

OBSTACLES TO TRANSFERRING THE LOW-COST MODEL TO LONG-HAUL OPERATIONS

Dr Nigel Dennis
Senior Research Fellow
Transport Studies Group
University of Westminster

INTRODUCTION

- Low-cost airline revolution has been largely confined to the short-haul market
- More difficult to transfer the low-cost formula to the long-haul market
 - partly because of regulatory framework
 - facets of low-cost operations are less compatible
- Long-haul taken to be >6 hours

COST ISSUES

- Less scope to increase utilisation
- Difficult to match the marginal cost of economy class seats in a mixed configuration aircraft of major carriers
- Some 'frills' must be retained
- Less scope for labour savings
- More difficult to ignore cargo

UTILISATION OF SHORT AND LONG-HAUL AIRCRAFT

| Airline | 737-300 daily utilisation (hours) | Europe pax load factor (%) | 747-400 daily utilisation (hours) | Long-haul pax load factor (%) |
|-----------------|---|----------------------------------|---|-------------------------------------|
| Air France | 7.6 (A320) | 65 | 14.1 | 81 |
| British Airways | 7.6 | 62 | 12.0 | 75 |
| bmi | 6.5 | 60 | | |
| KLM | 7.1 | 71 | 15.0 | 82 |
| Lufthansa | 7.1 | 62 | 15.3 | 83 |
| Virgin Atlantic | | | 14.6 | 81 |
| easyJet | 11.0 | 81 | | |
| Air Berlin | 10.5 (737-800) | 74 | | |
| Ryanair* | 9.8 (737-800) | 78 | | |

Source: IATA, AEA and CAA Statistics * estimated from available data

744

First Class:

Rows 1 - 5; 14 seats

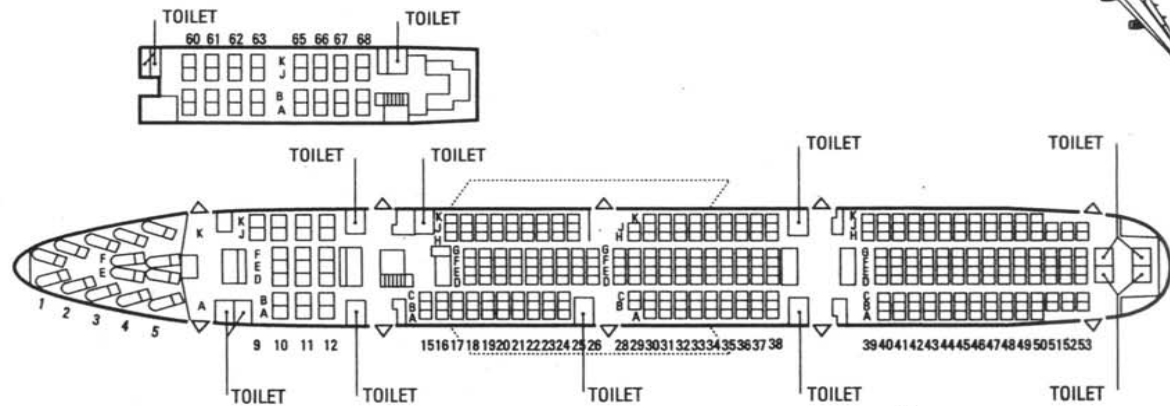
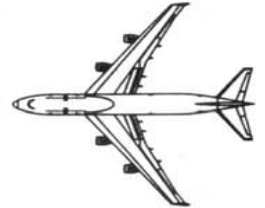
Club World:

Rows 9 - 12, 60 - 68; 55 seats

World Traveller:

Rows 15 - 53; 332 seats

Boeing 747-400



SEAT PITCH – ECONOMY CLASS

some examples

| | | | |
|-------------|-----|-----------------|-----|
| American | 33" | Lufthansa | 32" |
| Air Canada | 32" | Air France | 31" |
| Delta | 32" | British Airways | 31" |
| Continental | 31" | KLM | 31" |
| United | 31" | Virgin Atlantic | 31" |

