Which came first for low-cost carriers, the focus on business passengers or the expansion at primary airports?

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ARTICLE INFO

Article history:
Published 29 June 2015

Keywords:
Business passenger
Hybridisation
Low-cost carrier
Primary airport

ABSTRACT

Due to hybridisation, the airline sector is no longer a binary world consisting of low-cost carriers (LCCs) and network carriers. LCCs are adjusting their models to the prevailing market conditions. In order to gain higher yields, LCCs have started to attract business passengers by offering bundled fares, operating from primary airports, and revaluation of the product by business passengers themselves. Furthermore, secondary airport routes are saturating, making a move to primary airports inevitable. Next to gaining higher yields and secondary airport route saturation, LCCs are shifting from secondary to primary airports in order to capture slots and market share at congested airports.

Introduction

LCCs have always been adjusting their business models to the prevailing market conditions. This study calculates the hybridisation – blending the low-cost and network business models – of the airline sector, and illustrates that it is no longer a binary world, but rather a full spectrum from ultra-low-cost carriers towards full-service carriers. Subsequently the study focuses on two aspects within the low-cost hybridisation: the focus on business passengers, and the expansion at primary airports. LCCs are getting more business passengers on board because of three adjustments to their business practices: offering better value for money, offering bundled fares, and expanding at primary airports. However, attracting higher yielding passengers due to expansion at primary airports might be a side effect, as LCCs are moving to primary airports due to market saturation at secondary airports and the nearing congestion at primary airports.

Methods and Data

During the research, both quantitative and qualitative methods are used. A literature review on the developments in the low-cost market is performed in order to identify the current theoretical issues and debates related to the topic, and to identify the current state of knowledge about the problem. The literature review focuses on key studies in the field, from frequently cited older studies to more recent work in order to build on a broader and up-to-date collection of data.

In order to identify all developments, it is crucial to interview experts from different industry segments: airlines, airports, authorities, and the academic field. It is of importance to have a well-balanced division in the number of interviewees per category in order to gain a correct perception of the developments, and issues. The diverse group of experts from all aspects of the industry – airlines (6), airports (5), academics (7) and authorities (1) – ensures a broad and wide view is obtained from within the sector. By conducting multiple semi-structured interviews with experts from all industry segments, qualitative data is gathered. The semi-structured interviews leave room to adapt questions during the interview. However, the subjects of discussion are set. The goal of semi-structured interviews is to explore and probe into several factors that might have an influence on the central theme (Sekaran & Bougie, 2013). The semi-structured interviews provide the opportunity to ask for more clarification and leave room to address new topics brought up by the interviewee. The interviews contributed to a better understanding of the dynamics in the airline sector and the hybridisation of LCCs.

Definition and Selection of Low-Cost Carriers

The relevant LCCs in this research are decided to be the ten largest LCCs on the European market by Available Seat Kilometres (ASK) offered per week. Data from the Official Airline Guide (OAG) about calendar week 24 of 2015 is used for the selection. It must be noted that in this comparison easyJet Switzerland is considered incorporated in easyJet and Iberia Express is excluded from the LCC selection as it is incorporated in Iberia. The same accounts for AnadoluJet, which is incorporated in Turkish Airlines.

A typical LCC is characterised by the ability to compete on price as a relative cost advantage is achieved over their competitors (Francis, Dennis, Ison & Humphreys, 2007). In this research we use the definition provided by the International Civil Aviation Organization (ICAO) for the term low-cost carrier: "An air carrier that has a relatively low-cost structure in comparison with other comparable carriers and offers low fares or rates." (ICAO, 2009). However, the focus on low costs is hard to define in business practices, as low costs can be achieved in multiple ways. CAPA uses ten business model practices listed in the first column of Table 1 to determine whether a carrier is an LCC. The criterions in the second column show how these practices are assessed, whereas the values in the third column are the values typically obtained by LCCs.

