Low-Cost Carriers
A Revised Business Model for Future Success

Bachelor thesis within Business Administration
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Jönköping May 2012
Acknowledgements

The authors would like to thank the following people for their help and support in the process of creating this thesis, without you our research would not have been possible.

First and foremost, our tutor Francesco Chirico for his challenging questions and regular feedback that helped guiding us in the research process.

The authors would also like to thank the industry experts for providing us with useful data from the interviews. Especially, Lufthansa Consulting for taking their time and sharing their great knowledge.

We would also like to express a sincere gratitude to the seminar group for their valuable comments and feedback throughout this course.

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Bachelor’s Thesis in Business Administration

Title: Low-Cost Carriers – A Revised Business Model for Future Success
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Date: 2012-05-18
Subject terms: Airline, aviation, LCC, business model, low-cost carrier, strategy, success, challenges, market environment, nonmarket environment

Abstract

Background: For the last 40 years the average profit margin in the airline industry has been 0.1%, which clearly shows how tough the market is. One reason for this is the constant evolution of the industry due to the countless factors affecting the market. This creates a continuous appearance of new challenges in various contexts faced by the airlines. However, earlier research has shown that because of the low-cost carriers’ unique cost structure they are affected further by a number of the challenges compared to other airlines. This threatens their operational efficiency, which is fundamental for their profitability. Therefore, new ways to maintain profitability and create future success has to be found.

Purpose: The purpose of this dissertation is to help LCCs improve their success and profitability. In order for that to happen the major challenges in the market and nonmarket environment faced by European based LCCs ought to be identified. In light of the recognized challenges, the homogenous elements of the LCC business model will be scrutinized and the model will be revised with added, removed and modified elements.

Method: In order to meet the purpose of this study, the authors chose an abductive approach by firstly conducting an extensive literature review to get a general understanding of the industry. Thereafter, qualitative semi-structured interviews with industry experts and various aviation companies were conducted. This enabled the authors to identify the major challenges faced by LCCs and recognize where the business model had to be adjusted.

Conclusions: In conclusion, the identified challenges have a more significant impact on LCCs than FSCs but the gap between the two models is getting narrower. Consequently, adjustments of the business model are crucial and cover finding additional innovative ancillary revenues, lowering all possible costs, targeting new segments of price-sensitive customers, keeping the employees satisfied and continuously adding value to the offered service.
# Table of Contents

1 **Introduction** ................................................................................. 4  
  1.1 Background ............................................................................. 5  
  1.2 Problem Statement .................................................................... 5  
  1.3 Purpose ..................................................................................... 6  
  1.4 Research Questions ................................................................. 6  
  1.5 Delimitations ............................................................................ 6  
  1.6 Definitions ............................................................................... 7  

2 **Frame of Reference** ...................................................................... 8  
  2.1 Strategy ..................................................................................... 8  
  2.2 Baron’s 4I’s ................................................................................ 9  
    2.2.1 Issues ................................................................................ 9  
    2.2.2 Information ....................................................................... 10  
    2.2.3 Interests ........................................................................... 11  
    2.2.4 Institutions ....................................................................... 12  
  2.3 Ghemawat’s Six Sources of Profit ............................................. 13  
    2.3.1 Volume .............................................................................. 13  
    2.3.2 Cost .................................................................................. 14  
    2.3.3 Differentiation .................................................................... 14  
    2.3.4 Industry Attractiveness/Leverage ....................................... 15  
    2.3.5 Uncertainty/Risk ............................................................... 16  
    2.3.6 Knowledge/Resources ..................................................... 16  
  2.4 Business Model ......................................................................... 18  
    2.4.1 What is a Business Model? ................................................ 18  
    2.4.2 Use and Potential .............................................................. 19  
    2.4.3 Characterizing a Business Model .................................... 20  
  2.5 Low-Cost Business Model ........................................................ 21  
    2.5.1 Value Proposition .............................................................. 22  
    2.5.2 Operating Model ............................................................... 23  
  2.6 Low-Cost Carrier Activity Circle .............................................. 23  
    2.6.1 Service .............................................................................. 24  
    2.6.2 Airports ............................................................................ 25  
    2.6.3 Schedule .......................................................................... 26  
    2.6.4 Sales ................................................................................. 26  
    2.6.5 Personnel ........................................................................... 26  
    2.6.6 Aircraft ............................................................................. 27  
    2.6.7 Operations ....................................................................... 27  
    2.6.8 Pricing ............................................................................... 28  
    2.6.9 Finance ............................................................................ 28  

3 **Method** .................................................................................... 29  
  3.1 Research Approach .................................................................... 29  
  3.2 Research Design ........................................................................ 30  
  3.3 Data Collection ......................................................................... 30  
  3.4 Research Strategy ....................................................................... 31  
  3.5 Primary Data Interviews ............................................................ 31  
  3.6 Types of Secondary Data ............................................................ 32  
  3.7 Data Analysis ............................................................................ 33
3.8 Merits and Limitations .................................................................34
3.9 Rigor and Reliability .................................................................34

4 Empirical Findings .................................................................35
  4.1 Liberalization and Deregulation ....................................................35
  4.2 Fuel, ETS and Environmental Issues ............................................36
  4.3 Taxes .................................................................................37
  4.4 Unions ...............................................................................37
  4.5 Uncertainty ...........................................................................38
  4.6 Consolidation ........................................................................39
  4.7 Competition .........................................................................40
  4.8 Change in Customer Demand ...................................................41
  4.9 Long-Haul for Low-Cost .........................................................42
  4.10 Business Model ...................................................................44

5 Analysis ..................................................................................47
  5.1 Analysis of The LCC Industry .....................................................47
    5.1.1 Corporate Culture .............................................................47
    5.1.2 Cost and Revenue Structure ..............................................48
      5.1.2.1 Ancillary Revenues ...................................................48
      5.1.2.2 Cost .........................................................................48
    5.1.3 Demand and Supply ..........................................................49
      5.1.3.1 Demand .................................................................49
      5.1.3.2 Supply .....................................................................51
    5.1.4 Ownership Structure ..........................................................51
    5.1.5 Taxes and Subsidies .............................................................52
    5.1.6 Further Market Challenges ................................................52
  5.2 Analysis for Revised LCC Business Model ......................................53
    5.2.1 Corporate Culture .............................................................53
    5.2.2 Additional Ancillary Revenue .............................................53
      5.2.2.1 Semi – Bundled Service ............................................53
      5.2.2.2 LCC Distribution System ..........................................54
      5.2.2.3 Additional Revenue Streams ......................................54
      5.2.2.4 Cost Cuts ..................................................................56
    5.2.3 Miscellaneous ...................................................................56
  5.3 Characterizing the Present and Future LCC Business Model ..............57
  5.4 Revised Business Model ...........................................................60

6 Conclusion ..............................................................................62

7 Discussion ..............................................................................64
  7.1 Limitations ...........................................................................64
  7.2 Further research .....................................................................65
  7.3 Implications for Practice ........................................................65

List of references ...................................................................66
Figures
Figure 4 - Ghemawat's Six Sources of Profit ..............................................13
Figure 5 - Relationship between Strategy, Business Model and
          Real - firm world .............................................................................19
Figure 6 - Low-cost Business model .........................................................22
Figure 7 - LCC Activity Circle ...................................................................24
Figure 8 - The Abductive Research Process ...............................................29
Figure 9 - Stages of qualitative data analysis .............................................33
Figure 10 - Revised Business model for European based LCCs.................61

Tables
Table 1 - Baron's 4I's ...............................................................................9
Table 2 - Economic Benefits .....................................................................11
Table 4 - Bodies and tasks .......................................................................12
Table 5 - Interviewees .............................................................................32
Table 7 - Examples of semi-bundled service packages ............................54
Table 8 - Suggestions to additional ancillary revenues ...........................55
Table 9 - Characterizing the present LCC business model .....................59
Table 10 - Characterizing the future LCC business model ......................60

Appendix ..................................................................................................71
Figure 1 - International Airline Regulation Environment .......................71
Figure 2 - Crude oil prices 1947 – 2010 in 2010 dollars .......................71
Figure 3 - Oil consumption and Industrialization 1900 to present ..........72
Table 3 - LCCs represented in ELFAA .....................................................72
Table 6 - Semi-structured interview questions ......................................73
1 Introduction

In this section the reader will be provided with background information and an introduction to the chosen topic. Furthermore, the problem statement, purpose and research questions will be presented followed by delimitations and definitions.

“If the Wright brothers were alive today Wilbur would have to fire Orville to reduce costs”

— Herb Kelleher, Former President of Southwest Airlines, 1994

Neither the Wright brothers (Wilbur and Orville), who successfully invented the first flying machine, nor Neil Armstrong, who was the first person to set foot on the moon, could have imagined that one day a company called Ryanair would offer a flight from Stockholm to Paris for the same price as that of an average lunch.

Starting from the first handmade gliders to massive commercial aircrafts with a capacity of over 600 passengers, the commercial airline industry has faced various ups and downs and has by now turned into a highly sensitive, competitive and challenging market. Ryanair, easyJet and Southwest Airlines are examples of three prominent airlines using a low-cost business approach in which all operational and capital costs are minimized with the objective of offering lower fares than other airlines. Airlines having this cost efficient vision go under the name low-cost carriers (LCCs). One of the LCCs most fundamental business model characteristics is the fact that their offered services are no-frills, which means that no additional features such as meals, transfers and baggage allowances are included in the given price.

The general purpose of having a business model is to create value for a specifically targeted customer group. LCCs’ traditional customer is a price-sensitive person who prioritizes cheap prices over convenience. Nevertheless, some of the LCCs such as easyJet found a new potential customer segment and started to target business travelers by offering flexible one-day tickets to primary airports as well. Basically, this shows that there is no unified business model used by all LCCs. However, there are certain homogenous elements that are widely exerted and will receive particular attention in this thesis. The industry outlook is indeterminate, and in that regard, it is presently unknown what elements of the business models will eventually prevail.

This thesis will embark upon a journey towards the prospective success of LCCs. First, a short history behind the evolution of LCCs will be presented. Second, a strategic analysis of the business environment will be carried out in order to scrutinize the European LCCs’ playground and to identify the challenges affecting their business operations. Third, elements of the LCC’s activity circle will be elaborated on. Fourth, conducted interviews will be presented and summarized to verify, add to and strengthen the secondary findings. Fifth, the analytical section will bring about a revised business model in order for LCCs to remain successful. Finally, the major findings will be presented in a concluding section in the end.
1.1 Background

The airline industry was heavily regulated worldwide in the years up until 1978 when policymakers in the United States (U.S.) decided to deregulate the market by decreasing the government’s involvement. The intentions of this act were to foster a healthy and improved economic growth for the commercial airline industry (Fu, Oum and Zhang, 2010). Consequently, the market turned out to be more accessible with fewer barriers to entry and many airlines became privatized. Among these existing airlines, Southwest Airlines were the pioneers of the low-cost carrier concept, and starting their first operations in 1971. After the deregulation act Southwest Airlines grew rapidly with constantly increasing profits. The liberalization process crossed the Atlantic in 1992 and an Open Skies agreement was established between the U.S. and the Netherlands (Oum, 1998). The European Union (EU) turned into a single market in that same year and its air transport operations today have become almost completely deregulated. Following thus development, also the LCCs in Europe started to grow rapidly and gained market share. However, there are still regulations in practice concerning ownership restrictions and certain intra-regional flights.

The airline industry is considered to be a tough market with high costs and many firms bogged down in the red. This notion can be easily understood when considering that the average profit of the whole airline industry has only been 0.1% over the last 40 years (IATA, 2011). Still, companies are founded and extremely cheap tickets can be offered. Even though the overall industry profit is extremely low, LCCs have outperformed the Full Service Carriers (FSCs) in terms of their operating margin for the last decade. Concretely, Ryanair had an operating margin of 22.7% in 2006, whereas British Airways’ margin is about three times lower at a mere 7.35% (Kumar, 2006). There are about 40 airline companies in Europe today that can be classified as LCCs, and together they account for more than 35% of the intra-European air traffic. The two largest European based LCCs, Ryanair and easyJet carried 68 million passengers in 2006. Until 2011 the number of passengers has increased to over 131 million, which is close to an increment of 100% in 5 years (ELFAA, 2012).

1.2 Problem Statement

There is an endless amount of challenges affecting European airlines due to the constant evolvement of the industry. However, previous research has shown that a handful of these challenges have a more direct and significant impact on LCCs, which are taking the bigger hit as a result of their specific cost structure (IATA, 2010; Karivate, 2004). These challenges can be identified in various contexts and are continuously threatening airlines’ profitability. This constant economic threat only aggravates the necessity for of maximizing operational efficiency, which is a major cornerstone of the LCCs’ business approach.

The balance between customers and suppliers in the airlines’ business world has been disturbed due to developments in the global economy (Teece, 2009). As an outcome, there are more choices available in the market and the customers have changed their
priorities. Although some of the major LCCs’ profits are high, the volatile industry and the high costs are forcing all airlines to re-evaluate their value propositions in order to continue seizing value in this new environment.

The value proposition is the core of a business model and it is constituted by all major elements that contribute to the business activity. If the elements of a business model are not appropriately adjusted to the competitive situation, assets such as superior technology, outstanding labor force or unique leadership skills are not sufficient when seeking sustainable profits.

1.3 Purpose

The purpose of this dissertation is to help LCCs improve their success and profitability. In order for that to happen the major challenges in the market and nonmarket environment faced by European based LCCs ought to be identified. In light of the recognized challenges, the homogenous elements of the LCC business model will be scrutinized and the model will be revised with added, removed and modified elements.

1.4 Research Questions

1) What are the major challenges that threaten the profitability of European based Low-Cost Carriers?

2) How are these challenges affecting the Low-Cost Carrier Business Model used in Europe?

3) How can the Low-Cost Carrier Business Model be revised to make the Low-Cost Carriers more successful in the future?

1.5 Delimitations

The economic world is built up on different economic ideas and capitalistic perspectives. Hence, the business diverges among the various cultures and continents. Emerging markets have a bright future in terms of airline prosperity as they are comparatively young and unshaped, whereas the European market already has an intense route density with fierce competition that is creating more complex and interesting challenges. Established in these reasons, the focus of this thesis will be limited to European based LCCs to make it as powerful as possible. Nevertheless, ideas and thoughts will be brought in from other cultures due to the fact that the airline industry has a two-way relationship with the macro economy (Fu, Oum and Zhang, 2010). The addressed challenges will be chosen depending on the frequency of their recurrence and significance. To limit the boundaries of this thesis the authors have chosen not to consider challenges such as natural disasters since that perspective would be too broad to receive representative results. Finally, due to the industry’s heterogeneity and the many different constellations of the LCC business model that exist, the authors have decided not to include all present LCC business models but instead to focus on the homogenous elements among them.
1.6 Definitions

Airline Service Agreements (ASAs): bilateral agreements concerning air transportation service between countries or regions (Adler, Fu, Oum and Yu, 2010)

Ancillary revenues: revenue generated from goods or services that differ from or enhance the main services or product lines of a company. By introducing new products and services or using existing products to branch into new markets, companies create additional opportunities for growth (Investopedia)

Code sharing: a system by which two or more airlines agree to offer a single ticket and to use the same flight number for connections to a place where only one of them goes (Cambridge University Dictionary Online)

Consolidation: the process of maturation in some markets whereby smaller companies are acquired or step out of business, leaving only a few dominant players (investor-words.com)

Emission Trading Scheme (ETS): tradable-permit system in which a greenhouse gases emitter (firm or country under obligation to limit its total pollution emissions to a specified level) can buy/sell permission to emit a certain amount of emissions from/to other emitters who are below/above their limit(businessdictionary.com)

Fuel hedging: hedging allows companies to lock in fuel prices and margins in advance (EnRisk Partners LLC)

Full Service Carrier (FSC): an airline that provides all types of facilities which make the journey comfortable and hassle free (EzineMark.com)

Hub-and-spoke system: a transport system in which passengers travel from smaller airports to one large central airport in order to make longer trips (Cambridge University Dictionary Online)

Liberalization: to make laws, systems or opinions less severe (Cambridge University Dictionary Online)

Load factor: the number of paying passengers in relation to the number of seats available on a plane during a particular period (Cambridge University Dictionary Online)

Long-haul: A flight, typically beyond six and a half hours in length (Airlines.com)

Turnaround: the time required to get a plane back in service after a completed flight (yourdictionary.com)

Seat pitch: distance between the back end of a seat and the front end of the seat behind it. Also called leg room (BusinessDictionary.com)

Short-haul: A flight under three hours in length (Airlines.com)
2  Frame of Reference

In this section the chosen frameworks will be presented starting with Baron’s 4I’s and Ghemawat’s Six Sources of Profit to give an overview of the industry and to identify the major challenges faced by LCCs. These two frameworks are also necessary in order to conduct a strategic analysis for the revision of the LCC business model. Thereafter, the business model concept will be introduced followed by the general low-cost business model. Lastly, the low-cost activity circle is presented, which contains the main elements of the LCC business model.

