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The Future of Airline Business Models: Which Will Win?

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Abstract

This research is titled “The Future of Airline Business Models: Which Will Win?” and it is part of the requirements for the award of a Masters in Management from NOVA BSE and another from Luiss Guido Carlo University. The purpose is to elaborate a complete market analysis of the European Air Transportation Industry in order to predict which Airlines, strategies and business models may be successful in the next years. First, an extensive literature review of the business model concept has been done. Then, a detailed overview of the main European Airlines and the strategies that they have been implementing so far has been developed. Finally, the research is illustrated with three case studies.

Keywords: Business Models; European Airlines; Hybrid Carriers; Low Cost Airlines

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Introduction

The purpose of this direct research is to analyze which Airlines and airline business models have been successful in the European context, and which do not. The main goal is to build some future scenarios and predict some consequences, threats, challenges and opportunities, for such a vital industry in the globalized economy of nowadays. Although it is just a short analysis, this collecting approach might represent an interesting peace of research, mainly for airlines and potential entrants, but eventually for customers, academics and consultants as well. Likewise, the thesis is divided into three and distinct chapters that are not directly related. The first chapter is an extensive literature review of business models in strategy and organization. This theoretical part is crucial for the upcoming chapter that discusses all the business models in the European Airline industry. This part distinguishes and describes all the main European Airlines according to their business models, i.e. Low Cost Carriers, Full Services Carriers or Hybrid Carriers. In the last chapter, three case studies – Ryanair, Air Berlin and TAP Portugal – are presented as a way of illustrating the three different airline business models on a deeper way. Conclusions and predictions have been elaborated at the end of both chapter 2 and 3. Diversified bibliography has been used, such as several academic journals, business articles, annual reports and strategy books. In addition, an interview has been done to TAP's Sales Director, Dionísio Barum.

Chapter 1: Business Models in Strategy & Organization

The following literature review is structured through a timeline in order to achieve an extensive comprehension of the topic and its progress through the years. As Osterwalder, Pigneur and Tucci (2005) state, in business model literature the different authors rarely build on one another. Consequently, business model research as a whole advances more slowly than it could and often remains at a superficial level. Amit, Zott and Massa are three researchers who have done a strong contribution to the study of Business Models. Therefore, many of their literature will be considered. In addition, several publications of academic journals (e.g. *European Management Journal* and *Journal of Clear Production*) will be used as well. Finally, some papers that have been developed by some of the most reputable Universities and companies, such as Harvard Business School and Accenture, will complement this literature review.

This chapter will review the main contributions made to the study of Business Models in Strategy and Organization. The evolution of the concept will be discussed as well as its future. Business model design, innovation, enterprise classification and performance are topics that have been target of many research during last years and have will have a clear focus during the chapter.

Literature Review

Amit and Zott (2001) represents a first construct of the Business Model concept as a unit for future research on value creation arising from multiple sources and emerged during the internet boom. The first proposed definition states that a Business model “depicts the content, structure, and governance of transactions designed so as to create value through the exploitation of business opportunities”. This construct was considered useful in as much as it explained and predicted an empirical phenomenon (namely, value creation in e-business) that was not explained by the conceptual frameworks that existed at the time. Moreover, this construction comprised many of the previous theories: Schumpeter’s (1942) idea that “innovation is an act of ‘creative destruction’”; the notion that business model draws on “arguments that are central to the value chain framework” (Porter, 1985), in particular that processes and multiple sources of value (e.g. cost leadership and differentiation) matter; the business model perspective offered builds on the resource-based view of the firm (Wernerfelt, 1984; Barney, 1991; Peteraf, 1993; Amit and Schoemaker, 1993); the link between network configuration and value creation (e.g.,

Burt, 1992) and that the locus of value creation may be the network rather than the firm. Finally, Amit and Zott (2001) suggests that the emergence of virtual markets opens new sources of innovation, such as the business model innovation, that may require a parallel shift in strategic thinking.

Despite Amit and Zott (2001) represent a first construct of the concept, through a survey elaborated by *Accenture*, one year before, Linder and Cantrell (2000) had introduced what they have called “change models”. According to the definition, a change model is “the core logic for how a firm will change over time in order to remain profitable”. It is claimed that most firm’s business models – the organization’s core logic to create value – are under constant pressure to change (e.g. innovations in technology, changes in law, competitive moves, and shifts in consumer changes). Likewise, these pressures can weaken an operating model’s profitability. Thus, in response, firms partially or totally upgrade their business models in a wide variety ways. Nevertheless, Linder and Cantrell (2000) concluded that there is no evidence that one type of change or another inherently improves profit.

Few years later, Shafera, Smitha and Linder (2005) realized that there was still much confusion about what business models were and how could they be used in corporate management. To address the absence of a consensual definition, they came up with a new one: “business model is a representation of a firm’s underlying core logic and strategic choices for creating and capturing value within a value network”. Consequently, with a new definition, it is argued that a business model is not a strategy. While a business model does “facilitate analysis, testing, and validation of a firm’s strategic choices”, it is not in itself a strategy. This vision was reinforced by Seddon, Lewis, Freeman and Shanks (2004). It is claimed that a business model outlines the essential details of a firm’s value proposition for its various stakeholders and the activity system the firm uses to create and deliver value to its customers. Contrasting with Porter’s strategy definition, a business model should then be defined as “an abstract representation of some aspect of a firm’s strategy”. But, unlike strategy, business models do not consider a firm’s competitive positioning. In addition, Shafera, Smitha and Linder (2005) point out four problems associated with business models: flawed assumptions underlying the core logic; limitations in the strategic choices considered; misunderstanding about value creation and value capture; flawed assumptions about the value network. Markides and Charitou

(2004) have raised another problem: “how can an organization use two different business models in the same market and avoiding a conflict with one another?”. The paper argues that it is a very risky strategy and discusses several potential conflicts such as: risk of cannibalizing the existing customer base; risk of destroying the value of the existing distribution network; risk of compromising the quality of service offered to customers; risk of undermining the company’s brand and reputation; risk of destroying the overall culture of the organization; risk of adding activities that might confuse the employees and customers regarding the company’s incentives and priorities; risk of legitimizing the new business and creating incentive for other companies to also enter the market.

In the same year, other two contributive papers were written: Osterwalder, Pigneur and Tucci (2005), and Richardson (2005). The first showed that the business model concept still needed explanation. Therefore, they structured it into nine business model building blocks: value proposition, target customer, distribution channel, relationship, value configuration, core competency, partner network, cost structure, and revenue model. In addition, they made an important distinction between business models and business process models. The business model concept was generally understood as a “view of the firm's logic for creating and commercializing value”, while the business process model is more about “how a business case is implemented in processes”. The second paper, Richardson (2005), came up with an opposite idea to Shafera, Smitha and Linder (2005). He argued that the business model framework provides a simple and logical structure for the strategist to think about “how the many activities of the firm work to execute the strategy”. Thus, he was implicitly assuming a relation between business models and strategy. As he stated, “a well thought out business model does more than link the strategy, or theory of how to compete, with activities, it serves to complete the description of the strategy”. If the strategy is the many activities of the firm as Porter claimed, then Richardson (2005) defended that the business model framework “helps to create a consistent logical picture of how all of the firm’s activities form a strategy”.

In 2007, Zott and Amit (2007) made their second important literature contribution. The paper focused on how business model design – which they referred as the “design of an organization’s set of particular organization design issue” – affected the performance of entrepreneurial firms. Moreover, it highlighted business model design as a crucial task for entrepreneurs, and as a source of innovation. They started by hypothesizing that the

design of an entrepreneurial firm's business model, which is centered specifically on the themes of novelty and/or efficiency, is associated with the performance of that firm. Their analysis reached out two conclusions. First, there is a "positive and remarkably stable across time relationship between both novelty and efficiency". Second, they found indications of "potential diseconomies of scope in design"; that is, entrepreneurs' attempts to incorporate both efficiency- and novelty-centered design elements into their business models may be counterproductive. In addition, the paper operationalized and measured the business model construct, and showed empirically that it has impact on wealth creation. Nonetheless, they suggested that the business model might serve not only to exploit an opportunity for wealth creation, but its design might also be part of the opportunity development process in and of itself. It is argued that business models could create value by "enhancing the customers' willingness to pay or by decreasing suppliers' and partners' opportunity costs", for example, through improved transaction efficiency. Furthermore, it is claimed that the total value created was the value created for all business model stakeholders (focal firm, customers, suppliers, and other exchange partners). Finally, Zott and Amit (2007) developed for the first time a methodology that allowed them to outline the design elements of business models that are relevant for wealth creation, and it also allowed them to provide measures that can be more generally applied to entrepreneurial firms.

Zott and Amit (2008) introduced the firm's business model as a new contingency factor that captures the structure of a firm's boundary spanning exchanges in order to answer the following question: "How do the firm's business model and its product market strategy interact to impact firm performance?". An empirical analysis reveals that a "firm's product market strategy and its business model are distinct constructs that affect the firm's market value". It is argued that although a firm may get 'stuck in the middle' between two product market strategies such as differentiation and cost leadership (Porter, 1985), and also between two business model design themes such as novelty and efficiency (Zott and Amit, 2007), the same need not be true for a combination of product market strategy (e.g., cost leadership) and business model design theme (e.g., novelty). In fact, they are complement concepts rather than substitutes. This paper still made some other relevant contributions. First, it showed that adopting a broader view of organizations can be valuable for understanding wealth creation and performance. Second, it suggested that competitive advantage can emerge from superior product market positioning, as well as

from the firm's business model. Finally, it raised the issue that the timing of business model and product market strategy design can be determined simultaneously.

In 2009, other two relevant papers introduced new developments into the business model study. Magretta (2009) talked about the two basic critical tests to check if the business models followed by a company works. Likewise, he argued that when business models do not work, it is because they fail either the narrative test – the story does not make sense – or the numbers test - the profit and losses does not add up. In addition, he reinforced the position that a “business model is not the same thing as a strategy, even though people tend to use the terms interchangeably”. Casadeus-Masanell and Ricart (2009) presented a conceptual framework to separate and relate business model and strategy. The framework also delivered a clear separation between tactics – although similar to strategy are also plans of action - and strategy. According to them, strategy and business model, though related, are different concepts. A business model is the direct result of strategy but it is not strategy itself. As it is claimed, a strategy is a contingent plan of action as to what business model to use. The available actions for strategy are choices (policies, assets, or governance structures) that constitute the raw material of business models. Thus, strategy entails designing business models to allow the organization to reach its goals. Furthermore, they found evidence that “in simple competitive situations there is a one-to-one mapping between strategy and business model, which makes it difficult to separate the two notions”. Nevertheless, they have also showed that the concepts of strategy and business model “differ when there are important contingencies upon which a well-designed strategy must be based”.

Zott and Amit (2009) main contribution was to develop an activity system perspective on the business model. The activity systems perspective addresses all the vital issues of the business model (how a firm conducts business, links factors and product markets, and delivers value to stakeholders). Therefore, they argued that the activity system perspective brings several advantages for both managers and academics concerned with the study of business models. First, a focus on activities is a natural perspective for entrepreneurs and managers who must decide on business model design (e.g. which activities should be governed within or outside the firm's boundaries). Second, the “activity system perspective encourages the firm in systemic thinking when designing its business model”, instead of concentrating on isolated, individual choices (e.g. ‘make or

buy' decisions about particular products, or outsourcing a particular activity). Third, focusing on activities also “enables to relax several assumptions made in the transaction cost literature, such as the homogeneity of the governance challenges of firms involved in an exchange”. Finally, it embodies rich possibilities for further theoretical development (e.g. consider the social aspects of relationships between business model participants, as well as the transactional dimension of their relationships).

In 2010, some relevant contributions for business models innovation were published. Chesbrough (2010) identified and explored the barriers to business model innovation, which previous academic research had identified as including conflicts with existing assets and business models. First, the more traditional configurations of firm's assets, whose managers are likely to resist experiments that might threaten their ongoing value to the company (Amit and Zott, 2001). Second, Christensen (1997) argued that what “disrupts incumbent firms to business model experimentation is not their ability to conceive of the disruptive technology”. In addition, Chesbrough (2010) had noted a different cognitive barrier to business model experimentation, the “success of established business models strongly influences the information that subsequently gets routed into or filtered out of corporate decision processes”. Consequently, the paper proposed two approaches in order to overcome these barriers and experiment with alternative business models: construct maps of business models so that managers can clarify the process underlying them; the concept of “component business modeling”, which enables firms to simulate various possibilities before committing to specific investments in reality.

Teece (2010) argued that technological innovation by itself not guarantees business success. Indeed, when managers think of innovation they usually “neglect the proper analysis and development of business model which can translate technical success into commercial success”. Good business model design and implementation, joined with careful strategic analysis, are crucial to achieve commercial viability if “sustainable competitive advantage is to be built and innovators are to profit from their innovations”. As it is claimed, figuring out how to deliver value to the customer and to capture value while doing so, are the key issues in designing a business model. However, the “imperfections in the market for knowhow make capturing value from its production and sale inherently difficult”, and may often necessitate a business model where knowhow is “bundled into products and complementary assets used to realize value to the innovator”.

This might involve some of the trickiest issues that entrepreneurs and managers must address. Likewise, Teece (2010) developed the Profiting from Innovation framework in order to help strategists to figure out the appropriate business model/design and technology strategies. The framework recognized two extreme modes by which innovators can capture value from innovation: at one end of the scale stands the integrated business model, in which an innovating firm bundles innovation and product together, and “assumes the responsibility for the entire value chain from A to Z including design, manufacturing, and distribution”; the other extreme case is the outsourced (pure licensing) business approach; in between there are “hybrid approaches involving a mixture of the two approaches” (e.g. outsource manufacturing; provide company owned sales and support), which, in fact, are the most common, but they also require strong selection and coordination skills on the part of management.

Amit and Zott (2010) decided to contribute to business model innovation’s literature, as a way for general managers and entrepreneurs to create appropriate value, especially in times of economic change¹. As they claim, during economic downturns, the required Innovations to improve processes and products “require a considerable investment in everything from R&D to specialized resources, new assets and even entire new business units”. But, at the end, future returns on the up-front investments are always uncertain. Thus, the paper developed a business model innovation framework – similarly to Teece (2010) – that centered on “system-level design” and tried to answer managers if firms are able to more with the resources and capabilities they have. They proposed managers to address six questions that will allow managers to better understand how they can structure their firms’ destinies within the context of the networks and ecosystems in which they are embedded.: “what is the objective of the new business model” or “what perceived needs would be satisfied through the design of a new activity system”; “what novel activities are needed to satisfy the perceived needs” - Business model content; “how could these activities be linked to each other in novel ways” - Business model structure; “who should perform each of the activities that are part of the business model (e.g., the focal firm, or a partner), and what novel governance arrangements could enable this structure” - Business model governance; “how is value created through the novel business model for

¹ These considerations are of particular importance during economic downturns, such as the 2008-2009 global recession.

each of the partners”; “what focal firm’s revenue model will allow it to appropriate part of the value created from the new business model”. Finally, they argued that the purposeful design and structuring of business models can be an important source of innovation, particularly during periods of change and resource scarcity, high uncertainty and volatility in both capital and real markets that adversely affect revenues and profits.

Amit and Zott (2010) also came up with an updated definition of business model: “a business model is the bundle of specific activities that are conducted to satisfy the perceived needs of the market, including the specification of the parties that conduct these activities (i.e., the focal firm and/or its partners), and how these activities are linked to each other”.

McGrath (2010) discussed the increasing number of new business models and the corresponding right approach. He argued that strategies that aim to discover and exploit new models must engage in significant experimentation and follow a learning “discovery driven approach” rather than an analytical one. The experimentation can take place both within firms and across industries. Consequently, it may offer another source of competitive differentiation, as some firms “develop superior capabilities at experimentation and consequently can build better models more quickly than their slower counterparts”.

Demil and Lecocq (2010) tried to reconcile two different common uses of the business model concept. They claimed that both the static view - which aims to describe the configurations of elements producing (or not) good performance - and the dynamic view - which tries to grasp the ways in which a business model evolves over time - are useful, but they fulfilled different functions. Thus, they have developed the RCOV framework in order to help managers to reflect on the design of their business model and how to change it. As it is argued, the continued evolution of the elements in core business components implies that managers must constantly pay attention to their portfolio of resources and competences to help generate new value propositions and to modify their organization to best exploit its resources. Moreover, managers can also use the framework to think about the “systemic interactions between the different components of their business models”, and the “sequences of causes and consequences they produce”.

Baden-Fuller and Morgan (2010) introduced a more philosophical discussion about business models and sought to explore the question “Are business models useful?” They suggested that business models have a “multivalent character as models”. They can be found as “exemplar role models that might be copied, or presented as nutshell descriptions of a business organization”: simplified, “short-hand descriptions equivalent to scale models”. Furthermore, it is argued that the notion of a business model as a recipe captures something quite essential about a firm’s behavior. As a matter of fact, it defined the business’s characteristics and its activities in a way that matches the generic level that defines a kind or type of behavior but that also suggests why it works. Ben-Fuller and Morgan claimed that “it works because it embodies the essential elements and how they are to be combined to make them work”.

