

MARCH 2017

Joining forces in commercial aviation: how network and low-cost carriers can win by partnering in a new way



Following years of healthy profits—largely courtesy of rock-bottom fuel prices—airlines are facing tough challenges as fuel prices recover. Fares remain under pressure from overcapacity and economic uncertainty, and cost concerns persist.¹ To safeguard their bottom lines, carriers will have to get creative.

Our analysis shows that exploiting a yet underused tactic can help. The tactic? Using low-cost carriers as passenger feeders to network carriers. Our analysis reveals that that form of connectivity could help both types of carriers improve their financial performance. Achieving such connectivity won't be easy. But carriers that can ink the right collaborative agreements will stand the best chances of reaping the biggest benefits.

For some time now, commercial airlines have enjoyed relatively healthy profits. But big challenges are looming on the horizon—including the likely inevitable uptick in fuel prices and continued overcapacity, with consequent pressure on yields.² These conditions will continue to pose threats to carriers' bottom lines. Meanwhile, low-cost carriers (LCCs) continue to maintain a short-haul unit cost advantage over network carriers (NWCs). And that advantage persists despite some convergence in product and service offerings and NWCs' attempts to cut costs and replicate low-cost models.

To navigate this environment successfully, carriers will have to explore novel ways to protect their profit margins and boost financial performance. We have focused our analysis on a largely untapped opportunity to meet these imperatives: using LCCs as feeders into NWCs. This notion has stimulated discussion among airline executives, and some carriers have already taken steps toward collaborating in this way. But full implementation of this approach has remained elusive. The reason? Solving the NWC/LCC connectivity puzzle requires complex agreements covering multiple

¹ IATA Forecast December 2016.

² IATA Forecast December 2016.

considerations. These include how to best go to market with connectivity services and how to handle ticket sales, irregularities (including lost luggage and delayed flights), and baggage transfers. Furthermore, most LCCs are not yet set up to manage this form of collaboration.

Still, our analysis of public financial data and published flight schedule data shows that NWC/LCC connectivity can pay off handsomely for both types of carriers—in forms such as enhanced revenue, operating profits, and load factors. It can also free up limited slots at congested airports. In fact, airlines that are shying away from this approach may well be leaving considerable money on the table.

With these benefits to airlines come substantial benefits for passengers too. These include more connections to secondary markets operated solely by LCCs, new origin and destination (O&D) routings, a wider range of choices for long-haul destinations, and an opening up of direct flights to secondary long-haul destinations.

To capitalize on the connectivity opportunity, carriers must know how to identify specific areas of network overlap and complementarity. They also have to explore various connectivity moves based on real capacity and schedule data, and they have to quantify route-level business benefits. Even more important, they have to set up the right kinds of collaborative agreements, spelling out *who* will handle tasks like

marketing, ticketing, irregularities, and baggage transfer—and *how* to handle them. There's a lot to coordinate, but agreements that enable each carrier type to focus on what it does best would generate the most value for all parties involved. In some cases, airport operators could facilitate NWC/LCC connectivity, thereby easing the coordination burden for carriers.