Teece (2009) argues that every established company or startup must have an appropriate business model labeling the architecture of the core elements value creation and delivery of a service/product. The design of a sustainable business model is a fundamental element for business strategists when looking at how competitive advantage is achieved and profits are obtained. However, having an appropriately adjusted business model is not enough to ensure competitive advantage. Teece (2009) continues by stressing that if the competitive advantage is supposed to be protected when designing a new or updated business model, the combination of both a strategic analysis and a business model analysis is essential. Hence, this thesis will use two strategic tools: (1) Baron’s 4I’s and (2) Ghemawat’s six sources of profit. These will work as a foundation to structure and to create an understanding of the included airline industry outlook.

According to Baron (1995), the business environment should be divided into two parts: the market and the nonmarket environment. The most notable difference between these two is that competing companies are allowed to cooperate and take joint actions in the nonmarket environment, which is illegal in the market environment to foster competition. For a strategy formulation to be carried out successfully, strategies for both environments are required where the common goal is to improve performance. Incorporating the two strategies creates what Baron (1995) refers to as an integrated strategy. The framework called 4I’s is an extension of Porter’s five forces to cope with the nonmarket environment and it will therefore be used to address and analyze the influence of the external nonmarket factors on LCCs operations. For the market environment a framework developed by Ghemawat (2007) will be used. Ghemawat is another strategist who came up with six different sources of profit for a company when it is acting on more than one market. This framework equally has its origin in Porter’s five forces and the thesis will thus be consistent and will use these two frameworks for the strategic analysis.

2.1  Strategy

There are numerous different characterizations of the term strategy used in business settings. This thesis will use the definition announced by Porter (1996) where competitive strategy refers to performing activities in a different manner compared with the competitors. This opens up opportunities for companies to deliver inimitable value to the customer. Furthermore, Porter (1996) stresses the importance of strategic positioning, and differentiation from a customer point of view.
2.2 Baron’s 4I’s

The nonmarket environment “includes those interactions that are intermediated by the public, stakeholders, government, the media, and public institutions” (Baron, 1995, p 47). To deal with these interactions a nonmarket strategy is used, which includes social, political and legal measures that align firms’ external actions in conjunction with the market. To break down the nonmarket factors Baron (1995) came up with the framework called the 4 I’s; Issues, Institutions, Interests and Information. For an overview, see table 1 below.

Table 1 - Baron’s 4 I’s
Source: Evenett 2011

<table>
<thead>
<tr>
<th>4 I’s</th>
<th>Nonmarket environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issues: threats to or opportunities for profit.</td>
<td>Regulations, proposed laws, court judgments etc.</td>
</tr>
<tr>
<td>Information: what it takes to win</td>
<td>Prejudices, rumors, state reports, press coverage, etc.</td>
</tr>
<tr>
<td>Interests: goals (hopes, fears) of other actors.</td>
<td>Social and economic goals of policymakers, fairness, stability.</td>
</tr>
<tr>
<td>Institutions: ultimate decision-makers and their procedures.</td>
<td>Regulators, non-governmental organizations, elected officials, collective and/or non-unanimous decisions.</td>
</tr>
</tbody>
</table>

2.2.1 Issues

Issues are parts of a matter in dispute between opposing parties and they occur when the stakeholders in question have various interests. Here, issues are addressed by nonmarket strategies and referred to factors disturbing a firm’s performance. High governmental control is at one end of the spectrum, whereas high market control is at the other. The level of governmental control over profitable opportunities is considered as the most significant issue faced by firms (Baron, 1995). In the airline industry, the basis of issues lies in the aviation policy that incorporates the concerned organizations and the application of civil aviation (Kropp, 2011). The major regulation that is still preventing the European industry from allowing completely open skies is the regulation about the intra-European market for airlines registered outside of Europe. However, from an international perspective, ownership restrictions are still profoundly regulated and there are many regulations preventing capital and markets from being easily accessible (Wulf and Maul, 2010). Figure 1 in the Appendix shows an overview of the international airline regulation environment in 2010.
The continuously slowing economy in 2011 has decreased airlines’ ability to boost fares, which would be a desired possibility in face of the increasing fuel costs (Schlangenstein and Credeur, 2011). Figure 2 in the Appendix shows the crude oil prices since 1947 and the related global occurrences that have caused the fluctuations. As can be noticed, the price of oil has had an enormous increase since the terror attacks in September 2001. This rise is of big concern for airlines, especially with the average price of jet fuel increasing with 45% from 2010 to 2011 (Schlangenstein and Credeur, 2011). Furthermore, one should note the world share of oil consumption for emerging economies, which was almost reaching 60% in 2010. Figure 3 in the Appendix also shows data of the oil consumption per capita for five different countries and the difference between developed and emerging economies. The most remarkable numbers are China’s and India’s oil consumption; they use around 2 and 0.9 barrels/year per capita respectively, whereas the corresponding number for United States is 25.

During the 21st century environmental issues have been stressed to a large extent, most of all the carbon dioxide (CO$_2$) emissions. The European Union has dealt with this by implementing an emission trading scheme (ETS) with the purpose of fighting climate change. It means that significant emitters such as airlines are given a cap on how much greenhouse gases they are allowed to emit over a certain period of time and the companies can trade allowances amongst each other within these limits. The emissions must be reported annually and if the given allowances are exceeded, large fines are levied. The allowances are reduced over time with the aim of lowering the total emissions in EU by 21% before 2020 (European Commission, 2010).

### 2.2.2 Information

Information is generally understood as communicated or received knowledge about a particular issue or action. It can create reference points that orient people in their reasoning when comparing options and creating prejudices. Rumors and press coverage are examples of information that can hurt and benefit firms or entire industries. Bad media coverage can create a downward spin spreading false rumors and reputations of well-established brands can be hurt. Another example of bad media coverage is a documentary done by Enrico Porsia (2010) called *Low Cost, Journey to the Land of Wild Capitalism* which displays how Ryanair uses public tax money in form of subsidies as a revenue stream, in other words tricking the system.

Social media have been growing tremendously during the last decade (Kanalley, 2011). Their incredible capacity to spread messages and to reach millions of people in a short period of time is something that airlines are also well aware of. United Airlines discovered this a couple of years ago when the musician Dave Carroll got his checked in guitar smashed when the ground staff loaded it onto the aircraft. Dave created a music video as a response called United Breaks Guitars and it has been seen by 11.9 million people in only 2 years on YouTube.
2.2.3 Interests

Interest is a subjective and often irrational thought which varies depending on the stakeholder in question. Activist or interest groups can cause direct challenges for firms or industries, and nonmarket strategies are critical to deal with these groups (Baron, 1995). If not dealt with, further complications can result in products being boycotted, unlikeable media exposure or any other attempt by such groups to influence consumer preferences and pressuring firms connected to these products (Baron, 1995). The European Union (EU) was announced as a single aviation market in 1997 with 66 countries involved. The signed Airline Service Agreements (ASAs) stated that flights can be operated between EU member states and the countries involved without implications (Fu, et al. 2010). A few months later EU and U.S signed an Open Aviation Agreement (OAA), which was the latest major multilateral aviation agreement signed in the western world. The U.S benefited more than the EU, allowing U.S carriers to operate intra-EU flights, whereas EU carriers were neither authorized to operate intra-US flights nor allowed to have a majority stake in US operators (IACA, 2007). This gave rise to a second stage in the negotiation process where economic incentives were offered to remove the barriers and eliminate ASAs between EU and U.S markets, which combined constitute 60% of the total aviation market (IP/10/371, 2010). Booz Allen Hamilton Ltd (2007) identified the economic benefits from this agreement over a 5-year period, summarized in table 4.

Table 2 - Economic benefits
Source: Booz Allen Hamilton Ltd (2007)

<table>
<thead>
<tr>
<th>Economic</th>
<th>12 billion Euro in additional revenue and 80,000 new jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capacity</td>
<td>26 million additional transatlantic passengers equal to a 34% increase</td>
</tr>
<tr>
<td>Lower fares</td>
<td>Companies and customers can benefit between 6.4 – 12 billion Euro</td>
</tr>
<tr>
<td>Cargo market</td>
<td>1% - 2% growth</td>
</tr>
</tbody>
</table>

The implementation of a Multilateral Statement of Policy Principles, called The Agenda for Freedom was signed in 2009 by the European Commission, and later signed by several other nations worldwide such as the United States, Singapore and the United Arab Emirates. The interest was to open up the skies for airlines, create commercial freedom and more liberty in terms of pricing. The bottom line was to let airlines operate like any other global business (IATA, 2011). The agreement is an imperative statement of common government intentions to drive global aviation policy in order to nourish economic growth, create jobs and further develop tourism (IATA, 2011).

Another interest can arise from labor unions which have a strong interest in labor conditions and employee treatment. Although there are a few exceptions, LCCs prefer not to use unions since it would increase costs in the short run, which has been brought up in
the media recently. An example is Sveriges Television’s (SVT) published news report from February 4th 2012 where Ryanair’s cabin crew and pilots commented on the absence of unions and the terrible working conditions.

2.2.4 Institutions

Institutions differ depending on the matter and industry. For global actors there are national and supranational governmental institutions such as the European Union (EU) and the U.S. Government that have a strong decisive power when assessing the issues. However, industrial regulatory associations, large corporations or collective actions by market actors can also have a significant impact on how the institutions rule and reason in the nonmarket environment (Evenett, 2011). In the airline industry, there are private and public policy bodies on global, regional and national level controlling governments and airlines, see table 2.

Table 4 - Bodies and tasks
Source: Authors’ elaboration

<table>
<thead>
<tr>
<th>Bodies</th>
<th>Task</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governments</td>
<td>The global organ establishing standards and recommended practices for civil air transport to harmonize the political and legal framework</td>
</tr>
<tr>
<td>International Civil Aviation Organization (ICAO)</td>
<td></td>
</tr>
<tr>
<td>European Civil Aviation Conference (ECAC)</td>
<td>An institutionalized cooperation for the EU region, where authorities from all European countries are involved</td>
</tr>
<tr>
<td>Airlines</td>
<td>The global body forming industry standards and considering airlines’ interests with regards to the aero-political developments</td>
</tr>
<tr>
<td>International Air Transport Association (IATA)</td>
<td></td>
</tr>
<tr>
<td>Association of European Airlines (AEA)</td>
<td>The voice of FSCs, offering support to policy making within the EU</td>
</tr>
<tr>
<td>European Low Fare Airline Association (ELFAA)</td>
<td>Endorsing free and fair competition to empower continued growth and prosperity of low-cost airlines in the future. This body is representing the 10 largest LCCs in Europe, see table 3 in Appendix</td>
</tr>
</tbody>
</table>
2.3 Ghemawat’s Six Sources of Profit

Ghemawat’s (2007) six sources of profit for global operations is an extension made to Porter’s five forces with focus on the market environment and on what it might enhance a company in terms of economic profit and value creation. When applying the framework, one should carefully consider when and where profitable benefits can be attained. For example, when assessing an international expansion by acquiring a competitor or opening a subsidiary, the most beneficial source of profit should be devoted maximum attention to. The framework adds an extra feature named “competitive wedge” (Evenett, 2011), which can most easily be explained as the firm’s competitive advantage. Evenett (2011) explains further that firms operating in a single market have the following four potential sources of profit; volume, costs, differentiation and industry attractiveness/leverage. However, when firms operate in multiple markets they have two more sources, namely uncertainty/risk and knowledge/resources. The framework is graphically shown in figure 4.

Component 1 concerns volume as a source of profit that can be used by achieving the optimal level of economies of scale (Stigler, 1958). Caves, Christensen and Tretheway (1984) give a new perspective on this in their investigation when comparing the costs among airlines and they show that density is of greater importance than scale. The economies of density within the airline industry can be explained as the density of traffic or the level of utilization of aircrafts to their destinations. Due to the deregulations of the European market, cross-border M&A and alliances have become more common, which leads to further consolidation of the market (Brueckner and Pels 2005). Furthermore, Brueckner and Pels (2005) state that consolidated airlines improve their profitability by being able to purchase large amounts of aircrafts and fuel at discounted prices, and utilize each other’s aircrafts. Being a part of an alliance implies that the airline in question can fill up its seat capacity more easily, which is an important element for being profitable (Schefcyk, 1993). Currently there are three major alliances active in the

2.3.1 Volume

Figure 4 - Ghemawat's Six Sources of Profit
Source: Ghemawat (2007)
market: Star Alliance, SkyTeam and OneWorld, together covering around 55% of the
global capacity share (CAPA, 2011). While LCCs are not part of any alliance and there-
by have greater focus on density, Ryanair states in their Passenger Charter: “Ryanair
will not enter into alliances with other airlines so that we can pretend we fly to destina-
tions that we actually don't or charge high fares” (Ryanair, 2012).

2.3.2 Cost
The three strategies related to the margin (component 2, 3 and 4 in figure 4) concern the
choice of cost leadership, the differentiation strategy and the issue of industry attrac-
tiveness/leverage. The two components cost and differentiation together forms what
Evenett (2011) refers to as the competitive wedge, which is derived from Porter’s
(1985) generic strategies.

The cost leadership strategy emphasizes a focus on lowering operating as well as capital
costs. Additionally, cost leadership strategies can be based on superior access to mater-
ial, the use of a cost-saving technology and/or economies of scale (Porter, 1985). Porter
argued in his later work from 1998 that a “low-cost producer status involves more than
just going down the learning curve. A low-cost producer must find and exploit all
sources of cost advantage” (p 12). Ghemawat (2007) also stresses the importance of not
only focusing on scale and scope but additionally on factors such as location and ca-
pacity utilization. The latter is of particular importance for low-cost carriers and their
cost structure, but actually the whole airline industry is paying attention to the capacity
utilization due to the rising fuel prices. These results in increased costs, which have to
be balanced out one way or the other. One of the consequences is a clear demand for
more competent aircrafts in terms of fuel efficiency.

Amit (1986) argues that investing in cost leadership creates long lasting effects and is
an investment in competitive advantage. This has been the case in the whole airline in-
dustry since the introduction of LCCs, which decreased operating cost and increased
operational efficiency. Nevertheless, a company pursuing a cost leadership strategy
must consider the differentiation aspect since the product or service must be perceived
as qualitatively comparable to the rest of the market, and not only be have a low price
(Porter, 1985).

2.3.3 Differentiation
Porter (1998) claims that “in a differentiation strategy, a firm seeks to be unique in its
industry along some dimensions that are highly valued by buyers” (p 120). Fur-
thermore, Porter (1985) argues that the differentiation strategy or seen from customers’ perspec-
tive an increase of willingness to pay can arise from any part of the firm’s value
chain and should not be considered as a result of the firm’s cumulative activities. This
implies that a company should choose one feature or more that the potential customer
perceive as significant and are willing to pay a price premium for. Such features in a
differentiation strategy can be achieved when focusing on brand building or services
beyond the commodity itself (Ghemawat, 2007).
In the airline industry, brand building is becoming particularly more important as Michael O’Leary, the CEO of Ryanair said in 2010:

“Growth rates start to slow down significantly and it becomes more about the brand game, telling all the lies that you need to tell to get the fares up” (BBC, 2010). The two major cornerstones for differentiation strategies in the airline industry are (1) offering premium services as FSCs commonly do or (2) offering unbundled services where additional services such as checked in luggage or meals are only provided for an extra fee. The latter gives customer the opportunity to pay for what is desired instead of sweepingly paying for more than they actually want. Furthermore, it is important to remember that different customer segments have different needs, and deeper differentiation might have potential benefits (Ghemawat, 2007). For example, easyJet is a low-cost carrier that has started to target business travelers who have a greater need for convenience. Another aspect that differentiates FSCs’ and LCCs’ strategies is the distance of their flights. LCCs tend not to fly long-haul due to the difficultness of having profitable margins with increased costs and still offering low fares. Nevertheless, with the European short-haul market maturing, LCCs have started to consider and test the potential of long-haul low-cost flights as a new source of profit (Francis, Dennis, Ison and Humphreys, 2007). Porter (1985) also argues that the two strategies cost leadership and differentiation, are hard to combine since a differentiation strategy potentially entails more costs. On the other hand, a differentiation strategy can be a mean for achieving low cost (Hill, 1988). Equally, Hall (1980) claims that the differentiation strategy and cost leadership are not inconsistent even though many of the most successful companies are best in either one or the other.

2.3.4 Industry Attractiveness/Leverage

The fourth source of profit, the industry attractiveness / leverage, is essentially reflected in Porter’s five forces: bargaining power of suppliers, bargaining power of buyers, competitive rivalry, threat of new entrants and threat of substitute products and services (Evenett, 2011). The five forces analyze the potential profitability of an industry and can help when constructing a strategy or examining an industry as a whole (Porter, 1980). Moreover, Ghemawat (2007) makes use of these forces in order to evaluate how the industry can contribute to profits in global operations. As mentioned before, the airline industry is very complex but LCCs’ success shows that there are numerous opportunities for profit making. However, since a five forces analysis of the airline industry would be extensive enough for a thesis on its own, the authors have chosen to briefly mention the major forces affecting airlines to provide a general understanding. Nevertheless, the actual Ghemawat framework can implicitly be considered as an industry analysis since it touches on many of the concerned forces.

Practically, the airlines always used to have two different aircraft manufacturers to choose from (Airbus and Boeing), but now there are Russian, Chinese and Canadian aircraft manufacturers that have joined the scene and pushed competition further among the suppliers (Economist, 2011). Regarding the substitutes within the airline industry there are not that many alternatives to flights, especially not for the longer ones.
But, in some regions high speed trains can substitute flights and another alternative can be videoconferences.

