FUTURE SCENARIOS FOR THE EUROPEAN AIRLINE INDUSTRY: A MARKETING-BASED PERSPECTIVE

David Jarach
Bocconi University, Milan, Italy

ABSTRACT

The last couple of years have proven to be very tough for the airline industry. Macroeconomic turmoil, like 9/11, consequent economic recession, the threat of terrorism and the SARS virus have all had a combined drastic effect on both volumes and values of traffic performed by the industry. Microeconomic and industry-related changes, most definitively the dramatic growth of market power of low-cost carriers (LCCs), are haloing this condition of the airline environment, putting into deep crisis incumbents' traditional business models and giving life to liquidity losses, huge deficits and bankrupts. In the U.S. market, LCCs have been a reality since the early 1970s and have been counterattacked many times, with scarce luck, by incumbent network carriers. In the European environment, instead, LCCs' attack is fresher and the ultimate answers by national carriers are still to be put into practice. The risks of inaction, however, are probably stronger than in the U.S., due to the higher fragmentation of the European industry and the States' ownership of many carriers that still prevent radically invasive market reactions like mergers. After an introductory but compulsory parenthesis on the rise of the low-cost phenomenon in the airline industry, this paper aims to analyze the new market scenario for the airline industry, focusing on the European context. Furthermore, the paper will analyze the main marketing tactics UE carriers might adopt to cope with the huge wave of low-cost entities and survive in the current tough environment.

David Jarach is a Professor of Air Transport Marketing at Scuola di Direzione Aziendale (SDA) Bocconi Graduate School of Business and of Services Management at Bocconi University, Milan, Italy. He is also a Visiting Professor on Airport Marketing at Toulouse Business School, Aerospace Master in Business Administration (MBA) and of Services Marketing at Escuela Superior de Gestion Commercial Y Marketing (ESIC), Madrid. He is an advisor and consults for companies and governments acting within the air transport pipeline. He is a member of the Network Committee of the Air Transport Research Society (ATRS). He can be reached at the e-mail address david.jarach@sdabocconi.it.

CHANGING THE RULES OF THE GAME: THE NEW HYPERCOMPETATIVE CONTEST FOR AIRLINES AND THE RISE OF LOW-COST CARRIERS

Since the 1970s, traditional market leaders in industry after industry, saddled with complex, high-cost business models, have been under attack by companies with new, simpler ways to manage their operations and contain costs. This scenario occurred in the steel industry, when minimills took on traditional smelters; in automobile manufacturing, when more standardized Japanese cars won out over customized U.S. vehicles; in retailing, when superstores overtook conventional grocery stores (Hansson, Ringbeck & Franke, 2002); and, eventually, in fixed telecommunications. The concept of value migration best describes the flow of profit and shareholders' wealth across the business chessboard. Value leaves economically obsolete designs and flows to reinforce new business designs, that are capable of creating equal, if not an increasing, utility for the customer and capture value for the producer. This situation also explains why firms with similar product or service offerings, as it is in the broad environment of commodities, can produce significantly variant economic performances (Slywotzky, 1995).

In the case of airlines, the demise of tight regulation and the consequent rise of hyper competition have brought an abrupt end to the age of chivalry for this mature industry. In other words, within a short amount of time, historical rather than forced cooperation and chivalry have been cancelled as business pillars. The erosion of monopolies and oligopolies by means of new start-up value propositions, first in the U.S. and later in Europe, has dramatically changed the codes of competitive conduct and radically altered the customer's perception of the airline service, too. In other words, the gentility of tacit collusion and avoiding head-on competition, which were typically working in the regulated era, are now gone (D'Aveni, 1995), with mature airline service rapidly moving from value-added experience to pure commodity. This shift in the definition of competition has been relatively rapid and was largely unexpected even to the deregulation's advocates.

Waves of new carriers jumped, and later abandoned, notwithstanding the political exit barriers that the industry faces, deregulated environments. In the U.S, first, and later on all around the globe, a new category killer entered the market scene. Low-Cost Carriers (LCCs) provided a new, simplified value proposition to a wider market potential and rapidly acquired huge numbers of customers. The challenge, from that time on, has been for traditional carriers to cope with this apparently perfect and superior economic travel formula.

