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Long-haul low-cost

– Market Opportunities and Threats –

The Hague, Crowne Plaza Hotel
September 18, 2007
Content

1. LCC market success factors in short haul markets
   - Origin/destination focus
   - Product focus
   - Yield Management / Pricing
   - Ancillary revenues

2. Opportunities from applying traditional market success factors of LCCs to long-haul markets
   - Origin/destination focus (including feeder issues)
   - Product focus
   - Yield Management / Pricing
   - Distribution
   - Ancillary revenues
Lacking capacities and competition have been key enablers for LCCs to enter into short haul markets.

**Focus of market penetration**

- **prior to 1997**
  - Domestic services competing with low capacity/high yield offerings
    - Examples:
      - RYANAIR within UK/Ireland
      - Germanwings (1st edition) within Germany

- **1997 to 2005**
  - European services competing with low capacity/high yield offerings
    - Examples:
      - Mediterranean mainland destinations Italy/France/Spain
      - Alpine destinations
      - Scandinavian destinations
  - Home base penetration
    - Examples:
      - RYANAIR and easyJet within Continental Europe
      - SkyEurope, Wizz ... within CEE countries

- **since 2005**
  - Deregulation
  - Saturation
  - European high volume low yield markets (traditional charter markets)
    - Examples:
      - Aggressive penetration of Baleares and Canaries destinations
      - Greek Islands destinations
      - Turkish leisure destinations
      - North African leisure destinations
Simple („no frills“) product features not only reduce cost but also ease processes for customers

**Product Focus**

- **Sales and Distribution**
  - One class
  - One price at a time
  - »click and buy«
  - Open 24/7

- **Check-in and Boarding**
  - No physical ticket
  - Simple identification processes
  - Simple seating procedures
  - Non-stop

- **On Board**
  - Free seating
  - Service on demand

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*Easy to buy – easy to fly*
LCCs pricing strategies create additional demand for air travel.

Yield Management and Pricing

Yield Management

Business Travel

Leisure Travel

Mode of transportation

Choice of destination

Stay or travel

Additional demand for air travel
LCCs consequently search for ancillary contributions to allow for low ticket prices.

Ancillary revenue

- Subsidies for local infrastructures
- Success fees from incoming tourism boards and airport non aviation concessionaires
- Sales commissions from car rentals, hotels, … for cross-selling via LCC web page
- Separate charges for in flight services and other additional services (i.e. seat reservation, baggage, …)
Would all this bring any innovation to the long haul markets?

Not really!
Beyond hub-to-hub and hub-to-spoke routes only few O&Ds offer potential for non-stops.

Network economics of long haul markets

1. Long haul operations depends on feeder at the one or the other or even at both ends.

2. Network carriers don’t charge but even »pay« passengers for accepting being feedered.
Network carriers’ long haul aircraft offer Y-class seating capacities in excess.

Standard seat configuration

B 747-400

A 380

<table>
<thead>
<tr>
<th>Airline</th>
<th>B 747-400</th>
<th>A 380</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>65 F/B 338 Y</td>
<td>64 F/B 425 Y</td>
</tr>
<tr>
<td>Premium</td>
<td>48 »Premium«-Y</td>
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Singapore Airlines

<table>
<thead>
<tr>
<th></th>
<th>B 747-400</th>
<th>A 380</th>
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<tbody>
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<tr>
<td>Business</td>
<td>50</td>
<td>60</td>
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<tr>
<td>Economy</td>
<td>399</td>
<td>313</td>
</tr>
</tbody>
</table>

- Network carriers operate huge Y-class seating capacities in order to materialize large aircrafts’ unit cost advantage.
- A 380 will add even more surplus capacities.
To fill capacities Economy-class tickets are dumped into markets at rates hardly covering DOC.
Applying the »Product Specialist« approach to premium class services might offer a niche.