Wensveen (2007) argues that a successful entry to the airline industry requires large amounts of capital. However, loans and investments are easily accessible when the economy is booming and new carriers tend to enter the market even though the industry’s average profit over the last 40 years has been at only 0.1% (IATA, 2012). Furthermore, Wensveen (2007) states that the price-sensitive customer within the airline industry has gradually shifted towards prioritizing low price over short traveling time. Finally, maturing markets in an industry with a low average profit margin creates fierce competition for market share, which demands innovation and further expansions for continuous growth.

2.3.5 Uncertainty/Risk

Lancaster (2003) argues:

“Every business faces risk. Without risks, no company would be able to achieve anything or make a profit. The question every business faces is how to balance risk and reward. To do this the corporate entity must understand its risk set, the sources of those risks and the costs associated with operating within the particular set of risks. Airlines are no exception” (p 158)

The concept of normalizing risk is something that has become more common in every business and is used as a tool for generating more profit. Smithson’s and Simkins’ (2005) research showed that 92% of the world’s 500 largest companies that normalized risk also achieved higher profits. Ghemawat (2007) discusses both the importance of separating the sources of risk and the extent to which they affect a company. The risks considered here are supply and demand side risks, which can hypothetically be delays in the delivery of ordered aircrafts or greater use of videoconferences. However, risks can bring about benefits and can be considered as a source of profit. Risks should therefore be taken into account in combination with a reduction of undesired hazards (Ghemawat, 2007). Carter, Rogers, and Simkins (2004) showed in their research that there is a positive relation between fuel hedging and firm value, which means that hedging fuel can decrease airlines’ costs substantially. Several airlines have normalized risk by developing global alliances and have thereby obtained a better position in the market (Lufthansa, 2010).

2.3.6 Knowledge/Resources

Generating and deploying knowledge reflects how knowledge can be absorbed and spread within the company most easily and efficiently (Ghemawat, 2007). A high level of knowledge efficiency can be achieved through implementing company policies and guidelines for best practices within all domestic and international operations, for example, by replicating a successful business procedure in one market and adapting it to another. Bhatt (2002) discusses the progressive importance of knowledge management by stating that: “Faced with global competition and increasingly dynamic environments, organizations are being advised to assemble people of diverse talents and employ their
expertise to gain access to new markets and new technology” (p 31). Beyond only having the knowledge, a company should know how to use it properly since otherwise the knowledge is not as valuable.

An example of this was when a major American airline had to cancel the majority of its flights due to a snowstorm resulting in thousands of customers stranded on the airport. They were aware of the storms’ arrival and theoretically knew how to tackle it but were not able to turn the crisis into an opportunity by showing care for their customers. As a result, the company’s market position was heavily harmed (Basadur and Gelade, 2006). In contrast, Colvin (1997) describes how the company Southwest Airlines successfully manages its knowledge: “Its culture allows its employees to acquire knowledge quickly both from its clients and from fellow employees. It allows employees to use the knowledge instantaneously as they make decisions, and encourages employees to disseminate their knowledge to colleagues. Its culture rewards learning and the development of others. As such Southwest’s employees are able to provide very high levels of customer satisfaction, thus generating the repeat business that keeps it competitive” (p. 299).

Finally, Ghemawat (2007) argues that knowledge/resources as a source of profit can already have been implicitly covered under other sources and double-counting should be avoided.

One of the main ideas behind Ghemawat’s (2007) framework is to maximize the potential of a business by looking at one or several prospective sources of profit. When analyzing a business through this lens the importance is to remember that not all the components might be relevant for every industry because the application of the framework does not work as a system of simply ticking off boxes. Nevertheless, all components should be considered since they might differ in relevance over time. One source might also endanger another, which is another issue that should not be overlooked when using the framework.

Lastly, according to Ghemawat (2007) there are three questions that should be asked to validate the strategic choice:

1. Is the selected strategic option likely to lead to sustained value creation and capture?
2. Does experience tend to confirm or contradict the results of the analysis?
3. Has enough attention been devoted to considering whether any better alternatives can be devised?
2.4 Business Model

2.4.1 What is a Business Model?

The business model concept itself has not been devoted much attention to in economic theory or literature before the 1990's. Despite the fact that lately more scholars have tried to tackle the concept of business models but, Linder and Cantrell (2000) still argue that business models are only moderately understood even though many pages have been written with the intention to clarify. Also, there is no common consensus about how to define it, how it is ought to be structured, the nature of the concept and the evolutionary course of business models (Morris, Schindehutte and Allen, 2005). This lack of unanimity made Morris et al. (2005) interested in researching the available perceptions of a business model and so they summarized the most common components. The outcome showed 15 recurring components with 6 being cited most frequently: (1) the firm’s value offering, (2) economic model, (3) customer relationship, (4) partner networks, (5) internal infrastructure, and (6) target markets. This ambiguity around business models has raised confusion when it comes to terminology and has resulted in an interchangeable usage of the terms *business model* and *strategy*. What is the point of having two expressions for the same thing? Are they that similar? A very comprehensive discussion trying to examine this issue was brought up by Seddon, Lewis, Freeman and Shanks (2004), and their definition of a business model and distinction between strategy and business model will be used in this paper. As mentioned earlier, a strategic analysis is crucial when creating, updating or renewing a business model (Teece, 2009) and the research done by Seddon et al. (2004) determines that a business model is an abstraction of strategy thus represents certain aspects of a firm’s strategy. A strategy is denoted as firm specific, whereas a business model can be applied to more than the firm in question. To avoid confusion, the definition of strategy is described above in section 2.1 and is based on Porter’s papers from 1996, which arguably can be viewed as a very comprising definition based on 50 years of thinking at Harvard School of Strategy (Seddon et al. 2004). How do the concepts differ? Since the term business model is now defined as an abstraction of the strategy, the two definitions contain closely related elements. However, the major difference is that business models are focused on the core logic and value creation, whereas strategy has the competitive positioning as a priority (Seddon et al. 2004). For a graphical overview of the relationship between business model, strategy and a real-world firm, see figure 5.
2.4.2 Use and Potential

The true potential and use of business models are presented by Osterwalder, Pigneur and Tucci (2005). The authors outline five categories of business models’ functions, namely **understanding and sharing**, **analyzing**, **managing**, **prospect**, and **patenting**:

- **Understanding and sharing** highlight that business models can aid to clarify the business logic through communication, visualization, understanding and sharing. Since a business model represents the business concept it should always be known and communicated throughout the organization.
- **Analyzing** a company’s business logic is easier when using a business model. In other words, a business model can be seen as a new analytical component that helps measuring, observing and comparing the logic of a firm.
- Using a business model can also enhance the **management** of a firm and as a result changes in the business environment can be dealt with more quickly. Additionally, a better fit between strategy, business organization and technology can be developed.
- **Prospects** for the potential future of a company can be described with help from a business model, and it is also argued that business models foster innovation.
- **Patenting** is a legal area where business models started to be a subject. Since the dawn of e-businesses, one example is the legal dispute between Amazon and Barnes & Noble concerning the one-click ordering system (Osterwalder et al. 2005)
2.4.3 Characterizing a Business Model

Many theories have contributed with elements and perspectives of business models but there is not an explicit theoretical foundation behind it. The development or rearrangement of a business model is a complex task that Morris et al. (2005) facilitated by presenting a standard framework for characterizing a business model. The framework has three levels of decision making: foundation, proprietary and rules.

- The *foundation level* represents broad consistent decisions defining what basic pillars the company stands on. Outlining these allow comparisons and identification of universal models.
- The purpose of the *proprietary level* is to customize the elements in order to reassure that the focus is placed on value creation. Hence, it entails internal innovation.
- *Rules* are used as a guiding framework for business operations, and they control the implementation of decisions made at prior levels (Morris et al. 2005)

Within each level there are six decision components answering the six questions assembled below.

<table>
<thead>
<tr>
<th>Component</th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <em>Factors related to offering</em></td>
<td><em>How do we create value?</em></td>
</tr>
<tr>
<td>2. <em>Market factors</em></td>
<td><em>Who do we create value for?</em></td>
</tr>
<tr>
<td>3. <em>Internal capability factors</em></td>
<td><em>What is our source of competence?</em></td>
</tr>
<tr>
<td>4. <em>Competitive strategy factors</em></td>
<td><em>How do we competitively position ourselves?</em></td>
</tr>
<tr>
<td>5. <em>Economic factors</em></td>
<td><em>How do we make money?</em></td>
</tr>
<tr>
<td>6. <em>Growth/exit factors</em></td>
<td><em>What are our time, scope, and size ambitions?</em></td>
</tr>
</tbody>
</table>

Component number four will be left out when assessing the framework in this paper, based upon the chosen definitions of and distinction between business model and strategy delineated earlier.
2.5 Low-Cost Business Model

There is a fairly recent trend in business models today, which is the low-cost business model that has brought about enormous changes in global markets. The trend towards low-cost first started in emerging economies. However, it did not take too long for it to spread to developed countries. Since globalization plays an important role in transferring knowledge and innovation, multinational firms in developed countries have followed this trend and used it to ensure additional value creation.

Kachaner, Lindgardt and Michael (2011) gathered all the aspects from the low-cost business model and then analyzed it from both the companies’ and the competitions’ perspective.

The current economic situation in developed markets has forced companies to offer new and innovative ways of delivering low cost products and services. However, the low-cost concept may carry different meanings in customers’ mind. Kachaner et al. (2011) present the low-cost business model as “a truly new value proposition that addresses both existing and new customers and is supported by a novel operating model” (p 43).

The understanding of low cost business model varies and although sometimes perceived that way, lowering cost does not necessarily mean lowering the quality. There are four important key points that Kachaner et al. (2011) persistently point out in order to prevent misconceptions of the model.

“Low cost is not low margin. It can be highly profitable.
Low cost is not low quality. It usually entails a narrower range.
Low cost is not cheap imitation. It is true innovation.
Low cost is not unbranded. It is frequently supported by potent brands” (p 43)

Although, every low cost business model differs among various industries and firms, most of the successful low-cost business models have been formulated on similar key elements as cornerstones. The general characteristics of the low-cost business model rely on two main elements strongly tied together: value proposition and operating model, see figure 6.
2.5.1 Value Proposition

The value proposition of a business model consists of three fundamental features, (1) **Target Segments**, (2) **Product or Service Offering** and (3) **Revenue Model**. These will be explained according to the low-cost business model.

**Target Segments**: As a first step, it is important to focus on the price-sensitive customer since that is the core idea of the model. When identifying the price-sensitive customer segment, the segment borders must be defined clearly. This also includes considering customers’ preferences and acceptance towards the products or service (Kachaner et al. 2011).

**Product and Service Offering**: The low-cost business model should focus on creating unique and extreme offers rather than marginal ones. The innovators strictly avoid any additional frills that create cost or complication. Kachaner et al. (2011) also point out the importance of creating a brand by saying that a “brand can be important to establish presence and trust as can designing high core service standards” (p. 44). Unbundling products or services gives an opportunity to shape the extreme offers to customers, and it may generate a lucrative cash flow, which will be explained in the revenue model.

**Revenue Model**: As already mentioned above, a low-cost business model should focus on customer segments in which the price sensitivity plays a critical role.
This practice is strongly correlated with the revenue model. Since the customer is aware of the core product or service, the pricing should focus only on these. Ali Sabanci, CEO of Pegasus Airlines, states that in order to create a strong revenue stream from the targeted customers, all kinds of frills should be eliminated (2010).

2.5.2 Operating Model

In the Operating Model there are three core elements: (1) Value Chain, (2) Cost Model and (3) Organization. These elements will also be explained according to the low-cost business model.

Value Chain: The value chain is focusing on adding value to the product/service through many different activities. The idea is to acquire an optimized asset base in which innovators should outsource additional activities but retain the core activities in-house. The advantages of doing this are “leverage up-to-date, standardized assets to facilitate scale-up and keep maintenance costs low” (Kachaner et al. 2011, p 43).

Cost Model: The cost model involves setting a specific target for the cost, which is in line with the delivery of the value proposition. By using this as a starting point, a firm can work backwards to reach the target. In practice, this is usually done by applying a low cost procedure from sourcing through distribution. Nevertheless, it may be advantageous to spend more money on areas that are critical to the firm’s value proposition.

Organization: An effective operational plan has to be created within the organization. Employees should be aware of the main idea of the low-cost business model and any kind of entrepreneurial activities should be supported. The human resource policy should be radical and a right person to right position mentality should be adopted by the organization (Kachaner et al. 2011).

2.6 Low-Cost Carrier Activity Circle

As previously mentioned, the deregulation acts gave birth to free market entrance and exit by opening up a new area in the airline industry. The outcome generated interest in a new type of business model within the airline industry, namely the low-cost approach.

Figure 7 is a LCC activity circle including all the fundamental elements of the low-cost carrier business model, but it is not a business model. Its purpose is to identify the main characteristics of low-cost carriers in the airline industry. However, it is important to mention that each low-cost carrier practices many of these elements but not all. Hence, the LCC industry is heterogenic (Vespermann and Holztrattner, 2010). Depending on the market-, pricing- and cost strategy, the low-cost airlines might choose different elements to emphasize and implement.

### 2.6.1 Service

Offering no free meals onboard and no free baggage allowance aims to reduce the cost as well as the time aircrafts spend on ground. These are key components in the unbundling process of services and enable LCCs to offer low fares to customers. Additionally, more baggage and beverages loaded cause greater fuel consumption, which means added cost to airlines and higher fares to customers (Air-Scoop, 2011).

By not assigning any cost-free seat reservation to passengers, LCCs seek to reduce the delays since passengers tend to move fast and be on time or even early to get a better seat in the aircraft. The most time consuming activity for airlines is the check-in process of baggage as Michael O’Leary, CEO of Ryanair mentioned this during his speech at the Innovation Convention 2011 in Brussels:
“As everybody knows in the airlines business, when Moses came down from the mountain top, the first commandment was thou shall not be commit murder, and the second commandment was thou shall have an inhalable right to check in a bag on an airline free of charge. We don’t think so because this is the most useless service ever invented by mankind”

It is obvious that if a passenger does not have any other baggage than a carry-on baggage, there is no need to come to the airport one hour before the flight and get in the check-in line. The LCC gives an opportunity to check-in online and to print the boarding pass in advance. If considering 75 million passengers per year and 75 million boarding cards, avoiding the printing deliberately reduces the cost (Michael O’Leary, 2011).

Since the intention is to offer the lowest fares to customers, LCCs tend to cancel the business and first class services and instead replace them by a one class service. This allows LCCs to squeeze in more economy class seats, hence, creating more capacity as well as reducing the risk of flying empty seats in business class. Also, there are no lounges at the airport which eliminates the cost of rent and additional service (Dobruszkes, 2005).

2.6.2 Airports

According to Vespermann & Holztrattner (2010), larger airports are the natural monopolies in aviation. However, secondary airports try to tap into this market by offering lower landing fees with less congestion. Airport costs are roughly 12% of the total cost. Therefore LCCs are striving to decrease these as much as possible (Doganis, 2001). When it comes to airport choice, there are different determining factors that exist such as low charges, basic terminals and quick turnarounds. Of course, there are also some drawbacks of secondary airports such as their location, which is usually far from the city center and in a limited catchment area (Warnock-Smith & Potter, 2005).

According to Warnock-Smith & Potter (2005), one of the significant features of LCCs’ operations is flying to secondary or regional airports. However, the drawbacks have made some of the LCCs such as easyJet change their airport strategy and they tend now to fly to low-cost terminals in primary airports. The most prominent effect of low-cost terminals in primary airports is the easy access to city centers. Still, these have their drawbacks as well since the low-cost terminals are usually far from the main terminal and might be missing basic amenities such as aerobridges or railway connections. Most of the low cost terminals do not offer any kind of connecting facility with the main terminal, which creates several difficulties for transferring passengers who need to re-enter the security check before a second custom check when connecting to another flight (Air-Scoop, 2011).
2.6.3  **Schedule**

LCCs want to keep the costs down and thus are extremely negative about offering connecting flights. Delays in the air traffic might come from connecting passengers changing flights and can create a very disadvantageous domino effect for the rest of the air transportation. Therefore, low-cost carriers fly short-haul point-to-point destinations (Dobruszkes, 2005).

Since LCCs due to their low level of investments have low entry and exit barriers in comparison to other airlines, the number of destinations is quite high and dynamic. These aspects allow LCCs to organize a multiple base system in different countries, which results in a better traffic flow. Additionally, secondary airports tend to accept LCCs’ operations since these airlines are crucial for the future cash flow (Porsia, 2010). All these aspects create a strong incentive for LCCs to access new destinations and to exit from non-profitable airports. As a benefit of low landing fees in secondary airports, LCCs can increase their take-off and landing frequencies, which gives them a competitive advantage due to the wider range of offered flights for the customers (Alamdari and Fagan, 2005).

2.6.4  **Sales**

Chang and Shao (2010) argue that one of the biggest cost components for airlines is the cost of employees. LCCs are seeking possible ways to keep the employee costs down by offering all services online such as customer service, ticketing and sales. These implementations give an opportunity for LCCs to avoid the agency commissions and Global Distribution Systems (GDS) fees (Mason, 2000).

