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# Blending Models

*While the low-cost carrier model has proven quite successful during the past several years, even the purest of LCCs are forced to implement characteristics of network carriers to gain a broader passenger base and expand market reach.*

■ By Christine Kretschmar | *Ascend* Contributor

From an initial skeptical status to a now-well-regarded position in the airline industry, the success and popularity of low-cost carriers in recent years has generally been well documented.

Allowing the masses to conveniently travel the globe at affordable prices, low-cost carriers have maintained continuous growth.

But after more than a decade of multiple LCC success stories, deviations from the original low-cost-carrier business model have become apparent. In fact, few of today's low-cost carriers are "pure." Most are now considered "hybrid" carriers — operating an entirely new business model that is essentially a blend of pure LCC elements with those of the more traditional network carrier.

Many in the air travel industry harken back to the early days of Southwest Airlines as the birth of the LCC business model — but Pacific Southwest Airlines in 1949 was actually the first U.S. air carrier to use the low-cost airline title.

Since 1971 — when Southwest Airlines initiated service — the carrier has operated under the low-cost model with enormous success. In fact, the carrier has sustained profitability almost continuously ever since its inception.

Meanwhile, in Europe, where entrance of low-cost carriers into the larger airline equation is much more recent, expansion of the LCC business model generally coincided with the final deregulation of the air passenger market during the 1990s.

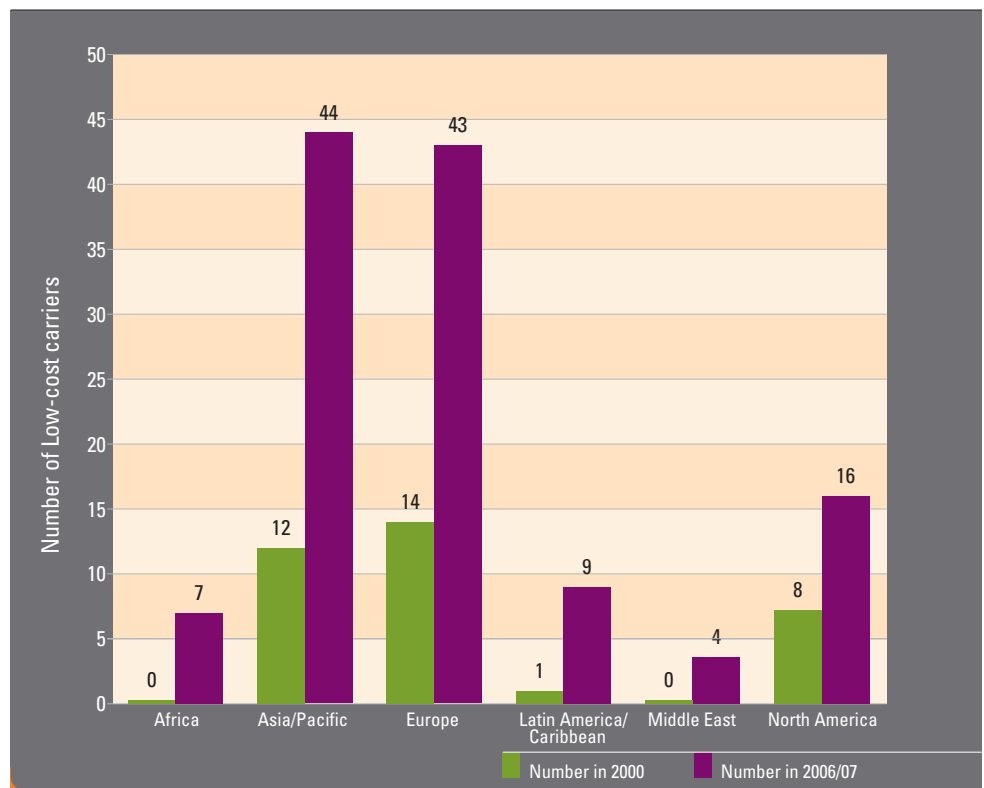
Genuine low-cost operations in Europe actually began with the founding of Irish-based Ryanair in 1985, which openly used Southwest Airlines as its role model and was then followed 10 years later by easyJet.

