

THE IMPACT OF LOW COST CARRIERS IN EUROPE

(Presented by Albania, Armenia, **Austria**, Azerbaijan, **Belgium**, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, **Denmark**, Estonia, **Finland**, **France**, **Germany**, **Greece**, Hungary, Iceland, **Ireland**, **Italy**, Latvia, Lithuania, **Luxembourg**, Malta, Moldova, Monaco, **Netherlands**, Norway, Poland, **Portugal**, Romania, Serbia and Montenegro, Slovakia, Slovenia, **Spain**, **Sweden**, Switzerland, The former Yugoslav Republic of Macedonia, Turkey, Ukraine, **United Kingdom**)¹

1. BACKGROUND

1.1 In the current difficult climate for European aviation, one sector is performing extremely well, the so-called low cost/no-frills carriers. While the flag-carriers are experiencing severe difficulties, withdrawing from routes and cutting staff, the low cost sector continues to expand at a tremendous pace. There is evidence that the low cost carriers are even becoming dominant players on a significant number of intra-European shorthaul point-to-point routes. The extent to which this expansion of the low cost carriers will affect the traditional airline hub-and-spoke networks poses interesting questions for the European industry and policy makers.

1.2 Europe's experience of low cost scheduled operators began in 1991 when Irish carrier Ryanair transformed itself from a conventional regional airline into a carbon copy of the US low cost pioneer Southwest Airlines. By focusing initially on serving the large leisure market between Ireland and the UK, the airline had a dramatic effect on services across the Irish Sea. The second phase of Ryanair's rapid growth has involved the carrier in building up a network of intra-EU routes linking London's third airport, Stansted, with over 50 under-utilized, secondary airports in a number of countries, making the second largest low-cost carrier in Europe.

1.3 After the acquisition of its rival and British Airways offshoot Go, EasyJet, established in 1995, is currently the largest low cost carrier in Europe. Several other low cost scheduled carriers have also been established as a reaction to these developments or are currently being launched, including, Buzz and bmibaby in the UK, Virgin Express in Belgium, Basiq Air in the Netherlands, and German wings and Germania in Germany.

¹ The 15 Member States of the European Union appear in bold

2. CHARACTERISTICS OF LOW COST CARRIERS

2.1 The chief difference between low cost carriers and traditional airlines fall into three groups: service savings, operational savings and overhead savings. Low cost airlines tend to focus on short haul routes (of generally less than 1,500 km). To achieve the low operating costs per passenger required, this type of carrier needs to have as many seats on board its aircraft as possible, to fill them as much as possible, and to fly the aircraft as often as possible. Competitive advantage derived from greater aircraft productivity is of paramount importance and is achieved by a combination of using uncongested secondary airports and not offering anything other than point-to-point services, like interlining. Secondary airports have two main advantages over larger airports: they tend to charge airlines less for using their services; and, as they are less busy, delays due to congestion are less. In addition, low cost airlines operate a single type fleet. By having only one aircraft type, pilots and cabin crew can operate on any aircraft in the fleet. Another key area where a low cost airline can gain a cost advantage over network carriers is in distribution. Significant cost savings can be made by selling directly to customers via the Internet and call centres and by using electronic ticketing. By not selling via travel agents, low cost airlines avoid travel agency commissions and also avoid computer reservation system fees. Lastly, the area of cost savings that is perhaps most apparent to passengers of low cost airlines is in the on-board service.

3. STRATEGIES OF LOW COST CARRIERS

3.1 There are basically two types of low cost business models in Europe: that of EasyJet, on the one hand, and Ryanair on the other. Ryanair serves secondary airports at relatively low frequencies and focuses on new leisure markets with no direct competition. The Ryanair model focuses on costs rather than on markets, which includes strongly persuading suppliers and airports to reduce charges. EasyJet serves primary -high costs- airports at high frequencies and focuses on existing, business and leisure, markets and also new markets, accepting competition from incumbent carriers. The other low cost carriers try to follow one or other of these models, although they tend to be offshoots of major carriers, so lack the cost advantages of EasyJet and Ryanair.

4. IMPACTS

4.1 The London airports, notably Gatwick, Luton and Stansted, have been the nursery of low cost carriers in Europe. The capacity constrained hub airport of Heathrow has until now no presence of low cost carriers. Since 1997, the number of routes served by no-frills operators from these airports has increased from 17 to 74, with around 15 new destinations being started each year. The increased number of routes served from these London airports is mainly attributable to the no-frills airlines; almost a quarter of the total seat capacity ex-London is now provided by low cost carriers, with Ryanair the second biggest carrier after British Airways. Very few of the destinations targeted by the low cost sector have been subsequently dropped.

4.2 In contrast to the rapid growth in the number of flights and seats supplied by the low cost carriers, the output of full service providers has either stagnated or contracted. The main carriers therefore find themselves in somewhat less dominant market positions in their home market. Customers have not lost out in terms of the routes served or the flights offered, but the incumbents have marginally reduced in importance in these markets. However, relatively few of the short haul markets served from London by the major carriers have experienced a reduction in capacity, which is most likely due to the need for these carriers to feed passengers into their long-haul network. This would seem to suggest that in the principal short haul markets, low cost developments have not forced network carriers to retrench. It is in the smaller markets that incumbents are more likely to reduce capacity in the face of increased competition.

5. OUTLOOK

5.1 Liberalization in Europe has opened up tremendous opportunities for the low cost carriers. If they maintain the 25% year on year growth that has been seen recently, they will possess around one third of the intra-European market in ten years time. In addition, new price sensitive markets will emerge, such as Germany, Scandinavia and the countries of Eastern Europe.

5.2 Despite the success of the low cost carriers, however, there is insufficient evidence to conclude that they severely cannibalize on the networks of the major full service carriers, as the majority of the passengers, especially on the thin routes, is newly generated traffic. On some thick European feeder routes, however, traffic is diverted from the network carriers. It appears unlikely that the no-frills airline will enter long-haul markets to any significant extent, as the characteristics of these markets militate strongly against the no-frills business model.

5.3 Uncertainties also remain over the sustainability of the low cost model. Simplicity has been the key to the success of the low cost carrier. The current expansion of some low cost carriers (notably Ryanair and EasyJet) is liable to expose them to more of the head-to-head competition at the same airport, which, in general, low cost carriers have hitherto sought to avoid. Meanwhile, the major carriers may learn to respond more effectively to the new environment, and the low cost segment will become available to ever more entrants.

6. CONCLUSIONS/POLICY CHALLENGES

6.1 Consumers have benefitted from the rise of the low cost sector in terms of more competition, more destinations, greater frequencies, and a greater diversity of fares. While there has been some impact on the major airlines, around 50% of the traffic carried by low cost airlines is newly generated, and there is little evidence that the hub and spoke networks of the major carriers are being adversely affected to any great extent. The feed of the major carriers may be squeezed on certain routes that are subject to point-to-point competition from low cost carriers, but indications are that they are more likely to respond by reducing aircraft size than by withdrawing from routes altogether.

6.2 There are a number of issues for aviation policy makers connected with the expansion of the low cost sector. These include mitigating environmental effects, especially at hitherto secondary airports, since the majority of the low cost carriers tend to select routes between regional airports. These airports are often confronted with a tremendous traffic growth, which requires large capital expenditure for infrastructure investments. Ensuring passenger rights are upheld, especially since some low cost carriers have different conditions of carriage compared to the traditional carriers; ensuring the maintenance of a level competitive playing field; maintaining high standards of safety in Europe's increasingly crowded skies; and organizing the allocation of ever scarcer capacity at congested European airports.