FSCs generally use the GDS, which are worldwide computerized reservation systems covering flights, hotels and car rentals that are reachable from a single point a time. However, these GDS companies (Amadeus, Galileo, Sabre etc.) demand high fees for airlines to be registered into the system. Hence, the LCCs prefer to operate their sales online through their webpage since it reduces the cost substantially.

There is another service typically offered by FSCs called Frequent Flyer Programs (FFP), which LCCs are not willing to offer due to the additional cost components (Klophaus, 2005). The CEO of Ryanair, Michael O’Leary confirmed in his speech at the Innovation Convention 2011 that Ryanair is not willing to offer FFPs because obviously LCCs cannot afford to give away free flights and create additional personnel and operational costs if unnecessary.

2.6.5  **Personnel**

As already mentioned, low personnel costs are imperative. LCCs therefore try to find efficient and relatively productive crew members who accept the work conditions and wage rates that the LCCs can offer. Generally, LCCs’ personnel do not have any unions, which would usually support their strike rights and salary negotiations. However, LCCs are still under regulation of local labor ministries (Alamdari and Fagan, 2005).
Usually, the personnel of LCCs have a very tight and strict schedule with more job assignments than in the FSC working environment. According to Dobruszkes (2005), LCCs’ cabin crews need to have additional responsibilities such as loading the luggage and assisting with the ticketing service. The recent implementation of banning night flights due to noise restrictions e.g. in Germany, are not applicable for the majority of the LCCs since most of the secondary airports are being far from the city center where the ban is not effective. This creates an opportunity for the LCCs to maximize the utilization of their employees with flexible working hours. Furthermore, there are various ways to motivate employees. One is having an encouraging corporate culture, and another one is offering the right to buy a specific number of shares at a fixed price, which is called the employee stock program, the latter of which is usually practiced by LCCs in Europe.

2.6.6 Aircraft

Aircrafts are very expensive assets to acquire and maintain and every additional second that an aircraft is on the ground creates further cost for the airlines (Button, 2009). Therefore, it is very important to utilize the aircrafts efficiently and make short turnarounds to break even and eventually generate profit. To maximize the utilization of the aircrafts, the right type of aircraft and its features are imperative. In the air transport industry, economies of density are extremely important due to the inherent utilization factor. According to Dobruszkes (2005), “in the air transport sector, economies of density are essential and much more effective in reducing unit costs than economies of scale” (p 250). Therefore high seat density and short turnarounds are crucial for LCCs. Also, aircrafts are expensive due to the highly technological parts and the oligopoly in the market situation. LCCs tend to have one type of aircraft, which usually is a very cost-efficient B737 or A319. The choice of one type allows LCCs to have less costly training for the flight attendants and pilots (Franke, 2004). Another important aspect of LCCs’ aircraft strategy is to outsource maintenance, repair and operations (MRO) services which are also being facilitated when one aircraft type is used. Hence, LCCs try to lower costs and at the same time order a large amount of aircrafts at once to reduce the price by letting two manufacturers (Boeing and Airbus) compete with each other (Air-Scoop, 2011).

2.6.7 Operations

Another way of cutting costs is by focusing on operational efficiency. Since the European LCCs operate short-haul flights, there are no overnight accommodation costs for crew members. LCCs also try to keep the number of crew members at the legal minimum with maximum responsibility, and often omit cleaning the aircrafts in order to shorten turnarounds (Porsia, 2010). The productivity of ground services equally affects the short turnaround times and is therefore essential for LCCs efficiency. Ground staff is responsible for everything as soon as the aircraft touches down, which include fuel refill, transportation of baggage and aerobridges. Efficient operations are the core of the LCC business approach since many costs can be cut that may finally decide over the profitability of the entire enterprise.
2.6.8 Pricing

In contrast to traditional airlines, the pricing strategy of LCCs is based on unbundling the services to exclude no-frills from the original price of the ticket. For each additional service or product that is desired, an extra fee is charged. Therefore, the pricing strategies of LCCs are very dynamic (O’Connell and Williams, 2005)

LCCs use the first come first serve principle. Offering same conditions and obligations to each customer is advantageous in order to reduce the different ticketing rules.

Generally, there are no refunding or rebooking possibilities for the passengers. However, if the passenger desires to change or rebook a ticket that has already been issued an additional fee is levied (Alamdari and Fagan, 2005).

LCCs offer incredibly low prices, particularly with the intention of effective promotion in the public. The reason for this is to catch the price-sensitive customers’ attention and buying power. Ryanair often uses this low-entry pricing method and sometimes offers a scarce amount of one-euro flights to many destinations, bringing the low-cost approach to an all new level of attention and desirability (Air-Scoop, 2011).

2.6.9 Finance

The finance structure of LCCs’ is based on ancillary revenues. As explained earlier, unbundling the products and services leads LCCs to generate more revenue streams. According to Gillani (2010), European customers are less price-sensitive to additional items not included in the ticket price. Implementing ancillary revenues has a significant impact on customers understanding of the core service. Therefore, LCCs aim to re-educate their customers’ by making them aware of the fact that they only pay for the seat and the flight (Gillani, 2010). According to IdeaWorks (2011), Ryanair derives almost 21% of their total revenues from ancillary revenues, easyJet a similar percentage of 19.2 %. These revenue streams can be extra baggage fee, seat reservation fee, airport transportation fee, booking fee, credit card usage fee and so forth. The revenue percentages differ since each LCC uses different elements but they all constitute a major source of profit.
3 Method

In the following section, the reader will gain insight into the empirical data gathering process used to fulfill the purpose of this study. Authors will discuss and justify the chosen methods and will explain the different reasons behind the choice.

3.1 Research Approach

After identifying the extent of previous research on LCCs’ business model, which was less than to be expected, the authors began to search for theories that could be helpful for fulfilling the given task. Meanwhile, the authors started to collect empirical data in the field by interviewing different industry experts to identify the major challenges for LCCs and potential shifts in the existing business model. Next, the resulting theories were tested for whether they are sound enough for analyzing the challenges and revising the business model in general. After completing the empirical findings, the authors realized the need for extension of the frame of reference by adding further theories and models, in order to create a coherent whole. Then, the authors combined the findings with the frame of reference, and a clear pattern of results was laid out for interpretation. Finally, the authors took the liberty to revise the LCC business model also graphically on the basis of the analysis. According to Saunders, Lewis & Thornhill (2007), this process is called an abductive approach to research (figure 8) and it is basically a combination of the inductive and deductive approaches. This means that the researcher deduces the individual experiences within a pre-determined framework, focuses on adding a new understanding and produces a new theoretical framework (Dubois and Gadde, 2002).

The deductive approach involves developing a theory that is subjected to a rigorous test where laws present the basis of explanation. It allows for anticipation of phenomena and predicts their occurrence. On the other hand, the inductive approach does not require the researcher to start directly with a certain prearranged theory or conventional framework (Saunders et al. 2011) and instead, data is collected and the theoretical part is developed only after the data analysis.

Figure 8 - The Abductive Research Process
Source: Kovács and Spens (2005, p 139)
3.2 Research Design

According to Saunders et al. (2011), the research design is a certain plan in which the researcher clarifies the way of answering the research questions. From an academic perspective, the research design can differ depending on the area of research. Nevertheless, the rationale is that the research questions should be answered for which there are three different designs to choose from: Exploratory, Descriptive and Explanatory Studies.

*Exploratory study* is a way of finding what is happening by having a broad view of the research. In an exploratory study, research is flexible and leaves space to change the direction as soon as new data from one of the following three types of sources is discovered: (1) existing literature, (2) interviews with experts and (3) focus groups (Saunders et al. 2011). Researches focusing on certain relationships between two or more of the tested variables may be termed *explanatory studies*. In turn, if a phenomenon, event or person mainly requires pure data collection, the according research is termed a *descriptive study* (Saunders et al. 2011).

As mentioned before, the abductive research process will be the basis of this study. Hence, the major focus of the authors will lie on exploring challenges that are affecting the European LCCs and creating a link between the primary data and flaws in the existing business model in order to come up with a revised version for the future success of the European LCCs. This process requires a certain flexibility since the airline industry, especially the LCCs industry, is very dynamic and sensitive and has not been researched to a great extent so that discovering new data may have powerful implications. Therefore, the exploratory study has been chosen as the most appropriate research design.

3.3 Data Collection

Every research has several basics when it comes to data collection. Saunders et al. (2011) state that there are two types of techniques for collecting the right data. These techniques are called *quantitative method* and *qualitative method*. *Quantitative data selection* is a term used for any type of data selection that either uses or generates numerical data. *Qualitative data selection* is a term used for the opposite, which means non-numerical data (Saunders et al. 2011).

In this thesis, the authors have used qualitative data in order to shape the analysis, fulfill the purpose and answer the research questions. Using qualitative data provided an in-depth understanding of the real issues in the industry. With respect to the industry’s sensitivity and the lack of history, numerical data would not endow significant results. Additionally, numerical data would not help the authors to completely understand the market and nonmarket challenges, and therefore to fulfill the purpose of this study due to the inherent complications of quantifying these challenges. After a discussion with several professors on qualitative and quantitative research, the authors realized that the qualitative research method would be the most appropriate data collection technique to apply in this study.
3.4 Research Strategy
There are various research strategies such as experiments, interviews, surveys, case studies, action research, ethnography and archival research. Most of them can be attributed to either the inductive or the deductive approach but since the main intention is to identify the most suitable strategy for the task (Saunders et al. 2011), further classifications are not necessarily purposeful.

During the research on finding the best possible research strategy and techniques of data collection, the authors were in between two options: qualitative interview study and industry case study. However, the initial attempts to conduct interviews with European low-cost carriers failed. There are several reasons for this failure but one in particular was clearly expressed by the leading low-cost carrier representatives themselves. The recent negative publications and documentaries about LCCs forced these airlines to prevent sharing any inside information with the public. This drawback has eliminated the industry case study alternative and left the authors with only one option to gather qualitative primary data, which was conducting interviews with external industry experts.

3.5 Primary Data Interviews
According to Saunders et al. (2011), there are three types of interviews, semi-structured, structured and unstructured. Semi-structured interviews have the main concepts and questions at hand. However, these questions and concepts may be subject to change in the course of the interview (Saunders, 2011). From the beginning, the authors decided to conduct e-mail and phone interviews with LCCs. Nevertheless, the response rate was extremely low and LCCs were not willing to share any kind of strategic information due to internal policy restrictions.

In the meantime, the authors became aware of the fact that a travel event called ITB was held in Berlin in mid-March. This event is known to be the world’s largest travel trade show where many of the leading airlines, airports, aviation consultancy firms and travel agencies attend. The group decided to send down one of the members to Germany with the hope of getting corporate access and conducting interviews, which turned out to be a major success. Thirteen semi-structured interviews with senior consultants and leading FSCs were managed (table 5) and gave various and most likely unbiased information for the dissertation as well as enough room for interpretations. This type of interview technique was chosen since it is the only one that allows collecting a maximum amount and variety of information. It also gives insights into the real dynamics between the different aspects that are being discussed. Basically, it enables the authors to specify a predetermined framework in which their own views and perspective can be included to keep a clear path in the conversation while equally offering space for new ideas and influences from the interviewee through interview questions (table 6).
3.6 Types of Secondary Data

There are three types of secondary data: *Documentary secondary, Multiple Source* and *Survey data*, which according to Saunders et al. (2011) are each divided up in two parts: written and non-written.

The authors of the thesis focused primarily on written and non-written documentary secondary data. It was especially crucial to gather enough information on the LCCs’ business model due to the fact that European LCCs have been rejecting any kind of information sharing with external parties. Therefore, the written data comprise of consulting and annual reports of European LCCs, research papers, journals and interview scripts of top management of European LCCs done by other researchers. The non-written data used consists of online video recordings of specific documentaries about leading LCCs in Europe as well as of media accounts on social video websites.
By observing all the available data in the airline industry, the authors were able to minimize the initial lack of primary data on LCCs.

3.7 Data Analysis

Every study needs a certain data and analysis due to the fact that results from the data collection can change the research’s direction.

“The techniques, the nature of the respondents and the issues explored can change and evolve as a project develops” (Malhotra & Birks, 2006).

The process of data analysis for this qualitative interview study consists of four important steps. In order to analyze the data perfectly, the authors followed these steps and tried to get results of best quality (figure 9).

The first step of the process is called qualitative data assembly where all the data of the research is gathered in its rich and varying formats (Malhotra & Birks, 2006). The authors have prepared the audio tapes and their transcripts, secondary data from industry, company reports and literature reviews.

The second step of the process was reducing the data which means to extract and select the important data from the data cluster. In order to capture the most relevant data, a coding procedure, which aims to organize the data in certain themes or codes has been used. Ten different themes have been identified in the empirical findings section with the help of the coding procedure which allowed the authors to handle the massive amount of raw primary data (Malhotra & Birks, 2006).

For the third and fourth step, the authors displayed the data. Displaying data is another procedure where the authors summarize and present the reduced data. According to Malhotra & Birks (2006), there can be many ways to summarize and present the data such as using a graphical format or spreadsheet as well as choosing appropriate verbatim quotes for illustration of the issues under ten different data themes.

As a final step, the authors tried to present the data with an explanation of its verification by seeking explanations from different findings of different researchers and by using secondary findings and theories to support this data. To show the readers that the personal views are eliminated by explaining the issues from using both the theoretical framework and empirical findings was the main objective of this thesis.
3.8   Merits and Limitations

According to Saunders et al. (2011), there are several quality issues in semi-structured interviews. These mainly consist of the interviewer bias and the response bias. As already discussed previously, one of the biggest limitations was that LCCs were not willing to discuss any kind of information due to recent negative events in the media which had a very harmful impact on LCCs reputation. Nevertheless, the bias issue could be reduced by interviewing external sources instead.

Another limitation was the interviewees’ limited preparation. The possible semi-structured interview questions were sent to some of the interviewees in advance. However, since it was a last minute decision to attend the travel fair and there were many airlines, airports and consulting firms attending, it was not possible to send the basic structure of the interview questions to all of the chosen interviewees. Most of the interviewees were not prepared for the comprehensive questions, thus some answers were unstructured. Additionally, the authors realized that in fact those who were not informed about the interview could give answers of similar quality to those who were informed.

The key merit of the chosen research approach was the richness of the interviews since it permitted the authors to interview members of a wide range of different segments in the airline industry. Furthermore, this approach allowed the authors to compile different views from competitors, which balanced out some biases within the answers. However, a lack of precise information might have been the case since LCCs were not represented adequately in the interviews. The authors tried to overcome this by interviewing independent consultants in order to get a more neutral view of the situation.

3.9   Rigor and Reliability

“Reliability refers to the extent to which your data collection techniques or analysis procedures will yield consistent findings” (Saunders et al., 2009, p 156). Saunders et al. (2011) argue that there are certain threats to reliability such as participant error and bias, as well as observer error and bias. It is possible in a semi-structured interview approach that there are various biases that already arise due to the sole presence of the human element. Also, the inability to get interview data from the LCCs hindered the results to some extent. However, the authors tried to minimize these errors and used that unforeseen change of plans to their advantage by including the enriching information given by external industry players of almost all aviation industry areas. Additionally, to eliminate the biases of the industry players, the authors successfully conducted significant interviews with independent consultants which are rather neutral players in the industry and therefore do not tend to let any personal views affect the results.

Concluding, the authors believe that the primary data gathering method was rigorous and reliable since the interviews were conducted over such a wide array of aviation industry specialists.
4 Empirical Findings

This part of the thesis will present the answers from the interviews conducted at ITB in Berlin by using quotes and explanations of the answers. The answers are structured under headings chosen from the most frequently reoccurring topics in the interviews.

4.1 Liberalization and Deregulation

The market is still regulated when it comes to foreign ownership, but further liberalization of the aviation market is expected and it will impose significant changes on this matter. Basically, it will directly affect the ownership and capital structure of airlines according to two of the interviewed experts. More specifically it seems like the whole industry will face major changes in the future and a great uncertainty is revealed.

“The biggest change that will come to the airline business will be further liberalization of the aviation market. The liberalization in US arrived some decades ago, and in Europe 20 years ago, while Asia has just begun. Once the aviation market will become more liberalized there will also be cross border capital stakes among airlines that will change the big picture, because nowadays airlines are not allowed to purchase more than a certain percentage of a foreign company, in order for them to maintain their traffic rights. Once this will change the market will become more liberal where ownership will change in terms of capital” (C. Stenkewitz, Sales Executive, Singapore Airlines 2012-03-08).

“I will say more cross national investment, I mean right now most markets are still regulated when it comes to foreign investment but even that is loosening up and I wouldn’t be surprised if we are not talking about global airline groups or global brands within 20-30 years . . . but right now we wouldn’t be able to invest in US airlines but I don’t think that will last long” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

The deregulation of the airline industry has both been appreciated and depreciated. Allowing cross-national investment appears to be welcomed from a FSC’s long-term perspective. Lower fare prices for customers are one positive aspect from the consumer side and the societies’ line of thought is equally positive towards open markets since a more innovative environment is created and competition is fostered. The downside is the matter of survival for airlines since the competitive rivalry is more intense. Hence, new innovative operational solutions must be implemented.

