

THE IMPACT OF THE ECONOMIC CRISES FROM THE XXIST CENTURY ON THE EUROPEAN LOW-COST AIRLINES' MARKET

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Abstract:

Considering the fact that the airlines' market is very sensitive to the economic fluctuation, in this paper, we will analyze the impact of the 2001 and 2007 crises on the evolution of the European low-cost carriers, in terms of annual revenues and profits, number of routes, of transported passengers and changes occurred in the implemented strategies. In order to reach up this objective, we have conducted a complex analysis of the secondary data included in various international statistical reports, air transport journals, Official Airlines Guide databases and in the operators' publications. The analysis of the information obtained showed that the two crises from the beginning of the XXIst century did not influenced very much the European low-cost airlines. In order to cope with the unfavorable economic situation, most of the European low-cost operators have implemented different strategies: while some of them have adopted a cost-cutting program, others were launching an expansion strategy. Actually, the largest European low-cost carriers (such as Ryanair and easyJet), took advantage of the unfavorable global situation, by offering more services at low prices in order to increase their market share and, consequently, the profits. Yet, the small and medium European low-cost airlines have better surpassed the 2001 crisis than the 2007 downturn.

Key words: economic crisis, low-cost airlines, business environment, business strategies

JEL classification: E32

INTRODUCTION

Between the transport sector and the economic activity seems to be a strong, positive correlation: any increase of the production and trade will inevitably generate a greater need for transport; a decrease of the same parameters will lead to a descendent demand for transport. In this context, a particular attention should be given to the airline industry, which has proven to be very sensitive to the economic cycles.

It was noticed that, during crises, the decreased demand generates a revenue crisis which is usually followed by a cost and profit crisis, fueled by massive overcapacities. Therefore, those airlines that do not respond quickly by reducing the capacities and taking consolidating actions may experience huge losses. Moreover, it should be mentioned that, during an economic downturn, it was observed that many of the airlines' clients, especially the leisure travelers, are widely changing their buying criteria, preferring a lower price and reduced comfort over extensive connectivity and seamless travel.

The two major economic crises from the beginning of the XXIst century have spread out almost all over the world and had significant consequences. For the air transport sector, the impact of these crises consists in a decrease of the demand (less transported passengers and goods), an important reduction of the supply (through bankruptcies and reduction of the frequency), a changed transport flows (through mergers of routes and loops), lower profits of the airlines and, last but not least, in a process of changing strategies. Yet, there were airlines, both traditional and low-cost, which felt less the crises' influence than the others. Moreover, the impact of the 2001 crisis was at a smaller scale and with less dramatic consequences on the airlines' market than the one from 2007.

In the present paper we will focus our attention on the European market of the low-cost carriers, trying to identify the influences that had, firstly, the 2001 and, secondly, the 2007 crisis on these airlines, in terms of transported passengers, changes of routes, annual revenues, changes in the implemented strategies etc. In order to reach up this objective, we have conducted a complex analysis of the secondary data included in various international statistical reports, air transport

journals, Official Airlines Guide databases and in the operators' publications. We have structured the results obtained in three parts: the impact of the 2001 events on the European low-cost airlines' market, the consequences of the 2007 crisis on these carriers and conclusions.

THE EVOLUTION OF THE EUROPEAN LOW-COST AIRLINES' MARKET BETWEEN 2000 AND 2007

Before the events of September 2001, many European legacy (traditional) airlines were confronting with serious problems, determined by various factors. First of all, the rapid growth of the low cost operators, especially in intra-European markets, was generating a strong downward pressure on the fares of the legacy carriers. Secondly, the fuel price and the labor costs were rising (for example, between October 1998 and October 2000 the fuel prices have doubled and the labor costs were rising as new wage agreements were negotiated in the aftermath of the very profitable years of 1995–1999). Moreover, a slowing down of the economic growth in some developed economies, such as those of Germany and Japan, generated a decrease in the demand of the airlines' services (Mason and Alamdari, 2007).