TRADITIONAL AIRLINES VERSUS LOW-COST CARRIERS

In fact, what has been a tough challenge since the early beginnings for network-based, traditional operators in the fight with LCCs is basically the confrontation between two radically different business models. The formers' one is based on a calm, oligopolistic market aimed to support the idea of global coverage of the entire world arena. The latters' one, instead, is apparently only focused on a more niche oriented approach. In fact, it is aimed at getting benefit from offer vacuums and from the service of *pariah customers*, starting from visiting friends and relatives, ethnic and leisure based movements and later on climbing up to reach cost-conscious business travelers. Tables 1 and 2 summarize the main differences in the market approaches of network-based and low-cost carriers.

In fact, some of the basic advantages of LCCs are apparently quite obvious and are certainly not industry-specific. For instance, part of a better cost management process can be easily correlated to the fresh market entry and, thus, to highly efficient hiring and salary practices for both headquarter staffs and crews. Another benefit, most definitively in the European context, may be linked to some form of comparative advantages, like in the case of a more favourable fiscal legislation providing tax incentives for local operators. For instance, Ryanair is registered in Ireland, where corporate taxes are far lower than in other countries of the continent, like Belgium. Eventually, effective business-to-business (B2B) tariff negotiations that many LCCs are able to perform[1] are simply a consequence of airports' vulnerability, due to the absence of a clear airport marketing activity[2] (Jarach, 2002). In fact, in every industry facing power imbalances in pipeline relationships, opportunistic behaviours by channel leaders are in practice to exploit the power imbalance of the counterpart, typically in the form of huge discounts (Jarach, 2001).

This said, evidence shows that some parts of LCCs' healthy cost condition could also be apparently matched by traditional carriers through isolated[3] copying of some of the LCCs' business elements. For instance, a narrower cost imbalance could also be obtained by sporadic rather than cosmetic measures, like firing personnel and then hiring personnel back at lower salaries, as the Swissair-Swiss conduct explains. Or through the

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[1] Frequently in the form of huge subsidies for start-up and expansion of low-cost operations.

[2] This means the absence of a clear airport market positioning and, consequently, no airport marketing plan.

[3] This means that these measures are not coordinated and integrated inside a strategic business plan or reengineering platform.

creation of an subsidiary that is being responsible for all aircraft purchases and leasing transactions, for instance. Most of the other elements of the LCCs' formula, however, seem to request a much more radically deeper reengineering of the entire value proposition and are not definitively sensitive only to one shot actions.

Table 1. The pillars of network-based airlines

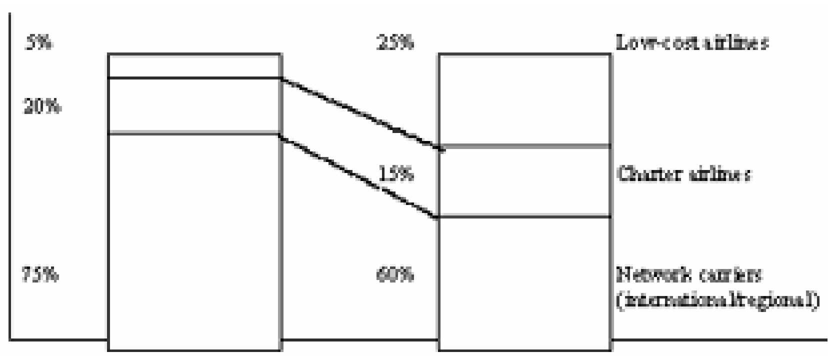
⇨	Massive marketing expenses (advertising, Frequent Flier Programs, travel agents' overrides, network analysis)
⇨	Expensive fragmented and complex services (classes of tariffs and service, catering, lounges, ground services, etc.)
⇨	Massive use of technology (hard technology: aircraft tailored for each route and prescription; soft technology: CRS legacy systems)
⇨	Ancient-regime financial targets (in contrast with macroeconomic shockwaves and lifestyle changes)

Table 2. The pillars of low-cost airlines

⇨	Minimal marketing expenses (word-of-mouth on comparative advertising, airports' supports)
⇨	Personal, convenient and pleasant service (reengineering around core benefits, easy price discrimination)
⇨	Judicious use of technology (hard technology: fleet standardization; soft technology: Internet and CRS avoidance)
⇨	Structural efficiencies (no overstaffing, high productivity, no hubbing costs
⇨	Realistic financial targets (based on their own business model)

