frontier, Allegiant, Virgin America, JetBlue, Sun Country Airlines. Some companies seized their activity over the time, such as ATA Airlines and Tower Air. Similar development could be seen on the European air transport market, where some companies cancelled or were absorbed by those with better marketing, management or product.

On the European market, the Irish company Ryanair appeared as the first low-cost carrier in 1985. Since its inception from 1985 to 1988, the company had experienced dynamic growth, accompanied by the growth in the aircraft fleet size, number of connecting flights and aggressive pricing policy. Their success was reflected by the market share of standard carriers such as Aer Lingus and British Airways which started to shrink by 1989 under the influence of the Irish carrier. An important factor for Ryanair´s success was the treaty liberalising the market between the United Kingdom and Ireland in the 80´s, as a result of which the company achieved its great success with the London-Dublin route. [5]

The second major player in the field of low-cost transport in Europe is EasyJet. It was established in 1995 in the UK. Its first route connected London and Scottish Glasgow with fares comparable to the price of a pair of jeans, which greatly helped to market the airline. The success of EasyJet and Ryanair has forced others, whether traditional or low-cost carriers, to reduce the prices and gradually increase the service levels in European air transport. These two companies are respected players in the field of air transport to this day and their business decisions must also be addressed by large carriers with a rich history of air travel in Europe.

Over the years 1992 to 2012, up to 43 low cost airlines have been established in Europe, 17 of which attempted to directly imitate the South West business plan. Another 15 were charter traffic airlines with low cost operation features and the last 10 were low cost subsidiaries of traditional carriers. The main driving force for the creation of all these companies were gradual liberalization and the creation of a single market for air transport services in the European Union. [5]

First companies with a low cost business model to begin to operate in Asia at the turn of the millennium and encouraged by the success of European companies EasyJet and Ryanair. The first to appear in 2001 is Malaysian company Air Asia. Following the pattern of American and European low cost airlines they were trying to bring air travel at lowest prices possible. Eventually, the company has succeeded, as today it is the dominant airline in the whole Asian region. Air Asia was able to reach out to people who could not afford air transport until then. This success has not gone unnoticed by others, so gradually competitors have entered the market. Namely, Singapore's Tiger Airways and Jetstar, which have been fighting for market shares at the routes between Asia and Australia, as well as the Australian market itself. [7]

3 DEVELOPMENT OF A LOW COST PRODUCT

Traditional carriers offer two basic travel classes, namely economy and business. These products are most commonly offered for flights within a single continent or for short flights. Economy class is the standard product while business class is already a premium product where various premium services are included. These can be anything from better meals to more comfortable seats. For long haul, inter-continental travel, the first class is offered containing a variety of above-standard services that vary according to the offer of individual carriers. This variant represents the highest possible standard of travel in commonly available air transport.

The original intention behind creation of low-cost carriers and the product they offered in air transport was and still is to offer “basic” air transport product covering the needs of a common, undemanding traveler. The emphasis is placed on low price, withdrawing many services and comfort on board. Often times this business model is also called as “no frills”.

However, in addition to the traditional air transport product model, new models have been emerging, mainly geared to transport at the lowest price, withdrawing some but not all services usually seen with the standard product, the low-budget model ("budget"). A typical representative of this model is Germanwings. Typical representative of the basic model is RyanAir. Bjelicic [2] identifies four most common products in air transport as shown in Figure 1.