Ten years after the first clear introduction of the business model concept (Amit and Zott, 2001), Amit, Zott and Massa (2011) provided a broad review of all the other received literature on business models. Although the paper did not introduce any particular contribution, the authors achieved some interesting conclusions, criticized and made suggestions to advance its study once the scholars seemed not agree on what a business model is. First, they argued that employing more precise concepts would allow other researchers to “better understand what the business model in the respective study is meant to denote”. In particular, e-business model archetypes, business model as cost/revenue architecture, and business model as activity system deserve a more distinct clarification. Second, they found four new “interconnecting and mutually reinforcing themes” around the notion of business model as “new unit of analysis”, offering a “systemic perspective” on how to do business, encompassing “boundary-spanning activities” (performed by a focal firm or others), and focusing on “value creation” as well as on value capture. The papers finished by suggesting that these conclusions are “moving the field toward conceptual consolidation”, which they claimed as to be necessary in order to “pave the way for more cumulative research on business models”.

Burkhart, Krumeich, Werth and Loos (2011) reinforced the same conclusions of Amit, Zott and Massa (2011). They claimed that research in the business model field is still very unstructured and little consensus exists among scientists. Thus, the paper focused on improving this situation by structuring the research field to achieve a more “holistic view” of the concept and proposed a classification framework. It was developed containing 17

evaluation criteria (e.g. field of research, state of business models, underlying type of business, scope of business models and, components of business models), divided into five groups, and corresponding attributes. The final outcome were 30 papers that could be identified and thus classified as promising and relevant papers covering the business model research sufficiently.

In 2011, another relevant contribution was published. Huelsbeck, Merchant and Sandino (2011) introduces a first structured test to the assumed “cause and effect relationships” implicit in the business model of a single business unit company. Testing business models was something rarely done but, as the paper argues, it might be very valuable. Nevertheless, the statistical results were weak and only one of four leading indicators (instrument placements) was significantly associated with both future financial performances and stock returns. The authors concluded that their research site was not ideal for demonstrating the value of testing a business model. They claimed that in order to maximize the potential for demonstrating that value, in addition to finding the conditions that they sought—e.g., data availability; and stable strategy, management team, and business conditions—researchers should seek sites where “managers’ confidence in their model is low” and where they “take actions to induce greater variation in the performance drivers”. As they argued, the managers’ initial confidence in their business models is probably “the major determinant of the perceived value of the tests”.

Storbacka (2011) developed a solution business model framework that assists firms wishing to design solution business models. It categorized all the capabilities and management practices necessary for the effective management of such a business model. The primary dimensions of the framework were the four phases of the solution process (develop solutions, create demand, sell solution, and deliver solution) and the three groups of cross-functionality (commercialization, industrialization, and solution platform). The solution processed “intersect with commercialization and industrialization”, forming the so-called capability categories: “develop solutions”, “create demand”, “sell solution”, and “deliver solution”. The paper suggested that firms must “move beyond selling and delivering ad-hoc solutions”. In fact, they need to find a balance between commercialization (understanding segments and customers) and industrialization (“modularizing and standardizing solution components for scalability and repeatability”). Thus, “platform investments” - investments into new organizational

capabilities – are required so that this balance is created with a solution business model. Furthermore, it is indicated that it is the investment in the solution platform that “creates the foundation for a sustainable competitive advantage in solution business”. But, it requires the “intricate coordination of resources and business processes across all functions”.

Zook and Allen (2011) brought the concept of the “repeatable business model”. The paper pointed out that although 80% of companies well understand that differentiation is the prime source of competitive advantage, it tends to wear with age, and not just because competitors try hard to undermine or replicate it. They argued that often the real problem is internal and has to do with the “growth generated by successful differentiation begets complexity”, and a complex company tends to “forget what it’s good at”. Evidence shows that most of the time reinvention is the wrong way to go. Really successful companies build on their fundamental differentiation and the result is simple: a repeatable business model that a company can “apply to new products and markets over and over again to generate sustained growth”. They claimed that successful companies grow in ways that exploit their core differentiators by replicating them in new contexts. Consequently, they “turn the sources of their differentiation into routines, behaviors”, and activity systems that everyone in the organization can understand and follow.

Wirtz (2011) represented much more than an academic research paper since it was one of the first books entirely dedicated to business models. The book reviewed all the main literature contributions made until 2011. It started by exploring the business model as a concept. Then, it collected the main structures of business models, i.e. value creation, partial models, and its actors and interactions. Finally, its last part was dedicated to the business model management: the types of business model, design models, its implementation, adaptation and modification, and controlling. In addition, there was a final part that presented and discussed some of the most paradigmatic business models’ case studies from different industries.

Amit and Zott (2012) continued their previous research about business model innovation, two years before. In particular, the paper focused on the argument and showed evidence that the way as “companies do business will often be as, or more, important than what they do”. In other words, the research revealed that in a highly interconnected world,

especially one in which financial resources are scarce, “entrepreneurs and managers must look beyond the product and process” and focus on ways to innovate their business model. It is claimed that “fresh business model” can create and exploit opportunities for new revenue and profit streams in ways that may “neutralize the old business model” that led the company into a cycle of declining revenues and pressures on profit margins. Therefore, the paper suggested six critical questions that managers may ask themselves as they consider business model innovation: “what perceived needs can be satisfied through the new model design?”; “what novel activities are needed to satisfy these perceived needs?” (business model content innovation); “how could the required activities be linked to each other in novel ways?” (business model structure innovation); “who should perform each of the activities that are part of the business model? Should it be the company? A partner? The customer? What novel governance arrangements could enable this structure?” (business model governance innovation); “how is value created through the novel business model for each of the participants?”; “what revenue model fits with the company’s business model to appropriate part of the total value it helps create?” This approach seems to encourage systemic and holistic thinking when considering innovation, instead of isolated, individual choices.

Studying business model innovation seemed to be gaining relevance and, in 2013, three important papers were published. First, Lambert and Davidson (2013) made a very considerable contribute by identifying, organizing and analyzing existing empirical research to highlight the value of the business model from 1996 to 2010. Then, Massa and Tucci (2013), by reviewing the growing literature on business models and business models innovation found evidence that, in the course of most industrial sectors, there will come a time when the “traditional way of creating, delivering, and capturing value is no longer valid, efficient, useful, or profitable”. They predict that in such moments, organizations embracing business model innovation will have the possibility of “reshaping several industries” and, eventually, change the world. Finally, although the topic is not directly about business model, Boons and Lüdeke-Freund (2013) adopted the business model perspective in order to advance research on sustainable innovation. They reached out some interesting conclusions to the business model innovation study. Particularly, they offered a first general definition of sustainable business models by proposing examples of “four normative requirements” that business models should meet in order to support sustainable innovations. First, the value proposition provides

measurable ecological and social value in concert with economic value. Second, the supply chain involves suppliers who take responsibility towards their own as well as the focal company's stakeholders and requires that a firm actively "engages suppliers into sustainable supply chain management". Third, the customer interface motivates customers to take responsibility for their consumption as well as for the focal company's stakeholders. Forth, the financial model reflects an appropriate distribution of economic costs and benefits among actors involved in the business model and accounts for the company's ecological and social impacts.

Roelens and Poels (2013) argued that since the beginning of the millennium, with the emergence of the internet-based enterprises, many research about business models has been published and a second-generation papers on the concept has been raising. Therefore, they seek to answer to the following question, "what are the common business model components (i.e. model elements and their relationships) which underlie the integrative second-generation papers on the business model concept?". As result, they proposed an "integrative business model framework". The constituting elements of this framework are the resources, value chain, competence, distribution channel, value proposition, value network and financial structure. Moreover, the integrative framework could also be applied to "integrate business models with goal models", which reflect the formulated strategy of the company. As it is argued, this would ensure that a company would align its strategy with the goals it seeks to achieve.

In 2014, research concerning network-based business models gained particular relevance. Lund and Nielson (2014) have sought to understand "how partners positioned around a business model can be organized into a network-based business model that generates additional value for the core business model and for both the partners and the customers". Particularly, in situations of ongoing global financial when companies tend to focus on cutting their costs to a minimum, in turn reducing key resources and activities in their respective business models. Rindova (2012) has identified three mechanisms linking partnering portfolios in strategic entrepreneurial networks that have an impact on firm growth by enhancing the value proposition while at the same time reducing costs through partnering: configuring partnering portfolios to pursue distinctive logics for sourcing external resources; aligning resource-sourcing and resource-linking logics in new product development; embarking on different growth trajectories, which contribute to different performance patterns. Nevertheless, this paper showed evidence that start-up

business models often have a “very poor overview over the relationships between the activities performed, the necessary resources, and how to configure the involvement of partners in their business model”. Among the key problems is that it is difficult to create an ownership model and it is difficult to find projects where “stakeholders are able to mix their existing business models to something new, without the new business models potentially interfering, hurting or directly cannibalizing their existing business”. It is claimed that the “entrepreneurs’ ability to understand the business model and the ability to manage the network-evolution pattern, to adapt the business model continuously, and to understand and coordinate activities, resources, and how partners became involved in value creation”, are the key success factors.

Ozkan-Canbolata, Basa and Cafri (2014) focused on inter-firm networks as “ties of integration mechanism”. They developed a model which answers to questions of “how network modalities resulting from inter-organizational relations affect the value creation of firms embedded in network (franchising)”. The evidence showed that the ways in which individuals are attached to macro-structures is often by way of their local connections. These are the ones that most directly constrain actors, and provide them with access to opportunities.

Amit and Zott (2014) made a relevant contribution by being one of the few exceptions to link the business model concept with the dynamic capabilities framework, which are two strategic management perspectives that have been kept separated for years. First, they suggested and provided a rich account evidence that the “process of business model design can be conceived of as a dynamic capability”. Then, it is claimed that the “sensing, seizing, and transforming competency clusters that constitute dynamic capability” are “closely interwoven” in the dynamic process of business model design. In fact, using the business model design process as a conceptual lens allows for a dynamic (i.e., process-based) account of dynamic capability. Finally, they argued that despite the importance of Business model design as an important managerial function tool, it should be viewed as “part of a firm’s ordinary capabilities” (in terms of the day-to-day performance of activities), but it also requires dynamic adaptation and transformation, which links to the dynamic capabilities framework.

In 2014, another research trend was the linkage between business models with technological innovation performance and information systems. Hu (2014) developed a conceptual model for linking business model design themes, organizational learning, and

technological innovation performance. He found evidence of three relevant facts. First, “efficiency-centered business model design” has an indirect influence on technological innovation performance. Second, “novelty-centered business model” design has a mixed influence on technological innovation performance. This approach seems to be consistent with Teece (2010), who found that novelty-centered business model “design meets the requirements for the commercial success of new products”. Third, the influence of efficiency-centered design on organizational learning is stronger than the influence of novelty-centered design. This is consistent with Zott and Amit (2007) who gave emphasis on cooperation among existing business model participants.

Veit, Clemons, Benlian, Buxmann, Hess, Kun-disch, Leimeister, Loos, and Spann (2014) identified the business model concept as the “missing link” between business strategy, processes, and Information Technology. It is argued that business and information systems engineering community offers “distinct and unique competencies” such as, translating business strategies into IT systems and managing business, that can be used on the business model research. Within this research gap the authors proposed three distinct streams: business models in IT industries; IT enabled or digital business models; and IT support for developing and managing business models.

In 2014, some more relevant contributions were done to the vast but fragmented literature of Sustainable Business Models. Bocken, Short, Rana and Evans (2014) proposed a categorization of “sustainable business model archetypes” in order to unify and explain some of many business model innovations for sustainability. Eight sustainable business model archetypes were developed and are viewed as a starting point for the previous argument: maximize material and energy efficiency; create value from ‘waste’; substitute with renewables and natural processes; deliver functionality, rather than ownership; adopt a stewardship role; encourage sufficiency; re-purpose the business for society/environment; develop scale-up solutions.

Finally, Reima, Parida and Ortqvist (2014) represented a first literature review of Product Services Systems (PSS). These kind of business models have been emerging by the desire to combine economic prosperity and sustainable resource management. Nevertheless, they found evidence that abandoning traditional business models that focus on a dominant product or service in favor of the newer PSS business models continues to be a complex undertaking. Moreover, they found support for the notion that most PSS offers can be categorized into the product-oriented, use-oriented, and result oriented business models.

Chapter 2: Business Models' Overview in the European Air Transportation Industry

2.1. Introduction

Following the 2008 post recession, studying the main Business Models of the Air Transportation Industry is considered one of the most challenging research topics due to its uncertainty. The unpredictability caused was not exclusive on the demand side, which is also part of a downturn cyclical. In addition, the effects of the rocketing increase in fuel prices which ate into profits earned in 2008, plus the extensive meltdown of the finance sector weakened demand for air travel in a stronger way. Analysts quickly established a comparison with the recession that followed the events of 11th September of 2001. Nevertheless, while the mechanisms seem to be different, the pains of the post-2008 crisis are at least as severe (Franke and John, 2011).

According to International Air Transport Association (2010), besides the recession, global mobility, both for business and leisure purposes, remained a central element of modern societies. The growth rates of aviation returned to its historical growth rates. Despite of these figures, the past events led to a transformation of the industry. Franke & John (2011) argue that the dynamics of the downturn have enlarged the gap between successful and less successful business models. Up to the time, two main business models dominated the airline market. The so-called FSC (Full Service Carriers) and the LCC (Low-Cost Carriers). Afterwards, Frank and John (2011) claim that the occurrence of new business models has been accelerated. Analogous to what arise in the post 9/11, the recession did not represent just a threat to the industry, but, rather, the downturn induced the low cost model to be spread over the main European and American routes. The new dynamics that have been raising since 2008 will define the future of the Industry and corresponding new rules, or putting in a different way, the new business models.

As mentioned above, the economic conjuncture has been the driving force for raising new business models in the industry. But, and starting now looking exclusively to the European market, it is not a new phenomenon that the established European airlines have come under a lot of pressure since some years ago. As Dennis (2005) argues, European FSCs have had a collapse in profitability and doubt cast over their traditional business

model. Meanwhile, there has been dramatic growth by the LCCs and other new entrants. The short haul network has been the most affected with some of the European majors such as British Airways, Aer Lingus and Lufthansa watching new competitors entering the market.

Nevertheless, surprisingly, looking at the evolution of the market share in Western Europe, from 2008 to 2013, Lufthansa increase its market share by 4 percentage points (Table 1, Appendix, Euromonitor Passport Statistics). In 2013, it represented 7% of the Western European market. British Airways also increased its market share by 1% from 2011 to 2013. Other strong players maintained or increased their positions, such as, Alitalia, Iberia, Air France, SAS, Swiss Air and KLM. Furthermore, in the same period, the two biggest LCCs in terms of market share – Ryanair and Easyjet - kept their upward trend by having recorded increases of 1 p.p. and 1.2 p.p., respectively. Finally, other companies, such as Air Berlin, that as we will see later in the chapter have chosen another type of business model – Hybrid model – also has seen an improvement of 3.3 p.p. in its market share, during the same period.

Another interest approach is to look again at the market share value, but now in terms of the Global Brand Owner. In fact, some FSCs followed a dual brand strategy in the last years and decided to create subsidiaries so that they can compete in a different way with the most established LCCs. The most relevant cases are Vueling (Iberia's subsidiary), HOP! (Air France's subsidiary), Eurowings (Lufthansa's subsidiary) and Transavia (KLM's subsidiary). As it can be seen on Table 2 (Appendix, Euromonitor Passport Statistics), in 2013, Deutsch Lufthansa Group² had almost 11% of the Western Europe's market Share, International Airlines Group³ had 8.3% and the Air France – KLM Group⁴ had 8%.

Therefore, the main purpose of this chapter is looking at how the European Air Transportation Industry for Passengers has been changing. It is very relevant to consider that according to Airbus Forecast⁵, in 2026, Europe will be still involved in 33% of Global Air Traffic. Then, an assessment of these dynamics in the industry – in terms of pricing strategies, distribution channels, revenues streams, cost structure, customer targets, share

² Includes Lufthansa, Eurowings, Swiss Air and Austrian Airlines

³ Includes British Airways, Iberia, Vueling and Future Airways

⁴ Includes Air France, KLM Royal Dutch Airlines, Transavia and HOP!

⁵ Airbus; Oliver Wyman Analysis (2006)

coding partnerships and value proposition - and their impact over the main European Airlines is key in order to predict the future of the industry in the next years.

2.2. Full Service Carriers (FSC) in the European Market

According to Reichmuth (2008), a “legacy” or “full service network carrier” is an airline that focuses on providing a wide range of pre-flight and onboard services, including different service classes, and connecting flights. In most Western European countries, the (former) national carrier operates as an FSNC. Examples are Air France (France), KLM (Netherlands), Lufthansa (Germany), British Airways (UK), Iberia (Spain), Austrian Airlines (Austria), SAS (Sweden, Denmark and Norway), TAP (Portugal), Alitalia (Italy), Swiss International Airlines (Switzerland), Luxair (Luxemburg), Brussels Airlines (Belgium), Finnair (Finland), Aegeon Airlines (Greece) or Icelandair (Iceland). Likewise, legacy carriers tend to be the national carriers in most Eastern European countries, such as, LOT (Poland), Czech Airlines (Czech Republic), UIA (Ukraine), Tarom (Romania), Croatia Airlines (Croatia), Serbia Airlines (Serbia) or Bulgaria Air (Bulgaria). While most of the former national carriers in larger EU countries are now either fully or at least to a major extent privatized, some (often smaller) EU countries still have significant interests in their respective national carriers. The most eminent exception is TAP, which still is 100% state-owned company, but it is currently under a privatization process⁶ by the Portuguese Government.

