Philosophies of legacy carriers and low cost carriers

Air travel has undergone vast changes over a very short period of time. Moreover these changes are clearly only the beginning of what appears to be a real revolution and trend. The proliferation of low cost carriers (LCCs) has been the key structural change in aviation over the past two decades. While the legacy airlines are cancelling routes where possible, cutting down the commissions of the travel agencies and downsizing employees, the low-cost airlines are ordering hundreds of new planes, opening new routes, achieving 95% of its bookings through the internet, and generating high profit. It is not the carrier itself that makes it a low-cost or full-service carrier (FSC), but it is the operating model that makes the difference. The different approaches and concepts where the FSCs and LCCs differ in their management philosophies are discussed using the two generic models.

Distinction between the legacy and low-cost carrier business model

While legacy carriers may feel the impetus to compete and retain market share at a primary airport, a low-cost carrier does not seek to compete with legacy carriers on traditional metrics. The basic low-cost business model is to: keep costs as low as possible (for example, through minimal services, a single type of aircraft, point-to-point routes and e-ticketing), the use of non-union labour, and price aggressively to win a share of the existing market, while stimulating demand from price-sensitive customers.(Mannix & Pierret, 2008, p. 2). By reducing these complexity costs and overhead costs, it becomes possible to offer the same ticket for a much lower price. The most famous examples of low-cost carriers are Southwest and Ryanair.

The full service carriers (FSCs) are unlikely to be able to match the LCCs in operating cost terms, since they are structured for a different market built on global interconnecting services.

The different concepts where the FSCs and LCCs differ are explained below. (Graf, 2005)

Product / Service Concept

Porter (1980) has identified two competencies that he felt were most important for businesses: product differentiation and product cost. Passengers go for low cost carriers primarily because of their low fares, while passengers selecting full service airlines will tolerate a higher fare to gain an advantage through the additional airline products.

The FSC focuses on having a comprehensive and differentiated service. They have a global network with a high number of daily flights and destinations worldwide. They sell several products for several customers segments (first class, business, economy). They primarily focus on business and high yield service-oriented passengers. The product also includes several service amenities (baggage transfer, seat assignment, seat comfort, free food, primary airports, special services, various distribution channels, loyalty program).

Differentiation is achieved by FSCs through a strong brand image. They put in a lot of effort on having brand management emphasising on service amenities and product offer viz. reliability, quality, flight schedules, connections, frequent flyer programmes and comfort. . For example Singapore Airlines focuses on a fully branded product/service differentiation strategy. Innovation, technology, quality and excellent customer service are the major drivers of the brand. Therefore, branding is a powerful and strategic weapon for a company while distinguishing a company from its competitors. and services offered by full service carriers .

LCCs follow a different approach having highly efficient operating model based on simplicity and low cost. They have limited number of daily flights and destinations. They have focused point-to-point network that often lacks the hub connectivity of full service airlines. Operations are often located at uncongested, low-cost airports, bypassing the primary airport in a multi-airport region (de Neufville, 2003).

They have a simple and single product offering for one customer segment only focusing on leisure and low yield passengers. LCCs are a no-frills service (no baggage transfer, no seat assignment, limited seat comfort, catering against payment, secondary airports, no special services, only direct distribution, and no loyalty program). This allows the LCCs to have a lower operating cost structure than the FSCs. These low-cost management strategies are passed on to the customers reflected in the low ticket fares. Their operations at secondary airports help to limit direct competition with other airlines.

Revenue Concept

FSCs have complex pricing system and a revenue management system that increases revenues by focusing on yields. The price differentiation is highly important to exploit the customers’ readiness to pay. Hence they follow a complicated fare system with high number of fares at a time. FSCs target higher yielding traffic to seek profit margin.

LCCs have a simple and transparent pricing system having only one fare at a time unlike the FSCs. The prices are differentiated only by time of booking and strength of demand. LCCs have a simple revenue management system increasing revenues by focusing on volumes. Thus they target low costs to seek a profit margin.

Thus there are two sets of drivers that influence an airline’s operating income: cost drivers and revenue drivers. An airline can either choose to be a cost-driven or revenue-driven airline, but it is hard to be both. . (Chopra & Lisiak, n. d., para. 3)

FSCs maintain high revenue per revenue passenger mile (RPM), a high load factor, and a longer flight stage allows an airline to increase its sales and therefore achieve a revenue advantage. Thus, legacy carriers are able to perform better in high-demand environments. (Chopra & Lisiak, n. d., para. 3). But during an economic downturn, the demand tends to disappear hitting the FSCs hard.

LCCs maintain a low number of employees per ASM and low salary per employee compared to FSCs. This allows them to lower its operating expense and therefore achieve a cost advantage.

