

FLAG CARRIERS: SHOULD WE PRESERVE THEM?

PEDAGOGICAL CASE STUDY OF MALÉV HUNGARIAN AIRLINES

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Project submitted as partial requirement for the conferral of

Master in International Management

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October 2013

Acknowledgments

Completing a master course is a difficult challenge in anybody's life who decides to follow up their academic studies. Writing my master thesis was one of the most difficult challenges I faced in all my academic years, which is why I would like to express my gratitude to those who helped me throughout this long process.

I would like to give my special thanks to my Supervisor, Professor Antonio Robalo, who guided me on the right path of developing the topic of this dissertation, which was very dear to me, given the fact that I could work with a theme from my home country, Hungary.

I would like to thank to all dear colleagues of mine from the MIM 2011-2012 edition, you all contributed to my life, one way or another. I will always keep you all in my hearth!

And last but not least, I would like to give special thanks to the best husband on the world, Sérgio Vera Pedro. Thank you very much for all your support, for all your help, and patience you had in these past couple of months! I could have not done it without you!

Table of Contents

Acknowledgments	i
Table of Contents	ii
Abstract	iii
Resumo	iv
Presentation of the Case	1
Introduction	2
The Case	3
The History of Malév Airline	5
Low Cost Carriers and their expansion over national carriers	9
Summary	11
Questions	11
Annexes	12
Methodology	23
Personal motivations and relevance of this study	23
Research Methodology	23
Thesis Structure	24
Pedagogical Note	25
Teaching Objectives	25
Methodology	25
Literature Review	26
Analytical Tools	30
Analysis of Questions	34
Management Conclusion	53
Bibliography	55

Abstract

This pedagogical case study is dedicated to show the recent changes in the airline industry, whereby the majority of the so-called ‘flag carriers’ disappeared, either through privatization or bankruptcy. This is due to lack of capacity to adapt to a new environment, by which network carriers and low cost carriers are fighting with continuous cost reduction and business model changes in order to attract more passengers. Recent studies show that the model of low cost carriers is more suitable in the short haul markets, through which carriers can focus on point-to-point execution rather than network fares. Therefore, network carriers are being forced to re-evaluate their way of service with a result of a new model adapted from the low cost carriers. The case study will present the incident of Malév, the Hungarian flag carrier, focusing on the steps that lead to bankruptcy, and analysis of the competitors’ strategic movements occurred right after its official stop of operations on February 3rd, 2012.

Keywords: Airline, Flag carrier, Hungary, Low cost carrier, Network carrier

JEL classification: **H760** State and Local Government: Other Expenditure Categories, **L930** Air Transportation

Resumo

O âmbito deste estudo de caso é mostrar as recentes mudanças no sector da aviação, evidenciadas pelo desaparecimento, por privatização ou falência, da maioria das chamadas ‘companhias de bandeira’. Este facto deve-se à falta de capacidade de adaptação a um novo ambiente, onde as companhias áreas lutam por uma contínua redução de preços e mudanças no modelo de negócio, de modo a atraírem mais passageiros. Estudos recentes demonstram que o modelo de negócio das companhias *low cost* é mais apropriado para o mercado de curto e médio curso, onde as companhias se podem focar na execução *point-to-point* ao invés das tarifas de rede. Deste modo, as companhias de rede têm sido forçadas a reavaliarem os serviços oferecidos, adaptando um modelo de negócio semelhante ao das companhias *low cost*. O caso de estudo apresentará o incidente da companhia área de bandeira húngara Malév, centrado-se no caminho percorrido pela mesma e que a levou à falência, e análise dos posicionamentos estratégicos dos concorrentes, que ocorreram logo após o término oficial das operações, a 3 de Fevereiro de 2012.

Palavras-Chave: Companhias aéreas, *low cost*, companhias de rede, companhias de bandeira, Húngria.

Classificação de *Journal of Economic Literature* (JEL): **H760** State and Local Government: Other Expenditure Categories, **L930** Air Transportation

Introduction

The aviation market is by far one of the most complex in the commercial transportation sector. If, in one hand, we have big major players, the so called Network Carriers, or NCs, in other hand, we have the Low Cost Carriers, or LCCs, which are gaining increasingly more terrain all over the world. The greatest change happened in the 90's and continued in the 2000's, with several deregulation processes of the aviation market globally. With this move, the dices were played, and the industry would never be the same again.

This pedagogical case study is dedicated to show the recent changes in the airline industry, whereby the majority of the so-called 'flag carriers' disappeared, either through privatization or bankruptcy. This is due to lack of capacity to adapt to a new environment, by which network carriers and low cost carriers are fighting with continuous cost reduction and business model changes in order to attract more passengers. Recent studies show that the model of low cost carriers is more suitable in the short haul markets, through which carriers can focus on point-to-point execution rather than network fares. Therefore, network carriers are being forced to re-evaluate their way of service with a result of a new model adapted from the low cost carriers.

In order to support these changes with a theoretical and practical background, later on in the Pedagogical section the reader will be able to gain a better understanding of the airline industry, using Porter's Five Forces model; to see how different market entry strategies play a role among competitors; and to have a practical approach on the recent changes in the business model of network carriers on the short haul flights.

The pedagogical case study will present in details the incident of Malév, the Hungarian flag carrier, focusing on the steps that lead to bankruptcy, and analysis of the competitors' strategic movements occurred right after its official stop of operations on February 3rd, 2012.

Presentation of the Case

The aviation market is by far one of the most complex in the commercial transportation sector. If, in one hand, we have big major players, the so called Network Carriers, or NCs, in other hand, we have the Low Cost Carriers, or LCCs, which are gaining increasingly more terrain all over the world. The greatest change happened in the 90's and continued in the 2000's, with several deregulation processes of the aviation market globally. With this move, the dices were played, and the industry would never be the same again. LCCs increased their market share, with the network carriers (flag carriers) struggling to survive, either through privatizations, or with mergers. Some eventually fell apart, with governments battling to keep companies alive. One of the recent and yet famous case is the Malév Hungarian Airlines'. Let us see in deeper perspective the history and story behind this former airline.

Malév Hungarian Airline (Malév) was established in 1946 as the Hungarian-Soviet Joint Stock Company. Apart from being the national flag carrier for Hungary, the company became famous for the continuous and frequent changing ownership issue, which reflected the Hungarian Government's struggle upon letting go the past and taking advantage of the window of change, brought by the LCCs to Europe. After being privatized and later on renationalized twice, the airline ceased its operations in February 3rd, 2012.

The purpose of this case study is to present the changing tendencies in European airline industry, particularly the disappearance of big national flag carriers; the struggle of NCs against the expanding LCCs; and to provide a hint for the future inclinations to come in the airline industry.

The case will focus on the recently ceased Malév Hungarian Airline as an example, so that we can better understand what internal and external factors lead to the fall of Hungary's national flag carrier and to learn what conclusions other airlines can take out of this example.

The Case

One of mankind's greatest inventions which changed our travel habits forever was the invention of airplanes. In fact, the breakthrough for commercial aviation started after the Second World War in Europe, when the first commercial airplane routes were set up. Today's air travel has become so common that it would be hard to imagine our lives without it. The airline industry therefore changed the way we live and do business by offering shorter travel time and creating a new concept of distance, when compared to classic means of transportation. The airline industry exists in a competitive market, which has been an ever-changing area and where the volume of passengers increased despite the always-recurring recessions and terrorist attacks all over the world. According to International Air Transport Association (IATA)'s Fact Sheet (1), in 2012 the statistics showed 542 million passengers and the forecast for 2013 states 572 million passengers worldwide. Despite the fact that in the last decades the volume of air travel has expanded exponentially, the industry itself shows low profitability in general compared to other industries. Even so the average EBIT (earnings before interest and taxes) margin generated by airlines in the 2000s was 0.7%, some of the airlines still managed to generate an excess of 8% of EBIT (2). By looking at the numbers one can find that there are no specific characteristics what could be applied to every successful airline and find as common success factor. No matter the size of the fleet, the business model they use or geographical pointers, in every segment we can identify profitable airlines. Such airlines who managed to find a special niche in their sector, or create a strong brand image are airlines like the high class service provider Emirates Airlines, the costs cutting Ryanair or the semi-privatized flag carrier of Russian Federation, Aeroflot.

In Figure 1 we can find examples for some of the successful airlines by their EBIT margin.

In order to sustain this incredible growing number of passenger traffic, airport development is needed all over the world. Throughout the years airports got closely attached to the airlines, as some of the successful airlines could not arise without a successful base airport. In 2012 (3), the top five busiest airports were: Hartsfield–Jackson Atlanta International Airport with a nearly one hundred million passengers per year, Beijing Capital International Airport, Heathrow Airport in

London, Haneda International Airport – Tokyo and O'Hare Airport in Chicago with a number of 67,091,391 passengers.

Budapest Liszt Ferenc Airport (BUD) is Hungary's biggest international airport and one of the largest among the new member states (after 2004) of European Union (EU). Hungary is situated in center-east Europe giving a strategic location to serve as a connecting spot between the East and West. The airport offers international connections mainly to destinations in Europe, Africa and Middle East. The airport is located 16 km away from the capital city, and originally was constructed for military purposes in 1943, but in 1947, it was reconstructed to serve civil aviation.

During the first years of the airport's operation, the airlines operated only a few international flights mainly to neighboring countries, but when the Hungarian Airline (Malév) was established in 1956 the growth in yearly traffic began to increase. In the next four years, the number of landings at Hungary's single international airport has increased from 4,786 at opening to 17,133 and in passenger traffic from 49,955 to 359,338.

In 1980 the number of landing aircrafts and passenger traffic reached, respectively 32,642 and 1,780,000 passenger, which called for more capacity, and with that, the construction of a new terminal was called upon. From November 1st, 1985, passengers had been received in Terminal 2A, which was mainly operating flights for Malév, Lufthansa, AirFrance and Swissair. The old terminal continued to receive the remaining airline traffic under the name of Terminal 1. The construction of Terminal 2B had started in 1997. When this terminal started operating, it added 3.5 million passengers of additional passenger traffic a year, with its seven gates and five remote stands. Once Hungary became a member of the European Union in 2004, the terminals were divided up strategically: Terminal 2A, continued to serve high class traditional airlines such as British Airways, Air France or KLM who operated flights between the Schengen zone; Terminal 2B was dedicated for flights which were to outside of the Schengen zone and Terminal 1 was used only for LCC operated flights.

In Figure 2 we can see the percentage of flights operated by airlines at BUD before the bankruptcy of Malév

In the late 90s early 2000s, the aviation industry was experiencing a high boost of passenger traffic which also arisen at Budapest Airport - within 1998 and 2005 alone, passenger figures at BUD doubled – from 3.9 million to 7.9 million. The present numbers called for a new major investment in the life of the airport. (4)

The Hungarian State, sole owner of the airport decided for a partial privatization. The integration of a private strategic partner with international experience was expected to have a positive effect on the future development of the airport and was hoped to provide new transport connections to the city, new car parking and shopping facilities, new terminal capacities and a quicker and better service. In 2005, the State's privatization agency initiated a tender for a concession. 75 percent of Budapest Airport Zrt.'s shares were given to the British company, BAA Limited, owner and operator of British airports.

