

DIFFERENCIES BETWEEN LOW-COST MODEL AND FULL-SERVICE MODEL IN AIR INDUSTRY

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Abstract: The aim of this paper is to review current state of operational models of airline on the market, based on history and development and the reasons behind them. Article compares Low-Cost operational model with established Full-Service carrier model in form of operational and pricing differences. Historically important events which caused rapid growth of Low-Cost carrier model are mentioned and discussed. For comparison of pricing approach actual data from airline reservation system Amadeus as well as live data provided on air carriers' websites was used. The ongoing development on the air transport market as well as high competition and new customer demands clearly shows that both of the operational models are partly outdated. This resulted in step-by-step product changes in both operational models which are now approaching similar product portfolio often called as hybrid operational model. Result of the review points to possibility for further research of airline hybrid operational model.

1 Introduction

In this article differences between low-cost carriers (furthermore LCC) and full-service carriers (furthermore FSC) will be discussed. These models are used in air transport industry for a prolonged period side by side. In the beginning they were focused on different segments of customers, however with changes in the air transport industry, they began to interfere with each other. Nowadays they mostly act as a direct competition and with actual demand on the market; both are forced to come up with new hybrid solutions or models. This is resulting from historical development on the market since World War 2, when partial liberalization on the air transport market begun, and thus allowed low-cost carrier model to be implemented on the market. The raise of the low-cost carrier began to be noticeable after year 2001 when low cost carriers were able to double their market share. This was the result of economy crisis during mentioned period; however the raising trend remains until today.

2 Methodology

Mainly statistical secondary data from annual reports reported by the airlines and collected by the company IdeaWorksCompany were used. For further analysis, annual reports from 4 previous years were used. After collection of the data, they were processed, considered by own experience, consulted with another aviation professional, compared and found measured ratios. As a

result of these ratios, predictions are made for further development. Main source of prognosis data was processed from last three years, as these data are the most accurate in form of development on commercial aviation market. These predictions and prognosis are prepared from the results of the analysis adjusted by the estimate of the IATA as a most reliable source of the market.

3 Historical development of Low-Cost Carriers

After Second World War, demand for air travel rapidly increased and together with rapid innovation in technological area, airlines were able to offer very low fares which resulted in higher numbers of population to be able to afford air tickets which was impossible before. This resulted in the necessity to change status quo of the aviation market.

The first breakthrough came in 1978 when USA adapted 20 years old law with a new one called Airline Deregulation Act that deregulated the airline industry. The long title of this act is: "An Act to amend the Federal Aviation Act of 1958, to encourage, develop, and attain an air transportation system which relies on competitive market forces to determine the quality, variety, and price of air services, and for other purposes" [1].

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Figure 1 The Causal Relationship between Air Service Liberalization and Economic Growth [2]

The figure 1 above shows relationship between liberalization on the market and economic growth. Even the long title of this act indicated purpose to encourage the competition on the market. This act removed the US Government as a controlling body over the aviation market in the United States and created free market enabling a new competition to arise.

After the successful implementation of US deregulation act, other countries followed the example and started with liberalization of their markets step by step. Liberalization on the different markets resulted in rapid development in the aviation industry in terms of passengers’ traffic and movements thus enabling further competition on the market and therefore again lower prices. In Table 1 below the most important events and their results are noted.

Table 1 Main events of liberalization and their effect [2] (own processing)

Event	Results
U.S. deregulation, 1978	Emergence of hub and spoke systems, low cost carriers with nationwide route networks, new entrants and integrated cargo carriers.
U.K Liberalization of Secondary Airports	Growth of international services to Manchester, Birmingham, Glasgow, etc.
Open Skies Agreements for United Arab Emirates	Growth of Dubai as major international hub.
Domestic deregulation in India	Development of low-cost carriers and aggressive, expansion-oriented airlines.
U.K-India Bilateral and Creation of New Frequencies	Growth of capacity, new gateways and additional carriers operating U.K.-India service.
Domestic deregulation in Brazil	Growth of low-cost carrier Gol and others.
Single European Market	Growth of low-cost carriers. Ryanair, EasyJet, etc. New services, traffic growth, new gateways throughout European Union.