Apart from (former) national carriers, there are additional, independently owned and operated FSNCs in some of the larger EU countries. Some of the most prominent examples are Virgin Atlantic (UK), Air Europa (Spain), Aigle Azur (France), Widerøe (Norway), Olympic Air (Greece) and Sata International (Portugal). Nevertheless Virgin Atlantic cannot be consider a proper network carrier as it focuses on long haul flights out of London and Manchester only. In Germany, the only noteworthy FSNC besides Lufthansa used to be BA’s subsidiary Deutsche BA - later sold to private investors and

⁶ <http://www.ch-aviation.com/portal/news/32934-lisbon-to-dispose-of-66-stake-in-taps-privatization-process> CH-aviation (18/11/2014)

renamed dba - which had operated almost exclusively an intra-German network until it was taken over by hybrid carrier Air Berlin in 2006⁷.

Once again, considering Table 1 (Appendix), we are able to verify that five of the European major FSC players are Lufthansa, British Airways, Air France, Alitalia and Iberia. Therefore, in order to make a comprehensive Business Model European analysis, it becomes necessary to break down the markets of Germany, France, UK, Italy and Spain.

Deutsche Lufthansa AG leads the air transportation market in Europe with 10.8% market share (Deutsche Lufthansa AG, 2014). In fact, the merger between Lufthansa and Austrian Airlines in 2009 enabled the company to boost its market share in few years. This share jumped to 11.4% in 2011 but has since declined, in line with the strong growth in LCC market share. Furthermore, Lufthansa was the second largest air transportation operator globally in 2013, holding a 4.4% market value share. Even so, Deutsche Lufthansa lost its global leadership position to the group emerging from the merger between American Airlines and US Airways. Currently, the airlines keeps suffering hard competition from low cost carriers in Europe on short and medium-haul routes, and it has been incurring extra costs and significant losses. In addition, in 'Lufthansa: The Hesitant Decision Maker', Popova (2013) states that its financial performance has been seriously affected by poor economic conditions and high taxation in Europe. Moreover, Popova (2013) also explains that over the last years Lufthansa has been very hesitant in its decision making (for example with regard to fleet upgrades, costcutting measures) at a time when other players have been very aggressively expanding and transforming their operations. By contrast, Deutsche Lufthansa AG (2014) claims that Lufthansa most relevant problem has been the heavy internal structure of its business model, since it has been causing elevated costs, and continues to pressure the company despite recent changes such as IT outsourcing. Nonetheless, the same report points Lufthansa's strengths as being able to continue enjoying its strong brand recognition, notably among business travelers, and of setting new trends and innovations. The Airline remains to date

⁷ <http://www.ft.com/intl/cms/s/0/cd9b315a-2e55-11db-93ad-0000779e2340.html> Financial Times (18/08/2006)

the largest member of the Star Alliance⁸. The group as a whole keeps diversifying its portfolio of regional, international and low cost carriers.

Although the French market represents a great opportunity for Airlines due to the fact that Paris CDG is the most powerful hub in Europe with more than 18,000 connecting routes (Air France KLM Group, 2014), its major player – Air France-KLM – doesn't seem to benefit from this. Indeed, in 'Legacies still a major millstone for Air France – KLM', as Popova (2014) argues, it is evident that despite almost 10 years of the merger, both Air France and KLM appear to be competing each other in the short haul segment. Consequently, this makes the existing threat from LCC even more dangerous, which represents a disappointment of the corporate strategy of the Group. Both carriers are not having success to create real synergies. Besides, according to Air France KLM Group (2014), another relevant threat for its business model is Air France-KLM high labour costs as a proportion of total cost in the aviation industry, which is one of the highest. On one hand, Air France – KLM, is responding by shifting its strategy of a pure FSC business model to become a more low cost focused in its short to mid haul business, mainly by boosting Transavia operations (Popova, 2014), as it will be explained later on the chapter. In addition, the company is focused on adjusting capacity distribution to optimize its route networks and cut loss-making routes. On the other hand, according to 'Air France KLM Group' (2014), the group also responded by its recent upmarket move is designed to target the inelastic, very high end of the market which is a significant source of revenue. The Airline intends to offer a better product, more caring service and higher quality. This new approach may well prove fruitful in the short term in order to achieve profitability through the revenues side. Therefore, what stands out from the French experience is that the second biggest European company in terms of market share (8.3%) is changing its approach from its past FSC business model. However, it is not clear if it is changing for an even more rigid FSC model or for a more focused low cost strategic approach.

The UK market can be considered to be a model for further development, since LCCs started there and thus have their longest tradition there (Reichmuth, 2008). The schedule airline British Airway is the leading carrier in the UK with three main operating hubs – Heathrow, Gatwick and London City Airports. As explained above, the other potential

⁸ The other European Airlines are TAP, Swiss Air, Brussels Airlines, Austrian Airlines, LOT, SAS, Adria Airways, Coatia Airlines and Aegeon Airlines

FSC competitor, i.e. Virgin Atlantic focuses on long haul flights. Thus, Low cost competition, in particular the British LCC Easyjet, represent the main threats in terms of short and mid haul competition, according to ‘British Airways Plc in Travel and Tourism’ (2011). British Airways has merged⁹ with the Spanish FSC’s Iberia in 2011. The same report also states that British Airways is very active in promoting its loyalty programme. Loyalty programmes allow the building of a detailed profile of clients, and British Airways is expected to leverage its programme not only to improve the customer experience but also to drive additional revenues. Therefore, British Airways’ business model is very clear and its pricing strategy reflects it too. Alderigo, Cento and Piga (2011) makes a comparison between British Airways and KLM’s different pricing strategies. While KLM uses both the booking time before departure and the minimum stay as a discriminating device, British Airways focuses on inter-temporal price discrimination only. The conclusion standing out here is that British Airways’ price setting, at least for its cheapest fares, is similar to the low-cost approach, although it is generally applied using higher fares. This seems to be a distinct strategy when comparing with the other main FSCs that has as main target the low cost competition in the short and mid haul.

With 2% of the European market share, in 2013, Alitalia is the Italian major FSC. Such UK, France and Germany, the Italian market is not different and the most relevant threat are the LCCs. In addition, according to Reichmuth (2008), this gains even more relevance due to the fact that in no other European country there are more airports served by LCCs than in Italy. During ‘Euromonitor International Interview Series: Antongiulio Zecchini, Head of Network – Development of Alitalia Compagnia Aerea Italiana SpA’ (2013), Zecchini explained that the initial strategy to fight LCCs was the merger with Air One since it enabled the Group to increase capacity and decrease distribution cost. As we will see following in the chapter, it is called the dual brand strategy. Nevertheless, in November 2014, Alitalia decided to cease Air One’s operations¹⁰, and Alitalia remains the only brand operating in the market. But, as Zecchini refers, the competition in short haul is not exclusive from Easyjet and Ryanair. “Alitalia’s position on the Rome-Milan route has been challenged by the high-speed rail network, with train services absorbing much of the traffic between Rome and Milan”. In the past flying was the most popular way of travelling between these two cities and now it is the opposite. Finally, Bergamini,

⁹ <http://centreforaviation.com/analysis/british-airways-and-iberia-merger-completed-planning-to-add-more-airlines-to-the-group-44282> CAPA Centre for Aviation (26/01/2011)

¹⁰ http://www.alitalia.com/it_it/promooffline/air-one-e-coupon.html

Gitto and Mancuso (2010) argue that Alitalia's main failure to the threat of competition in domestic market was its sluggishness to react, often seemingly more interested in preserve its existing position than pursuing new markets.

According to Reichmuth (2008), the Spanish FSC's air market is very similar to the French. They both have a comparable development of the supply of FSNCs mainly driven by the home carrier's development. Air France and Iberia both hold – in contrast to British Airways – relatively high domestic market shares. They also both hold relatively high regional market shares, although the trend is developing differently in each country. In both countries, the LCC market emerged relatively late, but now it seems that there was a tremendous “sleeping demand”, which represents a big threat for Iberia. Furthermore, it is questionable what will happen in the domestic market when the AVE train increases supply. Nonetheless, Fageda, Jimenez and Perdiguero (2010) argue that Iberia's strategy has been successful. It points out Iberia's dominant position in two of Europe's largest airports, which has seen the company concentrate its network operations in Madrid and its low-cost operations, i.e. Vueling, in Barcelona.

Another relevant company in terms of European market share is Brussels Airlines. As a FSC, instead of following a premium pricing strategy, Brussels Airlines differentiates price offering. Jarach, Zerbini and Miniero (2009) explains that Brussels Airlines' management feels that because of its differentiated price offering, it can segment customers according to their needs and desires. Therefore, with flexibility in price and aircraft configuration, Brussels Airlines is able to offer both business and leisure passengers a customized offer that satisfies their various needs.

To sum up, the success of some low-cost carriers in expanding their market shares has forced legacy carriers to revise their traditional strategies and, in some cases, to reconsider their business models (Alderighi, Cento and Piga, 2011). However, unlike the LCC, the major airlines have not generally tried to shift any flight and cabin crew to lower cost economies. Instead, they still put a large number of crew in expensive accommodation away from home to operate early morning flights from other countries, rather than setting up a local crew base (Dennis, 2005). Furthermore, as stated on CAPA (2009), established airlines have become victims of their past success, struggling with a combination of several problems, such as entrenched management and labour practices; substantial debt

commitments as a result of both growth and volatility; extensive network of high cost stations; uneconomic routes; complex and costly marketing arrangements and distribution channels. The future of the FSC business model is of high difficulty predictability.

2.3. Low Cost Carriers (LCC) in the European Market

Low cost carriers (LCC) focus on cost reduction in order to implement a price leadership strategy on the markets they serve (Reichmuth, 2008). While LCCs initially focused on short-haul services, they have since extended their networks to medium-haul services due to the increasing competition on the established routes. For instance, both Ryanair and Easyjet fly from Western Europe to Morocco. More recently, Ryanair has announced its plans for transatlantic long haul flights¹¹. In fact, LCCs continue to be the most successful business model in air travel and they continue to gain popularity and market share (Low-cost Carriers: Exploring new territories, 2014). In addition, LCCs are also taking advantage of the increasingly popularity of budget air transportation in order to increase their dominance of domestic routes. For example, in Europe, players such as Ryanair and Wizz Air are becoming very close contenders with the national operators in countries such as Poland and Romania, while in Slovakia and Hungary they are the market leaders. It is also important to mention that, according to Innovata (2013), the European market for LCCs continues to be the one recording the fastest global growth in terms of Available Seat Kilometres (ASK). Figures for 2012-2013 (Table 3 – Appendix, Innovata) show that Ryanair, Norwegian and Easyjet achieved growth rates of 33.9%, 27.0% and 19.4%, respectively. A last note to say that ‘Meet Euromonitor International at World Low Cost Airlines Congress’ (2013) predicts healthy growth in low-cost flight sales over the 2012-2017 period, with Finland showing the highest growth in Europe. This prediction represents a victory against LSCs in Europe in terms of value growth mainly due to the rising availability of more and more routes as well as the growing popularity of short weekend trips, considering the latter Euromonitor report.

The liberalization of the intra-EU air services market provided the legislative framework in which LCCs could develop (Lenartowicz, Mason and Foster, 2013). Ryanair was the

¹¹ <http://www.theguardian.com/travel/2015/mar/16/ryanair-plans-to-offer-flights-between-europe-and-america> The Guardian (16/03/2015)

first EU airline to take advantage of the new European regulatory environment. Nowadays, we have several LCCs spread over Europe, such as: Vueling, Volotea (Spain), Meridiana (Italy), HOP! (France), Easyjet, Thomson Airways, Jet2Go, Flybe (UK), Ryanair (Ireland), Eurowings, Germanwings, TuiFly, Condor Flugdienst (Germany), Jetairfly, Arkefly (Belgium), Transavia (Holland), SmartWings (Czech Republic), EnterAir (Poland), Norwegian (Norway), Tuifly Nordic (Sweden), Flybe Nordic (Finland), Air Baltic (Latvia), Wizz Air (Hungary), Blue Air (Romania) and Wow Air (Iceland). Nevertheless, as Pearson and Merket (2014) argue, market entrance immediately means that those companies are at a disadvantage given that they cannot benefit from first-mover advantage and the promotion that is derived from being the ‘consumer champion’ from being the first to offer lower fares. They point out the examples of Ryanair (in Western Europe) and Wizz Air (in Eastern Europe). All the other incumbent LCCs might have faced more difficulty to appeal to passengers and gaining sufficient traffic and revenues.

The utilization of small airports, the high-density seating and the online direct selling system are usually considered some of the main drivers of the LCC business model. As Reichmuth (2008) explains, the airport fees will be lower, the fixed costs will be spread over more passengers and the aircraft utilization is maximized. However, not all low-cost carriers have implemented all of the above aspects. Therefore, it is crucial to analyze the main characteristics and strategies of the European LCCs in order to understand how European LCCs became so successful and what might be the future of this trend and of this business model in Europe.

First, EasyJet, for example, is among those LCCs that operates from a few large hubs (Amsterdam, Madrid, Munich, Paris CDG). According to ‘de Wit and Zuidberg’ (2012), Ryanair has persisted with this secondary airports strategy, Madrid and Lisbon representing some few exceptions. This point is further illustrated by the fact that Ryanair has a market share as measured by offered seats of over 75% at nearly half of its bases. By contrast, EasyJet does not even have such market share at a single base, which indicates that EasyJet opts to focus on main intra-European routes, while Ryanair looks for niche markets. This point is very relevant for Ryanair’s pricing strategy as well. As Malighetti, Paleari and Redondi (2009) explains, the offer of the discounted fares appears as an incentive to use secondary airports. However, if Ryanair plays a dominant role in the departure airport, not only average prices are lower, but also significant discounts are

more likely on tickets purchased in advance. On the other hand, although Easyjet flies to primary airports, it manages to recover these costs in yield through targeting business travelers (Popova, 2012, 'Easyjet differentiates itself strongly from the European LCC leader Ryanair'). According to Salanti, Malighetti and Redondi (2012), even if low-cost carriers do not typically provide business class, it does not follow that they do not target business travelers, as EasyJet currently operates a large number of typically business routes with convenient and frequent schedules. But, in fact, Easyjet aims to be a long-term partner for airports and to explore further opportunities on the back of its partnerships, which is a total opposite strategy when comparing with Ryanair despite both operate under the same Business model – LCC.

Then, as 'Exploring New territories' (2014) concludes, increasing seat density on board of the aircraft has been one of the recent strategies of European LCCs in order to lower unit costs and at the same time increase ticket sales while limiting airplane orders. Furthermore, the so-called "de-seasonalisation" of the winter-summer schedule is another approach which LCCs are adopting with the same purpose. As a matter of fact, the pricing structure of many European LCCs has been improving since those airlines have been adopting much more flexibility with fares as a direct response to demand levels. In addition, many of the LCCs have been grounding aircraft when particular routes are underperforming. On the same report it is also explained that fuel efficiency through high performance next-generation airlines is considered to be one of the main strategies for the leading European point-to-point carriers because it enables them to achieve economies of scale. Many of the LCCs are adjusting their fleet to reflect consumer demand and expansion plans so that they can develop an intra-regional presence. According to Boeing figures (Table 4 – Appendix), among the bigger spenders worldwide are European operators such as Ryanair – 175 new aircraft orders in 2013 – and Easyjet – 380 new orders in 2013 – according to Airbus (Table 5 – Appendix). By homogenizing their fleets LCCs manage to decrease their maintenance costs. Finally, the online direct selling system remains crucial for LCCs. In accordance with skyft.com, in 2013, Ryanair and Easyjet were the first and third worldwide in terms of website performance, respectively (Table 6 – Appendix).

Despite the success of the model, De Wit and Zuidberg (2012) indicates signs of a saturating continental market for LCCs, in terms of decreasing average frequencies and increasing average route distances. The route density constraints that stem from this will

likely lead to a slowdown in organic LCC growth over the next few years. For instance, as 'Exploring New territories' (2014) indicates, High-speed rail is increasingly putting pressure on LCCs, particularly in Europe where the segment is developing very strongly. Among the biggest markets for HSR are Spain, Italy, France, Germany and Sweden. Thus, LCCs to might be forced to (partly) adopt other business strategies for future growth. Then, some examples of new business strategies to assure future growth include: shifting to primary airports, starting hubbing activities that enable passengers to transfer from one to the other flight, signing codeshare agreements, entering alliances, and acquiring other airlines.

But, much has been done recently. For instance, in terms of codeshare agreements for LCCs, Morandi, Malighetti, Paleari and Redondi (2015) explain that codesharing agreements have been only concerned to FSCs due to the fact that LCCs point-to-point network structure does not contemplate the exploitation of these kind of alliances, which would be costly and of tough complexity. However, in September 2014, Ryanair announced a partnership with Amadeus GDS¹² (Global Distribution Systems) for codesharing, which might represent a new paradigm in the European LCC business model in the future. In addition, 'Exploring New territories' (2014) states that Easyjet and Volotea are among the companies which are diversifying their operations through GDS by partnering with one GDS player or working with several distribution operators. As the report argues, that might have a link with the fact that LCCS are more intensively targeting business travelers. This represents a revisiting strategy regarding distribution channels for the established European LCCs.

Concerning alliances and acquisitions, it can be one viable solution for the industry in Europe, as past experiences can prove it. Lenartowicz, Mason and Foster (2013) claim that an airline's financial situation is one of the key drivers for a carrier to merge. The example of vueling and Clickair, two failing airlines, that in 2009 decided to merge under the name of Vueling, is paradigmatic. The paper makes still some predictions for eventual future M&A in Europe. For example, Easyjet has probably the highest motivation to grow through the merger. Despite being the second biggest LCC airline, it still has not managed to secure a high market share in many of its markets. The acquisition of a local leader could considerably strengthen its position. In addition, for different reasons, Norwegian,

¹² <http://corporate.ryanair.com/news/news/14924-ryanair-partners-with-amadeus-gds/?market=en>
Ryanair (24/09/2014)

Vueling and Wizz Air – which have the most similar business models according to the paper - are potential targets or partners because despite they appear to be well run, none of them have the scale or resources to be an important payer at the European level. Furthermore, Flybe and Germanwings are neither in a position to be market leaders, focusing on their particular niche markets.

