

# Impact of deregulation and low cost carriers on the airline industry

[Business](#), [Industries](#)



## **Introduction**

The report will be assessing and evaluating how deregulation and the growth of low cost carriers have affected global competition and market trends in the types of products offered to customers in air travel. The report will identify the key roles of the low cost carriers and how they are affecting the global competition and the market trends by introducing their means and methods over the bigger airline industry. It will also be witnessed in the report how the airlines have come a long way from the past till now and how the industry is on a constant change due to needs and demands put up by the customers which currently is being handled by the low cost carriers in some ways.

While air travel was once a luxury only the rich could afford, the entry of more airlines serving the busiest and most profitable routes has caused airfares to plummet. Some of the airlines that will be looked at are Buzz, Go, Ryan Air, and Easy Jet. These are well known low cost airlines. This report will look sequentially at the marketing environments of the airline industry and will analyze the main forces shaping its future. It will concentrate on the impact of low-cost airlines on this industry.

### Main

The airlines are relatively new as a market driven industry. In 1938, the airlines faced steep competition that was vigorous and unstable. The industry asked the government for a regulatory body to control competition. The newly formed CAB froze the industry structure and blocking out new

firms, which ended up creating monopolies. The industry continued in this state despite growth in traffic, increased profits, and changing conditions. The turning point for the airline industry began in the late 1970's when the industry needed to break free from its regulated environment.

New technology and ample profits made competition a viable option. The result was the passing of the Airline Deregulation Act in 1978.

One of the large effects of deregulation was the increase in the number of carriers and increased competition. In 1978, there were 43 carriers certified for scheduled service with large aircraft. By 1983, there were over 60 new carriers since the act was passed. With the slew of new airlines, the airline industry was able to reach new markets and grow tremendously. United with the price drops, air travel became a more favorable way to travel. Today there are no close substitutes for travel over 150 miles. However the trend of an invasion of airlines eventually turned into many mergers, acquisitions, and bankruptcies in the late-1980s to early-1990s (see Figure 1)

Still seen today, another effect of deregulation is the development of the "hub-and-spoke" network. The major airlines developed this network to efficiently manage and serve more markets with the same fleet of planes. Another advantage of the "hub-and-spoke" network is that airlines will carry the traveler from departure city to arrival city and not have to hand over customers to competing carriers. Travelers enjoyed traveling with one airline though an extra stop was required.

A marketing innovation that airlines initiated after deregulation was the frequent flyer program. Repeat customers earned points toward free tickets or upgrades. This program generated loyalty beyond service and satisfaction with travelers. Recently, the frequent flyer program extends beyond receiving points for flying. The most popular is the use of credit cards (points per pounds/dollars) and using points to purchase things other than airline tickets.

A technological advance in the industry came with the introduction of computer-reservation systems (CRS). This allowed airlines to keep track of fare and service changes. The systems allow agents to process millions of reservations a day. Today these transactions have significantly increased and with the introduction of the Internet redefined how travelers shop, purchase, and receive tickets.

According to Geneva News article low-cost carriers found not just tourism to help it establish it self in travel. They found out that what could begin as a tourist route may be quickly adopted by businesspeople. This meaning that the low cost airlines also are used by business. So the companies also get some business even during the off-seasons. These airlines help offer a cheap way to be able to get to the business places, historical area, and Interesting cities. We see in Belobaba (2003) report that Easy Jet, Europe's leading low-cost airline. Now what helped it become such a big name in low cost air travel in Europe Going to Easy Jets website, they attempt to explain how they work. It can be seen that they broke it down into three things to make them a low cost airlines; The first thing is it is a ticket less airline, this cuts cost of

paper and printing. The next thing they do is efficient use of airports; this means Easy Jet can make the most of its time. Easy Jet also made a few deals with airports cutting landing fees. The last thing Easy Jet has done to make its airline so low cost is there's no such thing as a free lunch. This helps as it cut costs off food, and may help the airlines earn money on the food they sell.

In Belobaba (2003) report we see the U. S. situation with airlines. The report starts off talking about the 11/09/01 incident. Were after the attacks on the twin tower, the whole thing had negatively affected the volume of business travel and 12. 5% lower than in the preceding year. The report goes on talking about the growth of low cost airlines. Reduced willingness on the part of business travelers and tourist to pay the higher airfares charged by network carriers. Also some interesting points in the report are.

“ In the US, low-fare airlines have exhibited slow but steady growth since deregulation, but low-fare carriers as a group accounted for less than 7% of US domestic air passengers in 1991, compared to 81% by Major network carriers [The remaining 12% was carried by smaller regional and local carriers]. Low-fare carriers grew more rapidly in the US through the 1990s, to the point that the carried 20% of all US domestic passengers as a group in 2002.”

To look at a more world aspect of tourism we see in Christianto (2003) article that in 2000, there were 7. 58 million passengers, but the number increased to 8. 27 million in 2001 and to 8. 96 million in 2002. Also according to the

article the figures are expected to reach 10.34 million in the coming years. It goes on talking about the price war. A war between the more high class big Airlines, and many of the airlines that offer cheaper tickets. In this war they are trying to set a floor price were airlines may not go under this price. This is due to the high numbers of passengers going to low cost airlines to travel.

We are starting to see that with these low cost airlines the bigger airlines are having problems holding on to their customers. Now there are airline companies that are forced to lower their price to compete with these low cost airlines. We see British airways as one of those companies. British airways have recently launched a series of cheap flights.

