

Have The Frills Really Left The European Airline Industry?

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ABSTRACT

The emergence of low-cost scheduled carriers in European aviation has attracted attention from business and leisure travellers as well as from established carriers. This paper examines low-cost carriers in terms of their operating features and considers implications for European transport markets. Relevant aspects of the operating environment of European airlines are examined. An analysis of the USA situation in relation to low-cost carriers is also provided. It is suggested that further research into the development of budget air travel in Europe needs to be undertaken. Copyright © 2000 John Wiley & Sons, Ltd.

Keywords: airlines; low cost; no-frills; budget.

INTRODUCTION

Low-cost, no-frills air travel has finally reached Europe. Budget airlines EasyJet, Ryanair and Debonair have all survived their inaugural period and gained sufficient public following to worry Europe's established scheduled carriers (Wickers, 1997). In addition to offering low fares these airlines impose fewer restrictions and so are beginning to poach business as well as leisure and budget travellers. All aircraft have to meet the same Civil Aviation Authority (CAA) standards and safety requirements. Budget airlines are there-

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fore posing a threat to scheduled carriers, as evidenced by British Airways (BA) introduction of a discount carrier of its own named Go in May 1998. It appears that low-cost carriers have not only created new markets but have also posed direct competition to existing carriers and routes.

The main aim of this paper is to examine low-cost airlines in terms of their operating features and their impacts on European transport markets. Deregulation of the airline operating environment, both in North America and Europe, are examined owing to the role this has had in influencing the development of low-cost carriers. The paper considers relevant aspects of the European aviation market, including the significance of the development of high-speed rail travel and the regulatory framework affecting aviation. The importance of airline 'load factors' is discussed, as this is a crucial aspect of the operation of low-cost carriers. Challenges to existing carriers and routes are considered alongside the responses of incumbent airlines to the new competition.

No-frills airlines, also known as low-cost carriers and budget airlines, are scheduled carriers with significantly lower costs than mainstream airlines and so offer much lower average fares. Cost savings are typically made in the areas of distribution, service and aircraft utilisation, as discussed below. The 'no-frills' airline sector has emerged from an extended period of cartel domination and fixed pricing structures, followed by route and price deregulation, in the USA and Europe. Airlines have experienced considerable change in the framework within which they operate, particularly as a result of this process of deregulation. The impact of deregulation is examined initially in the USA and subsequently in Europe.

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THE IMPACT OF DEREGULATION

Deregulation, or liberalisation as it has been termed in Europe, involves the effective removal of many of the regulations affecting civil aviation. This has emerged, through relevant government decisions in many areas of the world, from a background of a tightly controlled industry. The development of air transport was greatly affected by government influences and legislation. Where deregulation has occurred, the process has aimed at allowing market forces to reign through deliberate removal of state control. It was the areas of route entry and air fares, both of which had been tightly controlled previously, that were mainly affected. A number of issues and trends can be attributed to the process of deregulation, at least in part. The emergence of low-cost carriers is one such trend.

Deregulation in North America

The North American experience of deregulation, which resulted from the 1978 Airline Deregulation Act, is a far reaching version of deregulation. The Civil Aeronautics Board (CAB), which had been heavily involved in the regulation of air transport in the USA, was disbanded following implementation of the Act and market forces took over. There was an initial increase in the number of new entrants, many of whom could offer lower fares than incumbents as a result of lower overheads and other savings. Deregulation brought in many low-cost new entrant airlines and at first it appeared that the advocates of deregulation were to be vindicated by events (Hanlon, 1996). By the mid-1980s the increased competition and choice together with the lower fares that characterised the newly deregulated domestic airline market in the USA was considered a success. It was only after this initial period that the surviving established carriers began to use their inherent strengths to fight back and were once again dominant by the end of the decade. A return to the concentration levels experienced in the industry prior to deregulation then occurred. The mid-1980s therefore can be viewed as a turning point in respect of the short-and long-term outcomes of deregulation in North America.

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The European experience

In Europe the road to deregulation has been rather longer and has had the USA experience to draw upon as the process of liberalisation has been more recent. The outcome has also been a great deal less drastic. Liberalisation has occurred in three packages of measures, which came into effect between 1993 and April 1997. The implications of these for both the introduction of new services and for fare setting are great. Government approval is no longer required when airlines set fares or launch new services. Any European Union airline can, in theory, now start domestic services in another member country. The process is now complete and airlines of any country can treat any other country of Europe as a home base for the purposes of air travel.

Liberalisation was never intended to go as far as deregulation and a larger degree of regulation remains in place in Europe. There has been a gradual relaxation of controls covering market access and capacity, fare setting and access to routes. Flexible new procedures for the approval of fares mean member states can no longer block proposals for economic low-fares. This allowed smaller airlines, which previously focused on domestic or regional services, to operate on important intracommunity routes. It also gave them more freedom to charge what they wanted and to meet demand by varying capacity levels (British Airways, 1997). Although the regulations have not automatically created a more competitive European airline industry they have certainly created an environment conducive to this.

