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# Impact of Deregulation

Dr George Williams

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# Pre-Deregulation in the US

- **Carriers were not able to compete in terms of price**
- **Service quality and frequency were the main means by which they competed**
- **Load factors were low and unit costs high as a result**

- **A study by Jordan (*Airline Regulation in America, 1970)* of inter-state trunk airline fares in 1965 showed that *if there had been no regulation these would have been 32 – 47% lower***

# Airline Competition in Major US City Pairs (1970)

| Number of competitors* | Number of city-pairs |
|---|---|
| 1 | 4 |
| 2 | 90 |
| 3 | 38 |
| >3 | 3 |

Source: US Dept of Transportation, “Top City Pairs”, 1970
(*at least 10% market share)

## *US Trunk Airlines Pre-Deregulation (c. 1970)*

**American**

**Braniff - *bankrupt in 1981 and ceased operating***

**Continental - *bankrupt in 1983, but re-established***

**Delta – *bankrupt in 2005, exited Chapter 11 in 2007***

**Eastern - *bankrupt in 1989 and ceased operating***

**National - *acquired by Pan Am in 1979***

**Northeast - *acquired by Delta in 1971***

**Northwest - *bankrupt 2005, exited Chapter 11 in 2007***

**TWA - *acquired by American in 2001***

**United - *bankrupt in 2002, exited Chapter 11 in 2006***

**Western - *merged with Delta in 1986***

# US Deregulation

- US interstate markets tightly regulated from 1940
- US Domestic Market fully liberalised in 1978
- US international markets tightly regulated since 1945
- Intra-European Market gradually liberalised 1987-1997

*Forms of Regulation*

| | *Domestic US* | *Intra-Europe* |
|---|---|---|
| **Fares** | ✓ | ✓ |
| **Capacity** | ✗ | ✓ |
| **Market Entry** | ✓ | ✓ |

# Response to Competition in the US

- Realigning route networks – linear to *hub and spoke*
- Interline to Online connections
- Franchising of feeder services
- Change in methods of distribution
- CRS development and exploitation
- Frequent flier programs

# Outcome of US Deregulation

- Lower fares
- Increase in market concentration
- Poor profitability
- Entry of low cost no-frills airlines
- Use of Chapter 11 bankruptcy protection

# European Liberalisation

Liberalisation an on-going evolutionary process

Impact of Tight Economic Regulation

Breaking the Mould:

~ affinity group charters

~ inclusive tours

Changing Market Conditions

# Key Differentiating Features

- Europe comprises over 30 autonomous states each with its own language, culture and administrative procedures. (80% of airline trips are international.)

- Around 20% of intra-European demand (RPKs) is carried on non-scheduled (charter) services. (Most of this traffic consists of inclusive tour holidaymakers travelling from Northern Europe to Mediterranean resorts.)

- Hub and Spoke Systems already in existence, but not exploited.

- Flag carriers were nearly all state-owned. (Very few independently owned airlines operated scheduled services.)

# European Flag Carriers

| | % State Owned | Airline Equity Holder % |
|---|---|---|
| Aer Lingus | 28 | |
| Air France - KLM | 19 | |
| Alitalia | 50 | AF 2 |
| Austrian | 40 | |
| British Airways | 0 | |
| Finnair | 58 | |
| Iberia | 0 | BA 10 |
| Lufthansa | 0 | |
| Luxair | 23 | LH 13 |
| Olympic | 100 | |
| SAS | 50 | |
| TAP | 100 | |

# The European Approach

**Stage 1** **Bilateral Harmonisation**

**Stage 2** **Bilateral Liberalisation**

**Stage 3** **Multilateralism**

***Key Underlying Objective:***

***Achieving a Common European Market***

# Outcomes of European Liberalisation

- Acquisition of local *potential* competitors
- Acquisition of carriers based in other EU states
- Franchising of feeder airlines
- Outsourcing
- Emergence of low cost "no-frills" carriers (e.g. Ryanair, easyJet, Germanwings, Norwegian)

# Impact of Deregulation in the French Domestic Market

# *Paris (Orly) - Toulouse  November 1994*



| Depart | Aircraft | Seats |
|---|---|---|
| 06.50 | A330 | 412 |
| 08.15 | A320 | 172 |
| 09.10 | A330 | 412 |
| 11.30 | A300 | 314 |
| 13.15 | A320 | 172 |
| 14.25 | A330 | 412 |
| 15.30 | A300 | 314 |
| 16.20 | A320 | 172 |
| 17.20 | A330 | 412 |
| 19.15 | A300 | 314 |
| 21.05 | A330 | 412 |
| 21.55 | A320 | 172 |

# Paris (Orly) - Toulouse  November 1995

| *Air Inter* | | Air Liberté | | Euralair | | TAT | |
|---|---|---|---|---|---|---|---|
| Dept | A/c | Dept | A/c | Dept | A/c | Dept | A/c |
| *06.10* | *A320* | 06.05 | MD83 | 07.30 | B732 | 06.05 | F100 |
| *07.05* | *A330* | 07.55 | A310 | 09.45 | B732 | 08.30 | F100 |
| *08.15* | *F100* | 09.05 | A300 | 17.20 | B732 | 11.15 | F100 |
| *09.05* | *A321* | 12.25 | A310 | 20.35 | B732 | 16.10 | F100 |
| *10.40* | *A320* | 15.05 | MD83 | | | 18.45 | F100 |
| *12.05* | *A320* | 17.00 | A310 | | | 20.00 | F100 |
| *13.25* | *A321* | 19.45 | A300 | | | | |
| *15.15* | *A321* | | | | | | |
| *17.00* | *A320* | *18.15* | *A300* | *20.15* | *A320* | | |
| *17.50* | *A320* | *19.15* | *A321* | *21.10* | *A330* | | |

# Impact of Competition on Paris (Orly) - Toulouse

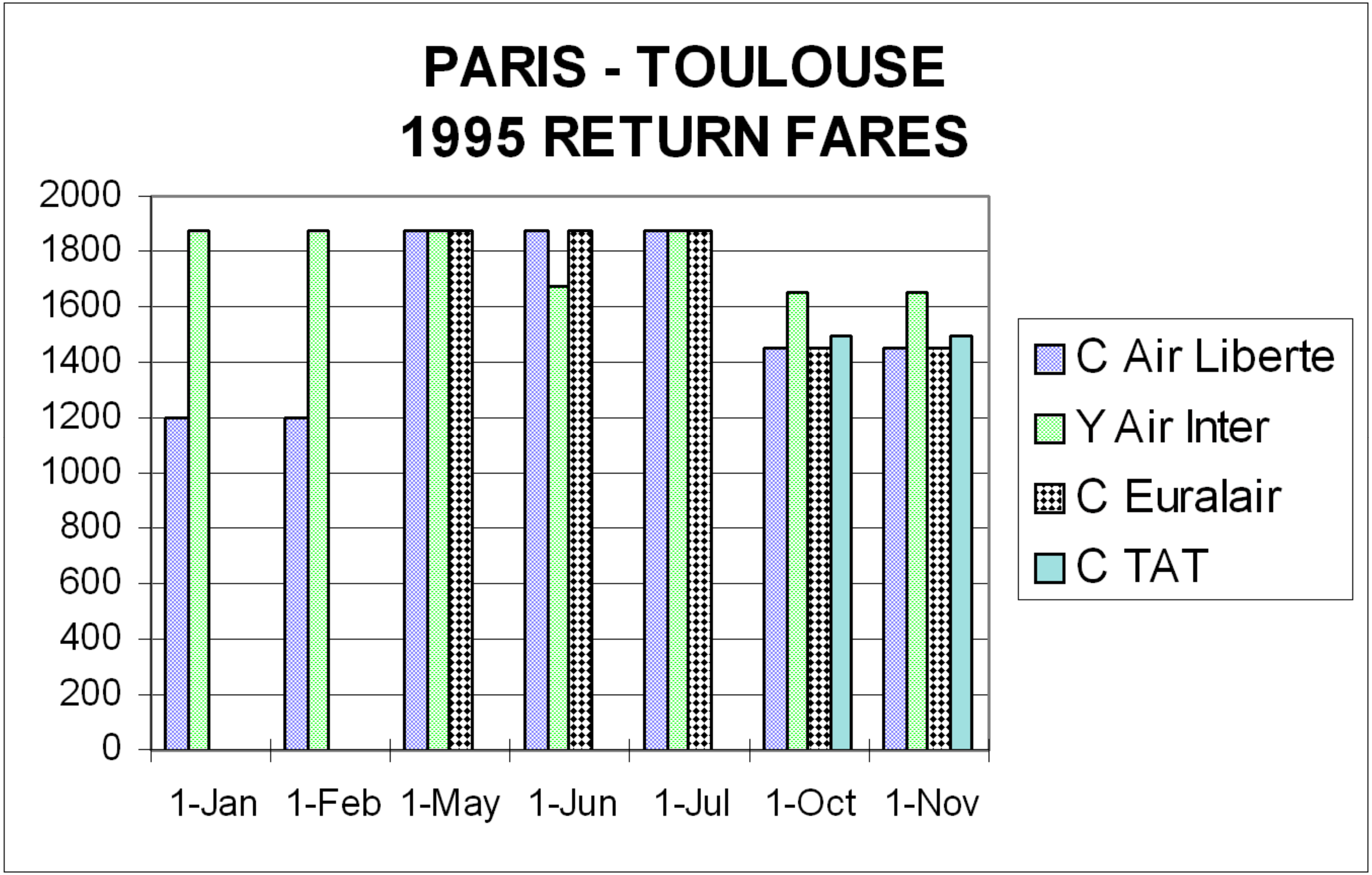
| | October 1994 | October 1996 | % change |
|---|---|---|---|
| Daily Frequency | 13 | 32 | 246 |
| Daily Seats | 3690 | 5326 | 44 |
| Seats per flight | 284 | 166 | - 42 |

# Incumbent response in France to deregulation

- Increase frequency
- Downsize aircraft
- Match new entrant discount fares
- Maintain single class
- Maintain high density seating
- Maintain minimal in-flight service

# Air Inter Fleet March 1994

| Aircraft type | Number in fleet | Seating capacity |
|---|---|---|
| Mercure | 8 | 156 |
| Airbus 320 | 35 | 172 |
| Airbus 300 | 19 | 314 |
| Airbus 330 | 3 | 412 |
| *On order* | | |
| Airbus 319 | 9 | 142 |
| Airbus 321 | 7 | 207 |
| Airbus 330 | 12 | 412 |


PARIS - TOULOUSE
1995 RETURN FARES
2000
1800
1600
1400
1200
1000
800
600
400
200
0
1-Jan
1-Feb
1-May
1-Jun
1-Jul
1-Oct
1-Nov
C Air Liberte
Y Air Inter
C Euralair
C TAT

