

## **Case Study 2**

### **Low-Cost Carriers**

#### **Introduction**

Low-cost carriers are one of the most significant developments in air transport in recent years. With their innovative business model they have reduced both the fares and levels of service on routes. At the same time, they have increased the number of people who have access to air travel and greatly increased the range of airports available for holiday travel. Yet the jury is out as to whether low-cost carriers are a true revolutionary concept or simply an evolutionary development in air transport.

#### **Low-Cost Carriers**

As air travel continues to expand across the world, there is no doubt that low-cost carriers (LCCs) have fuelled this growth by creating a more competitive environment for air travel. LCCs have been one of the most significant developments in air travel in this century and have completely changed the way that people travel and make choices, not just in terms of carriers, but in terms of the mode of transport and where they travel from. Indeed LCCs have transformed the language of airlines as the traditional distinction between scheduled and charter airlines has in effect disappeared, and LCCs have risen to take their place. The British Airports Authority estimates that LCCs flew less than 8 million passengers in 1998 compared to 59 million in 2005 and that in Europe alone the two leading LCCs - EasyJet and Ryanair - account for around one third of capacity. In the future there will be more LCCs on long haul-routes and variants on the model are emerging such as 'business only' carriers operating a 'less frills' rather than a 'no frills' service.

### **The Low-Cost Carrier Concept**

Low-cost carriers are airlines that work to a business model of low fares and few extra services for the passenger. They are sometimes known as 'no frills' or discount airlines. The concept developed in response to the deregulation of airlines, firstly in the USA in 1971; in Europe in the 1990s; and then in the rest of the world. LCCs have a business model that delivers much lower operating costs and a different debt structure to full service airlines (FSAs) (Table 2.1). This is because FSAs trade on their convenience and levels of service to passengers, both of which imply higher operating costs. A range of innovations characterize the LCC business model:

- Paperless ticketing;
- Internet-based bookings;
- Minimizing staffing levels and encouraging the multi-skilling of staff, so they can take on a variety of roles in the organization;
- Using only one type of aircraft to reduce training costs;
- One class for passengers;
- No frequent flier service;
- Earning income from services that are provided free on FSAs - such as catering, headphones and pillows;
- Flights to regional airports that charge lower landing fees and often have spare capacity. This reduces congestion at the busier airports;
- Flying point-to-point without the need to set up a feeder network for their airports; and
- Operating a yield management system by selling seats at different prices according to supply and demand. On any one flight there may be many different fares, allowing loss-leading (and headline-grabbing) fares to be charged.

This business model allows LCCs to charge significantly lower prices than the FSAs. In turn, this increases load factors and allows LCCs to make a profit on smaller operating

margins. As a result, LCCs pose a significant threat to the FSAs on many routes. In Australia for example, the LCC (Virgin Blue) competes head to head with the FSA (Qantas) on intercity routes - such as Sydney/Melbourne - and has significantly lowered fares on these busy routes. In response Qantas has launched its own LCC - Jetstar, but as with other scheduled carriers there is a danger that the LCC takes sales from the FSA. The FSAs have responded in other ways to the threat of the LCCs. They are adopting the low-cost sales model by using the Internet for ticketing, increasingly using paperless tickets and self-check in booths, as well as operating their own yield management systems.

### **Issues associated with Low-Cost Carriers**

Whilst at first sight, LCCs appear to be a very good addition to the airline industry, particularly for the passenger, a range of issues and controversies are associated with LCCs:

- Their business model leaves LCCs vulnerable to significant changes in their operating costs, particularly in terms of fuel prices.
- There are concerns that the growth of LCCs means that they end up by competing with each other on routes. In response they need to differentiate themselves by adding extra services – such as business class seats, reserved seating and catering, in effect reverting to the full service model. Other airlines, such as Ryanair have responded by aggressive cost-cutting (eliminating window blinds and reclining seats, for example) in an attempt to compete on price.
- LCCs tend to quote the fare exclusive of airport fees and other taxes and costs. This has been criticized as misleading.

