



Airlines-within-airlines: A business model moving East



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ABSTRACT

Low-cost carriers (LCCs) are a significant threat to the sustainability of network airlines. That LCCs are growing – particularly within Asia-Pacific – exacerbates this problem and network airlines have reacted to this by creating lower-cost subsidiaries, known as airlines-within-airlines (AWAs). The purpose of this paper is to determine the necessary criteria for successful AWAs while updating analysis of past, present, and proposed and announced AWAs. For this, we revisit existing literature and airline data, mainly from annual reports, from such AWAs. Initial results indicate that AWAs have limited success, with 27 failures of an identified 67, although only three in Asia-Pacific. Of those presently operating, 58.1% are from Asia-Pacific with this region containing 40.0% of the proposed and announced carriers. In our view it is ill-defined strategies, late market entrance, excessive management control, insufficient dissimilarity from the parent, higher costs and less efficiency vis-à-vis low-cost competitors, and operating within highly competitive markets with excess capacity and comparatively low fares that are key reasons for failure. In contrast, the most successful AWAs have considerable autonomy from their parent, market dominance, decisive leadership, and less deviation from the pure LCC model unless a sufficient revenue premium is achieved.

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1. Introduction

“Low-cost carriers represent an increasing and significant threat to the long-term viability of legacy airlines” (Taneja, 2010, p. xxxiii). That this model is a growing global phenomenon exacerbates this difficulty still more (Graham and Vowles, 2006). Most recently, the growth of low-cost carriers (LCCs) has primarily been within Asia-Pacific due to expanding open skies, rising disposable incomes within fast-growing economies, and often large populations yet frequently poor surface transport (Holloway, 2008), although growth also remains with more mature regions. To help counteract this increasing threat, a number of network airlines have created lower-cost subsidiaries, colloquially known as airlines-within-airlines (AWAs).

The aim of this paper is to determine the necessary criteria for successful AWAs while providing up-to-date analysis on past, present, and proposed and announced AWAs. The paper is structured as follows. Section 2 provides a brief introduction to AWAs and other ways by which network airlines may respond to the threat posed by LCCs. Section 3 details the methodology and data used.

The results are presented and discussed in Section 4, while Section 5 offers some conclusions.

2. Existing literature

The intensifying penetration of LCCs, and numerous other factors, have together resulted in “potentially crippling circumstances” (CAPA, 2009) for network airlines, within short- and medium-haul markets, although the impact of LCCs varies around the world (Ito and Lee, 2003). Yet it is very difficult for network airlines to compete with lower-cost counterparts, with competitive responses, or survival strategies, typically involving in-house cost reduction and efficiency improvement, although cost-cutting has often been temporary rather than representing a meaningful and prolonged mind-set change – which is changing only very recently as a result of the high and volatile fuel price. Although it has not always proven easy or expeditious, the cost reduction of network airlines has seen the increasing elimination of product attributes – with passengers increasingly having the choice of a la carte options and whether or not the attributes are offered depends upon passengers’ willingness to pay – that has reduced the distinguishability between the two broad models and lowered the unit cost differential (Dunn, 2011). As LCCs increasingly add attributes in their quest for higher-yielding passengers as a result of evolution, operating environments, and the search for new opportunities, this

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change represents a growing trend towards model convergence and increasing hybridisation.

Competitive responses of network airlines have also included consolidation through mergers and acquisitions (Merkert and Morell, 2012), the elimination of unprofitable operational elements, increasing fleet commonality (Merkert and Hensher, 2011), fare reductions as a temporary competitive weapon, reduced capacity and hopefully improved yields, investment in price and product differentiation with no guarantee of a sufficient price premium – or a do nothing approach from an unwillingness to accept the changing reality (Gillen and Gados, 2008; Hazledine, 2011; Morrell, 2005). Indeed, “companies are struggling to keep pace with rapidly changing business environments, putting their futures at risk” (Walsh, 2012).

Alternatively, the creation of AWAs may provide a strategic mechanism to counteract unprecedented LCC expansion and thereby protect existing markets (Lin, 2012). Depending upon the specific objectives of each established business, they may also enable the participation of the parent in the growth of lower-priced air travel, thereby more cost-effectively targeting that typically growing market segment, to pre-empt and hopefully dissuade future low-cost entry, and the opportunity to increase corporate value and to later profit from the sale of the unit (Graf, 2005). However, irrespective of the chosen measure, survival strategies are often unsuccessful (O’Connell and Williams, 2011).

Because existing literature on AWAs primarily dates from the 2005–2008 period and is thus out-of-date, this paper seeks to update and further knowledge and understanding, especially for Asia-Pacific given the increasing expansion and importance of the region.

3. Methodology and data

The undertaken research utilised both quantitative and qualitative methods as this enabled us to obtain relevant, insightful data while providing greater understanding and meaning.