The implementation of the so-called Third Aviation Package was the most important step in liberating European air transport of government constraints. It is, for example, now more difficult for governments to stand in the way of the establishment of new carriers to protect their national flag carrier. Airlines can charge and react to market conditions without government interference (Humphreys, 1994).

Debonair was the first British-based carrier to offer intra-European flights following European liberalisation. The launch of Virgin Atlantic Airways' subsidiary Virgin Express in Brussels similarly took advantage of dereg-

Int. J. Tourism Res. 2, 423-436 (2000)

ulation. Completion of the European Commission's rules on deregulation has stimulated market growth, as evidenced by reports of passenger traffic through airports (Williams, 1997). In Europe, however, it is estimated that as little as 1% of routes are served by fifth freedom carriers (Mellman, 1997).

LOW-COST CARRIERS: THE AMERICAN EXPERIENCE

Deregulation in North America encouraged a range of low-cost, low-frills airlines, competing on trunk routes with major operators and, generally, failing to survive for any significant length of time. These carriers had difficulty sustaining intense competition over an extended period of time. Tempted into reduced maintenance standards in order to reduce costs, they undermined customer confidence. Indeed, perceived problems of this type persist in the USA, as reaction to the ValuJet crash in the Everglades testifies (Baum, 1997).

It is now two decades since deregulation in the USA and the major carriers still dominate the major routes. Nonetheless, low-cost USA carriers take 27% of internal passengers (Underhill, 1998). In some respects Laker pioneered low-cost, limited service air travel with Skytrain on trans-Atlantic routes, and charter regulations provided restricted access to low-cost travel on major holiday routes (Baum, 1997). Low-cost operators in the USA include Southwest Airlines, Tower Air and ValuJet. The latter has been renamed AirTran following the Florida DC-9 crash. The Department of Transport in America estimates that cut-price airlines such as Southwest Airline and ValuJet save passengers some \$4 billion a year (Anon., 1997c).

The majority of the start-up airlines entering the USA market following deregulation lasted only a few years, although some did survive and are still developing, such as Tower Air. According to Milman (1997) most provide point-to-point services with a limited fleet of older jets purchased or leased from a major carrier. Low-cost fares with minimum restrictions are the result of a no-frills service with less room between seats and no meals. Some have unique operating policies, which have led to niche markets (Milman, 1997). The only

significant advantage of the new-entrant airlines is lower labour costs, whereas they are disadvantaged by a lack of market identity, thin capitalisation, limited resources, relatively unsophisticated yield management systems and a perception that they are unsafe following the ValuJet crash (Flint, 1998).

Not all low-cost carriers in the USA have been short-lived. Southwest is a highly successful niche market operator and is ranked amongst the top 50 airlines in the world (Wheatcroft, 1992). The airline is widely attributed with pioneering low-cost scheduled air travel. 'Texas-based Southwest Airlines remains the inspiration for most low-fare newcomers on both sides of the Atlantic.' Southwest has 252 aircraft and loyal customers, yet other low-cost airlines in the USA are falling into bankruptcy protection. Indeed, given the nature of the USA private enterprise market, the larger carriers may well beat the smallest at the low-cost game there (Lockwood, 1997).

Other low-cost carriers have found strategies to help them survive. The creation of critical mass through merger has acquired a following among many of the low-cost USA airlines currently facing difficulties. One example is ValuJet and AirTran Airways (now operating as AirTran Airlines). The merger enables mass to be created as a niche player. Pan-Am, which was reborn as a low-cost airline, has also been merged with Carnival, another low-cost airline.

Although a small component of the USA airline industry, these start-ups have had an impact on the major carriers, who will usually match fares in competitive markets. They may also increase capacity and eliminate fare restrictions. In 1994 two major carriers responded with their own low-cost subsidiaries. Continental introduced Continental Lite and United brought in Shuttle by United, but neither lasted more than a year (Milman, 1997). USA airlines are accused of alleged predatory activities against new-entrant airlines. The main focus appears to be so-called 'barriers to entry' and the 'market power' of the network airlines (Flint, 1998). The low-cost carriers in the USA face fierce competition, including price matching (Walker, 1997).

The future survival of the start-ups is by no

Table 1. Traffic of commercial air carriers – 1986 and 1991 to 1994 (source: adapted from ICAO, 1991–1994)

Year	Passengers carried (thousands)
1986	960 010
1991	1 134 700
1992	1 145 370
1993	1 141 440
1994	1 232 620

means guaranteed. The US Department of Transportation has acknowledged that low-cost competition could disappear altogether. The Department of Justice is to work with them to produce a better definition of what predatory practice is and to develop a clear enforcement policy for the industry (Walker, 1997). Low-cost carriers in the USA have tended to operate on high-volume trunk routes, using mainline airports, and this is one way in which they differ from European low-cost carriers.