In conclusion, low-cost travel is becoming the dominant way of flying within Europe (Dobruszkes, 2013) and European LCCs are competing with network airlines in short-haul markets (Fageda, Jimenez and Perdiguero, 2010). Despite the LCC business model is based on pricing fares at a low cost, loyal passengers are essential to any successful airline (Akamavi, Mohamed, Pellman and Xu, 2015). Likewise, European LLCs seem starting to target new customers. For instance, by deviating from the traditional low-cost approach and bundling services - the unbundling of fares is one of the characteristics of the archetypical LCC business model - LCCS are standardizing their offering and having better control on the level of service provided to the customer, which is seen as very relevant for capturing a wider range of passengers and targeting new upmarket segments (Fageda, Suau-sanchez and Mason, 2015). Moreover, some LCCs are introducing frequent flyer programs, such as Germanwings, or improving the flight experience, such as Vueling and Norwegian that have introduced Wi-Fi on board (Exploring New territories, Euromonitor, 2014). Although companies such as Ryanair and Wizz Air remain loyal to the purest LCC model in Europe, as they mainly use smaller airports and even charge baggage handling fees (Reichmuth, 2008), changes are expected in the market due to reduced disposable income levels in Europe ‘Exploring New territories, Euromonitor’ (2014). It is claimed that price will remain the main decision factor for the average European tourist and, consequently, last-minute offers, city breaks, early booking deals, promotions and discounts are all expected to grow further in popularity among eager tourists. As a result, in Europe, the competition between the major LCCs will intensify. The competition among the three biggest players in the LCC market - Ryanair, EasyJet and Norwegian – will increase and will push for a larger share of business travelers.

2.4. Hybridization of the European Market

To differentiate themselves from other LCCs, some low-cost operators are adopting different business models that include, for instance, shifting to primary airports, starting hubbing activities, providing meals and other in-flight services, and entering alliances (de Wit and Zuidberg, 2012). This process is called the Hybridization of the business model. Particularly, in Europe, FSCs have joined the battle for cost-conscious short haul passengers. Consequently many LCCs have been forced to change and adapt their business strategy. Hence, as Klophaus, Conrady and Fichert (2012) claim, most European LCCs are adopting a hybrid market strategy modifying key elements of their basic business model.

It is not an easy task to identify among the European LCCs those that tend to follow a hybrid business model. Even so, there is one reaching consensus among most of the authors: Air Berlin. As described by Reichmuth (2008), Air Berlin is a carrier that changed its business model from a holiday to a hybrid one. The Airline enjoyed the first mover advantage by being the first to sell seats only on its leisure routes and this led the company to soon become one of the largest leisure's airlines in Germany. Part of the hybridization process was the introduction of the so-called "Euroshuttle" low cost services from various airports in Germany to key destinations, such as London, Rome, Milan, Vienna and Zurich. Nevertheless, Air Berlin most differentiates from the other LCCs by offering connecting flights at its hubs in Berlin, Dusseldorf, Nuremberg and Palma de Mallorca. Furthermore, the Airline provides a full range of services including meals, drinks, newspapers, assigned seating and frequent flyer program. Nevertheless, Air Berlin has been experiencing severe financial difficulties (Popova, 2014, Air Berlin: Light at the End of the Tunnel?) despite Etihad Airways' equity-investment strategy in 2011¹³. Several reasons have been pointed out for this: the long delay in the opening of Berlin's new Brandenburg Airport, the increase of the fuel prices and local taxation. The Airline received another financial injection of 300 million convertible bond from Etihad Airways in April 2014¹⁴ but the problems continue. Furthermore, the Carrier remains investing more and more, as it is noticeable in 2013, when it ordered 85 new Airbus

¹³ <http://www.airberlingroup.com/en/about-airberlin/alliance-partners/etihad-airways>

¹⁴ http://ir.airberlin.com/en/ir/financial-news/ir-releases/2014/2014-04-27_airberlin-is-achieving-substantial-recapitalisation-as-the-basis-for-an-accelerated-turnaround-leading-to-sustainable-profitability

models (Table 5 – Appendix). As Popova (2014) argues, Air Berlin has gone down the route of becoming a ‘hybrid airline’, which has created serious problems for the player. In fact, by minimizing the boundaries in terms of services can lead to a lack of clear brand awareness among the customers. This will be reflected on the prices charged and ultimately on the financial profits of the company. Air Berlin seems to need a restructuring in order to focus on achieving higher efficiency, controlling employee costs within the short-haul segment, downsizing the airline’s fleet and countering the high-speed rail transportation and airline competition. In other words, Popova (2014) claims that Air Berlin must find its identity in its business model and find a strong partner might be a solution. Nonetheless, EU ruling¹⁵ which currently caps foreign ownership at 49% can represent a big challenge for the Airline since the potential Etihad Airways’ interest might not be materialized.

Another Airline whose business model many Authors classify as hybrid is Aer Lingus – the Irish flag carrier. Ryanair has been trying to take over Aer Lingus for a decade¹⁶ but the acquisition has been facing several EU legal constraints. The Airline is an Oneworld alliance member used to offer a full-service product on flight from Dublin and Shannon to Europe and transatlantic services to the US. But, as Reichmuth (2008) explains, the increased competition on both markets, led to heavy losses which eventually resulted in a drastic redesign of the airline’s business model. Aer Lingus now offers low-cost services from Dublin to major European airports which – at the same time – feed the carrier’s full-service, two class long-haul flights to North America. Nevertheless, the two class system and the codesharing with Oneworld seems to confirm Morandi, Malighetti, Paleari and Redondi (2015), who advocate that as long as airlines go hybrid, appears much more relevant to explain the codesharing decision. The paper argues that the increased involvement of LCCs in codesharing is partially due to the hybridization of airline business models, which confirms both Air Berlin and Aer Lingus codesharing with the global alliance Oneworld.

Due to the difficulty in distinguishing a hybrid airline from a LCC or a FSC, many authors have decided to test several hybrid characteristics in many European LCCs in order to identify which ones follow a hybrid business model. For instance, Tomová and Ramajová

¹⁵ http://madb.europa.eu/madb/barriers_details.htm?barrier_id=970122&version=3

¹⁶ <http://www.telegraph.co.uk/finance/newsbysector/transport/11408325/Timeline-Ryanair-vs-Aer-Lingus-the-decade-long-battle-of-the-Irish-airlines.html> (The Telegraph, 12/02/15)

(2014) decided to test if on-going hybridization of airlines business models in Europe is confirmed by frequent flyer programs' implementation within LCCs (Klophaus, Conrady and Fichert, 2012). Actually, Klophaus, Conrady and Fichert (2012) had found that Ryanair and Wizz Air coincide with pure low-cost carrier model, while Easyjet, Aer Lingus and Vueling were characterized as airlines within hybrid carrier group with still dominating low-cost elements. In addition, Transavia, Germanwings, Norwegian, Flybe and jet2go were labeled as hybrid carriers with dominating traditional airline business model elements. Finally, Air Berlin, Niki (owned by Air Berlin), Air Baltic and Meridiana correspond to traditional FSC business concept. Tomová and Ramajová (2014) confirmed in their paper that not only ongoing implementation of frequent flyer programs within the mentioned group of airlines can be seen as a further evidence of airlines going hybrid, as their evolution in time is an evidence as well. However, the different classification between Aer Lingus and Air Berlin contradicts many other authors who argue that those airlines are the closer to a hybrid business model. In addition, both papers add Easyjet, Vueling, Transavia, Germanwings, Norwegian, Flybe and Jet2go as eventual hybrid airlines, since they collect many of the characteristics considered in the paper. Jarach, Zerbini, Miniero (2009) still adds Brussels Airlines as a hybrid business model. They claim that Brussels Airlines' idiosyncratic mixture of legacy and low-cost features that has allowed it to combine both models in a distinctive position allowing it to target business customers with an unconventional convenience approach. To close, they even argue that strategic behaviors, which selectively combine pure legacy and pure low-cost strategy traits, are seen as potentially sustainable. Nonetheless, this vision seems to contradict Air Berlin's current financial position.

A last relevant fact concerning the hybridization of the European Airline market has to do with the airport's adapting strategy to the changes in the business models. Fageda, Suau-Sanchez, Mason (2015) point out Dusseldorf International Airport, which has even trademarked the term "Next Generation Hub", as a new paradigm. Instead of relying on mainly one dominant carrier (either LCC or FSC), the airport is trying to capitalize on a mix of carriers and the three business models (e.g. Lufthansa, Air Berlin, TUIfly), understanding that connecting passengers are its key growth factor.

2.5. The Dual brand Strategy

According to Gillen and Gados (2008), one of the two major ways that FSCs have adopted to respond to LCCs has been the establishment of low cost, ‘airlines within airlines’, attempting to apply elements of the LCC business model. Nonetheless, it doesn’t mean that it is a successful strategy into the business model. As they argue, having an LCC subsidiary does not improve the chances of unit cost reductions in mainline operations. Thus, direct competition with LCCs is not optimal, since the cost gap cannot be closed, and using an offshoot to achieve this is likely to be ineffective.

In the European context, the major Airlines have decided to adopt this strategy. For example: Iberia and Vueling (Spain); Air France and Hop! (France); KLM and Transavia (Netherlands); Lufthansa, Eurowings and Germanwings (Germany). All these cases demand a careful and deeper analysis.

A major concern for Air France-KLM has been the rapid growth of LCCs and the Airline has been incurring in losses in its short haul operations. The group’s gap in this segment made it difficult to respond to the threat, and as a result Air France-KLM is pushing Transavia forward in order to really attack this market and also creating subsidiaries in addition to the existing HOP! (Air France KLM Group, Euromonitor, 2014). Meanwhile, HOP! is also being expanded as Air France's short-distance operations are being merged with those of HOP!. According to Air France-KLM¹⁷ the new unit should break even in 2017. HOP! operates 510 daily flights to 129 destinations in France and Europe and aims to become a leader in servicing domestic routes in France and European routes. Its main hubs are Paris and Lyon. Nevertheless, Popova (2013), in ‘Is it HOP! or Flop for Air France Group?’, introduces several problems for the subsidiary. First, the Airline is using an old and fuel-thirsty fleet, which cannot be compared with the new and much bigger airplanes from firms such as Ryanair. Then, there is a high level of complexity with this brand, which is bound to experience setbacks in becoming a serious contender to leading low-cost players Ryanair and easyJet. Finally, HOP! faces significant rivalry from high speed rail and car rental in France. In addition, the three regional players have different organizational culture, different fleet aircraft and varied industrial relations, which might

¹⁷ <http://centreforaviation.com/analysis/air-france-klms-new-plan-to-grow-lcc-transavia-has-taken-too-long-a-union-confrontation-looms-186783> CAPA (14/09/14)

slow synergies within HOP! when the merger is concluded. 'Air France KLM Group SA in Travel and Tourism' (2014) argues that part of the solution may be finding a partner in the LCC segment to help propel Transavia and HOP! up the leaderboard. To sum up, the group seems to be forcefully trying to bring to life a model that has not yet worked for them, as proven by HOP!'s difficulties, and the strategy may well require a re-think because Ryanair and EasyJet continue to increase their dominance on domestic routes, thus further diminishing the survival prospects for HOP!

In a different situation, Gillen and Gados (2008) assess Lufthansa's Germanwings as a successful LCC subsidiary, which operates short haul on point-to-point flights for a number of bases in Germany. Moreover it was the first LCC in Germany to offer connecting flights. Despite its apparent success, Lufthansa's group is restructuring, by boosting its Eurowings (48 destinations) and Germanwings (86 destinations) operations in Europe and, at the same time, launching a long haul LCC operation in the Spring 2015, targeting routes in Asia (Deutsche Lufthansa AG in Travel and Tourism, 2014). In this case it is relevant the fact that Lufthansa uses the dual brand strategy with two LCCs. On one hand, Lufthansa plans to boost Eurowings by transitioning its fleet to more economical aircraft servicing domestic German and European routes from secondary airports on behalf of Germanwings. On the other hand, Germanwings will be meanwhile taking over most short and mid haul routes. The biggest challenge might be the limited brand awareness of Eurowings, as it is argued on (Deutsche Lufthansa AG, Euromonitor, 2014). This new strategy can be important to meet LCC competition but not to eliminate it. As Gillen and Gados (2008) explain, Lufthansa's dual brand strategy has have been successful not in eliminating competitors but at holding their market share to about 30%. They also claim that Lufthansa has been disciplined in using its secondary carriers to avoid cannibalizing its primary product and to not create brand confusion, something which many others have been guilty of.

In Spain, Iberia's dual brand strategy took a different process. Iberia created a low-cost subsidiary (Clickair) to enable it to compete with a formidable low-cost competitor in the Spanish market (Vueling). Some year later, Iberia ended up acquiring Clickair and a merger between the latter and Vueling - with the brand name of Vueling - was the outcome. However, the process was not easy. Following the merger, there is evidence of a substantial increase in the prices charged by Iberia's subsidiary (Fageda, Jimenez and Perdiguero, 2010). Consequently, the European Commission agreed to the merger on the

proviso that some slots on certain routes were transferred to other airlines airlines¹⁸ (case N° COMP/M.5364 –Iberia/Vueling/Clickair). But, in fact, Fageda, Jimenez and Perdiguero (2010) evidence on prices were right, since, as they show the figures later, in the summer of 2009, Vueling was charging higher prices than Vueling and Clickair were before they joined forces.

In the UK, although British Airways was one of the first major Airlines to follow this strategy, it does not have a LCC subsidiary anymore. As Dennis (2005) argues, GO – the British Airway’s subsidiary - had cost levels around 20% below British Airways. This meant that it could operate viably on lower yields and compete more closely on price with the LCCs. Nevertheless, Graf (2005) explains that despite British Airways’ success in creating value on the stock market for its subsidiary Go, it could not hamper the growth of Ryanair and EasyJet. Therefore, it sold its low-cost unit to Easyjet for a considerable price, which enforced the transformation of its original business model.

So far, the dual brand strategy seems to be gaining relevance within the major European FSCs in the short-haul segment. However, as Fageda, Jimenez and Perdiguero (2010) argue, in the LCC arena, the leading players may take on a growing role and further consolidation and increased concentration in the industry are expected. Easyjet’s take over to the financial stabilized British Airways’ subsidiary GO represents a strong alert to other subsidiaries not so financial balanced, such as HOP! and Transavia.

2.6. The End of Charter Flights?

The last airline business model that deserves a careful analysis in Europe is the so-called charter airline. The term “charter airline” was widely used to describe these airlines as most holiday flights were then not sold directly by the airline to the passengers but were included in charter packages offered by tour operators (Reichmuth, 2008). As Williams (2001) claims, since the early 1960s, Europe’s charter airlines have accounted for a significant proportion of air transport activity in the region, mostly as a result of being able to carry their clients for under half the cost that scheduled carriers would have incurred. However, nowadays, many holiday flights are operated as scheduled, albeit often seasonal services (Reichmuth, 2008), which means that Charters Airlines provide a

¹⁸ http://ec.europa.eu/competition/mergers/cases/decisions/M5747_20100714_20310_802534_EN.pdf

very similar service to LCCs. In fact, many European Charter Airlines have been changing their core business model to a low-cost one. There are several cases. Graf (2005) points out the examples of Transavia and Germanwings. During the nineties, KLM operated convenient flights through its subsidiary Basiq Air, which was just a dual brand with offerings following the low-cost carrier business model. In December 2000, its operations have grown out of Transavia, the subsidiary and charter carrier of KLM. Apart from selling both capacity to tour operators and seats directly to individual passengers, Transavia started with scheduled flights in connection with KLM services in the nineties. In the meanwhile, these services have been abolished and substituted by flights labeled with the Basiq Air brand and based on the low-cost carrier business model. However, aircraft were flying in the colors of Transavia and later the double branding changed to the solely use of the Transavia brand for all operations. A similar restructuration happened with Germanwings. The German LCC began flying in October 2002 as a separate low-cost carrier entity but fully belonging to the Eurowings Group. In the latter firm, which also operates a regional carrier business model, Lufthansa participated with 24.9% of the shares, and recently increased its part to 49%. The foundation of Germanwings resulted from the transformation of the unprofitable charter business of Eurowings into a LCC. More recently, the British Monarch Airlines – one of the strongest Charter Airlines in Europe – has decided to cease long-haul and charter operations from April 2015, converting to a low cost model focusing on short-haul leisure routes¹⁹.

2.7. Conclusion: comparison of the main Business Models in Europe

After a careful analysis of the main business models and business strategies in the European Airline Industry, it is finally possible to make comparisons and distinguish the most standing out trends and common characteristics.

Starting to look at the countries of origin where, in Europe, the most relevant airlines come from the western European countries, we are able to state that they dominate the market. By comparison the airlines of the Eastern countries are mainly the national flag carriers. Few exceptions are Wizzair (Hungary), Air Baltic (Latvia), Blue Air (Romania) and Enter Air (Poland). Western countries like Germany, UK, Ireland, France, Italy, Spain, Holland and the Scandinavian keep dominating most short and mid haul routes.

¹⁹ "Monarch Sold". *Airliner World*: 8. December 2014.

These countries have several airlines following the different business models and some M&A activity is expected to concentrate more on the European market.