The fact is that you do not need to be a start-up to build a business model focused on a previously ignored market, but it helps. Established companies have great difficulty seeing how unprofitable segments can be served profitably, particularly if those established companies have been very successful. That is because their own success blinds them to opportunities right in front of them, in a sort of business myopia. For example, try to put yourself in the shoes of the executives who ran the dominant airline of the 1970s and 1980s and watched a struggling Southwest Airlines try to get off the ground. With the failures of discount carriers People Express and Laker Airways making headlines, would you have believed that another cut-rate U.S. airline would survive, much less become the most profitable carrier (Rosemblum, Tomlison, & Scott, 2003).

Figure 1. Projected change in intra-European passenger market shares, 2000-2010



Source: Association of European Airlines and International Air Transport Association, internal figures, 2000

THE CHALLENGE OF OUR TIMES

Coming to the current situation, the world's major traditional carriers are being faced with some of the worst—rather than hardest and unpredictable—challenges in the rules of the game of their market environment since the first Wright Brothers' flight at Kitty Hawk just 100 years ago. For instance, U.S carriers alone lost more than $10 billion in 2002, according to the Air Transport Association, up from the $8 billion in the disastrous year of 2001 and, generally speaking, worldwide airline losses topped $50 billion in 2002 (Hansson, Ringbeck & Franke, 2002). These tragic figures necessarily ask for a deep analysis and request to understand all the real causes, distinguishing the cyclically-correlated ones from the structural ones.

The traditional carriers' business model has been a great success and a major innovation when looking back at the early 1990s, but today it is showing to be unsustainable in the current form. Strictly tied to massive physical infrastructures, diverse and inconsistent fleets of aircraft, legacy information systems and large labor pools, traditional airlines are today struggling to give even a medium-term perspective to their existence on the market. Most definitively, what seems today highly debilitating for traditional carriers is their inability to overcome their cost burdens with boom period pricing, as they did in the second half of the 1990s. From one side, post-9/11 economic de-facto[4] recession and the inherent constant terrorist threat, with the adding of the second Gulf War, are still keeping away vast amounts of passengers from worldwide carriers. From the other side, the recent SARS world health alarm and the consequent travel warnings and bans by the World Health Organization for China, Hong Kong, Singapore and Taiwan has simply cancelled for a number of months the Far East arena as an air travel destination for both business and leisure traffics, with major airlines implementing up to 90% capacity cuts on the previous flown hours to the area. As a parallel consequence, these macroeconomic events are accelerating the pace of diffusion of videoconferences as an adequate substitute for meetings. This is another clear signal that these external shocks will not be absorbed by carriers with the same substantial inaction performed during the previous cyclical crisis.

On a microeconomic, industry-related focus, instead, this tough airline environment is proving to be apparently much healthier for LCCs that are dramatically increasing their own market shares on a worldwide basis. What can be highly surprising for non-industry analysts finds, instead, rather simple, non-technical explanations. For instance, sales figures[5] prove that SARS and the threat of terrorism are still preventing long-haul travels, most definitively in the case of highly-sensitive, risky destinations, like China, Canada or the Middle-East. On the contrary, this negative effect is much less in the case of short-haul flights[6], where safer trips are involved and where tariff stimulation[7] may push tourists and business professionals to abandon personal or company flight bans.

The impact of both these macro and microeconomic turmoils on technical indexes for International Air Transport Association (IATA) actors has been quite immediate. Traditional carriers are being faced with a significant yield dilution with a steeper-than-forecasted curve, well over the 2-3% decline recorded on a year-round base in the last decade. This condition finds quantitative evidence to the fact that cost per average seat mile (CASM) runs well over revenue per average seat mile (RASM), this gap already reached 2 cents per seat mile at the beginning of 2002 in the U.S

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[4] Generally speaking, economic macroindicators do not reflect on a worldwide basis a situation of recession. However, it is vastly accepted that terrorist attacks create uncertainty conditions for the market, and this blocks long-term investments.

[5] Provided by IATA and American Express, for instance.

[6] These sales figures do not include the two weeks immediately following 9/11.

[7] This situation can be easily explained by the negative demand-to-price elasticity that is now starting to affect even business travel, where budget cuts reduce travel or shifts it to LCCs.

