LOW COST AIRLINES IN EUROPE

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“Truly,you were wafted in from paradise…”

"No dear, from Luton Airport"

(1970s British television advert)

(London) LUTON AIRPORT –

- 30 miles north of the capital
- Off main M1 highway but difficult to access
- Chiefly a charter airport (Britannia, Monarch airlines base). Very few scheduled flights
- Not in a salubrious/wealthy area
- Poor airport infrastructure
- 1990 passengers – 2,680,000
- 1995 passengers – 1,810,000
- 2000 passengers – 6,173,000
- 2003 passengers – 6,809,000
- Why the difference? – easyJet –

  - commenced operations November 1995, now has 68% of all passenger at Luton

Two main drivers of LCC activity in Europe since mid 1990s -

- ✈ easyJet (Stelios Haji Ioannou)
- ✈ Ryanair (Michael O’Leary)

easyJet based Luton and Gatwick

Ryanair based London Stansted and Dublin

<u>Connection?</u>

Upfront, outgoing, entrepreneurial –

Freddie Laker and Richard Branson “without the style”

Victor Kiam – style public recognition

Appealing to the “common man”

Dissimilarities with US LCCs

- ✈ Lack of ‘fun’ element as found on (e.g.) Southwest Airlines
- ✈ Utterly rigid operating platform focused upon COST
- ✈ Denial of loyalty schemes
- ✈ Virtually no onboard service that doesn’t earn revenue
- ✈ Very extensive use of Internet reservations, up to 95%

Dissimilarities (continued)

Carrier	Loyalty scheme	Automated check in	Airport lounge	Premium Cabin	Free food/drink	IFE	Online sales
AirTran	Y	Y	N	Y	Y	Y	64%
Jet Blue	Y	N	N	N	N	Y	74%
Southwest	Y	Y	N	N	Y	N	55%
Westjet	Y	N	N	N	Y	Y	69%
EASYJET	N	N	N	N	N	N	94%
RYANAIR	N	N	N	N	N	N	94%
VIRGIN EX	N	N	N	N	N	N	55%

(Courtesy of Airline Business magazine)

Dissimilarities between easyJet and Ryanair

- ✈ easyJet uses primary airports (London Gatwick, Paris CDG/Orly, Barcelona, Zurich etc)
- ✈ Ryanair more inclined towards secondary and tertiary airports (Brussels South/Charleroi, Paris Beauvais, Stockholm Skavsta, Girona etc)

("Cheap" downtown airports such as Love Field, Hobby, Midway don't exist in Europe)

These are the two fundamental operating models now, upon which others base their aspirations.

But really only one?

Ryanair history

- Started up1986 out of European liberalisation
- Very low unrestricted fares but casual about costs –
- - hence almost failed (twice – 1986 and 1990)
- Moved to London Stansted – just starting to boom
- Michael O'Leary (accountant) studied SW model –
- - applied it very rigorously… and then some!
- Applied tough but beneficial productivity agreements (staff/pax ratio 1:10000)
- Benefited from cheap, freely available B737-200s
- Brought work in-house where possible
- Introduced extraordinary pricing policies coupled with aggressive in-flight sales (b/e l/f 50%)
- Brought in innovative marketing deals with airports e.g. $2 million p.a subsidy from Strasbourg