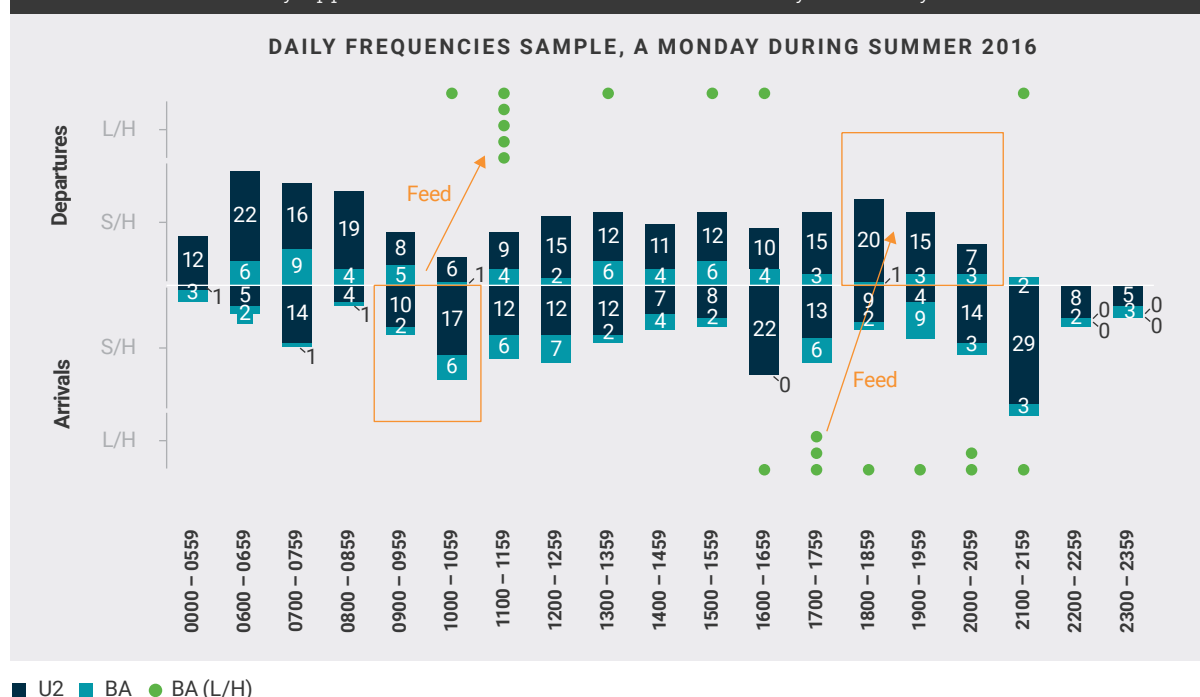
With these points in mind, let's take a closer look at some case studies that showcase the potential upside of connectivity. We will then examine the kinds of agreements that could help carriers tap this opportunity, and consider the airports' potential role in fostering NWC/LCC connectivity.

QUANTIFYING THE POTENTIAL: CASES IN POINT

Using our network analytics tools and synergy framework, we calculated realistic hypothetical economic benefits of NWC/LCC connectivity. We used public financials for major carriers at two European airports that have great potential for this kind of cooperation:

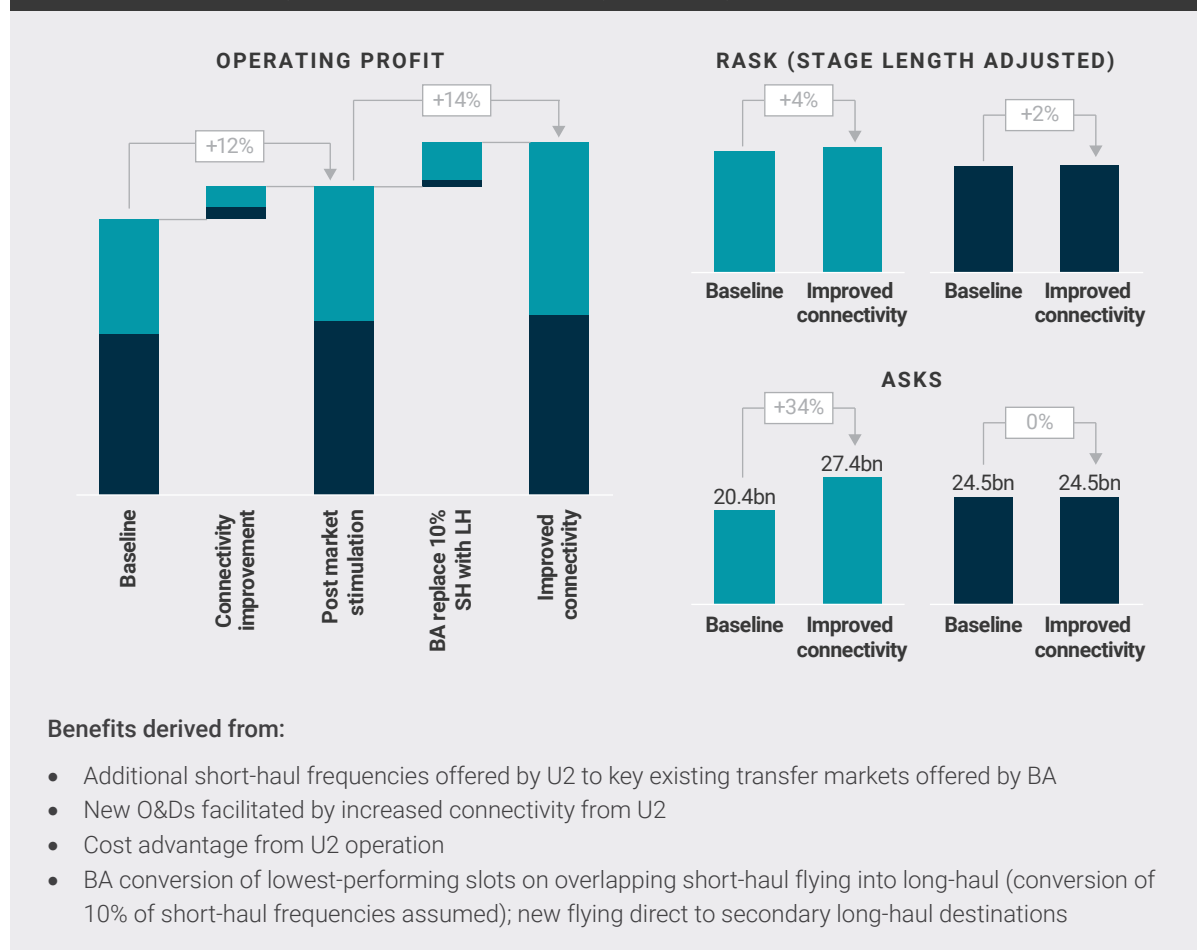
- Resident long-haul carriers British Airways (BA) and Virgin Atlantic (VS) and short-haul LCC easyJet (U2) at Gatwick in London
- Nonresident long-haul carriers plus the dominant LCC easyJet at Malpensa in Milan

FIGURE 1: Connectivity opportunities at Gatwick for British Airways and easyJet



Source: OAG Data (2016), AlixPartners' analysis

FIGURE 2: Connectivity benefits for British Airways and easyJet at Gatwick



■ U2 ■ BA

Source: Annual reports; AlixPartners analysis

Note: Scenario shown reflects estimated impact on performance of Gatwick-based flying

Here's what our analysis revealed:

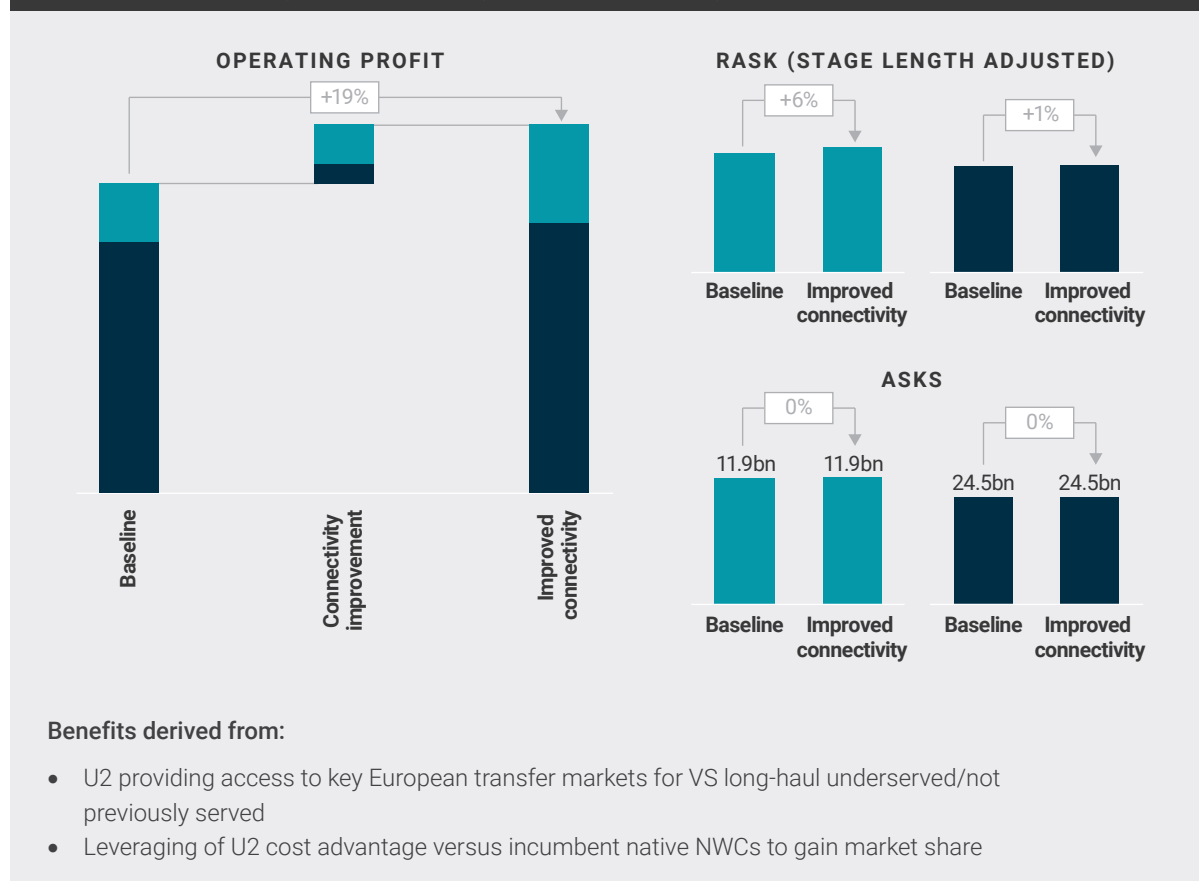
London: Gatwick Airport

As the world's busiest single-runway airport, Gatwick is facing serious constraints on its capacity. BA and U2 share many overlapping short-haul routes throughout Europe, with BA, VS, and some nonresident network carriers handling long-haul routes, most of them to the Americas. Although Gatwick is not set up as a connecting hub, we found that the distribution and timing of short-haul flights during a typical day at Gatwick could easily accommodate an increase in long-haul-flight frequency. Put another way, there's a sufficient number of short-haul flights arriving two to three hours before long-haul flights, thereby giving a sufficient volume of short-haul passengers arriving at Gatwick plenty of time to catch long-haul connections (figure 1).

As much as 95% of BA's short-haul seats are on routes overlapping with U2's. Indeed, U2's short-haul capacity out of Gatwick is more than three and a half times that of BA, and half of that capacity is on nonoverlapping routes. Improved connectivity between the two airlines would deliver significant benefits for both (figure 2). For instance, by converting slots from financially lower-performing short-haul routes to better-performing long-haul routes, BA would be able to focus more sharply on its core competency. All the while, it could maintain—and perhaps increase—the required volume of feeding traffic that U2 could provide at a lower cost and a higher capacity, with benefits from opening up new markets and O&Ds.

VS and U2 could similarly benefit from improved connectivity (figure 3). VS does not have a short-haul network to feed long-haul routes out of European markets, and it relies only on point-to-point traffic and US connections to operate its Gatwick services.

