

# *Some Musings on LCC's*

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*What is a Low-Cost  
Carrier (LCC)?*

# *There is Widespread Disagreement on What an LCC Is*

**People can't even agree on what  
dimensions are relevant**

- Unit cost?
- Relative cost?
- Prices?
- Network architecture?
- Features/frills?
- Formation date?
- Role in industry?

*What is an LCC?*

**Low unit costs**

- The obvious answer

# *What is an LCC?*

## **Relative costs**

- Consider an airline operating with high people and capital productivity, but in an otherwise high cost environment
- What about an airline that efficiently produces a premium product?
- Value is a function of both costs and product/quality

# *What is an LCC?*

## **Prices**

- It's easy to reduce fares
- It's tougher to achieve low costs
- Low fares without low costs is a formula for eventual disaster

# *Questions About Prices*

Is an airline with high fare levels, but few fare conditions a low-fare airline?

Is an airline with low fare levels, but stringent fare conditions a low-fare airline?

Is an airline with low fare levels and conditions, but high average fares a low-fare airline?

Is an all first-class airline that sells at Y-cabin levels a low-fare airline?

# *What is an LCC?*

## **Network architecture**

- Hub & spoke
- Point-to-point
- Hybrid

All of the above are forms of networks.

∴ Network carrier  $\neq$  Hub & spoke carrier

# *What is an LCC?*

## **Features and frills**

- Do you have to be a no-frills airline to be an LCC?
- Can a no-frills airline be a high-cost airline?
- What is the definition of quality?

# *What is an LCC?*

## **Formation date**

- Does “Legacy airline” refer to age?  
(Hint: Southwest was formed over 30 years ago.)
- Does “Legacy airline” refer to burdens/advantages of historical systems, processes, employee seniority, assets, etc.?

# *What is an LCC?*

## **Role in industry**

- Can LCC's be non-niche?
- Can traditional majors be niche players wrt geography, product, or customer segments?
- Do LCC's exist in isolation of other airlines?

*What We Thought We Knew  
Was Often Wrong or No  
Longer True*

# *Some False “Truths”*

**LCC's are a U.S. phenomenon**

*Look in Europe, Australia, Latin America, Africa and Asia for numerous counter-examples*

**LCC's only fly domestic**

*WestJet? JetBlue? Spirit? Air Asia? Ryanair?*

**LCC's only fly short-haul**

*What about all the transcon services?*

**LCC's only fly where the weather is good**

*Buffalo, NY? Chicago, IL? Minneapolis, MN?*

# *Some False “Truths”*

LCC's primarily serve low-cost,  
uncongested airports

*Except when they don't*

LCC's only fly one aircraft-type

*EasyJet, AirTran, JetBlue(coming), Frontier,  
ATA [both different gauges & different  
manufacturers]*

LCC's only fly point-to-point

*Functional hubs at ATL and DEN*

*Dispersed multi-leg & micro-connecting  
complexes*

# *Some False “Truths”*

**LCC's fly only old aircraft**

*Numerous examples of new deliveries*

**LCC's all offer simplified strings-free fares**

*Kinder & gentler - generally yes*

*Harsher elements - sometimes*

*No-strings - often, but not always*

**LCC's offer no-frills service**

*IFE, leather seats, deluxe snacks, easier transactions, decent personal space*

# *Some False “Truths”*

**LCC's are fundamentally efficient**

*Most are.*

*Absent labor savings, a few are less efficient in terms of productivity and non-labor CASM than the best of the rest*

**LCC's are small**

*Historically yes. Not always the case today. Southwest is a major; JetBlue is almost there; others are growing rapidly*