All in all, the liberalization of aviation market enabled new types of competitors to enter the market. After all, the changes done, the environment in the aviation was very open and even smaller companies were able to invest to new modern aircrafts with guarantee that the legislation will not be in the way.

The price of product consists of cost items that we must reduce. Direct and indirect costs will be reduced by using of new methods [5]. New Low-Cost Carrier model was introduced in US by Southwest Airlines, which began the era of LCC around the world resulting from the successful implementation and wide acceptance model on the market by the US citizens. This whole model was driven on one thought still advertised by Southwest airlines until today: „If you get your passengers to their destinations when they want to get there, on time, at the lowest possible fares, and

make darn sure they have a good time doing it, people will fly your airline” [3]. Their model consisted of several factors that enabled them to offer very low fares and thus attracted customers who would otherwise not fly:

- Fares: Unrestricted and low price;
- Network: Point to point high frequency routes;
- Distribution: Travel agents and call centres, no tickets;
- Fleet: High utilization, same type of aircraft across the fleet;
- Airport: Secondary airports with short turnaround times;
- Sector length: Short (around 400nm);
- Staff: High productivity with competitive wages and profit sharing [4].

At later stage, this was widely accepted by other carriers on the market. In Europe, after adaptation to Single

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European Market, this was used by two new airlines which, until today, are still playing the important part in European aviation industry. Ryanair and EasyJet adapted these policies and according IATA study from 2006, they were able, together with other smaller LCC, to gain almost 20 percent of passengers share in just 7 years – from 1.4% in 1996 to 20.2% in 2003 [2]. On the Table 2 below development of LCC growth is represented.

Table 2 Share of capacity of Low-Cost Carriers on European Market [2] (own processing)

Year	LCC Share of capacity
1996	1.4%
1997	2.8%
1998	3.7%
1999	4.2%
2000	6.0%
2001	6.4%
2002	11.1%
2003	20.2%

With development of LCC, classic network carriers gained new challenge in form of a price competition on

similar routes. Previously, they were able to offer premium services, which customer accepted as they had no other choice and necessity to travel remained. With growth of Low-Cost model classic customers were offered much cheaper option to travel. This situation resulted in lower load-factors for full-service airlines. They began to have difficulties to operate profitably on short and medium haul routes. This, together with the Great Recession, led to bankruptcy of several airlines in US and Europe. Not only airlines had economic problems, but also customers' purchasing power decreased. To survive such an environment, all airlines needed to focus on profitable operations and therefore they needed to focus on cost-saving and to generation of additional revenue in form of auxiliary services.

4 Comparison of Low-Cost Carrier and Full-Service Carrier model

To understand the importance of auxiliary services it is also necessary to understand the different approaches by the Low Cost and Full-Service Airlines. Even when the core product and main service they provide is the same – transport from point A to point B – they are approaching the pricing differently.

Table 3 Pricing comparison between LCC and FSC on similar route as of 19th April 2018 (own processing)

Budapest to Dubai 05.Sep 2017	Emirates to DXB	Wizzair to DWC	Dubai to Budapest 12.Sep 2017	Emirates from DXB	Wizzair from DWC
1x 30 kg bag	Included	HUF 19,850	1x 30kg bag	Included	HUF 19,850
Airport Check-in	Included	HUF 3,200	Airport Check-in	Included	Included
Cabine Bag	Included	HUF 5,750	Cabine Bag	Included	HUF 5,750
Seat Selection	Included	HUF 2,250	Seat Selection	Included	HUF 2,250
Refreshement	Included	HUF 2,195	Refreshement	Included	HUF 2,195
Air Fare	HUF 102,400	HUF 106,500	Air Fare	HUF 102,200	HUF 30,990
Grand Total	HUF 102,400	HUF 139,745	Grand Total	HUF 102,200	HUF 61,035
Vienna to London 04.Sep 2017	Austrian to LHR	EasyJet to STN	London to Vienna 11.Sep 2017	Austrian from LHR	EasyJet from LGW
1x 23 kg bag	Included	38,38 €	1x 23kg bag	Included	38,38 €
Airport Check-in	Included	Included	Airport Check-in	Included	Included
Cabine Bag	Included	Included	Cabine Bag	Included	Included
Seat Selection	Included	5,04 €	Seat Selection	Included	6,05 €
Refreshement	Included	15,30 €	Refreshement	Included	15,30 €
Air Fare	173,87 €	93,92 €	Air Fare	89,52 €	41,42 €
Grand Total	173,87 €	152,64 €	Grand Total	89,52 €	101,15 €