Airline annual reports, both of parent airlines and their AWAs, were an important source of data because we sought to gather yield, load factor, and other pertinent information. This information was used to provide a comparison between the yields and load factors of parents and their AWAs to establish whether any significant relationships exist. Yield was calculated as operating revenue/revenue passenger kilometres (RPKs) and load factors as RPKs/available seat kilometres (ASKs). We fully intended to gather earnings before interest and taxation (EBIT) data for greater insight, but this was, in most instances, not possible due to limited availability and being too out-of-date. Note that all data is, unless stated, from 2011, with yields calculated, where possible, using passenger revenue only.

Industry publications, particularly from Centre of Aviation (CAPA; formerly known as Centre of Asia-Pacific Aviation) and Flightglobal Pro (formerly Air Transport Intelligence or ATI), were useful sources of data. This was because they provided some data which annual reports did not, particularly related to load factors, dates of operation, and other background information. However, up-to-date data and data availability were, in several instances, still a major issue.

Semi-structured interviews were undertaken with eight airline managers, analysts, and consultants. These primarily complemented the quantitative data by providing better understanding of the contributing reasons for AWA failures and successes.

4. Results

In this section we first present and evaluate findings from past, present, and proposed and announced AWAs, before we discuss the contributing reasons for the failures and successes of AWAs.

4.1. Analysis of past AWAs

Table 1 shows that there have been 27 past AWAs until the cut-off date of mid-2012. Note that Virgin Express, 100% owned by the Virgin Group rather than Virgin Atlantic, was not deemed a real AWA. While also not a real AWA and thus also not within the table, Lufthansa Express, created and ended within the mid-1990s, did have lower-paid and longer-working staff that appeared to work specifically on Lufthansa Express services.

The average length of existence for these past AWAs was 4.48 years with an average ownership level of 97.03%. This high ownership rate was due to the parent being registered within the same country as the AWA, thereby allowing full ownership, with this reducing somewhat with presently-operating AWAs.

Of these 27, only six (22.2%) were from the USA – with US operators the first worldwide to launch their own AWAs. While this shows that the AWA concept is not new – it is now nearly 20 years old – that it started within the USA is unsurprising given that this country deregulated its domestic routes before others and thus first experienced the LCC phenomenon. However, Europe, with 13 (48.1%), has had the most AWA failures, with the timing of the emergence of these AWAs again illustrating that the concept follows deregulation. The dominance of the European AWAs helps to explain why the primary period for past AWAs was between 2002 and 2005, when 13 (48.1%) AWAs commenced operation worldwide. It was anticipated that Asia-Pacific would have few past AWAs due to the concept being relatively new there, although

Table 1
Synopsis of past AWAs.

Country	Airline	Airline ownership	Start date	End date
USA	Continental Lite	100% by Continental	1993	1995
USA	Delta Express	100% by Delta	1996	2002
USA	MetroJet	100% by US Airways	1998	2002
USA	Shuttle by United	100% by United	1994	2002
USA	Song	100% by Delta	2003	2006
USA	TED	100% by United	2004	2009
Canada	Tango	100% by Air Canada	2001	2003
Canada	Zip	100% by Air Canada	2002	2004
Mexico	MexicanaClick	100% by Mexicana ^a	2005	2010
UK	Buzz	100% by KLM	2000	2004
UK	Go Fly (Go)	100% by British Airways ^b	1998	2003
UK	MyTravelLite	100% by MyTravel	2002	2003
UK	Thomsonfly	100% by Thompson ^c	2005	2008
UK	bmibaby	100% by IAG	2002	2012
Sweden	Snowflake	100% by SAS	2002	2004
Finland	FlyNordic	100% by Finnair	2004 ^d	2008
Germany	HLX	100% by Hapag-Lloyd	2002	2007
Netherlands	Basiq Air	100% by Transavia	2000	2005
Netherlands	V-Bird	100% by DutchBird	2003	2004
Poland	Centralwings	100% by LOT	2004	2009
Spain	Clickair	20% by Iberia ^e	2006	2009
Italy	Volareweb	100% by Alitalia	2008	2009
Morocco	Atlas Blue	99.9% by Royal Air Maroc (RAM)	2004	2009
Morocco	Jet4you	100% by TUI	2006	2012
India	JetLite	100% by Jet Airways	2007 ^f	2012
Thailand	One-two-GO	100% by Orient Thai	2003	2009
New Zealand	Freedom Air	100% by Air New Zealand	1995	2008

^a Started as Click and then became MexicanaClick when it was 100% owned by Mexicana.

^b Originally.

^c Was certainly partially a LCC, with this operation at 4 UK airports (Bournemouth, Coventry, Cardiff, and Doncaster).

^d When renamed FlyNordic.

^e Despite its low ownership, Iberia appeared an influential party.

^f JetLite merged into the Jet Connect brand.

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