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## Research Paper

## Low-cost carriers and secondary airports: Three experiences from Italy

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## ABSTRACT

The paper analyses the relationship between low-cost carriers and secondary airports in Italy, resulting from the deregulation process and from the changes in the internal market due to the weak situation of the former flag carrier Alitalia. To do that, the paper discusses the incentive schemes used by airports to attract airlines. The paper begins by providing a general framework for incentives, supporting the analysis by means of three case studies (Aeroporti di Puglia, Alghero's airport, and Emilia-Romagna's airports). Findings from the study show that discounts on landing and/or terminal charges, revenue-guarantee schemes, and co-marketing agreements are the instruments most often used in Italian airports. The majority of them are publicly owned, entailing the use of public money to cover losses regardless of the real impacts of these strategies in economic and tourism terms. Therefore, to strengthen their role, airport policies need to be carefully defined and be included in a wider strategy aimed at promoting destinations and local development, rather than simply promoting air traffic.

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## 1. Introduction

Following the deregulation process, which took place in Europe in the nineties, the air transport market in Italy showed a constant growth in terms of passengers carried, both on domestic and international routes. In this paper, after a short overview of the deregulation process in Europe, an analysis of the Italian context recalling the role of the former flag carrier *Alitalia* and evidencing the growing importance of medium/small airports due to the presence of low-cost carriers (hereafter LCCs) is provided. In the second part, the paper analyzes the instruments (co-marketing agreements, direct subsidies, discount on landing and/or terminal charges and revenue-guarantee schemes) used by airports to attract airlines, both from a general point of view and using three case studies. The paper sheds light on the role of these strategies in improving and promoting the accessibility of some areas, evidencing also their primary contribution to the proliferation of airports whose losses are, in the majority of cases, paid by the public purse.

## 2. Background

## 2.1. The deregulation process in Europe and its effects

Prior to deregulation, air transport was based on highly regulated bilateral agreements between nations. The

deregulation process in Europe followed four steps (ELFA, 2004; Graham, 1998; Malighetti, Paleari, & Redondi, 2008; Mawson, 1997) that led to a unique domestic market for the continent. According to Fu, Oum, and Zhang (2010) and Mawson (1997) liberalization entails a series of changes to the air transport sector such as increased competition among airlines, and improvements in both the service quality and productive efficiency of the airlines. Three main results of the deregulation process (Fu et al., 2010) can be listed on the supply side, namely the entrance and the development of LCCs, the re-organisation of network carriers and the further development of the intra/intercontinental markets. LCCs, thanks to a completely new managerial strategy, have been able to gain growing market shares both on short and medium-haul routes reaching first positions (for Ryanair and easyJet) in the European ranking for passengers carried (CAPA, 2011), representing 31% of the intra-European market in terms of seats (Dobruszkes, 2013). From the demand side, liberalization led to a growth in passenger traffic both in main airports and in medium/small secondary airports that were underused and located in areas with a latent demand for air transport (both new demand and diverted demand from more expensive transport alternatives) (Dobruszkes, 2006). The single aviation market has also changed the traditional business relationship between airport and airline (Starkie, 2012), forcing airports to modify their approach in negotiating with airlines. This is because the capability of LCCs to guarantee high level of passengers creates an asymmetry between the two partners, with more market power in the hands of the airlines (Barbot, 2006). In the case of airports that are closely located, this situation pushes the airports to compete harder

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(through low charges and/or handling fees, co-marketing agreements, etc) to attract carriers (Barret, 2000, 2004).

The remainder of the paper further discusses the instruments used by airports to attract airlines promoting their destinations. The paper shows that for smaller airports, these strategies do not generate any direct commercial benefit, as the revenues generated are insufficient to cover the cost of the incentives. In such circumstances, they tend implicitly or explicitly to be justified as a means to promote and market the destinations. Moreover, the effectiveness, impacts on local economy (which may also be used to justify the use of incentives) and long-term sustainability of these instruments have seldom been analyzed in detail by decision makers.

## 2.2. The Italian context

Prior to deregulation, the air transport sector in Italy was dependent from the former state owned flag carrier Alitalia, operating from its main airport in Rome and from a few other airports. Following the liberalization of air transport, Italy witnessed a considerable growth in terms of passengers. According to ENAC<sup>1</sup> there are currently 46 commercial airports (Fig. 1), differing both for their scale and type of operation.

According to the Transport Statistical Pocketbook<sup>2</sup> (2013), Italy has a similar number of big and medium airports (i.e. airports with more than 1 million passengers) compared to other European countries (Germany, Spain, UK, France), but fewer small airports (with fewer than 0.5 million passengers per year). Traffic trends for Italy show a constant growth in terms of passengers and cargo, with some slowdowns corresponding with economic crises and other events. At the end of the crisis, traffic always recovered, in particular for the passenger sector. The 2007 financial crisis and the crisis of Alitalia represent the greatest traffic slowdowns in the last twenty years, and the industry has still not recovered from these. Comparing domestic and international trends in passenger numbers (Fig. 2), a higher CAGR for the period 2000 to 2012 can be observed for international passengers (5.3%) than for domestic passengers (2.42%). The growth trend for international passengers has been constant since 2003, corresponding, somehow, to the growing presence of LCCs at Italian airports (Bergamo, Rome—Ciampino, Pisa, Catania, etc).