The calculation of the value per LCC is shown in *Appendix I*. Table 2 shows the ten carriers that are considered in this research. The second column of the table shows the LCC index obtained by the selected carriers. The LCC index is the average of the score on every ten business model practices stated by CAPA (*Appendix I*). This LCC index shows the level of consistency with the archetypical LCC in terms of the offered product (Klophaus et al., 2012). An LCC will score a 1 or close to a 1. A network carrier would score a 0 or close to a 0. Fare bundling does not affect the LCC index score as long as the carrier keeps offering the basic fare and product along with the bundled product.

Table 2
Selected European LCCs and their index based on S15

LCC	LCC index
Ryanair	1.00
easyJet	0.94
Pegasus	0.92
Jet2.com	0.81
Vueling Airlines	0.79
Monarch Airlines	0.79
Germanwings	0.72
Norwegian	0.72
Aer Lingus	0.58
airberlin	0.53

Source: Calculation and sources in *Appendix I*

Table 1
Criterions for the LCC business model

Business model practice	Used criterion	Typical value for an LCC
High seating density	Seat density utilisation index	1
High aircraft utilisation	Daily aircraft utilisation index	>12 hours per day
Single aircraft type	Fleet homogeneity index	>0.75
Low fares, including very low promotional fares	Fares being main website advertisement	Yes
Single class configuration	Single class configuration	Yes
Point-to-point services	Only offering point-to-point services	Yes
No free frills	No free frills in lowest fare category	Yes
Predominantly short- to medium haul route structures	Flights performed with narrow body aircraft shorter than 6,5 hour	Yes
Frequent use of second-tier airports	Predominantly secondary airports	Yes
Rapid turnaround time at airports	Short turnaround times throughout daily operations	Yes

Source: CAPA, (n.d.); Klophaus, Conrady & Fichert, (2012); Hauwert (2013)

Table 2 shows that many LCCs have found a mixture between the traditional LCC business strategy and the traditional network carrier business strategy. Due to the hybridisation, it has become difficult to draw a boundary when defining carriers regarding their cost-structure, legacy, product, price, or service. The airline sector should be seen as a full spectrum that cannot longer be divided into two separate groups; every airline offers its own product and proposition.

However, the calculation in *Appendix I* shows that not all LCCs are changing the same business model practices. The only business model practice that is still achieved by all selected LCCs is the offering of 'low fares, including very low promotional fares'. This shows that the offering and marketing of low fares by LCCs is still essential in LCC business practices. Deviations in the traditional business model practices can mainly be found in aircraft utilisation, fleet homogeneity, and point-to-point services. The lowest scoring airlines for every deviating business model practice are shown in Table 3 with an explanation for the deviation.

Winning over Business Passengers

As illustrated in the previous paragraph, the low-cost sector and the offered products are hybridising towards a more of a full-service product. This resulted from the continuous adaption of LCC business practices to the prevailing market conditions. This shift in strategy reflects among other aspects from the focus on business passengers. LCCs are getting more business passengers on board for three reasons: (1) business travellers revaluate the LCC product once they have experienced it, (2) LCCs are offering bundled fares which are possible to be booked true GDS', and (3) LCCs are expanding at primary airports where business passengers can be found.

Business Passenger Revaluate the LCC Product

Research shows that once business passengers experience the LCC product, they are inclined to use LCCs more often (Neal and Kassens-Noor, 2011). Hence, LCC marketing strategies are aimed at getting business travellers to experience the low-cost product in order to win market share from the network carriers. Early studies on the difference between business passengers using LCCs and network carriers have not indicated significant different market segments. Mason (2001) concluded that "there does not seem to be two distinct market groups in the UK short-haul business travel market, more a blurring across the sector. Passengers using low-cost airlines for business also use network carriers and vice versa". A traveller heterogeneity study confirmed this and stated that it is consistent with the fact that LCCs are stealing a significant market share of business passengers, rather than creating new markets from business passengers that previously did not fly (Huse & Evangelho, 2007).