EUROPEAN AVIATION

European civil aviation has experienced a period of profound change, particularly during the past decade. The European environment is clearly very different to that in the USA and has additional institutional barriers to new entrants. Airport costs and congestion are significant and few slots are available for a new service. Furthermore, flag-carriers have had time to prepare for competition (Flint, 1998). High fares and financial weaknesses of many European flag-carriers, together with uncongested regional airports, have, however, created a gap in the market. Annual air travel growth estimates for Europe as a whole are 5% but for the UK sector this is soaring at around 10% (Lockwood, 1998). The European market for air travel has already grown, as illustrated in Table 1.

British Airways alone experienced an increase in passenger numbers in excess of two million between 1993 and 1997. Dennis (1999) using data from Aviation Strategy places the growth in European passengers for the new entrants in context by looking at these in comparison to a competitive scheduled carrier,

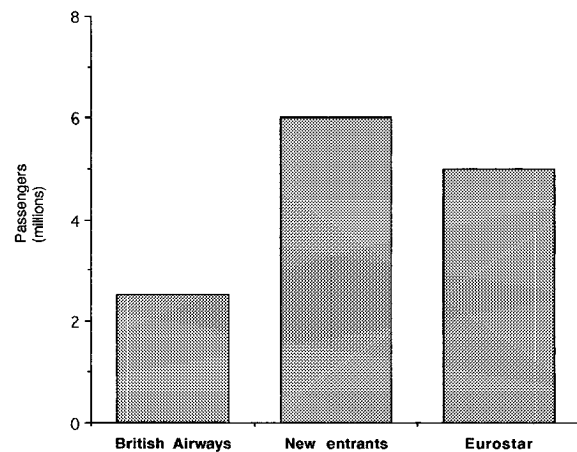


Figure 1. Growth in European passengers 1993–97 (source: Dennis, 1999)

namely British Airways, and the alternative transport form provided by Eurostar. This is illustrated in Figure 1.

The emergence of low-cost carriers in Europe

The first of the new-style low-cost carriers to operate out of the UK and to sustain services over a significant period of time was Ryanair. The Irish carrier exploited bilateral deregulation between the UK and Ireland from the mid-1980s onwards, creating a pricing and demand revolution on Irish Sea routes. The volume of passengers has grown dramatically as a result. Ryanair helped to drive mainline carrier, British Airways, off the London–Dublin route. The product and service offerings of other mainline competitors, notably Aer Lingus, were also affected. The main impact of Ryanair, however, has been to create new markets for trans-Irish Sea travel, competing directly with sea transport and forcing investment in that sector. At the same time they have enabled large numbers of leisure travellers to travel cheaply and flexibly between many regional points in the UK and Ireland (Baum, 1997).

As a privately owned Irish airline company, Ryanair, following a strong rise in profitability, increased pre-tax profits by 37% to £21.4 m in the half-year to 30 September 1997 (Murray Brown, 1997). Ryanair carries 4 million passengers a year on a fleet of 20 Boeing 737s, mostly out of Dublin. 'Such has been its impact

that on every route where it competes with Aer Lingus it is now the market leader' (Wickers, 1997). The airline is committed to building its operations into mainland Europe from Stansted and is intent on year-on-year growth of about 25% (O'Connell, 1997).

No other low-cost operator to enter the British markets really succeeded on the same scale as Ryanair until the mid-1990s, with the emergence of carriers such as EasyJet, Debonair and Virgin Express, operating within the UK and western Europe. It was a decade after Ryanair launched its service between Waterford and Gatwick that EasyJet was born and another year after that before Debonair began operations. Virgin Express purchased Euro-Belgian Express, a Brussels-based carrier in 1996. More recent airlines to emerge include the Italian carrier Air One and Euroscot Express (Debonair and Euroscot Express have ceased trading since this paper was submitted) (Wickers, 1997).

Unlike many small, commuter or 'feeder' carriers in Europe, these airlines generally operate on, or parallel to, major trunk short-haul routes, traditionally dominated by flag carriers, as opposed to thin, business routes. Low-cost airlines have added some 30 flights a day to those operated by British Airways, British Midland, Jersey European and KLM/AirUK on London-Scotland routes (Lockwood, 1998). Flag-carriers are also entering the market, with Lufthansa, Alitalia and Iberia all looking to start low-cost divisions (Marston, 1998).

The UK Civil Aviation Authority (CAA) believe that the combination of low-cost carriers using Luton is affecting Heathrow and Gatwick fares. Although Luton is known as a charter airport, its build-up of scheduled services led to an even split of the airport's 2.4 million passengers between the two forms (Feldman, 1997). Attracted by the flexible workforce, liberalised aviation sector and relatively low social security costs, most low-cost entrants have based themselves in the British Isles (Skapinker, 1998). The European market has been forecast by one city analyst to triple over the next four years (Marston, 1998).