“Generally it has had a very positive effect on the fares for the customers . . . certainly, from an airline point of view a regulated market is much more effective because it is easier to survive, but from a customer point of view certainly the deregulation was a good thing. What I believe, if you are in a regulated market but this is true for any business, there is a big danger that you don’t compete . . . so I think that in a regulated market all airlines would still be governmentally owned and they will not be truly innovative” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

Nevertheless, deregulations have been one of the prominent driving forces for the development of the industry and have strongly contributed to the upswing of LCCs. The removal of the Airline Service Agreements in Europe is a core element in the process, from which both airlines and airports have benefited.
According to Vladimir Kamynin, Marketing Director at Domodedovo Airport (2012-03-08), LCCs receive more credit for the liberalization progress. Dan Martin, Senior Charter Accountant Manager at Air Charter Service gave a brief corroborative statement summing up the essential element of the deregulation process:

"Deregulations in Europe are what make it work. It is an open market. Earlier there were bilateral agreements between countries, now that is different in the EU" (2012-03-09).

4.2 Fuel, ETS and Environmental Issues

Liberalization and deregulations are not the only dominating nonmarket challenges for airlines and LCCs in particular. Two frequently appearing issues during the course of our interviews were increased fuel prices and the policies regarding emissions. The sales executive Christian Stenkewitz from Singapore Airlines was bluntly supporting the former by saying "any airline can go bankrupt now with skyrocket fuel prices" (2012-03-08).

Obviously the fact that fuel prices are rising is known to anyone who has ever driven a car or watched the news, and this rise is a big issue for airlines. Fuel is an uncontrollable cost that cannot be avoided by any airline, but the negative impact of the rise will be relatively more substantial for LCCs. The reason is that both their cost structure and business model are based on low operating costs which Dan Martin, Senior Charter Account Manager at Air Charter Service stated:

"A few main ones in my eyes, firstly higher fuel prices. The LCC model is based on selling at relatively low price and if 30% of your costs are related to fuel that is dangerous . . . and it is out of their control and affects all airlines but Low Cost Carriers first because of their business model, it is based on operating quite cheaply” (2012-03-09).

A societal byproduct of fuel consumption is pollution, which has become a frequently discussed topic during the 21st century. Discussions in the field are about climate change, emissions and policy making. As mentioned earlier, the European Emission Trading Scheme is constantly reducing the allowances, creating a growing challenge for airlines. Once again the LCCs take the bigger hit with tougher rules.

"Rising fuel prices is definitely a challenge, but also the Emission Trading Scheme is certainly something . . . that threatens all airlines and especially low cost airlines” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

Lufthansa Consulting did not really answer why LCCs are affected more by the ETS. Nevertheless, that answer was received by Norman Gage, Director at New Generation Consultancy:

"Another challenge will be as how they get around the CO2 emissions in Europe. I am going to state that initially it is not a problem, but because the age of their fleet, as their fleet gets older they are not replacing it because they cannot invest. They want to get the most out of the aircraft, then maybe two years down the road we have a challenge with the European Emission Trading Scheme” (2012-03-09).
Again it is a matter of the LCCs’ cost structure and unwillingness to invest that basically advances the problem to a later point in time. What is also implied here is that new aircrafts are “becoming more fuel efficient” (N. Gage, Director, New Generation Consultancy, 2012-03-09) and the need for these is increasing substantially in order to cope with the fuel prices and emission limits. What Dan Martin at Air Charter Service touched upon earlier with fuel prices being out of the airlines control is supported by Kridhakorn Sirabhabhoh, Senior Advertising Manager at Bangkok Airways when he says that “the fuel price . . . is an uncontrollable factor. You see in the world we have war, the oil price increase. It never goes down” (2012-03-08).

As the primary findings show, LCCs are substantially more affected by these issues but it is important to remember that “environmental issues are becoming more important independent from the business model” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08), causing all airlines to restructure.

4.3 Taxes

The ETS can be seen as a tariff or tax, which is not explicitly increasing in terms of money, but instead the EU commission deals with it through tougher standards and allowances. However, the emission tax is not the only tax faced by airlines. Governments have imposed a specific tax on airlines that is constantly increasing.

“Taxes that are raised by government, especially in Germany and also in GB that threatens all airlines and especially low cost airlines” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

“[A challenge] is obviously tax, increasingly governments are taxing aviation” (D. Martin, Senior Charter Account Manager, Air Charter Service, 2012-03-09).

Taxes are similar to fuel prices in two ways. (1) They both are uncontrollable costs and (2) linked with occurrences in the macroeconomic environment. When the world economy is having a slowdown governments need to raise their revenues, which is usually done by increasing taxes. Dan Martin, Senior Charter Accountant Manager at Air Charter Service provided this information when he said that "airlines can’t control taxation which is becoming higher and higher . . . and when most governments don’t have money, they will probably raise taxes” (2012-03-09). Benjamin Weidmann, Head of Strategy at Sun Express contradicted the Lufthansa Consulting perspective that taxes are damaging LCCs more than FSCs by stating that “all over Europe, airline taxes were introduced and that’s just adding to the cost and if you are a high cost airline anyway, it gets you” (2012-03-08).

4.4 Unions

Some LCCs have started to use unions because they could not find a profitable and relatively ethical way to go around it. LCCs are facing external pressure from unions, but still often neglect them since unions will increase labor costs, which go against their cost focus. However, there is always a down side. Not using unions imposes danger on the operational activities and can eventually lead to internal protests and even greater costs.
“Mr. O’Leary [the CEO of Ryanair] or somebody will not accept any unions, but look at Air Berlin, they did not accept any unions in the beginning but at some point you are stuck and your cockpit stop, your cabin staff will no longer accept that they are paid less than everybody else in the business, and this is something that the low cost carriers will face sooner or later” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

Another example that Benjamin Weidmann, Head of Strategy at SunExpress (2012-03-08), mentioned was the airline Iberia. They started a low cost arm called Iberia Express with the intention of using unions, but that was a costly decision since a strike started only two months after establishment.

4.5 Uncertainty

The LCC airlines have experienced a rapid growth for a long period of time since the deregulations but now face a future of uncertainty due to several challenges, which can be tackled in many ways. One reason for the uncertainty is the lack of historical development to look back at and learn from. The only earlier example is the development of LCCs in the US where Southwest Airlines turned out to be the single survivor.

“If you look at the development of low cost carriers, and not only in the last 10 years it is really hard to say whether so many low cost carriers survived as a typical no frills airlines in Europe because we don’t have the experience yet. We have talked about their business model for 10 years now which is not really, there is no historic evidence and again, if you look at the US where liberalization started much earlier the only low cost airline that really survived in the long term is Southwest” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

Furthermore, Esther Samtlebe from Lufthansa Consulting states that the high growth has on the one hand generated profits for the LCCs but on the other hand brought along various disadvantages. This is not only the case for airlines but for almost every company experiencing rapid growth. They have to deal with internal obstacles when expanding. Fabian Kraft, Head of Business & Network at Skywork airlines shares the same view and believes this will be a challenge on its own for some LCCs.

“Low-cost airlines have to face the challenges of growing older and that is a challenge itself. As I said before the organizations are becoming bigger, you have more bureaucracy” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

“I think the biggest challenge for LCCs in Europe is hard to say, to cope with the needs of the people, LCCs get bigger and bigger, LCCs take up more and more destinations and more and more airports, sometimes there is a loss of service quality” (F. Kraft, Head of Business & Network development, Skywork Airlines, 2012-03-08).
4.6 Consolidation

Another important issue that is expressed by several of the interviewees is the consolidation effects from the deregulations of the European market. The consolidation process allows the airlines to gain efficiency and to become more competitive. This development will decrease the number of airlines in the European market but meanwhile increase the size of those still in business, not taking into account the regional niche airlines that can still stay profitable. Both Esther Samtlebe and Andreas Kraus at Lufthansa consulting support this view and explain the issue further.

“It will lead to more consolidation and it will continue because you cannot exist as a lone standing airline unless you operate in an absolute niche market. But in Europe you don’t have that many niche markets so you need a certain fight and to be able to compete against each other. In general I think it makes sense because as it was before, basically every tiny little country had their own little national airline” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

“I expect much more consolidation, probably less than 10 airlines ruling 75% of the global airline business, it is like in the big consumer goods industry, and many airlines will not survive” (A. Kraus, Director Airline Commercial, Lufthansa Consulting, 2012-03-08).

The consolidation process that is taking place in Europe will not only depend on the cost-saving alliances but also on the potential increase of cross-national investment due to the liberalization in other regions outside Europe. Increased liberalization is not only happening in Europe but simultaneously in other parts of the world, which will bring along additional opportunities for growth on a global scale.

“I wouldn’t be surprised if we are not talking about, I don’t know, no longer talk about two or three European airline groups but we might talk about global airline groups or global brands. Not only alliances but also cross investment. Right now we wouldn’t be able to invest in US airlines but I don’t think that will last more than 20-30 years, because you need to be a global brand to be able to survive. If you look at Europe today, the ones that really have the potential to survive in the long term are all airline groups” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

The global mergers will create fewer and larger companies that will control the whole market and create a greater potential for survival and success. Alternatively, there are partly contradicting views supporting that the European market is already fully consolidated due to the large amount of mergers that have occurred in the recent past. In this view, there will only be additional global mergers.

“I think, for the acquisitions in the past 3 years, airlines within Europe are consolidated. Like Lufthansa bought Austrian airlines and British Airways with IBERIA. I think this has come to an end, because the new merger set-ups like Malev, are exiting the market. I don’t think there will be more take overs within Europe, but rather market exits. And others take over the market and they grow like Ryanair. There will be more global mergers. Increasingly there is a shift on the mentality that you need global mergers and probably also airlines regulators become aware of that” (B. Weidmann, Head of Strategy, SunExpress Airlines, 2012-03-08).
4.7 Competition

Even though the consolidation of the market tends to decrease competition, the increasing market concentration will for some companies create an even tougher environment, which especially the LCCs might have to face in the near future. This is also due to the increase in supply of low cost options for the customers when the FSCs are becoming more cost efficient.

“If you look at the market itself people are saying that it is growing tremendously especially in the low cost section, which is actually true but many people actually forget to have a look at the capacity increase in the low cost section which has grown tremendously too. So in fact, if you look at both ends you will see very fierce competition in the low cost market itself, and I think that is a real challenge” (T. Chotichanapibal, Executive Vice President, Thai Airways, 2012-03-08).

The previous view is well supported and is said to force the airlines to become even more cost efficient in their battle for the customers. The solution is somewhat short-term since costs can in the end only reach zero while revenues can grow endlessly. The price war will therefore hurt many airlines badly if they are not finding new revenue streams or as Begona Strass, Sales Manager Leisure at Iberia Airlines, mentions, coming up with new innovative ways to change the cost structure.

“There are a lot of seats offered in the market but demand is not high enough to cover all this offer. That’s why they are fighting hard for the low prices. They have to tackle the problem by changing the cost structure, being more cost sensitive to compete with all these market changes. They have to find a quick solution in terms of demand and aircraft size” (2012-03-08).

The solution regarding demand and aircraft size refers to the higher demand in the summer and lower during the winter that many airlines are trying to meet by using larger aircrafts during peak season and smaller when the demand is lower. Even though the competition is already tough within the airline industry there are certain factors that can still make it tougher.

“Probably, a big challenge will be when one decides to compete with another under the same roof, on the same day. If you look at Ryanair and easyJet for example, they don’t challenge one another. Even on the same city to city there is not that much competition, they try to keep themselves apart. I think probably their biggest challenge will be a new entrant. Possibly as aircraft change, because they all serve you ready to Airbuses or Boeing, and as the smaller Embraers [an aircraft model] come out they become more fuel efficient” (N. Gage, Director, New Generation Consultancy, 2012-03-08).

There will be new entrants using more fuel efficient aircrafts as a core resource on the market in the future. Additionally, there are views that the market concentration is just starting and will become more intense in the future.

“You see some tendency to concentration but at the same time new airlines are being founded. There are always entrepreneurs stupid enough to launch their own airline, concentration will be much higher than today, in Europe, Ryanair and easyJet will be more dominant than today” (B. Weidmann, Head of Strategy, SunExpress Airlines, 2012-03-08).
4.8 Change in Customer Demand

The market is not only developing by becoming increasingly concentrated but the customer demand has also changed, partially due to the development of the LLCs operations, which other airlines have to adapt to. With more price-sensitive customers, especially in times of recession, costs have to be cut and the low price is more essential than ever.

“Customer demand has changed the biscuit. If you can spend less money on a flight and it takes 1 or 2 hours more, you will not need the FSCs, unless you have a lot of money. In Europe every business man nowadays flies with easyJet, because it is cheap and short flights” (C. Stenkewitz, Sales Executive, Singapore airlines, 2012-03-08).

There are not only changes concerning the FSCs but also the LCCs are starting to adapt their business in order to meet demand and find new revenue streams by focusing on new segments. One example of a LCC that has seized the opportunity of more price-sensitive customers in the corporate sector is easyJet when targeting business travelers.

“easyJet has now extended their customer group to business travelers, which means that they have to adapt their service model because the expectations of a business traveler are different from those traveling for leisure travel” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

The view that business travelers’ expectations are different from leisure travelers is supported by Fabian Kraft, who expands on the topic and explains the business travelers’ various needs for convenience and flexibility when flying.

“Business people want to have a reliable operation, want to be a little bit flexible. Where they don’t need to come to the airport 2.5 hours before the flight departs standing in a queue with 150 people. There’s a challenge of LCCs to attract the business people to attract more passengers paying higher fees.” (F. Kraft, Head of Business & Network development, Skywork airlines, 2012-03-08).

Businesses always have to change and adapt to the challenges in the market in order to meet the demand, no matter if you are a FSC as Lufthansa or an LCC as Ryanair. This is a natural development that all airlines have to face at some point.

“I mean if you take Lufthansa as an example, and compare them in the 1980s and Lufthansa today, they are two completely different companies, completely different way of thinking of doing things on the service orientation level” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

One indication that shows how the FSCs and LCCs are coming closer to each other is the mutually increased use of ancillary revenues, meaning not having everything included in the original price as has usually been the case for all FSCs. Thereby the airlines can focus on decreasing costs, which only can reach zero, and can meanwhile increase the opportunities for additional revenue streams.
“If you have a look at the model nowadays it is not just low cost, it is ancillary revenues as well, so they are breaking the service item up, or the components up, and then charging for the unbasic ones and I think that is the thing that they need to work on, the two ends, one is certainly the cost the other one is how they can maximize their revenue. I think a lot of carriers are doing that, including the full service airlines” (T. Chotichanapibal, Executive Vice President, Thai Airways, 2012-03-08).

In order to meet the changing demand new ways of attracting customers are needed, which the LCCs have started to consider by finally negotiating with GDS creators. However, presently that cooperation is too expensive and creating an internal distribution system with help from Sabre would be a more favorable option. Thereby, the LCCs’ offer will be more easily accessible to customers.

“The most significant challenge for low cost airlines is to be spread also with the GDS on the one side, because most people book directly on their site, but to enlarge their distribution channel they should click to us, to Amadeus or Sabre Travel Network etc. It is expensive. I mean for them it is more expensive but they are now changing their minds... [Can they create their own system?] The first enhancements are there, the first talks are with easyJet, they were the first mover there. Might perhaps take some time for the others. We have talked already with all of them, so negotiating, but I cannot say more at the moment” (T. Benz, Account Manager Online, Sabre Travel Network, 2012-03-08).

A very innovative way of finding new revenue streams that have worked in Thailand, created by Bangkok Airways is by building their own airports. This approach might be hard to implement in European democracies but it is nevertheless a great example of finding new ways to generate revenue for airlines.

“We make everything to make people know about services. About our tangible assets, we have very beautiful airports, we own our airports, 3 airports. I think we are the only private airline that owns their airport... decrease cost and charge other airlines for using them” (K. Sirabhabhoj, Senior Advertising Manager, Bangkok Airways, 2012-03-08).

4.9 Long-Haul for Low-Cost

In a time when sustaining future growth is one of the largest challenges faced by airlines, finding new ways to increase market share and to generate revenues is crucial. Currently, one well discussed topic within the airline industry is the potential and existence of long-haul low-cost flights. Christian Stenkewitz, Sales executive at Singapore Airlines elaborates further on why and how they are going to become successful in such a provenly tough part of the airline industry.

“We have found an answer, start our own low cost carrier to operate medium -long-haul routes, single aircraft type operate on long-haul flights, different from the normal low cost carriers” (2012-03-08).
“A group of companies need to see how to secure growth and future growth as a group for the coming years. One cornerstone of the future growth, or step one is to start a long-haul low cost carrier, which will be implemented next month called 'Scoot', will be the low cost arm of Singapore airlines. For the scoot approach we have identified, we can tap into a market which is growing, and have a new customer base at the end of the day, and of course if you operate medium haul or long-haul routes with the low cost airlines, you need to make sure that you generate some minimum yield and that you are profitable, and of course low cost carriers on long-haul routes will have a business class, how it will look like, no one knows” (2012-03-08).

Nevertheless, there have been recent attempts on this business approach that have failed, which is something Christian Stenkewitz is well aware of.

“There was a long-haul LCC from Asia to Europe, Air Asia X, Kuala Lumpur – France, Kuala Lumpur – London, but stopped two months ago because they didn’t make profit, that is one argument too why it is very hard to operate profitable long-haul routes with a low cost approach.”