The bursting of the dot.com bubble in 2000 caused a three years economic downturn, with an initial reduction of the global air traffic demand, especially in premium class products, and a pressure for competitive pricing (Franke and John, 2011). The events of September 2001 amplified the crisis from the airlines' industry due to the fact that the traffic started to slowly decrease in many key markets. In this context, while many traditional operators registered important profit loss in 2001, or even were on the verge of bankruptcy, the large European low-cost carriers (such as Ryanair and easyJet), took advantage of the unfavorable global situation: they were offering more services at low prices in order to increase their profits. For example, to enhance its reputation among consumers and to reduce the costs, Ryanair launched in 2000 a site through which it was possible to make the reservations and purchase the tickets online. This method had the expected success, in the first quarter of the year 2000, the company registering about 50000 reservations per week. Actually, in 2002 and 2003, Ryanair and easyJet won around 22 million new passengers.

Between 2002 and 2004, many low-cost airlines, such as Buzz, bmibaby, MyTravelLite or Jet2, have emerged on the UK market. Moreover, the acquisitions of British Airlines' subsidiary Go by easyJet and KLM's subsidiary Buzz by Ryanair contributed to the consolidation of the Western European low-cost airlines' market. According to Credit Suisse First Boston, in 2004, the low-cost carriers accounted for 20% of European airline passengers, and 43% of the domestic UK market (Travel Weekly, 2004). Yet, we can notice that for quite a long period of time, the activity of the European low-cost airlines was mainly focused on the western space (European Parliament, 2007).

The development of the low-cost model in the Central and Eastern Europe was facilitated in 2002 by the Czech and Slovak Governments who both liberalized their bilateral agreements, allowing low-cost air services with the UK (Burghouwt et al., 2003). This offered them the opportunity to take advantage of the inbound tourism market and to prepare for joining the single European aviation market. Slovakia became the first country in Central-Eastern Europe that has operated the 'Southwest copy-cat' model, with the help of the Sky-Europe airline, which started serving Amsterdam, Paris and London in 2003.

The adhesion of the states from Central and Eastern Europe to EU involved the correlation of their legislation to the Community's and the extension of the "open skies" agreement. Full membership of the single European aviation market has led to the proliferation of air services. The agreement allows any airline from the EU carry passengers and freight within the Community and benefit, in each of these countries, of the same rights as those of the local companies. Therefore, it has led to the establishment of new low-cost routes served not only by the existing operators, but also by the new market entrants. By the summer of 2004 the low-cost carriers' sector had grown in number to around 50 airlines, according to the European Low Fares Airline Association (ELFAA)

(Airline Business, 2004). In figure 1 it can be seen the percentage of the seats provided by the low-cost carriers on the domestic and intra-European Union routes, at the end of 2004. However, aside from easyJet, Ryanair and Air Berlin, most of the low-cost airlines were generating only very marginal levels of profit.