LOAD FACTORS

Load factors were introduced above as an

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important aspect in the management of low-cost carriers. Holloway (1997) describes load factors as measuring the percentage of an airline's output that has been sold. He adds that according to the International Civil Aviation Organisation (ICAO) in 1995 scheduled services achieved a provisional passenger load factor of 66.9%. This figure represents passenger-kilometres flown per available seat-kilometres. In the same year the International Air Transport Association (IATA) members had an average 67.4% passenger load factor on scheduled services. Although these figures tend to disguise regional and seasonal variations, the mid-1990s saw consistently high load factors in most major air transport markets. Influences on load factors include the nature of demand. It is usual for there to be a trade-off between yield and load. High-yield products, such as first class seats, often include high accessibility as a feature. What is crucial from the airline's perspective, however, is the break-even load factor, because unless related to this the actual load factor has little significance. Low-cost carriers will be concerned with keeping this break-even load factor at a low level and low unit costs are one way of achieving this. Holloway (1997) further illustrates this with the example of ValuJet, the Atlanta based start-up, which expanded rapidly following its launch in 1993, when its break-even load factor was 45%. He also cites that Southwest's break-even load factor was five percentage points below the average for USA major carriers owing to its competitive cost structure. Essentially, airlines are considering the nature of their product and the yield that can be earned on it. Operating features of low-cost carriers are now discussed.

OPERATING FEATURES OF LOW-COST CARRIERS

Pricing structures

No-frills airlines tend to use simplified pricing structures based on demand-regulated single fares or flexible return tickets without the high-cost premium fares required by mainstream airlines for fully flexible travel (Baum, 1997).

Int. J. Tourism Res. 2, 423-436 (2000)

Service levels

In-flight services on most flights are curtailed or even eliminated, thereby reducing costs and labour. Faster airport turn-around are also facilitated in this way. These are often no more than 30 minutes. Beverage service, where offered, is usually charged to customers and on international flights duty-free sales are promoted as sources of revenue generation (Baum, 1997). EasyJet frequently makes reference to the fact that there is no such thing as a free lunch (Rigby, 1997). In line with most of their peers, they do not offer free food. One exception, Debonair, which is described as more a 'low-frills than no-frills' airline, offers some refreshments (Wickers, 1997). In-flight entertainment is similarly often excluded from the package. Ryanair use in-flight entertainment systems for promotional purposes. Interestingly though Wickers (1997) suggests the days of free flight fun are also numbered on the larger carriers, citing the fact that American Airlines now charges for feature films and Nintendo.

Free seating arrangements

By offering free seating arrangements boarding times are reduced. Plastic, re-useable boarding cards are often used again, improving turn-around times. This can, however, cause congestion at check-in where dedicated flight check-in desks are frequently used with single-line queuing rather than a common line (Baum, 1997).

Rapid turnaround times

Free seating arrangements are not the only reason for faster turnarounds, as reduced service levels and other factors are relevant. The outcome is increased aircraft utilisation. Rapid, 20 minute turn-around times by EasyJet lead to high utilisation levels of 11.5 h a day (Gallacher, 1997).

One-class travel

Low-cost carriers tend not to offer different classes of travel, although Wickers points to the fact that Air One exceptionally offers business-class travel but that this is achieved

with the same configuration by keeping the middle seat free.

Distribution

A major saving made by low-cost carriers is that they tend not to maintain offices in the cities they serve. The direct purchase of tickets by telephone and with payment by credit card is encouraged by budget airlines keen to cut out the middleman and avoid paying commission to travel agents. Ryanair's reduction in travel agent commission rates received a great deal of publicity. Airlines vary in respect of the amount of sales they make directly. Debonair's direct sales account for only 38% of their total, as compared with 100% for EasyJet (Gallacher, 1997). Additional savings in distribution costs are considered below.

Computer reservations systems. Computer reservations systems (CRS) are widely used by scheduled carriers. Fees charged for using these can, however, prove excessive for airlines operating on thin margins, especially as these are not differentiated according to ticket type (Bou Habib, 1995). Computer reservations systems can have high distribution costs per ticket and so this is a further area where low-cost carriers have tried to make savings.

Ticketless travel. Ticketless travel saves carriers money, not only by cutting out commission to the middleman but also by increasing productivity by freeing up check-in staff and also by removing the cost of the ticket itself (estimated at about US \$3). The trend seen in the USA towards ticketless travel is starting to have an impact in Europe, where the low-cost carriers have supported their use (Bray, 1996). Purchases are made by telephone using a credit card. A reference number is issued and the passenger then shows some identification at the airport. Technology clearly has been important to this development. EasyJet are fully ticketless.

Interline agreements. The lack of ticket or baggage interline agreements with other airlines displayed by low-cost carriers helps maintain a simple booking system, so keeping reservations costs down.

Removing the added value

Frequent flyer programmes (FFPs) are not usually offered by low-cost carriers, although Debonair has one called Destinations. Customers receive a free return flight for every 10 return flights or 20 one-way flights completed (Anon. 1997a).

Contracting out

No-frills operators try to make savings by contracting out as many services as possible. This is something for which mainline operators, such as British Airways, have also recently shown a preference.

Load versus yield

Seats are usually sold on a first come, first served basis with the cheapest seats being sold first as opposed to the traditional approach of trying to sell as many high revenue tickets as possible. This is the opposite approach to most traditional yield management systems. EasyJet's break-even load factor is 50–55% as compared with Debonair's 57% (Gallacher, 1997). Load factors were discussed in more detail above.