**LCC's are regional specialists**

*Now the exception more than the rule*

# *Some False “Truths”*

**LCC's are painful to buy and fly**

*Many offer operational excellence*

*Many are easy to do business with*

*Most exceed their promises to customers*

**LCC's offer only one class of service**

*AirTran and Spirit have two cabins*

*Virgin Blue offers preferred seats*

**LCC's crowd them in**

*Pitch differences are diminishing*

*Some run high load factors; others run low load factors*

# *There Are All Types of LCC's -- Few Entirely Fit the **Classic Model***

## Network

	AirTran	Am West	ATA	EasyJet	Frontier	JetBlue	Kulula	Ryanair	Song	Southwest	Spirit	Ted	Virgin Blue	WestJet
Point-to-Point	Mainly No	Mainly No	Mainly No	Mainly Yes	Mainly No	Mainly Yes	Mainly Yes	Partially No	Mainly Yes	Partially Yes	Mainly No	Mainly No	Partially Yes	Mainly Yes
Short Haul	Mainly No	Mainly No	Mainly No	Partially Yes	Mainly No	Mainly No	Mainly Yes	Partially Yes	Mainly No	Mainly No	Partially No	Mainly No	Mainly No	Mainly No
Domestic Only	Partially Yes	Mainly No	Mainly No	Mainly No	Mainly No	Mainly No	Mainly Yes	Mainly No	Mainly Yes	Mainly Yes	Mainly No	Mainly Yes	Mainly No	Partially No
Satellite Airports	Partially No	Mainly No	Partially No	Partially Yes	Mainly No	Partially No	Mainly No	Mainly Yes	Mainly No	Mainly No	Mainly No	Mainly No	Mainly No	Partially No
Single Fleet	Mainly No	Mainly No	Mainly No	Mainly No	Mainly No	Partially No	Mainly Yes	Partially No	Mainly Yes	Partially Yes	Mainly Yes	Mainly Yes	Partially Yes	Partially Yes



Partially Yes



Mainly Yes



Partially No



Mainly No

Information based on carrier web sites & news articles; no guarantee of accuracy; and assessments have a subjective element.

# *There Are All Types of LCC's -- Few Entirely Fit the **Classic Model***

## Product

	AirTran	Am West	ATA	EasyJet	Frontier	JetBlue	Kulula	Ryanair	Song	Southwest	Spirit	Ted	Virgin Blue	WestJet
No-Frills Inflight				■			■	■		■	■		■	▨
Young	▨	■	■	■	▨	■	■	■	■	■	▨	■	■	■
Old Aircraft	■	▨	▨	■	■	■	■	■			▨	▨	■	
Single Class	■	■	▨	■	■	■	■	■	■	■	■	■	▨	■
No AP Lounges	■	■	■	■	■	■	■	■	■	■	■	■	■	■



Partially Yes

Mainly Yes



Partially No

Mainly No

Information based on carrier web sites & news articles; no guarantee of accuracy; and assessments have a subjective element.

# *There Are All Types of LCC's -- Few Entirely Fit the **Classic Model***

## Revenue Side

	AirTran	Am West	ATA	EasyJet	Frontier	JetBlue	Kulula	Ryanair	Song	Southwest	Spirit	Ted	Virgin Blue	WestJet
No FFP	Mainly No	Mainly No	Mainly No	Mainly Yes	Mainly No	Mainly No	Mainly Yes	Mainly Yes	Mainly No	Mainly No	Mainly Yes	Mainly No	Mainly Yes	Mainly No
No Interline Associated	Mainly Yes	Mainly No	Partially No	Mainly Yes	Partially No	Mainly Yes	Partially No	Mainly Yes	Mainly No	Mainly Yes	Mainly Yes	Mainly No	Mainly No	Mainly Yes
High Load Factors	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Partially No	Mainly No	Mainly Yes	Mainly Yes	???	Mainly Yes	Mainly Yes
Internet Dominated	Mainly Yes	Mainly No	???	Mainly Yes	Mainly No	Mainly Yes	Mainly Yes	Mainly Yes	???	Mainly Yes	Mainly Yes	???	Mainly Yes	Mainly Yes
Restriction-Free Pricing	Partially No	Partially No	Partially Yes	Mainly Yes	Partially Yes	Partially Yes	Mainly Yes	Mainly Yes	Partially Yes	Partially No	Mainly Yes	Partially Yes	Partially Yes	Partially Yes
Kinder/Gentler Pricing	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Mainly Yes	Partially Yes	Mainly Yes	Mainly Yes