(C. Stenkewitz, Sales executive, Singapore airlines, 2012-03-08).

Since it is such a tough business and challenging concept, there are of course doubts to it within the industry. Especially, concerning the cost structure of a low-cost long-haul carrier compared to a low-cost short-haul carrier.

“Me personally, I don’t think it will work. There are so many characteristics that a classical low cost carrier needs to meet to be really low cost that you cannot do long-haul, I mean turnaround time, you need a really short turnaround time to be able to operate low cost in the sense of really low cost and not low frills. When you operate long-haul routes you automatically have longer turnaround time. On short-haul you can decrease the seat pitch as much as possible and people might accept it but when we are talking about flights of 8 or 9 hours, we are entering an area where people will not accept it. I compare it a little bit to when looking at North America, some of the domestic flights are really long-haul flights if you fly from New York to Los Angeles, and people were not fully accepting that the classical domestic service, which was now reduced to zero, was also provided on the long-haul flights. They wanted some ability to have full luggage, greater seat pitch and needed something to eat.”

(E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

Andreas Kraus at Lufthansa Consulting has the same view and stressed the cost structure as being the major challenge for the long-haul low-cost concept as well as the advantages of the FSCs concerning the hedging of fuel.

“It is a simple equation, when it comes to the cost side, when looking at a long-haul operation the share of the fuel costs tend to be extremely higher, and in that extent, big legacy carriers [FSCs] have a huge competitive advantage on the purchasing side, they just purchase much more fuel, that means that they have better conditions on their side. It is really hard to get a cost advantage over the legacy airlines carriers [FSCs] on the long-haul, and that is why they are not successful in that sense.”

(A. Kraus, Director Commercial Airline, Lufthansa Consulting, 2012-03-08).
4.10 Business Model

The opinions regarding future prospects of LCCs differ between the interviewed individuals. However, some insights to what can be improved from a business model point of view were given. By looking at the LCCs’ development and expansion, one can easily argue that the model worked extraordinarily well in the past if compared to FSCs. This has caused the two business approaches to tilt towards each other in some regards.

“The low cost model was very well, but when talking about fuel costs which is getting higher and higher and travel insurance and other things is getting higher and higher the gap starts to narrow between the low cost airlines and the premium airlines” (T. Chotichanapibal, Executive Vice President, Thai Airways, 2012-03-09).

Now it is known that the differences are diminishing between the LCC model and the FSC model. Andreas Kraus at Lufthansa Consulting provided a more specific explanation to how the evolution of the business models will continue with all the consolidations happening in the market:

“I would not expect that somebody is talking about low cost carriers at all anymore, I would just assume a standard business model for an airline and a deregulated market . . . and people will not talk about business model A or B anymore but about a huge and global industry with some few survivors with huge market power, in which we have everything under control on the distribution side” (2012-03-08).

The proof concerning this shrinking gap was outlined by Esther Samtlebe at Lufthansa Consulting when she presented some new tendencies in certain LCCs’ operations:

“What you see in Europe right now is that the traditional low frills/low cost concept where you just focus on the mouth market and just operate from remote airports to remote airports obviously that doesn’t work by itself anymore, otherwise easyJet wouldn’t focus on the business travelers, Ryanair would not go to the untraditional airports and it is more and more that Ryanair now doesn’t operate from Weeze but from Barcelona, Palma so they also need to address the traditional traveler to continue their growth” (2012-03-08).

The need for change is obvious since some LCCs’ have changed their segment and airport strategy already. The gap between the two models is getting narrower, but are only LCCs adapting? Esther Samtlebeat Lufthansa Consulting argued that “at the same time the legacy airlines [FSCs] adapt their model more and more, so the separations between the two models are getting closer and closer” (2012-03-08). Basically, the adaptation is mutual but all in all the FSCs are taking the greater step since “[LCCs] put pressure on legacy airlines[FSC] because they have to compete with them. That’s why a lot of airlines are re-structuring and Iberia is also re-structuring” (B. Strass, Sales Manager Leisure, Iberia Airlines, 2012-03-08). Another factor that supports this uneven tilt is FSCs’ attempts to start low-cost subsidiaries to compete.

A very important aspect of the general LCC business model is continuous growth, hence, “companies need to see how to secure growth and future growth for the coming years” (C. Stenkewitz, Sales Executive, Singapore Airlines 2012-03-08), and if that is not maintained the future looks very dark according to Lufthansa Consulting:
“If Ryanair doesn’t grow anymore the business model is dead, because the whole business model is built on growth” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

Business models are not firm specific, however, they are not completely generalized for the entire industry. Therefore, it must be altered to suit the customer’s perceived needs, which is a dynamic factor changing with the overall economy and spending patterns.

“If you want to get the mouth market you need to attract the traders (read: business travelers) and you cannot go there with the model that Ryanair has where basically for everything extra, you need to pay extra” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

Given that the European history is very brief when it comes to LCCs, important lessons can be learnt by looking at the American long-term survivor Southwest Airlines. A successful element of their model has been the leadership skills and the CEO’s ability to create a corporate culture and company mentality.

“Southwest survived because of their very special spirit, and the spirit of their CEO, and because they manage to get a company mentality and a company spirit which is very unique in the business . . . that is really one of the success factors for Southwest, and you know the stories where pilots would actually start cleaning the aircraft to make sure they keep the turn-round” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

However, this success factor has not been proven in Europe so far where the CEOs’ approaches are very different. If reading between the lines, the quote below touches upon the absence of unions causing an unpleasant work environment.

“I am not sure if Mr. O’Leary (CEO of Ryanair) has the same courage and ability to build up such a spirit, and basically before company working for the support, everybody in the company is working for the success of the airline and is not just fed as a dog” (E. Samtlebe, Senior Consultant, Lufthansa Consulting, 2012-03-08).

As mentioned earlier, the LCC model is very valued and respected by some, but inappropriate and disliked by others. The following are some abstracts from different interviews commenting on the LCC approach.

“I think the low-cost business model is a quite sophisticated one. I think to attract, to rely on those passengers who pay a little bit more to make the operation profitable, these passengers will hardly go by secondary airports. LCCs must focus more and more on primary airports . . . and in Switzerland Geneva is between primary and secondary airport. Between Basel and Zurich, the hubs, then Geneva with a quite big catchment area” (F. Kraft, Head of Business & Network development, Skywork Airlines, 2012-03-08).

“There are lots and lots of people who love the model. But it is not for everyone. There are still lots of markets out there for premium airlines” (T. Chotitchananapibal, Executive Vice President, Thai Airways, 2012-03-09).

“[LCC is] the most successful part of aviation. If you look at Ryanair, they carry more passengers than any other” (D. Martin, Senior Charter Account Manager, Air Charter Service, 2012-03-09).
“LCCs can’t survive with the fees of 1.99 also 10 euro” (F. Kraft, Head of Business & Network development, Skywork airlines, 2012-03-08).

Charter service is apparently not an option for LCCs with the current business model. Basically, charter services do not fit the operational structure used by LCCs. Two examples are the frequency and the turnaround time, which has to be altered if this service is desired.

“[LCCs] don’t tend to charter aircrafts since they are very heavily utilized operations. They tend to do 2-3 rotations every day and just don’t have the downtime on the ground to charter. During the winter a lot of airlines are leaving aircrafts on the ground” (D. Martin, Senior Charter Account Manager, Air Charter Service, 2012-03-09).

Finally, the argument by Benjamin Weidmann, Head of Strategy at SunExpress supports the fact that the current business model is not suitable for long-haul flights.

“I think in the current setup, the low cost business model is not sustainable and you can also see in the industry, in Asia, they started to offer long-haul and they are cutting down their network” (B. Weidmann, Head of Strategy, SunExpress Airlines, 2012-03-08).
5 Analysis

This section will analyze the primary findings together with the frame of reference. The analysis section is divided into four parts. In the first part, the major recurring challenges for airlines, in particular LCCs, are introduced. In the second part, solutions and suggestions will be outlined for the revised LCC business model before the third part, in which the characteristics of the present and future business model are compared in two tables according to section 2.4.3 respectively. Finally, in the fourth part of the analysis, the revised LCC business model will be presented along with added and modified elements.

The future environment for LCCs is uncertain and Benjamin Weidmann claimed, "I think in the current setup, the low cost business model is not sustainable" (2012-03-08). The qualified speculations about prospective changes given by the interviewees opened up room for innovative interpretations regarding what has to be done in order for LCCs to prosper. Many of the identified challenges in the strategic analysis were touched on by several of the interviewees and this way the empiricism added some new insights and implications to the revision of an improved LCC business model. Therefore, the authors decided to categorize the section of analysis of the LCC industry (5.1) under six different headings, which are as follows: (1) Corporate Culture, (2) Cost and Revenue Structure, (3) Demand and Supply, (4) Ownership Structure, (5) Taxes and subsidies, and (6) Further market challenges.

5.1 Analysis of The LCC Industry

5.1.1 Corporate Culture

Baron (1995) argues that interest groups can harm a company if not taken care of by nonmarket strategies, and the empiricism takes the same standpoint when it comes to unions. The unfair conditions and relatively low salaries for employees working in the LCCs industry are challenged by individuals and the media alike. As mentioned earlier, LCCs prefer not to use unions and since it may not have any legal consequences in several European countries, it mostly comes down to ethics and an economic evaluation over the long run. As long as the world economy has not fully recovered from the crisis and employees depend on keeping their job, they are more likely to accept the lack of unions at their established job. When the economy is back on its feet and the tense employment situation experiences relief, the level of acceptance will be lower and pressure from both internal and external sources will require a change in this matter or else the brand name can receive unpleasant attention and employees might decide to change their work place. Southwest Airlines was the most thriving surviving LCC in the U.S. and it successfully uses unions in combination with “...the spirit of their CEO,...a company mentality and a company spirit” (E. Samtlebe, 2012-03-08). Basically, they have motivated workers and a dedicated CEO who obviously respects his employees and cares for them. This management ability to create a good working environment where knowledge is easily transferred and employees feel appreciated was the fundamental feature in Southwest Airlines’ achievements. In other words, the creation of a corporate culture was the essence of the American LCC’s success.
5.1.2 Cost and Revenue Structure

LCCs’ current cost structure seems to be an obstacle when dealing with any type of additional costs. One reason is that a price increase in any of the resources that airline companies require has a stronger effect on LCCs since their entire model and profit generation depends on it. To provide an example: fuel costs are roughly 30% of the total cost for airlines (D. Martin, 2012-03-09), and if you are a LCC trying to minimize the operating expenses, uncontrollable costs such as fuel will represent a larger fraction of the total cost. While FSCs are used to managing more cost such as those deriving from using GDS systems or providing additional services to their customers, an increase in the fuel price will not affect their total operating cost with such a high percentage as it would for the LCCs. Having fare prices of 10€ will not even cover the fuel cost per passenger and thus would easily create a loss if ticket sales were the only operating revenue for LCCs. As a result, it is evident that additional revenue streams are extremely important because only lowering controllable costs does not automatically guarantee profit for LCCs. Moreover, uncontrollable costs have a greater impact on LCCs. The pursuit for higher profitability within the airline industry is therefore two-sided: (1) maximizing revenues and (2) reducing costs (T. Chotichanapibal, 2012-03-08).

5.1.2.1 Ancillary Revenues

T. Chotichanapibal (2012-03-08) stated that being a LCC does not only mean low costs but also ancillary revenues, and as mentioned before, LCCs cannot simply raise fare prices in order to maximize revenues. This means that they have to find more revenue streams through either new ancillary activities or by creating additional value to the customer. Porter (1985) argues that in order to become differentiated and maximize revenues, companies require a certain uniqueness in the value chain which the customer is willing to pay a premium price for. There are many ways to differentiate and Michael O’Leary (2010) believes that when the market is maturing, the main focus will lie on the brand recognition itself. This has been seen in other industries as well and Ghemawat (2007) supports this view by stating that brand-building can be a critical differentiation point. Nevertheless, brand recognition alone does not arise from creating large marketing campaigns but is also directly related to the value proposition that a company offers to its customers. Ancillary revenues through additional service activities are thus important both from a revenue as well as from a brand game perspective. These new activities can arise in the two categories pre-flight and in-flight as will be elaborated more specifically in the business model.

5.1.2.2 Cost

Amit’s (1986) view that investments in cost leadership create long lasting effects in competitive advantage for companies is consistent with what LCCs have been doing since the very origin of their operations. It is clearly helpful for any company to constantly pursue the lowering of costs, especially in an industry with such low profit margins. Consequently, as brought up in the empiricism, the FSCs are also benchmarking the LCCs efficient processes in order to minimize their own costs as well while at the same time having access to some of the features that Porter (1985) mentions as essential to cost leadership such as superior access to material and economies of scale.
In the airline industry, these economies of scale affect two very important and areas of business, from which the majority of cost arises and can through which can therefore also be saved most efficiently: firstly, the access to aircrafts that are fuel efficient and cheap to maintain, secondly, the access to cheap fuel itself. If these two resources are available, the next step for airlines’ successful running is a high level of utilization to exploit the good conditions and maximize revenues while minimizing those times in which an aircraft is out of service. This coincides with Ghemawat’s (2007) argument that the level of utilization is fundamental for a successful cost leadership strategy.

Directly connected to the successful business of an airline is also the ability to deal with the uncertainty that is connected to the fuel prices. Not only do they constantly rise but they are also the least controllable element to include into the airlines’ calculations as the industry experts confirm. It is the most significant and uncontrollable challenge and especially LCCs take the bigger hit when unforeseen price increases occur. In order to maintain a certain level of profitability and success despite the harm that the fuel prices are causing there are “…two ends, one is certainly the cost [reduction of controllable costs] the other one is how they can maximize their revenue” (T. Chotichanapibal, 2012-03). But as Schlangenstein and Credeur (2011) point out, raising fares is not an option for LCCs. The real issue here is constituted in the fact that airlines have no control over the fuel price (D. Martin, 2012-03-09). Using logical reasoning with regard to the oil consumption patterns across the world, it can be argued that the oil price will also keep increasing in the future, which only stresses the importance of this issue. China and India are today consuming far less oil per capita than the U.S., but the emerging economies are growing ever more rapidly and all projections imply that they will pass the developed countries in world share consumption in the near future. When China’s demand for oil will equal that of the U.S. there will be a significant shortage in the world oil market and the price will go up eventually.

5.1.3 Demand and Supply

When analyzing the present situation in the airline industry, it is imperative to take a closer look at the existing demand and supply. Airlines are facing various challenges and it is advisable to identify and exploit all possible sources for business improvement.

5.1.3.1 Demand

Since airlines have very high fixed cost through the payment and depreciation of their major assets, the planes, a change in demand can have devastating consequences. Therefore, airlines and especially LCCs keep a high focus on filling the seats on each flight. Accordingly, Schefcyk (1993) argues that by being part of an alliance, airlines can reduce costs substantially by together filling up the airplanes. But apart from only cooperating with other airlines, LCCs can enhance the demand they face by respecting what customers actually desire. Wensveen’s study (2007) shows a gradual increase in customers prioritizing low prices over short traveling time which means that cost efficiency becomes more essential in the pursuit of customer demand. The empirical findings agree with this customer preference tendency towards price sensitivity by stating that other segments of customers beyond the typical holiday traveler have also started to
choose LCCs over FSCs despite their higher inconvenience. This opens up an opportunity to reach out to additional customer segments that are becoming more price-sensitive but still have different expectations than the present LCC clientele, easyJet has been doing just that and started to target business travelers. The above mentioned change in priorities also includes corporations that increasingly search for cheap tickets in order to reduce costs, especially in the recent times of recession. At the same time, business travelers have higher demands on convenience, which is not typically an element of the LCCs’ no-frills approach. Ghemawat (2007) stresses the criticalness of considering the different needs of different segments in order to satisfy the customer and thereby increasing the revenue. The same fact is pointed out by Lufthansa Consulting when claiming that today’s value offered by LCCs is not enough for every segment since the expectations are too different for LCCs to be able to unify them under their given value proposition. Furthermore, LCCs today do not have access to a large mix of marketing measures in order to attract these potential new customers since their distribution channels mostly depend on their own webpages that customers would have to search for specifically instead of being led to it through other channels as well. Therefore, there is a great interest for LCCs to enlarge their own distribution channels without using the expensive GDSs which can also be deducted from the long and unsuccessful negotiations between LCCs and existing GDS providers that have been reported in the empiricism.

Another challenge that is connected to the LCCs ability to meet the customers’ demand is the handling of increasing internal administration and bureaucracy that automatically when companies are growing. Although it is not the customers’ first priority, short waiting times and smooth processes are very important for the flyers’ experience. As the LCCs grow and fly to more and more destinations, the administration effort grows accordingly which can cause a potential decrease in service quality and dissatisfied customers. So far, LCCs have tapped into every profitable airport found and have therefore grown extensively with increased administrative burden as a byproduct.