In 2007 there was a change in the management when the new owner of BAA decided to sell its complete shares to the German group HOCHTIEF and three financial partners.

In March 2011, the name of Budapest Ferihegy International Airport was changed to Budapest Ferenc Liszt International Airport, in honor of the 19th century Hungarian composer.

Sky Court, the new expansion project including shops, restaurants and lounges, and also connecting inside Terminals 2A and 2B, was opened on March 27th, 2011. In the summer of that year, the refurbishing of the old terminal parts in Terminal 2 began and was completed in 2012. BUD served as a hub airport for Malév airlines until February 2012.

The History of Malév Airline

The history of the airline began in 1946 with the creation of the Hungarian-Soviet Civil Transport Joint Stock Company (MASZOVLET). After the 1956 revolution in Hungary against the Soviet occupation, Hungary acquired all the Soviet shares of MASZOVLET, and thus, Malév was born. Still in 1956, Malév had its first international flight, to Wien in Austria. Since 1969 Malév stopped its domestic operation, concentrating exclusively on international operations. In 1984 Malév became a member of IATA.

The fall of the Iron Wall and, consequently, the democratization of countries in the east bloc, where Hungary was inserted, brought a newly established democratic government, which joined to the ongoing tendency of privatizing state owned companies in Europe (e.g. British Airways 1987) and offered Malév for partial privatization. In 1992 an Italian public consortium of Alitalia and Simest bought 35 percent of the airline's shares and together with Malév became a joint stock company. This privatization attempt failed, for reasons we still do not know, as the Hungarian government never released the official document regarding this matter. In 1997 two Hungarian privately owned banks (MKB and OTP) bought 35 percent of Malév shares. Due to political reasons, in 1999 the Hungarian government decided to renationalize the airline and buy back its shares up to 97 percent of ownership.

In the following years, due to economic changes in Hungary, the government had no choice but to privatize the airline again, in order to ease its worsened monetary performance. According to the report done (5) by the Ministry of National Development, at the end of 2006, the airline has been at the edge of bankruptcy. However the government in office refused to assume the political and economic consequences of Malév's possible bankruptcy. The airline with its current characteristics, organizational and operating problems and financial standing was not an attractive investment for professional strategic investors. After several attempts starting from 2000, in 2007 AirBridge bought 99.95 percent of Malév's shares from the government.

During the privatization process the Hungarian government failed to perform an authentic verification and request of professional competence and financial standing certifications from AirBridge. According to the report this can be explained by the fact that the government's only aim was to get rid of the airline at all cost within the shortest period. The privatization agreement was for an amount of EUR 102 million what AirBridge paid through a credit asked from Russian Vneshekonombank. In other way, the buyer in this privatization practically did not invest or risk any money on his own.

With the financial crisis in 2008, AirBridge was incapable of meeting its payment obligations toward Vneshekonombank. In addition to operation, AirBridge also had obligations under the privatization contract, including repayment of the loans granted to Malév prior to the privatization. Malév throughout the years managed to collect a reasonable debt from the continuous money injections from Vneshekonombank, what by 2010 reached an amount of EUR

112 million.

At this moment the company was close to bankruptcy, but the Hungarian Government, due to patriotic feelings, decided to save its flag carrier and in February 2010, Malév was re-nationalized again with a use of state aid process confirmed by the European Commission. With this step the government officials seriously debited the country's budget, while shifting the pressure of long-term problem solution to the next government.

In Figure 3 we can follow the changes of ownership between the periods of 1946-2012

Malév at this point was already not bringing profit for the past 10 years. In 2008, Malév was with an amount of total financial debt higher than the complete assets of the company. By 2010, the total financial debt of the company reached a level of € 232 million. In spite of numerous capital increases by the Hungarian government the shareholder's equity has been negative since 2006.

In Figure 4 we can follow the profit changes of different airlines by PAX

As Malév was struggling with its own financial situation, worsened by the global economic crisis and the increased competition in the European aviation industry, the Hungarian government decided to issue state aid to rescue the company from collapse. It could be argued, that at this point, the Government should have let Malév fall, instead of injecting more capital into the already dying company.

When in 2010 the Hungarian Government used a state aid program in order to rescue Malév, its competitor, Wizzair had filed a complaint at the European Commission on the basis of use of illegal aid. The EC's competition law (6) forbids governments to hand out state aid. As a response Hungary proposed a restructuring program of Malév to the European Commission. Wizzair attacked this move as well, with a result of an official state aid investigation against Hungary by the European Commission.

In Figure 9 we can find the extract from the European Commission on competition legislation.

The investigation by the European Commission concluded in January 2012 that the state aid program was against the rules of the European Union as Malév would not have been able to obtain similar financing from the market on the terms given by the Hungarian Authorities. Thus the European Commission sentenced Malév to pay back all the state aid funds received between the period of 2007 and 2010. Summing up the debt before the renationalization and the state aid

program, Malév faced a value of 100 thousand millions Forints (€ 340 million), which was the final sentence on the airline. (7)

The Hungarian government issued a committee of liquidation of the airline and on February 3rd, 2012, Malév ceased operations, officially leaving 60 thousand millions Forints (€ 205 million) in debt (8).

During its business life, Malév operated around 50 destinations in 35 countries in Europe and Middle East, mostly with short haul routes, including OneWorld hubs such as Amman, London Gatwick, Madrid and Helsinki. Malév had an ideal geographic position to play as a hub position in the region. Its schedule network offered good opportunities for transfer between East and West, North and South. Budapest, as Malév's base, played an important role for transferring passengers towards the Balkans. The connection towards the Balkan region ever since of the disappearance of Malév was not reestablished by any other airline, therefore passengers travelling to Serbia, Bulgaria or Croatia might as well need to take 3 different stops in order to reach their destination.

In Table 1 - Passenger traffic at Budapest airport 2007-2013. Cells marked with red refer to Q1, which is the quarter when Malév bankrupted (Q1 2012). Source: Eurostat. and Table 2 - Budapest Airport passenger traffic on a monthly based (January 2011 - June 2012). Source: Eurostat. we can see detailed passenger flow data about the yearly/monthly at Budapest Airport

In Table 3 - International extra-EU air passenger transports between Budapest and each reporting country. Source: Eurostat. we can see the example of passenger flow changes among the Balkan area

Although Malév, with its flights, played an important role in the volume of flights towards the Balkan area, one cannot miss the fact that this particular market is still far from being developed, and that is the reason why no other carrier claimed to take over the routes to this area.

In Figure 5 we can see the routes operated by Malév

Malév's bankruptcy turned the LCC's penetration rate in Hungary upside down. Prior to 2012, the rate was relatively low with 24%. Following Malév's grounding, the LCC's rate in Hungary raised up instantly to about 51% (9). Previously, Budapest differentiated between its low cost and traditional offerings by using two separate terminals, whereas Terminal 1 was used for LCCs

and Terminal 2A/2B for network carriers. Currently, with the sudden change of LCC's penetration rate, the airport management decided to close Terminal 1, and at the end of May 2012 located all its operations to the recently renovated Terminals 2A and 2B.

In order to better understand the abrupt increase in the LCC's penetration rate, one has to look to the moves of each carrier. For instance, AirBerlin, an OneWorld alliance member, rapidly came on board and started its operations within few days. WizzAir, the low cost Hungarian airline, who before Malév ceased operations hold 10% of the airports capacity share, gained the most out of the new situation in Budapest airport - as they won the right for operations on routes like Kiev or Tel Aviv, and they became the first low cost operator in Europe with their weekly 4 flights to Dubai World Central. Ryanair quickly set up a new base, expanding with five aircrafts within two months. The response was so aggressive that there was a huge surge in capacity and within six months Budapest had restored 80% of its point to point traffic.

*"It surpassed our wildest dreams. We over performed against our revised plan. It was fantastic.
If anything, there was overcapacity, causing a price war."*

Kam Jandu (Budapest Airport aviation director) (10)

After a year of carriers fighting for position, Budapest airport found its stable point, where operations are now sustainable. The previsions for the year 2013 are to keep passenger numbers around a stable 8.5 million. Budapest airport is now one of the examples of Europe's airports, which can prove that LCCs and privately owned companies (NCs) can over take the business of the traditional flag carriers.

Low Cost Carriers and their expansion over national carriers

Not so long time ago, in the 80s and 90s, if you looked around one of Europe's airport the sight of the tailfins was an exhibition of different nations flag display. Airports were serving mainly flag carriers as they ruled the market of aviation. British Airways, Swiss Air, Air France, Alitalia and many others were coloring the skies of Europe. Network Carriers (NCs) were typically owned by their government (flag carriers), who were not so much prepared to run a business, but more to "wave the flag" around the world. In the early 2000s, a dramatic change set motion in

the European aviation industry once the NCs started to reduce capacity. As an example, whereas British Airways (BA) was maintaining its short haul business fares and reducing capacity for leisure travellers, Ryanair and Easyjet reduced their fares and strengthen their forces on increasing capacity. For instance, Easyjet took opportunity to establish its largest base at Gatwick airport (UK's 2nd major airport), while BA was reducing its capacity at that airport.

In a profit driven world, network carriers had no longer the power of fighting off the price cutting tactics of LCCs and soon the era of Ryanair and Easyjet began. Nevertheless of consumers' needs shift, most of the governments continued to think about their national carriers as they were maintaining the idea of flag carriers instead of profitable business investments. Ryanair and Easyjet both started out in the UK, and applied their low cost business model successively around Europe without attaching to them any patriotic identity.

This example involves the Hungarian government and its struggle to keep Malév in the air, even so the wings of the airline were already "half broken". Other great example is the case of the Italian government and Alitalia. The company, just as Malév, was wracked by losses and industrial strife, and went bankrupt in August 2008. But not like Malév, Alitalia had more than political will behind, and got resurrected when Compagnia Aerea Italiana (CAI), a consortium of Italian investors, paid € 1,052 thousand millions, injecting €427 million in capital and taking on €625 million of Alitalia's debts (11). Although Alitalia has been saved, the point is well made when we reflect that today the biggest airline in Italy is Ryanair.

In 2007, a study by Alamdari and Mason (12) was presented to the European Commission, predicting the following changes to occur till 2015 in the European Aviation:

- They predicted that due to full concentration of the network carriers, around five large European airlines would be still standing. The concentration will occur by mergers, bankruptcies, alliances or natural growth. Following Alamdari and Mason prediction, a report of the Association of European Airlines (AEA) in 2012 (13) summarized that Europe's skies are now ruled by the 3 big major: Lufthansa group, AirFrance / KLM group and International Airlines Group (IAG) proving right Alamdari and Mason's prediction.

Figure 6 represents on the map the different alliances in Europe as of April 2012

- Large network carriers will focus on long haul flights and use franchise or their alliance partnerships in feeding traffic.
- There will be fewer hubs as many operations will be substituted by direct flights

Small network carriers will have to find niches or act as feeder for large network carriers. AEA reports showed that in the average, AEA airlines intra-European routes lead to losses while long haul routes remained profitable.

Summary

Following this case, we can have a broader perspective that the general tendency for maintaining national flag carriers is becoming a struggle for governments. As Figure 7 shows as well, by 2011 only 10% of the airlines were publicly owned in Europe. The continuous growth of LCCs opened a different market segment for customers, which is more competitive in price, and offers of routes.