Low-cost carriers entered Asia/Pacific in 2000 — led by operators such as Malaysia's AirAsia and Australia's Virgin Blue.

In 2006, new low-cost carriers were introduced in Saudi Arabia and Mexico.

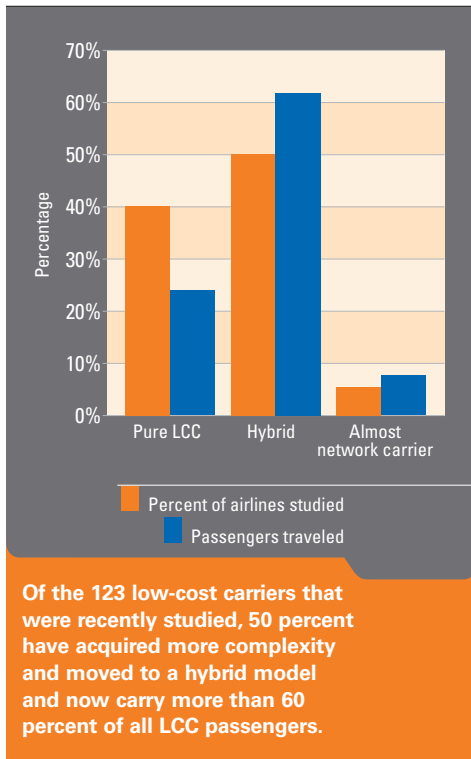
During the past decade, low-cost carriers have proven the most profitable and dynamic segment of the airline industry. Low-cost airlines around the globe — including Southwest Airlines, Ryanair and AirAsia — have shown consistent profitability dur-

## Low-Cost Carrier Growth



Low-cost carrier growth rate around the world has increased significantly during the last several years, specifically in Asia/Pacific and Europe. Many of these carriers, however, are adopting a hybrid model to better compete with each other and network carriers.

## Moving To Hybrid



ing times when more-established competitors have struggled to remain solvent.

In raw numbers, Asia/Pacific and Europe currently have the highest populations of low-cost carriers.

In terms of passengers boarded since benchmark year 2000, Latin America has increased dramatically compared to other major global regions, with an eye-popping 4,045 percent increase. Asia/Pacific, during the same period, has realized a 1,901 percent increase, and in Europe there's been a 333 percent increase.

As low-cost carriers have grown to the point at which they now carry about 25 percent of the world's airline passengers, many LCCs have found it necessary to modify their business models to take full advantage of market opportunities.

Different hybrid business models have adopted a variety of attributes from traditional network carriers. The top 10 include:

- Multiple aircraft types,
- Classes of service,
- International service,
- Long-haul or intercontinental service,
- Interline agreements,
- Codeshare agreements,
- Global distribution system participation,
- Connecting service,
- Ticketing procedures (either the issuance of accountable paper tickets or International Air Transport Association standard electronic tickets),

■ Multiple fares.

Based on a recent study where *Sabre Airline Solutions*® considered 540 of the largest global carriers, 123 are commonly referred to either by the airline industry or by themselves as "low-cost carriers." On the basis of how many points an airline scored with regard to the 10 key attributes, each of the 123 carriers was characterized as belonging to any of three sub-categories:

- Pure low-cost — This represents an airline that basically remains true to its original LCC model, which scores zero to two points according to the stated comparative attributes (that is, if an attribute applies to a low-cost carrier, that airline gets a score of 1 on that attribute; if the attribute does not apply, the airline's score on that attribute is zero).
- Hybrid — Carriers that scored between three and seven points are characterized as belonging to a new "hybrid" segment of low-cost carriers.
- Almost-network — An airline that scored from eight to 10 points is characterized as an "almost-network" carrier.

In addition, low-cost carriers in mature markets compete with each other more fervently on route and price. To extend their opportunity to grow, they have to find new ways to diversify. Normally, low-cost carriers can grow in any of three ways:

1. Increasing their network by entering new markets,
2. Expanding their customer base (attracting business travelers),
3. Pursuing mergers and acquisitions.