The survey carried out by Huse and Evangelho suggests that "after having experienced the low-cost product, passengers tend to reassess the valuation of some attributes – Frequent Flyer Programmes (FFP), inflight services, business lounges – in a way that is more favourable to the LCCs. Business passengers are likely to make up

Table 3
LCCs deviating from business model practices with explanations

Deviation	Airlines (in order of lowest score)	Explanation
Fleet utilisation	HOP!	Connecting flights into AFKL network
	airBaltic	Own connecting flights
	airberlin	Own connecting flights
Fleet homogeneity	HOP!	Differentiated fleet due to the merging of Airlinair, Regional and Brit Air
	airberlin	Differentiated fleet due to acquisition of dba and LTU
	airBaltic	Relatively small fleet consisting out of two sub-fleets
Offering point-to-point flights only	airberlin, Norwegian, Aer Lingus	Offer long-haul connecting flights
	Germanwings, HOP!	Connected to parent network
	WOW air, airBaltic, Flybe	Operate own connecting network

Source: CAPA (n.d.b); CAPA (n.d.c);

their minds about the value for money of the network carrier's product. Hence, LCC marketing strategies should be aimed at getting business passengers to experience the low-cost product in order to win market share from the FSNC." Experts state that the business passenger has become more price conscious and does not always choose the full-service flights on short-haul throughout Europe. Business passengers care about frequencies, and less about comfort on short distances. On short-haul flights, LCC and full-service products are already similar in many cases.

Fare Bundling

LCCs are known for the unbundled fares they offer. The price is a 'bare-fare', just the ticket and no ancillaries. However, LCCs are re-bundling their fares to offer passengers a complete ticket without the need to buy add-ons for the requested components. This ticket is mainly aimed at business passengers as it includes flexibility, priority and preferred seating. In Europe, easyJet offers 'Flexi Fare', Ryanair offers 'Business Plus', Vueling offers 'Excellence Tariff' and Norwegian offers 'Flex'.

Table 4 shows the extras included in the premium fare offered by the four largest European LCCs, excluding airberlin as the highly hybridised business model is not relevant in this comparison. Experts state that bundling the product has to do with offering tickets through GDS'; the system used by large Travel Management Companies (TMC). These GDS' leave no room for add-ons; the fare must include everything the business passenger wants. Furthermore, a TMC does not want to be surprised with higher expenses after a trip. However, the fact that the large LCCs are not offering long-haul flights is a limitation to attracting business passengers. It does give businesses bargaining power in negotiations with network carriers regarding corporate travel expenses.

Ryanair and easyJet have a business passenger share of respectively 25 per cent and 19 per cent. Ryanair is currently attracting more business passengers from smaller enterprises that are more price sensitive and geographically spread than larger enterprises (CAPA. 2014). According to CAPA, the combination of network improvements to include more primary airports, increased frequencies, the new Business Plus product, and

Table 4

Extras included in European LCC premium fares

	VY	FR	U2	DY
Checked Bag	x	x	x	x
Priority Boarding	x	x	x	x
Fully Flexible Ticket	x	x	x	x
Priority Security	x	x	x	
Free Airport Check-in	x	x	x	
Preferred Seating	x	x		x
Dedicated Check-in	x		x	
Free Middle Seat	x			
Included Meals	x			
Waiting Lounges	x			
Free Payment			x	
WiFi				x

Source: Individual airline websites

Ryanair's embracing of GDS' and TMCs, should lead to a higher penetration of business travellers from larger enterprises (CAPA, 2014). Ryanair always refused to allow agents selling tickets on its behalf and even took some agents to court, but Ryanair has made a U-turn (Tnooz, 2014). In combination with customer service improvements (e.g. allocated seating, relaxation of baggage limits, enhanced website, and a mobile app) LCCs are focussing more on the airline image, customer value, and passenger loyalty in order to attract more business passengers.

