Is there a long-haul low-cost gap?

Norwegian's decision to focus on short-haul leaves a hole in the market that may look inviting to some operators

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Singapore Airlines sees value in pursuing a twin-brand strategy with its low-cost subsidiary Scoot

In 2019, Norwegian Air operated by far the largest number of long-haul (more than 4,500km) low-cost flights in the world. It operated across the Atlantic and from Europe to Asia. But because of over-rapid expansion and huge debts it was haemorrhaging cash badly even before the impact of the pandemic in 2020.

So, there was no surprise when in January this year chief executive Jacob Schram announced that the carrier was abandoning long-haul and would focus on short-haul low-cost operations.

The preceding months and years had already seen other European long-haul LCC exits, including Primera Air, Wow Air, XL Airways and Air France subsidiary Joon, while IAG has significantly pared back its Level operation.

Does the collapse of Norwegian and these other airlines mean that the low-cost model is not financially viable in long-haul markets? Or, does it suggest that post-pandemic there will be a major gap available in the transatlantic and Europe-to-Asia markets for one or more low-cost airlines to exploit ?

In theory the low-cost model appears viable on long-haul routes because it produces significantly lower operating costs per seat or per passenger than can be offered by a legacy airline flying the same or similar aircraft. This is achieved by spending less to fly the aircraft and by packing it with more seats.

Seating on Boeing 787-9s in 2020

Legacy carriers	Seats
Air Canada	296
Air France	276
American	274
Virgin Atlantic	258
British Airways	216
Low-cost carriers	
Scoot	375
Norwegian	338
Westjet	320

Source: Doganis, 2021

TRIP COSTS

On long sectors, the cost savings which can be achieved using the low-cost model are not as significant as on short-haul routes. Nevertheless, a low-cost airline flying the same aircraft as a legacy network carrier should be able to achieve total trip operating costs about 15-20% lower than its legacy competitor. A recent study showed that, using a Boeing 787-9, a new-entrant low-cost operator could operate at up to 25% lower trip costs.

Low-cost operators can convert their lower trip costs on long sectors into even lower costs per seat-kilometre by adopting much higher seating densities in their aircraft than the legacies do.

Assuming a low-cost carrier operating a 787-9 across the Atlantic has total trip costs about 20% lower than those of legacy airlines but operates with the high 338-seat configuration used by Norwegian, then its CASK would be about half that of British Airways and about 30-35% lower than that of Air France, American Airlines or Virgin Atlantic. The CASK differential would be even greater if the low-cost carrier adopted the still-higher seating density used by Scoot, Singapore Airlines' low-cost subsidiary.

To compensate for their higher trip costs and CASK, legacy airlines must attract some business and leisure passengers prepared to pay substantially higher fares to travel in their premium cabins. In the case of Air France, such premium passengers represent only 8% of its traffic but generate 35% of its passenger revenues.

In contrast, low-cost airlines use very low fares, made possible by their much lower CASK, both to stimulate new demand and to divert passengers from higher-fare legacies. But low CASK does not in itself guarantee profitability, as Primera, Wow and Norwegian have found out. To operate profitably and cover their total operating costs, low-cost airlines must target high loads and very high seat factors on each flight. To achieve this, a long-haul low-cost operator needs to meet most of the following requirements:

- Focus on direct point-to-point routes with leisure and VFR demand;
- Avoid routes with very highly peaked seasonal demand variations;
- Prefer routes with traffic originating from both ends;

- Where possible, have some feed at one or both ends of a route provided either by its own short-haul operations (as is the case with Scoot, Jetstar and Westjet, for example) or by a commercial alliance with another carrier;
- Target long-haul routes under-served or not served by direct legacy flights. These may often be to large secondary airports not adequately served by a country's major carrier (Barcelona, Manchester and Marseilles, for example);
- Avoid dense traffic routes where legacy carriers offer high frequencies and high seat capacities, which enable them to match low-cost airlines by offering a few seats on each flight at very low fares;
- Use cheaper secondary airports where possible;
- Match frequencies closely to demand – a daily frequency on long-haul leisure routes is not essential;
- To more easily match capacity to demand on sectors of less than 8,500km, operate single-aisle aircraft such as the Airbus A321LR and -XLR rather than larger twin-aisle aircraft which are more difficult to fill year-round; and
- Use the newest, most fuel-efficient aircraft, since fuel cost is a very significant part of total costs on long-haul sectors;

In developing new long-haul low-cost operations, it may not be possible to meet all of these requirements on every route, but they are a valuable checklist.

Operators such as XL Airways were unable to make the low-cost model work on long-haul routes

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In Europe, demand for long-haul low-cost flights has grown rapidly. Their share of transatlantic passengers grew from 2% in 2014 to about 10% in 2019. This year, some LCCs such as Westjet and Air Canada Rouge are still flying, while JetBlue is due to enter the market. But there will still be a significant loss of long-haul LCC capacity compared with 2019. There will also be a cutback of low-cost capacity on Europe-to-Asia routes.

SUPPLY DEFICIT

As a result, there will be substantial suppressed demand for very low fares on long flights from Europe. In the short term, this may be met by the low fares likely to be offered by legacy carriers as they try to stimulate demand coming out of the pandemic. In the longer term, there will be a supply gap for long-haul low-cost low fare services. How could this be filled?

The first possibility is the launch of new low-cost carriers dedicated to operating long-haul services. They would be free of legacy costs as well as any heavy debts incurred in order to survive the pandemic.

One new entrant, Norse Atlantic, has already been launched by a group of executives previously linked to Norwegian, who are in the process of raising funds. Another, FlyPop, is planning flights to India. But any standalone new entrant would need time before it could make any real inroads into pent-up demand for low-fares across the Atlantic or to Asia.

Alternatively, existing legacy airlines could launch long-haul low-cost subsidiaries. Air Canada appears to have done this successfully with Air Canada Rouge; and in Asia, Singapore Airlines has done so with Scoot and Qantas with Jetstar. But then in Europe there were the more limited attempts of IAG with Level and Air France with Joon.

So, there is not much appetite among the large European carriers to enter the long-haul low-cost market with their own subsidiaries.

Though Lufthansa has tentatively just launched "Eurowings Discover" to do just that, it seems unlikely that this will be a significant player. All three European majors have failed to see any value in fully embracing a twin-brand strategy in which a low-cost independently managed subsidiary is a significant and crucial part of a legacy airline's total business. Yet Singapore Airlines and Qantas have done just that. Is a twin-brand strategy perhaps the key to long-term survival for major players in long-haul markets?

Air Canada Rouge is perhaps a template for legacy airlines

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SHORT SHIFT

In the end, EasyJet and Ryanair would seem to be the best placed to capitalise on this market gap. Given their size, their widespread brand recognition, their numerous bases in many key European markets and their existing short-haul networks, they can satisfy many of the requirements mentioned above for successful long-haul low-cost operations.

Michael O'Leary has spoken in the past of doing so, but held back. Perhaps 2021 or 2022 will be the right time for Ryanair or EasyJet to take the plunge. Someone should. It is a big underserved market out there. ■

Professor Rigas Doganis is chairman of the **Airline Management Group** and author of *Flying off Course: Airline Economics and Marketing*, the fifth edition of which is available to purchase from publisher Routledge and through Amazon