Following one of these growth possibilities generally means an airline is moving

and 7 percent demonstrated characteristics that place them within the more traditional "network" business model.

The study revealed that a total of 59 percent of the 123 low-cost carriers have broken the commonly assumed LCC operating parameters — pure LCC parameters such as point-to-point networks, single aircraft types and simple fares with no interline or codeshare agreements. That means 59 percent of the 123 airlines have introduced complexity into their once-pure LCC model.

In comparing the study results with actual passenger numbers, larger airlines (among the 123 in the original low-cost-carrier group) have generally been the ones to adopt more complexity, with 65 percent of all LCC passengers traveling on a, now, hybrid carrier.

Numerically, in fact, hybrid carriers had twice the average passenger volume compared to the pure low-cost carriers. Larger airlines are more likely to adopt a hybrid model, at least, in part, to feed their quest for more robust growth.

Further results of the study show that the hybrid attributes that are most likely to be adopted by low-cost carriers are international service, codesharing, connecting service, global distribution systems placement and multiple fare offers. (There is little domestic airline service in Europe, so in evaluating European low-cost carriers, the study partly discounted the "international" attribute.)

Regarding the top-10 defined attributes, taken as a whole, not only have they been widely adopted among LCCs, but it is clear that the largest LCCs are most likely to

HIGHLIGHT

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away from the pure low-cost-carrier model to a more complex business plan and operating environment.

Based on the analysis of 123 low-cost carriers worldwide, 41 percent of those low-cost carriers remained true to their pure LCC business model. Meanwhile, 52 percent moved toward a "hybrid" business model,

adopt them, supporting the hypothesis that a move toward hybrid status is a function of maturity and growth.

In the more mature markets of North America and Europe, airlines based on the LCC business model are substantially larger in terms of passengers carried than low-cost carriers in other regions.



These larger low-cost carriers in North America and Europe also have an average hybrid score that is significantly higher than LCCs in other regions — lending further support to the idea that increased complexity results from increased maturity and growth.

Of the 123 low-cost carriers identified in the study, North America's airlines carry an average of almost 10 million passengers each and have an average hybrid score of 3.9.

Europe has significantly more low-cost carriers, serving fewer than half as many passengers per airline as their North American equivalents. The average hybrid score in Europe is higher, but this higher score can be chalked up to the near non-existence of purely domestic airlines in Europe. Accounting for and adjusting this factor yields an average hybrid score in Europe of about 3.5.

Latin America and Asia/Pacific are at earlier stages of development of low-cost models — as reflected in both the average passenger numbers and the average hybrid score for these regions.

Africa and the Middle East, where low-cost carriers are still in their infancy, have the smallest airlines among the world's low-cost carriers. The low-cost carriers in Africa and the Middle East also remain closest to the original pure LCC business model.

In examining the adoption of new business models per region, it becomes evident that carriers in mature markets are more likely to adopt a hybrid business model and/or an "almost-network-carrier" model.

North America exhibits the lowest percentage (25 percent) of pure LCC models, while the other 75 percent of the North American low-cost-carrier market has moved toward the hybrid business model — but no low-cost carriers in North America have further diverted to almost-network carriers.

The market research also showed that the average ticket value for a hybrid carrier is 88 percent higher than that for a pure low-cost carrier (respectively, US\$179 versus US\$95 per passenger segment), indicating that hybrid carriers may be able to gain higher yields than pure low-cost carriers.

This extensive research project was intended to investigate and quantify the movement of pure low-cost carriers to more complex business models.

It appears that the move toward hybridization follows from the aspiration of any particular low-cost carrier for further growth. With significant growth comes the need for a more sophisticated technology provider.

The business model of the pure low-cost carrier is less complex than that of conventional airlines, and low-cost carriers'

needs have been largely met by specialist suppliers of very simple solutions acquired during the airlines' infancies.