(Hansson, Ringbeck & Franke, 2002). In a condition of fixed-costs that reach up to 90% of total costs and with few chances of cutting them in the short period, this revenue-cost imbalance naturally gives life to huge deficits, liquidity crises, job cuts, network reductions and, eventually, bankruptcies. This was the case in North America for Chapter 11 filings of USAirways, United Airlines, Hawaiian Airlines and Air Canada. Or in Europe for the bankruptcy of Swissair and Sabena, where these companies failed and entered the arena again with a different brand, but taking on the same historical and structural weaknesses, in what could be described as a sort of European answer to the U.S Chapter 11 instrument.

Thus, in order to survive, major airlines have no choice but to change their course, modifying their rigid business model to better match the challenge by LCCs. Although making fundamental changes in a long-standing business model is difficult and risky, it is not without precedents; it has happened in the manufacturing and financial services contexts. And, by far, the risk of inaction is much greater than the risk to change and the difficulty of finding a new working business path.

THE EUROPEAN BUSINESS CASE

In the EU environment, the late 1980s' airline deregulation process has pushed in dozens of start-up entries and, consequently, fierce price competition on many route legs. This condition has progressively pushed many former flag carriers into deep competitive and financial crises, as their cost structures were based on the previous oligopolistic regime and, thus, not consistent with new hypercompetitive patterns of action.

A major difference with the U.S. environment, however, lies in the fact that Europe has not recorded any significant capacity exit from the industry, as the above described Swissair-Sabena cases clearly evidence. On the contrary, recent announcements once again demonstrate that the *one country, one flag carrier* model is still working, but no longer achievable, especially in the case of small countries with a limited origin/destination demand[8]. If we exclude some small regional airlines and the notable exceptions of Ryanair-Buzz and Easyjet-Go in the low-cost cluster, no consolidation practices have taken place,. According to pure economic figures, no more than 4 national carriers and 20 regional carriers should act in the EU environment. Notwithstanding this, we still have 20 medium-sized airlines

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[8] Swiss, the Switzerland's national carrier, is probably the best example. But the same condition can be applied also in the case of Holland, Austria, Portugal and Greece, for instance, where global ambitions of local carriers have necessarily lowered the state-of-the-art market conditions.

and more than 50 regional airlines working, a figure that is continually increasing.

This high level of fragmentation, which many times has only an apparent basis in air service agreements' (ASA) ownership clauses, is reflected in the relatively low market force each major can deploy in the confrontation with large U.S. trunks and, definitively, with LCCs. While alliances have been a good solution for entering close markets or partly increasing revenues, they have actually failed in the goal of reaching higher cost efficiency. In this sense, we can say that until now partnerships have only marginally impacted on the chronic economic and cost vulnerabilities of EU carriers.

These elements help to explain why LCCs have really boomed for the last couple of years in the continental context. Recent post-9/11 updated statistics reveal that European LCCs are expected to account for up to 25% of the market by 2010, following the same path of market expansion that is taking place in the U.S., where some analysts predict that LCCs could reach up to 70% of domestic services. Figure 1 shows the current and the expected market condition in the European airline industry.

Today, Ryanair, Easyjet, Germanwings, Hapag Llyod Express and other European low-cost entities are abandoning their traditional British focus to explore other huge continental catchment areas in Germany, France and Italy. Acting as flexible, dynamic and innovative players, they are eroding the advantages of network airlines and making healthy profits. Or, when not yet profitable, they are consolidating market shares to build a greater critical mass or slot dominance on key airports[9].

The real strategic ultimate issue for European traditional carriers, however, is that they are not facing a unique and standardized low-cost business model, as a sort of European adaptation of the original no-frills American formula has taken place. Some LCCs, for instance, are considered pure Southwest clones and focus primarily on visiting friends and relatives and ethnic traffic: Ryanair is the best example. Others, like Easyjet, have since the beginning had a different focus aiming at capturing cost-conscious business travelers, and probably are the real top danger for traditional operators.

In this sense, time for change has come: major carriers have to choose between one of or a combination of six possible counter reactive market strategies to cope with LCCs. These tactics can be equally implemented in all market scenarios where traditional carriers are being touched by the low cost formula. Thus, they can equally work, if not already in place, in the

[9] As in the Easyjet-Paris Orly tentative, or in the Ryanair-Stansted or Easyjet-Luton cases.