Expansion at Primary Airports

The trend that business passenger are becoming a larger portion of the LCCs' total volume accelerated during the economic recession from 2008. Neal and Kassens-Noor (2011) compared the American network carriers and LCC Southwest Airlines during the 2007 recession and found that business models tend to focus on the same target groups during a recession. The reason that business passengers can be found at primary airports is that primary airports are often connecting economic centres. By flying on these routes, and by having schedules adjusted to the wishes of business passengers, LCCs will attract business passengers at primary airports (Shaw, 2011). However, in the expansion at primary airports there is a 'chicken and the egg' story. Primary airports bring higher costs with them, mostly in terms of airport charges due to more complex infrastructure. These higher costs for an airline need to be compensated by higher fares, assuming that an airline wants to break-even or make a profit on a route. These higher yields are often paid by business passengers as they book their flights shortly before departure and with more extras, leading to higher yields. Concluding, the fact that business passengers are getting on board LCCs might be because they are willing to pay the higher fares offered by LCCs on primary airports; thus LCC operations at primary airports are dependent on business passengers.

Expanding at Primary Airports

As mentioned in the previous paragraph, there is a 'chicken and the egg' story in LCC primary airport expansion. Two reasons can be identified for LCCs to expand at primary airports: (1) to sell higher yielding tickets, and (2) because of a saturation of secondary airport routes. The battle for the primary airport is taking place, but not at all primary airports. Experts argue that only the primary airports with a relative weak home carrier in terms of market share are targeted. The type of LCC is also of relevance to the hub expansion. Experts state hybrid LCCs will be successful, as LCCs have to attract the business passengers by bundling their product and connecting primary airports. The trick is to let revenues increase more than costs. That practice might result in an interesting margin to start operations at primary airports. Whilst pursuing the philosophy to be there first with the most, LCCs attempt to capture market share at slot-restricted primary airports. However, that practice is not limited to only LCCs.

Selling Higher Yielding Tickets

In the US, both Frontier and Spirit are expanding on Atlanta Hartsfield-Jackson Airport (ATL) in 2015. This second largest airport worldwide, based on seats offered, is dominated by network carrier Delta with 78.2% of Available Seat Miles (ASMs) and LCC Southwest with 8.6% of ASMs (CAPA, 2015). The two LCCs expanding at ATL will face fierce competition with Delta on all routes, and Southwest on thirteen out of the total of 23 routes offered by Spirit and Frontier in and out of ATL. The reason for this LCC expansion at ATL might be the relative high fares currently offered in and out of ATL. Frontier and Spirit both see potential to attract passengers from both Southwest and from Delta. The fare-gap between those airlines will ensure a reasonable higher yield on the LCC tickets.

In Europe, Ryanair is also replacing its focus towards the business passengers to attract higher yields. Ryanair's CFO Sorahan announced that 50% of the growth in the coming years will take place at primary airports that connect major cities and thereby attract business passengers (Flightglobal, 2015). Again, the business passengers that can be found at these primary airports will generally pay a higher fare where a higher yield is included.

Saturation of Secondary Airports

A second reason for LCCs to expand at primary airport is that the catchment areas of secondary airports start to overlap. Flights from secondary airports in overlapping catchment areas will increasingly compete with each other as, for example, is the case for Ryanair at the regional airports Eindhoven, Weeze and Maastricht (De Wit & Zuidberg, 2012). In 2012, Madrid Barajas airport (MAD) was the sole exception in Ryanair's secondary airport strategy. In 2015 however, Ryanair is operating on Madrid, Barcelona El Prat (BCN), Rome Fiumicino (FCO), Brussels Zaventem (BRU), and is more often mentioning Amsterdam (AMS) too (NOS, 2014). The saturation of secondary airport routes is disputed by industry experts. Some refer to the long-tail LCC business model of many routes with low-frequencies, leaving the LCCs no choice but to move towards primary airports. Whereas others argue that LCCs have too little capacity to operate higher frequencies at those secondary airports and that primary airport expansion is therefore not a result of saturating routes.