The list of bankrupted airlines is growing year by year as it is becoming more difficult to keep up with the competition. Without a market upturn or a drastic restructuring, several more European carriers are risking following Malév into the past of aviation history. Malév was an example for a failed attempt to maintain an airline running, which was already overwhelmed with debt, and which already could not continue to offer differentiated and value-added services.

Questions

1. What is the external environment the airlines are operating in the recent years? Please identify some examples of recent trends and industry attributes.
2. Which airlines benefited from the fall of Malév? Please identify some strategy models used by them.
3. Low Cost Carriers: Are they the future of short haul flights? Please justify your answer.

Annexes

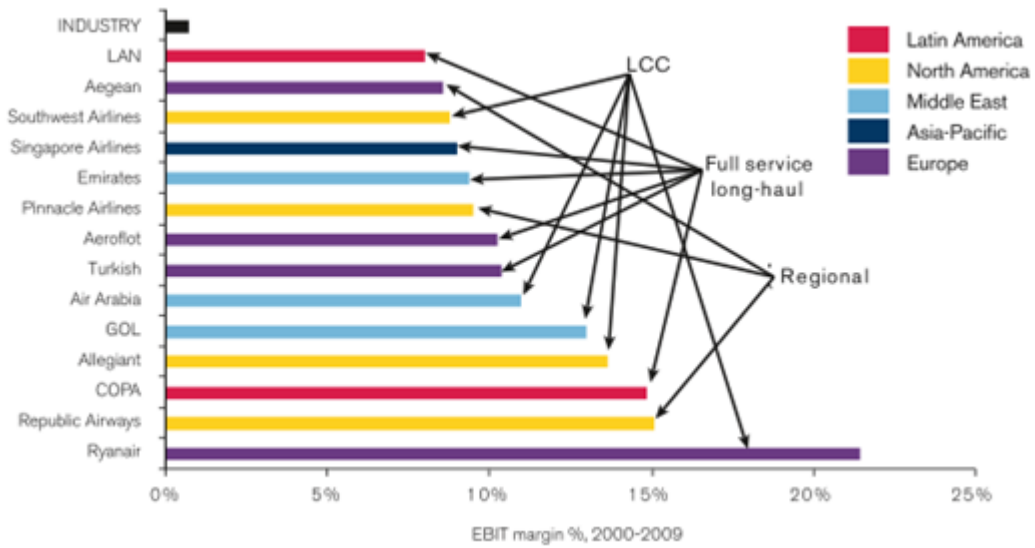


Figure 1 - Airlines with EBIT margin greater than 8%. Source: Vision 2050 Report, by IATA (2).

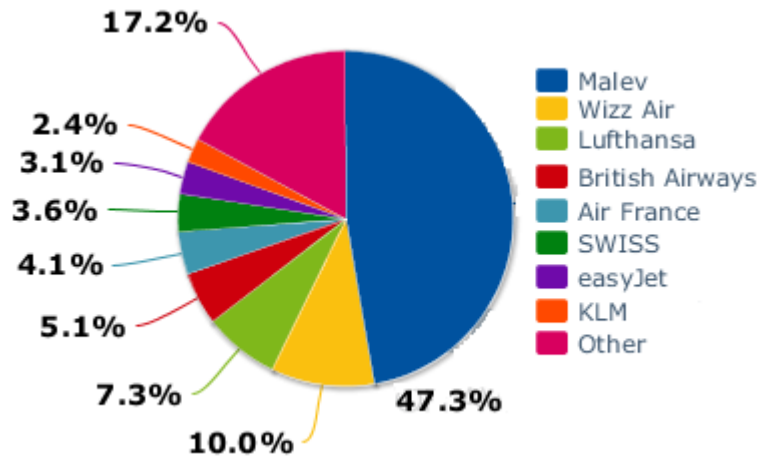


Figure 2 - Percentage of flights operated by airlines on BUD before Malév bankruptcy. Source: CAPA – Centre for Aviation (<http://centreforaviation.com>).

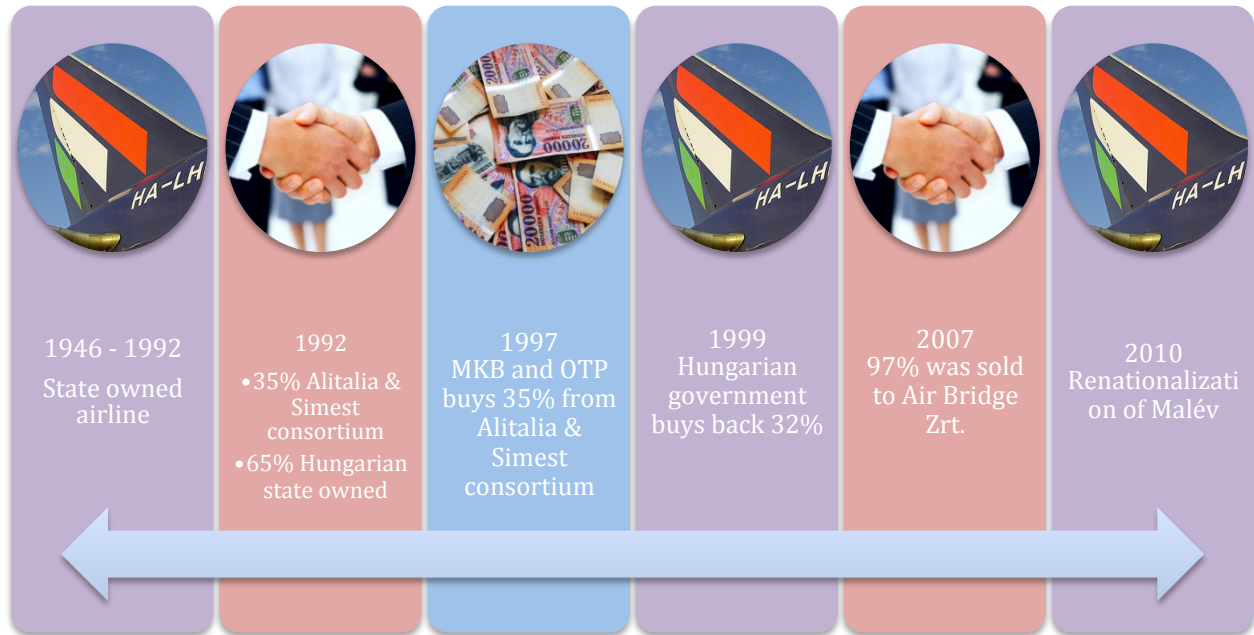


Figure 3 - Timeline of Malév's ownership changes from 1946-2012.

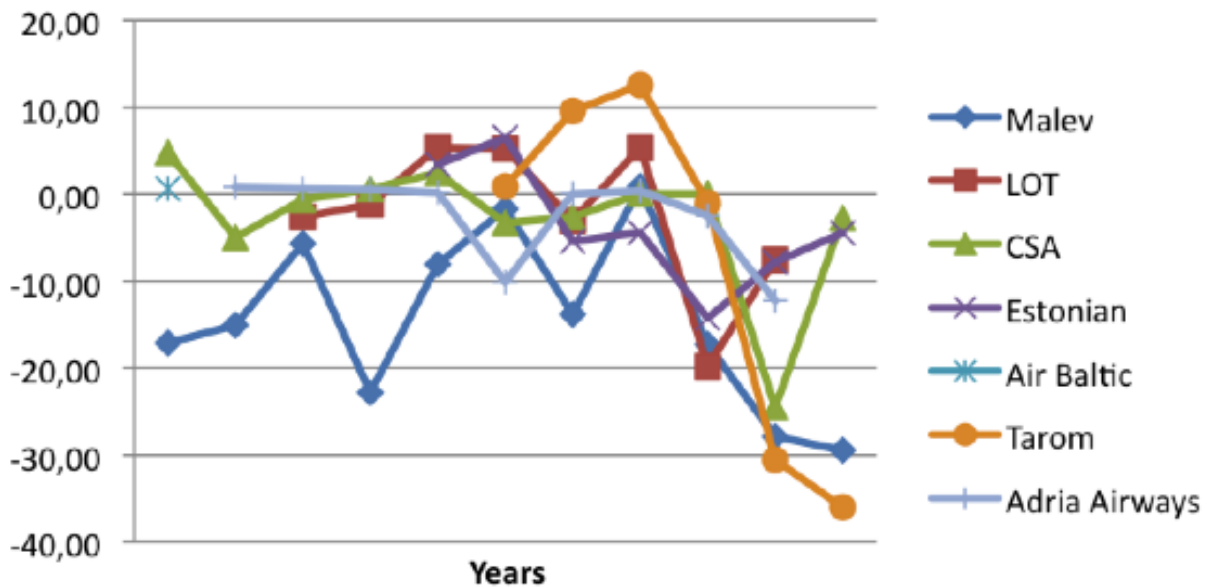


Figure 4 - Profit and Loss per PAX. Source: Garsonline (14).

Flag carriers: should we preserve them?
A case study of Malév Hungarian airlines

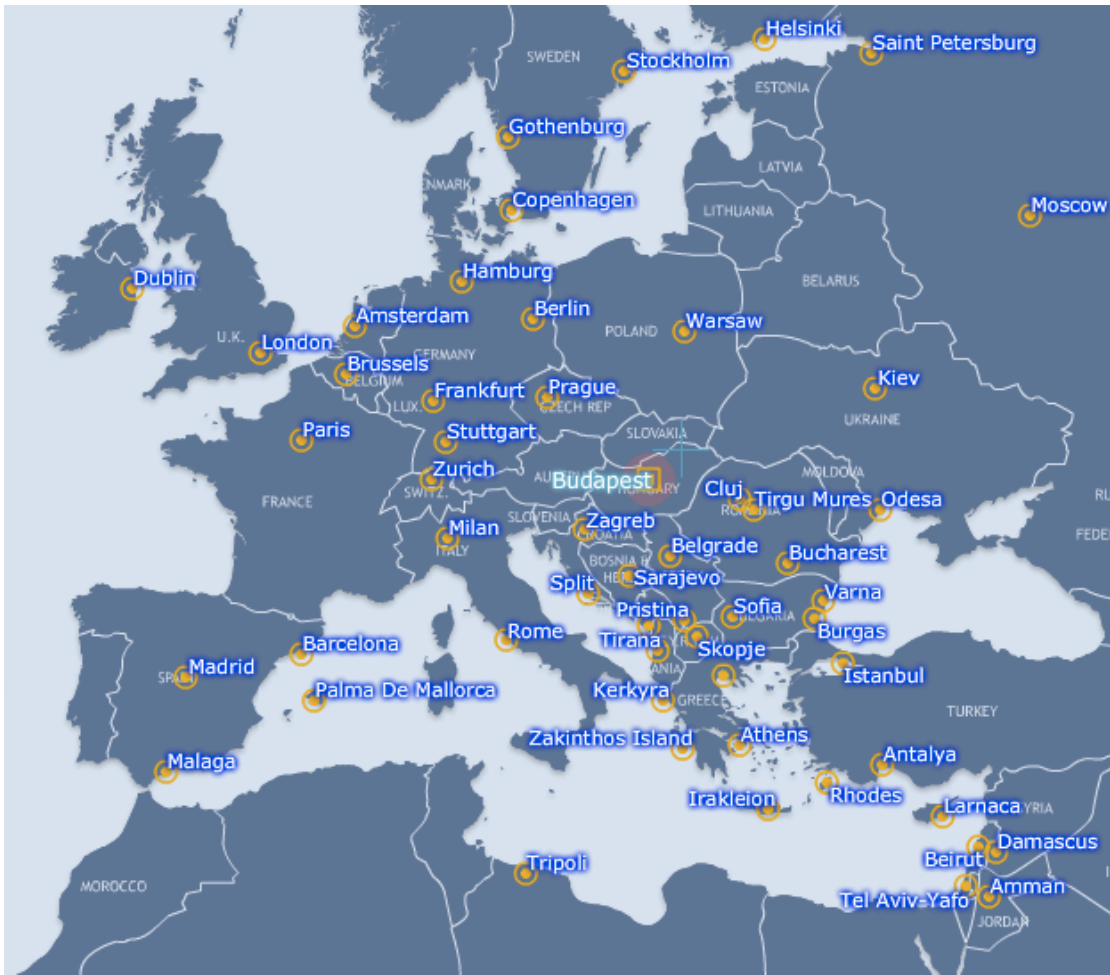


Figure 5 - Malév's route map prior to bankruptcy. Source: CAPA - Centre for Aviation (<http://centreforaviation.com>).