In terms of distribution channels, a new paradigm has been introducing in the Industry. Ryanair's recent partnership with Amadeus might lead other European LCCs to adopt the Global Distribution Systems (GDS) as distribution channel. However, this will have an impact on their cost structure once part of their business model's strategy has been based on direct online sales. Thus, this innovation represents a challenge for the European LCCs in the mid long run.

The targeted customers by the European airlines has been clearly in a changing process as well. On one hand, many FSCs, such as Iberia, Lufthansa and Air France – KLM have adopted a dual brand strategy in order to target a broader range of travelers, namely 'shoppers' – those travelers who search for the lowest price in many airlines' web site, even if they offer differentiated routes. This strategy enables FSCs to compete with LCCs in the short mid haul routes. On the other hand, some LCCs like Easyjet have started to introduce some routes in order to target business travelers, departing at appropriate schedules and flying to some main airports. A targeting convergence can be perceived in the two main business models. The hybrid business model appears as a reliable alternative for business travelers too.

The biggest global alliances, i.e. Star Alliance, Sky Team²⁰ and One World, are becoming stronger in the European market. They are particularly relevant for FSCs when operating long haul routes. Some dual brands, such as Vueling, seem to take benefit from their airline's group network. Moreover, few LCCs are starting to make some partnerships for longer haul flights. For instance, Easyjet (UK) and Transaereo (Russia). Surprisingly, or not, hybrid carriers such as Air Berlin and Aer Lingus belong to One World²¹, which seems to be one competitive advantage.

In terms of value proposition, FSCs keep betting on variety and flexibility of the routes, convenience of the departure time and location of the airports, comfort, customer service, entertainment on board and prestige. LCCs continue do sell low-cost fares and guaranteeing on-time arrival performance due to the fact that they frequently use

²⁰ The European Airlines belonging to this Alliance are Air Europa, Alitalia, Air France, KLM, Czech Airlines and Taron

²¹ The other European Airlines are Iberia, British Airways, Niki and Finnair,

secondary airports. Nevertheless, many LCCs like Ryanair and Easyjet appear making an effort to improve their customer service. Hybrid European airlines offer both a flight experience and an affordable price.

LCCs' cost structure relies on the utilization of small airports, high-density seating, online direct selling and a single and homogenous class. As described above, many European LCCs look to use bigger airports (e.g. Easyjet) and eventually GDS (Ryanair was one of the first), which will be a challenging fact in the next few years. Furthermore, after the recent Alps Tragedy²², some LCCs like Norwegian and Easyjet are requiring two extra people of the cockpit at all times²³, which will certainly increase crew costs. LCCs used to fly with minimal crew in order to minimize costs. Most FSCs (e.g. TAP Portugal) comply already with this internal rule. Nevertheless, due to LCC competition in short-mid routes, many European FSCs have been decreasing their operational costs and following a skimming pricing strategy – by creating more than two classes (e.g. Iberia) - in order to target more customers. In conclusion, FSCs' cost structure is predicted to change more in the short mid-term.

Revenues streaming within European LCCs and FSCs are not expected to suffer many changes. LCCs will keep relying on advanced booking, travel retail, onboard retail, excess baggage fares, sales of checked and cabin luggage. The main FSC (e.g. Virgin, Lufthansa and SAS) still price their fares at a premium, selling a full service to their loyal customers.

To sum up, in Europe there are two clear airline business models. First, we have several FSCs such as British Airways, TAP and Alitalia. Most of them are still the national flag carriers, others do not (e.g. Virgin and Sata). In addition, many FSCs have decided to follow a dual brand strategy (e.g. Lufthansa and Germanwings or KLM and Transavia). Then, LCCs are still gaining market share in Europe. Ryanair, Easyjet and Norwegian are the strongest. Finally, a Hybrid Business model with airlines like Air Berlin and Aer Lingus seems to be raising in the last decade. Nonetheless, the distinction among those LCCs that follow this business model in Europe is not clear. Furthermore, while Air Berlin has been threatened by its negative financial performance, rumors of British

²² <http://www.economist.com/news/business-and-finance/21647058-around-150-abroad-are-feared-dead-after-alpine-plane-crash-tragedy-alps> Economist (24/03/15)

²³ <http://www.businessinsider.com/r-airlines-introduce-two-person-cockpit-rule-after-alps-crash-2015-3> Business Insider (26/03/15)

Airways²⁴ taking over Aer Lingus starts to crop out. In the past, Ryanair's attempt to take over Aer Lingus were blocked by European Commission²⁵. A last note to say that Charter Flights have looking to lose importance in the European market for several years (e.g. Monarch Airlines ceased charter operations).

²⁴ <http://www.theguardian.com/business/2014/dec/18/british-airways-iag-moves-takeover-aer-lingus>
The Guardian (18/12/14)

²⁵ <http://www.businesspost.ie/#!/story/Home/News/EU+blocks+Ryanair's+Aer+Lingus+bid+on+monopoly+concerns/id/19410615-5218-512d-f17a-252ab1242192> Business Post (27/02/13)

Chapter 3: Three Business Models, Three Cases

3.1. Case Study: Ryanair

Ryanair is the largest and most successful European Low cost airlines (D'Alfonso, Malighetti and Redondi, 2011). According to Klophaus, Conrady and Fichert (2012), Ryanair is ranked number one on airline ranking consolidated LCC index, meaning that its business model is the purest low-cost. However, the original low-cost business model was gradually adapted and changed, generating several new versions (Diaconu, 2012).

This section is divided into three parts. The first concerns a detailed description of Ryanair's history, figures and achievements. The second part makes a complete analysis of Ryanair's business model and its key success factors. The third part raises some problems and predicts some of the challenges that the Airline might face in the future.

3.1.1. Ryanair's history, figures and recent achievements

Ryanair was founded in 1985 by Christopher Ryan, Liam Lonergan, and Tony Ryan., the Irish Airline was one of the smallest commercial airlines in the world with just 51 employees and 5,000 passengers in its first year of operation (Geller, Folan and Shain, 2013). As Mack (2013) states, Ryanair did not begin as a low-fare airline. In fact, it just had the intent of breaking the duopoly on London-Ireland flights held by British Airways and Aer Lingus. Diaconu (2012) conducted some interviews with the board management at the time, which reveals the fact that, when Ryanair entered the market, the company used a focused cost leadership strategy. Therefore, by implementing an aggressive cutting costs policy and tariffs, the Airline declared itself a low fares airline (different from low cost) focused on Irish and British consumers. The following years were of intense competition with British Airways and Aer Lingus. Nevertheless, despite the attempt to charge more convenient prices, the Airline was not profitable and, actually, in 1991, it came close to bankruptcy. Mack (2013) explains that when Michael O'Leary – the current CEO - analyzed the situation, he realized that offering services such as a business class, frequent flyer program and other extra amenities, was not compatible with its strategy. Gellen, Folan and Shain (2013) argue that O'Leary decided to follow Southwest Airlines, which at the time had been enjoying the perks of airline deregulations since the 70's,

which enabled it with the ability to implement the first LCC business model. Consequently, O’Leary proposed Ryan to eliminate free meals and beverages during flights, dispose some aircrafts, eliminate non profitable routes, and reduce airfares across the remaining network (D’Alfonso, Malighetti and Redondi, 2011). Finally, in 1992, the EU regulated its airline industry too. Likewise, non-national carriers were allowed to fly between any EU states, fact from which Ryanair took benefit. The expansion strategy, implemented by the company, allowed it to acquire a dominant position on the European market. As Diaconu (2012) claims, the increase in the number of the destinations operated by Ryanair was possible because of the creation of new branches, located in different countries. At the time, the Airline was seeking to become leader of the low cost tariffs. As Mack (2013) states, first the Airline focused on dominating the London-Dublin market and, then, it took off into the rest of Europe. In 1994, Michel O’Leary was named the new CEO. Thus, according to Dobruszkes (2006), it is in 1995 that the LCC concept becomes established in Europe with the adoption of that model by Ryanair. In 1997, the firm went public, floating on both the Dublin and NASDAQ stock exchanges. D’Alfonso, Malighetti and Redondi (2011) argue that this fact was the means to Ryanair, during the following years, enter into new European markets, serving new customers with different expectations, facing new competitors and undertaking an expansion that required a massive increase in fleet size and the opening of new secondary European bases like the contested south Brussels Charleroi. Concerning the latter, in 2004, the European Commission found that under the “prudent private investor criterion” Ryanair had been receiving subsidies equivalent to state aid from the airport’s owner (Graham and Shaw, 2008). The Commission considered these as partial financing of both investments and operating costs, thus constitutes an illegal hindrance to competition (Dobruskes, 2006). New European regulations, namely the ‘Charleroi ruling’, have been issued, which could have limited Ryanair’s expansion. Nonetheless, apart some reported losses such as in 2009 due to the global economic downturn, as Gellen, Folan and Shain (2013) argue, Ryanair’s growth has been extremely impressive during a period in which established major airlines have struggled mightily and gone bankrupt in many cases. In reality, Barros and Couto (2013) concluded that Ryanair is among only five European airlines productivity growth between 2001 and 2011.

In fact, this success can be easily explained by the most recent figures. As Ryanair reports in ‘Q3 Results Feb 2015’, in 2014, the company’s average fare of €46 represented the

Europe's lowest fare. When compared with the averages fares of Norwegian and Easyjet, Ryanair's main competitors charged fares 80% and 83% more expensive, respectively. Furthermore, with a cost of €29 (excluding fuel) Ryanair operated at the European's lowest cost. In addition, as reported in 'Full Year Result of 2014', the company established 121 new routes and opened 8 new bases. According to 'Q3 Results Feb 2015', these figures made of Ryanair Europe's number one airline in terms of coverage: 72 bases, 189 airports, 30 countries, more than 1600 routes. This growth trend seems to continue once that, in 2014, Ryanair ordered 180 aircrafts to be delivered until 2018, having the company a total of 380 Boeings on order. Moreover, the LCC is market share leader in Spain, Italy, Belgium, Ireland and Poland. In the UK and Portugal the airline ranks the second position, whereas in Germany and France, Ryanair is the third airline. It is also relevant to mention that, in 2014, over 90% out of about 530,000 flights arrived on-time. Finally, looking at the financial performance, the 'Full Year Result of 2014' reported revenues of €5,037m and a net profit of €523M, which may be considered positive because the traffic had growth 3% to 81,7M passengers concerning the previous year.

3.1.2. Ryanair's Business Model: key success factors

Many research has been done concerning Ryanair's LCC business model. Implementing a profitable and growing airline based on low cost seemed to be impossible some years ago. Interestingly, Academics have found some of the strategic decisions that have led the company into success.

First, since Ryanair's routes are mainly point-to-point, the company is able to reduce airport charges by avoiding congested airports, choosing secondary airports and regional destinations (O'Higgins, 2011). In fact, the largest proportion of its flights are between secondary airports, and even military bases (Francis, Fidato, and Humphreys, 2003). As Roseingrave (2000) argues, flying in and out of low-cost uncongested secondary airports has become the trademark of Ryanair. This strategic choice leads Ryanair to derive a significant cost advantage once uncongested airports enable the Airline to deliver a 25 minute turnaround, which enhance aircraft utilization and on-time performance (CAPA, 2013). Furthermore, since Ryanair was the first mover it enabled it to engage into advantageous – cheaper fees for landing, aircraft parking and handling facilities - long term contracts with those airports (D'Alfonso, Malighetti, and Redondi, 2011). Geller,

Folan and Shain (2013) also claim that these airports provide Ryanair with support that often includes labor, saving the Airline the costs of investing in their own workers at a new destination. As a matter of fact, these airports clearly benefit quite substantially from low-cost carriers and since there are more airports than carriers, Ryanair usually receives requests for service (Gillen and Lall, 2004). On the other way around, Barbot (2006) points out the Ryanair-Charleroi agreement as an example where subsidization or lower airport charges benefit consumers and negatively affect incumbent airlines. As part of this successful strategy, consequently, CAPA (2013) reports that recent years have seen primary airports offering Ryanair attractive deals and secure its presence (e.g. Madrid, Barcelona, Manchester, Edinburgh), which has led the airline to enjoy a dominant positioning in this important cost issue.

Second, Ryanair follows a very strict policy in terms of its internal organization. For instance, the company's employees perform several jobs, such as the cabin crew that cleans up the crew after passengers disembark (often joined by the pilots as well) in order to comply with its punctuality and fast turnaround time (Mack, 2013). Furthermore, it is stated that the cabin crew is even responsible for all the work at the terminal (i.e. checking guests in and boarding them at the gate.), and it is trained to prevent incidents of lost luggage and to unload planes as efficiently as possible in order to maintain the fast turnaround times. In addition, in fact, D'Alfonso, Malighetti, and Redondi (2011) argue that Ryanair presents the highest level of productivity in terms of passengers per employee, which is crucial because labor cost accounts for 40% of an airline's total cost. As reported on CAPA (2013), around 50% of the flight crew are contractors employed only when required. Following this outsourcing strategy brings flexibility to the company in choosing whether or not to renew contracts as they expire (Barrett, 2004). This is possible because Ryanair has adopted a deliberate non-union stance (Hunter, 2006). Moreover, outsourcing also bring flexibility in choosing between different suppliers of services such as aircraft maintenance and handling at airports. Geller, Folan and Shain (2013) still claim that Ryanair's emphasis on productivity among employees is reinforced by offering commission based incentives for flying hours and commissions for in-flight sales. Finally, D'Alfonso, Malighetti, and Redondi (2011) explain that the homogenous fleet significantly reduced training costs.

Third, Ryanair exploits revenues further than the traditional ones, enabling it to reduce unit costs. Actually, CAPA (2013) reports that Ryanair derives 20% of its revenue from

ancillary products and services. As O'Higgins (2011) states, Ryanair produces various ancillary revenues connected with its airline service, including in-flight beverage, food and merchandise sales. It also distributes accommodation, travel insurance and car rentals through its website. Yet, the short break packages form an important part of additional ancillary revenue with Ryanair integrating package holidays into its core business model (O'Connell and Williams, 2005). The excess bag charges are also recorded under ancillary revenues. But, Mack (2013) claims that using the busy and crowded company's website is the major source of ancillary revenues due to the possibility of opting out of choices that come with an additional price: priority boarding, travel insurance, checking luggage. Moreover, if after the online check-in, either one of these things is forgotten or a customer misspells his or her name, the Airline charges up to €40 to do it for the customer.

Forth, Ryanair was pioneer of making the use of Internet as its main distribution channel. By 2007, according to Diaconu (2012), the airline was reporting 90% of its direct sales via the internet and 99% in 2011 (O'Higgins, 2011). In fact, in 2011, Ryanair was the fifth most searched website worldwide (O'Connell and Williams, 2005). Diaconu (2012) argues that this method not only offers advantages both to the company and clients, but also it has been the most significant operating cost saver. D'Alfonso, Malighetti, and Redondi (2011) claim that by taking direct phone and internet reservations, the usage of the GDS system is avoided²⁶ as well as high fee commissions close to 7- 8% of total operating costs. Likewise, Ryanair does not rely on travel agents (O'Higgins, 2011) and by selling direct to the market enables the company to have detailed market information with respect to its customers (Diaconu, 2012).

Fifth, Ryanair minimizes its marketing and advertising costs, relying on free publicity through controversial and topical advertising, press conferences and publicity stunts' (O'Higgins, 2011). Furthermore, young people, often students, are hired to create its advertisements, which normally are only published in a few newspapers for a few days, as these ads are often offensive or provocative (Mack, 2013). Actually, O'Leary believes that 'any publicity is good publicity', meaning that Ryanair bases its advertising strategy on the so-called 'word-of-mouth' (Casadeus-Masanell and Ricart, 2011). Another

²⁶ This situation has changed recently (See chapter 2.3)

element of Ryanair's strategy for market stimulation is the issuing of free tickets (O'Connell and Williams, 2005). D'Alfonso, Malighetti, and Redondi (2011) claim that Ryanair's most important marketing strategy was being able to demonstrate and convince customers that lower costs were not associated with lower safety standards.

Sixth, Ryanair provides only the minimum customer service standards. As Mack (2013) argues, Ryanair deals with customer demands in a way that benefits the company and, instead of investing in improving customer service standards the company focuses on aspects that will save the company money²⁷. For instance, the Airline is not focused on the flight comfort of its customers and, according to CAPA (2013) it uses a high seat density (189 seats per aircraft, compared with Easyjet's 156 on A319s and 174 on A320s). This allows high aircraft utilization. Furthermore, the Airline operates with only three flight attendants in the cabin whereas big carriers employ five (Roseingrave, 2000). Furthermore, Mack (2013) explains that Ryanair has such a great record for fewer lost bags because it has fewer bags to lose – most passengers avoid the costs of checking luggage and plan to bring only a carry-on suitcase or bag, which cannot be considered a good customer service. Thus, the company does not spend funds trying to reconcile the situation of lost luggage. Finally, Casadeus-Masanell and Ricart (2009) claim that by using a single class and treating all passengers equally, the company achieves economies of scale.

Seventh, Ryanair's aircraft fleet is all composed only by Boeing 737-800. D'Alfonso, Malighetti, and Redondi (2011) explain that a homogeneous fleet allows a reduction in costs of training and maintenance, mainly outsourced. In fact, the training time for flight crews on the Boeing 737-800 is only two weeks versus an average of seven weeks to be trained on a different type of aircraft (Roseingrave, 2000). Furthermore, Boeing 737-800 is considered the next Generation aircrafts, the youngest and most fuel efficient in Europe (Diaconu, 2012). As a matter of fact, the Airline is currently the industry leader in terms of environmental efficiency. In addition, the average age of its aircraft is around 4 years, similar to EasyJet, but considerably younger than the 9-11 years that is typical for European flag carriers, which gives advantages in terms of fuel efficiency, maintenance costs and customer perception (CAPA, 2013). Moreover, to further save money on

²⁷ Minor changes have been made (see chapter 2.3)

maintenance, Ryanair generally sells their aircraft on the secondary market before the first major maintenance repair (Geller, Folan and Shain, 2013). Finally, Casadeus-Masanell and Ricart, (2009) defend that a standardized fleet increases Ryanair's bargaining power with suppliers.