- Ryanair and easyJet operate with 29" seat pitch
- Britannia tried and abandoned it on long-haul
- Some airlines squeeze an extra seat across the cabin (e.g. Air Transat A310, Emirates 777)

Exact configurations may vary within the aircraft and between routes

OTHER ISSUES

- Hub feed is crucial for long-haul operations
 - there are few dense routes
- Secondary airport strategy more difficult
- Bilateral agreements present a barrier to entry

EXAMPLE OF A TYPICAL BA FLIGHT FROM LONDON TO A SECONDARY US CITY

Origin points of passengers

| | |
|---------------------------------|------------|
| London | 23% |
| Germany | 15% |
| Switzerland/Austria | 11% |
| Africa | 9% |
| Middle East & India | 9% |
| Benelux | 8% |
| Rest of UK & Ireland | 7% |
| France | 6% |
| Mediterranean | 4% |
| Elsewhere | 8% |

Source: British Airways

COMPARISON OF FARES ON LONDON-CHICAGO 2004

| | £ | Index |
|-----------------------------|------|-------|
| One way (unrestricted) | | |
| First | 4721 | 100 |
| Business | 2931 | 62 |
| World Traveller Plus | 1319 | 28 |
| Economy | 536 | 11 |
| Return (cheapest excursion) | | |
| Summer | 490 | 5 |
| Winter | 230 | 2 |

Source: British Airways and Sabre

COST COMPARISONS PER PASSENGER FOR JOURNEY OF 4000 MILES (E.G. LONDON-CHICAGO) ONE WAY

| All figures in £ | Virgin Atlantic | high density all economy 90% load factor | with other adjustments |
|---------------------------|----------------------------|---|-----------------------------------|
| Flight Crew | 11.84 | 8.46 | 6.35 |
| Cabin Crew | 15.81 | 11.29 | 5.65 |
| Fuel | 47.09 | 33.64 | 33.64 |
| Insurances | 1.43 | 1.02 | 1.02 |
| Aircraft | 43.77 | 31.26 | 31.26 |
| Training | 0.86 | 0.61 | 0.61 |
| Maintenance | 28.51 | 20.36 | 20.36 |
| Airport | 27.59 | 19.71 | 9.86 |
| Navigation | 10.80 | 7.71 | 7.71 |
| Passenger services | 25.19 | 17.99 | 0.50 |
| Sales/commission | 20.37 | 14.55 | 1.00 |
| Advertising | 4.39 | 3.14 | 3.14 |
| Administration | 12.33 | 8.81 | 4.41 |
| Cargo specific | 8.10 | 5.79 | 0.00 |
| TOTAL PER PAX | 258.08 | 184.34 | 125.51 |

HOW FAR CAN FARES BE CUT?

TYPICAL EXCURSION FARES

LOW-COST FARES

Return including £30 government taxes

| | | |
|---------------------------------|------|------|
| Low season (25% of flights) | £230 | £176 |
| Mid season (50% of flights) | £360 | £306 |
| High season (25% of flights) | £490 | £436 |
| Average | £360 | £306 |
| Without tax | £330 | £276 |

The low-cost service can undercut traditional airlines by £54 return and make 10% profit margin but less legroom, no food/drink and worse handling!

DEMAND CONSIDERATIONS

- More difficult to stimulate additional trips in long-haul markets due to passengers' availability of time
- No diversion from surface modes
- Most promising opportunities in pure leisure markets (especially VFR) at low frequency or in very dense markets

CONCLUSIONS (1)

- Saturation of intra-European & US domestic markets means new entrant airlines will inevitably divert attention to long-haul
- New long-haul 'low-cost' carriers are generally breaking away from the low-cost model in terms of premium cabin and/or feeder traffic
- Established airlines are in a stronger position than in the short-haul market

CONCLUSIONS (2)

- Labour is an area where savings can be made by locating in a low-cost or low tax economy
- New operators may end up reinventing the traditional network airline model
- A new entrant doesn't have to be ultimately successful to have an impact on the market!