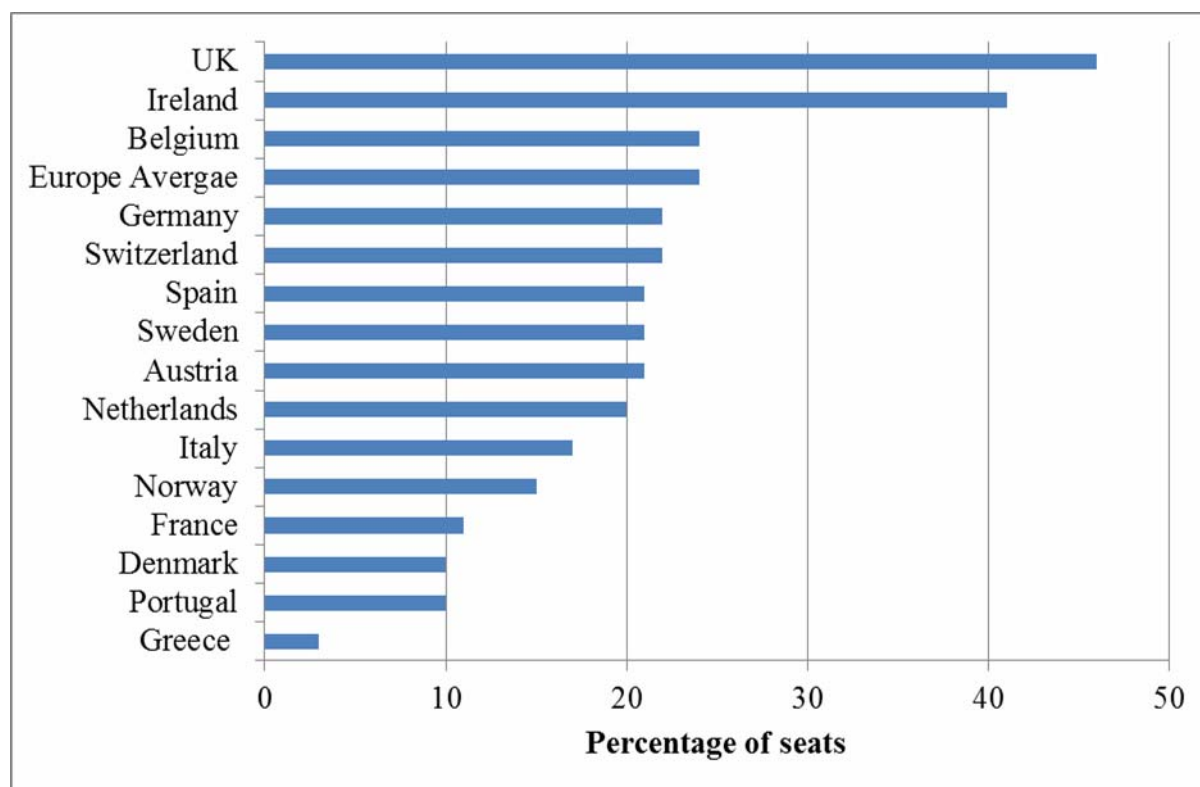


Figure 1. Percentage of the seats provided by the low-cost carriers on domestic and intra-EU routes, at the end of 2004.

Source: Compiled from Official Airline Guide (2005)

According to the life cycle model of the low-cost airlines from USA, designed by Francis et al. in 2006, which includes seven stages of evolution (innovation, proliferation, consolidation, second phase of new entrants, consolidation, market maturity and decline), we can estimate, based on the statistical data, that the European market of the low-cost operators has differently developed between 2000 and 2007. While the market of the low-cost carriers from Western Europe has reached up the consolidation phase, in Eastern Europe this market is only at the end of the innovation stage and in the Central Europe in the proliferation one.

Considering all the information mentioned above, we may say that, by early 2007, the European low-cost airlines' industry seemed to have successfully surpassed the 2001 events, most of these carriers registering important profits' increase. A significant impact on this positive trend had the consistent GDP growth, registered in many developed economies.

THE CONSEQUENCES OF THE 2007 CRISIS ON THE EUROPEAN LOW-COST AIRLINES' MARKET

By the end of 2007, the economic-financial crisis that started in USA has rapidly extended all over the world, having significant impact on national economies and, consequently, on individuals' consumption decisions. Of course, it has also influenced the evolution of both low-cost and traditional carriers. Yet, the negative consequences were smaller in the case of the low-cost airlines, which seemed to have increased their market share vis-à-vis the traditional carriers and

charter companies. However, in order to cope with the unfavorable global situation, both legacy and low-cost carriers have implemented some strategic measures.

The value of the airlines' shares fell in 2008 and the managers were forced to take vital strategic decisions regarding the way in which to reshape their companies and adapt to current business climate. Many low-cost companies have adopted a cost-cutting program through a personnel reduction and a diminishing of the capacity. This time, the strategies of lowering costs did not necessarily implied lower tariffs, especially in the case of the small carriers. For example, Finnair is to cut the size of its narrow-body fleet by 4 A320s aircraft in autumn 2012 as part of its savings program of 140 million EUR that has to be achieved by 2014 (Eurocontrol, 2011). There were also cases in which the European low-cost airlines, in order to survive the crises, have sold a part of the company's shares. It is the case of Air Baltic, formerly owned by Baltic Aviation Systems. For this company, the Latvian government has increased its shares up to 99.8%. Subsequently, the government agreed to a capital increase to allow fleet modernization and network adjustment of its flag carrier (World Airline News, 2011).

Meanwhile, the largest low-cost operators, such as Ryanair, easyJet or Air Berlin have adopted an investment strategy, based on creation of new routes, new branches, located in different countries, or on additional flights for the existing destinations.