Eight, as mentioned in the previous factors, Ryanair focuses all its strategy on achieving fast turnaround times. In order to maximize aircrafts use, by starting flights earlier in the morning and to end them later in the night, each plane yielded eight to ten hours per day of activity compared to the five or six of traditional airlines on the same routes (D'Alfonso, Malighetti, and Redondi, 2011). In addition, secondary airports are less congested and therefore it is easier to obtain slots, facilitating quicker turnaround time. To further reduce turnaround times, Ryanair withholds seat reservations, reducing boarding and landing times (Geller, Folan, and Shain, 2013). Moreover, Ryanair's 25 minute turnaround times are attractive to passengers (CAPA, 2013). As Mack (2013) argues, by focusing on punctuality, the faster the arrival, the faster the turnaround, the more costs are reduced.

Ninth, the pricing strategy is crucial for Ryanair's business model success because by charging the right low price the company will maximize its volume. Malighetti, Paleari, and Redondi (2009) arrived to interesting conclusions. First, there is positive correlation between the fares and route length, route frequency and the percentage of fully booked flights. In fact, Ryanair grants fewer discounts on long haul and high-frequency routes, despite advance purchase. Then, this paper finds a negative correlation between the Ryanair's importance in the departure and arrival airports and offered fares. As a matter of fact, if Ryanair plays a dominant role in the departure airport, not only average prices are lower, but also significant discounts are more likely on tickets purchased in advance, which indicates the importance for the carrier to fulfil its capacity. Nevertheless, in some cases, Ryanair can offer lower fares when employing secondary airports with no competition because those operations are subsidized. Finally, surprisingly, this research did not find evidence that the presence of competitors has a heavily impact on the average price. Eventually due to the fact that Ryanair operates most flights on the medium-to-small routes with no competitors. This means that direct competition on the same route does not lead to a decrease in average ticket prices, but rather induces the Airline to grant greater discounts on advance bookings. As Malighetti, Paleari, and Redondi (2010) claim,

lower discounts on advance bookings allow incoming revenues to cover fixed costs and reach break-even earlier. Furthermore, as expected, fares also show a positive and significant correlation with oil prices. The research still finds evidence of a strong seasonal effect, with prices being higher during the first part of the year, in particular, in August. Last but not least, the average prices peak and discounts on advance booking are significantly lower. Another relevant conclusion is that Ryanair pursues a strategy of more dynamic pricing activities in order to exploit the regions with strong economic growth (Malighetti, Paleari, and Redondi, 2010).

Tenth, Ryanair strategically targets its customers. According to O'Connell and Williams (2005), the Airline attracts a high number of younger people, with 24% of its passengers being in the under 24 year's age group. In addition, looking at the potential business customers, there is significant business traffic for Ryanair especially from the self-employed and employees of small-medium sized enterprises. Furthermore, as D'Alfonso, Malighetti and Redondi (2011) argue, the key Ryanair's success factor was the ability to understand the real price-demand curve and to develop a business model able to target unsatisfied demand (i.e. customers) through the introduction of many solutions adopted by charters on scheduled service.

To sum up, Casadeus-Masanell and Ricart, (2011) elaborate the three Ryanair's virtual cycles that quickly collect the mentioned success factors. Although they are not part of the definition of a business model, they are crucial in their evaluation. The first virtuous cycle argues that low fares lead to large volume, which increases Ryanair's bargaining power with suppliers. As a result, the fixed costs will be lower as well as the fares, once again. The second virtuous cycle claim that low fares lead to large volume, which increases Ryanair's aircraft utilization. As a consequence, the fixed costs over passenger will be lower, which represents lower fares again. The third virtuous cycle calls that low fares mean that customers expect a low quality service expected. Consequently, they do not expect services offered traditionally free of charge, such as meals, which will decrease the variable costs. Again, low variable costs imply low fares.

3.1.3 Ryanair: weaknesses, threats, challenges and future

Despite Ryanair's business model success, according to Popova (2013) at 'Can a Leopard Change its Spots - Makeover for Ryanair or Further Trouble in the Skies?', how quickly

the company changes its strategies in light of new business conditions (ie increased competition and fuel costs, currency fluctuations and a challenging European market) will determine how successful it will be in remaining the leading low cost airline in Europe. According to the same author, in 2013, concerns were raising from the fact that the airline was downgrading its full-year profit expectations for the financial year from €570 million to somewhere between €500- 520 million, driven by intensified price competition from both budget rivals as well as schedule operators, in addition to a weaker British pound and lower demand, leading to a fall in passenger bookings and a 2% decline in fares. The financial slowdown of an operator such as Ryanair raises questions like whether the airline was indeed losing its attractiveness among passengers and if overcapacity had been too rushed, thus weakening its competitive advantage. In fact, as Popova (2014) at 'Ryanair holdings plc in travel and tourism' argues, a market leader must continuously innovate, improve service and court passengers in an effort to retain its leadership. Failure to do so threatens its brand and ultimately its financial stability. This section overviews some of Ryanair's main weaknesses and threats, and tries to predict its future challenges.

Many of the Ryanair's weaknesses and threats might have to do with its weak internal culture. As argued on 'The Guardian' (2014), Ryanair's poor reputation in terms of customer service and job satisfaction may have a negative effect on its success in the future. Bamber, Gittell, Kochan and Von Nordenflycht (2009) concluded that the main organizational behavior issues, which Ryanair is facing, are the autocratic control approach of management over employees, stress and lack of motivation, staff turnover and weak organizational culture. In fact, Ryanair's human resource management is characterized by a rigid autocratic control, using often threats of cutting down retributions or firing in order to stimulate employees' action. Even pilots revealed that they are under pressure to save fuel as much as possible, which may be at the cost of safety, although Ryanair itself denies this is the case (Logman, 2013). According to Nortilli and Wong (2014), the company's weak culture arises from the behavior of the top management and it must be slowly changed to reach a strong one, where the employees are motivated and loyal, communication is frequent and the entire organization is aligned towards the achievement of its goal to be the best low-cost airline.

Another issue for Ryanair will be managing its bad relation with many of its stakeholders. As Bridoux and Stoelhorst (2014) state, The Airline's approach to stakeholders is

regularly under attack from industry observers and stakeholder groups. According to the same authors, one example are the competitors. Every time another airline enters a route already served by Ryanair, it typically reacts with a price war in order to drive the other airline out of the market and maintain its dominance on the route. Another example, according to CAPA (2013), is Ryanair's excessive bargaining power over Boeing. It reports that Ryanair had conversations with the Chinese manufacturer COMAC in order to develop a 199 seat variant of its C919 aircraft by around 2018.

Route density will likely a challenge for Ryanair. De Wit and Zuidberg (2012) find evidence that Ryanair is only capable of starting thin routes, which in turn is an indication of a saturating market and future, or already existing, route density problems. In fact, route density in European O&D markets will ultimately limit the growth perspectives for Ryanair. Therefore, they claim that some solutions might be: shifting to primary airports, starting hubbing activities that enable passengers to transfer from one to the other flight, signing codeshare agreements, entering alliances, and acquiring other airlines.

Moreover, Ryanair's brand perception will eventually be a future problem. CAPA (2013) argues that since Ryanair is frequently featured in surveys as having one of the weakest brands in European aviation, this perception may start to have an adverse impact on sales as the Airline matures. Actually, Popova (2013) at *Can a Leopard Change its Spots - Makeover for Ryanair or Further Trouble in the Skies?* claims that change is eminent at the company following the customers complaints and it appears to be ready to experiment and perhaps curb its business model: the website has been improved, thus making it much more easier to navigate; the airline has started to work with the major GDS players, such as Amadeus, Travelport and Sabre; Ryanair now appears on Google Flight Search; the no-frills airline is bringing back the allocated seating. Furthermore, she argues that these changes may start to pay dividends and attract a more varied customer base, including business travelers. Concerning this last point, Ryanair created a Business Plus fare with the aim to attract more business travellers, which currently represent 25% of the total number of passengers (Popova, 'Ryanair holdings plc in travel and tourism', 2014). At the same time, the company has made an effort to provide cheap accommodation to its customers by have launched a new website in partnership with HotelsCombined ('Key threats and opportunities facing global Airlines', 2012) and by having established a partnership with Booking.com (Popova, 'Ryanair holdings plc in travel and tourism', 2014). Finally, several other policies have started to be implemented in order to improve

customer service: more ticket flexibility regarding the change of dates; second small piece of hand luggage onto the plane in addition to the 10kg cabin baggage allowance; reduction in certain fees, such as the reissuance of a boarding card (Popova, 'Ryanair holdings plc in travel and tourism', 2014).

Despite its internal problems, Ryanair faces several external threats too. First, Twizell (2012) found evidence that recession on the European economy has led to a significant impact on the airline's industry, particularly on LCCs, that have had a double challenge of reducing operating costs and maintaining lower ticket prices (Weidema, 2011). Nevertheless, through a combination of increased price sensitivity from passengers and capacity cuts from many competitors, it has been possible to Ryanair to produce string financial results in times of economic weakness (CAPA, 2013). As a result of these downturn periods, the price of jet fuel, which accounts for around 45% of Ryanair's costs, is highly volatile. In addition, a high proportion of Ryanair's costs are in US dollars, making it vulnerable to a strengthening of the dollar against the pound and the euro (CAPA, 2013). Popova (2014) at 'Ryanair holdings plc in travel and tourism' argues that fuel efficiency through high-performance next-generation aircraft will be a primary green strategy in order to minimize this external issue. Second, as Barrett (2004) claims, the threat to the sustainability of the model comes from regulators rather than from passengers, airlines or airport authorities. As mentioned, Charleroi case was paradigmatic, but, more recently, in October 2013, the French authorities led to the airline being fined €9 million for breaching labor laws in the country by employing French staff using Irish labor contracts on one of its bases (Popova, 'Can a Leopard Change its Spots - Makeover for Ryanair or Further Trouble in the Skies?', 2013). This has increased financial costs for the carrier as well as undermining its reputation as a brand and employer. Michel O'Leary blames the European Commission and other EU bodies of taking delight in targeting Ryanair for selectively harsh treatment (CAPA, 2013). Third, De Wit and Zuidberg (2012) defend that air services to common destinations served at neighboring airports will increasingly cannibalize each other thus marking the end of possible future growth, as happened with Ryanair's network of regional airports in Eindhoven, Weeze and Maastricht. Fourth, Popova (2014) at 'Ryanair holding plc in travel and tourism' states that air travel taxes and airport fees will continue to force Ryanair to shift capacity between markets, axing flights or reducing its based aircraft. In fact, Ryanair has seen increases in airport charges in Spain's AENA airports and ATC

increases in Italy (CAPA, 2013). Furthermore, air travel represent a higher percentage of the price of a short haul ticket than a long haul ticket, making Ryanair potentially vulnerable to recent increases in air taxes in countries such as the UK (CAPA, 2013). Fifth, other threats such as summer seasonality of earning, or external events, such as earthquakes and volcanic ash disruption, might affect the Airline's profitability (CAPA, 2013).

During the last years, competition has been becoming stronger and the consumer behavior has been changing, which has been threatening Ryanair's business model. Concerning competition, Easyjet and schedule players have been decreasing their fares dramatically (Popova, 'Ryanair holding plc in travel and tourism', 2014). Moreover, Ryanair tends to offer lower frequencies on its routes than its competitors and often has departures at very inconvenient times (CAPA, 2013), which is a disadvantage in attracting higher yielding business passengers. Regarding changes on consumer behavior, Customers are adapting and becoming resistant to ancillary items, and are now travelling with only hand luggage to avoid excess baggage costs (Ryanair goes from strength to strength, 2010). As it is argued, the Irish player relies heavily on ancillary revenues, which represent some of the highest in the industry (Popova, 'Ryanair holding plc in travel and tourism', 2014). Furthermore, Ryanair remains overly reliant on Eastern and Western Europe, which are beset by maturity, unfavorable demographics and persistent economic difficulties. Consequently, Logman (2013) claims that Ryanair needs to adapt its strategies to assure future growth. In fact, Ryanair is rumored to be contemplating expansion in the Middle East (i.e. Lebanon, Israel, Jordan and Egypt) and Russia²⁸. In fact, the airline is hoping to achieve this through the establishment of a potential base in Cyprus (Popova, 'Ryanair holding plc in travel and tourism', 2014). As regards as other likely business models updates, Diaconu (2012) recommends to the Airline to use the main airports too, so that it could easily reach business travelers, who have been complaining that the airport serving major cities are many miles away, such as Milan-Bergamo or Barcelona-Girona (CAPA, 2013). Furthermore, although Ryanair does not have plans for code-sharing at the moment, by using main airports this possibility might become real in the future. In fact, De Wit and Zuidberg (2012) showed that 17.2% of Ryanair passengers surveyed had connected to other flights at London Stansted Airport. Finally, Diaconu (2012) defends

²⁸ <http://www.telegraph.co.uk/finance/newsbysector/transport/10995962/Ryanair-hints-at-flights-to-Middle-East-and-Russia-as-profit-forecast-rises.html> (The Telegraph, 28/07/2014)

that in order to become a true European airline, the company needs to increase its operations in the Eastern part of the continent, where, there are only a few destinations yet.

Finally, it is not perceivable yet whether Ryanair's future will result or not on a merger with the Irish flag carrier, Aer Lingus. O'Leary initial plan would be taking over Aer Lingus, a hybrid carrier combining low cost European routes with long-haul, in order to wide body operations between its Dublin hub and North America. This merger would give the Ryanair access to resources and "know-how" needed to start long haul operations (De Wit and Zuidberg, 2012). Nevertheless, Lenartowicz, Mason and Foster (2013) argue that it is not very likely that Ryanair would benefit from a merger with any smaller and weaker carrier. The European Commission on competition grounds have blocked some attempts, such as in 2013, due to the likely reduced levels of competition in the Irish market (Popova, 'Ryanair holding plc in travel and tourism', 2014).

3.2. Air Berlin: The hybrid business model paradigm

This section will discuss a very particular and almost single case of a "former charter carrier that moved towards the 'middle' of two business models" (Flottau and Buyck, 2013). As a matter of fact, Air Berlin follows a business model that combines several elements of FSCs, LCCs and charter business model (Vidovic, Stimac and Vince, 2013). It is the so-called hybrid business model, which offers high quality at affordable prices (Harvey and Turnbull, 2012). Therefore, in order to catch this model, it is crucial to look at Air Berlin's background, strategy and figures (parte one of this section). Nonetheless, as discussed on chapter 2, Air Berlin has been experiencing severe financial difficulties. The second part will go through some factors that do not enable Air Berlin to achieve its desired profitability. Finally, the third part will try to predict what might be Air Berlin's future as a consequence of its recent business model updates.

3.2.1. Air Berlin's background, strategy and figures

In 1979, with a single route flying from Berlin to Palma de Mallorca, Air Berlin initiated its operations as a charter airline (Harvey and Turnbull, 2012). Air Berlin remained a charter airline until the mid-1990's, when it "introduced a flight offer toward more tourist

destinations, becoming the largest tourist airline” (Vidovic, Stimac and Vince, 2013). In 2002, the airline started its really expansion by having launched scheduled flights from several airports in Germany towards important destinations such as London, Rome, Madrid, Amsterdam and Vienna (US Legacies: Mergers not the answer, 2007). This services of low-cost transportation is called ‘Euroshuttle’ and enabled Air Berlin to reduce its seasonality’s problems (Vidovic, Stimac and Vince, 2013). In 2003, the company became the second largest German airline, which is still its current position (Air Berlin PLC & Co Luftverkehrs KG in travel and tourism, 2014). At the end of 2005, Air Berlin was the first German airline to offer domestic flights within the UK, namely the routes London – Glasgow and London – Manchester (Moltesen, Sørensen and Haahr, 2008). Then, “further growth was achieved through takeovers and equity stakes position” (Air Berlin PLC & Co Luftverkehrs KG in travel and tourism, 2014). Successful mergers and acquisitions have included FlyNiki (2004), dba (2006), Contor, LTU and Belair (2007), which have led into the completely integrated Air Berlin Group (Air Berlin PLC & Co Luftverkehrs KG in travel and tourism, 2014). As Moltesen, Sørensen and Haahr (2008) argue, apart that it gave access to more markets and a larger number of aircrafts, this restructuration process enabled Air Berlin to increase flexibility and enjoy synergy effects. Furthermore, Air Berlin could finally be described as a ‘hybrid carrier’ that targets both business and leisure travelers (US Legacies: Mergers not the answer, 2007). In 2011, Airberlin becomes the first hybrid carrier to sign up for the full GDS distribution system Amadeus Altéa (Press Release Air Berlin group & Amadeus, 2011). In the same year, ‘Etihad Airways increased its stake to 30% in Air Berlin by providing US\$255M over the period 2012-2017’ and named two seats on the board of directors (Key threats and opportunities facing global airlines, 2012). On year later, in 2012, the Airline joined Oneworld alliance and sold the control of its frequent-flier programs to Etihad Airways due to its bad financial performance (Air Berlin PLC & Co Luftverkehrs KG in travel and tourism, 2014). Air Berlin has been the second largest German airline operating flights in Europe and to Africa and North America (Harvey and Turnbull, 2012).