# Paris (Orly) - Toulouse  May 1998

| Air France | | Air Liberté | |
|---|---|---|---|
| **Depart** | **Aircraft** | **Depart** | **Aircraft** |
| 06.30 | A320 | 07.10 | MD83 |
| 07.00 | A320 | 07.50 | F100 |
| 07.30 | B733 | 09.20 | MD83 |
| 08.00 | A319 | 11.10 | F100/MD83 |
| 08.30 | A319 | 12.10 | F100/MD83 |
| 09.00 | A319 | | |
| 09.30 | A320 | | |
| 10.00 | B733 | *Seats* | |
| 11.00 | B733 | *A320 (172)* | *F100 (105)* |
| 11.30 | A319 | *A319 (142)* | *MD83 (159)* |
| 12.00 | A319 | *B733 (141)* | |

# Paris (Orly) - Toulouse  October 2007

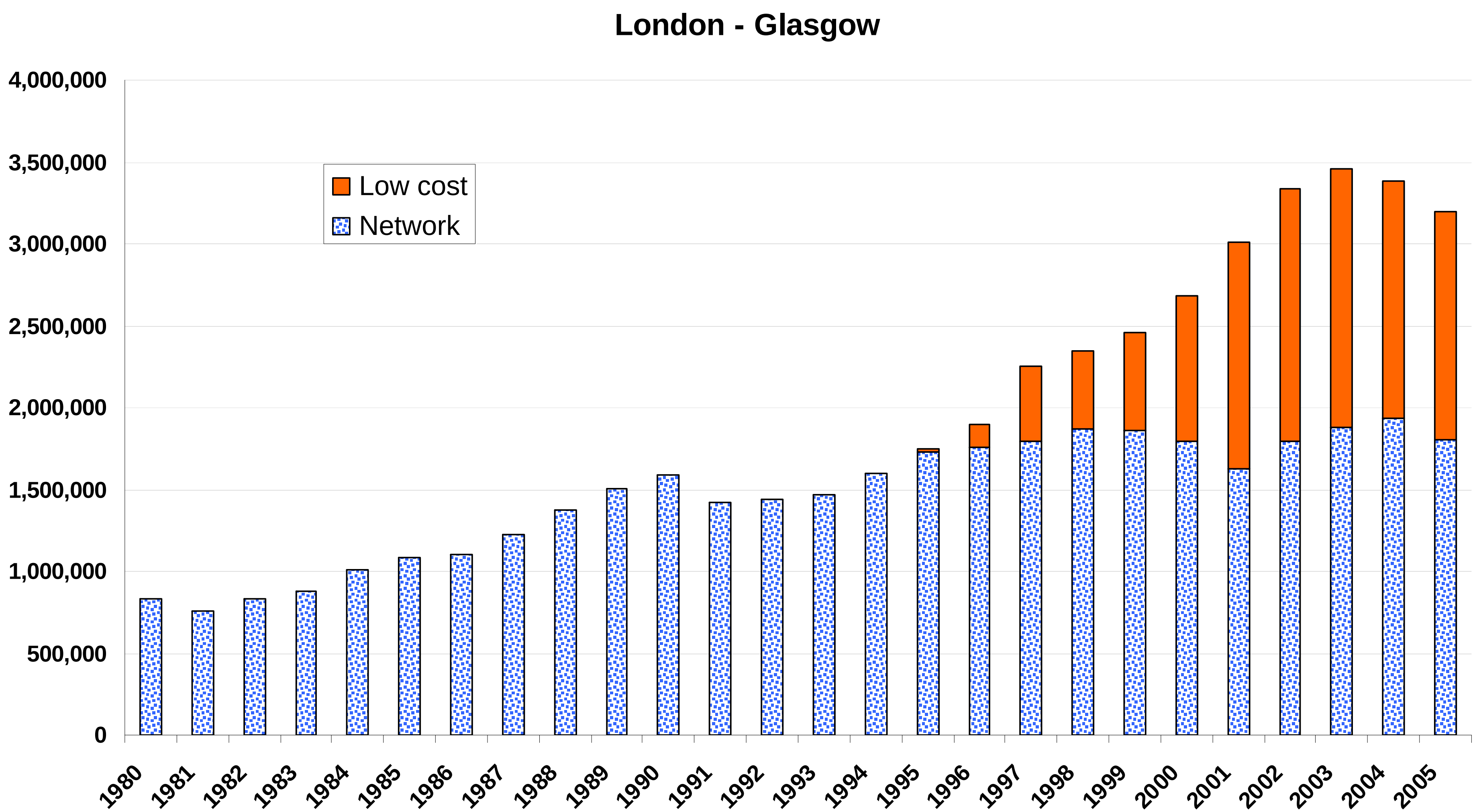
- **Air France – every 30 minutes in peak hours, hourly at off-peak times**

- **easyJet – 4 daily flights**

# UK Domestic Trunk Routes

- No-frills carriers have had a major impact on UK  domestic air routes, with around 50% of passengers travelling within the UK on such services (up from 37% in February 2003 and 22% in February 2001)
- London – Glasgow is one of the UK's busiest domestic city pairs, with services provided from four of the capital's airports
- Of the 3.2 million journeys undertaken in 2005, some 50% were on flights operated by low cost airlines

# Annual passenger traffic 1980 - 2005



# Traffic generation on London-Glasgow

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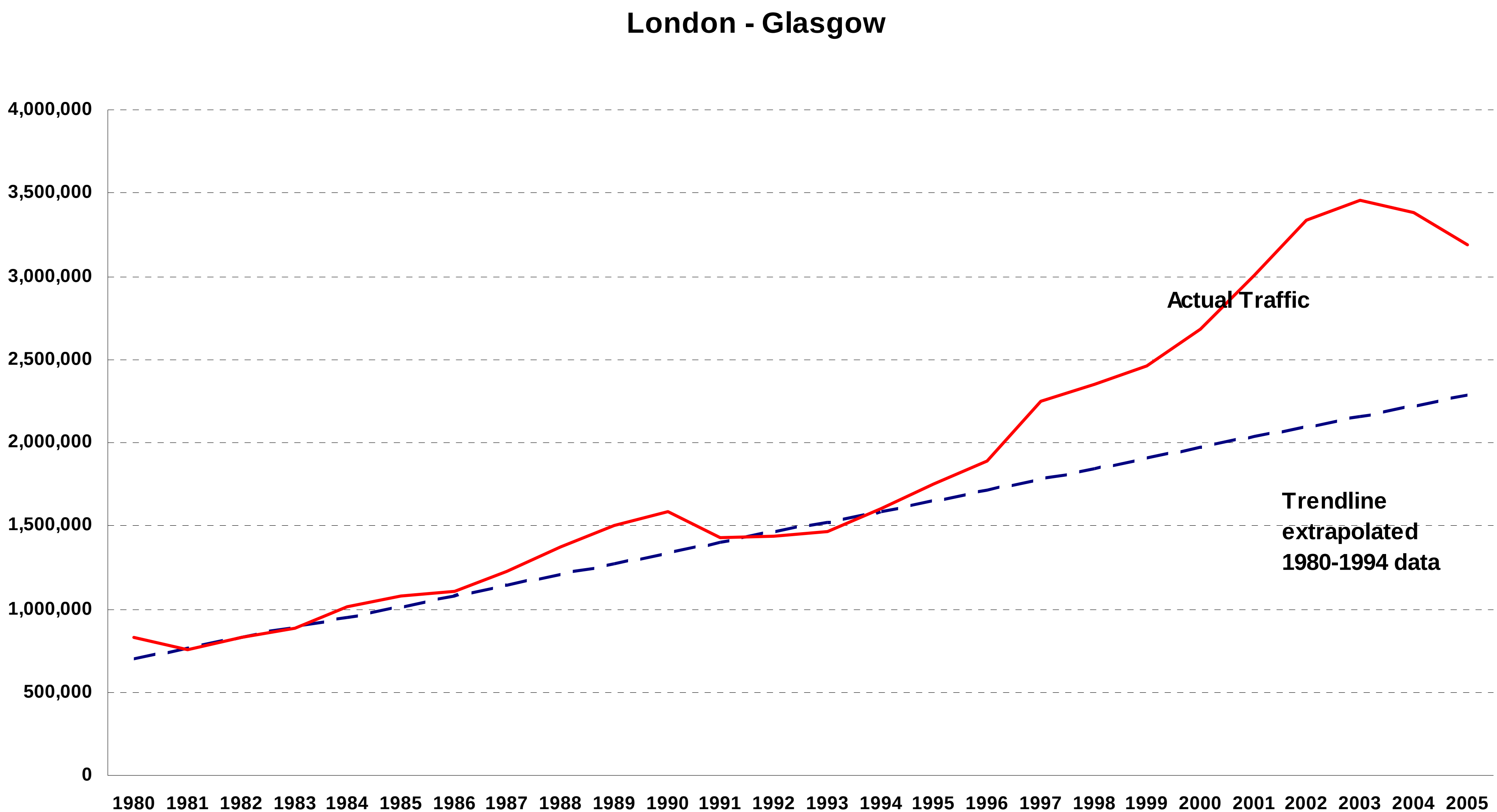

# No frills traffic at UK Regional Airports

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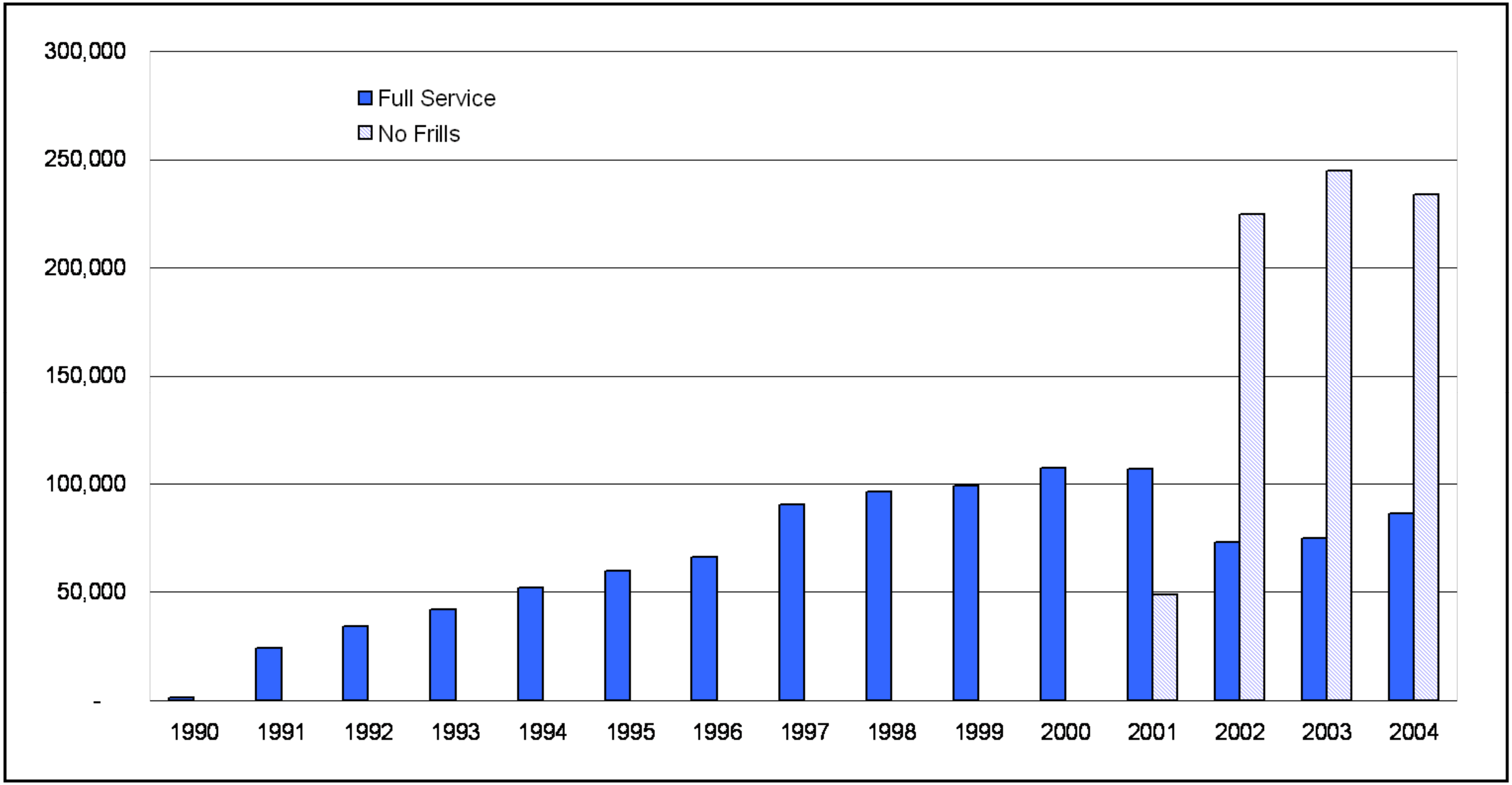
- Since 1999 UK regional airports have attracted the attentions of low cost operators

