



▶ The True Cost of a Flight

Limits to the cheap-flight strategy

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Twenty euros for round-trip airfare from Stuttgart to Mallorca—low-cost carriers have been attracting ever more passengers with offers like these since the 1980s. Generally speaking, consumers are pleased about the low costs. But with prices like these, it would appear that low-cost carriers have overplayed their hand. According to a representative survey from Porsche Consulting, 55 percent of respondents think that flights these days are too cheap.¹ How is it possible that the taxi to the airport costs more than the flight itself?

► Quantity over quality:

Airfare is becoming ever more affordable

Quantity over quality has been the motto of the airline sector since the markets were deregulated. In 1955 a plane ticket from Frankfurt to New York cost 4,000 German marks, about the same as a VW Beetle.² An average earner in Germany would have had to spend nearly an entire year's salary for that flight. Flying was something special back then. Passengers entered the plane on a red carpet and were served exclusive meals in spacious lounge areas.

Today the cost of a plane ticket is a far cry from the price of a VW Golf. Bargain hunters can book round-trip tickets from Germany to New York for 400 euros. But few traces remain of that early glamour. Instead, passengers have to contend with long lines at check-in counters and security stations, all manner of delays, and aching knees as a result of cramped seating.

► Testing passengers' patience

The average non-business traveler is quite willing to give up comfort for a low-priced ticket. But what about basic quality markers like punctuality and reliability? What reductions in quality are passengers prepared to accept there, and where do they "dig in their heels"? The aviation industry tested these limits—unintentionally—in the summer of 2018.

From June through September, more than 17,000 flights were either canceled or delayed by more than three hours in Germany alone.³ As a result, the number of complaints to conciliation bodies has doubled.⁴

The reasons for the many delays in 2018 were manifold: overuse of both air and ground capacities, tighter flight schedules, and fewer reserve aircraft. In addition, integrating the planes made available by the bankruptcy of Air Berlin presented major challenges to some of the airlines involved.

► Intensely competitive market with low profit margins

A closer look at the market sheds light on the current situation. Around 300 airlines are competing for customers in Europe today.⁵ The market is therefore fragmented and competition is correspondingly high—so high that every year a number of airlines go bankrupt or are bailed out by governments. Alitalia, Air Berlin, and Monarch are the most prominent recent examples. Among the low-cost carriers, it has hit the Icelandic WOW air in early 2019.

In addition, surplus capacities on many routes exert further downward pressure on prices. Established network airlines often have few means of countering the aggressive price policies pursued by low-cost carriers. But they are compelled to lower their own prices and further optimize their costs. When measures apply to personnel costs, trade unions respond ever more frequently with strikes. In 2018 there were more strikes than in the preceding five years combined.⁶ They disrupted millions of vacation plans and business meetings and left passengers with an enduring sense of displeasure.

Low ticket prices, rising costs, and the financial impact of delays and cancellations have been negatively affecting the bottom line for European airlines for some time now. Over the past nine years European airlines have shown an average EBIT

¹ Porsche Consulting (<https://www.porsche-consulting.com/de/medien/pressemitteilungen/detail/jeder-zweite-reist-am-liebsten-im-eigenen-auto/>)

² FVW (<https://www.fvw.de/biztravel/geschaeftsreisemarkt/luftansa-eine-flug-oma-kehrt-zurueck-12980>)

³ Eurocontrol (<https://www.eurocontrol.int/sites/default/files/publication/files/coda-digest-q3-2018.pdf>)

