The Evolution of the Low Cost Carrier Business Model – Connections, Hubbing and Interlining

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Agenda

1. Low Cost Transfers and Interlining – Challenges and Solutions
2. The Business Model of Cologne Bonn Connect
3. Analysis of Low Cost Carrier Connectivity
4. Interlining between Low Cost and Network Carriers

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1. Low Cost Transfers and Interlining – Challenges and Solutions

- Growing low cost carrier networks create opportunity for passengers to build do-it-yourself connection itineraries
- Airlines and airports have identified the revenue potentials of low cost transfer passengers
- Introduction of low cost carrier transfer schemes by the airports of Berlin and Cologne, as well as Germanwings

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- What are the characteristics of connections that can be generated with these transfer schemes, while the underlying schedule is not designed for accommodating transfer passengers?

1. Low Cost Transfers and Interlining – Challenges and Solutions

- The “legacy system”: Interlining through multilateral (IATA-Interlining) or bilateral agreements (pro-rate agreements, codesharing)

- Transfers include through ticketing, through baggage-handling and guaranteed connections
  - With some exceptions (e. g. Southwest, JetBlue, Air Berlin, Virgin Blue), not suitable for low cost carriers due to operational complexity and high costs
  - Pro-rate revenues in many cases not attractive for low cost carriers, when taking into account risks of missed connections and associated costs of rebooking, particularly on intercontinental connections

- Key requirement for a transfer system suitable for low cost carriers:

<u>No increase in complexity of business processes!</u>

1. Low Cost Transfers and Interlining – Challenges and Solutions

Major challenges:

- LCC one-way air fares are easily accessible for everybody over the internet
  - ⇨ But, with so many LCCs around, do passengers find the best solution when trying to combine flight segments?

- Characteristics of a multi-segment LCC itinerary:
  - No through ticketing – search costs for most passengers prohibitive
  - No through baggage handling – inconvenience of additional check-in
  - No guaranteed connection – risk of missed connections

⇨ Do-it-yourself LCC transfers are not very attractive for passengers

1. Low Cost Transfers and Interlining – Challenges and Solutions

Potential solutions:

- Prohibitive search costs:
  - Introduction of an internet meta search engine that finds automatically the best LCC connection
  - Booking could be conducted directly over the search engine, including a small commission for the service

- No through baggage handling:
  - Airports could introduce check-in counters at the baggage claim, as done in Cologne-Bonn

- No guaranteed connection:
  - Missed connections are a perfectly insurable risk: insurance premium could even be adjusted to missed-connection probability

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2. The Business Model of Cologne Bonn Connect

- The airport operator of CGN developed a scheme for LCC connections
- Combination of flights of Germanwings and TUIfly
- Operational between 2007 and 2010 (TUIfly then ceased its LCC operations)
- Minimum Connection Time: 90mins (120mins required for transfer insurance)
- Flights could be booked directly via the website www.cologne-bonn-connect.com
- Insurance was offered for 7.50 EUR per transfer – insurance up to a maximum of 500 EUR in case of missed connection (equals an implied missed connection probability of less than 0.015)
- Suggestions for stopovers in Cologne
- Check-In Counter directly at the baggage claim operated by the airport
- At the same time, Germanwings introduced its own transfer system “SmartConnect”: MCT 90 mins, 8,000 passengers in September 2007

Cologne Bonn Connect

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3. Analysis of Low Cost Carrier Connectivity

Critical assessment of low cost connection schemes:

- Marketing/asymmetric information: How do potential passengers at the "spokes" know that such a scheme exists at a particular low cost “hub”?
- Unidirectionality: feasible connections can often only be generated in one direction with acceptable connection times (example on the next slide)
- Competition: OD-city pairs with high demand are likely to be linked already by non-stop services and traditional connecting services by legacy carriers are much better distributed in the CRS and often also lower priced
- Additional Schengen-Visa needed for non-EU-citizens when travelling between non-Schengen countries (e.g. UK-Russia)

⇨ Low cost carrier connection schemes are often not convincing from the commercial perspective

3. Analysis of Low Cost Carrier Connectivity

Example of structure of connections within the Cologne Bonn Connect Scheme

List of Flights connecting to X3 2131 from Bilbao, arriving at 2:35pm:

Layover in CGN	Connecting Flight	Destination	Departure Time	Total Travel Time	Level of Circuity
2:20	X3 1140	Palermo	16:55	6:55	1.79
2:25	4U 16	Berlin-Schönefeld	17:00	5:40	1.01
2:25	4U 768	Zurich	17:00	5:40	1.51
2:50	X3 160	Berlin-Tegel	17:25	6:05	1.01
3:15	X3 10[illegible]	Hamburg	17:50	6:[illegible]5	1.01
3:50	X3 162	Berlin-Tegel	18:25	7:05	1.01
4:00	4U 754	Vienna	18:35	7:35	1.17
4:25	4U 78	Leipzig-Halle	19:00	7:35	1.03
4:30	4U 788	Budapest	19:05	8:20	1.17
4:35	X3 1110	Venice	19:10	8:05	1.49
4:50	X3 4110	Manchester	19:25	8:40	1.64
5:05	X3 4120	Birmingham	19:40	8:45	1.73
5:30	4U 18	Berlin-Schönefeld	20:05	8:45	1.01

Not one of these connections works in the other direction!

3. Analysis of Low Cost Carrier Connectivity

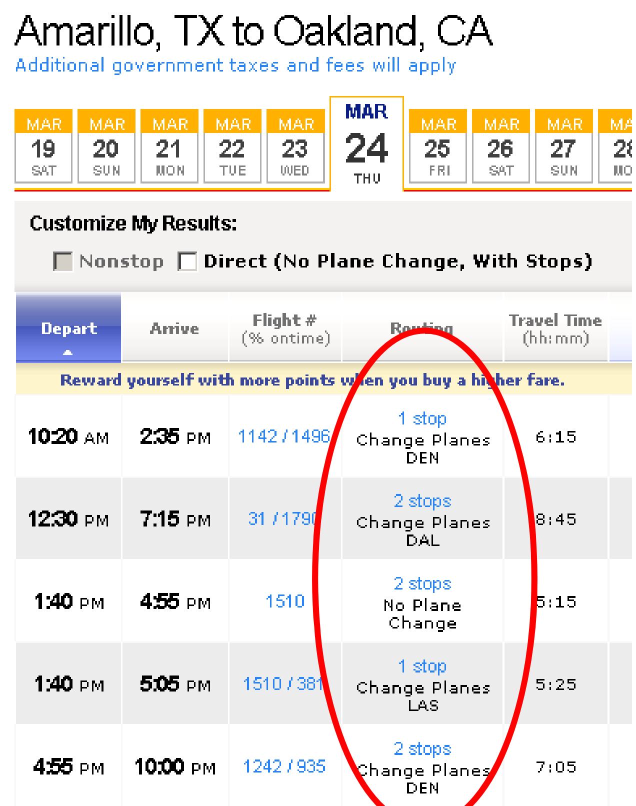
Ingredients needed for a working system of transfer connections:

- **Traditional wave structure (with known diseconomies: peakiness, congestion, low aircraft productivity)**

OR

- **Have as many flights to several "hubs" as possible that feasible and competitive connections emerge more or less "automatically" (waves do not matter anymore then)**

⇨ **Southwest Airlines does exactly that and Ryanair could if they wanted...**



Amarillo, TX to Oakland, CA
Additional government taxes and fees will apply

MAR 19 SAT | MAR 20 SUN | MAR 21 MON | MAR 22 TUE | MAR 23 WED | MAR 24 THU | MAR 25 FRI | MAR 26 SAT | MAR 27 SUN

Customize My Results:
Nonstop Direct (No Plane Change, With Stops)

Depart	Arrive	Flight # (% ontime)	Routing	Travel Time (hh:mm)
Reward yourself with more points when you buy a higher fare.				
10:20 AM	2:35 PM	1142 / 1496	1 stop Change Planes DEN	6:15
12:30 PM	7:15 PM	31 / 1790	2 stops Change Planes DAL	8:45
1:40 PM	4:55 PM	1510	2 stops No Plane Change	5:15
1:40 PM	5:05 PM	1510 / 381	1 stop Change Planes LAS	5:25
4:55 PM	10:00 PM	1242 / 935	2 stops Change Planes DEN	7:05

Source: Southwest Airlines

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4. Interlining between Low Cost and Network Carriers

- “Hybridisation” of the low cost business model
- Growing number of interlining/code share agreements between network and low cost carriers: JetBlue-American Airlines, GOL-American Airlines, JetBlue-Aer Lingus, Germanwings-Lufthansa
- Air Berlin to join oneworld alliance in 2012
- Advantages: Cost advantage in case of outsourcing of feeder services, revenues from mixed network/low cost carrier trips
- Possible future developments: LCCs will be the “production platform” for decentralised continental networks or even feeders to non-congested hubs, FSNCs concentrate on long-haul flights and hub fortresses