FSCs also usually have only one source of revenue which is from their ticket sales. LCCs on the other hand earn a lot of ancillary revenue from their on-board sales. “ LCCs have created the perception of a customizable flight experience, rather than a slow degradation of a familiarly-packaged item". (Bejar, 2008, p. 2). LCCs have removed frills so passengers pay only for what they want. E. g. check in baggage, meals, entertainment onboard are all available at affordable prices should the passengers want them. Low cost carriers were pioneers in the area of ancillary revenue generation, taking advantage of this key aspect of the airline business model years before their legacy counterparts began to.

Organisational Form

Corporate Culture and Human Resources

FSCs have a static corporate culture where there are strong leadership hierarchies. In most cases of legacy carriers, the management team is too large and somewhat ineffective due to duplication of work and lack of communication between departments. The lines of communication and span of control are quite large.

LCCs have a dynamic corporate culture having flat and lean organizational structures with reduced number of levels of the managerial hierarchy and the decentralization of decision-making. " Low cost carriers being relatively new entrants have an advantage over legacy and established carriers when it comes to keeping costs down, efficiency up and communication flowing. One way of doing this is through the establishment of a lean organizational structure where the ' right' people are hired to do the ' right' job". (Wensveen, 2009, p. 206). They have the advantage of establishing an efficient team from the start. Fewer management levels could do effective, focused and aggressive management.

The main features of a lean organisation include the following. These are displayed in a LCC model.

The ‘ right’ people are hired to do the ‘ right’ job”

The hands-on nature of CEOs and senior managers

Minimal enterprise footprint using contracting and outsourcing

Low capitalization through leasing.

Strong financial management systems and continual emphasis on cash flows

The culture of most LCCs primarily involves having a fun atmosphere and work environment compared to a legacy carrier. It gives due importance and emphasis on the overall welfare of its employees. E. g. Southwest Airlines has the operative principle of “ employees come first and customers come second”. This is coming out to be as the world’s most modern management idea.

To quote an example, the elements of company culture followed by Southwest Airlines are mentioned below (Strategy, 2009, para. 26):

Fun atmosphere and work environment – this means that employees enjoy their work entirely, having entertaining behaviours in performing their jobs, and frequent company-sponsored parties and celebrations.

Having the tradition of employee empowerment and decentralized decision-making – this serves as a motivator for employees, for they are being allowed to participate and express their opinions for the benefit of the company.

Cost-conscious and thrifty approach to operations – this aims to reduce overall operating costs, which enables the company to implement its effective strategies.

The highly motivated culture followed by LCC's assists in enhancing customer acceptance through internal marketing. It also paves way to reduced industrial disputes.

The legacy carriers are still struggling from the entry and growth of the LCCs. They are dealing with constant crisis management and are trying ways to become more efficient. But they have to continuously report to a board of directors and do not spend this effort on customer marketing. Very few legacy airline managers communicate with the staff at all levels effectively.

Unionisation – Industrial Relations

The high level of unionization in the airline industry, particularly among the legacy carriers play a major role in the extent to which labor costs can be controlled. Network carriers have sadly undermining relationships with its unions. They have to operate under the terms of union contracts that prevent them from making changes to match the cost of new entrants. (Wensveen, 2009, p. 187)

LCCs experience little labour conflict relative to its competitors. The management has a very positive relationship with the unions. Southwest has long emphasized the importance of labour/management partnerships. They have made the Unions as their Partners rather than as their adversaries. (Gittell, 2003, p. 168)

Growth Concept

FSCs have a diverse and hybrid growth concept. Its growth is either through its model or can be through acquisitions and alliances. They are heavily focused on capturing market shares. The FSCs sometimes being the national carriers wish and take pride in being the biggest airline having the most capacity. They always go for the latest technology such as bigger aircrafts (e. g A380) with larger seating capacity despite having adequate existing capacity. They usually get economic incentives from governments to build larger airline infrastructure and to create economic growth.

LCCs meanwhile follow a simple growth concept of opening the next route or base, when the budget is achieved. They focus on efficiency gains and ensure that growth is important to improve sourcing conditions (e. g. for capital, fees, prices). They operate in liberal regulatory environment that does not limit their development of services and has no restrictions on new entry into the market.

Competence configuration

Network Management

Legacy carriers have complex network management to maintain their global connections. The hub-and-spoke model created by the legacy airlines of course has tremendous efficiencies, allowing airlines to amass large quantities of passengers in a central location to fill planes. It allows the carriers to provide services to a larger number of city pairs, without a commensurate increase in cost compared to point-to-point networks and generate economies of scope. It is profitable to operate intercontinental flights. An important disadvantage of a hub-and-spoke network compared to a point-to-point network are the complexity costs because this system relies on tightly scheduled arrivals and departures, congestion and delay can occur during peak hours, especially at busy airports like Chicago, Heathrow etc.

Perhaps the most important characteristic of LCCs is that they operate in a point-to-point network that consists of direct flights between origin and destinations. LCCs have therefore established their hubs at less busier airports to avoid the additional complexity costs attributable to congestion and delay, such as fuel, missed connections and customer dissatisfaction. (Wensveen, 2009, p. 280)

The disadvantages of this type of network are the shorter range of the network; they can serve fewer destinations with the same air routes compared to a hub-and-spoke network. It is also unprofitable to operate intercontinental flights.