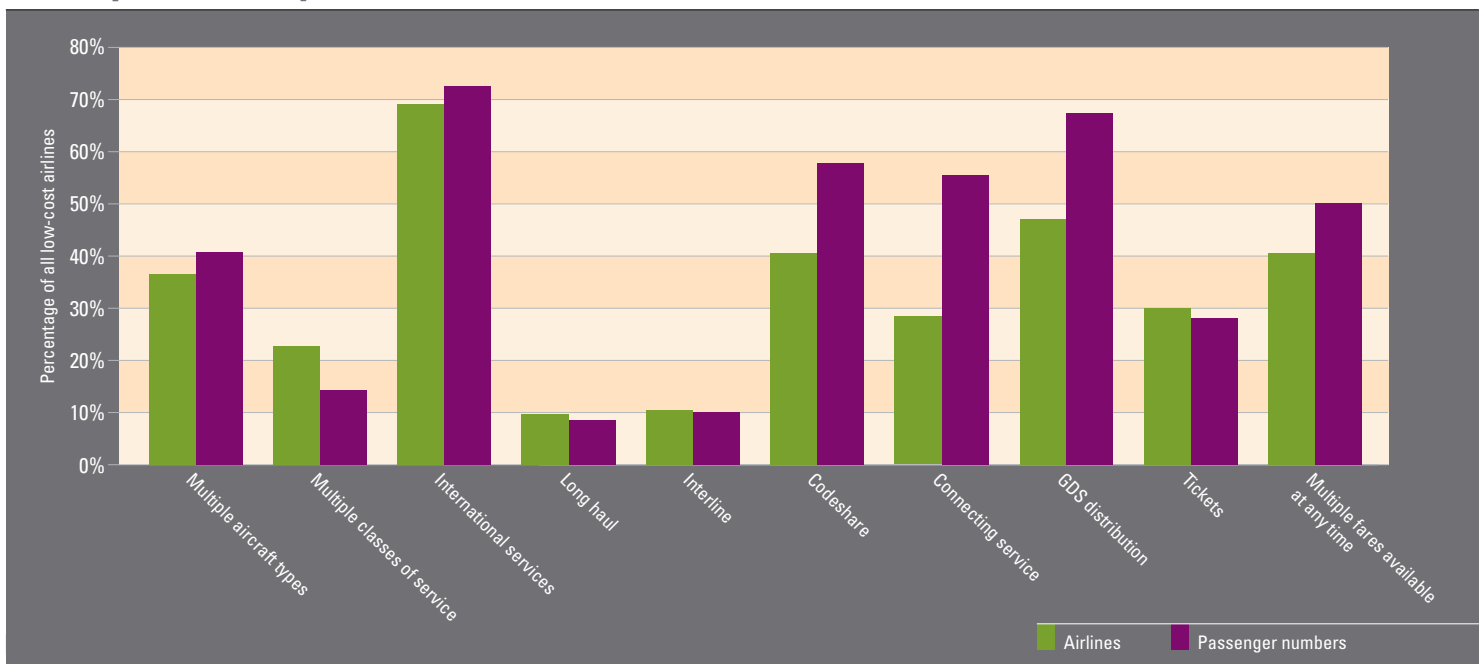
Research indicates that this picture is undergoing a metamorphosis in the evolution of low-cost carriers into hybrids that incorporate features that would once have been strictly the preserve of full-service airlines. And as low-cost carriers continue to modify, it is likely that their requirements for IT solutions will also become more sophisticated.

Vendors wishing to properly serve this new breed of low-cost carrier will be required to provide more sophisticated management practices and IT solutions, which may not be available from the current established suppliers to the LCC sector.

Based on the recent study, it is not only apparent that the trend among low-cost carriers toward hybridization is well established, but that the hybrid sub-category is likely to continue to grow as the low-cost-carrier market sector matures, competes and consolidates. **F**

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## Adoption Of Hybrid Characteristics



Low-cost carriers, when transforming to a hybrid model, have adopted several characteristics of traditional network carriers, most commonly, international service, codesharing, connecting service, GDS placement and multiple fares.