U.S., European or Asian environments. The pace of introduction of these market reactions, however, is much more urgent in Europe, where the threat is fresher and past conditions have created airline structures that must compulsorily be changed in the short-time. In other words, this goal has to be rapidly implemented, if the European industry aims to play a role in the world scenario in the next ten years[10].

SIX MARKET STRATEGIES FOR TRADITIONAL CARRIERS TO COUNTER REACT TO LCCs

On the basis of what has been previously said, European traditional airlines have to choose not only which part of the battlefield stay, but also which kind of market tactics to use to cope with the New Millennium challenges.

Although some academics predict that there will soon be only low-cost operators for all markets, even long-haul ones, we do not believe so. Chances for most of today's traditional carriers to survive, however, lie in a rapid adoption of one or more of the following six counter reactive tactics.

Resist

This option is the most conservative a traditional carrier may implement. The basis for this choice logically lies in the perception that LCCs are simply a fad and that, sooner or later, they will be abandoned by frustrated passengers coming back to the higher price/comfort combination. As a consequence, a traditional carrier will continue to do business as usual, eventually modifying only its own timetable with the aim of bracketing the low cost offer, for instance.

Airline managers frequently make comparisons between their own industry and what happened some years ago in the retailing arena. In that case, deep discounters were experiencing a rapid, massive growth, too. In the long-term, however, their market power was sometimes deeply marginalised In other words, airline managers believe that passengers are only migrating to LCCs out of curiosity and the low cost, but with no risks of developing loyalty to them. According to this thesis, these customers will, in fact, come back to what basically is believed to be a better overall deal

[10] It is important to underline that LCCs are beneficial to customers, thanks to their low tariffs. But, at the same time, their pressure on traditional carriers naturally forces the latter to streamline, for instance, abandoning unprofitable routes. This means that competition between countries can be affected, too, not forgetting that carriers are the logical facilitator of globalisation and movement of goods and people.

The mistakes of this approach are clear. First, market segmentation postulates that customers are naturally different in their value perceptions and conceives that some people could easily become loyal to the no-frills formula if it fits with their perceived value[11]. Second, huge price gaps resulting from direct competition on the same routes and airports, like in the case between a traditional carrier and a hybrid LCC, will naturally support the choice to switch to the cheaper alternative. This condition will likely have a broader impact on customers' travel lifestyles and will progressively marginalise traditional carriers from the profit zone of the market. The traditional airline will then be forced to try the retrench tactic.

In this sense, the only real way to maintain the market status quo for a traditional carrier is through State supports in the form of subsidies or rigid slot allocations that prevent LCCs from entering the former's national skies. The recent slot lottery at Paris Orly after the bankruptcy of Air Lib Express is frequently mentioned by Easyjet as a clear protectionist attitude by the French authorities to Air France.

Adapt

This option is, again, one of the least invasive, both from a political and a financial point of view. It aims to reach a minor impact on flight operations, but certainly not a deep reengineering of any structural value-chain processes. In this situation, airlines will adapt their own business model to that of LCCs by means of a copying strategy, with the goal of integrating in its own business models the simplest elements of the LCCs' design. The return to point-to-point service focus[12], for instance, is applied by the traditional carrier through lowering waves-based network interrelations in the form of more viable rolling hub concepts. This option is being implemented by American Airlines and is dramatically improving the company's productivity levels, while offering at the same time a chance to better serve lucrative origin/destination traffic and abandon uneconomical connecting routes.

Moreover, a reduction of in-flight catering frills may have a positive impact not only in the form of lowering direct costs, but also permitting to leave off galleys from aircraft interiors, with a chance of improving seating figures for the aircraft. This option is being done in Europe by Lufthansa,

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[11] The perceived value is the ratio between the benefits a service and a brand can offer to customers divided by the sacrifices a customer has to make to use that service and brand as opposed to other services and brands.

[12] Historically, we can say that traditional carriers had been tightly focused on point-to-point traffic. Deregulation required the need to develop hub-and-spokes networks.

Alitalia and Swiss[13] and probably offers the most apparent cost relief to traditional carriers.