Alliance membership as of April 2012

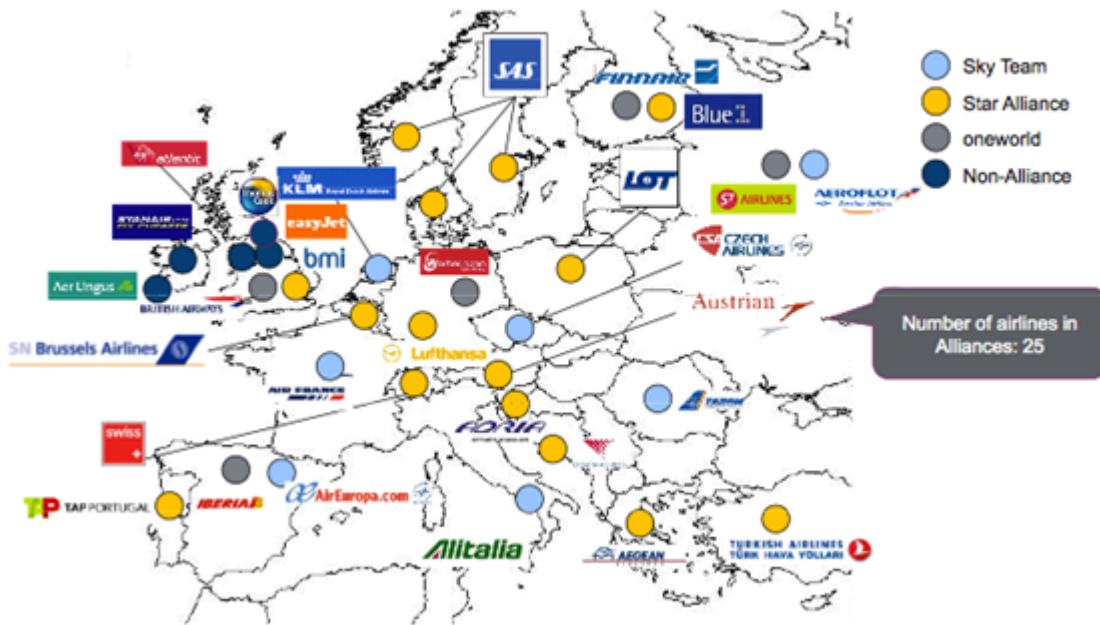


Figure 6 - Alliance memberships in Europe. Source: Association of European Airlines (AEA).

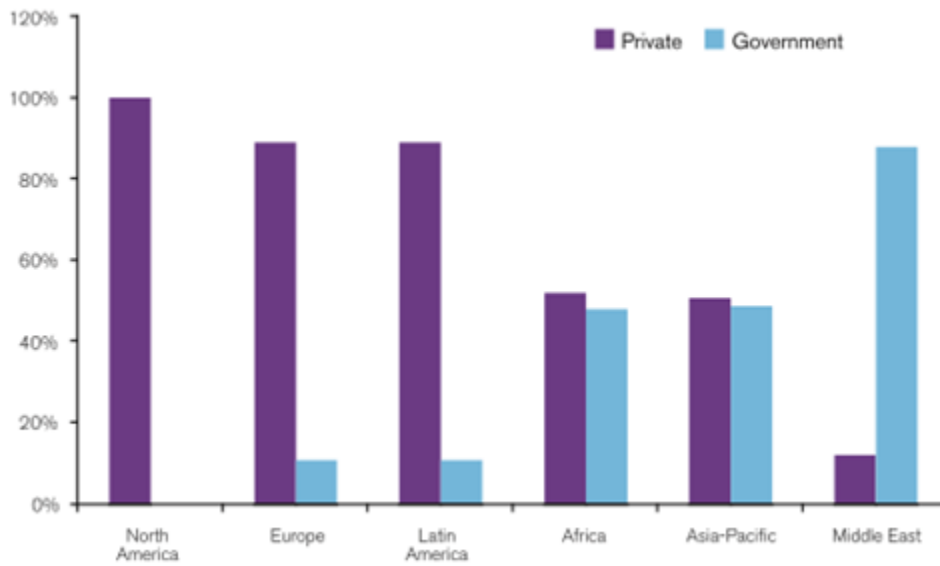


Figure 7 - Relation between privately and public owned airlines. Source: Vision 2050 Report, by IATA (2).

Table 1 - Passenger traffic at Budapest airport 2007-2013. Cells marked with red refer to Q1, which is the quarter when Malév bankrupted (Q1 2012). Source: Eurostat.

TIME/TRA_COV	Total transport	Intra-EU	Extra-EU
2007	8,580,261	6,520,091	2,059,943
2007Q1	1,596,646	1,235,686	360,960
2007Q2	2,250,248	1,735,777	514,244
2007Q3	2,797,073	2,054,052	743,021
2007Q4	1,936,294	1,494,576	441,718
2008	8,429,082	6,392,474	2,036,608
2008Q1	1,709,021	1,336,863	372,158
2008Q2	2,205,133	1,689,264	515,869
2008Q3	2,693,784	1,960,875	732,909
2008Q4	1,821,144	1,405,472	415,672
2009	8,081,067	6,210,719	1,870,348
2009Q1	1,461,971	1,153,824	308,147
2009Q2	2,109,502	1,625,586	483,916
2009Q3	2,616,507	1,954,953	661,554
2009Q4	1,893,087	1,476,356	416,731
2010	8,174,510	6,266,701	1,907,809
2010Q1	1,534,054	1,187,595	346,459
2010Q2	2,034,394	1,556,544	477,850
2010Q3	2,681,431	2,006,540	674,891
2010Q4	1,924,631	1,516,022	408,609
2011	8,884,837	6,867,805	2,016,717
2011Q1	1,640,948	1,307,035	333,913
2011Q2	2,332,902	1,825,871	507,031
2011Q3	2,796,295	2,074,819	721,161

2011Q4	2,114,692	1,660,080	454,612
2012	8,429,843	7,102,643	1,327,200
2012Q1	1,559,604	1,275,238	284,366
2012Q2	2,250,680	1,949,820	300,860
2012Q3	2,601,155	2,173,196	427,959
2012Q4	2,018,404	1,704,389	314,015
2013Q1	1,632,974	1,349,909	283,065



Figure 8 - Evolution of the yearly number of passengers at Budapest Airport, based on Table 2.

Table 2 - Budapest Airport passenger traffic on a monthly based (January 2011 - June 2012). Source: Eurostat.

TIME/TRA_COV	Total transport	Intra-EU	Extra-EU
2011M01	525,636	410,579	115,057
2011M02	486,733	388,960	97,773
2011M03	628,579	507,496	121,083
2011M04	733,021	579,595	153,426
2011M05	774,921	618,722	156,199
2011M06	824,960	627,554	197,406
2011M07	948,208	697,307	250,586

2011M08	956,938	703,585	253,353
2011M09	891,149	673,927	217,222
2011M10	841,588	642,912	198,676
2011M11	644,185	509,599	134,586
2011M12	628,919	507,569	121,350
2012M01	564,581	437,605	126,976
2012M02	419,823	342,346	77,477
2012M03	575,200	495,287	79,913
2012M04	709,210	618,080	91,130
2012M05	753,980	658,352	95,628
2012M06	787,490	673,388	114,102

Table 3 - International extra-EU air passenger transports between Budapest and each reporting country. Source: Eurostat.

TIME/ PARTNER	Montenegro	Former Y.R. of Macedonia	Serbia	Bosnia and Herzegovina	Russia	Ukraine	Israel
2010	13,815	60,305	78,848	25,428	141,798	103,376	191,813
2010Q1	1,572	10,228	17,493	5,453	30,932	16,635	32,676
2010Q2	3,833	14,668	17,505	6,481	38,250	27,506	54,429
2010Q3	5,632	23,142	25,980	8,178	43,132	34,689	63,991
2010Q4	2,778	12,267	17,870	5,316	29,484	24,546	40,717
2011	18,234	62,851	83,541	26,584	172,507	125,135	196,959
2011Q1	2,320	10,459	16,238	4,531	30,561	23,496	29,984
2011Q2	4,890	15,684	18,009	6,686	46,318	32,933	52,408
2011Q3	7,141	21,039	28,976	8,182	53,744	41,175	67,020
2011Q4	3,883	15,669	20,318	7,185	41,884	27,531	47,547
2012	1,033	4,549	7,072	2,001	142,832	50,861	130,468
2012Q1	815	4,527	6,852	1,965	35,749	15,353	20,854
2012Q2	184	0	0	:	34,694	12,205	27,622
2012Q3	34	0	0	:	38,313	11,533	49,358

Flag carriers: should we preserve them?
A case study of Malév Hungarian airlines

2012Q4	:	22	220	36	34,076	11,770	32,634
2013Q1		34	0	0	33,397	16,084	31,161

Figure 9 - Extract from the EU competition legislation (6).

I

(Information)

COMMISSION

COMMUNICATION FROM THE COMMISSION

COMMUNITY GUIDELINES ON FINANCING OF AIRPORTS AND START-UP AID TO
AIRLINES DEPARTING FROM REGIONAL AIRPORTS

(2005/C 312/01)

(Text with EEA relevance)

1. INTRODUCTION

1.1. General context

(2) In addition, a number of measures have been taken in areas such as allocation of slots^(*), groundhandling services^(†) and computerised reservation systems^(‡), in order to underpin this market liberalisation and allow businesses to compete on a level playing field. New targeted proposals will shortly be made in relation to slots (for the first time, a market mechanism for allocation of slots will be proposed to increase mobility in saturated airports), equal access to computerised reservation systems and groundhandling services. The latter proposal is aimed at boosting competition between service providers by increasing their access to the market.