FIGURE 3: Connectivity benefits for Virgin Atlantic and easyJet at Gatwick



Meanwhile, U2 serves core European markets with a high number of daily frequencies—markets that could present opportunities for transfer traffic on VS's North American, Mexican, and Caribbean routes. Improved connectivity between VS and U2 would give VS access to these key European transfer markets, where it currently has only limited access because of its lack of short-haul feed. As a result, VS could see its load factors increase to the levels that competing long-haul carriers flying out of Gatwick achieve, which could possibly unlock opportunities for additional destinations.

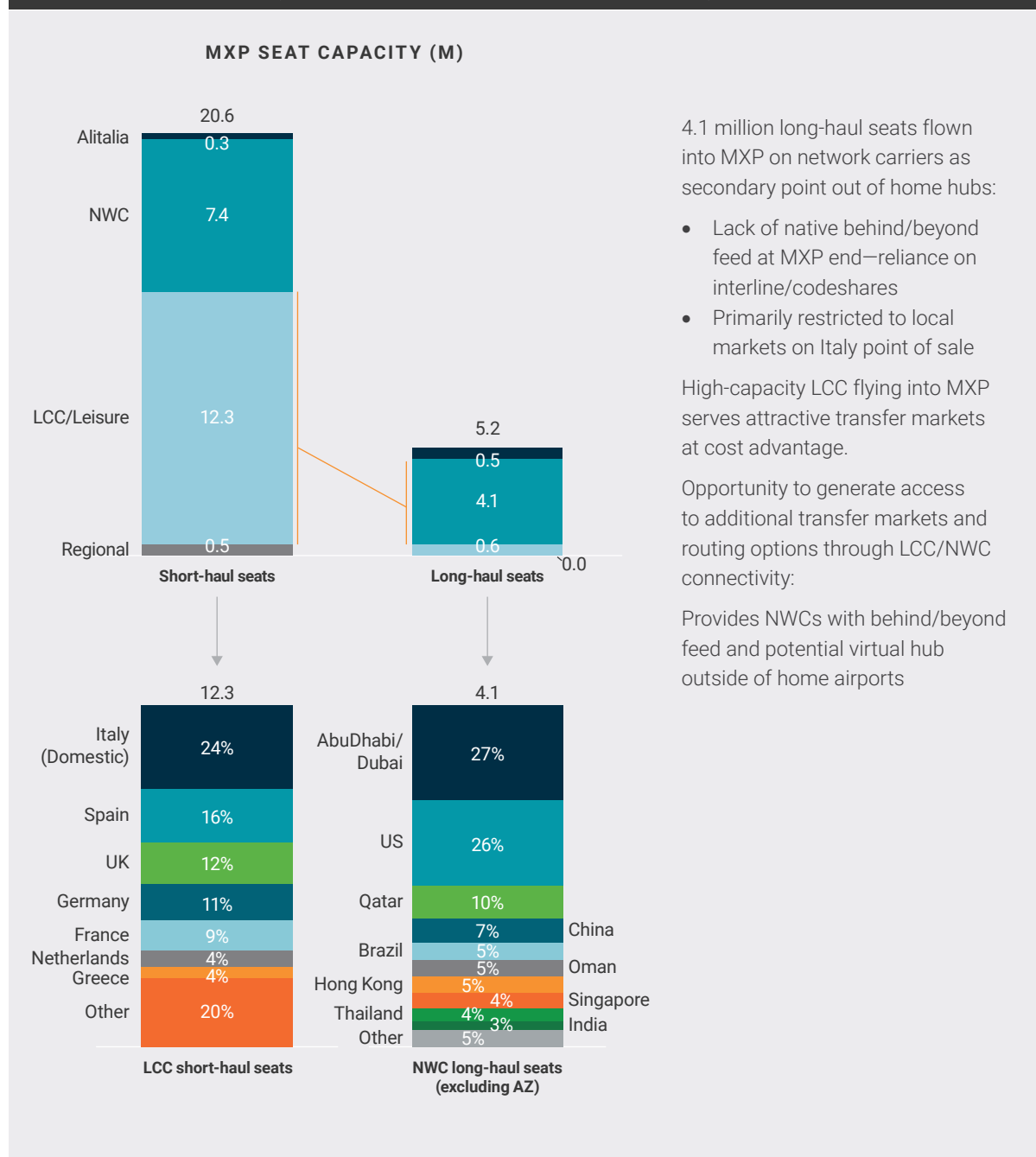
Milan: Malpensa Airport

At Malpensa, U2 is the dominant low-cost carrier operating the short-haul network. Without a dominant domestic long-haul operator, Malpensa has a small long-haul network operated largely by nonresident