Table 1. The number of routes and destinations for some of the most important European low-cost airlines in 2004 and 2009

LCCs in 2004	No. of Destinations	No. of Routes	Exclusive Routes* %	LCCs in July 2009	No. of Destinations	No. of Routes	Exclusive Routes* %
Alpi Eagles	9	22	27	Aer Lingus	59	88	69
Bmibaby	24	78	59	Bmibaby	29	63	51
Deutsche BA	8	26	31	Blue Air	34	45	87
easyJet	38	238	65	easyJet	110	445	79
Flybe	32	111	77	Flybe	56	162	90
Germanwings	32	66	70	Germanwings	66	121	85
Hapag-Lloyd Express	19	42	86	Transavia	68	96	91
Intersky	5	10	100	TUIfly	70	272	94
Jet2	13	23	91	Jet2	48	105	79
Monarch	11	32	31	Monarch	19	49	41
MyTravel Lite	14	30	60	Myair	31	50	82
Norwegian	21	46	35	Norwegian	75	164	95
Ryanair	84	292	93	Ryanair	145	818	93
Sky Europe	9	16	88	Sky Europe	33	57	84
Vueling	4	16	16	Vueling	44	89	81
Windjet	5	12	33	Windjet	29	46	93
Virgin Express	15	30	23	Wizzair	52	143	88

* Routes operated without any rival

Source: After Dobruszkes, 2006 adapted by the author

Due to the great number of the subsidiaries spread out all over the European Union (there were 20 in 2007), the International Air Transporters Association (IATA) conferred Ryanair the title of the largest airline in the world, in 2007. Since then, the number of the subsidiaries increased each year. Only in 2008 Ryanair has inaugurated four new bases (Alghero, Bologna, Cagliari and Edinburgh) and opened 223 new routes. To better serve the clients' needs, Ryanair has opened in 2009 eight new bases in Bari, Brindisi, Faro, Leeds Bradford, Oslo Rygge, Pescara, Porto and Trapani. A year later, Ryanair has settled its 42nd base in Barcelona El Prat and opened 10 new routes from its 43rd base in Valencia, in the end of 2010 (Eurocontrol, 2010). Yet, in order to be efficient, Ryanair has cut 16% from its capacity in the UK during winter 2010 compared to the same period of the previous year. Ryanair's expansion strategy seems to continue, since the

company has announced its intention of opening a base in Palma de Mallorca in 2012, basing 4 aircraft and adding 17 new routes to the existing 30 services from the Mallorca airport (Ryanair, 2011).

Another example of company that has implemented an expansion strategy is easyJet, which has ordered, at the beginning of 2011, 15 additional Airbus 320 airplanes, in order to better serve the 547 routes that it has. According to the company's annual reports, easyJet has launched more than 65 new routes in 2008, over 55 in 2009, more than 70 in 2010, about 35 in 2011 and, by June 2012, it wants to explore 18 new destinations (easyJet, 2012). Of course, as in the case of Ryanair, many of these routes are operational only in certain seasons. Table 1 provides an overview of the number of the destinations and routes operated by the some of the most important European low-cost carriers in 2009 compared to 2004.

Analyzing the data offered by the airlines' statistics, referring to their evolution between 2007 and 2011, we can notice a positive trend for the largest European low-cost carriers. As it also happened after the 2001 crisis, Ryanair took advantages of the nowadays unfavorable economic and financial situation by offering services at a lower price, in order to increase its market share – an average fare for a Ryanair's flight was about 35 Euros in 2009. The company had the expected results: the number of the transported passengers grew with 14% between 2008 and 2009 and with 10% between 2009 and 2010, while the revenues followed the same positive trend. For example, in the first half of 2009, its profit increased with 21% compared to the same period of the previous year. Moreover, for the financial year 2010, Ryanair reported a profit of 319 million €, a 204% improvement over the same period of the previous year. The traffic increased by 14% to 66.5 million passengers, comparing the same periods of time. The positive evolution was also maintained in the 2011 financial year, when the company had an 11% growth in traffic, to 73.5 million passengers, and an almost 15% increase of profits to around 360 million € (Eurocontrol, 2011).

As in the case of Ryanair, it is noticeable that Norwegian Air Shuttle has constantly increased its passengers and, consequently, the revenues, after the emergence of the nowadays crisis: between 2008 and 2010 the number of the company's passengers augmented with an annual average of 15% (Norwegian Air Shuttle, 2011).