Ryanair operating costs/ revenues

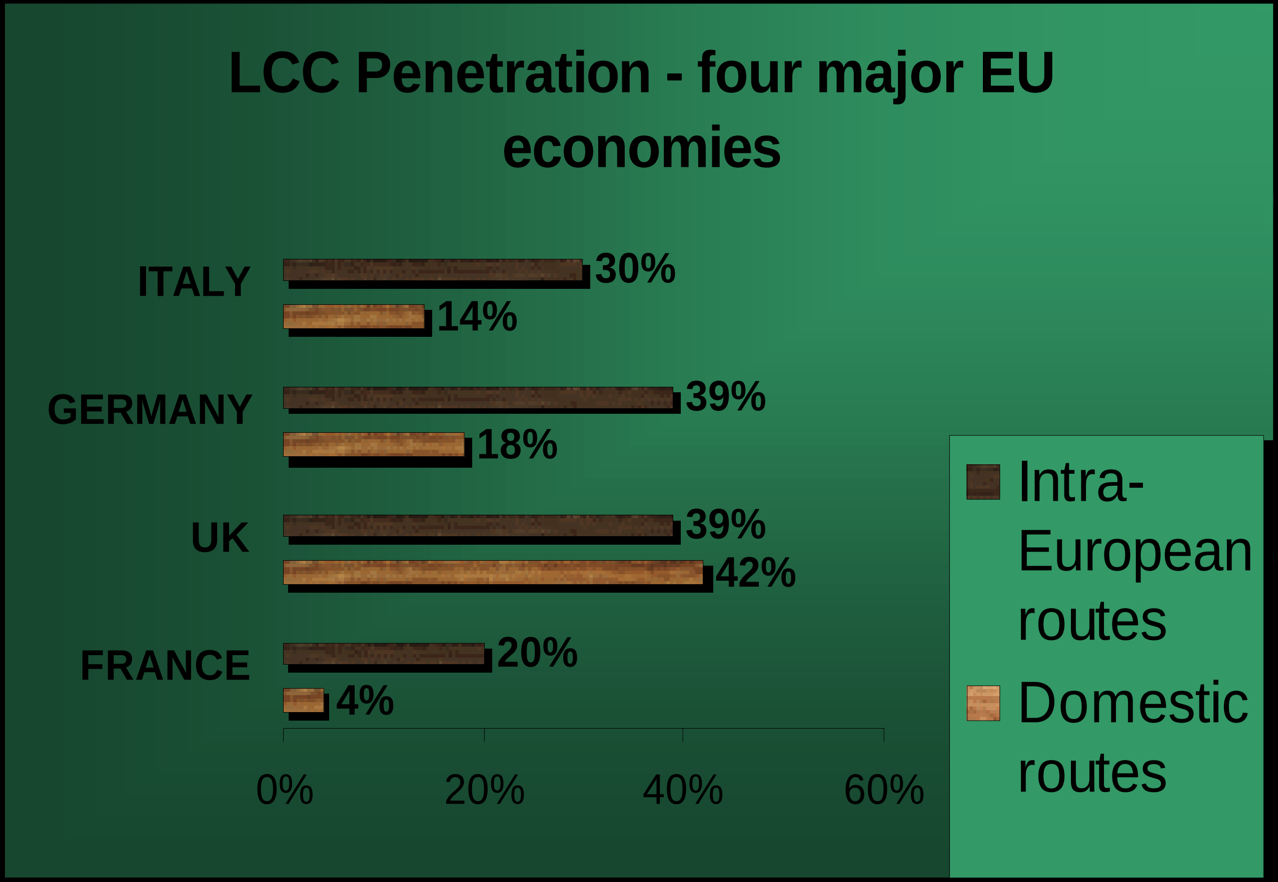
REVENUE	**AMOUNT GB£ (= $1.8)**
Fares	4218
In-flight sales of food drinks, spirits, tobacco	337
TOTAL	**4555**
COSTS	
Cockpit crew	271
Cabin crew	100
Other ground staff	125
Aircraft depreciation	375
Fuel	481
Engineering/maintenance	237
Marketing	**84**
Aircraft lease costs	325
Air traffic control	325
Handling charge (London Stansted)	687
Handling charge (Frankfurt Hahn)	**0**
Other costs	343
TOTAL	**3353**
Operating profit	**1202**

Rise of the LCCs in Europe

- ✈ In Britain – 9 budget airlines flying or planning to – Thomsonfly, AV8Air, bmibaby, easyJet, FlyBe, Fly Globespan, Jet2, MyTravel Lite, Now (+ Ryanair)

- ✈ In Europe – 30 budget airlines flying or planning to – including 4 in Germany, 7 in new entrant (east) European Union countries

LCC penetration in Europe



Rise of the LCCs globally

- ✈ In North America – 17 LCCs
- ✈ In Latin America – 5 LCCs
- ✈ In Asia – 18 LCCs (majority in last 12 months)
- ✈ In Middle East – 4 LCCs
- ✈ In Africa – 3 LCCs

(86 in all, genuine low cost carriers, not regionals)

Why the increase?