Retrench

Back in the 1980s, when facing a calmer market environment and basically a form of non-price competition, traditional carriers started to increase the scope and variety of their products by layering on new offerings to serve even larger and more diverse customer bases. This differentiation process faces a natural crisis when markets become mature and overcapacity forces to implement price cuts to retain demand. In mature markets simplicity, not complexity, seems to pay off when fighting for the supremacy of its own value proposition.

In this sense, failure in facing the LCCs' attack and scouting new inelastic clusters causes the traditional carrier to retrench. This process is being implemented by means of job cuts, network streamlining and capacity reductions. Each one of these three alternatives has clear pros, but a number of cons can equally arise.

Job-cutting measures would, for instance, dramatically benefit the profit/loss accounts of what is still a labour-intensive industry. However, the frequent risk is that, in reality, they can be implemented only after tight confrontations with unions and numerous strikes would significantly damage the carrier's image and reputation. This is why, under a purely financial metric, a long-term relevant benefit has to be actually discounted by subtracting lost sales and image and reputation damages[14]. By quantifying all these elements, some of them with clear psychological impact, it looks like job cuts have frequently proven to be only a panacea for the carrier, while not solving structural issues. A cosmetic solution to the problem of overstaffing can be achieved by firing off less unionised categories, like headquarter staffs, or by imposing cooperative salary reductions in exchange for job security. A similar experiment was conducted by Alitalia, but this option has not actually proved a good bargain for the company[15].

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[13] The three carriers are actually following different approaches on this matter. Lufthansa is cutting domestic catering to reduce the number of galleys to obtain more seating. Alitalia recently tried to cut its domestic catering with the goal of reducing the number of cabin crews, matched with the elimination of seats as to comply with International Civil Aeronautics Organization (ICAO) rules. Swiss recently decided to suspend free-of-charge catering in economy class, following a similar approach to that of LCCs.

[14] The result can be achieving by using this formula: *Long-term cost benefit = Cost saving from salaries – lost sales (t to t+1) – reputation damages (t + t+1) – loss of motivation.*

[15] Unfortunately, however, cost drivers for a carrier lie in the unionised crews, not in the back office.

Network streamlining focuses on reducing losses by cancelling unprofitable routes. Traditional carriers, when following this approach, usually decide to act first on long-haul destinations, due to the combination of high operating costs and inefficiencies in their price structures[16]. A narrower scope of action for a traditional airline, however, impacts dramatically on its own distinctive visibility, as network contraction actually reduces the hub-based, global carrier's attractiveness and seriously compromises its marketing promise of a seamless service to wherever.

Overall or route-focused capacity reduction, instead, may prove to be the best of the three alternatives. By phasing out current planes and trading them with smaller ones, airlines can better match demand in off-peak periods or on highly-contestable routes, thus applying simpler yield management practices, too. This option can be implemented statically by simply exchanging old planes with new smaller ones[17], or dynamically by combining for every route the capacity of different aircraft of the same family, as it works in the Airbus A318, A319, A320 and A321 case. This tactic would naturally drive LCCs to become volume leaders on trunk routes, with traditional carriers abandoning their anachronistic market share targets and refocusing on net present value upgrades. This approach is being implemented by British Airways, which has been hardly touched by LCCs after it lost in a couple of years some 15% of the all intra-European origin/destination traffic.

Fight

The fight option asks for the traditional carrier to go head-to-head with the LCCs by almost entirely matching its tariff policy. A vast amount of managerial literature illustrates the risks of a price war contest and how this risky decision should be undertaken only when a solid cost advantage is retained. This is definitively not the case for all traditional carriers. These elements help to understand why[18] fare wars usually take place not only in the first periods of LCCs' market entry, but also on a route-by-route basis and with the clear aim of avoiding halo consequences on the rest of the

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[16] The current pricing philosophy in the airline business asks carriers to hugely discount their own tariffs as to satisfy all clusters. On long-haul routes, hugely discounted prices are used to attract tourist traffic. These special tariffs, such as Public Excursion (PEX) or Advance Purchase Excursion (APEX) tariffs, seldom cover the per-capita cost of the flight, especially in the case of highly inefficient operators.

[17] This is currently the case of USAirways, which is phasing out F100s and some B737s and substituting them with smaller RJs from Bombardier and Embraer.