- Go, for example, began operations between Bristol and Edinburgh in September 2001, producing an even more dramatic increase in traffic volumes than that experienced on London-Glasgow

- Passenger journeys nearly trebled from 107,000 in 2000 to 324,000 in 2003 (329,745 in 2005)

# Bristol – Edinburgh traffic 1996-2004



# No frills impact on Bristol - Edinburgh

- Go’s traffic share during the first quarter of 2003 was a staggering 82%

- Despite this dominant position of the low cost operator (easyJet) with its three daily rotations, BA Citiexpress continued to provide five services each weekday using Embraer 145 regional jets until March 2007

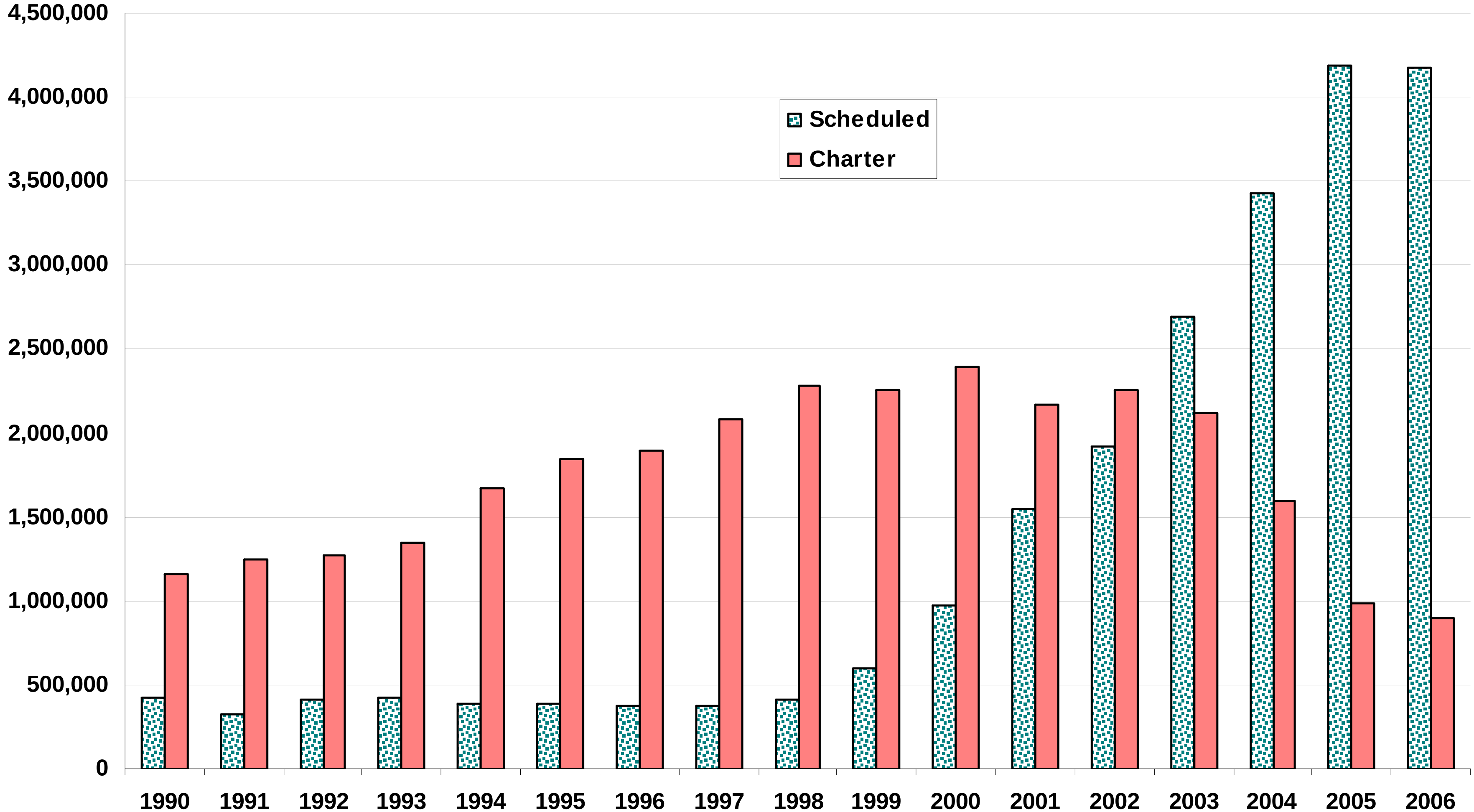
- It is worth noting that the full service provider experienced a drop of 31.5% in its passenger traffic on the route in 2002 compared to the previous year

# *UK Intra-European Scheduled Routes*

- **54% of passengers are now travelling between the UK and EEA countries on the services of no-frills carriers**

- **UK – Malaga routes provide a good example of the impact that low cost “no-frills” carriers have had on conventional network airlines and charter companies**

# UK – Malaga Passenger Traffic



# Industry Performance Comparisons

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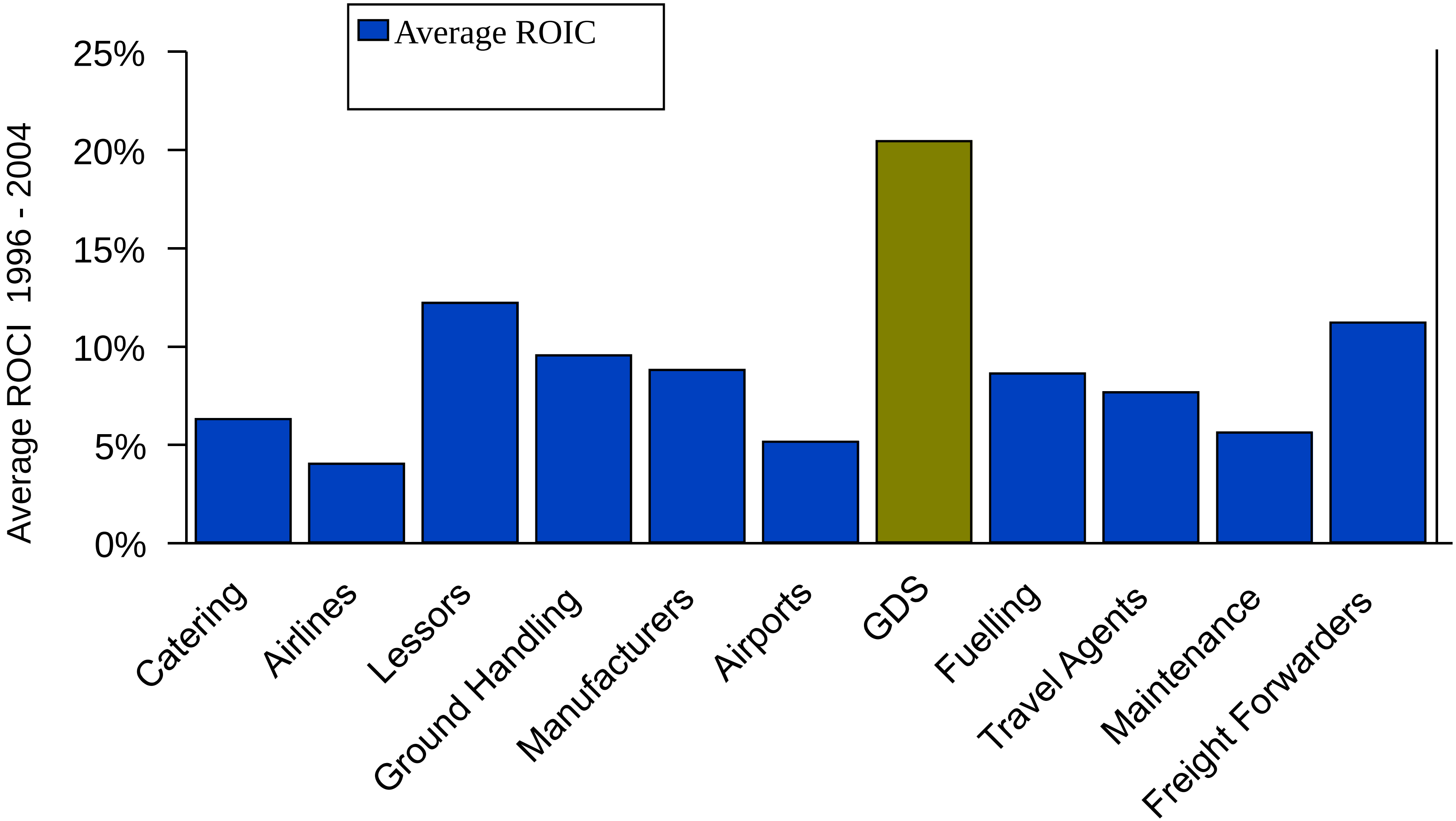


Source: Value Chain Profitability (June 2006), IATA

# Financial Margins by Regions in 2004

| Region | Operating Margin |
|---|---|
| EU[1] | 2.5% |
| US[2] | (1.0%) |
| Asia[3] | 6.0% |

1 20 network carriers (1.5%), 3 regional airlines (-4.0%), 4 LCCs (10.8%) and 6 charter airlines (9.6%)

2 Air Transport Association members

3 Association of Asia Pacific Airlines members

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Sir Richard Branson is said to have admitted when asked how to become a millionaire:

**“Start as a billionaire and buy an airline.”**

# Poor Financial Performance partly due to external factors

- Economic downturn
- Sept 11th 2001 terrorist attacks
- Iraq war
- SARS
- Increasing oil prices

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# Poor Financial Performance partly due to internal factors

- Overly complex operations
- Inability to modify business model quickly
- Obsession with market share and load factor at the expense of profit
- Excess capacity
- Hub inefficiency and congestion
- Ignoring low cost carriers as viable competitors
- Ignoring the changes in customers' purchasing behaviour

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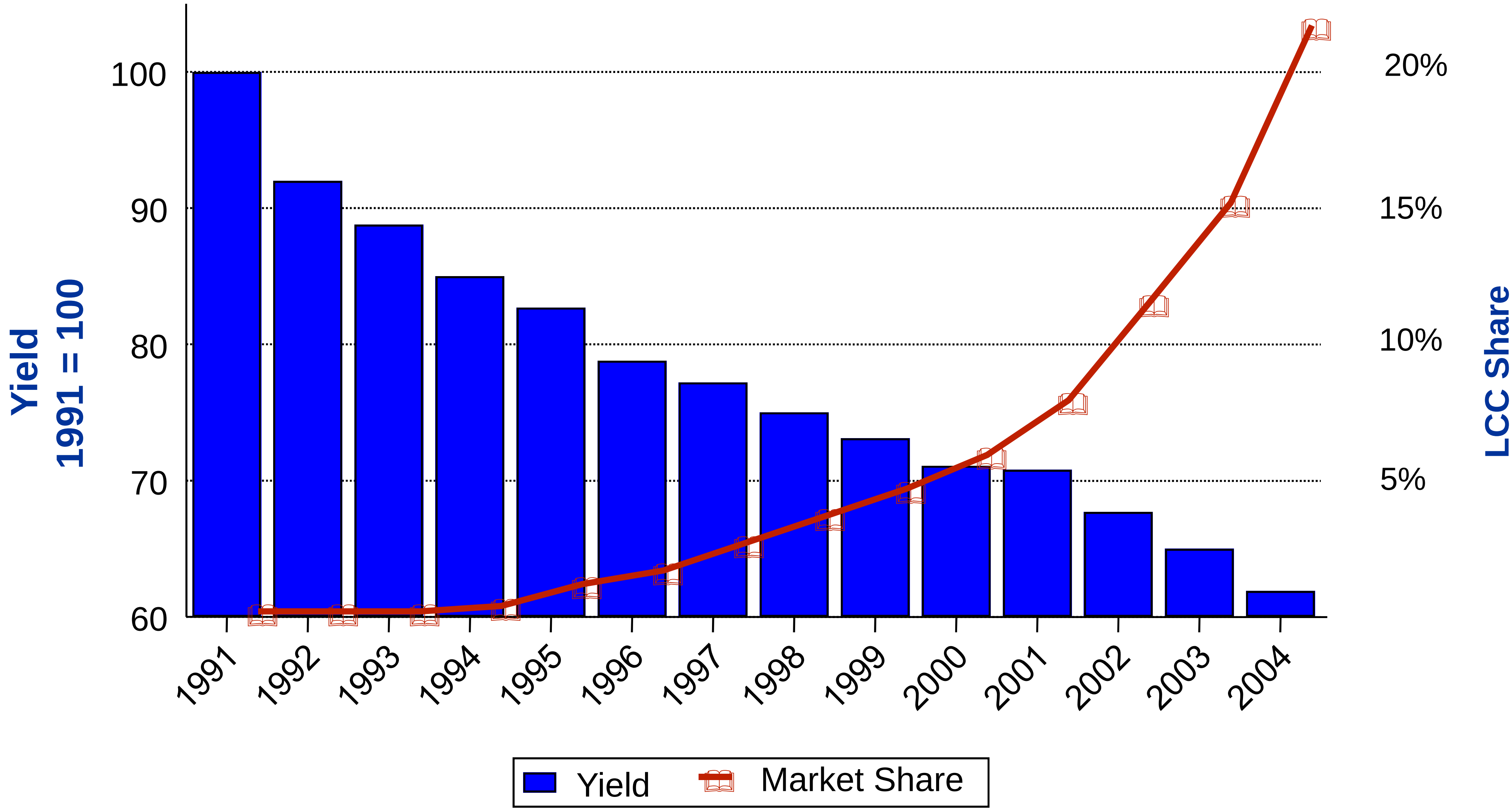
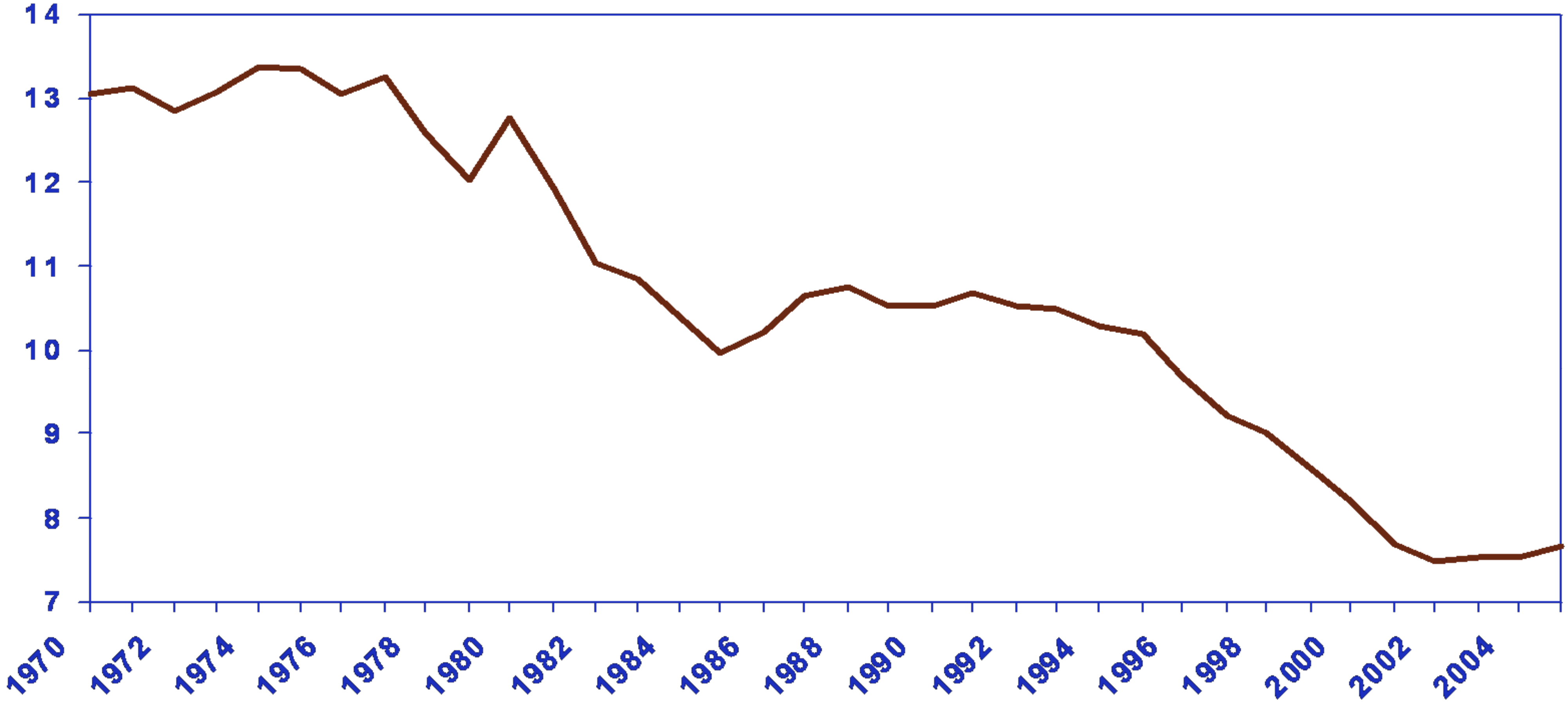
# Decline in European Short-Haul Yields verses LCC Share



