Airneth report 14

A journalistic report of the fifth Airneth Annual Conference
‘Consolidation and new business models in the air transport industry’

Introduction

The gradual process of liberalization has resulted in structural changes in the aviation markets. One of the changes has been more competition, lower fares and strong increases in passenger volumes. Airlines have reacted by joining into alliances and, in some cases, even by transnational mergers. Alliances allow airlines to achieve demand-side benefits such as network integration, either by route specific code shares or even by joining complete networks. Mergers can result in substantial cost reductions and, hence, meeting the lower fares required by the market. However, some scholars state that increasing market concentration could eventually have negative welfare impacts for the consumer.

Another major trend has been the emergence of low cost carriers, based on an entirely different business model. In contrast to most traditional airlines, these LCC's operate in point-to-point network configurations, often from secondary airports, which reduces their costs and fares, putting the market shares of traditional airlines under further pressure. The fifth Annual Conference of Airneth is addressing further future trends in this context.

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Regarding the recent developments in the U.S., the merger between Northwest and Delta Air Lines into Delta Air Lines was an important and striking event. **Perry Cantarutti**, Senior Vice President for Europe, Middle East and Africa of the new airline, highlights the changes that have occurred for the two merged companies. Whereas previously the two airlines - compared with other airlines in the U.S. - had a modest market, the new airline became at once the most important airline in the US in most markets. In addition, the merger resulted in financial benefits. Measured over the last three years, the total cost reduction plus additional revenues generated approximately 2 billion U.S. dollars. Also, the cooperation within the SkyTeam alliance has been strengthened and there is now a joint venture with two European partners, Air France/KLM and Alitalia. Delta Air Lines is convinced that in this way it can successfully face competition with the other two major alliances on the trans-Atlantic market.

That such actions are necessary in the highly competitive air transport market, is shown by **Rigas Doganis**. According to Doganis, the aviation industry is in crisis. Airlines had practically no profits in the last twenty years, despite the recovery that seems to take place the last two years. But high oil prices, competition from low cost carriers and from emerging airlines from the Gulf, put significant pressure on the financial position of the incumbent carriers. He also outlines that consolidation (either in alliances or mergers), is a possibility to face the crisis, along with cost reduction and restructuring of networks. Smaller companies will have to retreat, according to him, to short distance regional routes, and seek cooperation with large companies, who focus more on longer distances. Even for the low cost carriers, he sees a role for feeding passengers to long haul routes from major carriers.

Nigel Dennis of the Westminster University in London, sees the recent developments with the perspective of competition. He refers to Lufthansa, who states that the times that it had to compete with British Airways and Air France/KLM have gone forever. The new competitors are Ryanair and easyJet in the short haul markets and Emirates on the longer haul markets. Not only Lufthansa, but all major airlines face competition with the low cost carriers, even if they operate from secondary airports (Stansted, Hahn etc.). Despite of this competition, the major airlines are still able to achieve relatively high yields from their hubs. Looking to competition levels at the hubs, British Airways faces more competition at its hub Heathrow, compared to competition faced by the other airlines at their own respective hubs Amsterdam, Frankfurt and Charles de Gaulle.

Also **Jan Veldhuis**, program manager of Airneth, acknowledges that major airlines are retreating to the longer routes. They can however not operate these routes stand-alone, they need to be feeded from the shorter haul routes. But particularly these short routes face the pressure of new competition from point-to-point carriers. This causes dilemmas for airports, particularly for secondary smaller airports. The larger hubs have kept their focus on their hub-and –spoke systems, but for the smaller airports the dilemma emerges of either choosing a secondary hub status of a large airline with its inherent risks, or going for the point-to-point segment, with lower fares and hence a larger catchment area.

