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COMPETING AGAINST LOW COST AIRLINES

With ever-increasing pressure from low-cost carriers, **Patrick F. Murphy** *maps out the essentials for keeping up with the competition.*

Defining the low-cost airline

If we define low-cost carriers (LCC) as those with the lowest cost per ASK (available seat kilometre) then all Asia based carriers would qualify with average cost per ASK at less than six US cents. But not all Asia based carriers are categorized as LCCs. If we define them as those with the highest operating margin then the best known LCCs would qualify but so too would such airlines as COPA, Kenya Airlines, Philippine Airlines and Emirates. So we need a different definition. IATA, in its Airline Cost Performance economic brief states there is no standard definition or business model for these airlines, each incorporating mix of low cost, no frills, or low-fare characteristics. It is also a fact of life these days that most start-up airlines can be described as LCCs.

Why do start-ups generally equal LCCs?

Firstly, they start with a clean sheet of paper with no history and no employees with long established pay levels plus the baggage of overhanging pension obligations; also they don't start with long established work rules and staffing levels. They can start with a standardized fleet of new or relatively new equipment with little restriction on market entry in many parts of the world. They also have management and staff with the right attitude and the ability to be nimble and change as the business develops.

What they all have in common

Today all low-cost carriers provide short haul services only, of less than four hours. Onboard service is either limited or completely no-frills. They don't have hubs, and they don't interline or operate within an alliance with other airlines. For even keener cost-cutting many of them operate with standard fleet only, use secondary airports, sell directly to customers via Internet website bookings, and aggressively fight for position of price leader in their respective markets.

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What distinguishes low-cost airlines from legacy airlines

To keep fares as low as possible, low-cost carriers must constantly maintain high load factors. They need to achieve high productivity by maximizing aircraft utilization and staff efficiency. At the same time their prices must be perceived by prospective customers as the best on the market. Selling via the Internet cuts their distribution costs dramatically, and smart use of revenue management systems allows them to flex fares creatively to achieve optimum seat sales.

Legacy carriers with low-cost operations

Some legacy carriers such as British Airways, KLM, Continental and Delta have already tried and failed to operate low-cost airline subsidiaries. They sold off the business or just ceased operations. Aer Lingus, Lufthansa, Alitalia and Air Canada did at one time or another set up low-cost ventures but then reverted to traditional operations. And others such as United, British Midland, SAS, Iberia, Qantas, Singapore Airlines and Mexicana currently run low-cost airlines in parallel but independently from their legacy operations.

Ignore them at peril

Low-cost airlines are not going to go away. Legacy carriers ignore them at their peril. Classic examples of those which did and failed are Swissair and Sabena, although it must be said there were a number of other factors that led to their demise. Currently we see a number of airlines in deep financial trouble. Notable examples are Varig, Malaysian and Alitalia. And many European minors and US majors are floundering in the face of this fierce competitive challenge.

Latest trends

In the battle to achieve competitive advantage, many legacy carriers are moving nearer to the low-cost core business model by cutting their costs and differentiating in the services they offer to their customers. But as they do, the low-cost operators are moving away from their core with yet more and more innovative ideas. All of which leaves many carriers stuck right in the middle of this game.

Meeting the threat

So how *can* traditional airlines meet the threat from the low-cost operators? There are several options. Fundamentally, they can match what the low-cost airlines do. That means cutting costs and improving efficiency. Or they can differentiate with the product they offer. They can also focus on long haul operations to offset losses or lack of profitability on short haul routes. But above all they must remain competitive on price.

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Cutting costs

A successful business means a tight operation where every penny counts. Legacy airlines can tighten up by increasing aircraft utilization and reducing turnaround times. That creates the possibility of reducing the workforce in line with reduced manpower need in the area of pilots, cabin crew, ground staff, catering, maintenance and overhaul. They must also consider more outsourcing of functions if it helps reduce costs.

Other changes

Legacy carriers can consider offering one class of service, replace galleys with seats and decrease seat pitch. Internet distribution, self check-in for passengers and charges for on-board meals and drinks will all add to the cost-cutting effort. Fares can be simplified to match the competition and stimulate travel. Revenue management systems can be used to compete on fares rather than to simply protect yields, and non-ticket revenues can be generated by selling all kinds of innovative products to the passenger via the Internet site, at check-in, and on board. There should also be scope to close downtown ticket offices, reduce call centre activity and staffing, change the relationship with the travel trade as more and more sales and ticketing switch to direct over internet.

THE CRUCIAL DECISION

Legacy airlines, in order to compete with the low-cost carriers, have got to make some crucial and urgent business decisions. Most important of these are dealing with costs, increasing staff efficiency, improving asset utilization, differentiating their product. In all of this, airlines must be ruthless if they are to be successful Above all, airlines must learn to compete wisely on a head to head basis and stop complaining.

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About Patrick Murphy

Patrick Murphy is on the International Advisory Board of Performance Consultants International and is Chairman of Aviation Performance Consultants.

Patrick has over 30 years experience with the airline industry including as Chairman of the Board of Ryanair; as Director, Corporate Development with the International Air Transport Association (IATA); and managing commercial operations at Aer Lingus. He has been a speaker at airline conferences and has been engaged by a number of airlines to advise on competing against low cost airlines, future trends in air transport, environmental sustainability, and improving performance.

A full background is available at:
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