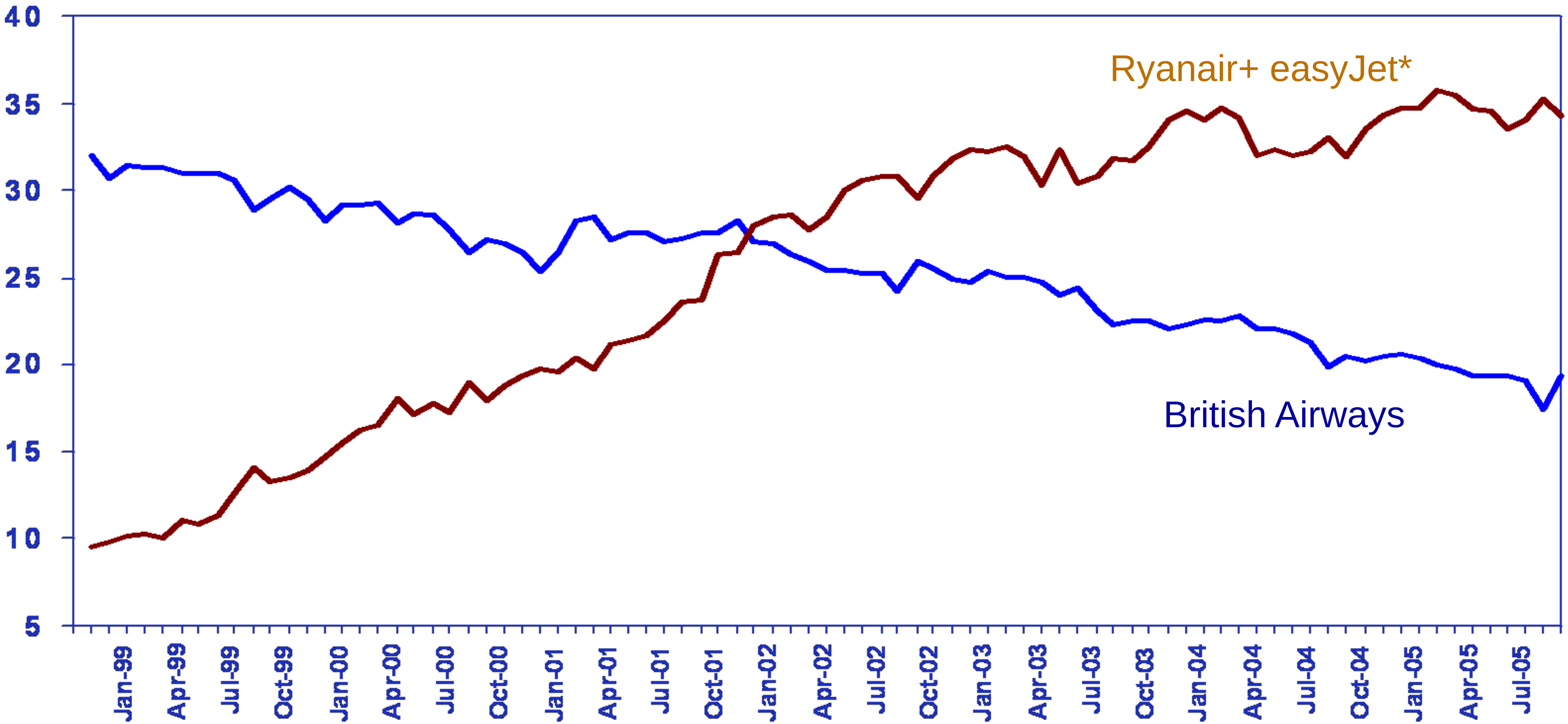

Sources: AEA, ABN estimates

# Average Real Yield Falling



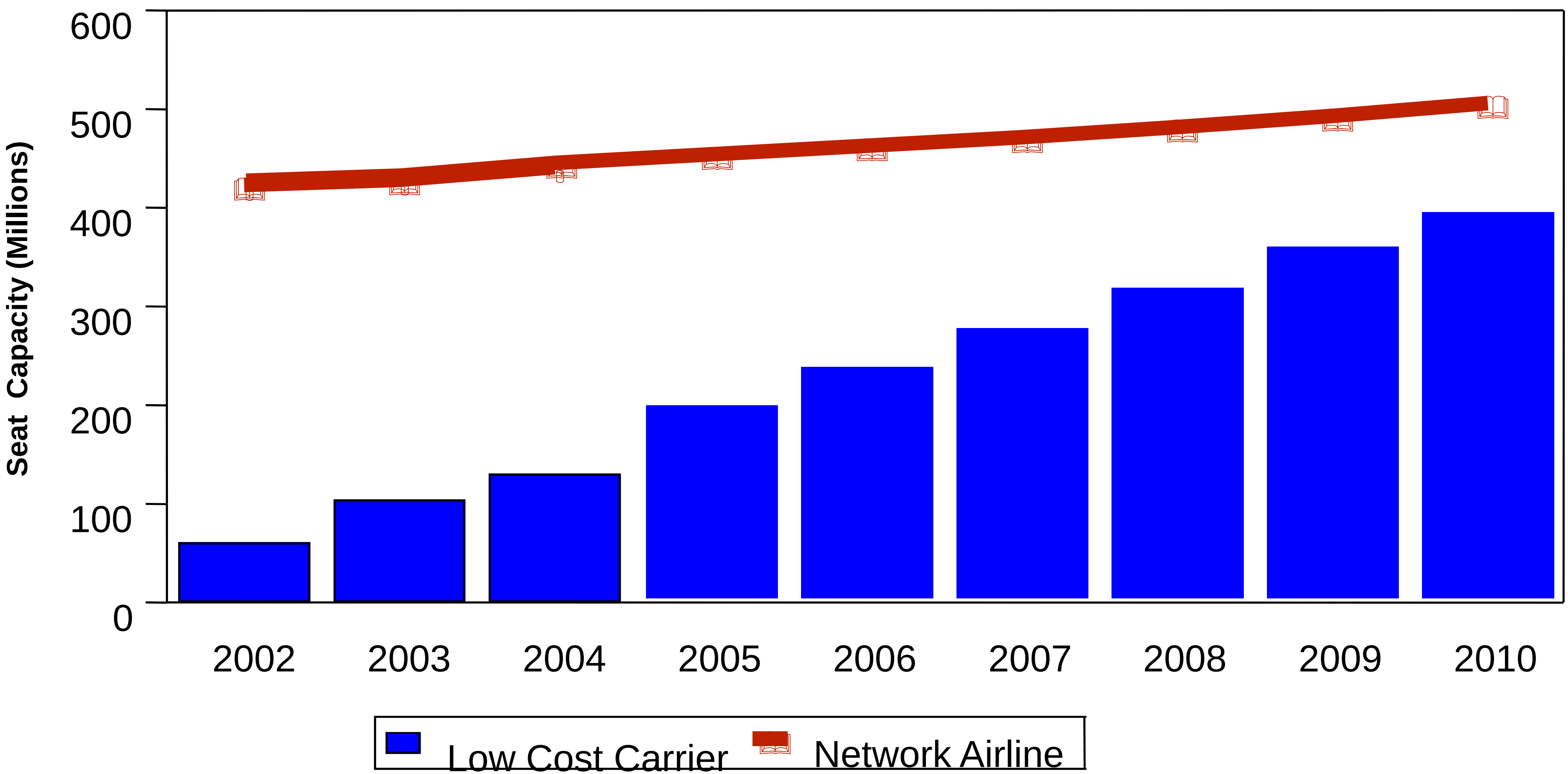

US cents per RPK, world scheduled airlines, deflated by US CPI, 1990=100 Sources: ICAO, IATA

# % of passengers - UK short haul scheduled flights




* Ryanair, Buzz, easyJet, go      Source: British Airways, 01.11.2005

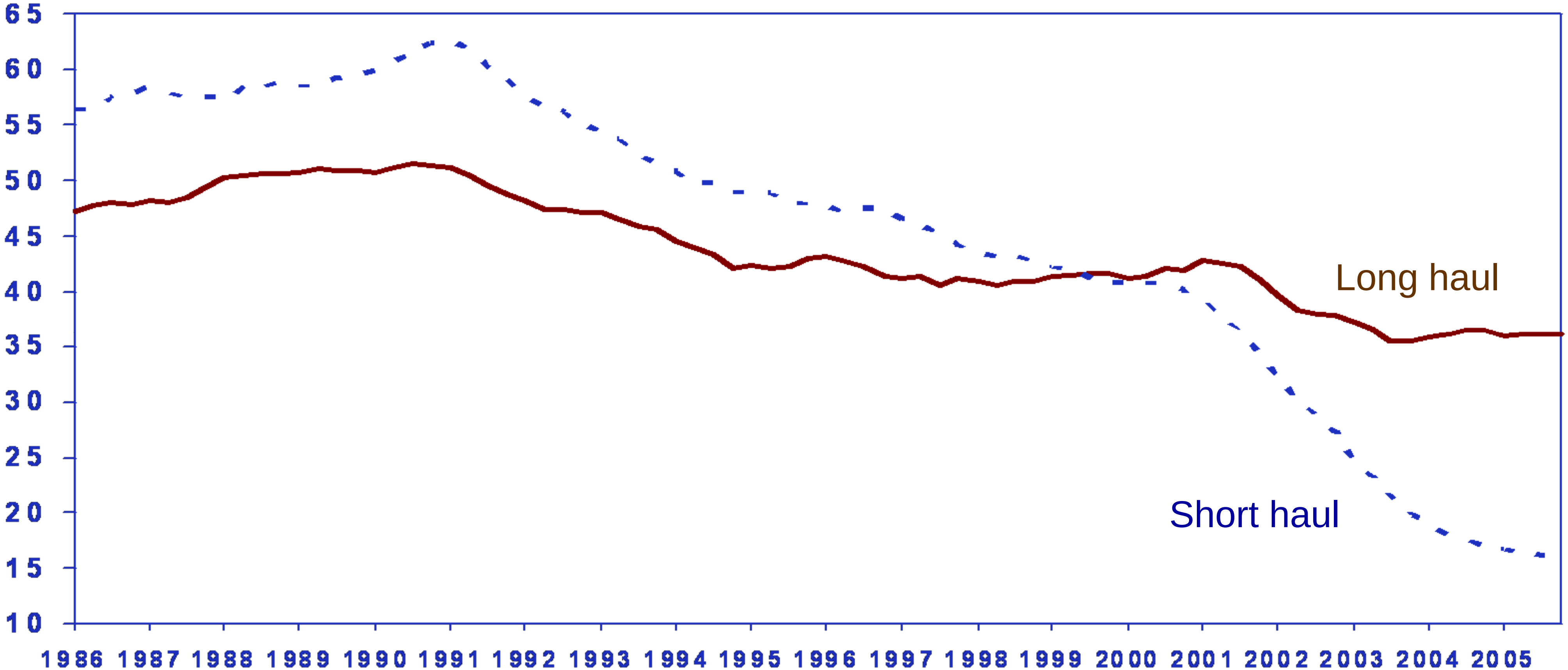
# Time series forecast, low cost carrier verses network airline
# European Seat Capacity 2002-2010




Source: O'Connell

# Shifting Pattern of Business Travel

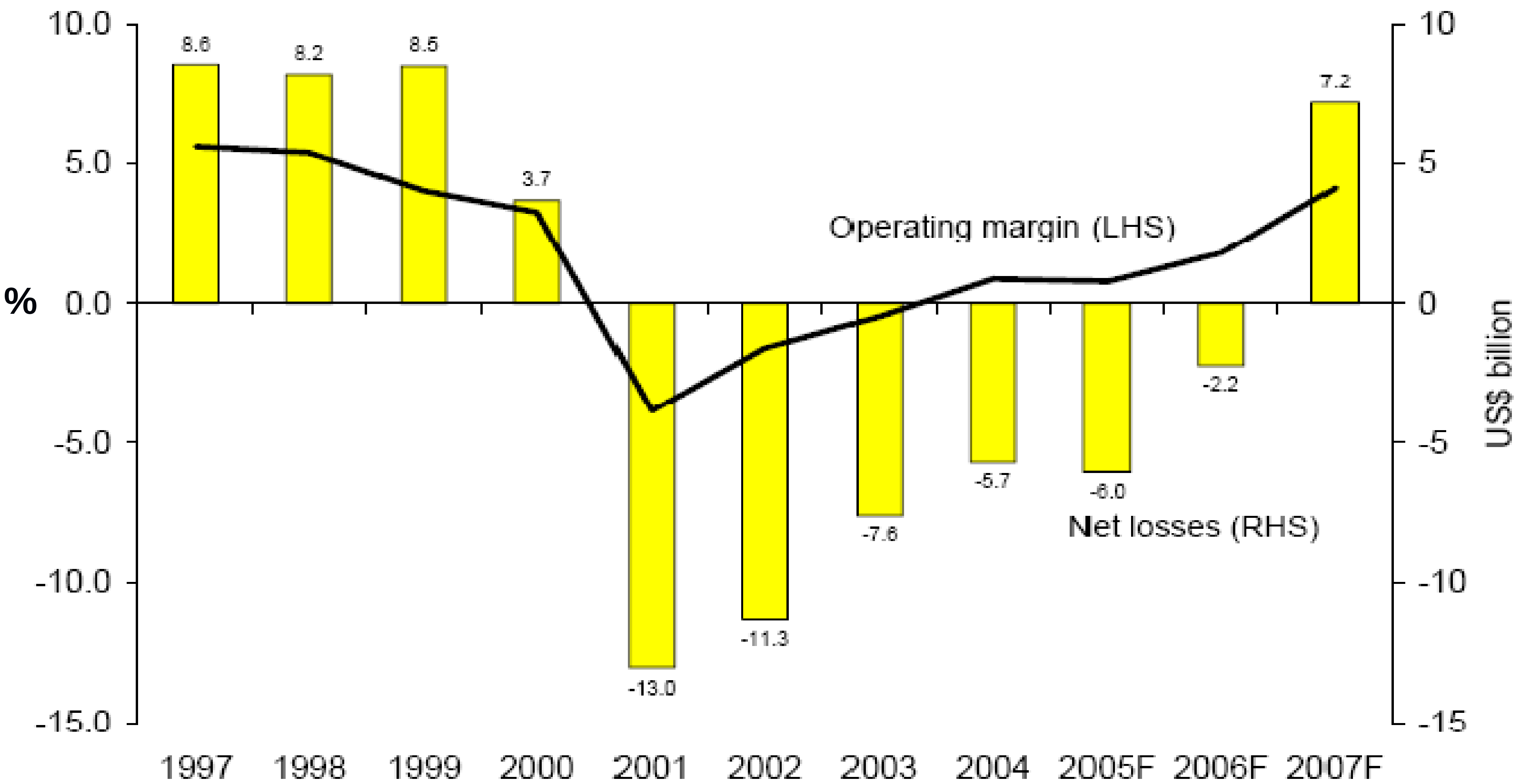
% of business travellers in premium cabins, 4 quarter average