Tui Travel has also announced a record high profit for the financial year 2011, which shows an increase of 18% compared to the previous reported year. These results are attributable to its strong online sales and to the demand for the exclusive resorts served by the company (Eurocontrol, 2011).

The data offered by easyJet in its Annual Reports reflects that, in the first two years after the beginning of the 2007 crisis, the company was negatively influenced by the economic downturn. So, even if in 2008 its revenues have grown with 31,5% and in 2009 with 12,9%, the profit has decreased with almost 45% and, respectively, 50% compared to previous years (2007 and, respectively, 2008). This negative evolutions were soon surpassed, for the 2010 financial year the company reporting an 11,5% increase in revenues and an 181,5% increase in the profits, compared to 2009. In 2011, the revenues increased with 16,1%, while the profits rose with 31,5%, compared to previous year. The easyJet's situation of the number of transported passengers and the load factor for the years 2007-2011 can be seen in the figures 2 and 3.

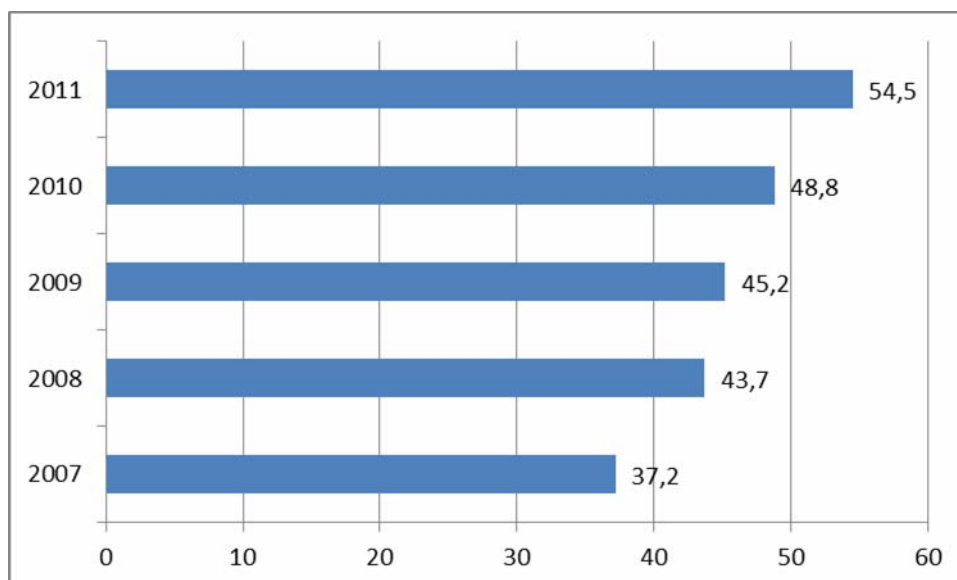


Figure 2. The number of the easyJet's passengers transported between 2007 and 2011, in millions.

Source: Compiled from easyJet Annual Report and Accounts, 2011
<http://2011annualreport.easyjet.com/overview/turning-europe-orange.aspx>