Probably, the hottest topic concerning how to increase customer demand by introducing new operational activities for LCCs is the discussion if low-cost long-haul flights are profitable or not. Generally, most customers would agree that they would like to be able to fly longer distances at low prices as well but it is yet to be determined whether LCCs are even able to offer that kind of service. There are opinions supporting both sides and earlier attempts to meet that demand have been made but failed. Nevertheless, there are FSCs trying the low-cost long-haul business approach with the hope of it becoming a profitable branch of their business. If it is profitable for LCCs is a tough equation to solve with respect to their cost structure, and although it is common for later successful business approaches to be doubted in the beginning, this decision should be considered extremely carefully and conservatively due to the huge risk in inheres. While some argue that long-haul flights will increase costs a lot and thus do not fit the LCCs’ cost focus, the empirical findings maintain that having a business class and yielding a minimum profit could be enough to manage that risk.
5.1.3.2 Supply

Over the past years, more and more LCCs have sprouted and it is fair to say that the market is maturing. Although this process of maturing usually causes a market to balance out and calm down, it can equally increase the pressure on the existing firms. This has been supported by the empirical findings where one example is given by N. Gage (2012-03-08) who outlines the possibility of two LCCs being forced to fully compete with each other by serving the same cities within the same time span. Today, that is not the case yet because it has so far been avoided by the airlines’ careful selection of cities and airports, where some use primary and others secondary airports. Nevertheless, this issue is imminent and it is to be expected that sooner or later they will collide.

A further development that can have explicit effects on the LCCs business environment is the capacity growth in the supply of low-cost alternatives for customers since many FSCs are starting to offer lower prices as well. This creates an even tougher competition for the pursuit of filling up the seats but even today, “there are always entrepreneurs stupid enough to launch their own airline” (B. Weidmann, 2012-03-08) despite the fact that the market has already started to mature and consolidated quite substantially.

5.1.4 Ownership Structure

The European airline transportation market is very liberalized and the remaining restriction concerning cross-national investment brought up by Wulf and Mauler (2010) “…is loosening up…” (E. Samtlebe, 2012-03-08). This means that further steps within the liberalization process will most likely take place in the near future and will “…change the big picture” (C. Stenkewitz, 2012-03-08). Airlines will then have the ability to own a majority stake in foreign airlines and the ownership structure will shift towards a new balance. The empirical findings support Brueckner and Pels (2005) in their reasoning on how the European airline market is consolidating, leading to higher profits for the surviving airlines and further market exits for those that do not. The consolidation process results in airlines going bankrupt, additional M&A activities, and foremost the growth of the three existing alliances; Star Alliance, SkyTeam and One-world. Moreover, the alliances’ growing influence on the market is consistent with Lufthansa Consulting’s views of more global brands ruling the market. Basically, “…it is like in the big consumer goods industry” (A. Kraus, 2012-03-08). Nevertheless, a LCC would most likely not join an alliance or merge with a FSC since that would oppose the logic behind their business model with point-to-point single class flights and unbundled services. The main reason for the formation of alliances lies, as mentioned before, in the importance of economies of density and their advantage over economies of scale in the airline industry (Dobruszkes, 2005). Still, mergers between two existing LCCs are a serious possibility that might occur in the future.

A further aspect to the ownership structure is added through the activities of the ELFAA which is representing LCCs in the aero-political arena with the intention of influencing policy decisions to create a better environment (ELFAA, 2012). Decisions like ELFAA’s that have this influence and potential for improvement can foster innovation and capitalize value, which is exactly what a completely liberalized market would do.
“Deregulations in Europe are what make it work” (D. Martin, 2012-03-09). This quote further supports the notion that deregulation is a driving force which changes the big picture for airlines since all bilateral agreements concerning air transportation between EU and U.S. are now removed. It definitely appears that the airline industry will end up in a position where they can compete like any other industry and possess more freedom of action, which matches the European Union’s intention.

5.1.5 Taxes and Subsidies

“Airlines can’t control taxation which is becoming higher and higher” (D. Martin, 2012-03-09). However, Baron (1995) claims that firms can carry out collective actions in the nonmarket environment to affect the governments’ decisions. Still, that is not an easy task to complete and complex cooperative agreements between airlines need to be established in order to generate enough power to oppose the governments’ desire to increase taxes. If taxes continue to increase in combination with the lowered CO2 emission allowances, LCCs will have a hard time to survive in their current state. In fact, LCCs are making a strategically smart move when setting up operations in smaller cities and demanding subsidies for their economic contribution to the area although that causes great unease among the affected stakeholders and can result in further pressure on the airlines. Despite its contradictive structure, the tactic of lowering taxes and using public tax money in the form of subsidies at the same time is an elementary aspect of the LCCs’ approach to increase profit, and will most certainly continue to prevail.

Also in general, nonmarket strategies have proven to be essential for airlines. Baron (1995) stresses the social, political and legal aspects to be the core of nonmarket strategies, social and political being of particular significance to LCCs and their operations.

5.1.6 Further Market Challenges

The market challenges that were brought to the authors’ attention through the secondary data showed that four out of the six sources of profits presented are of greater significance for European LCCs. The most important source of profit is to find a balanced mix between cost leadership and differentiation. The former cannot be omitted since the whole business approach is built around it. The latter is crucial to create inimitable value since every airline has a relatively increased cost focus nowadays. Even though uncertainty/risk will not explicitly decrease profits, it will increase costs and is therefore the second most important source of profit if managed accurately.

Last but not least, the importance of volume should not be overlooked even though economies of density have shown to be more important than economies of scale. This so-called ranking can be somewhat seen throughout the empiricism and analysis as well since most of the emphasis is put on lowering cost but still delivering unique value. In this sense, the conducted interviews gave new insights and space for sophisticated interpretations to what needs to be changed in the revised business model.
5.2 Analysis for Revised LCC Business Model

Scholars say that having an appropriate business model is essential for companies because it establishes the core logic of the delivered value. The empiricism did both implicitly and explicitly confirm that in face of the growing challenges the LCC business model must be improved if the LCCs want to survive and experience success in the future. The possible change in ownership structure, the fact that airlines will possess more freedom, and the diminishing gap between FSCs and LCCs are two aspects that further increase the importance of adjusting the business model. Therefore, in this section, the authors will try to give specific suggestions and implementations for the revised business model by using the analysis applied in the previous section, the analysis for the LCC industry (5.1). Finally, the authors provided their suggestions and implementations under three different headings, which are as follows: (1) Corporate Culture, (2) Additional ancillary revenue and cost cuts, and (3) Miscellaneous.

5.2.1 Corporate Culture

The American LCC pioneer Southwest Airlines has shown a specific recipe for success which above all is based on the formation of a strong corporate culture. Corporate culture in this sense covers four different aspects; (1) Actions to increase emotional attachment between employees and the company, which in turn will create a sense of commitment; (2) Listening to the employees’ ideas and thoughts, which can bring about new insights and innovative solutions; (3) Supporting entrepreneurial activities which fosters innovation further and (4) A positive spirit of the CEO that will create a better atmosphere throughout the entire company. The outcome of such a combination of positive effects on the corporate culture will be more satisfied and motivated employees. This creates a win-win situation for all stakeholders and bad media coverage concerning working conditions will be minimized while the customers feel that they are being taken care of well in terms of service and safety. One possible step towards a stronger corporate culture consists of installing employee unions since they provide its members a sense of being treated with the same amount of respect, care and autonomy as the other personnel working in other airline companies. Bottom line is to create a better brand image both internally and externally, which is the basis for the entire direction of the business model.

5.2.2 Additional Ancillary Revenues and Cost Cuts

5.2.2.1 Semi-Bundled Service

As mentioned earlier, LCCs’ current value proposition is not appropriate for every segment of customers. The solution for this is to alter the value proposition for corporate travelers to meet their demands and expectations while still offering relatively low fares. One way to do this would be offering something that goes against the original LCCs’ unbundled pricing strategy, namely a semi-bundled service package. The first step is to set up corporate agreements with firms, which allow the companies to make use of a certain package deal. This semi-bundled package deal means that the business traveler in question can add three extra service features (frills) to be included in a fixed package price.
The choice of what features to include is made freely among the pre-flight and in-flight services to fit the individual’s preferences. With this offer, the business travelers will at least get a minimum in desired convenience at a relatively cheap price. Table 7 below shows three examples of what these packages could look like.

Table 7 - Examples of semi-bundled packages
Source: Authors’ elaboration

<table>
<thead>
<tr>
<th>Package #1</th>
<th>Package #2</th>
<th>Package #3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>Drinks/snacks</td>
<td>Flexible one-day ticket</td>
</tr>
<tr>
<td>Checked-in baggage</td>
<td>Shuttle service</td>
<td>Use of entertainment system</td>
</tr>
<tr>
<td>Seat reservation</td>
<td>Wi-Fi</td>
<td>Checked-in baggage</td>
</tr>
</tbody>
</table>

5.2.2.2 LCC Distribution System

Most of the LCCs’ distribution channels today are very narrow and people buying tickets will most likely find them on the airline’s webpage. Enlarging their distribution channels would allow their low fares to be a lot more accessible to a large audience. As a solution, a specific distribution system made for LCCs that is not as expensive and complex as the currently existing GDSs could be created. In order for this to be realized, the first step is to set up agreements and to negotiate with the developers Sabre or Amadeus about a separate system which according to the empiricism is a process that has already started.

5.2.2.3 Additional Revenue Streams

The cost increase for airlines creates pressure to increase revenues, but since LCCs cannot simply raise their prices, the only remaining option will be to implement additional innovative ancillary revenues. Table 8 below shows new potential activities brought up by the authors which at this point are merely brief propositions that can be devoted more attention and research to by the individual airlines.
Table 8 - Suggestions for additional ancillary revenues  
Source: Authors’ elaboration

<table>
<thead>
<tr>
<th>Pre-flight</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Shuttle service for corporate travelers</strong></td>
<td>A shuttle service with fewer persons and optional endpoints in areas with high corporate density. The purpose is to create more convenience for the traveler.</td>
</tr>
<tr>
<td><strong>Currency exchange service</strong></td>
<td>Despite the broad use of Euros in the EU, millions of passengers are traveling from non-EMU countries such as Great Britain, Sweden, Norway and Switzerland. The idea is to pre book an amount of currency online when buying the ticket and then picking it up either through a currency machine in the departure hall or receiving it from the flight personnel already during the flight period after take-off and before landing. Customers will not have to wait in line at the currency exchange office, which can be valuable for people traveling on short notice. The exchange rate should be slightly lower than e.g. Forex to create a further incentive to use this service.</td>
</tr>
<tr>
<td><strong>Environmental damage support</strong></td>
<td>This is a replacement of the so-called fuel charge. It is a mandatory fee that is levied on the customer and the money is used to protect the environment in terms of meeting the emission standards through fuel efficiency investment. It will also contribute to the companies’ corporate social responsibility and brand image in general.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>In-flight</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Wi-Fi</strong></td>
<td>Wi-Fi should be accessible on every aircraft for a fee. The technology is already available and installing it will create further convenience and satisfaction.</td>
</tr>
<tr>
<td><strong>Entertainment system</strong></td>
<td>On longer flights (4-6 hours) the customers have the option to pay for using an integrated entertainment system with movies, games and music.</td>
</tr>
</tbody>
</table>

Cost-benefit analyses should be carried out to estimate whether these suggestions are feasible or not for each LCC individually, but that would be beyond the scope of this paper. Hence, these are only innovative alternatives that need more research but no matter what type of additional ancillary revenues each LCC chooses and implements, it can be one of the most basic sources of additional profit.
5.2.2.4 Cost Cuts

The second side in the pursuit for higher profitability is lowering the costs. The authors interpreted this as lowering all possible costs while still offering an appropriate value proposition. Certain elements in this revised business model will eventually increase costs, which means that cost must be lowered somewhere else. Three solutions to this challenge have been developed by the authors.

First, there have been two competing aircraft manufacturers for the airlines to choose from, but a change is emerging with Chinese, Russian and Brazilian manufacturers gradually becoming more competitive and there might be new opportunities to reduce cost further. Purchasing aircrafts from Boeing or Airbus does not generate any uniqueness or irreplaceable value and no further competitive advantage can be gained from sourcing only from these aircraft suppliers. At the same time, the upcoming manufacturers from the emerging economies most likely have cheaper technology and less bargaining power, which means that prices can be negotiated more easily. Such a type of new cooperation would be even more promising if several LCCs agreed on negotiating with the manufacturers together because then they could create their own economies of scale and lower the prices for aircrafts even further. This alternative has a great potential but to fully understand if this is a rational option is complex since Boeing and Airbus have oligopoly-like positions in the market and aircraft maintenance facilities would also have to be adapted to fit the possibly new type of airplane.

Second, increased fuel prices and aircraft fuel efficiency are two elements that the empiricism touched on. Carter et al. (2004) argue that one increasingly important aspect for airlines is the concept of fuel hedging, which has been shown to have a positive relation with the firm’s value. In other words, it is a very crucial source of cost reduction for airlines. The authors believe that significant savings can be obtained if investments are endorsed in fuel hedging and fuel efficiency. This is particularly important for LCCs if they want to keep up since FSCs “...have a huge competitive advantage on the purchasing side, they just purchase much more fuel, that means that they have better conditions on their side” (A. Kraus, 2012-03-08). Further developments in this direction will alter the LCCs cost structure and also help in not exceeding the emission allowances.

Third, the LCCs are experiencing taxes being raised on a continuous basis and it is argued to be an uncontrollable cost. Again, we suggest that this issue should be dealt with by joint actions of all LCCs and the concerned airline bodies to change governments’ minds or at least to add more certainty to the calculations.

5.2.3 Miscellaneous

Medium-haul: The contradicting perspectives concerning the profitability of long-haul low-cost flights inspired the authors of this thesis to come up with a third option and to merge the two opposing arguments halfway. Implementing medium-haul operations for which the flight length is not longer than six hours will result in additional catchment areas and attraction of more business travelers. The demand for convenience is greater on longer flights, which implies more costs, but at the same time it implies more ancillary revenues as well. These routes will have two classes instead of one and the im-
portant aim is to yield a minimum profit through the combination of higher fares in the first class and the ancillary revenues from the customers of both classes. Operating medium-haul flights will allow European LCCs to act on a semi-global market and to reach additional, less congested destinations.

*Mix of airport strategies and growth:* The empiricism and the secondary data show that the demand for flight destinations has changed. Therefore, the authors suggest that LCCs should mix their airport strategies by combining primary and secondary airports in their route network. However, to avoid direct competition with other LCCs, the selection of destinations should be executed very carefully. Closely linked to this careful selection is the challenge of increased administrative burdens, where it can be argued that a more manageable growth rate should be considered instead of a massive expansion since a growth in the company size automatically causes a growth in the need for additional administration. For airlines, the argument that economies of density are of greater importance than economies of scale supports this matter.

As a result, both additional revenues and cost cuts add value to the airlines’ business model for further success.

### 5.3 Characterizing the Present and Future LCC Business Model

Before the final revision of the LCC business model is displayed, the framework for characterizing a business model presented on page 20 by Morris et al. (2005) will be applied twice, once for the present and once for the future; see table 9 and 10 respectively. This step is included in order to facilitate the revision process, changes are showed in bold.
## Present

<table>
<thead>
<tr>
<th>Levels/Components</th>
<th>Foundation</th>
<th>Proprietary</th>
<th>Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>How do we create value?</strong></td>
<td>Sell services</td>
<td>Short-haul and low fares</td>
<td>Equal treatment of customers</td>
</tr>
<tr>
<td></td>
<td>No-frills</td>
<td>Point-to-point flights, only economy class</td>
<td>Additional fees for every extra feature</td>
</tr>
<tr>
<td></td>
<td>Unbundled services</td>
<td>Seat reservation, luggage allowances, reflection, hotels, car rentals, transfers, credit card service</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Internal distribution</td>
<td>Online booking, no global distribution services, no refundable fares</td>
<td></td>
</tr>
<tr>
<td><strong>Who do we create value for?</strong></td>
<td>Mostly B2C</td>
<td>Sell to individuals, and mostly leisure travelers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Regional</td>
<td>Europe</td>
<td>Specific guidelines for selecting destinations</td>
</tr>
<tr>
<td></td>
<td>Broad market</td>
<td>Price-sensitive</td>
<td></td>
</tr>
<tr>
<td><strong>What is our source of competence?</strong></td>
<td>Operating system</td>
<td>Insensitive hiring of employees (no unions)</td>
<td>Avoid strikes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>No hub-and-spoke routes</td>
<td>One or the other</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Secondary or low-cost terminals at primary airports as long as they are reasonably congested</td>
<td>Short turnaround time</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cost efficient ground operations</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Use one type of aircraft</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>No code sharing.</td>
<td></td>
</tr>
<tr>
<td><strong>How do we make money?</strong></td>
<td>Revenue source</td>
<td>Ancillary revenues, subsidies, tickets</td>
<td>Maintain low cost per passenger kilometer</td>
</tr>
<tr>
<td></td>
<td>High operating leverage</td>
<td>Reducing all controllable costs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>High volumes</td>
<td>Capacity maximization and many destinations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Low margins from ticket sales</td>
<td>Ability to offer low fares</td>
<td>Not raise prices</td>
</tr>
<tr>
<td><strong>What are our time, scope, and size ambitions?</strong></td>
<td>Growth model</td>
<td>Continuous growth that is consistent with the business model</td>
<td>Seize every opportunity</td>
</tr>
</tbody>
</table>

Table 9 – Characterizing the present LCC business model
Source: Authors’ Elaboration
Future