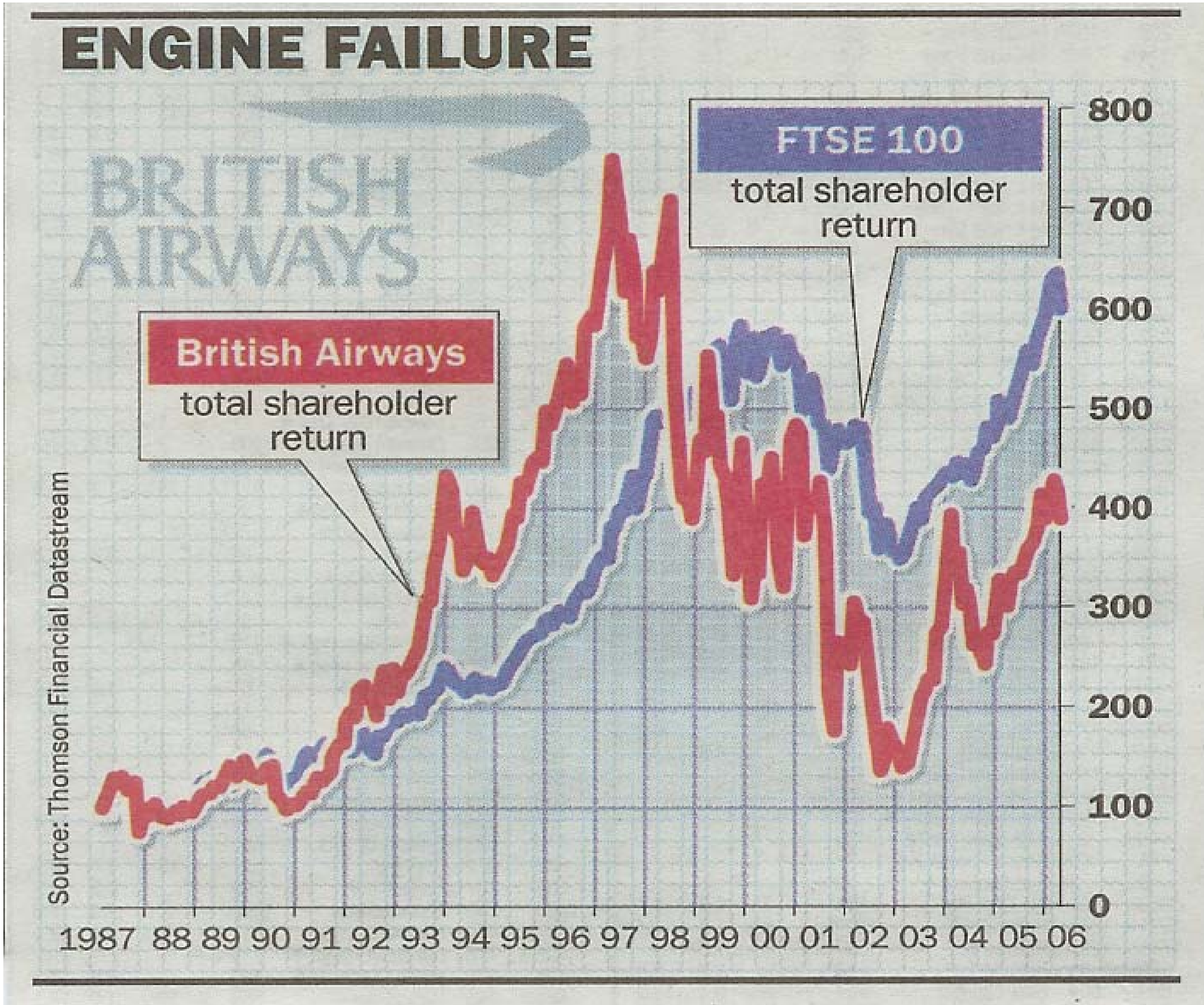

Source: British Airways, January 2006

# The results of Airline Deregulation so far

- Poor financial returns
- Falling yields
- Rapid growth of Low Cost Carriers
- Increased consumer awareness
- Development of Survival strategies
- Formation of global alliances
- *Emergence of new international hubs*
- *Innovation – new products*



%
10.0
5.0
0.0
-5.0
-10.0
-15.0
10
5
0
-5
-10
-15
US$ billion
8.6
8.2
8.5
3.7
-13.0
-11.3
-7.6
-5.7
-6.0
-2.2
7.2
Operating margin (LHS)
Net losses (RHS)
1997
1998
1999
2000
2001
2002
2003
2004
2005F
2006F
2007F




## BA FY 2004/5

## Operating margin 8.3%

***Source:***

***The Times 20/5/06***

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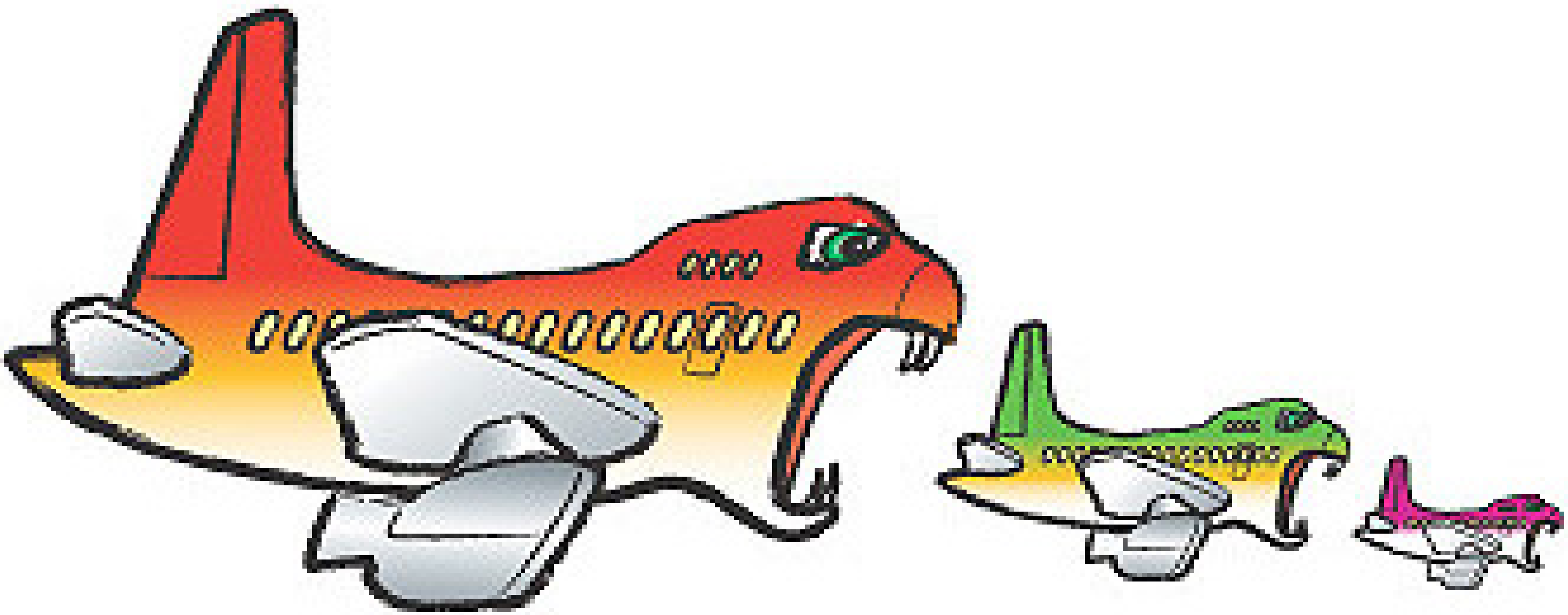
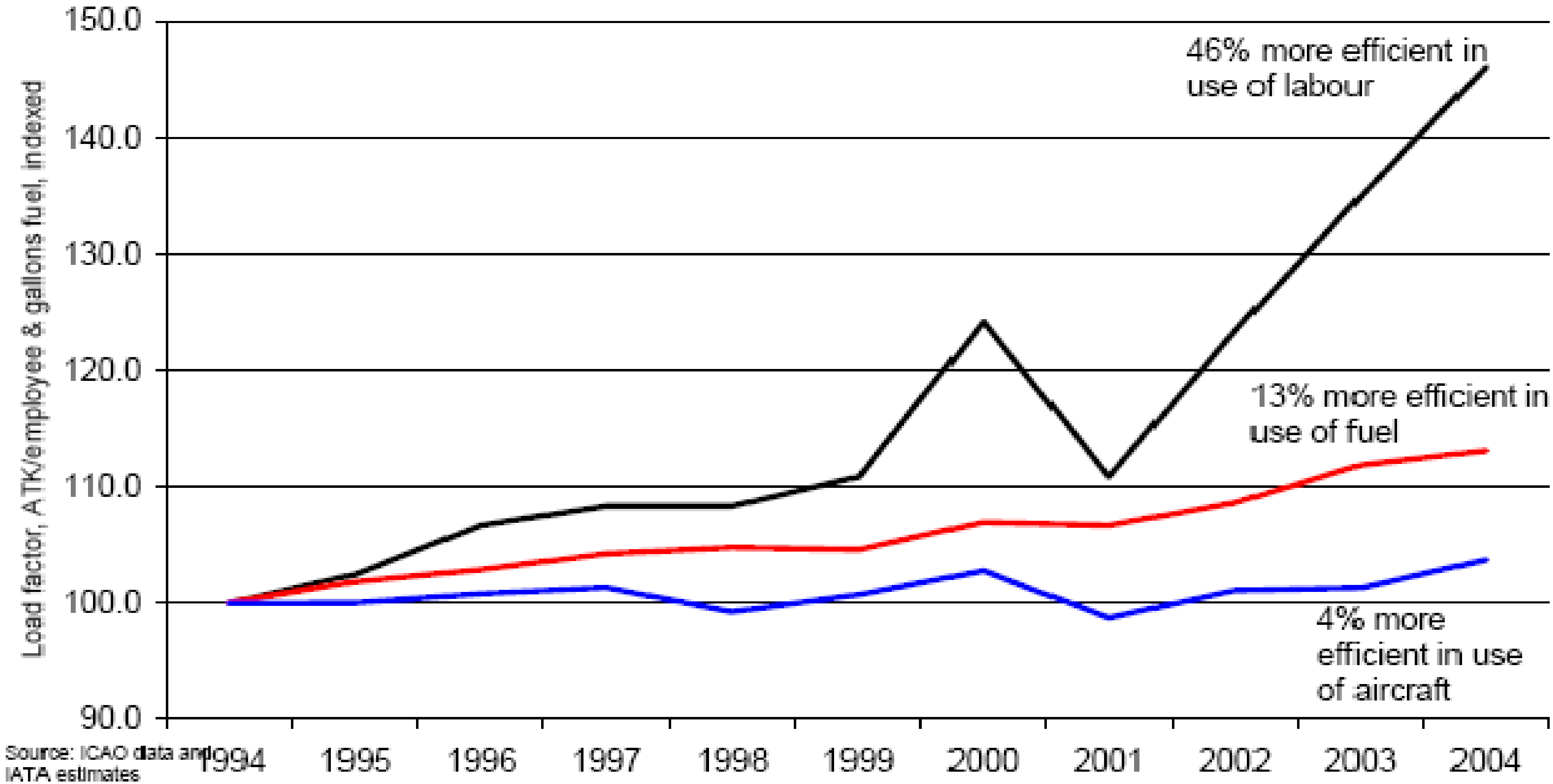
| Industry net profits, US$ billion | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| **Global** | **-5.7** | **-6** | **-2.2** | **7.2** |
| **Regions** | | | | |
| North America | -10 | -10.8 | -5.4 | 1.1 |
| Europe | 1.1 | 1.8 | 1.4 | 2.1 |
| Asia-Pacific | 3.4 | 2.9 | 2 | 3.1 |
| Middle East | 0.2 | 0.3 | 0.2 | 0.5 |
| Latin America | 0.1 | 0.2 | 0.2 | 0.4 |
| Africa | -0.4 | -0.4 | -0.6 | 0.0 |
| **Markets** | | | | |
| Domestic (US only) | -9.4 | -10 | -5.5 | 0.9 |
| International (IATA members only) | 2.9 | 2.7 | 2.1 | 5.1 |
| Other | 0.8 | 1.3 | 1.2 | 1.2 |