Booking restrictions

In addition to competitive fares, low-cost airlines generally offer fewer restrictions. This is an attractive feature to business travellers and one that is usually achieved by selling one-way tickets. The big carriers traditionally restricted business travellers by imposing a Saturday night stay on those purchasing cheap fares (Wickers, 1997). Low-cost airlines do, however, often issue non-refundable and non-returnable tickets. This means Easyjet has no need to implement an overbooking policy, as they can achieve load factors of 100% (Anon. 1996).

Aircraft, safety and comfort

Low-cost carriers tend to lease rather than purchase aircraft. Ryanair started out with Viscounts, graduated to BAC1-11s and now have an all Boeing 737-200 fleet. EasyJet also

use Boeing 733-200 craft and Debonair fly 146 Whisper Jets. EasyJet started out without any of its own aircraft, depending entirely on wet-lease arrangements until fully operational. Wet-leasing is a flexible option enabling carriers to increase or decrease schedules in response to demand. European Air Charters provide some high season services for Ryanair (Baum, 1997). Wet-lease arrangements are often used by start-ups because the rate for wet-lease arrangements, which is paid on a per-hour basis, covers all costs for aircraft, flight-crew, maintenance and insurance (Anon. 1996). The average age of EasyJet's fleet is currently seven years and by the end of 1999 it will be the youngest fleet in the air (Wickers, 1997). Seat pitch is often reduced to increase passenger numbers per flight. Debonair, however, has a seat pitch of 33 inches, which is greater than the legroom on most scheduled airlines.

Departure Points

Most of the new carriers utilise airports such as Stansted and Luton for reasons of cost and faster turn-arounds. Michael O'Leary, Ryanair chief executive, has warned that 'to attract tourism you need low airfares and for low airfares you need to have low access costs.' (O'Keefe, 1996). Incumbents on the other hand, tend to be based at major airports typified by high landing and passenger-handling charges and congestion. Turn-around times are thus affected as well as costs.

The use of routes that create parallels to trunk routes through use of secondary airports where landing charges are much lower is favoured by many start-ups. Luton and Stansted are used for London, and other similar types destination include Prestwick (Glasgow), Beauvais (Paris), Charlois (Brussels) and Skavska (Stockholm) (Baum, 1997).

Labour costs

Further savings include reduced labour costs, as new airlines have labour costs that are about 40% of those of the big carriers (Anon., 1997c).

Table 2. Estimated cost comparison: British Midland versus low-cost carrier British Midland data from CAA Statistics 1996. Load factors are assumed equal between the carriers (Dennis, 1999)

	British Midland	Low-cost + 20% seats and flights
Flight and cabin crew salaries	6.3	3.6
Flight and cabin crew expenses	1.9	0.0
Fuel and oil	6.1	7.3
Aircraft rental/depreciation	15.5	15.5
Training and development	0.8	0.8
Maintenance	8.7	10.4
Airport charges	14.7	4.9
Navigation charges	4.9	5.9
Handling and ground charges	14.4	11.5
Passenger services	6.5	0.0
Insurance	0.6	0.8
Sales and reservations	5.5	12.0
Advertising	3.5	5.3
Commission	7.6	0.0
Cargo specific	1.1	0.0
General and administrative	1.9	1.0
Total	100.0	79.0
Per PAX (index)	100	55
Cost per PAX	£83.30	£45.80

PAX: passengers.

Summary

The above list of operating features of low-cost carriers is not intended to be exhaustive but rather aims to outline the main features of no-frills airlines. The cost difference between no-frills and mainstream scheduled carriers is clearly paramount to the success of the former, and Dennis (1999) provides a useful comparison of the differentials. His estimates, shown in Table 2, are based on British Midland, an airline that is similar to low-cost carriers in that it operates Boeing 737 aircraft.

The impact that low-cost airlines are having is now considered.

CREATING NEW MARKETS

The impact of low-cost carriers on market growth can be seen by the influence of Ryanair on passenger numbers through Dublin. In 1986 these were static at two million passengers per annum and by 1997 had increased to seven million passengers per annum. Although this increase cannot be attributed entirely to Ryanair, the airline acted as a trigger, which coincided with the government's tourism policy push. This is a good example of synergy

between carrier strategy and tourism policy development.

The use of secondary airports, discussed above, can also create new markets. Prestwick's revival as a commercial passenger airport is, arguably, attributable largely to Ryanair's introduction of Dublin and Stansted links, and Bournemouth has developed additional direct scheduled services following Ryanair's profitable services, notably through Euroscot's flights to Edinburgh, Glasgow and Amsterdam.

CHALLENGING EXISTING CARRIERS AND TRANSPORT ROUTES

It is in the short-haul travel market, both domestic and international, that low-cost carriers in the UK have made a clear impression (Baum, 1997). The development of low-cost carriers has impacted on both sea and land routes and business has been drawn from these. For example, high-speed ferries and service upgrades on the Irish Sea have been significant developments. An interesting area to observe will be the national rail network within the UK, particularly the development of London-Scotland routes.