- ✈60+ new LCC airlines since September 2001. WHY?
- ✈Shrinkage of existing carriers
- ✈Aircraft, pilots and engineers available cheaply
- ✈Deep discounts available (aircraft 50% of 1990s cost)…
- ✈…Barriers to entry reduced
- ✈Possible to launch an LCC for $10m
- ✈Advances in software that operate reservation and yield management systems
- ✈But only 3 start ups in North America since Sept 2001 (+ Independence Air in June @ Washington)
- ✈Will arrival of Virgin change things? (Marketing contribution, aeronautical charges?)

New route generation by European carriers Jan03-Jan04
(New routes minus discontinued routes)

Carrier Name	Total Routes 2004	Change	Route Growth
Air France	1270	156	14%
Bmi (incl bmibaby)	322	142	79%
KLM	1126	80	8%
British Airways	975	67	7%
SAS	851	55	7%
Alitalia	770	32	4%
Iberia	641	22	4%
Lufthansa	1403	-8	-1%
easyJet	**220**	**124**	**129%**
Ryanair	**286**	**122**	**74%**
Germanwings	**58**	**38**	**190%**
Germania	**71**	**65**	**1083%**

(Data courtesy of Feather Consulting/Inovata)

Failures - Europe

- **AB Airlines (Sweden/UK)**
- **Debonair (UK)**
- **Aeris Express (France)**
- **Jet Magic (Ireland)**
- **Goodjet (Sweden)**
- **Flying Finn (Finland)**
- **Color Air (Norway)**
- ***(buzz) (UK/Netherlands)***

Typical reasons –

Under-capitalised/poor cash flow

Routes too thin (e.g. Scandinavia)

Low cost/full service mix didn't work – no rigid policy

LCCs replacing the charter operators? (1)

- Charter carriers were the first European low cost airlines, emerging from UK in late 1960s
- Selling whole or part airplane charter for package holidays and ‘seat-only’ offers
- Initiated the high daily utilization (up to 16 hours) and high in-flight sales revenues (from Duty Free goods) now typified by the LCCs
- Virtually no marketing costs (most sales through tour operators) and lower administrative costs than scheduled airlines
- Operating at very high load factors from high seating density with guarantees on revenues from tour operation sales
- Only ‘negative’ was seasonality of operation

LCCs replacing the charter operators? (2)

- **LCCs saw market opportunity – ironically out of UK charters' home base first - Luton**
- **Changing mores of buying public – more flexible travel arrangements demanded. Off peak travel. Long weekends. More disposable income. None of this being met by charter operators**
- **<u>But charter operators fought back</u> –**

Two class cabins (since 1989!)

Leather seats

In-flight entertainment

High standard food and beverage service

Much lower fares with flexible conditions and one ways

Greater use of regional airports

Even tentative hubbing experiments

Examples – Monarch Scheduled (previously Gold Crown), Excel and Air Berlin

RESULT – LESS PRODUCT DIFFERENTIATION. <u>BUT</u> charter airlines still losing passengers to LCCs

The majors fight back

- More innovative pricing (e.g one way special fares)
- More innovative marketing (e.g. BA reduces 3000 fare rules to 3)
- New low cost subsidiaries of their own (e.g. British Midland’s bmibaby)
- Or they “become LCCs” themselves (FlyBe, Aer Lingus, Olympic Airways - proposed)
- But BA sold Go. A mistake? Or did it realise it was just cannibalising its own higher cost full service operations?

European Low Fares Airlines Association (1)

- ✈10 original members (now 9, -Flying Finn). January 2004

AIR BERLIN, BASIQ AIR/TRANSAVIA, FLYBE, HAPAG LLOYD EXPRESS, RYANAIR, SKYEUROPE, STERLING, SVERIGE FLYG, VOLARE

- ✈Not Easyjet, bmibaby, Virgin Express etc

- ✈Mission statement:

“To ensure that European policy and legislation promote free and equal competition to enable the continued growth and development of low fares into the future, allowing a greater number of people to travel by air”

European Low Fares Airlines Association (2)

"A non-profit making organisation, to represent and protect the needs of low fare airlines and their customers." (cf. ACI-Europe, ERAA)

Key areas of interest:

- ✈ **Passenger compensation legislation**
- ✈ **Airline Agreements with Public Airports following the Ryanair/ Charleroi case.**
- ✈ **Liberalisation of European Air Transport**
- ✈ **Environment**

European LCC typical aircraft

- **Standard model Ryanair –**

  B737-200 (140 seats), B737-800 (190 seats)

  Latter is far more efficient but “empty seats” have given The City the jitters

- **Standard model Easyjet and others –**

  B737 – 300/400

  Airbus A320/321 now being introduced – Easyjet has order for over 100, Ryanair sticks with Boeing.