In the future there is a big possibility that all these big airlines will have to lower their prices considerably. As theses low cost airlines seem to be taking all the possible clients away from these big airlines. There is also too say that these big airlines are holding on to their passengers for long distance travels. As these airlines are more comfortable and more advanced the travelers like them more. As if you have to spend a long time in an airplane you would choose the best situation. There are only a few low cost airlines that are set up. The number of airlines in general isn't too high. We see in the U. S. for low cost airlines you have only two or three. As it's about the same for Europe as we see airlines like Easy Jet, Ryan Air, Go, Buzz and only a few others. As for other areas it was hard to find information on cheap airlines.

Europe seems to big the biggest point of low cost airlines. In Christianto (2003) report its shown that travel between Europe has been seeing some

serious growth. This alone shows that with low cost airline, there comes more tourism. There is also to say that in Europe it is convenient for people to move around for business and travel.

The first successful low-cost carrier is generally acknowledged to be Southwest Airlines in the United States, which pioneered the concept when founded in 1971 and has been profitable every year since 1973. With the advent of aviation deregulation the model spread to Europe as well, the most notable successes being Ireland's Ryan air, which began low-fares operations in 1991, and easy Jet, formed in 1995. As of 2004, low cost carriers are now edging into Asia, led by operators such as Malaysia's Air Asia. Many carriers have opted to launch their own no-frills airlines, such as KLM's Buzz and British Airways Go, but have found it difficult to avoid cannibalizing their core business.

The European airline industry is being shaken up by the presence of low-cost airlines. It is estimated that existing low-cost airlines has expanded their European market share from 5% in 2000 to 25% by 2010, as illustrated in figure 7, establishing themselves on a long-term basis which will have major effects on the European airline industry as a whole

The low cost carrier's airline industry is having a huge impact on the global airline industry. The table below highlights how the market is migrating to a new business model:

customer behavior is changing> Customers expect internet to provide lowest possible price offer> Price becomes decisive factor:- Destination is not!

- low cost carrier's develop routes according to costs

> low cost Carriers have generated growth of aviation in this segment

- People fly who would not have otherwise flown

Market structure is changing> Erosion of traditional “ national” markets:>

Segmentation of market into:- low cost on local markets

- Regional niche markets

- International/alliance markets

Greater flexibility and simplicity of traditional model> Established airlines are questioning their models.> Some have moved into the no-frills segment.

Flexible adaptation of traditional pricing models> Many full-service carriers offer simple and low prices.

Marketing focus on the actual product offered> Some carriers are marketing frills aggressively.

The SWOT analysis is used to analyse the internal and external view of the low-cost airline industry with a view to analyse the situation of the no-frills model upon today's world wide global industry.

STRENGTHS  
Simple fare structure  
Relative low unit costs

Multi-base network offering point-to-point service

Strong corporate culture  
e. e. Easy Jet



High commitment to safety and customer services

Efficient use of airports with rapid turnaround times

Highly profitable with rising demand

**WEAKNESSES** Customer expectations of service are increasing High aircraft utilisation means more vulnerable to delays

Prices are low, but they are not as low as they could be.

Weak brand loyalty between low-cost airlines and passengers

Growth in size means complexity

Seasonal variations and cyclical demand

Affected by economic downturns

**OPPORTUNITIES** Europe is a land of opportunity for low-cost airlines Significant growth of internet bookings expected – 17% annual compound growth rate of Internet user population

Increase in Britons buying second homes abroad

Outsourcing of IT functions such as call centres in India

Airport expansion

THREATS Flag carriers imitate low-cost business model offering 'cheaper flights to people booking well in advance' BA, as well as other airlines has redesigned its website to make online booking easier

New EU legislation travel compensation laws

Air passenger duty to rise ? 5-? 15 on economy tickets

Some customers prefer to book through a travel agent

The development of rail network within the EU

Video conferencing may take an increasing share of the business clientele

Threat of terrorism. e.g. bombings in Madrid

Lack of take-off and landing slots

Conclusion

Since deregulation arrived, budget carriers such as Easy Jet and Ryan air have grown to account for around a fifth of European air travel, thriving after the events of September 11th; their market share has grown rapidly.

Observers of the European airline industry have long believed that the flag-carrier system has created too many airlines and led to inefficient excess capacity. The suggested remedy is consolidation of the European industry via cross-border mergers, an avenue that is now open as a result of EU deregulation. The first major consolidation event is currently with the proposed Air France-KLM merger recently approved by EU regulators.

It is likely too that the low-cost sector will experience consolidation leaving Easy Jet and Ryan air as the two main players. While the big airlines consolidate, trying to win more premium business traffic, the cheap fares airlines will fight ruthlessly for leisure traffic. British Airways has already withdrawn from European routes where it makes a loss.

In the longer term, airlines are looking to join forces in the context of the prospects of the liberalization of air traffic between the United States and Europe, which is expected to lead to fierce competition on both sides of the Atlantic.

Two things matter to airlines - the amount of empty seats on their planes and the cost of getting those planes into the air. Reducing those two factors leads to profits, and in recent years, the European industry has been struggling.

The fear of terrorism and disruption in the world's aviation system has simply made things much worse. And looking to the future of European aviation, it seems that the issues associated with the environment will be addressed severely, possibly leading to taxation on the one thing supporting airline growth; Kerosene. Furthermore, the matter of over-capacity, which has led to a lack of taking-off and landing slots, could hinder further growth and drive up prices for the low-cost airlines.

While the full-service carriers are struggling to get back to the traffic levels they enjoyed in 2000, the budget airlines are growing by more than 10 per cent a year. The expansion of the EU provided vast opportunities for the low-

cost sector but for the budget airline industry to thrive; low-cost really does have to mean low-cost.

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