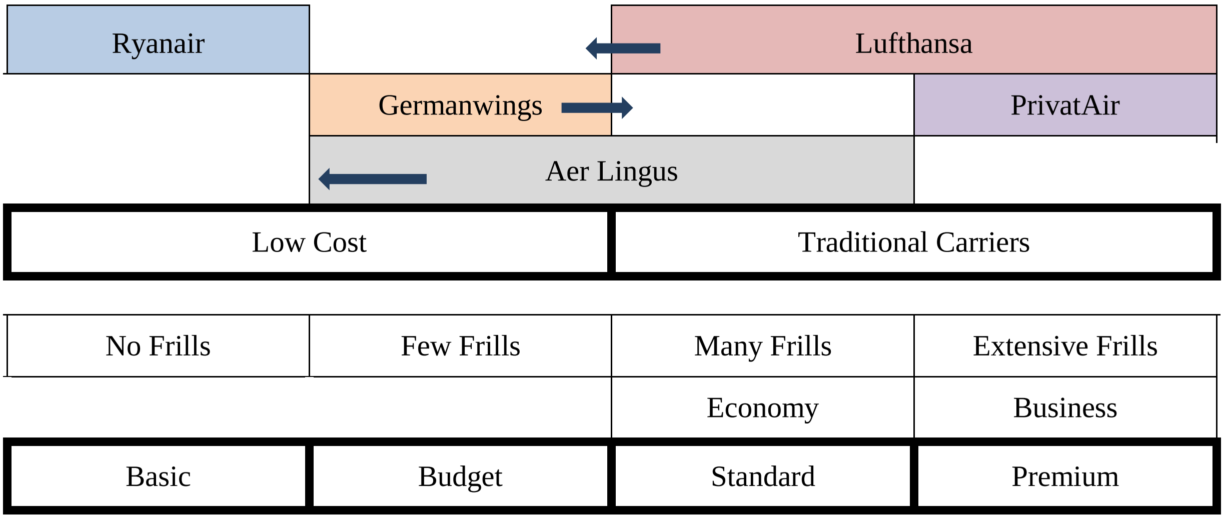

Figure 1. Overview of airline products with examples. [2]

When looking at the companies offering low prices, several categories can be identified:

- low cost start-up carriers, imitating the American model of South West
- subsidiary low cost companies of traditional carriers, "airlines within airlines" like Lufthansa´s Eurowings,
- subsidiary low cost charter carriers like SunExpress jointly owned by Turkish Airlines and Lufthansa Group
- originally traditional carriers who apply a low-cost business model
- state-subsidized airlines who can lower the fares through state subsidies, not through the application of an innovative business model. [1]

The budget segment has experienced an increase over the last 10 years as many new low cost companies have gradually developed and developed this model. In addition to the growth of this segment itself, the traditional carriers have begun to adapt to new trends in air transport. They are modifying their standard product to arrive at the budget product. This can be attained by either of these options or by their combination:

1. cutting down on, or eliminating some services from the standard product and thus cutting down the costs;
2. lowering ticket prices by restricting rebooking options.

Through this business approach of traditional carriers an area of growing competition rises in the field of budget product. On the other hand some carriers take a different approach and stress out the difference in standards and products. They recognize the reputation of offering long-term quality services and work on keeping their good name. With this step, traditional carriers try to fight against the consumers´ quality and price perception deformation caused by low cost offers, as the low cost companies by their very nature can not offer premium services.

4 COMPONENTS OF LOW COST BUSINESS MODEL

When analyzing the business model of low cost carriers, there are several common features that enable them to sustainably carry on the operations and create profit.

- Low costs for operations. The airline try to save cost wherever possible. Many examples of cost saving strategies will be mentioned later in the list.
- Airline ticket prices. While it is believed by general public that low cost airlines offer low prices, the truth is somewhere else. Automated revenue management software is reassessing the rate of sale, time to flight, selling target and revenue target at any point of time and adjust the prices to meet the target. [4] This can lead to fluctuation and rises as well as falls during the sale period. A BBC research tracked the development of prices by three low cost carriers on routes from London to three different cities during the 6 week period before flight, as depicted in Figure 2.