network carriers. These carriers are operating outside their hubs and as a result, have no natural feed, which makes Malpensa an operationally viable destination for only a relatively small number of carriers.

Improving U2's connectivity with these long-haul operating NWCs would provide them with access to additional transfer markets and routing options through the provision of short-haul flights on either side of a long-haul flight, otherwise known as *behind/beyond feed*. The NWCs would gain a sufficient amount of this feed to possibly constitute the creation of a virtual hub outside of their home airports. Indeed, for instance, a 1% feed from LCCs operating out of Malpensa could contribute to network carriers' load factors by up to 3% (excluding displacement/spill of existing passengers) (figure 4).

FIGURE 4: LCC behind/beyond feed at Malpensa for nonresident long-haul carriers

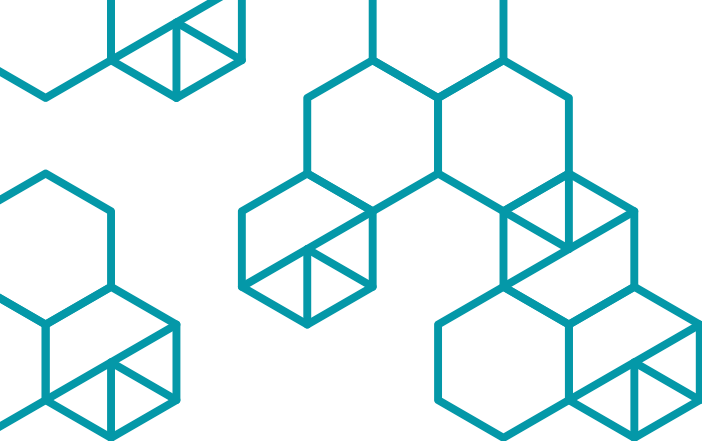


Source: Published schedule data; AlixPartners analysis

FORGING THE RIGHT AGREEMENTS

To reap the potential benefits our analysis revealed, carriers would have to draft the right kinds of commercial and operational agreements. To date, these arrangements have proved difficult to arrange. This is in part because of LCCs' discomfort with taking on increased complexities, liabilities, and risks, which goes against some of their historical operating principles.

Agreements would have to be set up so as to motivate the right behaviors and maximize the economic benefits available. For instance, these agreements should deliver measurable improvements to passengers' experiences compared with having to arrange their own connections, and they should support optimal commercial and operational performance between LCCs and NWCs. Only then can the connectivity relationships be sustainable.



Network and schedule alignment, pricing, marketing and selling, ticket servicing and changes, frequent-flier benefits, passenger through check-in, baggage transit and allowances, and service recovery for delays and irregularities—these are just some of the areas that agreements must cover if they're to enable LCCs to attract and deliver sufficient feed for NWCs.

Although traditional tools and agreements such as interlines and codeshares would facilitate successful connectivity across some of these areas, potential partners would have to find creative ways of overcoming the structural challenges inherent in LCCs' and NWCs' differences. Furthermore, if agreements are to remain sustainable, then how carriers share the benefits will prove just as important as what benefits are ultimately delivered.

UNDERSTANDING AIRPORTS' POTENTIAL ROLE

In some cases, hesitation on carriers' parts or lack of clearly dominant players could make it difficult for airlines to directly forge such agreements. Under these conditions, airport operators could play larger roles in facilitating network connectivity. Indeed, the trend away from hub-and-spoke and toward direct point-to-point services, together with passengers' increasing levels of sophistication and their willingness to self-connect, is creating opportunities for airports to foster such connectivity. So, perhaps not surprisingly, we're already seeing some airports stepping into this role.