Partially Yes

Mainly Yes



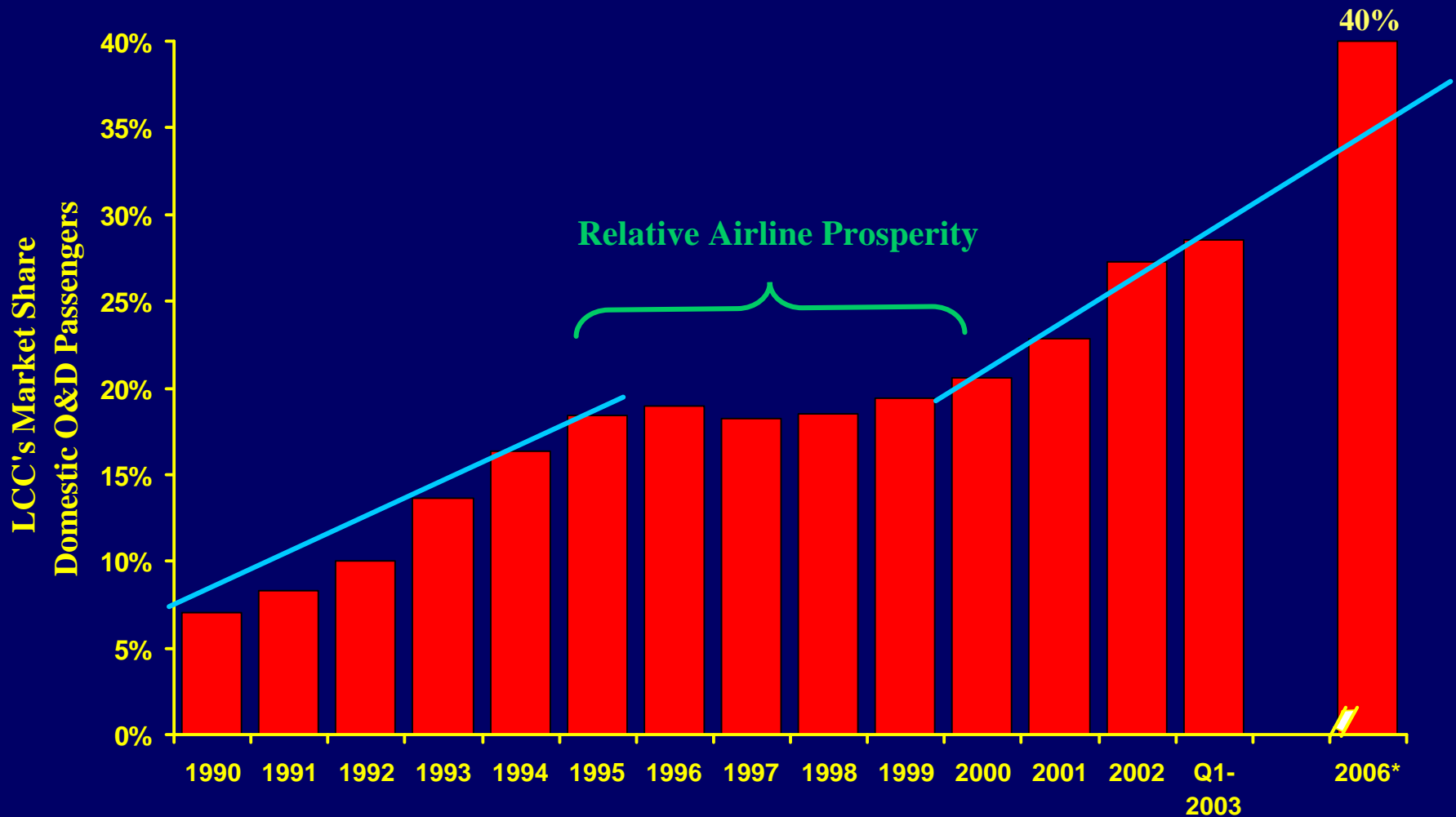
Partially No

Mainly No

Information based on carrier web sites & news articles; no guarantee of accuracy; and assessments have a subjective element.

# *Trends and Myths*

# *U.S. LCC Passenger Share Spurred in the Early/Mid-90's and Has Started Spurring Again*



Notes: Source: U.S. DOT DB1A database.