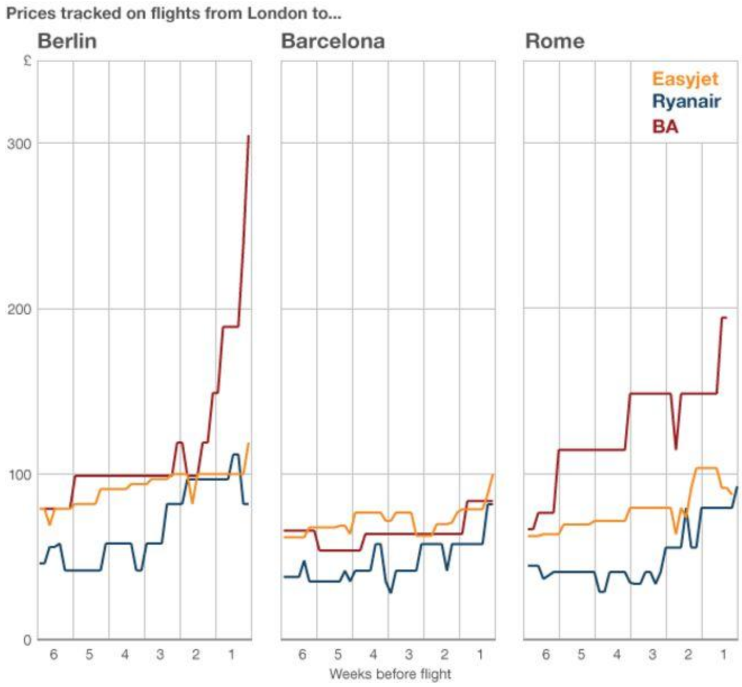

Figure 2. Development of prices 6 weeks before departure. [1]

- Point to point transport means the carrier offers direct transportation between city pairs with high demand, neglecting passengers transferring via an airport to other destination. Traditional carriers leverage from hub and spoke networks connecting smaller communities via airport hubs collecting passengers from feeder flights. [3]
- Short routes. The concept of low service makes it unlikely to offer the usual product of low cost carriers on long-haul flights.
- Lack of cooperation. In the context of differences between traditional and low cost carriers other feature is also important to mention. Traditional carriers can offer connections via hub airports not only in their own network, but also in cooperation with other carriers using interline agreements and/or alliance cooperation. With this they use joint marketing and frequent flyer programs. Until recently low cost carriers didn´t have this type of agreements and programs.
- Unified fleet of aircraft means the carrier only needs to train it´s personnel and ensure maintenance for one type of aircraft. All the sources – human and material – are universally usable.
- Aircraft features such as modified flight deck or missing fuel tank. Airplanes are often ordered from the manufacturer with adjustments correlating to the carrier´s needs. Low

cost carriers offer only one service class so the airplanes have build in maximum seating capacity allowed by safety regulation. As the routes flown are short to medium haul and the aircraft carry only required amount of fuel to lower the weight and thus the fuel consumption, not all fuel tanks are needed. With new orders the carriers go a step further and request aircraft with sealed fuel tanks and thus lower certified maximum take-off weight. This lowers some of the fees payed by airlines.

- Charged services. For many services the passengers have to pay. Examples are snacks and food on board, physical check-in at the airport, hold luggage and even carry-on luggage exceeding certain limit such as size or weight. The Irish Ryanair caused a stir when announcing the intention to charge passengers for using the toilet on board of aircraft.
- Use of small, secondary airports in the region is very common. Usually the airport fees payed by airlines are lower. Also these airport are often less crowded, which enables the airline to save time for handling and minimize possible delay.
- Outsourcing. Since most low-cost airlines do not have the required structures to be able to provide technical services such as maintenance and repair of aircraft, the only way for them is to outsource these services. External companies are able to perform these activities more professionally and with greater cost-effectiveness. In combination with the use of a unified fleet of aircraft, cost savings can be up to 60 % compared to traditional carriers. More savings come from the absence of the need for office space and extensive management of all the superseded departments.

5 FUTURE OF LOW COST FLYING

As mentioned in previous chapters, the aviation market is changing. First important change came on the supply side with the emergence of low cost carriers. Their product was met with demand. It also changed how consumers perceive air transport and what are their expectations. The shift on the demand side was so significant that traditional carriers had to act and adapt. Now the competition for the low cost carriers rises and they are trying to adapt their product and offering in order to keep their market share. Several changes in the behaviour of low cost carriers can be identified.