(1) These guidelines form part of the general plan to create a single European airspace, a subject on which the Commission has been working for over 10 years. The set of liberalisation measures known as the 'third air package', in force since 1993, has enabled all air carriers holding a Community licence to have unrestricted access to the intra-Community market, with freedom of tariffs, since April 1997^(§). As a corollary, to guarantee citizens continuous quality service at affordable prices throughout their territory, those Member States that wish to do so have established public service obligations relating to frequency, service punctuality, availability of seats or preferential rates for certain categories of users within a clear legal framework. These public service obligations have enabled air transport to make a significant contribution to economic and social cohesion and to balanced development in the regions.

(3) At the same time, the opening-up of the industry, which has obviously had a major impact on the activities and behaviour of traditional airlines or flag carriers, has been accompanied by strict control of State aid. The application of the principle of single aid for restructuring (one time-last time) has thus allowed the more adaptable airlines to make the transition from a relatively protected

(§) Council Regulation (EEC) No 2407/92 of 23 July 1992 on licensing of air carriers (OJ L 240, 24.8.1992, p. 1), Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes (OJ L 240, 24.8.1992, p. 8) and Council Regulation (EEC) No 2409/92 of 23 July 1992 on fares and rates for air services (OJ L 240, 24.8.1992, p. 15).

(*) Council Regulation (EEC) No 95/93 of 18 January 1993 on common rules for the allocation of slots at Community airports (OJ L 14, 22.1.1993, p. 1).

(†) Council Directive 96/67/EC of 15 October 1996 on access to the groundhandling market at Community airports (OJ L 272, 25.10.1996, p. 36).

(‡) Council Regulation (EEC) No 2299/89 of 24 July 1989 on a code of conduct for computerised reservation systems (OJ L 220, 29.7.1989, p. 1).

- operating regime to competing as normal players in the market. This has led to a significant restructuring of the whole air industry, a measure that became even more necessary after the events of 11 September 2001, the consequences of which on air transport were significant. Examples of consolidation in the industry are the recent alliances such as Air France/Alitalia, Lufthansa/Austrian Airlines and Iberia/British Airways, and the recent merger of Air France and KLM.
- (4) The *Open Skies* ⁽¹⁾ judgments of the Court of Justice have also given a new impetus to the air industry by confirming that the Community has international negotiating powers in the field of civil aviation. The importance of these judgments is considerable, since they will promote consolidation among European airlines and enhance their ability to face competition from third-country airlines on a Community basis.
- (5) There have been two other major developments on the European air transport market in recent years. One of these is the emergence of a number of new Community-wide companies offering promotional rates supported by a low-cost structure. The other development is the drive by airports in recent years to secure new air links.

1.2. Developments in the airport sector

- (6) The initial development of airports was often determined by purely territorial considerations or, in some cases, military requirements. These land-use planning considerations may still persist in some cases, but in many others airports have been transferred from State to regional control, in some cases to be operated by public companies, or even to the private sector. The process of transfer to the private sector has normally taken the form of privatisation or a progressive opening-up of capital.
- (7) The Community's airport industry has therefore undergone fundamental organisational changes that reflect not only the active interest of private investors in the airport sector but also a change of attitude on the part of the public authorities regarding the contribution of private investment to airport development. This development has led to greater diversification and complexity of the functions undertaken by airports.
- (8) However, this development affects the EU's airports differently. The seven largest EU airports account for over a third of all EU traffic, and the 23 largest account for more than two thirds ⁽²⁾. Although they are primarily providers of infrastructure to the air transport industry, these airports have become highly efficient commercial operators. On the other hand, most small airports in the EU are still owned and operated by public authorities in the public interest. As a result, the influence of one airport's activity on that of other airports and on trade between Member States varies greatly according to the category it belongs to (see Types of Airport, section 1.2.1 below).
- (9) Moreover, it is generally accepted that airports can have an impact on the success of local economies and on maintaining local services such as education and health. They also play a major role in the integration of the outermost regions of Europe. Passenger and freight services can be crucial for competitiveness and development in some regions. Airports that provide good services can act as a magnet for airlines and thus promote business activity as well as economic, social and regional cohesion within the EU.
- (10) However, the Commission notes that air transport is not the only driver of development in terms of regional accessibility. High-speed train connections also make a significant contribution to social and economic cohesion in the EU, particularly between large regional cities. As emphasised in the 2001 White Paper ⁽³⁾, rail/air intermodality, with rail and air travel complementing rather than competing with each other and high-speed trains connecting cities, is bound to boost capacity significantly.

1.2.1. Types of airport

- (11) In the airport industry there are currently several different levels of competition between the different types of airport. This is a key factor when investigating State aid, and makes it necessary to examine the extent to which competition could be distorted and the single market affected. Competition scenarios are evaluated case by case, based on the markets in question. However, research ⁽⁴⁾ has shown that, generally, major international hubs are competing with similar airports in all the

⁽¹⁾ Cases C-466/98 to C-469/98, C-471/98 and C-472/98 *Commission v the United Kingdom, Denmark, Sweden, Finland, Belgium and Luxembourg respectively* [2002] ECR I-9427 to 9741.

⁽²⁾ Based on data for EU-25 in 2004 from the Airports Council International.

⁽³⁾ European Transport Policy for 2010: time to decide, COM (2001) 370, 12.9.2001.

⁽⁴⁾ 'Study on competition between airports and the application of State aid rules' — Cranfield University, June 2002.

transport markets concerned, with the level of competition depending on factors such as congestion and the existence of alternative transport, or, in certain cases (see below), with large regional airports. Large regional airports may be competing not only with other large regional airports but also with the major Community hubs and land transport, especially if there is high-quality land access to the airport. This research has also shown that small airports do not generally compete with other airports except, in some cases, with neighbouring airports of a similar size whose markets overlap.

(12) In practical terms, the Decision of the Council and of the European Parliament on Community guidelines for the development of the trans-European transport network⁽¹⁾ defined three categories of airport:

- international connecting points (generally with an annual passenger volume of no less than 5 000 000),
- Community connecting points (generally with an annual passenger volume of between 1 000 000 and 4 999 999), and
- regional connecting points and accessibility points (generally with an annual passenger volume of between 250 000 and 999 999).

(13) The Committee of the Regions, for its part, proposed five categories of European airports in its Outlook opinion of 2 July 2003 on regional airport capacities⁽²⁾:

- major hub airports (over 25 million passengers, four airports), accounting for approximately 30 % of European air traffic,
- national airports (10 to 25 million passengers, 16 airports), accounting for approximately 35 % of European air traffic,
- 15 airports of 5 to 10 million passengers accounting for approximately 14 % of European air traffic,

- 57 airports of 1 to 5 million passengers accounting for approximately 17 % of European air traffic,
- 67 airports of 200 000 to 1 million passengers accounting for approximately 4 % of European air traffic⁽³⁾.

(14) According to the Committee of the Regions, regional airports generally fall into the latter two categories, but some airports in the intermediate category may also be considered regional airports.

(15) The Commission considers that there is a broad overlap between these two classification schemes, and for the purposes of these guidelines has defined the following four categories:

- category A, hereinafter 'large Community airports', with more than 10 million passengers a year,
- category B comprises 'national airports', with an annual passenger volume of between 5 and 10 million,
- category C comprises 'large regional airports', with an annual passenger volume of between 1 and 5 million,
- category D, hereinafter 'small regional airports', with an annual passenger volume of less than 1 million.

1.3. Low-cost companies

(16) Compared with traditional air carriers, the market share of low-cost airlines has risen from just 4,0 % in 1998 to 20,8 % in 2004, although this share varies considerably between Member States⁽⁴⁾. In 2004, the three main low-cost airlines transported over 62 million passengers in the EU⁽⁵⁾.

⁽¹⁾ NB: There are approximately 200 airports with fewer than 200 000 passengers per year.

⁽²⁾ Over 40 % in the United Kingdom, Ireland and Slovakia, 38 % in Spain, over 25 % in Belgium, Germany, Italy, Austria, Hungary and Sweden, 19 % in France and Greece, 18 % in the Czech Republic and less than 15 % in the other Member States. Source: OAG Summer Schedules 2004, seats available on intra-EU flights.

⁽³⁾ Ryanair, Easyjet, AirBerlin. Source: Airclaims.

⁽¹⁾ Decision of the European Parliament and of the Council of 23 July 1996 on Community guidelines for the development of the trans-European transport network (OJ L 228, 9.9.1996, Annex II, section 6).

⁽²⁾ Outlook opinion of the Committee of the Regions of 2 July 2003 on the capacity of regional airports (CdR 393/2002 fin).

Methodology

Personal motivations and relevance of this study

The idea for this subject originated from my home country, Hungary. The topic of this case study is the former flag carrier of my country, who served many passengers throughout the years of operations, including myself. I was personally touched when the news came to my knowledge; the airline I used to travel all around Europe no longer exists. Even so, the fact of possible bankruptcy was already in the media for years, no one in Hungary believed that it is in fact going to happen. After my initial investigation I became aware of the problems the airline was facing for more than a decade by this time, and it became obvious to me that the issue has more into it than my initial ideas were suggesting. As the after wind of the bankruptcy of Malév was in the news simultaneously with the time of deciding upon a possible thesis topic, I choose to dedicate my dissertation into the fall of Malév airline, and with my study contribute to those authors who were already suggested that the era of national flag carriers had passed.

Research Methodology

Throughout this case study development I used quantitative and qualitative sources to build my case upon. Luckily several articles are available in the topic of Airline industry; therefore during my desk research I did not face difficulties of finding relevant literature to support my case. The mentioned literature is being analysed in the literature review section. The quantitative sources were also in favour of the case: the European Commission EUROSTAT platform provides relevant statistical data in the topic.

Thesis Structure

While structuring the case study I used the supporting material given by our study coordinator (Order no 8/2012 of the Director of the School of Management), which explains ISCTE's guidelines on writing a case study. Based on the guideline, at the beginning of the dissertation the reader can find the case study itself, focusing on the bankruptcy of Malév airline, and the general tendency of low cost carriers expanding in the short haul flights market. The case study is followed by relevant annexes which varies between Figures and Tables collected from the internet or created manually. Passing through the methodology the reader will be able to follow the Pedagogical note throughout its different steps. The pedagogical note starts with the methodology of the case analysis and the expected teaching method in class. This is followed by the literature review where the reader can gain a better understanding over the already written literature of the topic I chose to analyse. The literature review is followed by a set of analytical tools, such as Porter's five forces model and the theory of Market entry strategies which will be in help of answering the questions raised at the end of the case study. Therefore the resolution of the case is going to be done under the Analysis of questions section. The dissertation will be concluded by the Management conclusion section where the reader will be able to have a final recap of the topics analysed in this thesis. The list of literature and sources used is available in the Bibliography section.

Pedagogical Note

Teaching Objectives

This case may be used to discuss the concept of changing dynamics within the airline industry, most specifically the relation between national air carriers and low cost carriers. By the end of the class the students should have discussed:

- The aviation industry in general
- Market entry strategies used by airlines
- The major tendency of LCCs in taking over network carriers in Europe
- The changes in network carriers business model

Methodology

The students should be focusing on the resolution of the following three questions. The teacher/or guide should be available to assist them with additional questions raised and providing the supporting material and theories.

Assignment questions:

- What is the external environment the airlines are operating in the recent years? Please identify some examples of recent trends and industry attributes.
- Which airlines benefited from the fall of Malév? Please identify some strategy models used by them.
- Low Cost Carriers: Are they the future of short haul flights? Please justify your answer.