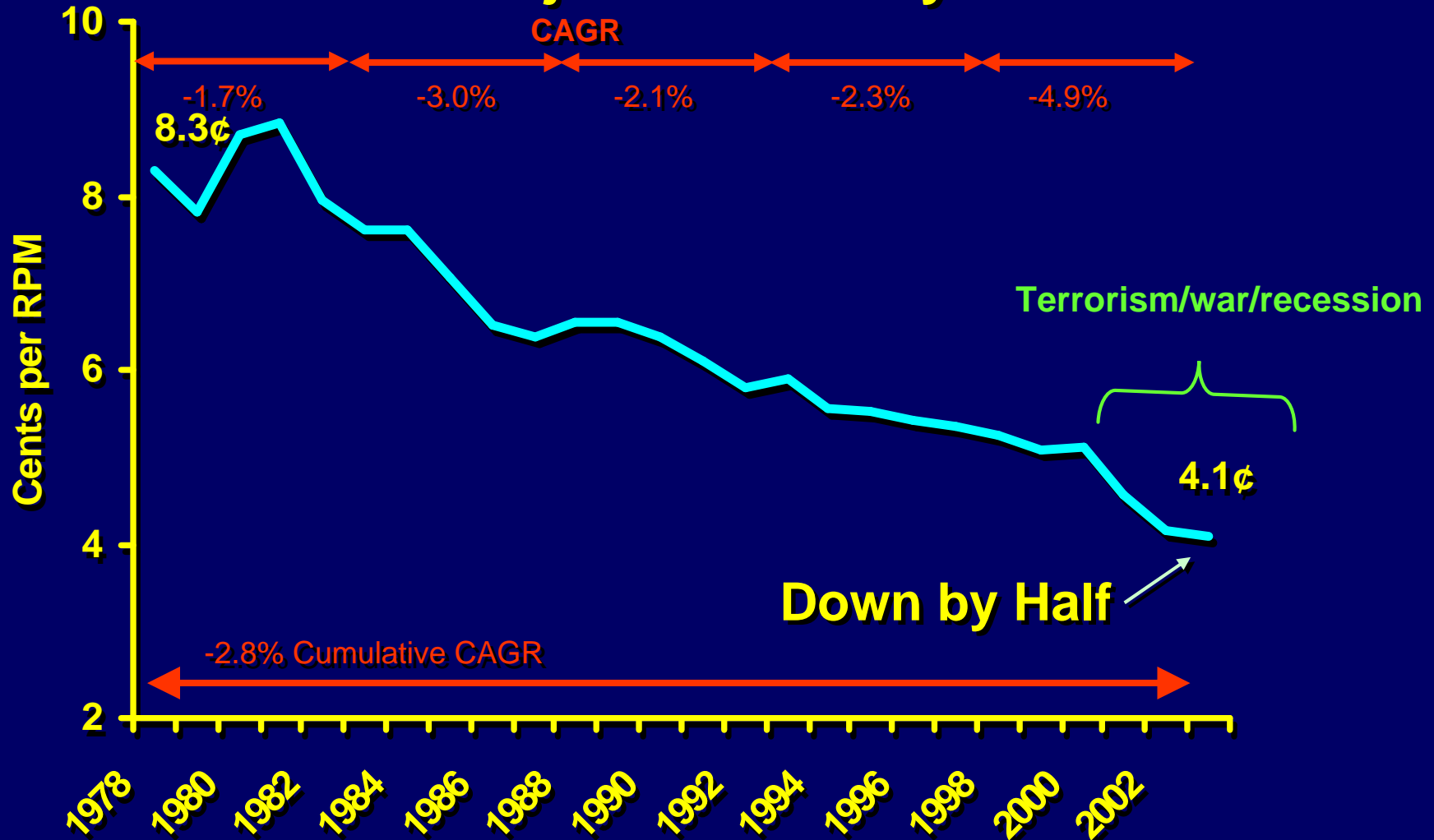
LCC's include: AirTran, Frontier, JetBlue and Southwest.

Majors includes: Alaska, American, America West, Continental, Delta, Northwest, United and US Airways.