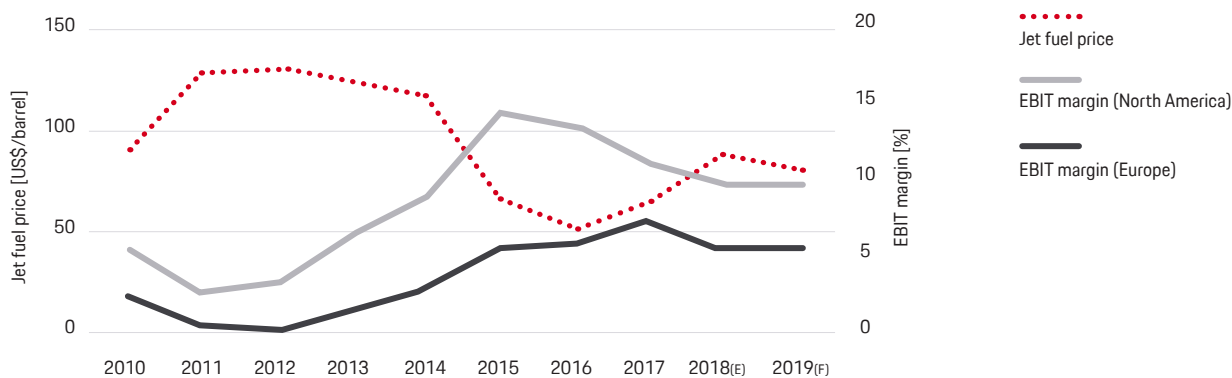
⁴ <https://www.spiegel.de/reise/aktuell/schlichtungsstelle-soep-beschwerden-haben-sich-verdoppelt-a-1243685.html>

⁵ AirlineTechnology.net (<http://www.airlinetechnology.net/airline-directory/airlines-europe-country.htm>)

⁶ <https://www.aerotime.aero/jurgis.petrosius/22201-2018-year-of-aviation-strikes-causes-effect-and-predictions-1>

of only 3.7 percent (see figure 1). By comparison, the average EBIT in the less fragmented US market for the same period of time was 8.5 percent. Rising jet fuel prices (see figure 1) since 2016 are negatively affecting those airlines in particular

that have not hedged their fuel risks. However, the airlines will feel the effects at the latest when the hedging contracts with the good conditions have expired.



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Fig 1. Fuel costs and EBIT for European and North American airlines (E = expected, F = forecast)⁷

► Rising fuel and personnel costs

Not only fuel costs but also personnel costs have been rising sharply, especially for low-cost carriers. In many cases, trade unions have succeeded in negotiating considerably better terms in the wake of the intensive strikes of recent years. If airlines are unable to pass the higher costs on to their passengers, they can expect their profit margins to decline further. And if the situation continues, they will run out of liquidity at some point and have to stop operating. This will open up capacities for other airlines looking to increase their share of the market. They can respond in a number of different ways—from acquiring individual planes and landing rights to taking over entire airlines.

Norwegian is one of the airlines recently suffering from the combination of higher fuel costs and low ticket prices. For 2017 and 2018 it posted total losses of 330 million euros, sold planes, and postponed delivery of new planes.⁸ A cost-saving program is expected to eliminate some routes and close bases in Europe and the USA.⁹ In the meantime Lufthansa, Ryanair, and British Airways have hinted at an interest in acquisition.

► The “civil aviation” system is operating at its limits

Continuing strong growth is not just a problem for airlines. Airports and their many service providers have been complaining about strained capacities and personnel shortages for years now. Numerous major European airports, including London, Amsterdam, and Frankfurt, are already operating beyond actual capacity limits. The consequences are well-known: overloaded security checks, overcrowded waiting areas, and delays due to prolonged check-in processes.

Low-cost carriers in particular demand very short turnaround times between landing and starting the next flight. If schedules are too tight and leave no room to maneuver, even minor disturbances lead to delays in take-off. Over the course of a day, they add up to major delays. Due to strict nighttime flight bans at many airports near urban areas in Germany, this can mean having to divert the last flight of the day to a remote airport. Flight security is also said to suffer from faulty personnel planning and inadequate investment in security systems.¹⁰ It takes up to three years to train an air traffic controller, which makes it difficult to respond to unanticipated periods of strong growth.