Take Gatwick. The airport provides a flight connection service, GatwickConnects, for self-connecting passengers. At the facility, passengers can quickly redrop bags and then transit through security. Gatwick also provides protection against irregularities such as lost luggage and delays, and it offers transfer services between terminals. Originally planned for Norwegian Air Shuttle (short- and long-haul connections), the facility

is now open to multiple airlines. Other airports, such as Malpensa and Barcelona, are following suit, with varying degrees of services offered. Still others, such as Stansted Airport, are relying entirely on a very high number of passengers to organize connections themselves.

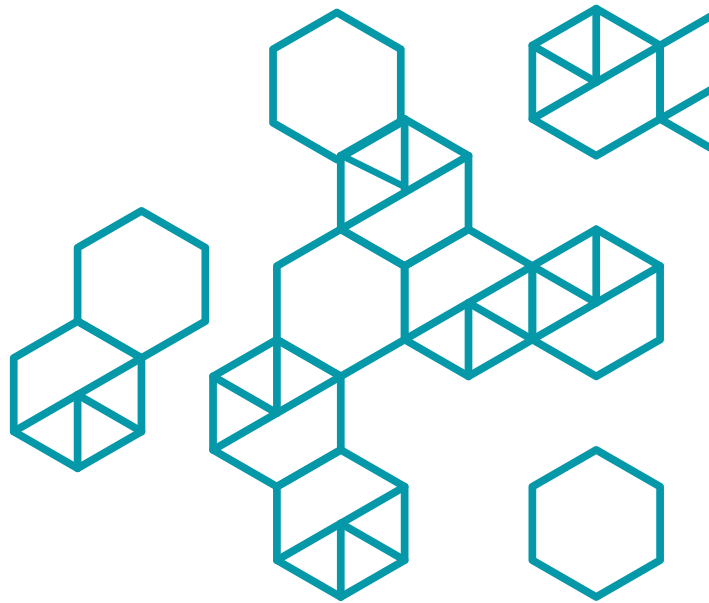
Experienced airport operators can help both types of carriers map out potential collaborations, enabling the airlines to bypass inherent complications and potential disagreements when collaborating. In this role, an airport operator might become the service provider for the connected flights in question and take responsibility for managing the complexities and challenges that come with the role. The airport might provide ticketing services on behalf of airlines, offer passengers and their luggage full connectivity throughout their journey, and provide complete protection against irregularities.

In this kind of arrangement, everyone wins. Passengers enjoy more opportunities to self-connect. They have a wider choice of carriers, options, and price points, and their risk in case of service disruptions is minimized. Long-haul NWCs receive additional passenger feed, while short-haul LCCs can offer customers a stronger value proposition in the form of greater connectivity. Meanwhile, the airport may itself attract more long-haul airlines through its offer of additional feed, and it could win more LCCs through the additional sales proposition. The airport might also earn fees from passengers or airlines in return for providing connectivity services.

Of course, this full-service approach to facilitating NWC/LCC connectivity comes with correspondingly high levels of complexity and risk for airports, because they would be shouldering the work and responsibilities involved. But seasoned airport operators should be able to manage those risks effectively.

CARRIERS SHOULDN'T LEAVE MONEY ON THE TABLE

For commercial airlines around the globe, the search for new ways to safeguard their operating margins should top their lists of strategic priorities. A focus on their core competencies by using short-haul LCCs as passenger feeders to long-haul NWCs could help. Establishing connectivity requires careful data analysis as well as thoughtful decisions about the kinds of commercial and operational agreements that would best suit the carriers involved. Hard work? Most certainly. But airlines that ignore this underutilized lever for improving their profitability risk leaving money on the table. And that's something no airline can afford to do in today's challenging business environment. [A](#)



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