Renato Redondi of the University of Brescia (Italy), emphasizes the risks for smaller airports related to a secondary hub status of a major carrier. Besides the risk of a decreasing role in the network of this major carrier, he argues that, once its secondary hub status is lost, it is unlikely that the earlier traffic volume will return soon. He has studied dozens of examples of airports that have lost their hub status. Known examples in Europe are Brussels and Zurich in 2001, both as a result of bankruptcy of their hub carriers. More recently, Barcelona and Milan Malpensa lost their hub status, due to restructuring of networks of the main hub carriers. Iberia and Alitalia focused on their primary hubs, respectively Madrid and Rome, as one of the responses to the crisis outlined by Rigas Doganis.

Christoph Brützel of the International University of Applied Sciences in Bonn sketches a further development of the current national flag carriers to (three), pan-European carriers, not managed from their own national bases, but from their European headquarters. The current three major alliances may develop to such conglomerates. To compete with emerging carriers from the Middle East, these new European airlines will also have to focus on direct services to secondary airports, both in Europe and Asia. Although managed from one point, several operational bases would be established with several brands in different European countries, which have still much potential.

Although there are trends of converging business concepts between LCC's and the established airlines, **Jaap de Wit** of the University of Amsterdam (and the Netherlands Institute of Transport Policy) sees – in contrast to the trends of convergence – a development at LCC's which is very unlikely going to be copied by the established carriers: the use of lower density networks. While the number of city pairs served has grown explosively in the last ten years, this growth has taken place at the expense of the average weekly frequency, which has decreased. This particularly has been the case with Ryanair, who serves most of its routes not even daily, but no more than several times weekly. The opposite was the case with South West in the USA, which serves most routes three to four times daily, which enables the latter airline to develop even a rudimentary hub-and-spoke system and realizing at some airports in the USA a connecting traffic share of over 30%.

Richard Klophaus of the Worms University of Applied Sciences puts also some question marks with regard to the converging business concepts of the two types of airlines, which he illustrates from an empirical study of the distinct business models. He defines a number of typical criteria for low cost carriers. Examples are: the use of point-to-point networks, limited distinct aircraft types and cabin classes, no-frills and no frequent flyer loyalty programs. By examining 25 different low cost carriers, he sees within this category a large diversity. Only few of them can be considered as 'real' low cost carriers, as they meet all criteria developed. Also he has observed a number of 'traditional network' carriers, where – also based in these criteria – hardly convergence trends are seen.

The possibilities for low cost carriers to enter long haul markets are discussed by **Peter Morris** of Ascend Worldwide in London. He challenges the common opinion that this business concept is not able to break through in the long haul market. This is often argued by saying that such airlines operate point-to-point networks, lacking feed and hence relying on the OD-markets alone, while generally long haul markets can only survive with significant additional short haul feed. Other arguments are the low cost carriers often use secondary airports, with smaller markets and the established carrier have better scope of 'marginal pricing' in their connecting markets. Despite of all these arguments, Virgin Atlantic once started as a 'long haul low cost' carrier and today similar concepts are emerging, particularly in Asia. He sees therefore perspectives in fast growing large markets, such as in Asia and the Middle East. We may even see the moment that an airline like Emirates with an A380 and 750 seats is the next example of such a 'long haul low cost' carrier.

The idea that low cost carriers have no connecting markets potential, is challenged by **Wolfgang Grimme** of the German Aerospace Center in Cologne. Because of their strong growth in the recent years, there are increasing opportunities for ‘self help hubbing’. The mere coincidence of flights that connect to each other, enables passengers to connect between two flights. But also airports and airlines have discovered the attractiveness of these concepts. The airport of Cologne has explicitly developed a schedule for ‘low cost connections’, which enable interline connections between Germanwings and TUIfly. There are even developing connecting concepts between the established and low cost carriers, such as between Lufthansa and Germanwings. Furthermore, low cost Air Berlin is joining oneWorld early 2012, with the possibility of code-sharing with other oneWorld members. His conclusion is a development into further hybridization of both concepts, where the low cost segment is also focusing on feed to the long haul flights of the established carriers.