⁷ <https://www.statista.com/statistics/225856/ebit-margin-of-commercial-airlines-worldwide/>

<https://www.thejakartapost.com/travel/2018/12/13/airline-profits-set-to-soar-in-2019-amid-shrinking-oil-prices-iata.html>

https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=pets&s=ema_epjk_pwg_nus_dpg&f=m

⁸ Norwegian Interim Report Q4 2018 (<https://www.norwegian.com/globalassets/ip/documents/about-us/company/investor-relations/reports-and-presentations/interim-reports/norwegian-q4-2018-report.pdf>)

⁹ Reuters (<https://www.reuters.com/article/uk-norwegian-air-routes/norwegian-air-to-shut-some-bases-and-axe-routes-to-cut-costs-idUSKCN1PA2HH>)

¹⁰ <http://www.airliners.de/lotsen-airlines-flugsicherung/45922>

► Airline pricing policy and cost comparisons

Low-cost carriers regularly use aggressive offers to attract passengers. But even if you search through the offers of premium airlines you will often find tickets for under 100 euros to various European destinations. Not all tickets are sold for so little, however. Only a comparatively small contingent is reserved for cheap prices. Passengers who need more flexibility or book later will pay considerably more. Airlines' sophisticated revenue management systems ensure that flights generate sufficient revenue overall to cover costs and sustain

business. Nevertheless, low-cost carriers advertise their ability to offer very cheap tickets on average. In 2018 round-trip flights within Europe cost between 80 and 120 euros.¹¹ By comparison, 80 euros only covers a standard, round-trip train ticket for travel between Stuttgart and Mannheim with Deutsche Bahn, a distance of 260 kilometers. By car, this amount would take one approximately 270 kilometers based on the standard calculation of 30 cents per kilometer.

What is the right ticket price?

But what is an appropriate ticket price? Prices should be calculated such that they can cover all relevant costs in a sustainable way. The average costs will be illustrated based on the example of a round-trip flight from Frankfurt/Main to Mallorca on an Airbus A320 with a passenger load factor of 80 percent.

Adding up all costs yields total expenditures of more than 30,000 euros per flight, which would mean 213 euros for each of the 144 passengers (see figure 2). If the average ticket price falls below that for an extended period of time, the route will lose money.

The assumptions made for this cost calculation apply to a classic airline. Airline business models and thus their cost structures differ markedly. Low-cost carriers are masters of

cost optimization and have spent decades optimizing individual cost blocks. For example, some operate a fleet of uniform aircraft. They receive quantity discounts from aircraft manufacturers and can maintain the same type of plane more efficiently. Creative solutions have also been found for personnel costs. Crew members are generally hired in countries that allow especially favorable salary conditions. In addition, quick turnaround (the duration between landing and takeoff) times mean that greater use can be made of aircraft and crew capacities. When one considers that low-cost carriers also have lower overheads and, for example, do not provide free meals on board, the cost per passenger in the example above is about 157 euros. This is still above the average ticket price of 80 to 120 euros and substantially above the aggressive prices advertised.

Cost block	Per flight	Per passenger
Aircraft and maintenance (Airbus A320)	4,900 €	▶ 34 €
Jet fuel	5,200 €	▶ 36 €
Crew	4,500 €	▶ 31 €
Airport and ground fees	7,000 €	▶ 49 €
Air traffic control, taxes, fees	5,100 €	▶ 35 €
Catering	1,200 €	▶ 8 €
Overhead	2,900 €	▶ 20 €



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Fig 2. Sample costs for a round-trip Frankfurt/Main–Mallorca flight¹²

¹¹ AIRTRAVELGENIUS (<https://www.airtravelgenius.com/easyjet-vs-ryanair/>)

¹² Porsche Consulting analysis | <https://investor-relations.lufthansagroup.com/fileadmin/downloads/en/financial-reports/annual-reports/LH-AR-2017-e.pdf> | <https://investor.ryanair.com/wp-content/uploads/2017/07/Ryanair-FY2017-Annual-Report.pdf> | <http://corporate.easyjet.com/~media/Files/E/Easyjet/pdf/investors/results-centre/2017/2017-annualreport-and-accounts-v1.pdf> | <http://www.aena.es/csee/ccurl/861/398/Aena-price-guide-2019-ed4.pdf> | <https://www.eurocontrol.int/sites/default/files/content/documents/route-charges/unit-rates-and-tariffs/ur-2019-06.txt?update> | https://ec.europa.eu/info/law/better-regulation/feedback/8088/attachment/090166e5b70f3251_sl | <http://www.airliners.de/passagierabhaengige-kosten-pro-passagier-airline-flug-aviation-management/41481>