Teaching approach:

We use this case for a 60 minutes session

Literature Review

This case study is dedicated to show the decreasing need for preserving flag carriers throughout the example of Malév Hungarian Airlines. With this study one should gain a general understanding over the recent changes in the airline industry, mainly focused on the European continent and airlines operating on it.

In 2011 the Hungarian Government issued (5) a **‘White paper on the Malév heritage’**, in order to emphasize the need for preserving the national flag carrier. The document was important for the Hungarian Government as at this time the airline already faced high debts and received several state aid programs, thus the Government felt the need to explain its past and present actions. As the paper argued, a national airline is needed to promote employment and serve numerous domestic businesses. In facts, the paper claimed that:

- The company pays nearly EUR 33 million in tax to the Hungarian Government
- Transports 3 million passengers a year to 45 direct destinations
- Contributes 40% of Budapest Airport’s turnover and without Malév, the airport operation could become impossible
- It exposes the Hungarian hospitality and products to international tourists, thus promoting the country and its tourism
- The lack of a national airline would mean a considerable competitive drawback to Hungary

Most of these arguments were biased, and after the fall of the airline in 2012 we could verify, that in fact, the fall of Malév was nothing but a temporary decrease in passenger traffic.

The paper blamed the “narrow minded and prodigal decisions” made during the previous 10 years of company governance, as a cause for the debts the airline accumulated by 2011. Worsening factor in the airline’s life was the always-changing general management, as pointed out in the paper, between the periods of 1990-2011, twenty different people were appointed to

manage Malév. For these choices professional considerations were not taken into account and only political loyalty was the deciding factor. The paper also discusses other bad decisions taken, such as the ‘irresponsible privatization’ in 2007, and the renationalization done in 2010 what the paper sums up as:

“...it can be stated that serious mistakes were made during Malév Zrt.’s renationalization by the previous government, as at that time, the company had already been practically incapable of independent operation, and its re-acquisition and sustention consumed enormous amounts of money.”

Therefore we can conclude that, nevertheless the Government was aware of the real status of the airline, they still continued to be biased and sustained as the priority aim to keep the national airline up in the air. This situation aligns with the report analyzed by **BBC reporter** (15) in 2010 whereby the author questioned the need for maintaining flag carriers via the example of British Airways. As the article mentioned, the question of flag carriers can be associated with patriotism and political pride rather than the business itself. The need for reshaping flag carriers operations was already raised in 2002 by **Emre Serpen** (16), stating that in order to keep up with the changing industry, governments should learn to focus on operations development and not on their political influences during decision making. Adding to all these, the report concluded by **IATA**, in 2011 (2), argues that while many airlines were government owned, this had changed already through liberalization, especially in the United States and Europe. In the United States, 100% of airlines are already privately owned, and in Europe this number is also significant with approximately 10% of airlines what are still governmentally owned. Therefore we can conclude that there is a general tendency of privatization of flag carriers. **Catherine and Doug Eckel** (17), in 1996, explored the topic of airline privatization, where they summarized the main impacts on an airline once it changes into private ownership. The first and most evident difference is that the ownership of the airline switches from public to private. The second change is that the airline’s objectives change to profit maximization, and thirdly, changes in regulation to enhance competition in product markets are likely to occur. In their study using British Airways privatization, they concluded that privatization leads to an increase in efficiency, drop in stock price of rival firms, and the ability to provide lower fares to the customers, which suggests that privatization is beneficial for both the company and the customers. The need for flag carriers can be approached throughout another point of view, by analyzing the increased competition by low

cost carriers among the operating airlines worldwide. As **David Duval** (18), in 2007, argued, low cost as a concept will probably become dominant in the airline industry. He based his statement on the fact that most air carriers worldwide already focus on cutting costs as a way to maximize revenue. **Bijan Vasigh, Tom Tacker and Ken Fleming** (19), in 2008, summarized the emergence of low cost carriers as the result of airline deregulations in the United States in the 1970s. According to **Eric Pels** (2009) (20), airlines after the deregulation were free to determine the optional network type and were able to focus on exploitation of density economies. Once an airline operates under density of economies, the cost per seat decreases, as the number of seats increases (**Brueckner and Spiller** 1991) (21). After the first wave of LCC start-ups in the States, Europe experienced the second wave of LCCs following the liberalization of European airspace. LCCs such as Ryanair and Easyjet expanded quickly, and acquired market share from Europe large established network carriers (**Bijan Vasigh, Tom Tacker and Ken Fleming** 2008) (19). In Eastern Europe the full membership of the single European Aviation market has led to the rise of different air services (**Graham Francis, Ian Humphreys, Stephen Ison, Michelle Aicken** 2006) (22). The relative success of SkyEurope and low cost services in Prague/Budapest led Austrian Airways and Czech Airlines to establish low cost subsidiaries and in 2004 for Malév to introduce low fare services. This case points out as well that the increase of LCCs is influencing the business model of network carriers. According to the report of **Association of European Airlines** (2012) (13), the main advantage of LCCs in Europe was that, unlike in the United States where the operating model adapted by LCCs is a network model, in Europe there were already enough mature markets that they could serve without needing to offer connecting services, mainly because those were already covered by NCs.

Eric Pels (2009) (20) stated that following a survey conducted by Barclaycard, 71% of the business travellers used LCCs for business trips, what also aligns with the idea that the passenger preferences may be changing. According to **Keith J. Mason and F. Alamdari** (2007) (12), the airline market is likely to consolidate into a small number of large network carriers and LCCs. In their predictions LCCs will carry out half of Europe's short haul traffic. With the increase of LCCs, NCs need to manage a way to keep up with the competition. This is not the first time in history that NCs faced competition. As **Markus Franke** (23) recalls, in the early 90s, NCs became trapped in a vicious cycle while competing against each other in capturing customers. The solution for NCs was a business innovation whereby airlines formed alliances and

partnerships with their competitors. Major airlines organized themselves into variety of partnerships whereby three main global alliances developed. However, the deregulation efforts have failed to change restrictive ownership clauses and bilateral traffic right agreements that meant that the major cost reduction potentials were not fully realized. Alliance creation was an important strategic step in order to preserve the power of NCs, but failed to prepare their members for the upcoming low cost challenge. This aligns with the report of **Association of European Airlines** (2012) (13) where it is stated that currently NCs are undergoing a series of business model changes, whereby these carriers are investing into advanced pricing and revenue management systems, in order to optimize their revenues. According to **Markus Franke** (23) (2004) the way NCs should be restructuring themselves into a new business model is to focus on the below three points:

- Restructure network/hub operations to remove scheduling constraints and reduce the cost penalty of complexity
- Simplify customer interface at the airport and in distribution
- Create separate business systems for distinct customer segments

According to a study conducted by KPMG (2013) (24) the cost gap between network and low cost carriers has fallen an average of 30% in six years, mainly because NCs have stepped out of their model and left some of their differentiators (i.e. free baggage in flight, catering in short haul flights). The service what today's NCs are offering on short haul flights is reaching the service of an LCC.

As seen above, different already existing literature can be found on the recent changes in the aviation industry: on the decreasing need for flag carriers, the emergence of LCCs and the battle among NCs and LCCs for future dominance over the skies.

In the following, the case is going to be further developed in order to gain a better understanding over the new rules of aviation.

Analytical Tools

In order for the reader to have a better understanding in what and how we are going to analyze each topic, we therefore introduce the analytical tools necessary for the study.

Porters' Five Forces

Porters' five forces is a framework for industry analysis, which was written by Michael E. Porter in 1979 for the Harvard Business Review (25). The theory assumes that there are five forces that identify the competitive power in a business situation, which are:

- Threat of new entrants
A new entry of a competitor can easily weaken a company's position in the market where they are positioned.
- Threat of substitute products
Whereby it is analyzed how easily our customers can switch to our competitors product.
- Bargaining power of buyers
Buyers have a strong force of influencing the price rate of your product/service. The level of bargaining power has to be measured to understand the level of control customers apply on our service.
- Bargaining power of suppliers
When suppliers have control over supplies and its prices, that segment is less attractive. The best approach is to try to make win-win relation with suppliers.
- Intensity of competitive rivalry
The intensity of competition among the existing players on the market can initiate advertising/price wars, and create a difficult environment to compete.

By using this analytical tool we can gain a better understanding over the general aviation industry as global, especially by focusing on the ever-increasing competition among LCCs and network carriers and the external environment they operate in.

Market Entry Strategies

When a company chooses to enter into a new market four major methods can be identified depending on their capital needs, control mechanism and possible influence on the foreign market. The four methods (26) are:

- Export
- Contractual agreements
- Joint Venture
- Wholly owned subsidiary

Although in the case of airlines, only the last three methods are applicable, it is important to mention each of them, in order to understand the different strategies when entering in a market.

The simplest way to enter a foreign market is through exporting (27). Exporting is a market entry strategy whereby the company enters into the foreign market by selling goods produced in the company's home country. Companies usually start with indirect exporting, working through independent international intermediaries and eventually they choose to move into direct exporting, whereby the company handles its own exports.

Another strategy is contractual agreement, which is a special form of coordinating a foreign market entry that offers more possibilities for control over operations than export does. It also allows the company to enter into the new market without investing its own equity. There are several types of contractual agreements, such as:

- Licensing

“A Licensing agreement is an arrangement wherein the licensor gives something of a value to the licensee in exchange for certain performance and payments from the licensee.” (28) The Civil Aviation Authority (CAA) defines the following types of licenses applicable for any airline who wishes to commence operations in any country:

Air Operators Certificate; Air Transport Licenses; Airline Operating Licenses; Route Licenses; Scarce Capacity Allocation and Foreign (non EEA¹) Carrier permits. (29)

- Franchising

“Franchising is an agreement whereby the franchiser grants the franchisee the right to use its trademark or trade name as well as certain business systems and processes, to produce and market a good or service according to certain specifications.” (30) Therefore franchising in the airline industry involves one airline allowing another to use its name, aircrafts, and anything associated with the brand image (uniforms, logos, etc.). As an example for franchise agreement can be mentioned Virgin Atlantic with two separate agreements: South East European Airlines and CityJet, or Air France with its franchise agreement with Jersey European Airways. According to Lesley Pender “European carriers are not unanimously embracing franchising as the strategy for the future. The concept cannot guarantee success.” (31) The main advantage for franchisors in franchising agreements is the access to new routes and market they are granted. Operating on these routes without franchising agreement would be impossible for some of the airlines. The disadvantage of the franchise agreement is the deep dependence from the franchisor. Many airlines use the franchise agreement for a certain period of time but later on they break it of – just like CityJet did with Virgin Atlantic. (32)

- Alliances

According to David C. Mowery, firms use strategic alliance collaboration to gain access to other firms' capabilities, supporting more focused, intensive exploitation of existing capabilities within each firm. (33) Therefore we can conclude that strategic alliances are parallel agreements between potential competitors. (26)

Examples for contractual agreements in the airlines industry can be identified with a model such as the strategic alliances. The three largest airline alliances are Star Alliance, One World and Sky Team.

¹ European Economic Area: countries of European Union plus Iceland, Liechtenstein and Norway.