In the Table 3 above, we can see the most common difference between the typical LCC Wizzair and EasyJet compared to FSC Austrian Airlines and Emirates. As with the FSC such as Emirates or Austrian Airlines, the typical holiday traveler has all the services included in the fare typically and does not need to worry about any additional

payments for the services he expects. On the other hand, LCC offers mostly lower fares for customers who would like to travel light, but only the basic transport fare is included in the price, and customer needs to pay additionally for services included in the fare of FSC. Also, on the table we can see that LCC serves only smaller

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airport with higher distance to the city center, thus enabling them to offer lower fares as normally landing and handling fees are lower in such airports.

The big advantage of LCC airlines is use of harmonized fleet, as they are normally offering just routes suitable for the aircraft and do not need to provide any feeder flights, they are able to minimize training and maintenance cost. Due to position of network airlines and due to necessity to optimize capacity according the need, network carriers use variety of the aircraft that are able to serve different destination, but this is increasing costs of training of the crew and maintenance.

Another difference can be found in customer care approach. Network carriers provide their customers with

ability to contact them directly in several ways, such as social networks, call centers or email contacts, which are provided nonstop and free of charge. LCC often offer just paid call centers with premium rates or just internet form with no published email contact. FSC normally have their own ground staff to assist customers in case of any requests or problems directly on-site, comparing to ground handling – outsourced - companies contracted by LCC.

If we look on customer comfort, typically FSC offers better on-board comfort as they are using lesser seats on the same aircraft type comparing to LCC, thus providing better seating comfort on board of the aircraft

Table 4 shows different seating capacities of comparable aircrafts with different carrier types.

Table 4 Seating capacity comparison (own processing)

Seating Capacity / Airline	EasyJet	Wizzair	Lufthansa	British	AirFrance
A319 - 100	156	n/a	138	144	142
A320 - 200	186	180	168	168	178
A321 - 200	n/a	230	205	205	212

The last-mentioned difference, however; for some customer the most important, is offered network. FSC offer a possibility to transfer at their hub or on their airline, and therefore guaranteeing for the customer higher variety of destination reachable. In case of any disruption network carrier will get customer to contracted destination by other routing or by use of their partner airlines. Low-Cost airlines are normally point to point airlines and do not offer any possibility to transfer within one ticket. Even in case customer holds two tickets on LCC and because of the disruption of the first flight, he will miss connecting flight, LCC will not accept any liability and customer must find and alternate solution himself.

All these differences are enabling LCC to provide lower fares on the similar routes. This approach made it easier for LCC to survive the great recession, however as recession is coming to its end, customers are again willing to pay more for the quality of travel but at the same time are still very price sensitive.

5 Conclusions

Article clearly shows different approaches done by both operational models. These differences began in early years after World War II. Notable event was liberalization on the market which resulted to growth of the air transport market which thus resulted in better economy and increased job possibilities. Liberalization of the air transport market is one of the key events in development of industry (see Table 1). After liberalization was in later stages, there was a clear rapid growth of new industry model on the air transport market when in 1996 only 1,4% of the market was taken by LCC, but in 2003 it was already 20,2% (see Table 2). With more and more shares taken by LCC model, interference between two previously separated models began. With raising passengers share and

with development of information technologies and aviation equipment, customer demand for quality increased, but at the same time acceptable price for ticket was expected to decrease. Both models started to operate side by side, however different approach to pricing prevailed (see Table 3). Given on customer demands, both models might be suitable for customer and not always the Low-cost approach is cheaper, however it is still offering more flexibility in pricing of included services. As of today, models still prevail, however due to ongoing change in customers' demands, both models need to implement services of the other into their product portfolio partially or completely, and thus new hybrid model is being applied to airlines operations. This means both airlines are now able to offer flexible but cheap fares and at the same time offer premium quality product for adequate prices. It is expected that in the future hybrid model will be used as a primary one on the aviation market.

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