Long-haul LCCs Gain Momentum

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Low-cost long haul, a business model well-established in Asia, has been slower to take off in other regions, with doubts about profitability lingering, for example, over Norwegian Air Shuttle's ambitious expansion plans. But modern fuel-efficient aircraft are giving innovative carriers a better chance of success, and the momentum is picking up.

Low-cost longhaul has reached relative maturity in the Asia-Pacific region, with carriers such as AirAsia X, Scoot, Cebu Pacific, Jetstar Airways and Jin Air all operating widebody jets on longer routes. Others, including VietJet, are planning their own entry into widebody long-haul operations.

Asian long-haul LCCs are well-established; other regions ARE catching up
Doubts remain over Norwegian's ambitious growth plans
Demand for long-haul LCCs is driven by growth in leisure travel

The AirAsia X group has been something of a standard-bearer and now operates a fleet of 31 Airbus A330s. It sent an emphatic signal by reconfirming an order for 66 A330neos and adding another 34 during the Farnborough Airshow in July. AirAsia X Group co-CEO Tony Fernandes notes this "shows how much faith we have" in the low-cost long-haul business.

Selecting the 251-metric ton maximum takeoff weight version of the A330-900 will allow AirAsia X to extend nonstop flights from Southeast Asia to Europe. Singapore Airlinessubsidiary Scoot already operates services to Europe, launching flights to Athens, Greece, and Berlin using Boeing 787s.

Many of the long-haul low-cost carriers (LCC) are subsidiaries of legacy carriers, and Japan Airlines (JAL) is looking to add another, announcing its intention to launch a long-haul LCC subsidiary that will also offer full-service options in a hybrid approach, beginning operations with two 787-8s. JAL established a corporate entity with the interim name TBL (To Be Launched) and will establish an executive management team in August, allowing launch preparations to begin, an airline spokesman says. The actual name of the airline and branding likely will be announced early in JAL's 2019 fiscal year, which begins in April 2019.

The development of long-haul LCCs means this sector is "rapidly approaching mainstream status," says Andrew Drysdale, executive director of Mentor Aviation Services. Airlines in this category have tripled their share of international seat capacity over the past four years, he said at the CAPA Australia Pacific Aviation and Corporate Travel Summit in Sydney. They are increasingly seeking opportunities in "price-sensitive" markets and serving "long, thin routes [between] city pairs" where legacy carriers cannot operate economically.

Norwegian's rapid growth is sparking doubts. Credit: Norwegian Airlines

New, more fuel-efficient widebody aircraft types are making long-haul LCCs more viable, Drysdale says. Jared Simcox, Scoot's general manager for Australasia, agrees the introduction of such aircraft is an advantage for the LCCs. Scoot and other relatively young airlines can build their fleets with new-generation widebodies, not only giving them fuel-efficiency benefits but also allowing them to configure new deliveries to incorporate the ancillary products passengers want.

For now, long-haul LCCs lag their short- and medium-haul counterparts when it comes to ancillary revenue share, partly because achieving a higher proportion of ancillary revenues is always going to be more attainable for a short-haul LCC offering lower fares.

Jay Sorensen president of product, partnership and marketing practice at IdeaWorks Co. and author of an annual report ranking global airlines' ancillary revenues, notes that in its 2017 report, Reykjavik, Iceland-based Wow Air—"an ancillary revenue powerhouse"—

is the only low-cost long-haul carrier among the top 10 LCCs for ancillary revenues as a percentage of overall revenues. It chalks up 28.5% of its total revenues from the extra changes helped by the new Wow premium offering aimed at enticing business travelers, including priority at the airport, flexibility, two checked-in bags and extra-comfortable "BigSeats."

The carrier's network extends as far as New Delhi to the east and San Francisco to the west; it operates an all-Airbus fleet including A330-300s and A320-family and A320neo-family aircraft.

"The two major activities for long haul carriers to focus on are baggage and seats. . . . Getting those two areas right will make all the difference revenuewise," Sorensen says.

The latest aircraft and seat designs allow LCCs to offer a more comfortable trip on long-haul services, Simcox says, and while LCCs aim to provide a range of unbundled service options, they must "meet the fundamental needs" of passengers on longer flights, such as arriving without a sore back.

Investing in quality seats is important so passengers can fly comfortably "even when [selecting] the most basic of options," says Cebu Pacific Chief Operations Advisor Rick Howell. Cebu has a large narrowbody fleet, but also operates A330s on short-haul routes and to long-haul destinations Dubai and Sydney, with flights to Melbourne, Australia, launching in August.

JAL recognizes there is a segment of travelers that cares most about a high-quality product and another that prioritizes cost, says Akihide Yoguchi, the carrier's vice president for marketing and strategy research in the Asia/Oceania region. JAL is looking to capture market share between the two extremes with its new long-haul LCC subsidiary, he says.

Long-Haul LCC Fleets

OPERATOR	IN SERVICE	ON OPTION	ON ORDER
AirAsiaX	22	10	110
Cebu Pacific Air	49	8	34
French Bee	3	—	—
Jetstar Airways	70	169	99
Jin Air	24	—	—
Norwegian Air Shuttle	77	10	196
Scoot Tigerair	45	11	41
VietJet Air	53	30	178
Wow Air	20	—	4
XL Airways France	4	—	—
Source: Aviation Week Fleet Discovery			

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Long-haul LCCs still face many challenges entering new markets. Howell says there was a lack of marketing support from Australian tourist authorities when Cebu Pacific launched flights to Sydney in 2014, despite the size of the inbound market. Another problem is that the cost of a visa for a Filipino to enter Australia can be greater than the cost of a Cebu ticket including airport taxes.