*Source: ICAO data to 2004. IATA forecasts 2005-2007.*

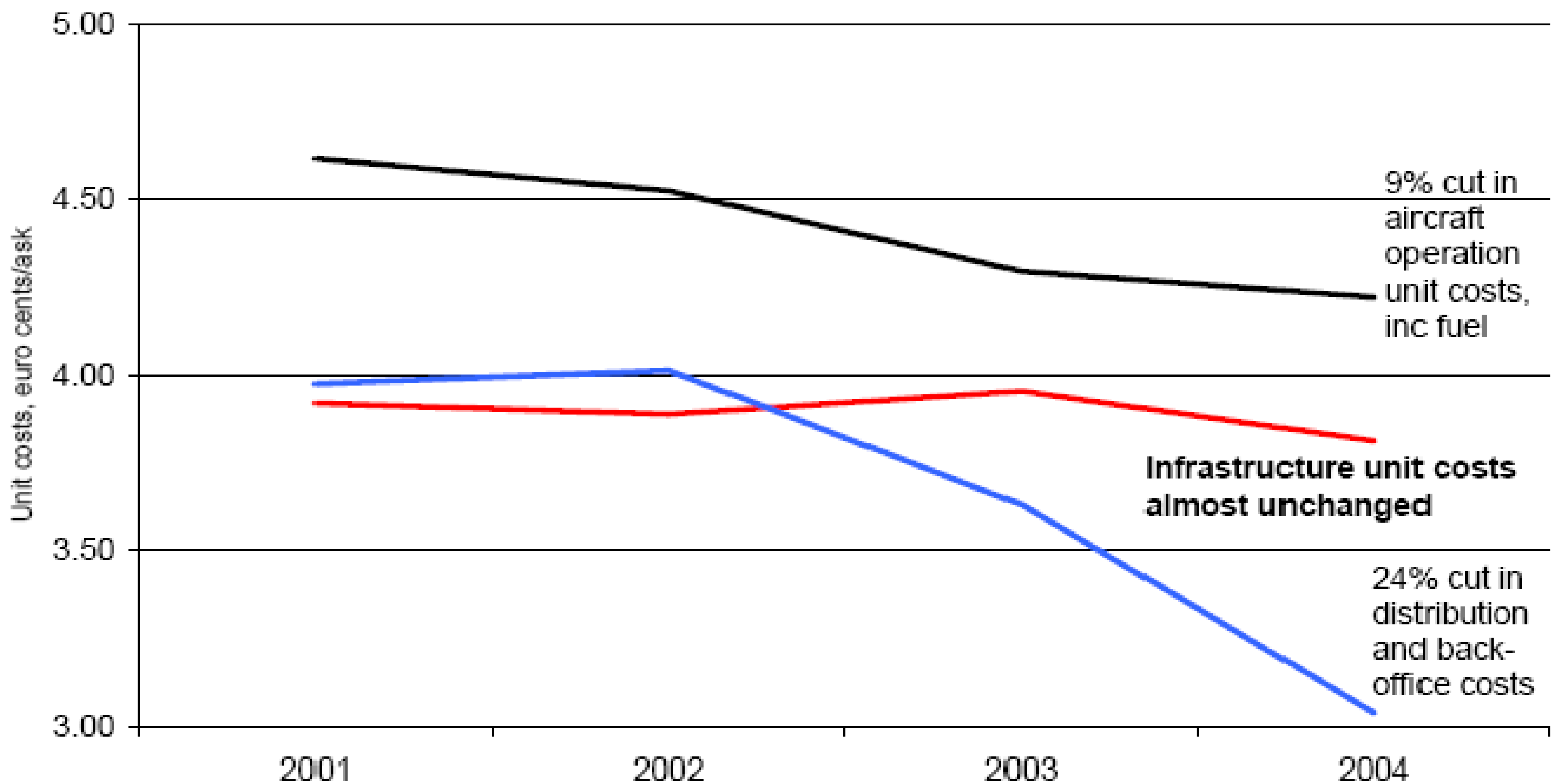
# Survival Strategies

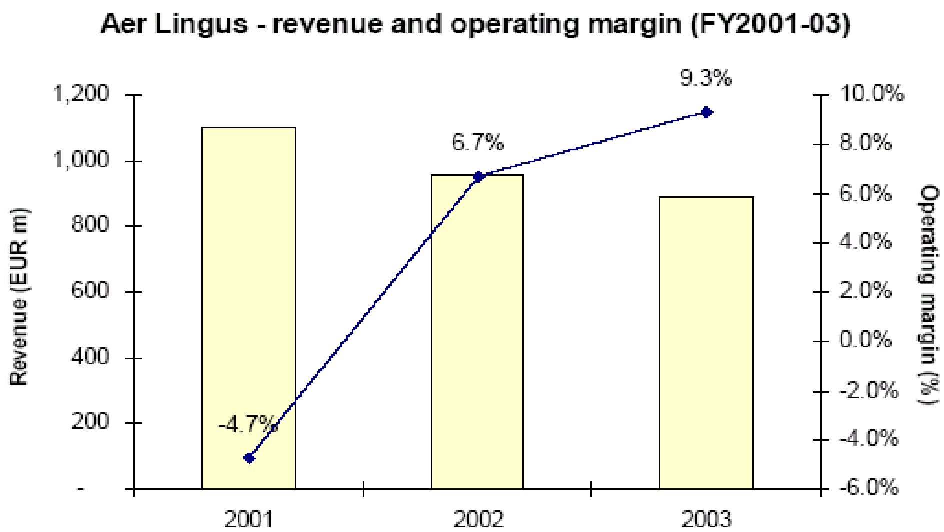


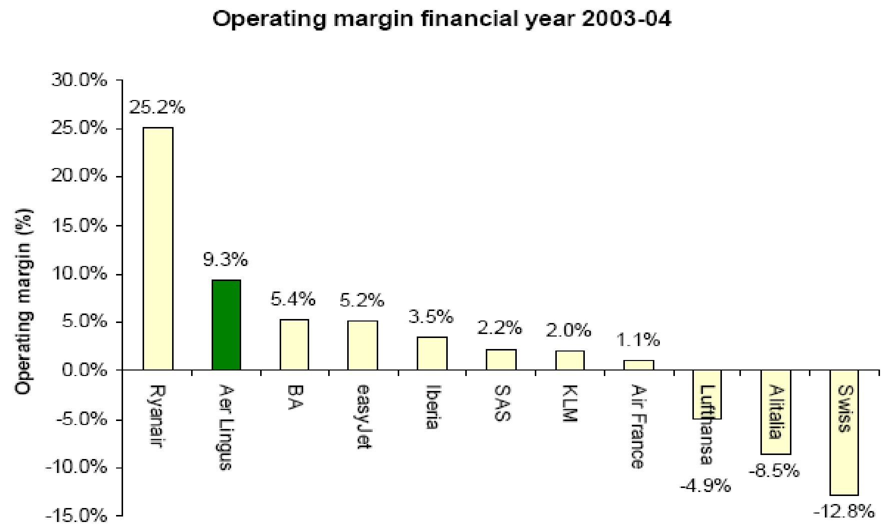
Productivity for global commercial airlines