Table 3. Impact of low-cost carriers. Compiled by Transport Studies Group from CAA Statistics. Data is for 6 month period June–November (international) or May–October (domestic). Market growth for all London scheduled traffic was 15% (Dennis, 1999)

Route: London to/from	Carriers	Airports	Market share (%) 1997	Market growth (%) 1995–1997
Nice	Easyjet	Luton–Nice	27	12
Barcelona	Easyjet	Luton–Barcelona	21	71
	Debonair	Luton–Barcelona		
Stockholm	Ryanair	Stansted–NYO	13	41
Amsterdam	Easyjet	Luton–Amsterdam	5	33
Glasgow	Easyjet	Luton–Glasgow	20	31
	Ryanair	Stansted–Prestwick		
Edinburgh	Easyjet	Luton–Edinburgh	10	31
Aberdeen	Easyjet	Luton–Aberdeen	10	26

Low-cost airlines are also having an impact on airport growth rates. Luton Airport for example has one of the fastest growth rates in the UK as a result of business driven by carriers such as EasyJet and Debonair. This replaces a former reliance on charter traffic (Anon. 1997b) Low-cost airlines have also been successful in attracting business travellers away from mainstream operators. A critical mass of lower fares can make routes less attractive to the major players, as argued by Ryan (1997).

Low-cost airlines are also targetting the cross-Channel market. An example is EasyJet's £59 one-way fare on the Luton–Nice route. The budget carrier now claims to have a 43% share of the route. Ryanair is targeting St Etienne and Carcassonne near Toulouse (Anon., 1997e). No-frills operators are also investing in new aircraft. EasyJet is investing in 12 new Boeing 737s and predicts that they will carry 6 million passengers a year by 2000 (Lockwood, 1998).

The share of traffic carried by no-frills carriers on key routes is significant, as illustrated by Dennis (1999) in Table 3. Dennis also provides details of traffic changes following the entry of low-cost carriers on a selection of both major and secondary European routes, as shown in Table 4.

The existence of low-cost carriers in Europe has aided tourist flows, with tour operators such as Inghams responding by rethinking its city breaks programme in order to capture those travellers booking seats separately with no-frills airlines (Noakes, 1998).

A THREATENING EUROPEAN ENVIRONMENT?

Consideration is now given to some of the operating characteristics affecting European aviation. It has already been mentioned that the airline environment of Europe is very different to that of North America. Some key differences that are considered potentially problematic for the continuation of the no-frills market are highlighted below.

State-aid

The issue of state-aid to national carriers of some countries in Europe has long been a contentious one. Throughout the process of liberalising European skies, a number of carriers receiving state aid contributed to the fact that progress was made only slowly. Meanwhile privatised carriers argued that until state aid becomes illegal in Europe it will be impossible to create a level playing field. Flag carriers received subsidies in 1990–1996 in excess of \$9 billion (Anon., 1997c). Sixty of the 80 new airlines formed in the EU between 1993 and 1996 failed partly as a result of pressure from state-subsidised carriers (Underhill, 1998).

Competitive transport forms in Europe

One aspect of the European environment that could prove threatening to low-cost carriers in the medium to longer term is the development

Table 4. Change in traffic following low-cost carrier entry (Dennis, 1999)

Route	Service	Percentage of traffic summer 1997	growth (%) 97-98	Percentage of traffic summer 1998
Major (London to Milan, Rome, Oslo, Geneva)	Conventional	93	+8	86
	Heathrow	(74)	+5	(67)
	Gatwick	(13)	-1	(11)
	Stansted	(5)	+75	(7)
	London City	(2)	-5	(2)
	Low cost	1	+951	11
	Charter	6	-42	3
	Total	100	+16	100
Secondary (London to Lyon, Toulouse, Venice, Pisa and satellites)	Conventional	81 of which	+15	67
	Heathrow	(38)	+26	(34)
	Gatwick	(43)	+5	(33)
	Stansted			
	London City			
	Low cost			21
	Charter	19	-19	11
	Total	100	+38	100

of high-speed rail networks. This is a significant threat to short-haul aviation markets and one that is likely to increase as more high-speed train networks develop in Europe. Confirming this threat, Flint (1998) argues that it is good, reliable and cheap rail travel that will hurt low-fare airlines more than established carriers. This has not, to date, been a development that has greatly affected the USA market, although they are working on a network (Westbrooke, 1996).

A useful example of a European market suited to travel by train is the London-Paris journey. Eurostar claimed to have captured around 50-55% of this market in 1996 (Westbrooke, 1996). The significance of Eurostar rail services on the London-Paris air market is confirmed by CAA statistics, showing a 25% fall in air passengers in 1997 as compared with 1994 (Anon. 1997e). The number of air passengers between London and Paris has fallen by one million, a decrease of more than 25% as compared with 1994, before Eurostar began operations. It may be pertinent that no budget airline currently offers a London-Paris service. According to the CAA, the Brussels market, which also has been affected, suffered less. A further high-speed rail service was, however, launched in Belgium in December 1997, cutting the journey time from London to Brussels. Eurostar hopes this will increase their share of

the market. There are also plans to extend the railway to the Dutch and German borders. The train has the advantage of taking passengers and their bags from city centre to city centre.