- A major issue is the fact that the low fares charged by LCCs have allowed many more passengers to fly when otherwise they would have used surface modes of transport. This supports jobs both in the air and on the ground and by opening up travel horizons, enhances the quality of life of consumers. It also is changing the face of tourism as the old-fashioned charter airlines cannot compete with the LCC model and tourists are encouraged to 'unbundle' their packages with DIY trips using LCCs. LCCs have therefore had a significant impact on the pattern of tourism.
- With flights growing at the rate of 5 per cent per year globally, aircraft are the fastest growing source of carbon emissions. Some therefore argue that the LCC revolution has come at a high environmental cost, not only in terms of emissions, but also noise pollution.
- The perceived environmental pollution caused by aircraft may mean that the deregulation of the skies which has facilitated the development of LCCs will change to a higher degree of regulation through environmental controls. Options here include regulation of emissions through a carbon-trading scheme for LCCs, reduction of carbon emissions through carbon offsetting, and technological solutions such as cleaner engines and the use of bio-fuel. It must however also be remembered that LCCs tend to fly with full aircraft, and as their aircraft tend to be newer, quiet and fuel efficient, the environmental costs are reduced to some extent.
- LCCs take advantage of regional airports where costs are lower and this has increased the number of destinations available. For example, it has made it easier for the British to make frequent trips to their second homes in rural France, and to take advantage of cheap city breaks in a number of East European countries. However, this opens up tourism in regions that are not always

prepared in the early years of the LCC service. This can lead to unregulated accommodation development, often of low quality, and poor destination management on the part of ill-prepared local authorities.

In summary, the Civil Aviation Authority (2006) argues that whilst the media thinks of LCCs as a revolution in travel, in fact they may simply be an evolution. There has been no technological breakthrough; rather the revolution is in terms of the business approach. Equally, FSAs are now adopting many of the business ideas of the LCCs and so we are seeing a 'convergence' of what were two very different the types of carriers.

### **Conclusion**

There is no doubt that LCCs have been one of the most significant developments in air transport in this century and they have had a major impact upon tourism demand and patterns of travel. Their innovative business model is now being adopted by FSAs, blurring the distinction between various types of carrier. This case has shown however, that LCCs have created a range of issues, not least their environmental impacts and consequences. It remains to be seen how sustainable the concept is in an era of high fuel prices, and also how the concept will evolve as LCCs begin to offer variants on the model, such as business airlines and long haul routes.

### **Discussion Questions**

1. In class, debate the 'evolution' or 'revolution' point about LCCs.
2. Draw up a table listing the positive and negative sides of the environmental debate surrounding LCCs.
3. Draw up a list of the key elements of the business model of LCCs. Rank the list in order of significance and annotate the table with the elements of the business model that have been adopted by FSAs.

### **Sources**

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- Civil Aviation Authority (2006) *No Frills Carriers: Revolution or Evolution*, CAA, London
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- Duval, D T (2007) *Tourism and Transport. Models, Networks and Flows*, Channelview, Clevedon
- Gross S and Schroeder, A (2007) *Handbook of Low Cost Airlines – Strategies, Business Processes and Market Environment*, Kluwer, Berlin
- Keller P, (2002), Introduction, pp 13-23 in *Air Transport and Tourism*, Vol.44, AIEST, St.Gallen

### **Useful Industry Sites**

**easyJet, UK**                      <http://www.easyjet.com/en/book/index.asp>

**Ryanair, Ireland**                <http://www.ryanair.com/site/EN/>

**Southwest, USA**                <http://www.swamedia.com/>

**AirAsia X, Malaysia**        <http://www.airasia.com/gb/en/home.html>

**Jetblue, USA**                    <http://www.jetblue.com/>

**Table 2.1 Comparison of Strategies of LCCs and Traditional Carriers**

	<b>FSA</b> s	<b>LCC</b> s
<b>Business Model</b>	Global strategy and high cost	Niche strategy and low cost
<b>Network</b>	Hub and spoke Global alliance	Point to point Regional airports
<b>Fleet</b>	Different types of aircraft Moderate aircraft utilization	One type of aircraft High aircraft utilization
<b>Product</b>	Full service Branding supports full service concept Complex fare structure	Self service Branding emphasizes price Simple fare structure
<b>Sales Policy/Distribution</b>	Sales departments Global Distribution System	Direct sales Internet based
<b>Operations</b>	Traditional check in procedures Multiple classes In flight service	e-ticketing and self service check in One class In flight extras available for purchase

*Based on Duval (2007) and Keller (2000)*