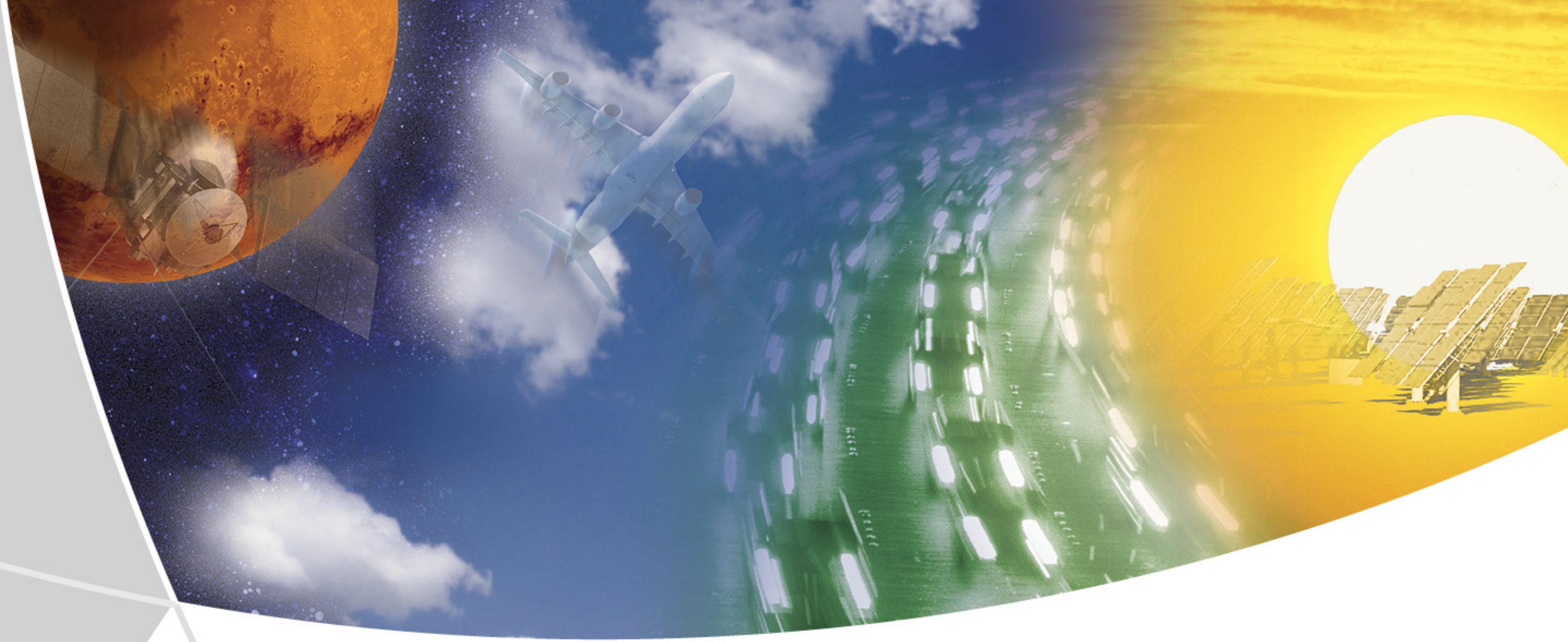
4. Interlining between Low Cost and Network Carriers

Example: Interlining Agreement between Lufthansa and Germanwings

- Effective 20th January 2011
- Germanwings lists flights in GDS (Amadeus)
- Lufthansa and Germanwings fares can be combined
- Germanwings‘ GDS fares higher than internet fares
- Germanwings becomes part of Lufthansa‘s corporate bonus scheme „Partner Plus“
- „Miles and More“ Frequent flyer program mileage accrual possible

Conclusions

- Do-it-yourself low cost connections mainly unattractive
- Low cost connection schemes remain a niche product, as connections are limited due to issues with low frequencies and directionality
- Offering connections by low cost carriers can make sense for the passenger, in case a critical mass of frequencies and potential transfer points is exceeded ⇨ Southwest Airlines, Ryanair (?)
- “Hybridisation” of the low cost business model continues
- Potential scenario: Low cost carriers evolve into production platforms for short-haul feeder services, network carriers concentrate on long-haul flights



Thank you for your attention!

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