According to DLR (2008), in no other European country are there more airports served by LCCs than in Italy. In the last few years, LCCs have increased their role, while full-service carriers (hereafter FSCs) have reduced their market shares. This is largely due to the weakness of the former flag carrier, Alitalia, which proved to be unable to face the new scenario resulting from market liberalization, but it also derives from the limited involvement of other FSCs into the Italian domestic network. In the majority of cases, LCCs started using secondary airports with idle capacity located in areas previously not served by FSC; the analysis of 2000–2012 CAGR data<sup>3</sup> confirms that where there was a LCC, traffic grew faster (always by above 10%) than the average value for Italy (4.21%). Fig. 3 compares CAGR values and LCC market share in the airports where this increase has been faster. In almost all the cases, Ryanair is the dominant carrier.

Research conducted by KPMG (2011) shows how the traffic distribution of LCCs in Italy is mainly located in medium-small catchment areas (i.e. less than 0.5 million inhabitants). Nonetheless, the presence of LCCs is rather homogeneous among all airport systems, including the main ones (Milan Malpensa, Venice and Rome Fiumicino). The analysis of 2012 traffic data for the 46 Italian

airports with respect to total traffic, shows how the first five airports serve more than 50% of the total traffic, while this value reaches nearly the 90% if we consider the first fifteen airports. Rome and Milan historically play a major role, while regional airports such as Bologna, Naples, Venice and Catania, operating with a mix of low-cost and full-service carriers, have gained increasing importance following the deregulation process (Table 1).

Concerning the ownership of airports (Fig. 4), Italy follows the European trend where the role of the public sector is still strong (ACI, 2010). Adding together the airports wholly in public hands and those with a major public presence, it can be seen that 73% of all Italian airports have a public-sector orientation. Among the first 15 airports per passengers carried in 2012, eight are publicly or nearly publicly owned while only Rome, Venice and Napoli have private majorities.

For the coming years, it is likely that this situation will be challenged because of the weak financial situations of many airports and their respective public administration. A greater presence of private airports could be foreseen. For example, Milan, Forlì, Salerno, Turin, Genoa and Palermo have already planned the privatization or the reduction of the public-sector share for their airports.

## 2.3. The role of Alitalia

The Italian air transport system has been strongly influenced in recent years by the events regarding Alitalia (hereafter AZ), whose story is characterized by a series of difficulties in which bad management, strong political pressure, and the heavy influence of trade unions, led to significant losses that had to be covered by public transfers (Beria, Niemeier, & Fröhlich, 2011). Giuricin (2009) estimated that between 1996 and 2008 the government gave more than Euro 4 billion to save AZ. Since 2000, AZ has constantly lost market share both on domestic and international routes; in particular between 1996 and 2006 it lost 14.8% of its European market share and 10.6% of its Asian market share (Bergamini, Gitto, & Mancuso, 2010). Despite the overall growth of passenger traffic in Italy, Alitalia market shares have been constant or declining while its competitors, including LCCs, have increased their market shares. Passenger traffic in Italy grew with a CAGR of 4.21% over the period 2000 to 2012, while in the same period AZ registered a CAGR of only 0.42%. The domestic market share fell from 65.9% to 44% between 1998 and 2005, and the European market share from 22.5% in 2002 to 17.4% in 2005 (Boitani & Scarpa, 2006). Finally, the new carrier born after the privatization, *Compagnia Aerea Italiana* (CAI), which is jointly owned by a dozen of Italian investors and AirFrance-KLM<sup>4</sup> (the airline initially owned 25% of the company, but this has now decreased to 7%), has not been able to recover market shares neither on domestic markets or on international ones, leaving more and more room to LCCs, especially at secondary airports. Fig. 5 compares the weekly seats offered by Alitalia Group in the Italian airports (excluding the main ones of Milan, Rome and Venice) and the number of routes operated by AZ versus those offered only by other carriers.

It is thus evident that the role of Alitalia is marginal in many airports, including those that have registered high traffic growth in the last decade (e.g. Bologna, Pisa, Treviso, Bari).

## 2.4. The race of airports to attract airlines

Following the liberalization of air transport, some medium/small airports (for example Bergamo, Pisa, Catania) have gained a

<sup>1</sup> ENAC – the Italian Civil Aviation Authority – was established on 25th July 1997 by Legislative Decree no.250/97 as the National Authority committed to oversee the technical regulation, the surveillance and the control in the civil aviation field (source: ENAC website accessed 24 October 2012).

<sup>2</sup> <http://ec.europa.eu/transport>

<sup>3</sup> We consider here only values above 11%.

<sup>4</sup> In 2008, an attempt to sell the carrier to AirFrance/KLM failed due to political intervention and to a refusal by trade unions to accept the proposals of Air France with regard to labor issues.

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