[18] Back in the 1980s, instead, tariff confrontation was performed on a national basis, as the U.S. market has shown.

traditional airline's markets[19]. However, there is also empirical evidence of a longer, more subtle, form of price war between the incumbent and the new entrant. This kind of alternative works when the traditional carrier is strongly attacked by the LCCs in the former's domestic market. In this case, the fight option is also done by means of some indirect pricing tactics. A typical example is provided by the tactic of increasing commissions paid by travel agents in order to block access to trade and increase the distortion power the agent can have on customers' purchase decisions (Jarach, 2002).

By copying the LCCs' pricing, a traditional operator basically tries to defend its volume market share and to discourage the new entrant from further invasion plans. This option seems inconsistent because traditional, high-cost carriers should target high-yield traffic while not focusing their attention on load factors only, and consequently on low-yield, ethnic traffic, for instance.

Join

The join option requests a traditional carrier to directly enter the low-cost cluster with an identical business design. This can apparently take place in two different ways.

The first one is the creation of a low cost subsidiary by traditional carriers. This alternative will prove to pay off its best results if the airline is really able to rigidly split business traffic and leisure and visiting friends and relatives movements, the former being allocated to the main trunk carrier and the latter to the low-cost subsidiary. In this case, the low-cost subsidiary becomes responsible of all highly contestable routes where price cuts can be sustained only by a similar cost structure of that of the attacking LCC.

This case was first provided by the U.S. environment in the early 1990s, with United giving life to Shuttle, USAirways creating Metrojet, Continental spin-offing Continental Lite and Delta creating Delta Express[20]. Recently, European carriers also decided to jump in the low-cost arena, as in the British Airways/Go, SAS/Snowflakes, KLM/Basiq Air cases, or, indirectly,

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[19] A typical example is provided by the Delta-AirTran case on some domestic routes out of Atlanta. In Europe, there is similar evidence on some routes to and from London.

[20] Delta Airlines have just started up a new low-cost subsidiary, called Song. This entity, however, is much more a JetBlue rather than a Southwest clone, operating from the same markets and targeting cost-conscious business travellers, most definitively women. Delta Express, instead, was the hypercompetitive answer by Delta to the invasion of the Florida market by Southwest, which the former unsuccessfully tried to imitate in its own business model.

with Lufthansa and the Germanwings experiment[21]. Moreover, the European environment provides evidence of the emergence of charter carriers' low-cost subsidiaries, like Hapag Lloyd Express or MyTravel Lite for MyTravel.

The survival ratio for low-cost subsidiaries, however, shows that most of them have actually failed[22]. In fact, it has proved very difficult to create a LLC inside a highly-unionised or rather conservative company without the same entrepreneurial spirit and scope of salary concessions that are being obtained by genuine low-cost start-ups. On a broader view, we can say that mingling complex and simple operations, each of which has distinct objectives and missions, often increases costs and lowers service standards of the whole company; there is evidence for this across the board for businesses, and is not industry-specific for airlines.

The second option is provided by the transformation of the entire traditional carrier into a LCC. This path of action naturally fits better in the case of a regional carrier, as it was successfully implemented in the case of the British operator FlyBe. Matters of dimensions and a lower cost-per-seat gap justify this statement. For instance, in Italy there is speculation that Eurofly, a charter carrier with a minor stock participation of Alitalia, is going to undertake a radical change and enter and fight within the low-cost arena. Volare, another Italian regional and charter carrier, has also announced that beginning in 2004 all of its services will be operated by Volareweb.com, the group's low-cost subsidiary.

Unfortunately, the transformation of a national full-service operator into a LCC, as in the case of rumours around SAS, is a Herculean task for management. Unions and employees will be unwilling to accept a salary reduction unless in the form of an employee stock ownership program (ESOP)[23] program. But the passage to the low-cost arena means that the traditional carrier will automatically leave most of its long-haul network, too. This decision will crash against governments' will to maintain an international visibility, with participation in an umbrella alliance being highly preferred to the (probably) higher revenue-generating low-cost option. Thus, many incumbent airlines will find this transformation difficult, with price-cutting measures becoming a short-term implementation and

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[21] Germanwings is the low-cost subsidiary of Eurowings. Lufthansa has some 25% of Eurowings share, with an agreement to grow up to 50%.

[22] This figure is related to the U.S market. European low-cost subsidiaries are very young, so it is too early to say that they are still on the market because of different conditions or because they have not yet had the time to fail.