<table>
<thead>
<tr>
<th>Levels/Components</th>
<th>Foundation</th>
<th>Proprietary</th>
<th>Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>How do we create value?</td>
<td>Sell services</td>
<td>Short and medium-haul but still relatively low fares</td>
<td>Flights should not exceed 6 hours.</td>
</tr>
<tr>
<td></td>
<td>No-frills</td>
<td>Point-to-point flights, more than one class</td>
<td>Two classes on medium-haul</td>
</tr>
<tr>
<td></td>
<td>In-flight services</td>
<td>Serve food/drinks/snacks/Wi-Fi/entertainment system</td>
<td>No additional fee for customers</td>
</tr>
<tr>
<td>Services components</td>
<td></td>
<td>Further unbundling, semi-bundled services for business travelers</td>
<td></td>
</tr>
<tr>
<td>Internal distribution</td>
<td></td>
<td>Online booking, LCC distribution system, no refundable fares</td>
<td></td>
</tr>
<tr>
<td>Who do we create value for?</td>
<td>B2C and B2B</td>
<td>Sell to individuals, and corporations</td>
<td>Corporate agreements</td>
</tr>
<tr>
<td>Regional and semi-global</td>
<td></td>
<td>Europe, Asia, North America, Africa</td>
<td>Specific guidelines for selecting destinations</td>
</tr>
<tr>
<td>Broad market</td>
<td></td>
<td>Price-sensitive and flexible customer segments and business travelers</td>
<td></td>
</tr>
<tr>
<td>What is our source of competence?</td>
<td>Operating system</td>
<td>Highly motivated and careful hired employees with unions</td>
<td>A reasonable mix of both</td>
</tr>
<tr>
<td></td>
<td></td>
<td>No hub-and-spoke routes</td>
<td>Short turnaround time</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Secondary airports and low-cost terminals at primary airports as long as they are reasonably congested</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cost efficient ground operations</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Use one type of aircraft or replace if cheaper alternatives from the emerging economies can be found</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>No code sharing.</td>
<td>With respect to rising fuel prices</td>
</tr>
<tr>
<td></td>
<td>Investments</td>
<td>Fuel efficiency and hedging</td>
<td></td>
</tr>
<tr>
<td>How do we make money?</td>
<td>Revenue source</td>
<td>Ancillary revenues, subsidies, tickets</td>
<td>Maintain low cost per passenger kilometer</td>
</tr>
<tr>
<td></td>
<td>High operating leverage</td>
<td>Reducing all controllable costs and taking joint actions against policy makers concerning uncontrollable costs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>High volumes</td>
<td>Capacity maximization and numerous careful selected destinations</td>
<td>Balance between frequency and number of destinations</td>
</tr>
<tr>
<td></td>
<td>Low margins from ticket sales</td>
<td>Ability to offer low fares</td>
<td>Not raise prices</td>
</tr>
<tr>
<td>What are our time, scope, and size ambitions?</td>
<td>Growth model</td>
<td>Continuous growth that is consistent with the business model</td>
<td>Manageable growth rate</td>
</tr>
</tbody>
</table>

Table 10 – Characterizing the future LCC business model
Source: Authors’ Elaboration
5.4 Revised Business Model

The differences and similarities in the business model characteristics are now clearly outlined and more easily identified. To complete the business model in the following section, further elements will be included from the low-cost business model (2.6) and low-cost carriers activity circle (2.6) combined with the analysis above. The following figure is the revised business model that the authors created for European based LCCs in order for them to remain successful.

When looking at the revised business model, the claims on diminishing the gap between the LCC and FSC business model from Lufthansa Consulting and T. Chotichanapibal, seems to hold since some elements are changing towards a full-service perspective. However, up until the time when the two approaches are more or less similar, the authors believe that using this revised business model with the added and modified elements is a strategic option that will lead to sustained value creation which can protect the LCCs from being overrun. It can enhance the LCCs understanding of the situation, enrich their business logic, allow management to be one step ahead and show prospects for the future business environment. There might be more alternatives to consider especially in the area of ancillary revenues. Hence, more attention should be devoted to this matter by the individual firm to determine what new elements would add value in their specific case. After all, this is a model brought up for the general LCC approach and as mentioned in the introduction, all companies in the industry are slightly different.
Figure 10 – Revised Business model for European based LCCs
Source: Authors’ elaboration
6 Conclusion

This section will conclude the analysis and the findings, give answers to the research questions and thereby fulfill the purpose of the thesis.

This research project has clearly shown that continuous adaptations of the business operations and the model are essential in order to cope with the constant changes in the business environment. LCCs in Europe have prospered since the dawn of their industry, but several facts indicate that significant challenges are causing trouble for airlines, and LCCs in particular.

The major challenges that the authors identified during the research were widely spread in both the nonmarket and the market environment. With respect to the economic situation in the world today, uncontrollable costs such as fuel prices, taxes and policies are hindering the room for flexible strategic maneuvers. All controllable costs are minimized, but not without complications. The labor force is dissatisfied and lots of external pressure from certain interest groups is put on LCCs. The market situation is likely to change completely in the future with a more consolidated market which will eventually result in global brands through M&A and alliances. This consolidation process per se will result in increased competition and especially in face of their low profit margins airlines will have to fight for their survival. When the final step towards a completely open market is followed through, cross-national investments will be enabled and the ownership structure will adjust accordingly. Hence, the whole industry will be more globalized. The balance between supply and demand has altered and created a surplus of seats leading to lower fares in the whole industry. In other words, the FSCs mimic the LCCs with the purpose of increasing their market share. Another reason for this phenomenon is a change in customers’ priorities where low prices are increasingly favored over short traveling times. Basically, the demand has changed and new needs have to be met. The LCCs business model is built upon continuous growth thus seeking for constant expansion with new destinations and sources of profit. However, the options for expansion are limited because the European short-haul market is maturing, and the growth itself has to be considered as a challenge as it results in increased bureaucracy and administrative burden.

The above challenges will affect the LCC business model in various ways. Developing a corporate culture and starting to use unions will ease the pressure from internal and external sources which will increase the satisfaction among employees, but at the same time will give opportunity for the rise of strikes and similar undesired antagonisms. Nevertheless, these actions have proven to be a successful strategic element in the U.S. for the sole survivor Southwest Airlines. Since some of the added elements in the revised business model will increase costs, attempts to lower them in other areas are even more important. Even though the uncontrollable costs are difficult to tackle, an attempt to fight taxes is recommended by taking joint actions in the nonmarket environment with competitors and airline bodies. To limit the damage of increased fuel prices and lower costs, new investment strategies should be considered because fuel efficient
aircrafts and hedging are fundamental. Additional innovative ancillary revenues have to be employed in order to increase revenues when costs are rising. However, what specific elements to enforce depend on the individual airlines and according feasibilities. The change in demand and priorities will force LCCs to re-evaluate their value propositions to fulfill the various needs of present and future customers. For the business travelers, this is achieved via corporate agreements and by offering semi-bundled service packages. In order to better reach out to potential customers and make the LCCs’ low fares more accessible, the authors suggest that a specific distribution system should be developed for LCCs with support from Amadeus or Sabre. Additionally, a more careful selection of destinations and airports should be considered to ensure a more manageable growth rate and to ease the inherent administrative burden. Another recommendation that strengthens the careful selection argument is the avoidance of direct competition with other LCCs. Finally, starting to operate medium-haul flights with two classes is an option to avoid the slowdown in growth while reaching additional catchment areas.

The revised business model is built on the general low-cost model and new elements have been added to every cornerstone. More emphasis has been put on additional ancillary revenues through pre-flight and in-flight services as well as on lowering both variable and fixed costs. The altered service offerings will strengthen the LCCs value propositions and will therefore generate additional revenues. The LCCs value chain and organization has received some innovative thoughts that the authors consider to be relevant to continue in prosperity. Bottom-line for success is to lower all possible costs on a continuous basis while still delivering satisfying and innovative value to the targeted customers.
7 Discussion

This discussion finalizes the thesis by first discussing additional observations made during the research. Secondly, the strengths and weaknesses of the thesis will be discussed in the limitations section. Thirdly, suggestions for future research will be outlined. Lastly, implications for practice will be discussed and are to be considered as recommendations.

Before embarking on this journey, the authors were aware of the fact that the airline industry is very competitive with almost no average profit margin. However, the extensive material that has been gathered from primary and secondary sources showed more precisely how complex the industry really is. The answers provided by top management and consultants to the posed open questions fit extraordinarily well with the secondary findings but additionally provided several new insights as well. That outcome strengthened the research substantially and made the authors efforts worthwhile. One of the most interesting findings was revealed by the interviewees’ different opinions regarding the future prosperity of LCCs where some believed that only the market leaders will survive while others even doubt the very existence of LCCs. Another question for which the answers diverged strongly from each other concerned low-cost long-haul operations. The most unexpected answer the authors received was the view that the airline industry will consist of a few global actors in the future, and that one unified business model will be used by all types of airlines. Accordingly, recent tendencies support the notion that FSCs and LCCs are assimilating and will probably meet somewhere in the middle. Finally, one of the most enchanting ideas from the primary findings was the possibility for airlines to operate own airports and to use them as a new sort of revenue stream. This idea can of course not work everywhere and its realization would be very contradictory for LCCs who want to keep low fixed and variable costs but nevertheless it is a very innovative idea that should be examined further.

7.1 Limitations

The revised business model that was created by the authors is subject to individual change since all LCCs have a differentiated touch and vary in their execution of the low-cost strategy. However, the authors agree that a majority of the elements are homogenous and can be used as a foundation for all LCCs. Getting in contact with qualified employees working for LCCs was not an easy task to complete. Consequently, the authors had to shift the focus to other sources of data to include unbiased perspectives from different sectors after the realization of the issue. However, it would have been an enrichment for the mix of answers if it had been possible to include some LCCs directly as well. All the data used in this thesis is referring to the major European LCCs and the American Southwest airline, which together gives a good overview of the industry. Nevertheless, many smaller LCCs were disregarded and additional aspects might have been overlooked. There is always some uncertainty involved when talking about the future, especially in this case when no substantial historic pattern can be used for prediction. This background situation also explains why the authors did not use the quantitative research method to meet the purpose of this thesis.
7.2 Further Research

During the course of this research, several related topics crossed our minds that have not been researched yet. The question if low-cost long-haul flights are beneficial is something that the authors expect to be worth looking into, similarly as the question whether the geographical operational area has a significant impact on the success. Furthermore, many issues regarding airlines’ growth in emerging markets came up during the research, and if the world economic development continues in the same direction as it does today, threats from Asian carriers are likely to have a significant impact in the future. Another perspective that would be interesting to consider is to execute a multiple case study and compare the major LCCs in order to get a deeper understanding of the major operational differences.

A topic that the authors came across but did not receive enough information about to stress it in this thesis was the M&A possibilities of LCCs or the possibility of creating an alliance, which would most likely increase the costs to some extent, although it might also give opportunity to protect and strengthen the low-cost approach. The low-cost business model is fairly new in Europe but is already being practiced in several different industries such as in retailing and other commodities. Since it has proven to be successful in many cases, an interesting research can be set up for the LCC business model in a completely new setting e.g. the cargo industry.

7.3 Implications for Practice

Derived from the research, there are a number of insights that can be valuable implications for managers. One example is the major benefits from having a good corporate culture which allows the employees to feel and take ownership. This has shown to be very beneficial in the long-run as creating a more enjoyable working environment is enabling employees to provide superior service to the customers. Furthermore, a good corporate culture has shown to increase employees’ efficiency at work, which is imperative for LCCs. Another implication that derives from the results of this thesis lies the importance of the continuous pursuit of new target segments, destinations, products and services to offer. This is an action that has to be executed constantly since the LCC business model is built upon continuous growth that requires constant adaption to the changing market situations. Finally, the LCCs’ core capability is still their ability to cut costs, which should remain a focus for them as long as they are more agile in their organization than FSCs.
List of references


Booz Allen Hamilton Ltd (2007). The Economic Impacts of an Open Aviation Area Between The EU and The US. London: European Commission Working Paper, Ref: TREN/05/MD/S07.5265


Appendix

Figure 1 – International Airline Regulation Environment
Source: Roland Berger, 2010

<table>
<thead>
<tr>
<th>Region</th>
<th>Regulations</th>
</tr>
</thead>
<tbody>
<tr>
<td>NORTH AMERICA</td>
<td></td>
</tr>
<tr>
<td>Rates and traffic rights</td>
<td>Relatively low restrictions, limitations either due to bilateral agreements or slot restrictions at coordinated airports. Open skies with Europe since 2008.</td>
</tr>
<tr>
<td>Foreign participation and control</td>
<td>USA: Foreign participation limited to max. 26% of voting rights.</td>
</tr>
<tr>
<td>Cabotage: right</td>
<td>In the US not allowed – despite recent efforts to liberalize. Major restrictions for many airlines for market entry.</td>
</tr>
<tr>
<td>Antitrust</td>
<td>Major concerns regarding anti-competitive practices. However, airlines are finding mergers to improve profitability.</td>
</tr>
<tr>
<td>Other relevant topics</td>
<td>USA: Major concerns regarding potential impact on oil reserve in case of crisis. Major mergers with foreign majority participation. Chapter 11 bankruptcy process reduces consolidation.</td>
</tr>
</tbody>
</table>

Limitations of consolidation process: Low Medium High

Figure 2 - Crude oil prices 1947 – 2010 in 2010 dollars
Source: WTRG Economics

Crude Oil Prices 2010 Dollars

<table>
<thead>
<tr>
<th>Year</th>
<th>Price (2010$)</th>
</tr>
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<td>$20</td>
</tr>
<tr>
<td>1948</td>
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<td>$82</td>
</tr>
<tr>
<td>1980</td>
<td>$84</td>
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<tr>
<td>1981</td>
<td>$86</td>
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<tr>
<td>1982</td>
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</tr>
<tr>
<td>1983</td>
<td>$90</td>
</tr>
<tr>
<td>1984</td>
<td>$92</td>
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<tr>
<td>1985</td>
<td>$94</td>
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<tr>
<td>1986</td>
<td>$96</td>
</tr>
<tr>
<td>1987</td>
<td>$98</td>
</tr>
<tr>
<td>1988</td>
<td>$100</td>
</tr>
</tbody>
</table>

World Price


- U.S. 1st Purchase Price (Wellhead)$20.62
- "World Price"$20.62
- Avg U.S.$20.62
- Avg World$20.62
- Median U.S. & World$20.62
Table 3 - LCCs represented in ELFAA
Source: ELFAA website

<table>
<thead>
<tr>
<th>LCCs represented in ELFAA</th>
</tr>
</thead>
<tbody>
<tr>
<td>easyJet</td>
</tr>
<tr>
<td>flybe</td>
</tr>
<tr>
<td>Jet2.com</td>
</tr>
<tr>
<td>Norwegian Air Shuttle</td>
</tr>
<tr>
<td>Ryanair</td>
</tr>
<tr>
<td>SverigeFlyg</td>
</tr>
<tr>
<td>Transavia.com</td>
</tr>
<tr>
<td>Vueling</td>
</tr>
<tr>
<td>Wizz Air</td>
</tr>
</tbody>
</table>
Table 6 - Semi-structured interview questions

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>What do you think about the deregulation process in the European market? Do you think it is completed?</td>
<td></td>
</tr>
<tr>
<td>What will be the expected changes in the airline industry in ten years?</td>
<td></td>
</tr>
<tr>
<td>What is the biggest problem for airline industry today and what will be for the future?</td>
<td></td>
</tr>
<tr>
<td>Most of the airlines claim that the biggest challenge is and will be the fuel prices, do you agree?</td>
<td></td>
</tr>
<tr>
<td>What do you think about LCC business model in general?</td>
<td></td>
</tr>
<tr>
<td>What are the existing challenges for low-cost carriers especially in Europe?</td>
<td></td>
</tr>
<tr>
<td>What will be the future challenges for LCCs in Europe?</td>
<td></td>
</tr>
<tr>
<td>Do you think that LCC business models will change in the future with regards to both global and European perspective?</td>
<td></td>
</tr>
<tr>
<td>Do you believe that low-cost carriers are being a threat to your airline? If yes, how do you plan to tackle with this problem?</td>
<td></td>
</tr>
<tr>
<td>How do LCCs affect you in the market and how do you compete with them?</td>
<td></td>
</tr>
<tr>
<td>Do you think that it will be better for full-service carriers to tackle this challenge by creating their own low-cost airline? Would there be another option?</td>
<td></td>
</tr>
<tr>
<td>What do you think about long-haul low-cost carriers? Do you think it will be possible to implement long-haul flights into the LCC business model after seeing the failure of Air Asia (Paris- Kuala Lumpur)?</td>
<td></td>
</tr>
<tr>
<td>What would be the next target group for low-cost carriers in Europe?</td>
<td></td>
</tr>
<tr>
<td>What do you think about the GDS systems? How does it add value for airlines?</td>
<td></td>
</tr>
<tr>
<td>What do you think about low-cost airlines not being in GDS systems? Do you think low-cost airlines should implement their own GDS system or try to get in existing GDS systems?</td>
<td></td>
</tr>
<tr>
<td>Do you offer low-cost terminals for LCCs? What are the pros and cons?</td>
<td></td>
</tr>
</tbody>
</table>