

The Evolution of LCCs

A Case Study

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The Evolution of Commercial Air Travel

Although commercial air travel services have been offered for approximately 80 years, the last 10 years have seen dramatic changes within the industry in Europe. The deregulation of the airline industry has been the primary catalyst for this change, although there are additional factors that have contributed towards this transformation. Interestingly, it is not the physical “hardware” that has changed (despite advancement in fuel efficiency and avionics, jet aircraft are essentially as fast and comfortable as they were 30 years ago.) Rather, it is the service itself that has altered considerably. The growth of the “Low Cost Carrier” (LCC) has revolutionized air travel, making it accessible to a much larger percentage of the population in North America and the EU, and more recently, the Indian subcontinent and South East Asia / Australasia.

Prior to the advent of LCCs, legacy carriers such as British Airways and KLM carried the majority of passenger traffic. Prices for scheduled travel were maintained at an artificially high level, with the airlines catering primarily to their most profitable customers: business travelers. Charter operators catered to leisure travelers, but in much smaller numbers. In Europe, in particular, the industry was described as the antithesis of a perfect competitive market, with “overpriced fares” and “government-run airlines.”¹ Once markets were deregulated, this bloated cost structure allowed LCCs, such as

Southwest Airlines in the United States and easyJet in the EU, to focus on customers who wanted convenient and inexpensive travel options.²

Unlike the legacy carriers that typically offer 3-4 classes of service, low cost carriers offer just one class, often with higher density seating. In some instances, Seat configuration of LCCs creates up to 15% more seats on their aircraft than on those of established legacy carriers.³ LCCs typically utilize a standardized fleet to reduce maintenance and training costs. In addition, they use high volume, point-to-point routes, often from less crowded secondary airports, thus avoiding inconvenient and expensive primary airports. They also save on expenses by returning flight crews to their base country at the end of daily operations, which negates the need for hotel rooms and transport. Their two key strategic goals can be described as filling aircraft to ensure that profit margins are maintained and turning around aircraft in the shortest possible time. This has been successfully demonstrated by Southwest Airlines (whose pilots are even under instruction to taxi aircraft as quickly as permitted from terminal to runway and vice versa.) This is a good illustration of the resource leverage approach, as described by Prahalad and Hamel.⁴

LCCs generate much public awareness through aggressive marketing and advertising campaigns. The focus of their advertising is not on the services that they do not offer (catering, lounges, frequent flyer mileage,) but on the incredibly low prices they offer

customers. The Internet has revolutionized sales distribution channels, and the airline industry is no exception. Low cost carriers rely on direct sales techniques through the Internet, thus eliminating the need for expensive commissions to travel agents, and expensive call centers. Distribution now makes up 3% of costs at Ryanair versus 10% at larger carriers.⁵

Evolutionary Process versus a process of “just change.”

Low cost carriers have now overtaken many legacy carriers in market capitalization.⁶

In order to maintain profitability, legacy carriers have been forced to follow suit, cutting fares on competing routes without alienating passengers who purchase their premium brand offerings (i.e. first and business class.) In addition, the legacy carriers have copied the aggressive marketing techniques employed by the LCCs, offering discounts when purchasing tickets online, outsourcing call centers and closing ticketing offices in city centres, where real estate costs are higher. The dissolution of such pedigreed carriers as Sabena and Swissair were due in part to their inability to adapt to this new environment. In addition, a protectionist agenda (especially in Switzerland,) a diluted brand offering that left customers confused as to whether they were full service or low cost,⁷ and flawed airline alliances that poached traffic instead of feeding it, ultimately led to their bankruptcy. Although there was no direct competition to the Concorde in terms of speed, the loss of profitability for both British

Airways and Air France helped lead to the demise of this aircraft also.

Many legacy carriers have also created spin-off low cost subsidiaries to remain competitive, only to absorb them again (United Airlines with their Ted brand, and Delta Air Lines with Song are two examples.) Baum's discussion of niche-wide dynamics and the ability of specialists versus generalists to adapt to changing business environments can be applied in this instance; both United and Delta were unable to segment their business brands from their leisure brands. Both airlines have also filed for Chapter 11. Baum also discusses how core changes within an industry "renders obsolete" established routines. The legacy carriers could certainly not continue charging inflated prices for travel once the LCCs entered the market. Finally, he discusses how large size reduces impetus for change. This clearly happened with both Sabena and Swissair, with unfortunate consequences for both parties.

The Crucial role that Ryanair played in the evolutionary process

Within the EU, one of the biggest success stories in the aviation industry is easyJet, a low-cost no-frills carrier. Together with Ryanair, the companies are projected to take 25% of the intra-Europe market by 2010. Between 1995 and 2003, the airlines added more than £4 billion in market value⁸ while the majority of legacy carriers lost value. Both easyJet and Ryanair offer competitive products – extremely low fares and no onboard services. They both follow direct sales techniques, ticketless travel, outsource as much as is necessary and encourage Internet sales. Both are considered model examples of low cost carriers, and both have been incredibly successful financially. Within their home nations (UK and Ireland respectively), both have been able to capitalize on first-mover advantage, rapidly establishing a customer base and reputation for cheap fares. However, there is a subtle difference emerging between

the two, namely that easyJet has been able to capture a growing percentage of the business traveler market.⁹ Recall that one of the principle arguments for LCCs was that they would cater to leisure travelers who would purchase tickets far ahead of time, and would be less concerned with in-flight service offerings, especially for short haul journeys. Under a harsher economy, with companies looking to save finances, easyJet's walk-up fares can be considerably cheaper than advance purchase fares on legacy carriers. The appeal to business travelers is increased due to the fact that easyJet operates from both primary and secondary airports, thus allowing business travelers easy access from airports to the city and vice versa. By contrast, Ryanair's airports can be many kilometers away from their named "destination," where landing charges are cheaper (Frankfurt – Hahn airport is 125km from Frankfurt, and Stockholm – Skavsta is 100km south of Stockholm.) To this extent, easyJet has been increasingly successful at capturing market share from legacy carriers, while Ryanair's focus has been on serving destinations that were previously underserved, or unaffordable to leisure travelers. This is also reflected in their route planning: easyJet expansion focuses on additional frequencies between key European metros, while Ryanair is focused on as much international expansion as the market can sustain.

Airlines are in the service business. Schumpeter's discussion on what constitutes innovation often refers to the manufacturing industry, especially with regard to R&D advancement, technological superiority and production. However, he does argue that innovators can be defined as "breakers of monopoly." The LCCs have shown that they are not only capable of doing this, but have forced others to imitate. Even more remarkable is that they have been able to achieve this without a competitive size advantage; something that Schumpeter argues is necessary for innovation. EasyJet commenced operations 10 years ago with

just 2 leased aircraft, and has since morphed into a billion-pound operation with over 109 aircraft.¹⁰

References

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- ⁴ <http://www.coursework.info/i/65720.html>
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- ⁶ Mercer Management Consulting "Impact of low cost airlines" 2002
- ⁷ Knorr "Why Swissair failed" University of Bremen Institute for World Economics and International Management
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- ⁹ Mason, "Marketing low-cost airline services to business travelers" Journal of Air Transport Management 2001
- ¹⁰ EasyJet Annual Report, 2005