▶ Everyone benefits from a robust and healthy system

What direction should civil aviation in Europe take? How can airlines maintain sustainable business and passengers enjoy reliable and pleasant flights? Could the American example of markedly fewer airlines serve as a model? That would mean further consolidation of the European market and the disappearance of small airlines in particular. Less competition on the market would make it easier for airlines to raise prices and pass on rising costs to their passengers. If the airlines thereby also succeed in balancing out their capacities, they could expect more stable and higher profit margins. If the margins are higher, they would have greater freedom to invest in more stable processes and better service. This could shift the competitive focus from pricing to quality.

▶ Passengers look at more than price

A survey by the international online magazine Aerotime News Hub showed that 77 percent of respondents are willing to pay more if it ensures flying with well-paid and well-rested pilots.¹¹ This shows that for most passengers, price is not the only factor. It indicates limits to further optimizing personnel costs on the basis of unfair compensation and unreasonable working conditions.

If this approach is extended to airports and their service providers, more stable processes could be expected on the ground as well. This would also alleviate the acute personnel shortages for airport service providers. For passengers this could mean finding their luggage faster at baggage carousels or no longer having to wait for stairways or buses upon landing. As an aside, satisfied and friendly personnel make the airport and flight experience considerably more pleasant. Passengers evidently share this view, as the Aerotime survey¹³ indicates.

New Porsche Consulting survey:

Consumers will pay for quality

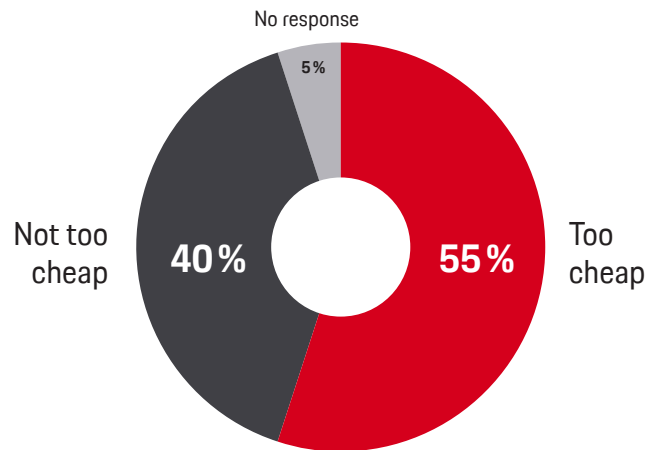
These conclusions are supported by a new study commissioned by Porsche Consulting and conducted by forsa in March 2019. It surveyed 1,003 women and men between the ages of 20 and 65. Fifty-five percent of respondents said that flights are too cheap and they are willing to pay more for air travel. Only 15 percent would refrain from air travel if no budget flights were available. These responses are associated with the hope or expectation of higher service quality: only 31 percent of survey participants would accept delays in exchange for cheap ticket prices. However, consumers are also sensitive to extra costs. Only 38 percent are willing to accept

additional costs for luggage. A certain conflict is evident here: passengers expect airlines to have generous rules, especially for carry-on baggage, but do not want these rules (usually established but frequently ignored) to be strictly enforced. Yet precisely this leads to longer boarding times in practice, which in turn result in delays.

Nevertheless, according to one result of the survey there is room for optimizing ground services: 67 percent of respondents could imagine checking in their luggage at automated counters.

¹³ Aerotmie.aero (<https://www.aerotmie.aero/skycop.com/22203-survey-discloses-what-kind-of-airlines-european-fliers-wish-for>)