Congestion at Primary Airports

A third reason that came up in the interviews is that LCCs are ensuring slots and market share at primary airports before they are too late. Some experts indicated that primary airport expansion is a combination of all mentioned three reasons. As there is no consensus among the experts about this third reason, it still can act as a catalytic effect for LCCs to shift to primary airports. The reason for primary airport expansion came up in seventeen interviews. Of those seventeen experts, 52.9% mentioned the higher yield as the reason. 35.3% of the experts argued that the saturation of secondary airport routes was the reason. The last 11.8% argued that ensuring slots and market share at primary airport initiated the LCC move to primary airports.

Conclusion

This research was initiated to demonstrate the hybridisation of the airline sector and to identify changes in the business strategies of LCCs regarding the changed focus towards business passengers and primary airports. It is concluded that the definitions of 'network carrier' and 'LCC' are no longer valid. Firstly, as it tends to define one party based on the product and the other party based on the cost-structure. Secondly, we see carriers operating a network model whilst having low-cost characteristics. Due to the hybridisation, it has become hard to draw a boundary when defining carriers regarding their cost-structure, legacy, product, price, or service. It is understandable that the definitions to define business models have become vague due to hybridisation, as this is inherent to hybridisation. The airline sector used to be a binary world consisting of LCCs and network carriers that complied with specific business model characteristics. This has changed and therefore we argue that the airline sector should be seen as a full spectrum that cannot longer be divided into two separate groups; every airline offers its own product and proposition.

To answer the question which came first for low-cost carriers? The focus on business passengers, or expansion at primary airports? It remains a causality dilemma. However, it is not essential to know which development caused the other, what is important to know is that these developments are taking place and thereby reshaping the landscape of the European airline sector. LCCs are benefitting of changing dynamics in the low-cost sector, and it is crucial for the incumbent network carriers to understand these shifts and to respond accordingly.

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Appendix I – Low-Cost Carrier Calculation

Table A1 shows the values scored by the selected ten airlines on all the business model practices stated by CAPA. These values are partly indexes and partly nominal values.

Table A1
Low-Cost Carrier scores on CAPA business model practices

Low-Cost Carrier	Designator Code	Million ASK's week 8/6/15-14/6/15 (1)	High seating density (2)	High aircraft utilisation (hr/day) (3)	Single aircraft type (4)	Low fares, including very low promotional fares (5)	Single class configuration (6)	Point-to-point services (7)	No (free) frills (8)	Predominantly short- to medium-haul route structures (9)	Frequent use of second-tier airports (10)	Rapid turnaround time at airports (11)
Ryanair	FR	9060	100%	12:30	1	Yes	Yes	Yes	Yes	Yes	Yes	Yes
easyJet	U2	5961	100%	12:12	1	Yes	Yes	Yes	Yes	Yes	Yes/No	Yes
airberlin	AB	3435	93,8%	8:21	4	Yes	Yes EUR/No ICA	No	Some	No	No	Varies
Norwegian	DY	3421	96,5%	12:10	2	Yes	Yes EUR/No ICA	No	Yes	No	Yes/No	Yes
Vueling Airlines	VY	2568	99,7%	11:53	1	Yes	Yes	No	Yes	Yes	No	Yes
Pegasus	PC	1614	100%	9:57	2	Yes	Yes	Yes	Yes	Yes	Yes/No	Yes
Aer Lingus	EI	1614	91,6%	11:11	2	Yes	Yes EUR/No ICA	No	Yes EUR/No ICA	No	No	Varies
Germanwings	4U	1398	94%	10:31	1	Yes	No	No	Yes	Yes	Yes/No	Yes
Jet2.com	LS	1346	99,3%	10:36	2	Yes	Yes	Yes	Yes	Yes	No	Varies
Monarch Airlines	ZB	1187	96,9%	13:11	2	Yes	Yes EUR/No on A330	Yes	Yes	No	Yes/No	Varies