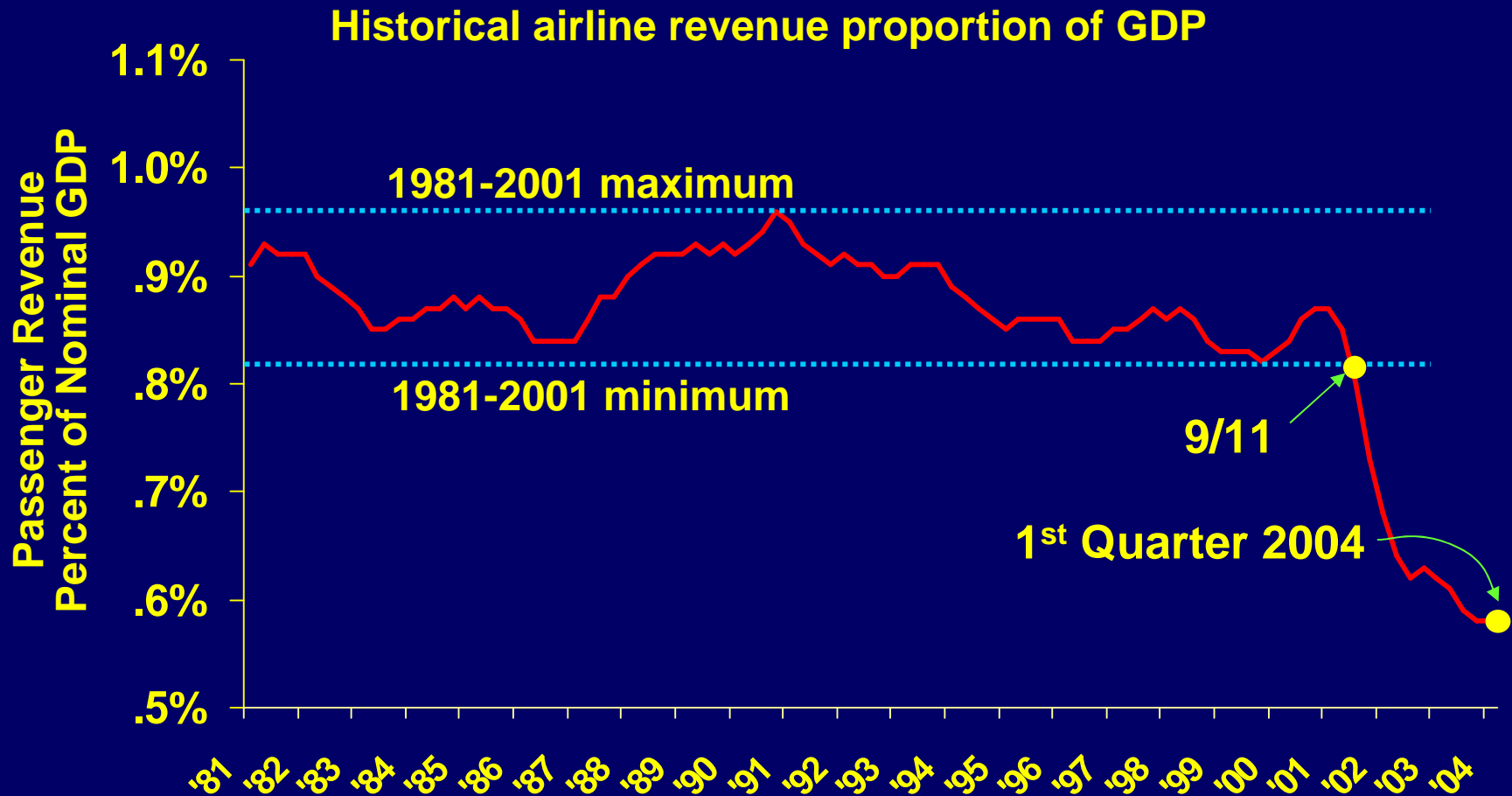
\* Merrill Lynch Research forecast

# Real Yields Have Been Declining For Years

## Inflation Adjusted Industry Yield

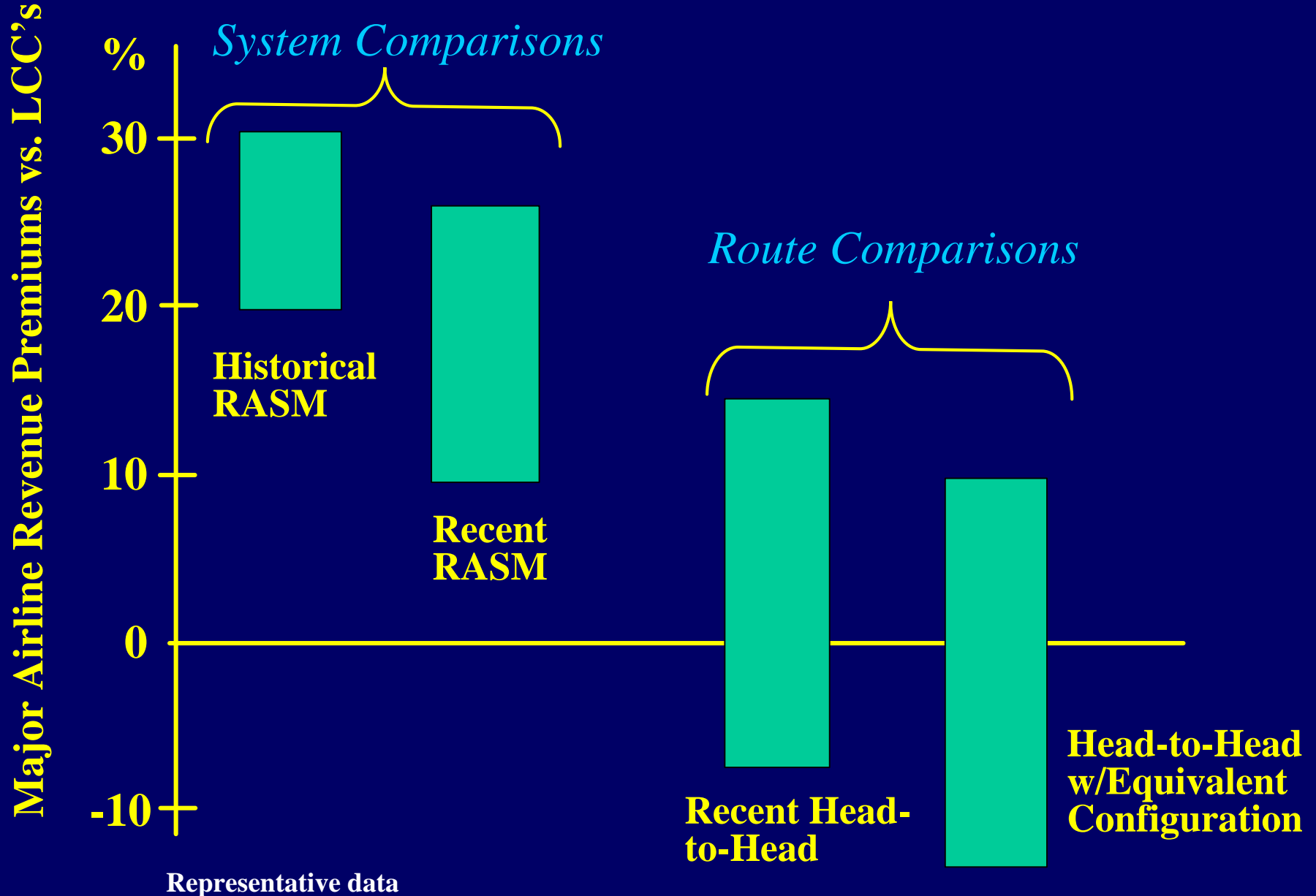


# *Airline Revenues Have Fallen Off the Chart Relative to the Economy*



Source: UBS Investment Research, DOT Form 41 - System Passenger Revenues. Major airline data