For business travellers trying to reach destinations at a distance from the main rail terminals and airports, Hoverspeed too has been targeting the short-haul market with a product not dissimilar to business class on an airline (Westbrooke, 1996). These levels of competition between different modes of transport must be good for passengers.

Charter carriers

A distinction has long been drawn between scheduled and charter airlines. Scheduled carriers are those that operate to a published timetable. There are approximately 1200 scheduled carriers world-wide (Hanlon, 1996). Only a small share of all carriers are charter carriers. Charter airlines are distinguished by certain operating features and typically (although not in all cases) by lower cost. Reasons for lower costs include firstly high utilisation of the aircraft. For example, more seats and less leg room as well as more flights per day (often at less convenient flight times). Secondly, consolidation of flights can take place where these are not sufficiently full. Thirdly, charter carriers tend to offer lower

levels of service and to use different (often less convenient) airports. Finally, these airlines are often smaller and so have lower overheads. The distinction between scheduled and charter airlines could be said to be lessening, particularly with the emergence of more low-cost scheduled operators. Many of the new entrants display some (although not all) of the features of charter carriers. Lower levels of service and the use of secondary airports are two examples. The fact that charter capacity has increased in the UK in recent years could contribute to a potential oversupply in the market. This inevitably would result in the failure of some carriers.

The nature of charter flights has also been changing, with some evidence of increased flexibility. A service that enables customers to mix and match flights on charter airlines was launched, removing the rigid time-frame of 7 or 14 day stays required by charter airlines. Teleticket allows passengers to switch between operators for outbound and return journeys (D'Arcy, 1995).

Airport availability

Additional deterrents to low-cost carriers on particular routes include the lack of availability of slots or secondary airports.

There are further threatening aspects of the European operating environment that have more in common with the North American situation. The behaviour of incumbent airlines is one such aspect.

The incumbents' responses to low-cost carriers

The emergence of low-cost carriers clearly poses a threat to Europe's flag carriers. It appears that established carriers need to cut costs and give up some routes. Cutting costs has not, however, proved easy. British Airways faced strike action for attempting to replace cabin attendants' allowances with a basic pay structure, and Lufthansa has been cutting costs for over five years and believes this needs to continue. The problem with pulling out of routes is that many of these provide passenger feed to longer haul and more lucrative routes (Anon., 1997d).

Mainstream airlines have, in some cases, reduced fares significantly, as seen by KLM's response to EasyJet competition on the London-Amsterdam route. Other airlines have curtailed services. Airlines have also restructured both their pricing and services on some routes. Jersey European's Glasgow-Birmingham-Paris service, for example, has many 'no frills' characteristics. Virgin Atlantic, which has a successful long-haul, mainstream product, entered the European market with an economy brand, Virgin Express (Baum, 1997). This is an interesting example of an airline using main name branding for the budget operation, but Virgin Express had no complementary 'mainline' service in Europe.

In 1997 British Airways also launched a study of the no-frills market, having decided they could no longer ignore the low-cost competition. British Airways had observed American airlines being savaged by competition and was fearful for its network of European routes (Lynn, 1997). This resulted in a decision to establish a low-cost carrier of their own. Such a move had been described by Stelios Haji-Ioannou, EasyJet's chairman, as 'the biggest challenge to our survival so far.' (Parsley, 1997).

Barbara Cassani of British Airways explains the move as a big company response to a marketplace change (Lynn, 1997). Go is a subsidiary of British Airways, with its own headquarters at Stansted, the airport from which it operates its Boeing 737-300s. The subsidiary currently flies these to destinations in Italy, Denmark and Portugal, selling seats direct rather than through travel agents. The airline intends to add more destinations to its portfolio.

KLM has introduced a number of measures, including a price challenge from Heathrow, fare restructuring, including £38 singles, and fare variation. The latter includes feeder tickets to long-haul routes from Amsterdam. KLMuk launched four flights a day from London City to Manchester in October 1997, with introductory fares starting from £55 return. The airline is focusing on London City and Stansted for domestic development. Similarly, EasyJet's £29 fare between Luton and Glasgow is almost matched by special return fares of £59 offered by BA, Air UK and Jersey European, which

include meals (Lockwood, 1998).

These moves by incumbents have prompted reactions from low-cost carriers. EasyJet complained to the EU Commission against KLM's pricing policy. KLM allegedly matched EasyJet's low fares on an unrestricted basis. Substantial EU measures to prevent KLM-style pricing policies will be crucial to success (Gallacher, 1997). Debonair wrote to Lufthansa after the latter challenged its Air Travel Organiser's License (ATOL) by pressing the German transport ministry to declare it invalid. The German Civil Aviation Authority (CAA) intervened. Lufthansa objected to Debonair's omission of airport tax in fares advertisements and has allegedly displayed limited matching of Debonair's fares (Gallacher, 1997).