- **Financing** – typically operating lease (‘Short term’ philosophy?)

- **Experimentation** – bmibaby sub-letting routes to Air Wales using ATR42

- **Maximum route length** – 800 miles (1280kms) – 2 hours flying

The future. In European LCC's favour -

- New entrant EU countries - deregulation
- Still many undeveloped airfields (GA) – anything will do for airlines adding big capacity…
- …big demands by airports desperately seeking airlines
- Military airport conversion – Neiderrhein (RAF Lahrbruch) (Netherlands-Germany), RAF Valley, RAF Finningley (a.k.a. Robin Hood Doncaster Sheffield), RAF St Mawgan, RNAS Culdrose (all UK), Murcia (Spain)
- Occasional green field/new build development – Athens Spata, Cuidad Real (Spain), Berlin BBI

The future. <u>Not</u> in European LCC's favour -

- **Airspace problems (Eurocontrol)**
- **<u>Regulatory issues</u> –**

- Ryanair now back at Charleroi after tax breaks offered to all airlines

- but issues remain with new 'overbooking' compensation rules (made worse by airspace problems)

- **Over-rapid expansion, excess capacity**
- **Proposed UK aviation fuel tax +33% on ticket price, spreading within EU? Sponsored by environmental lobby**
- **Collapsing house prices in UK**
- **Loss of focus (historical and contemporary)**
- **Too cheap!**
- **Attitude of media –**

  -Build them up to knock them down

  -Waiting for an 'incident'

Forecasts (a.k.a. the guessing game)

Market share of LCCs in Europe

(from 5% in 2000, 10% in 2002, 15% now)

2005	**30%**		Sunday Times February 2004
2007	**14%**		McKinsey Quarterly 2002/no.2
2010	**24%**		Travel Daily News March 2004
2010	**50%**		“The Middle East “January 2004
2010	***25%***		***Mercer/AEA/IATA 2000***
North America 2006		40%	Leslie Millar, 5th April 2004
Global forecast 2015		25%	Singapore Business Times 09/03

(Data courtesy of Centre for Asia Pacific Aviation, Sydney)

Product drivers in a similar direction, long-haul

Long haul low or fixed cost business or premium class only services, actual or proposed (virtual airlines?) –

- ✈**Privat Air (for Lufthansa, Germany – USA)**
- ✈**Air France Dedicate (France – intercontinental high revenue business destinations)**
- ✈**BMI feasibility study on small jets operating long-haul ex UK**
- ✈**Blue Fox (UK) London – New York, Los Angeles, San Francisco**
- ✈**Bluetail (Germany)**
- ✈**Business Jet (Netherlands)**
- ✈**FlyBlu (UK) Birmingham – Fort Lauderdale!**
- ✈**Premium Airways (France), Paris-New York**
- ✈**Riviera Jet (France)** ***(advisor – Sir Freddie Laker)***
- ✈**Cologne-Bonn airport seeks LCC clones for trans-Atlantic $99 returns**

(Similar developments in the Middle East: Royal Jet, United Aviation etc)

Short, mid, long term prospects

Will LCCs thrive?

In the short and mid-term YES

- Extra capacity demands, especially in east Europe (cf. parts of Asia, Latin America – opening up new travel possibilities

In the long term, how do LCCs square with:

-Personalised travel (Nasa project)

-Bizjets

-Business class only small/medium/large jets

-Dreamliners + A380s

-Next generation Supersonic, Hypersonic travel, Pulse detonation, Scramjets

-Ever-improving ICT, video technology

-Every other change is in the realm of comfort and ‘high tech’

Is it just a passing phase at this level?

Only time will tell. In the meantime, as Bob says (often)…

Stay Tuned!!

Thank you for listening

An essay on Low Cost Airlines is included in the conference documentation.

<u>Discussion points.</u>

How define an LCC?

Is the concept exportable?

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