# How Real is the Traditional Airline Fare Premium?



# *The “Conventional Wisdom” Often Changes and Reverses*

## Period

## Conventional Wisdom

1970's

LCC's will drive Majors out of business

1980's

Majors have mass, strength & have adopted the best of LCC's -- LCC's are doomed

1990's

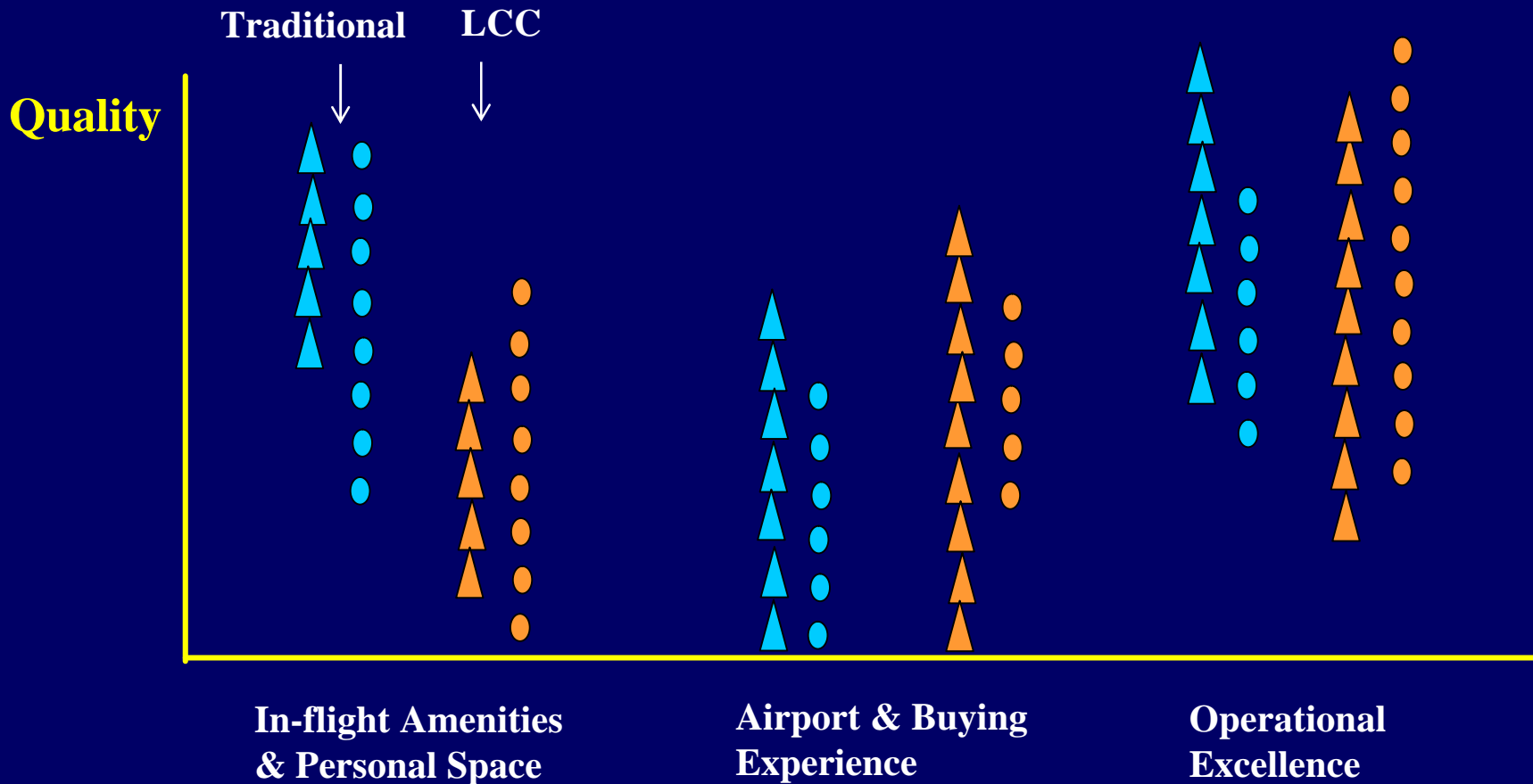
LCC's will co-exist as limited niche players

## Early 21st Century

- Version A LCC's will drive the dinosaurs out of business
- Version B LCC's will dominate large O&D's; while hub & spoke airlines serve markets too small for LCC's
- Version C Like Version B, except that LCC-RJ's will further crush hub & spoke operators

**Might the conventional wisdom  
change or reverse again?**

# Do Traditional Airlines Truly Please Customers More? [depends on which customers]



- ▲ Typical expectations
- Typical performance

**LCC's often do a better job of exceeding their customers' expectations**

# *A Personal Vision of the Future*

# *An Alternate Outlook*

Diverse airlines will co-exist and thrive

- Kia, Toyota and BMW satisfy diverse customer segments
- Motel 6, Sheraton and Four Seasons satisfy diverse customer segments