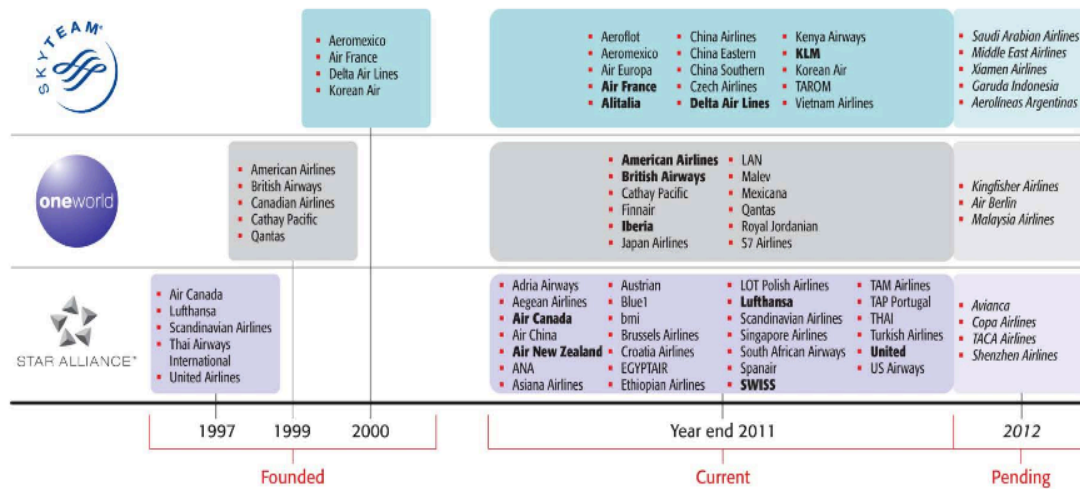


Figure 10 - Main Airline Alliances in the world. Source: CWT (35)

Another market entry strategy is the well-known joint venture (JV), which is often defined as a joint undertaking by two existing businesses in which they share common risks (losses and liabilities), profits and management while the same time the separate parties remain independent (34). One of the famous joint ventures in the airline industry is the Lufthansa group – Air Canada – United Airlines JV. Apart from the basic naming classifications, in practice it can be difficult to determine the difference between airline JVs and alliances, especially because they can be structured differently around the world, and because the many existing partnerships vary in terms of maturity, sophistication, and transparency to the buyer (35). For airlines in an alliance the focus is on combining their operations, and with it, creating an expanded global network. Airlines with JV relations are most closely blinded together as they often share revenue and costs and may fly under a shared operating certificate. They are also able to align pricing and identify themselves as a single entity, which offers them the benefit of a merger without the costs involved with it.

Last but not least, a wholly owned subsidiary is a company whose common stocks are fully owned by another company, also called the parent company. A company can become a whole owned subsidiary through acquisition/merger by the parent company, or a spin off from the parent company (36). In the airline industry the tendency is to merge. The strong price war that the competitors generated has turned the airlines industry into an unprofitable industry. Therefore in the past decades airlines initiated mergers to reduce competition, expand their

network and take advantage of cost collaboration. Some of the famous mergers from the past few years are:

- Air France – KLM (2004)
- Lufthansa – Swiss Airlines – Austrian Airlines (2009)
- Unites Airlines – Continental Airlines (2011)
- British Airways – Iberia (2011)
- LAN – TAM (2012)

Analysis of Questions

What is the external environment the airlines are operating in the recent years? Please identify some examples of recent trends and industry attributes.

To gain a better understanding of what network carriers and LCCs face in the aviation industry, Porter's five forces model can help us by giving an insight of different forces acting against or in favor of the carriers.



Figure 11 - Porter's Five Forces Model.

Industry rivalry

Rivalry in the airline industry is highly intense. The competition within the industry is mainly based on the decisions they make on price and quantity. Primarily, each airline has to define its overall capacity i.e., their aircraft fleet. The planning of this step assumes a considerable, or almost vital, importance as this is usually set for longer time periods, given by time lags in aircraft delivery and building the necessary company infrastructure. Following the infrastructure plan, operational decisions have to be made, mainly to decide how to allocate the capacity among the possible connections or routes. Usually every six months a new plan is being set up regarding frequency of the flights between destinations (2). Once the capacity is decided upon it is important to set the prices for each connection. The price can be changed at any time depending on the booking rates and competitor movements. Setting the initial price involves a strong relation with the initial capacity planning as the choice of aircraft fleet linearly influence the price but the prices feasibility on the market determine the original seat size of the fleet.

Once airlines decide upon their capacity, they are faced with other different variables. On the

cost side, acquiring more planes gives higher returns, while by operating larger planes marginal costs per passenger can be reduced. On the risk side, having free capacity in periods of increased demand are high and fully accrue to airline owners. Hence, airlines end up acquiring too much capacity and operate many connections that cover only their marginal costs of operation, not the capital cost already encountered.

Nevertheless, there are a number of barriers that limit airline's ability to reduce capacity if needed. Several reasons can be found for this. Let us think about a situation whereby airlines, in recession, are forced to sell an aircraft. Getting out of a leasing contract is exceedingly costly as well as keeping capacity idle. The "use it or lose it" rules on different airports can create barriers to leave behind some of the routes.

We can conclude that various rivals tend to compete more aggressively in order to keep their business in the competition. On individual markets, airlines tend to be in highly mixed positions. While the market for flights between two destinations is the core market for an airline that offers direct flights, it is often a marginal market for another airline, which is providing the service through a transfer connection. Between such heterogeneous rivals the ability to avoid deep price competition is less likely. It is also important to note that airlines are exposed to specific policies in their home market. Once they compete internationally, they meet companies operating under different conditions what can affect the competitive interaction between the two in terms of efficiency or value proposition. Airline's cost structure also depends on different economic incentives. Over time, labor costs tend to rise and the pressure for business development forces airlines to increase complexity of their operations.

Threat of new competitors

The possibility of new competitors arriving to our market of operations is extremely high. More than 1300 airlines were registered in the past 40 years (2), and the rates are surprisingly not slowing down, despite the low industry profitability. Nevertheless of the high number of new

competitors, a significant share of new entrants in the industry eventually fails, even in the LCC segment.

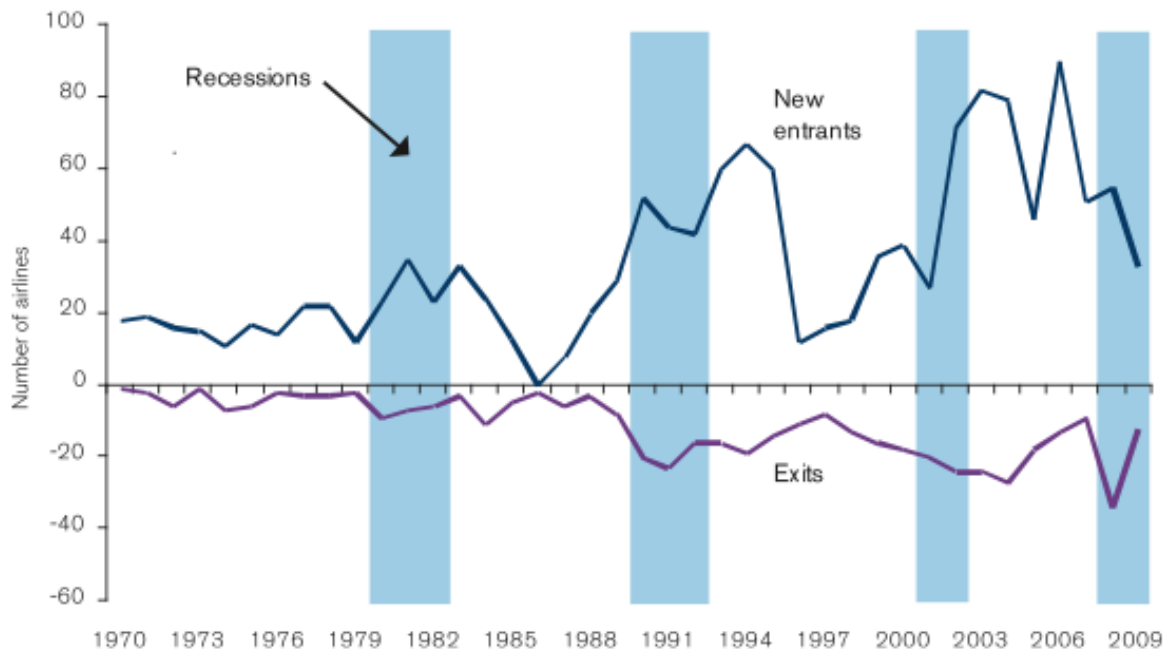


Figure 12 - Number of new entrants vs exits in Airline Industry (worldwide). Source: Vision 2050 by IATA

As we can see from the above chart as well, the number of new entrants in the market is continuously increasing in a higher rate than the ones that exit the markets.

A new entry of a competitor as seen above occurs often, mainly through existing airlines expanding their services to new markets. A recent example occurred at Lisbon airport where so far, from the most valuable LCCs, only Easyjet operated flights from, but as of October 2013, Ryanair, the competitor of Easyjet initiated its operations. In markets where the serving flag carrier was impacted by an entry of a new competitor, government policies in the past could favor the local existing airline, but with the new EU laws these are already unlikely to happen. The European Union has strict laws against governments funding their local airlines, with legal punishment to countries that not comply with the regulation. A penalty was already applied in 2012 to Hungary (7), for funding Malév.

Bargaining power of buyers

The bargaining power of buyers in the airline industry became significantly high with the spread of Internet and travel agents. A relevant portion of customers are highly price sensitive especially within those from mature markets. There is a low perceived willingness to pay for different extra services. Customers' loyalty to specific airlines is low as well, unless it is a frequent traveller who can really benefit from companies loyalty program such as business travellers. Different players in the industry can influence customers bargaining power, such as the power of channels and the power of end customers (2).

When talking about the power of channels we are focusing on the different intermediaries who are delivering a service for the end customers, which afterwards influences airlines operations. Examples of such channels are aggregator websites, who directly concentrate on one place the consumer's buying power. By using different websites the consumers can focus on the price factor, what increases the pricing transparency across airlines. The other channel aggregator is the predecessor of aggregator websites, such as travel agents. These agents often represent large corporate clients with a significant power of demand across carriers.

When talking about the power of end customers we are focusing on the needs of different customer categories. For business customers, frequency of flights between different destinations is the key factor. Airlines have tried to avoid customers switching between competitors with the use of their loyalty programs. As an example, by setting expiration of frequent flyer miles, airlines can create incentives to use miles and therefore stay loyal to the given airline. In the case of leisure travellers, the choice would be more influenced by the price than by other factors such as travel time or carrier specific services. In average the service between network carriers and LCCs on board can be identified very similar, while additional costs such as baggage or priority boarding may play a differentiating role for a choice of airline when comparing prices. For leisure clients there is no significant cost associated with flying with different airlines, therefore the loyalty programs are not the right initiative for them.

Bargaining power of suppliers

The bargaining power of suppliers is very high in several critical sectors, such as: Airframe and engine manufacturers, Labor, Airports and Ground handling.