Opinion on airfare prices

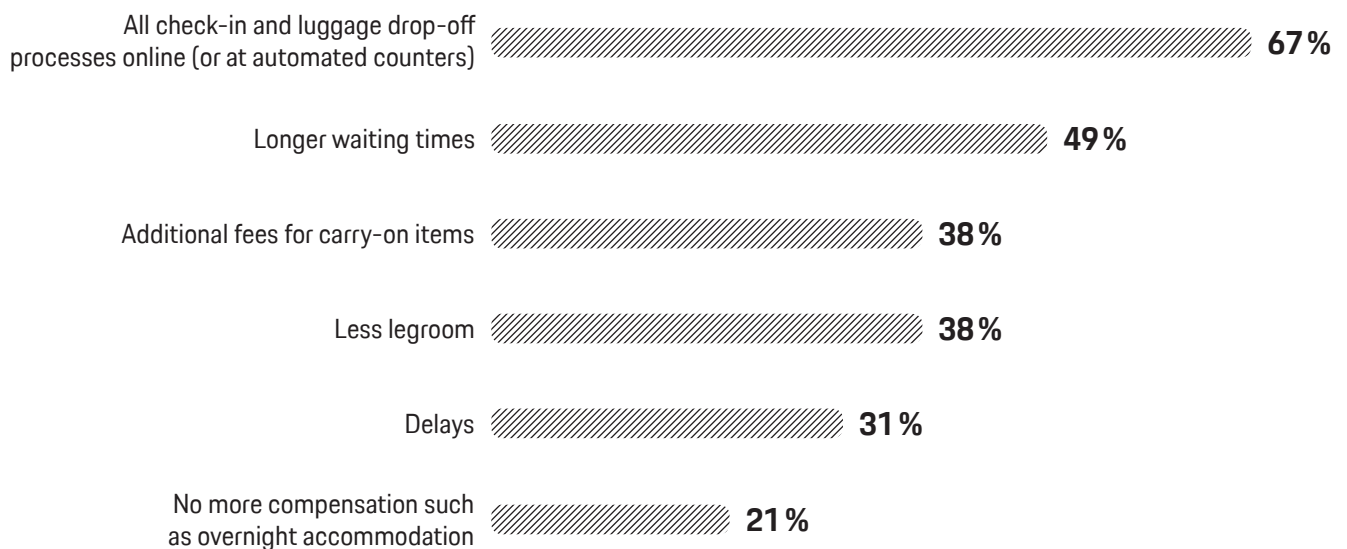


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Fig 4. Survey on cheap flights in Germany—price perception¹⁴

Basis: representative survey commissioned by the Porsche Consulting management consultancy and conducted by forsa March 12–22, 2019, using systematic random selection of 1,003 people in Germany aged 20 to 65 who had taken non-business flights over the preceding three years.

Accepted losses in service and quality for low cost flights



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Fig 5. Survey on cheap flights in Germany—accepted restrictions¹⁴

Basis: representative survey commissioned by the Porsche Consulting management consultancy and conducted by forsa March 12–22, 2019, using systematic random selection of 1,003 people in Germany aged 20 to 65 who had taken non-business flights over the preceding three years.

¹⁴ <https://www.porsche-consulting.com/de/medien/pressemitteilungen/detail/jeder-zweite-reist-am-liebsten-im-eigenen-auto>

// At a crossroads

Civil aviation in Europe is at a crossroads. It can only undergo the transformation to a healthy system if it can earn sustainable profits in a fair, competitive environment. A balance should be struck between the interests of passengers, airlines and airports. The aviation industry should once again place greater emphasis on reliability and service quality. In the long term, no one benefits from cheap tickets—it is not economical for the airline and the passenger often does not receive the service promised.

To establish a healthy equilibrium on the market, flexible ways are needed of balancing demand with the ground and air capacities on offer. Processes and procedures must be designed in such a way that travel becomes more of an experience again and less of a chore. Flight prices should be appropriate, reflect real added value for customers, and stand in reasonable relation to prices for other means of transport. A ticket to Mallorca may then cost more than the taxi ride to the airport.



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»Europe's air space and roads are overcrowded, and even trains are often filled to excess. The future of mobility will be about connecting all modern means of transport in intelligent ways. For that we need mobility hubs that are easy to reach and offer ideal connections to all travelers—from door to door. Airports with multimodal connections via seamless railway links, integrated aerial taxi services, and automated cars will play a major role here.«

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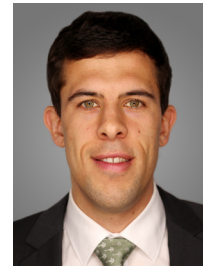
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