Marketing Strategies

The FSC have a complex communication system emphasising on sophisticated brand management. The economies of scope enjoyed by large airlines build customer loyalty, particularly the business class travellers who are less concerned about cost but on flexibility and convenience. “ Frequent-flier programs confers advantages to size that cannot be offset by a smaller airline that is attempting to compete only on the basis of price”. (Wensveen, 2009, p. 276).

The LCCs on the other hand have a simple communication system having a selective process through brand awareness advertising only in the relevant geographical markets. They emphasise communication on the prices rather than service. Their target market is the leisure and casual travellers.

They focus on IT and “ below the line” marketing. E. g. Virgin America announced the opening of their new route to Toronto on Twitter. LCCs make use of the direct online internet sales to help keep sales and distribution costs low. This reduces the costs arising from paying expensive commission to the travel agents for handling ticketing process and reducing the number of personnel needed to staff the company’s reservation centres. Their technology friendly marketing schemes make the younger age group receptive to them.

LCCs as a group were early to recognize the power of the internet to facilitate ancillary revenue generation. LCC pioneer Ryanair included the two most popular ancillary offerings – hotel booking and car hire- when it first launched its website in 2000. Other low cost airlines soon followed suit. (Bejar, 2008, p. 1).

LCCs generate much public awareness through aggressive marketing and advertising campaigns. The focus of their advertising is not on the services that they do not offer but on the incredibly low prices they offer customers. Some other innovative marketing techniques employed by the LCCs include offering discounts when purchasing tickets online, outsourcing call centres and closing ticketing offices in city centres, where real estate costs are higher.

LCCs are most customer-oriented in their marketing approach. They balance customer orientation with operating efficiency after proper market research. They find target markets and open new routes concentrating on passenger needs.

Motivation and Buyer Behaviour

Maslow’s motivation theory explains how people are motivated by particular needs at particular times. The airlines have to understand what happens in the buyer’s consciousness motivating their buying decisions.

LCCs have been successful in motivating the leisure travellers and even brought about a new sensation and revolution in making flying an affordable means of travel.

Outsourcing of operations

LCCs often outsource many of their fixed services to third-party service providers such as check-in, baggage handling, maintenance, and ground activities. This is reflected in the “ employees per aircraft” coming out at one quarter of that of the FSCs. This reduces employee and infrastructure costs.

Coordination Concept

FSCs have various models and coordination model with different alliances. These operators seek to have partners in global alliances to reduce costs and have a globally connected network management system. FSCs also enter into various complex capital arrangements and franchise agreements to implement their model.

(Hamilton & Morrish, 2002) has identified four advantages of alliances:

Access to new markets by tapping into a partner's under-utilised route rights or slots.

Traffic feed into established gateways to increase load factors and to improve yield.

Defense of current markets through seat capacity management of the shared operations.

Costs and economies of scale through resource pooling across operational areas or cost centres, such as sales and marketing, station and ground facilities and purchasing.

LCCs usually have just a single and simple model maintaining explicit contracts with their suppliers and revenue partners. They do not join any alliance or interlining. This saves them from the alliance associated costs and obligations. They gain full brand integrity with no dilution associating with alliances. Moreover, LCCs usually do not participate in the scope of IATA airlines. Keeping away from these associations eliminates the complexities arising from the regulatory rules and practices. LCC thus concentrate more on improving their efficiency.

Interlining and Code sharing agreements

Legacy carriers have had the upper hand over low-cost carriers in the area of interlining. With the development of hub airports, long haul carriers use interlining to bring passengers from a number of close destinations to a single hub airport for transfer onto a large long haul aircraft. Interlining will be of considerable importance for the legacy carriers and they are introducing the new 747-8 and or the A380 into their fleet. Few cities can generate the 500 passengers per flight departure necessary to fill these aircraft to each long haul destination being served, but 25 cities might generate 20 passengers each, filling the aircraft.

Legacy carriers have the advantage of the years of patient and meticulous work that IATA has done to ensure that the systems and the processes necessary to transfer passengers and baggage work. Within the IATA interline systems it is possible to buy a ticket to and from any airport served by IATA's members (not just your own airline) in one currency, with one ticket, check in your luggage and pick it up when you get there.

LCCs usually being point-to-point carriers do not typically take part in code sharing due to their simplified route structures. " Code sharing involves contractual, liability, connectivity and accounting issues, which LCCs keep away from allowing them control cost." (Wensveen, 2009, p. 278)

Conclusion

There is no doubt that LCCs have demonstrated an alternative to the legacy carriers forcing them to review their management approaches to cost and operating structures. Low cost carriers are now dominating the leisure markets and are now slowly encroaching on business segments. Legacy carriers have been unable to match the fares of low cost airlines because they were burdened with inefficient operating practices. But needless to say low-cost and legacy carriers have complementary strengths.