As Vidovic, Stimac and Vince (2013) explain, what defines Air Berlin’s business model when comparing with a LCC, is that Air Berlin offers the complete service level on board (e.g. catering, entertainment, etc.) as well as transfer flights from its hubs (Berlin, Dusseldorf, Nuremberg and Palma de Mallorca). The connecting flights are only allowed through codeshare arrangement within the Oneworld alliance. In particular, the codeshare

agreements with American Airlines and Etihad Airways have given Air Berlin the access to long-haul markets, which are strategically crucial for the company (CAPA, 2012). The company makes a “great effort to distance itself from airlines like Ryanair” (Moltesen, Sørensen and Haahr, 2008). They defend that its main competitor is Lufthansa because Ryanair is a low-quality airline in which the number of clients who rebook to fly with the airline is quite lower than at Air Berlin (Harvey and Turnbull, 2012). This is also due to the fact that Air Berlin “flies into and out of centrally-located airports”, which is an opposite strategy if compared with Ryanair’s (Moltesen, Sørensen and Haahr, 2008). Actually, during an interview²⁹, the ex CEO Joachim Hunold explains that Air Berlin’s business model depends on central airports despite of their more expensive taxes. As he defends, “at the end of the day it is all about how much money is earned on each flight”. This strategy clearly reveals that although it follows a hybrid business model, Air Berlin has a ‘clear focus on value enhancement’ (Annual Report, 2007). Moltesen, Sørensen and Haahr (2008) argue that by following a customer orientation (e.g. comfort, modern, fuel-efficient aircrafts, in-flight menus), Air Berlin manages to produce efficiency and achieve customer retention. This aspect gains relevance through Air Berlin’s frequent flyer program ‘Topbonus’ – very successful among business travelers - and its fare structure (‘YourFare’) – which offers different fares according to individual booking preferences (Annual Report, 2007). Furthermore, the company has safety as the “prime objective in performance measurement” (Annual Report, 2007). Not less important, Air Berlin’s customer’s focus relies on the customer management Amadeus’ system that enables the company to see its reservations, manage its inventory, control better the departure operations and better integrate with its partner airlines – which are key for the hybrid model (Press Release Air Berlin group & Amadeus, 2011). Concerning the latter, Etihad’s partnership plays a very important role for the model because it makes possible the use of synergies in several areas, such as procurement, maintenance, route networks and loyalty (Annual Report, 2007). Moreover, the cooperation with another partner, NIKI, gives Air Berlin the opportunity to collaborate in its Top Bonus air miles loyalty program, which is a key factor once the company considers Vienna airport has the ideal for transfers of German travelers to Eastern Europe (Niki Lufthart GMBH in travel and tourism, 2014). Moltesen, Sørensen and Haahr (2008) defend other three very relevant elements of the business model. First, in order to minimize the volatility of the most significant cost for

²⁹ <http://airberlin-08.sw-gb.de/index.php?id=181&L=1> (Air Berlin webpage, 2008)

Air Berlin, i.e. oil prices, the company engages in hedging transactions. Second, the Airline has established its own flight academy because it represents a way of recruiting the best pilots, develop a good reputation as an employer reducing the turnover and the training is cheaper. Third, Air Berlin was the first in the world to introduce fitted winglets and traffic alert and collision systems (TCAS). These have contributed to the increase of environmental performance and safety, which, in turn, has improved customer's perceived quality.

Although Air Berlin presents an innovation in terms of business model, the financial and operational performances have not been successful. In fact, since 2007 only in one year the company achieved profitability. According to table 7 (Appendix), the average price per passenger has remained stable from 2008 to 2013 – about €92 – but, the number of customers has been considerably declining. Therefore, as the 'Annual report' (2014) shows, in 2014, despite the revenues slightly increased by 0,3%, the company obtained a negative EBIT of €26.7M. Its hybrid cost structure seems to be too heavy. Nevertheless, considering the available-seat miles (ASK) indicator, the total costs per ASK decreased by 2.8%, between 2013 and 2014. But, at the same time, the total revenues per ASK also decreased by 2.7%. Surprisingly, the addition of the codeshare with US Airways, in 2014, has boosted the number of clients (CAPA, 2014). In fact, Lufthansa and Air Berlin together accounted for 65% of total value sales in Germany (Transportation in Germany, 2014). This is also due to the strong brand awareness and customer loyalty that the Airline enjoys in the market, with more than 92% of Germans knowing the brand (Annual Report, 2007). Annual Report (2014) also reveals that in order to improve the shareholder's situation – losses per share of €22 – the company has engaged in another restructuration program that led to decreases of 5% and 14% in the number of employees and number of destinations, respectively.

3.2.2. The hybrid business model: why is it failing?

Air Berlin has been presenting a negative profitability performance for several years. In fact, there was only one year since 2007 with a very small net profit (CAPA, 2015). As reported on 'Air Berlin PLC & Co Luftverkehrs KG in travel and tourism' (2014), although the company has been incurring in several restructuring programs, it remains losing retail market share to its competitors because the increased revenues do not keep

up with the high costs. In particular, as it can be observed on Table 8 (appendix), when comparing with the other LCCs, such as Ryanair, Air Berlin has about half of Ryanair's passengers but many more employees and daily flights, which is a considerable imbalance. Furthermore, Table 9 (Appendix) shows that the passenger load factor is 74%, which is only 5% above Lufthansa and quite below other LCCs, such as Germanwings and EasyJet. Obviously these results challenge the sustainability of its business model. Popova (2014) at 'Air Berlin: Light at the end of the tunnel?' claims that among the several factors, the unsuccessful merger with LTU, in 2014, has been the first reason for the negative results because Air Berlin has started to operate unsustainable routes. As Moltesen, Sørensen and Haahr (2008) argue, another reason has been the dependence on the seasonality of weekly flights to Palma De Mallorca during the peak holiday season, which has felt the effects of the recent economic downturn in Europe. Moreover, 'Key threats and opportunities facing global airlines' (2012) shows evidence that the air travel tax introduced by the German government - due to the excess of domestic flights - has been hitting Air Berlin in a higher proportion than its competitors. 'Air Berlin PLC & Co Luftverkehrs KG in travel and tourism' (2014) also argues that after one more restructuration that has led Air Berlin to sell its fleet and remain with only 10 aircraft, the company is using fleet operated by lease, which is not common among airlines and is costlier. Finally, eventually the major problem is the fact that Berlin's new airport "has been postponed several times" (Air Berlin PLC & Co Luftverkehrs KG in travel and tourism, 2014). As the sales vice president, Titus Johnson, claims during an interview, Air Berlin is being more affected than its competitors because the company planned its schedule and its expansion based on the assumption of this new airport (Interview: Air Berlin VP Titus Johnson, 2014).

3.2.3. Which future for Air Berlin's hybrid business model?

Despite its bad financial and operational performance, Air Berlin faces many other threats and challenges that will contribute to the definition of its Airline's business model. On the other hand, many opportunities seem to arise. Eventually, they may lead Air Berlin to success.

Popova (2014) at 'Air Berlin: Light at the end of the tunnel?' claims that seven years of losses is not sustainable anymore in such a competitive and consolidated European market. Furthermore, she defends that the only way to turn the adverse situation over

consists in focusing on “achieving higher efficiency while controlling costs within the short-haul segment”. In order to achieve this, it is argued that turnarounds times may be shorter (Air Berlin PLC & Co Luftverkehrs KG in travel and tourism, 2014). In addition, a gradual harmonization of its fleet to a single Boeing aircraft family for each of short-mid and long hauls might be relevant since deployment, maintenance, crew rotation and training costs would enable the company to achieve a higher efficiency (CAPA, 2014). The efficiency may also be achieved through a larger focus on connecting high volume routes in its main markets, i.e. Germany, Austria, Palma de Mallorca and Switzerland, which would reduce the operation’s susceptibility to seasonal volatility (Air Berlin Profile, 2012). On another and outdated perspective, at “US Legacies: Mergers not the answer” (2007), it was argued that Air Berlin’s future would not depend on a cost-strategy but, rather, on implementing a successful customer orientation for both short and long haul passengers.

The strategic location and utilization of airports will be very important for the future of Air Berlin’s hybrid business model. In particular, it is capital for the Airline to “expand its non-stop long haul flights services from Berlin to Dusseldorf”, so that the company can consolidate its second position on German market (Key threats and opportunities facing global airlines, 2012). As it is argued on ‘US Legacies: Mergers not the answer’ (2007), Dusseldorf has a huge potential for growth and to become a major hub due to its recent strong investment. As a matter of fact, in a future’s point of view, it is safer betting on high margins on long-haul flights rather than the low margins on the point-to-point European business (US Legacies: Mergers not the answer, 2007). Nevertheless, this does not mean that Berlin drops importance for the strategy of the group. Actually, after the new Berlin’s airport is ready, Air Berlin believes that it will boost its market share, it will become the biggest carrier, and there will be a great opportunity to developing business out of Berlin (Interview: Airberlin VP Titus Johnson, 2014).

The future of the Airline also seems to rely on the cooperation with its equity partner, Etihad Airways. Even though the main purpose of this alliance is to exploit synergies in all the several areas of both companies (Air Berlin profile, 2012), this strategic partnership also intends to save costs, become Air Berlin more efficient and seek for new opportunities (Interview: Airberlin VP Titus Johnson, 2014). It goes from working together to sharing knowledge and resources. Nonetheless, the partnership is not sufficient for leading the company into profitability, because “financial injections can

only have a limited effect” (Popova, ‘Air Berlin: Light at the end of the tunnel’, 2014). Moreover, this partnership has been threatened by the German Federal Aviation Authority since October 2014, who has refused to approve codeshare on 34 routes, including Berlin to Abu Dhabi and Abu Dhabi to several destinations in Europe (CAPA, 2014). In fact, as it is argued, the partnership revenues with Etihad Airways are crucial for Air Berlin’s recovery plan and this decision may have an impact in the mid double digits. In addition, this decision would have a negative impact in Germany too. Forsyth (2014), after careful cost-benefit analysis, concluded that Germany gains from allowing Etihad Airways to access to Berlin represent a very good deal. Actually, these benefits arrive to final consumers since with this partnership they can chose between “a map of networks of both Airlines with no overlap” (Interview: Airberlin VP Titus Johnson, 2014). Not only the partnership with Etihad is very important, but Air Berlin’s low cost subsidiary NIKI might represent a great opportunity. NIKI has been identified by the hybrid carrier as having a clear focus on tourism and has been very profitable in the recent years (CAPA, 2015). Therefore, Air Berlin may take benefit from its close relation with hotel chains such as Accor, IHG and Marriott, in order to offer hotel loyalty programs because it may increase returning customers and help to boost passenger numbers (Key threats and opportunities facing global airlines, 2012).

Despite of the repeatable result failures and several restructuration’s programs, Air Berlin appears to maintain its original idea of adopting a hybrid business model in order to consolidate its position in the market. ‘Air Berlin: strategy and business model’ (2015) states that the hybrid Airline will keep improving its “flexible business model” by adding new destinations and offering a combination of both leisure and business flights. ‘US Legacies: Mergers not the answer’ (2007) has warned for the complexity of dealing with two the types of operations (i.e. short and long haul) as well as the two types of target customers (i.e. leisure and business). This argument is reinforced at CAPA (2014), where it is claimed that Air Berlin has not resolved yet its “fundamental question” of being a short point-to-point LCC, a FSC, a leisure operator or a high frequency business airline. Also Popova (2014) at ‘Air Berlin: Light at the end of the tunnel’ claims that a new strategic approach is mandatory and “radical change is the only way to become successful”. Nevertheless, the company keeps believing that “with its international network, its frequent flyer program TopBonus, its fare structure YouFare and its business model focus on efficiency, it is placed in an optimal position to face global competition”

(Air Berlin: strategy and business model, 2015). Therefore, the hybrid carrier intends to remain in all business segments of Europe (i.e. leisure and long haul) and keep its focus on its European network (Germany, Austria, Switzerland and Palma de Mallorca) but it will “redouble its efforts” to it more efficiently (CAPA, 2014). This effort will be done by the new CEO Stefan Pichler through a redesign of the hybrid’s model – focus on management and leadership structure as well as look at market segmentation and capacity adjustments - which aims for profitability and growth starting in 2016 (CAPA, 2015).

3.3. TAP Air Portugal: the traditional FSC business model

The purpose of this part of the chapter is not to study how a European FSC designs its business model. Rather, it intends to explore how a traditional European FSC airline, such as TAP Portugal, looks at the threat of LCCs and how it has been adapting its business model in order to remain competitive within this new reality. Namely, what are its competitive advantages, strategic decisions and customer’s perceptions. Furthermore, it is interesting to analyze and compare how TAP sees the European market and the other FSC’s strategic approaches to the same scenarios. This part of the chapter has received the priceless contribution of Dionísio Barum, Sales Director at TAP Portugal.

3.3.1. The Portuguese airline market and TAP

TAP Air Portugal was created in 1945. It is the Portuguese flag carrier and it is 100% owned by the Portuguese state (Caetano, Martins, Cornacho, Moreno and Ferreira, 2012). In 2005, TAP joins Star Alliance³⁰. Currently, TAP operates 87 routes to 38 countries worldwide (TAP Annual Report, 2014). The Portuguese airline is a reliable and appealing carrier for Portuguese tourist, who historically prefer the national airline due to its high quality services and safety standards (Transportation in Portugal, 2014). In fact, the Portuguese Airline has been voted as the best European airline company in 2011, 2012 and 2013 by the *American Global Traveller* (TAP Transportes Aéreos Portugueses SA in travel and tourism, 2014), which means that the quality standards of TAP have a strong reputation abroad. In 2012, the Portuguese government has decided to privatize TAP in a very tough and polemic process – as mentioned on chapter 2 -which is expected to finally

³⁰ <http://www.publico.pt/economia/noticia/tap-formaliza-entrada-na-star-alliance-no-dia-4-de-junho-1194242> (Público, 19/05/2004)

be finished in 2015 (TAP Transportes Aéreos Portugueses SA in travel and tourism, 2014). Although the Airline has not been profitable during many years, TAP was the biggest exporter in Portugal several times, such as in 2009, when it contributed with around €1.4 billion in sales to the external markets (Caetano, Martins, Cornacho, Moreno and Ferreira, 2012).

3.3.2. TAP as a FSC: business model, competition and future

First, it is key to understand what are TAP's business model, competitive advantages and weaknesses. Dionísio Barum, Tap's Sale Director, considers TAP as a medium size European airline that operates with a special focus on the 'triangle' Europe-Africa-South America. Actually, Caetano, Martins, Cornacho, Moreno and Ferreira (2012) point out the Brazilian market and the other Portuguese speaking routes as the major strengths and opportunities for TAP. This vision is reinforced by Barum, who argues that TAP main competitive advantages are its geography and the fact that the Portuguese Airline stands out as the most international among all the airlines in the Portuguese speaking countries, particularly in Brazil. In fact, as a medium sized airline, TAP had taken the right decision in 2001, when it decided to combine long and short-haul flights while taking benefit of its geography and good relationship between these countries. It has decided to increase the number of routes to Brazil and Africa and has done Lisbon and Porto the main European hubs for the Europeans passengers who fly to those destinations (Selected papers from the Air Transport Research Society Conference Porto, 2012). On its 'Annual report' (2014), TAP defends that its Lisbon hub is a "key European gateway at the crossroads of the African, North and South America Continents". This right strategy is corroborated by the 'World Travel Awards', which have distinguished TAP as the "World's Leading Airline to Africa in 2011 & 2012 and as the "World's Leading Airline to South America" in 2009, 2010, 2011 and again 2012³¹. Thus, it is not a surprise that the development of new routes to South America and Latin America remains on the top of the company's priorities for the next years (TAP Transportes Aéreos Portugueses SA in travel and tourism, 2014). Another argument in favor of this strategy is that Portuguese speaking countries are currently emerging economies which can "partly offset the negative effects of the European economic downturn" (Caetano, Martins, Cornacho, Moreno and Ferreira, 2012). In addition, Barum claims that other competitive advantages

³¹ http://www.staralliance.com/en/about/airlines/tap-Portugal_airlines/ (Star Alliance Official website)

are the experience and maturity of the company as well as the fact that Portugal is a pleasant, calm and pacific country, which attracts many tourists (contrasting with the current situation in the ‘Arabic World’).

TAP’s customers see TAP as a traditional, high quality and reliable airline (TAP Transportes Aéreos Portugueses SA in travel and tourism, 2014). Leite (2009) found evidence of high standards for Tap’s sympathy, comfort and satisfaction. In particular, Portuguese tend to have a higher preference than foreign passengers. Barum adds that TAP’s customer satisfaction is both onboard and on land. Nevertheless, the Sales Director describes the relationship among TAP and its customers as “hate or love”, changing according to the period. He admits that punctuality is the most negative aspect. As a matter of fact, the company reveals some signs of inefficiency as Barros and Peypoch (2009) concluded, by ranking TAP as 23rd in terms of European airlines efficiency. Marques (2011) also claims that ANA (the Portuguese airport operator) also suffers from very low productivity and efficiency, which affects the on-land efficiency of the largest airline operating in Lisbon and Porto. Caetano, Martins, Cornacho, Moreno and Ferreira (2012) argue that it is very important that investors believe that TAP can improve its current operational efficiency in order to leverage the results in Africa and South America, which ultimately would have a positive impact on the company’s negative equity. Regarding this, the privatization process may lead to a more positive valuation by the investors. Furthermore, apart from its punctuality due to its low operational efficiency, Barum explains that customers also complain about the fact that Tap’s network is not so wide, missing, for instance, a route to Asia. Leite (2009) found evidence that customers also complain of the high prices. Finally, the fact that TAP is not a big company, the Portuguese economic situation, the bad financial performance and the delayed privatization’s process are considered weaknesses of the Airline (Caetano, Martins, Cornacho, Moreno and Ferreira, 2012).