The incumbents, however, may be over-reacting. Low-cost carriers do not have an easy time, particularly when trying to obtain the landing slots they desire and many have not survived (Anon., 1997d). It is not unusual for new entrants to be taken over by established carriers or be put out of business. Only 6% of Europe's routes are served by more than two airlines, whereas others are still controlled by pairs of national carriers (Anon., 1997c). Proving that predatory pricing has taken place is extremely difficult and, despite the regulations discussed below, in practice many small low-cost operators will find themselves out of business before they are able to bring a case forward.

Regulatory framework

Much regulatory change has taken place in Europe in the past few years, with state aid now receiving serious attention and protection from predatory behaviour likely where this can be proven to exist. In Europe, the diverse nature of the marketplace together with the watchful eye of the European Commission may help smaller carriers (Lockwood, 1997). Europe now has most of the right laws in place as well as the commission in Brussels, with its competition authorities and a transport commissioner, all of whom can ensure the laws enable new airlines to enter the market (Anon., 1997c).

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Rivalry

There is some evidence of rivalry between Debonair and EasyJet. Debonair announced that it would offer a Luton-Nice fare of £69 one way in December 1997 and EasyJet quickly responded with a short-term discounted fare of £39 one-way and an increase in capacity. Continued rivalry would not be good for either carrier (Gallacher, 1997).

Budget airlines are predominately hub-centric, as few of the routes they operate are not direct point-to-point, hub-spoke services or parallel routes. Hub systems are common to non-budget airlines, but what is different is that budgets do not operate through-fares from spoke to hub to spoke. Therefore, fares with budget carriers from spoke to spoke via a hub can be relatively high. Added to this is the risk that onward connections are not guaranteed. Travellers will receive no compensation from a budget airline if a connection is not made. Budget airlines therefore benefit communities close to hub locations to a far greater extent than those at spoke locations, where the only benefits are point to point services to the hub.

CONCLUSIONS

Having assessed the opportunities for low-cost start-up carriers to enter the aviation markets of North America and Europe following the respective processes of deregulation and liberalisation in these areas the paper examined the subsequent emergence of no-frills air travel. This included detailed consideration of the features of budget airlines together with examples of start-up operators. The paper highlighted some aspects of the European environment that may prove to be problematic for low-cost carriers in the long run.

It can be concluded that low-cost airlines appear to have drawn business from land and sea carriers, creating a new market of airline users. This growth of the budget sector signifies an increasing polarisation of services, with one end operating to more traditional levels of service and benefits with full airline services and access to global rewards that go with such provision. The alternative economy offering is an entirely different product. The

Int. J. Tourism Res. 2, 423-436 (2000)

emphasis nonetheless is on giving certainty together with value and high quality. Here the consumer is not faced with surprises about what is or is not included in the service offering (Baum, 1997). The major effect has been the creation of an alternative type of travel product, reduced operating costs and the creation of competition.

Given their growth and impact so far it is easy to envisage a healthy future for budget airlines in Europe. The business travel agents, Carlson Wagonlit, for example believe some companies would prefer to spend less for more basic products. In a recent survey of UK business travellers it found that only one-third use the in-flight facilities and more than three-quarters indicated that they would be prepared to travel on 'no-frills' flights within Europe (Daneshkhu, 1996).

There are, however, significant threats facing the sector. Jonathan Ornstein of Virgin Express describes the biggest challenge facing the airline as that of keeping costs at a level to allow them to price the product attractively. He claims that 25% of costs are totally outside the airline's control but warns that they will go directly to the European Parliament if need be to knock down unfair barriers and monopolies (McLaren, 1996). The responses of mainstream operators could also prove damaging as could further development of high-speed rail services or the introduction of more flexible charter services. The distinction between scheduled and charter airlines may be lessening, particularly with the creation of low-cost airlines.

One challenge to low-cost carriers identified by Sir Michael Bishop of British Midland, is that the favourable treatment in terms of low rates offered to low-cost carriers by airports may be coming to an end. These airports, as they become more popular, will want to charge the going rate. He adds that the reliance of some low-cost carriers on duty free sales to generate profits could also prove problematic with the abolition of duty free in the EU. Compliance with new EU noise regulations is also forcing some no-frills carriers to buy new aircraft (Skapinker, 1998). Clearly keeping costs down and responding to competition is going to be difficult. Gallacher (1997) advises that partnership has been proposed as a means

of survival for low-cost European carriers faced with fierce competition from incumbents. This would help new-entrants to build critical mass. This is something the USA new-entrants have opted to do in many cases (Walker, 1997).

As has been the case with many aspects of deregulation it is important to look to the North American example and to learn from their experience while taking account of the difference in airline environments in Europe and the USA. There is a need for further research into the operation of low-cost carriers in the European context before a clear picture of their potential for success in the longer term is likely to emerge.

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