Elsewhere, the long-haul LCC model has been slower to take off—the U.SA., for example, does not yet have its own long-haul LCC operator. That is set to change next year with the relaunch of World Airways, backed by a new investor.

"The low-cost long-haul model is in principle possible, but also more challenging to execute well than the short-haul low-cost model," says Loizos Heracleous, professor of strategy at Warwick Business School.

While long-haul LCCs can manage only 15-20% in cost savings compared with their full-service competitors, a smaller gap than their short-haul counterparts can achieve, these savings are "still significant," he says.

“It would be inevitable for long-haul LCC carriers to engage in alliances and in internal processes aimed at increasing ancillary revenues, invest in marketing and branding and select the right routes to achieve high load factors, and continue to be ruthless in cost-cutting.” He adds, “The demand for low-cost long-haul travel would be there if the price is right and if the flying experience is bearable.”

In Europe, skepticism about the business model remains. Norwegian Air Shuttle dominates the long-haul LCC segment in Europe, but a rapidly growing network and fleet—it placed a massive order for 222 aircraft, split between Airbus A320neos, Boeing 787 MAX8s and 787-800s in January 2012—not to mention mounting debt and load factors that have failed to keep up with the pace of growth in recent years, have caused observers to question the sustainability of the carrier’s strategy, particularly given of rising fuel prices.

“Norwegian’s growth is damaging the company, as it pivots away from its profitable Nordic core and toward a long-haul low-cost business model, which we estimate is losing €20,000-25,000 ($23,000-$29,000) per flight,” Bernstein analyst Daniel Roeska wrote in a research note initiating coverage of the stock in June.

A second-quarter profit of 300 million Norwegian krone ($36 million), announced in July, up from a loss of 691 million krone a year earlier—a turnaround due to lower unit costs—and CEO Bjorn Kjos’ insistence that growth would slow in line with Norwegian’s strategy—did little to reassure Roeska. He cautioned that losses and gains related to nonoperational issues were included in the cost reduction, and while maintenance costs were flat they could rise again later in the year.

Even if Norwegian radically reins in its growth plans, reviews its strategy, trims its fleet, optimizes its route portfolio and clamps down on costs, it will remain loss-making for the next four years and require 12-14 billion krone in financing, Roeska estimated.

But if Norwegian’s ambitions provide a cautionary tale on the perils of being overambitious, network carriers and new entrants alike are still keen to tap the potential of low-cost, long haul, acknowledging that lower ticket prices are stimulating new demand rather than taking it away from existing sectors.

At the recent Paris Air Forum, Marc Rochet, president of French Bee, which operates low-cost flights between Paris and Punta Cana, Dominican Republic, Tahiti and the French Indian Ocean department Reunion, with an Airbus A330-300 and A350-900 fleet, said any lingering doubts over the feasibility of low-cost long haul were unjustified.

“People say the same things about low-cost long haul today as they did about low-cost short- and medium-haul [service] 25 years ago: It won’t work, it can’t work. It is OK to get it wrong, but it is not OK to be in denial.”

A simple look at the numbers demonstrates why long-haul LCCs are here to stay, Rochet says: “Air transport is doubling every 15 years, and 80% or more of the clientele, especially in long-haul, are traveling for leisure. For them, the No. 1 motivator is price, because they are traveling for personal reasons but also are not traveling alone.”

Rochet adds, “I am absolutely convinced that low-cost long haul has a great future. I don’t know whether low-cost will eventually represent 35% of the long-haul market or 40% or 50%, but I do know it will be successful.”

That success will depend on two fundamental factors, according to Rochet. Given the importance of pricing to the potential customer, “We need a lot of innovation—low-cost will not work with old equipment. And we need courage—a lot of elements have to be called into question.”

Laurent Magnin, CEO of XL Airways, which operates mainly to destinations in the U.S. and Caribbean and recently launched a flight to Jinan, China, sees the rise of long-haul LCCs as a sign of a broader change in the global aviation industry, which “has been dominated for half a century by business travelers who were not paying for their own tickets,” he says. “There will always be business class, but now we have a billion people saying to us ‘any more than €500-600 return for an economy ticket is daylight robbery.’”

Industry analyst John Strickland, director of JLS Consulting, cites International Airlines Group (IAG) as a company that has significant growth ambitions in the segment and has made a positive start with Level, the Barcelona,Spain-based LCC that made its first flight in June 2017.

IAG also wants to take over Norwegian, which would significantly increase its low-cost long-haul activity, Strickland says. But with two takeover offers rejected so far and IAG CEO Willie Walsh saying the group will not hold on to the 4.6% of Norwegian shares it owns if it can’t take it over, as much uncertainty hangs over the two companies’ relationship as over Norwegian’s own strategy.

For now, Level is growing on its own, starting flights from Paris Orly Airport to Montreal and the French Carribean island Guadeloupe last month, as well as launching short-haul operations from Vienna.

Strickland believes European network carriers have recognized the huge potential of low-cost long haul but agrees teasing out profitability is not easy. “Stand-alone long haul LCCs have faced substantial difficulty in achieving sustainable financial returns,” he says.

But with huge growth potential up for grabs, more long-haul LCCs are likely to enter the market. “The success of carriers such as AirAsia X and Jetstar shows the business model can work if executed well,” adds Heracleous. “It is just a matter of time before the model spreads around the world.”

But to avoid Norwegian’s woes, would-be long-haul LCC success stories need to appeal to business travelers and must have a strong connecting network. While cost advantages from technologically advanced aircraft with dense cabin configurations will not be as significant as in short-haul, filling lower-demand routes will be a challenge, says Roeska.