5.1 Hybridization of products in aviation

Hybridization of air transport products means transferring attributes of another business model into one´s own business model. The first hints of these processes are starting to emerge after 2000, when traditional carriers begin to respond to the threat of low cost companies by applying similar procedures and characteristics that are typical of the low cost business model. A certain shift also occurs with low cost carriers, who, on the contrary, try to adapt their products with feature typical for traditional carriers to please their customers.

5.2 Low cost, long-haul product

In fact, low cost long-haul flights is not an entirely new concept. Carriers have tried this model in the past, when they operated routes offering products with only basic or budget characteristics, so being below the traditional economy standard.

The difference with todays low cost long-haul routes is the approach typical for low cost carriers. They choose only routes with high proportion of point-to-point traffic and business travellers, with no need to ensure feeder flights to meet target passenger load. Standard service provided on long-haul flights such as headphones, blanket and cushion, in-flight-entertainment etc. can be bought for extra fee.

5.3 Transfer connections

As the standard low cost model operates point-to-point routes without the possibility of transfer between flights, many customers were forced to buy tickets for separate flights and thus “self-connect”. This approach is risky and time consuming. In case of a cancelled leg the self-connecting passenger looses all the connecting flights as a standard feature of low cost flying on low fares is the inability of late cancellations and ticket change. While normally transferring passengers only wait for about 45 minutes for their next flight not having to care about their luggage and often avoiding repetitive security checks, self-connecting passengers have to plan 2 hour gaps between flights to be able to pass al the pre-flight procedures.

Lately airlines and airports did recognize problems arising from self-connecting passengers and the approach is changing. Airports can exploit the network potential by offering a self-connect product to facilitate the passenger in this process. Airlines start to re-think their model and first low cost carriers appeared who operate hub airports with transfer opportunities or even cooperate with traditional carriers and act as feeder lines for their customers. Travel agents could also use the situations and work as insurance providers with special insurance product for self-connecting passengers in case of failed connection.

5.4 Alliance cooperation

Three global airline alliances historically consisted of traditional airlines who leveraged the joint forces to maximise marketing, sales force, customer satisfaction and loyalty via frequent flyer programs, waste alliance networks etc.

The sharp expansion of novel low cost airlines in Asia let to the creation of very first regional Asian-Pacific alliance of low-cost carriers named Value Alliance Partnership, which includes companies such as Singapore Airlines, Tiger Airways, ANA Holdings Inc., Nok Airlines Pcl, Vanilla Air, Nook Scoot, Tiger AIrways Australia, Jeju Air and Cebu Pacific Air. This co-operative alliance has established its own website where passengers can buy tickets together with other services offered on board. The products on this website are offered by all members of the Alliance as one comprehensive package of services. The Alliance itself and its members offer flights to 160 destinations, and their aircraft fleet consists of 174 aircraft. [1]

The gradual growth of the low cost segment impacted the traditional alliance cooperation as well. The global Star Alliance decided to introduce a new form of collaboration called the “Connecting Partner Model”. This type of collaboration allows the linking of low cost and hybrid partner companies with the traditional carrier lines that are part of this alliance. There is therefore an effective collaboration between two different business models, which have so far competed. [5]

6 CONCLUSION

The aviation market changed over the course of half a century. Important milestones shaping todays face of this industry were deregulation of the market in 80´s and 90´s enabling growth and new competition. Also important was the establishment of South West, which became the model for many airlines who came later.

Clearly distinctive in the past, today the low cost product is becoming of interest for traditional carriers who are trying to find new business opportunities and keep up with the market. On the other hand evident deficiencies of the low cost product offer space for airlines as well as airports and insurance companies to offer additional products and services, targeting for example the self-connecting passengers.

The evidence of cooperation between low cost companies as well as among competitors with different product models leads us to the assumption that we can expect a gradual increase in the formation of new clusters or cooperation with classic alliance model.

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Contact

Ing. Dorota Liptakova, PhD.
Technical University of Kosice, Faculty of Aeronautics,
Rampova 7, 041 21 Kosice, Slovakia
Tel: +421 55 602 6190
email: dorota.liptakova@tuke.sk