Second, it is crucial to analyze how TAP places itself against LCC’s competition. Barum, Sales Director at TAP, considers that LCCs in Europe are not a threat, but a reality which FSCs have to deal with. However, he considers that, so far, despite the fact that Portugal has seen a rocket increase in its air traffic, both LCCs and FSCs have peacefully “lived together” in the market. This may be considered positive because, as Barum claims, LCCs can be characterized by entering into strong price wars. But, at the same time, this seems to contrast with Caetano, Martins, Cornacho, Moreno and Ferreira (2012), who have

argued that TAP has been facing a “strong competition from LCCs”. Despite Ryanair’s recent entrance at Lisbon’s hub, in 2013, the Sales Director defends that TAP still has a dominant position by operating about 60% of Lisbon’s airport passengers (in particular the triangle Africa-Europe-South America). As a matter of fact, regardless of LCC’s competition, it is claimed that “TAP remains strong within the Portuguese travel industry and is consolidating its position” (TAP Transportes Aéreos Portugueses SA in travel and tourism, 2014) as well as offering more affordable prices with the same quality standards (Transportation in Portugal, 2014). Moreover, as it can be seen on table 10 (Appendix), between 2008 and 2013, the number of passengers at TAP grew almost 3 million. This number is the result of the entrance of LCCs in Portugal, which have steeply increased and developed tourism demand in Portugal (Lourenço, 2008). Thus, and there is here a clear contrast with the previous vision, this number is due to a trend and do not correspond to an organic growth. Actually, the real figures show that relatively, “TAP has consistently been losing passengers to the LCCs, mainly Ryanair and Easyjet” (Marques, 2011). In fact, Barum admits that, after TAP, LCCs are already the largest operators in terms of passengers. Namely, Easyjet and Ryanair operate 16% of Lisbon’s airport passengers. At Porto’s airport, this percentage is even larger because the number of passengers of the ‘triangle’ is lower, since Lisbon is a larger hub for connecting flights. As Tap assumes on its ‘Annual report’ (2014), the main threat for TAP comes exactly on several of its European short-haul operations, with Ryanair and Easyjet leading TAP to a tradeoff situation, where increasing fares is limited and, at the same time, the average fare is decreasing as it is reflected on the yield. Likewise, on table 10 (Appendix), it is possible to see that the average fare has decreased from €126 to €104, between 2008 and 2013. The FSCs Lufthansa and SATA complete the top-5 in terms of market share in Portugal (Marques, 2011).

One could argue that a solution for competing with the LCCs in the European market could be the creation of a LCC dual brand, such as Iberia and Air France-KLM have done. Nonetheless, TAP’s Sales Director quotes a famous airline’s manager, who states “or you born as a LCC or you will never become a LCC”. He points out the example of Air France and Transavia as one of the biggest historical failures. He tells that after the merger with KLM, Air France decided desired to prepare for the future due to Ryanair and Easyjet Threat, but made the mistake of investing too much on aircraft fleet and human resources to operate the new aircrafts. This investment was supposed to make Transavia achieve

10% of Ryanair and Easyjet's market dimension. However, Air France's pilots were afraid of its contractual position because there was a reduction on the number of pilots at the FSCs, while the number at Transavia was increasing. Therefore, they decided to organize a 2 week's strike which cost €400M to the Group and stopped Transavia's market development. Barum's argument is that a LCC business model implies lower cost operations and different work conditions when comparing with FSCs. His position is very clear and he argues that, in the future, in Europe, only FSCs and LCCs will have its market position saved. There is no space for dual brands. However, Barum also acknowledges that Iberia and Vueling are a positive exception, but for different reasons. As he explains, Vueling has its hub in Barcelona and flies to all over the Europe at a low cost and under Iberia's brand. On the other hand, in Madrid, Iberia keeps operating under its own brand. Barum defends that what Iberia did was creating a LCC in order to fly from an airport (Barcelona) that it shouldn't be operated by Iberia because its hub is Madrid. Nevertheless, the Sales Director warns that there is still a large difference between Iberia and Ryanair or Easyjet, and on Airline's industry size really matters.

Regarding code-sharing agreements as a way to compete with LCCs, Barum defends a totally different perspective. He argues that this kind of operations represent some complementary value to a single point-to-point operation, namely when is a small Airline, such as TAP. Likewise, he claims that Star Alliance represents a lot for TAP as well as for the other FSCs because these agreements enable each airline within Start Alliance to complement its network and to improve their service. For instance, agreements with the Brazilian TAM or US Airlines give the opportunity to TAP of offering many more destinations in Brazil and US, rather than just the few routes that the Airline operate to these countries (Lourenço, 2008). In fact, the Sales Director explains that the impact on the results of these kind of agreements is larger as smaller is the dimension of the airline. He points out the example of TAP which does not flight to Bangkok or Asia. An agreement with Thai Airways International makes possible to TAP add this point to its network. In addition, it also gives the opportunity of attracting a client who wants to fly with TAP from Luanda to Bangkok rather than fly with South African Airways through Johannesburg. Furthermore, these agreements gain even more relevance concerning other external threats. As a matter of fact, 'TAP Annual Report' (2014) makes reference for the fact that in the future, non-European Airlines, namely in South America, may threat the strategic positioning that TAP has in key regions, such as Brazil and Africa.

Finally, regarding the future of Tap's business model, the company is aware that in order to face both short and long haul threats successfully, "fleet renovation needs to take into account the average overall factor", which is crucial to be increased (TAP Transportes Aéreos Portugueses SA in travel and tourism, 2014). Concerning the future of the European market, Barum argues that it is uncertain. First, all LCCs defend that they are the future and that they will dominate the long-haul too, which did not happen so far. Actually, he claims that in markets where the air traffic falls, LCC business model's performance shows weaknesses: some LCCs leave the market due to its low dimension and others engage on price wars with FSCs in order to keep what remains from its position. Then, the Hybrid Carriers claim that they are the most appropriate for the future because they manage to compete on both scenarios, i.e. long haul and short haul. On the other hand, FSCs defend that they will keep surviving as they have done during the last years of LCC growth. As the TAP's Sales Director concludes, the future will be determined by the market and its willingness to pay for a superfluous good, such as travelling. This will result from the evolution of society's behavior and improvement or not of its living standards, which are unpredictable.

3.4. Conclusions

After studying these three European Airlines and their different business models, it is possible to reinforce some of the conclusions found on chapter 2 regarding the main European business models.

First, Ryanair continues operating its paradigmatic and very successful LCC business model. Nevertheless, the LCC competition has been increasing and becoming stronger. The company's quick response to the several changes on consumer behavior and its ability to improve its internal organization without increasing its cost structure, will determine its success. Moreover, reproducing its original business model in long haul operations (Middle East and US) seems to be its future challenge in order to keep growing.

Second, Air Berlin's 'stuck in the middle' business model has not been profitable so far. Unless the hybrid carrier clarify its strategy, i.e., focusing on short point-to-point LCC or on long-haul operations as well as targeting business travelers or tourists, Air Berlin does not seem able to continue operating under this model. The partnership with Etihad Airways will be crucial for the company's future.

Finally, so that TAP Portugal's FSC business model can survive to LCC competition, the Airline must rely more and more on the triangle 'Portugal-South America-Africa', where the Portuguese Airline presents some competitive advantages.

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Interview

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Appendix

Table 1

Brand Shares (by Global Brand Name) | Historic | Retail Value RSP | % breakdown

Brand	Company name (GBO)	2008	2009	2010	2011	2012	2013
Western Europe							
Air							
Lufthansa	Deutsche Lufthansa AG	6,6	6,6	6,8	7,0	7,0	7,0
British Airways	International Airlines Group	-	-	-	4,1	5,0	5,1
Air France	Air France-KLM Group SA	5,2	5,2	4,8	4,8	5,0	5,0
Ryanair	Ryanair Holdings Plc	2,5	2,8	3,0	3,2	3,4	3,5
easyJet	Easy Group Ltd	2,1	2,5	2,7	2,9	3,1	3,3
Emirates Airlines	Emirates Group Plc	1,7	1,7	1,7	1,9	2,3	2,6
Air Berlin	Air Berlin Plc & Co Luftverkehrs KG	2,3	2,4	2,6	2,7	2,7	2,6
Swiss	Deutsche Lufthansa AG	1,4	1,6	1,8	2,1	2,1	2,1
Alitalia	Compagnia Aerea Italiana SpA	2,0	1,9	1,9	2,0	2,0	2,0
Iberia	International Airlines Group	-	-	-	2,1	2,0	2,0
Turkish Airlines	Turkish Airlines AS	1,7	1,7	1,9	1,7	1,9	1,9
KLM Royal Dutch Airlines	Air France-KLM Group SA	2,1	1,9	1,9	1,9	1,8	1,9
Virgin Atlantic	Virgin Group Ltd	1,6	1,4	1,6	1,6	1,7	1,8
SAS	SAS Group	1,3	1,2	1,3	1,5	1,6	1,7
Thomson	TUI Travel Plc	-	1,4	1,3	1,3	1,4	1,4
Norwegian	Norwegian Air Shuttle ASA	0,8	0,8	1,0	1,1	1,2	1,3
Austrian Airlines	Deutsche Lufthansa AG	-	1,2	1,2	1,2	1,2	1,2
Thomas Cook	Thomas Cook Group Plc	1,1	1,4	1,3	1,3	1,2	1,2
Vueling	International Airlines Group	0,4	0,5	0,7	0,7	0,8	1,0
Condor	Thomas Cook Group Plc	0,7	0,8	0,8	0,8	0,9	0,9
Finnair	Finnair Oyj	1,0	0,9	0,9	0,9	0,9	0,9
Aer Lingus	Aer Lingus Group Plc	0,9	0,9	0,8	0,8	0,8	0,8
Scandinavian Airlines Norge	SAS Group	1,1	0,6	0,8	0,9	0,9	0,8

Source: Euromonitor

Table 2**Company Shares (by Global Brand Owner) | Historic | Retail Value RSP | %
breakdown**

	2008	2009	2010	2011	2012	2013
Western Europe						
Air						
Deutsche Lufthansa AG	8,0	10,6	10,9	11,4	10,8	10,8
Air France-KLM Group SA	8,8	8,7	8,2	8,2	8,3	8,3
International Airlines Group	0,4	0,5	0,7	7,0	8,1	8,0
Ryanair Holdings Plc	2,5	2,8	3,0	3,2	3,4	3,5
Easy Group Ltd	2,1	2,5	2,7	2,9	3,1	3,3
SAS Group	3,5	2,2	2,5	2,7	2,8	2,8
Air Berlin Plc & Co Luftverkehrs KG	2,3	2,4	2,6	2,7	2,8	2,7
Emirates Group Plc	1,7	1,7	1,7	1,9	2,3	2,6
TUI Travel Plc	1,2	2,6	2,5	2,5	2,5	2,5
Compagnia Aerea Italiana SpA	2,0	1,9	1,9	2,1	2,1	2,1
Thomas Cook Group Plc	1,8	2,2	2,1	2,1	2,1	2,1
Turkish Airlines AS	1,7	1,7	1,9	1,7	1,9	1,9
Virgin Group Ltd	1,6	1,4	1,6	1,6	1,7	1,8
Norwegian Air Shuttle ASA	0,8	0,8	1,0	1,1	1,2	1,3
Qantas Airways Ltd	-	0,4	0,4	0,8	1,0	0,9
Finnair Oyj	1,0	0,9	0,9	0,9	0,9	0,9
Aer Lingus Group Plc	0,9	0,9	0,8	0,8	0,8	0,8
TAP SGPS SA, Grupo	0,7	0,7	0,8	0,8	0,8	0,8
SN Air Holding	0,7	0,6	0,6	0,7	0,7	0,7

Source: *Euromonitor*

Table 3

Top 10 LCCs 2012-2013 ASKs/week

Airline	Nov 2012 (million)	Nov 2013 (million)	% Growth 2012/2013
Southwest Airlines	3261	3443	5.6
Ryanair	1439	1927	33.9
easyJet	1057	1262	19.4
JetBlue Airways	1265	1253	-0.9
Gol Transportes Aereos	880	924	4.9
Lion Airlines	788	865	9.7
Westjet	663	697	5.1
Jetstar Airways	682	661	-3.0
Norwegian Air Shuttle AS	484	615	27.0
AirAsia	585	596	1.9

Source: *Innovata***Table 4**

Aircraft Orders of Selected Airlines with Boeing 2013

Airlines	Aircraft type: 737
Ryanair	175
WestJet	75
Southwest Airlines	55
Alaska Airlines	5

Source: *Boeing*

Table 5**Airbus orders 2013**

Airline	A319	A320	A321	A330-200	A330-300	A350-800	A350-900	A380	TOTAL Orders
Air Arabia		44							44
AirAsia		475							475
Air Berlin	13	54	18						85
Air One		26							26
easyJet	172	208							380
Indigo		260	20						280
Interjet		60							60
Jetblue Airways		183	30						213
Kingfisher Airlines		26	6	20		5		5	62
Lion Air		169	65						234
Norwegian		100							100
Spirit Airlines	7	98	30						135
Tigerair		58							58
Volaris	11	63							74
Vueling		62							62
Wizz Air		86	26						112

Source: *Airbus*

Table 6**Website Performance of Major LCCs Worldwide 2013**

Site	Estimated Visits, October 2013	Page Views per Visit	Leading Country (% Share of Total Web Visits)
Ryanair.com	22.4 million	3.2	UK (23%)
AirAsia.com	16.2 million	8.2	Malaysia (28%)
easyJet.com	15.2 million	5.7	UK (36%)
Southwest.com	15.1 million	7.5	US (97%)
Wizz Air.com	8.2 million	5.8	UK (23%)
Jetstar.com	6.6 million	6.2	Australia (34%)
Jetblue.com	6.4 million	7.7	US (88%)
Voegol.com.br	5.6 million	6.3	Brazil (96%)
Lionair.co.id	5.0 million	8.4	Indonesia (92%)
Voeazul.com.br	4.8 million	2.3	Brazil (97%)

Source: www.skift.com November 12, 2013

Table 7

Brand (GBO)		2008	2009	2010	2011	2012	2013
Air							
Austria							
Air Berlin GmbH & Co Luftverkehrs KG							
Air Berlin (Air Berlin Plc & Co Luftverkehrs KG)	Average Price Per Passenger (Local currency)	78,9	80,8	86,4	92,3	92,4	92,4
Air Berlin (Air Berlin Plc & Co Luftverkehrs KG)	Average Price Per Passenger (US\$)	115,4	112,3	114,5	128,3	118,7	122,7
Air Berlin (Air Berlin Plc & Co Luftverkehrs KG)	Number of People ('000)	1.600,0	1.500,0	1.400,0	1.300,0	1.344,5	1.389,0
Austrian Airlines AG							
Austrian Airlines (Austrian Airlines AG)	Average Price Per Passenger (Local currency)	208,3	-	-	-	-	-
Austrian Airlines (Austrian Airlines AG)	Average Price Per Passenger (US\$)	304,9	-	-	-	-	-
Austrian Airlines (Austrian Airlines AG)	Number of People ('000)	8.397,8	-	-	-	-	-

Source: *Euromonitor*

Table 8

Case Study Airlines – Operational Data, 2011

Airline	Annual profit (loss) € million	Load factor %	Countries/ destinations	No. of aircraft (June)	Daily flights	Employees	Passengers (million)
Air Berlin	(97.2) [*]	79	34/171		1,567	9,209	35.3
easyJet	292.5 ^{**}	87.5	30/130	203	1,260	7,571	55.5
Ryanair	401.0	82.2	27/162	272	1,300	8,063	72.0
Vueling	10.4	75.6	20/110	48	253	1,438	12.3

* 2010 ** based on 1.17 (£/€) exchange rate

Source: Harvey and Turnbull (2012)

Table 9

Utilization of short-haul and long-haul aircraft

Airline	Boeing 737/ Airbus A320 daily utilization hours	Europe passenger load factor (%)	Boeing 747-400 daily utilization hours	Long-haul passenger load factor (%)
Air France	8.3 (A320)	63	14.5	81
British Airways	8.0 (A320)	68	12.9	77
British Midland	8.6* (A320)	67		
KLM	7.4 (737-300)	75	15.5	84
Lufthansa	8.4 (A320)	69	15.2	83
Virgin Atlantic			13.9	78
EasyJet	11.8* (737-700)	77		
Buzz	11.3* (737-300)	75		
Air Berlin	10.5 (737-800)	74		
Germanwings	na	82		

Source: Francisa, Dennis, Ison and Humphreys (2007)**Table 10**

TAP Transportes Aéreos Portugueses SA							
TAP Portugal (TAP SGPS SA, Grupo)	Average Price Per Passenger (Local currency)	126,1	116,7	118,0	115,5	106,8	104,7
TAP Portugal (TAP SGPS SA, Grupo)	Average Price Per Passenger (US\$)	184,6	162,2	156,3	160,6	137,3	139,0
TAP Portugal	Number of						
(TAP SGPS SA, Grupo)	People ('000)	8.614,6	8.550,1	9.120,8	9.811,2	11.005,8	11.670,9

Source: Euromonitor