[23] Employee Stock Ownership Programs (ESOP) have been widely used in the '90s for obtaining salary concessions. Today, there is literature that evidences that ESOPs have only created greater governance problems for their companies.

drastic cost reduction only a mirage. It is comes as no surprise that in the European low-cost environment we still find a lot of stuck-in-the-middle low-fares/high-cost airlines, like Meridiana in Italy, or the defunct Air Lib and Air Lib Express in France.

Ally

This could really become the next frontier for the whole airline business. What we still have not seen, however, is some sort of extensive contractual agreement between a traditional carrier and a low-cost carrier, the only exception being the limited route-based, block-space agreement between Virgin Express and Sabena. The advantages for both actors could be significant. The low-cost carrier could more easily grow in its target market. This process could be achieved by the help, without competition, of the traditional carrier, with the latter supporting the former, for instance, with public relations or in trade and commercial relationships.

The traditional airline could, instead, avoid a bloody fare war, preserving the value of its own scarce resources by transferring its own capacity on those routes that cannot be served by LCCs: like in the case of regional-feeder services and long-haul routes[24]. In the highly contestable, trunk medium-haul services its commercial presence would be guaranteed by block-space agreements, eventually, interlining those services with its own long-haul network[25].

Thus, as the process of market growth by LCCs continues, the ally option could be the most efficient and effective answer to cope with the changes of market boundaries. The fact that these alliance patterns are still not in action is not only result of LCCs targeting all possible customers in the growing phase of their product lifecycle; but also, because egotistic behaviours by traditional carriers' top managers and their belief that LCCs are simply transitory within the airline business. These are the real technical and human explanations for this option not being implemented.

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[24] Feeder and regional services are typically thin markets, where capacity needed is not that of LCCs for achieving their break-even load factors. Long-haul services, on the other hand, are immune from LCCs because on a long flight on-board comfort becomes a primary issue and even cost conscious passengers are unwilling to trade it for a low fare. For many routes, moreover, strict bilateral agreements and single-designation practices still protect the monopoly of traditional national carriers.

[25] Developing an on-line connection in the form of code-sharing between a traditional and a low-cost operator promises, instead, to be a very risky business. For instance, the superior quality image of the traditional operator could be diluted by the association with a low-cost operator.

CONCLUSIONS

The Darwinian process that many industry observers have long predicted for the world airline industry has not yet occurred, especially not in Europe. This aspect, when dealing with the European environment, is strictly linked with the clear protection that countries still provide to their flag carriers, either as shareholders or simply as a matter of pride. State aids, in various forms, are still at work, even if they were banned in the early 1990s. It is certainly true that the conditions that all airlines have had to cope with for the last two years were not only traumatic, but also totally unpredictable. Thus, many liquidity crises can be certainly related, at least partly, to these factors.

But, if the goal is to exit the current downturn cycle with a streamlined number of actors, and, in fact, with a stronger European industry, there is no more time to waste in the process of adapting traditional carriers' business pillars to current competition patterns. At the same time, the business model innovator will not stay still, but it will constantly work to figure out how it can do more for its customers, for example, by reducing cost structures and passing on some of the savings to customers.

In this sense, every traditional carrier has to evolve into a new type of airline capable of being centered on these five pillars of action:

1. ***Simple*** in its value proposition, with service diversity encouraged only when market needs ask for it, like in the long-haul sector;
2. ***Committed*** in its endless effort of cost reductions, as the only way to survive in the market, due to yields' erosions;
3. ***Proactive*** in its continued research of new cluster demands to match with existing products;
4. ***Consistent*** in its marketing approach, avoiding the temptation to raise short-term benefits in the form of lower prices for a lower service, for instance, whist privileging its own natural long-term view; and
5. ***Clear, transparent and effective*** when dealing with internal customers' relationships, as a labour-based service practice may only survive thanks to the consensus of its own employees.

We cannot say if Jan Carlzon's late 1980s prophecy that only four traditional carriers will survive in the New Millenium is still alive. What is certainly true is that the European market may sustain a significant number of airlines, as it is today, only if they are internally consistent with the current scenario and with a clear elective positioning in mind. Unfortunately, that is exactly what is currently missing from Europe's traditional carriers.

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