Eos Airlines
JFK - STN
48 seats per B757
Focus:
High-Yield
Corporate VIPs
Key Differentiators:
Large horizontal bed with personal service

MAXjet Airways
JFK / IAD / LAS - STN
100 seats per B767
Focus:
Large and small business
Affluent leisure
Key Differentiators:
Low, flexible fares for traditional Business Class

Source: John Wensveen: OPPORTUNITIES FOR THE LONG-HAUL LOW-COST MODEL
However, even Business-class yields are not up in seventh heaven any more.

Source: http://www.OPODO.de, 15.09.2007
Where »Product Specialists« enter into markets, incumbents have lowered fares to defend their stake.


<table>
<thead>
<tr>
<th>Rank</th>
<th>Airline</th>
<th>London</th>
<th>New York</th>
<th>Return fare (UK£)</th>
<th>Stops</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Maxjet</td>
<td>STN</td>
<td>JFK</td>
<td>835,10</td>
<td>nonstop</td>
</tr>
<tr>
<td>2-5</td>
<td>Silverjet</td>
<td>LTN</td>
<td>EWR</td>
<td>997,50</td>
<td>nonstop</td>
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<tr>
<td>5</td>
<td>Air India</td>
<td>LHR</td>
<td>JFK</td>
<td>1.085,60</td>
<td>nonstop</td>
</tr>
<tr>
<td>6-36</td>
<td>Air France</td>
<td>LHR</td>
<td>JFK / EWR</td>
<td>1.358,10</td>
<td>1 stop</td>
</tr>
<tr>
<td>37-41</td>
<td>American Airlines</td>
<td>STN</td>
<td>JFK</td>
<td>1.466,68</td>
<td>nonstop</td>
</tr>
<tr>
<td>42-76</td>
<td>American Airlines</td>
<td>LHR</td>
<td>JFK</td>
<td>1.472,40</td>
<td>nonstop</td>
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<tr>
<td>77-124</td>
<td>KLM / Northwest</td>
<td>LHR / LCY</td>
<td>JFK / EWR</td>
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</tr>
<tr>
<td>125-148</td>
<td>KLM / Air France</td>
<td>LHR</td>
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<tr>
<td>149-151</td>
<td>EOS</td>
<td>STN</td>
<td>JFK</td>
<td>1.666,68</td>
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<td>Delta</td>
<td>LGW</td>
<td>JFK</td>
<td>1.706,10 – 1.753,70</td>
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<tr>
<td>158-159</td>
<td>Continental</td>
<td>LGW</td>
<td>JFK</td>
<td>1.776,10</td>
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</tr>
<tr>
<td>160-189</td>
<td>Northwest/KLM</td>
<td>LCY</td>
<td>JFK / EWR</td>
<td>1.792,80 – 1.808,20</td>
<td>1 stop</td>
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<tr>
<td>190-198</td>
<td>Lufthansa</td>
<td>LHR</td>
<td>JFK / EWR</td>
<td>1.813,50 – 1.817,70</td>
<td>1 stop</td>
</tr>
</tbody>
</table>

Source: [http://www.OPODO.co.uk, 15.09.2007](http://www.OPODO.co.uk, 15.09.2007)

Last but not least, incumbent leisure carriers apply LCC pricing strategies for long haul services.

**Examples**

Long-haul low-cost – what makes the difference?
In conclusion, economics of long haul markets, timing and reactions of incumbents leave little opportunity for long haul LCCs.

**Summary of opportunities**

<table>
<thead>
<tr>
<th>Key enablers of LCCs</th>
<th>Reasoning</th>
<th>Drivers</th>
<th>Rating</th>
</tr>
</thead>
</table>
| **Origin/destination focus** | ▪ Hub&spoke  
▪ Oversized economy compartments due to addiction to »optimize« unit cost | Market economics |  |
| **Product focus** | ▪ Leisure travel O&Ds served by leisure carriers at LCC cost standards  
▪ Higher share of hardly manageable DOC (i.e. fuel, air traffic control)  
▪ Web based distribution has been adopted by incumbent players | Market economics & timing |  |
| **Yield management / pricing** | ▪ Strategies applied by incumbent players | Timing |  |
| **Ancillary revenues** | ▪ Lower impact because of higher share of DOC | Market economics |  |