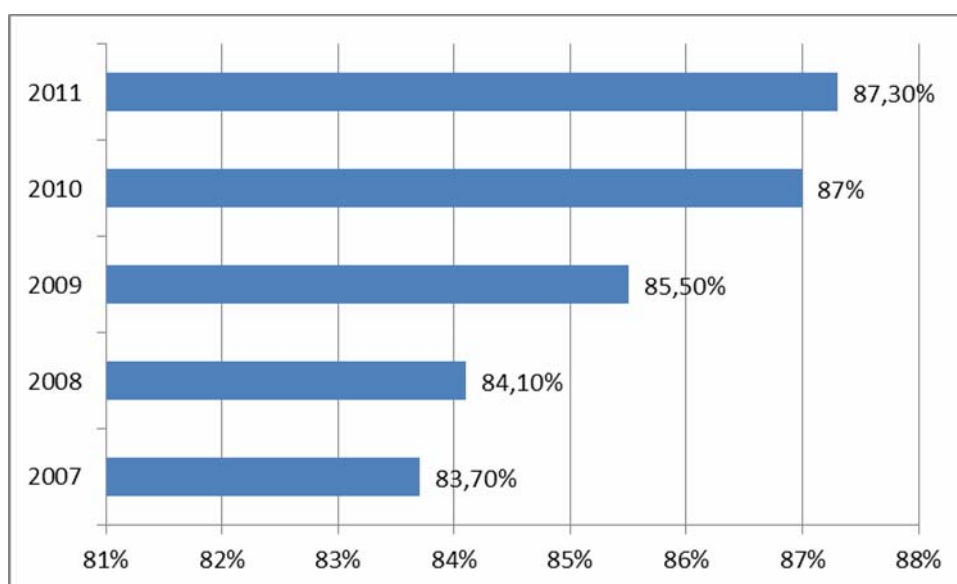


Figure 3. Percentage of the easyJet's load factor between 2007 and 2011.

Source: Compiled from easyJet Annual Report and Accounts, 2011
<http://2011annualreport.easyjet.com/overview/turning-europe-orange.aspx>

Considering all the aspects detailed above, about the evolution of the LCCs after 2007, we may say that the reduced fares of the low-cost airlines are a good argument for attracting clients especially during the crisis.

Now, the important question that many analysts have asked is whether the growth rate of the European low-cost airlines can be maintained in the future. In an analysis by Deutsche Bank, it is estimated that, at least on medium term (7-8 years), the low-cost airlines' market will continue to experience a growth in volume of roughly 15%, as a consequence of a combination of shifts from other air transport segments, GDP growth and a rising propensity to travel. Consequently, on average, the European low-cost operators are expected to achieve annual growth rates between 10%

and 15%, an important contribution to this percentage being claimed by Ryanair, easyJet and Air Berlin (Macario and Van de Voorde, 2009).

CONCLUSIONS

Before the 2001 crisis, the airlines' market was confronting with serious problems, reflected in a reduction of the global air traffic demand, especially in premium class products, and a pressure for competitive pricing. Therefore, the events of September 2001 amplified the economic downturn from the airlines' industry, the traffic starting to slowly decrease in many key markets. Yet, the large European low-cost carriers took advantage of the unfavorable global situation: they offered more services at low prices in order to increase their profits. Moreover, between 2002 and 2004, many low-cost airlines have emerged especially on the Western European market. In 2004, the adhesion of the states from Central and Eastern Europe to EU has led to the establishment of new low-cost routes served not only by the existing operators, but also by the new market entrants. Therefore, we notice that by the summer of 2004 the European low-cost carriers' sector has grown in number.

At the beginning of 2007, the European low-cost airlines' industry seemed to have successfully surpassed the 2001 events, the largest carriers registering important profits' increase. A significant impact on this positive trend had the consistent GDP growth, registered in many developed economies. However, the small and medium low-cost operators were generating only very marginal levels of profit.

The global economic-financial crisis from 2007 had significant impact on the evolution of both low-cost and traditional carriers. Yet, the negative influence was smaller on the largest low-cost airlines, which had increased their market shares, revenues and profits. However, in order to cope with the unfavorable global situation, the airlines have implemented some strategic measures. While the small and medium size low-cost companies have adopted a cost-cutting program, through a personnel reduction and a diminishing of the capacity, or have sold a part of the companies' shares, the largest low-cost operators, such as Ryanair, easyJet or Air Berlin have adopted an investment strategy, based on creation of new routes, new branches, located in different countries, or on additional flights for the existing destinations.

Analyzing the data offered by the airlines' statistics, referring to their evolution between 2007 and 2011, we can notice a positive trend for the largest European low-cost carriers. In the case of the four European low-cost airlines that we have analyzed – Ryanair, Norwegian Air Shuttle, easyJet and Tui Travel – we have noticed that, in general, there were positive trends between 2007 and 2011 in the number of passengers, revenues and profits.

We cannot say the same thing about the main legacy carriers, which have registered, between 2007 and 2011, a decrease in the number of transported passengers and, consequently, in their revenues. Actually, the huge decrease in the number of the flights in 2009, registered in Europe, was mainly caused by the evolution of the major network carriers (such as British Airways, Austrian Airlines or Iberia), which had an average of 6% decrease in the number of their flights.

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