## Unit cost performance for European network majors, short-haul

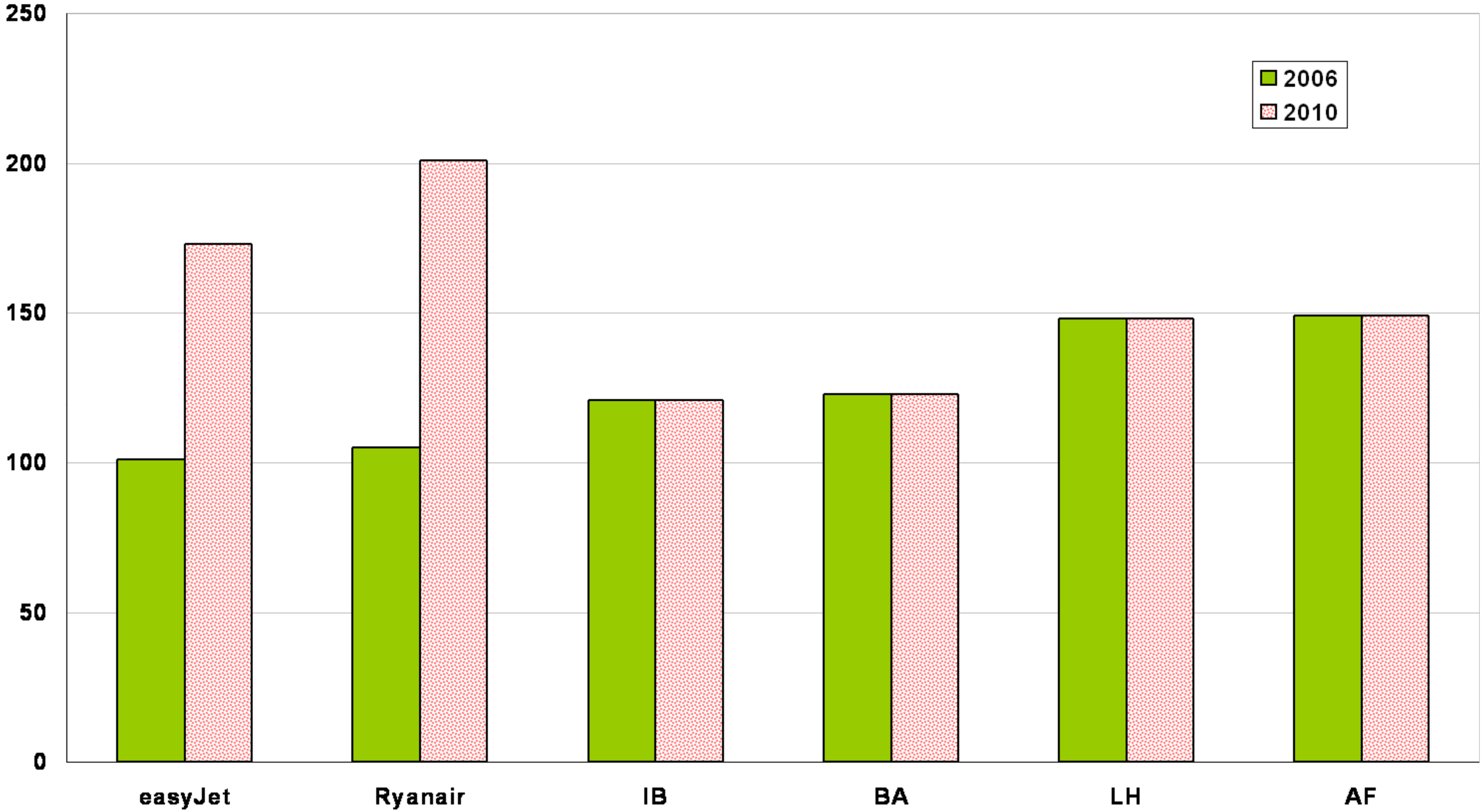




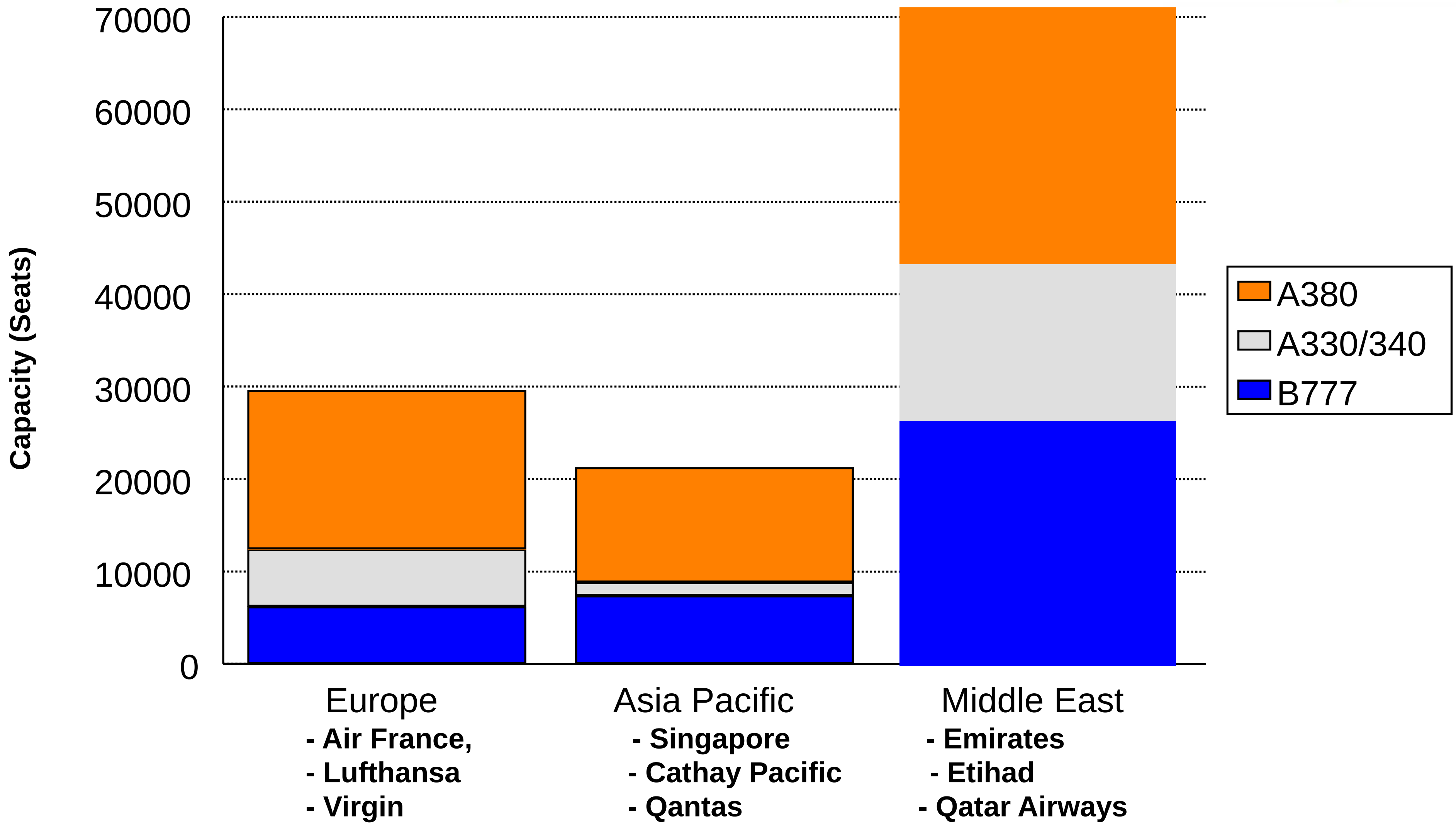




| | Ryanair | Aer Lingus | Ratio Ryanair/Aer Lingus |
|---|---|---|---|
| Passengers (m) | 23.13 | 6.60 | 3.5 |
| Scheduled revenues (EUR m) | 925 | 730 | 1.3 |
| Ancillary/Other (EUR m) | 150 | 158 | 0.9 |
| Total Revenues (EUR m) | 1,074 | 888 | 1.2 |
| Operating costs (EUR m) | 803 | 805 | 1.0 |
| Operating profit (EUR m) | 271 | 83 | 3.3 |
| Operating margin | 25.2% | 9.3% | 2.7 |
| Average fare (EUR) | 39.97 | 110.69 | 0.4 |

# Short haul fleet growth in Europe

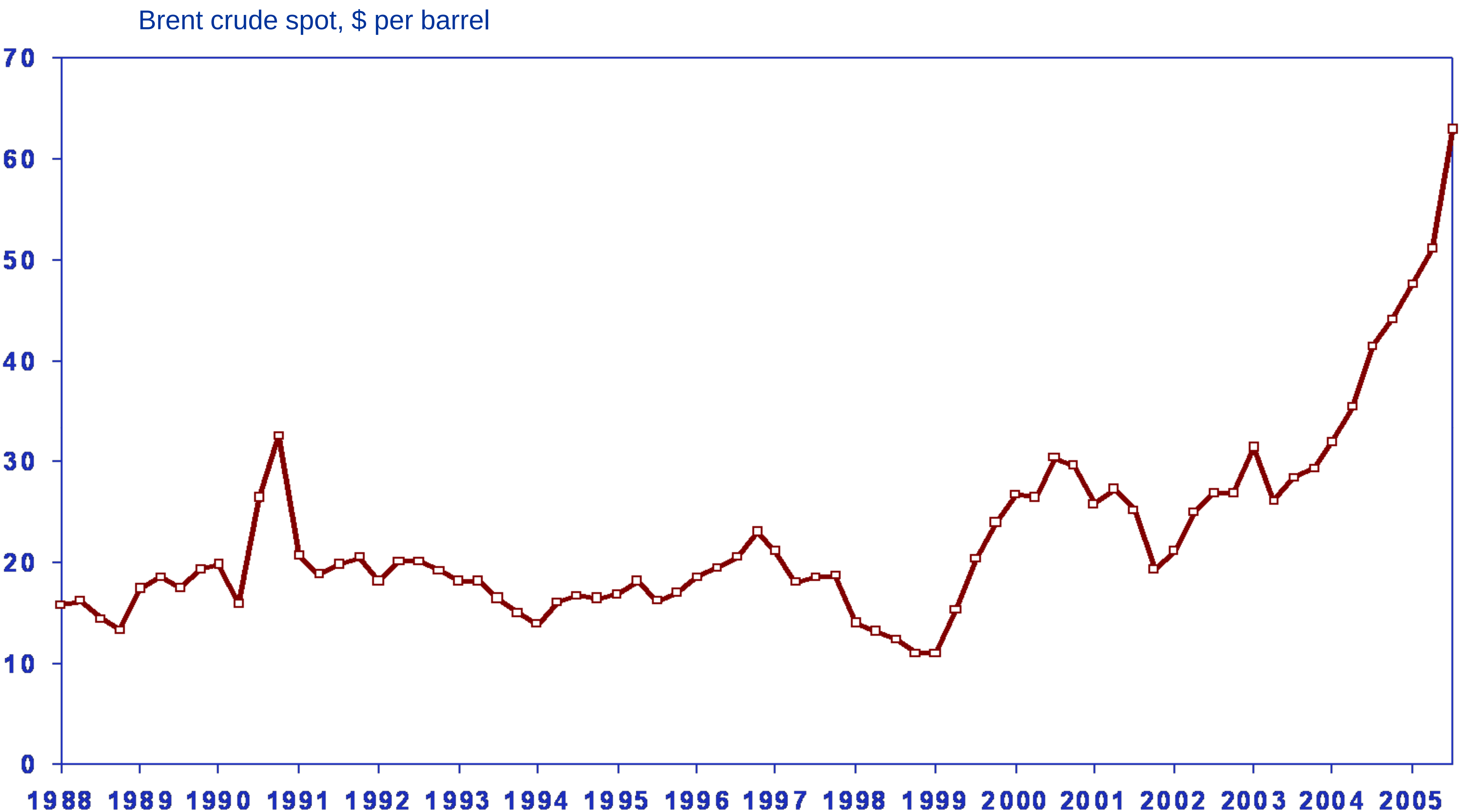


# Long-Haul Capacity on Order




Sources: ACAS, Aviation Strategy
Note: Firm order also including those via lessors

# Oil Prices Rising Sharply



# Continuing Evolution

***More differentiation*:**

- **Lower cost business class only airlines**
- **Greater emphasis on customers’ convenience**
- **Low cost with frills**
- **Longer haul low cost services**