LCC's will no longer exist as a prime differentiating category

# *What Will the Winners Look Like?*

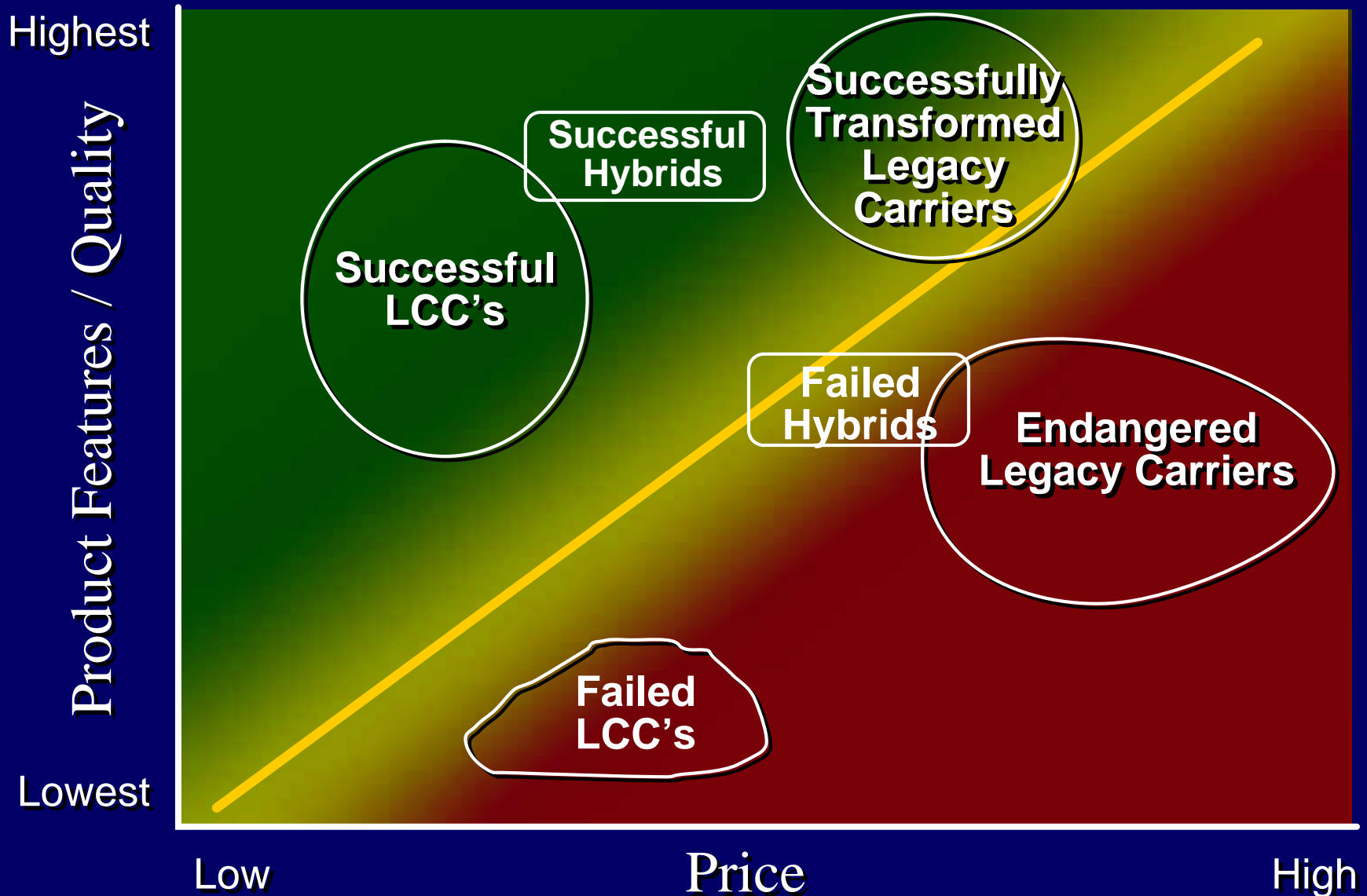
All successful airlines must be

- efficient
- operationally excellent
- align their product with their customers' needs

Airlines will continue to be differentiated by

- the markets they serve
- how they serve these markets
- product features

# *The Market Will Likely Embrace Various Airline Positionings*



# *A Formula for Success*

*Any airline can buy any aircraft, most any software, hire a top-notch ad agency, and fly any domestic route*