Airframe and engine manufacturing is highly concentrated globally into some of the biggest companies. The two major airframe producers are the French Airbus and the American Boeing. Switching between them does not bring big costs for the companies, as the costs for new aircrafts are fixed, and the supplier provides training (if needed). Nevertheless, most of the airlines chose to build up their fleet with a base of a chosen airframe (fleet of Airbus or Boeing). As for the engine manufacturers, the main players are Fairfield (General Electric Company group), the London based Rolls-Royce Holding, and Pratt & Whitney owned by United Technologies Corporation. Given the fact that these companies are highly positioned in the airline industry they have a great bargaining power over the airlines.

When it comes to labor, airlines are dependent on their skilled employees, especially on pilots and technicians. Airlines that work with one main hub (such as network carriers) increase the chances of existence of an increased power of unions. These unions are usually segmented into different type of staff, with each of them having the possibility to disrupt operations.

Airports hold a special bargaining power, as most of them hold local monopolies with limited competition from secondary locations around them. There are few new airports being built, therefore airlines have to manage their routes based on already existing players, calculating with the different pricing airports set for their services. Many airports have become more aggressive in their pricing strategies after being privatized, which resulted that most of European airports manage to earn their yearly cost of capital (2). Airport switching costs are relatively high for network carriers that are focusing on providing connections to their customers. For point-to-point airlines, especially for LCCs is easy to switch between different metropolitan airports, especially using those where network carriers are not using.

Last but not least, in the case of ground handling companies, airlines are their specific, and most of the cases, only client. A significant number of airlines still provide ground-handling services themselves (around 60%) (2) but the level of outsourcing to independent providers and airports is

expected to grow in the future. Ground-handling and catering companies have limited bargaining power over airlines as mainly, as seen above as well, airlines can provide the service internally.

Threat of substitute products

The biggest threat for airlines is not a new substitute with alternative methods of transport but the decision to not to travel. For instance, this is especially the case for leisure travellers who can decide to spend their money on other activities, and for business travellers who may decide to delay their trips. Air transport is still positioned in first place when talking about speed of travel, while the cost of flying is becoming more affordable. The significant drop of in real costs of air transportation has increased the advantage of air travel against substitutes, and further technological improvements are expected. Reduced costs on Phone/Web/Video conferences are cutting some of the needs of business travellers. In point-to-point short haul connections high-speed trains can rise to generate competition in Europe and Asia.

Industry's state of art

From the above analysis we can conclude that the airline industry is facing deep underlying challenges in achieving attractive economic returns. The industry's low profitability is a result of a price-dominated rivalry between already existing and new entry airline competition. Price sensitive customers and powerful suppliers have the power to capture majority of the value airlines create. Nevertheless these factors can be found in many other industries as well, i.e. hotel industry or automotive industry, yet, they manage to result with a higher profitability rate when compared to airline industry.

According to IATA's research (2), airlines low profitability is due to government policies, strategic choices by airlines and behavior of suppliers. Due to government intervention airlines operate in a semi-liberalized market environment with various restrictions to cope with. When governments privatize airlines, they let labor unions gain powerful positions to gain their approval, rather than creating an efficient market structure. When governments privatize airports

they look for maximizing revenues instead of the overall value creation in the industry. When governments are concerned about environmental costs or air service to specific locations, they focus on narrow regulatory solutions or political pressure instead of creating a market environment in which airlines have an incentive to serve these objectives.

Another key reason for low profitability is the airlines' and suppliers' behavior pattern. The issue is caused by airlines' focus on volume and yield, rather than on margin. They compete on size and network breadth, rather than on differentiation. Eventually with these actions they contribute to a market environment that is worse for everyone. Two good examples are the drive to improve yield management and the growing outsourcing of activities.

Yield management, as it applies to airlines, is the control and management of reservations inventory in a way that increases (maximizes, if possible) company profitability, given the flight schedule and fare structure (37). But the extensive use of yield management may cause a negative impact on the industry. Frequent price changes have reduced its transparency, leaving customers constantly uncertain about whether they got the 'fair price' (2). This increases the use of aggregator websites, as customers are looking for the better deal, as price became the key product feature in the airline industry. Outsourcing has been one of the key mechanisms to reduce costs in the short term. But it impacts on a longer-term the industry structure: It gives less control to airlines over their value chain, reducing the potential for differentiation. It harmonizes cost structures and service levels across airlines, reducing competition to the factor 'price'. And it further reduces entry barriers into the industry.

Therefore we can conclude that both network and LCCs are operating in a highly competitive industry where different elements/players are influencing the decision making process. Cost is a key factor in terms of capturing customers, therefore in order for network carriers to keep up with the LCCs expansion on a short haul market a reorganization of pricing strategy is the key for the upcoming years.

Which airlines benefited from the fall of Malév? Please identify some of the market entry strategies these airlines profited from.

This question is focusing on the competitor movements following the fall of Malév airlines on February 3rd, 2012. Many of the airlines jumped on the opportunity rose, and by analyzing their movements can point out potential market entry strategies used by airlines.

Malév, before grounding, was operating between 50 short haul destinations with a fleet of 22 aircrafts. Among the long-haul flights, Malév was operating from 1990s to 2007 flights to Toronto and New York JFK airports. Malév, as a One World alliance member, was operating with codeshare agreements together with airlines such as British Airways, Iberia and Air Berlin. Outside the One World alliance they also worked with codeshare agreements with Air Baltic, Air France and Alitalia.

On the February 3rd, 2012 many Malév passengers were left stranded in different locations without a plane ticket to return home. The first competitor, who rose for the opportunity was the LCC competitor, Hungarian WizzAir. Wizzair offered a rescue plan for Malév passengers, with a promotional fee of 9900 HUF (33€) in exchange for a one-way Malév ticket between the period of February 3rd and March 24th for 16 destinations. (38)

Table 4 - Malév's Alliance Members and Partners with Code Share, prior to grounding.

One World Alliance Member	Code share
AirBerlin	Aeroflot
American Airlines	Air Baltic
British Airways	Air France
Cathay Pacific	Alitalia
Finnair	Bulgaria Air
Iberia	Carpatair
Japan Airlines	Czech airlines

LAN	Ethiad Airways
Malaysia Airlines	Hainan Airlines
Quantas	Moldavian Airlines
Royal Jordanian	Syrian Air
S7 Airlines	

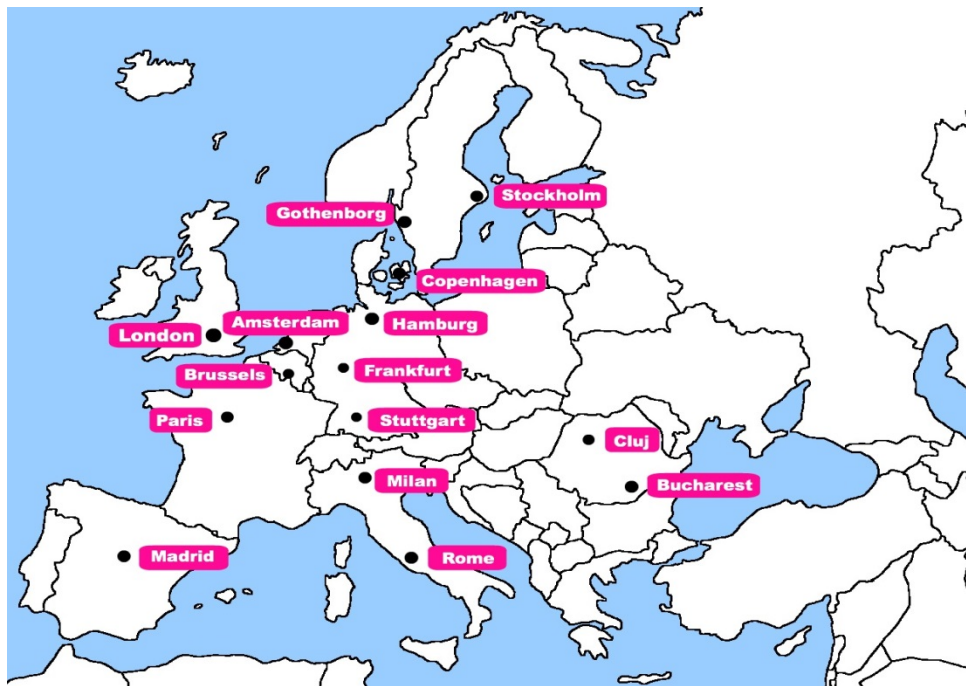


Figure 13 - Wizzair's destinations with a promotional fee of 9900 HUF, immediately after Malév's grounding.

Following Wizzair, 20 other company reacted to the new empty slots on Budapest airport, with two main purposes: Some initiated new routes to/from Budapest, others increased their already scheduled weekly flights to/from Budapest.

Table 5 - Changes on different companies' routes in Budapest. Source: CNN (10).

	New routes to/from Budapest	Increased number of flights to/from Budapest
Airlines		TAP
	Wizzair	Alitalia
	Ryanair	Tarom
	AirBerlin	Aerosvir
	Qatar	LOT
	Jet2	Germanwings
	Transavia	Lufthansa
	AirBaltic	Finnair
	Smartwings	Brusselsairlines
	Blue 1	Aeroflot
Aegean	Norwegian	

Ryanair, the other LCC operator in the market, announced 26 new routes from Budapest in order to capitalize on the grounding of Malév. Ryanair also based 4 aircrafts in Budapest with a plan of carrying up to 2 million passengers per year. (39)

Some of the network airlines also grabbed the opportunity of the liberated routes available and entered into the Hungarian market as operators for scheduled short haul flights. Few operators used their already existing knowledge on the market as they were already working with Malév either through the alliance membership, or via codeshare, therefore creating weekly scheduled flights to/from Budapest, or increasing on the volume of the already existing timetable was an easy opportunity for them. An airline who benefitted from it is the One World member Air Berlin who announced on the day of the fall of Malév, that they are going to fly between Berlin and Budapest on a daily base (40). Aeroflot, the Russian network carrier, who used to work with Code share with Malév increased its weekly volume from 10 to 14 flights (41). Alliance

memberships as mentioned before are beneficial for the airlines, as via this agreement airlines can link their network of routes and sell tickets on the flights of their alliance partners, therefore offering customers access to several destinations around the world with one single network. Furthermore, alliance memberships offer opportunities to the airlines in entering new markets directly or indirectly via their member partners, therefore, having the possibility of receiving market know-hows directly, without much effort done. With wider network, an airline can also benefit from broad brand recognition, mainly via code sharing agreements with a partner in a particular region (42). This gives the possibility to familiarize customers with a particular brand in a new region, create value attached to its brand, and by using the alliance membership reduce marketing costs involved. In case of the fall of a member airline, it can create a one and only opportunity for an airline member to take over the routes operated by the fallen member, using the already gained market knowledge and the value created in the local customers' perception.

The above listed airlines benefited from the fall of Malév, and by analyzing BUD's traffic, we can conclude that Malév's direct or indirect competitors managed to take over the empty slots left by the fallen Hungarian airline, and continue operations leaving BUD with a total of 8,429,843 passengers in the end of 2012.

Low Cost Carriers: Are they the future of short haul flights? Please justify your answer.

In the recent years airline industry faced a struggling period. Airlines in all regions battle to generate return on invested capital equal to the weighted average cost of capital except for LCCs in Europe, Asia-Pacific and Latin America.

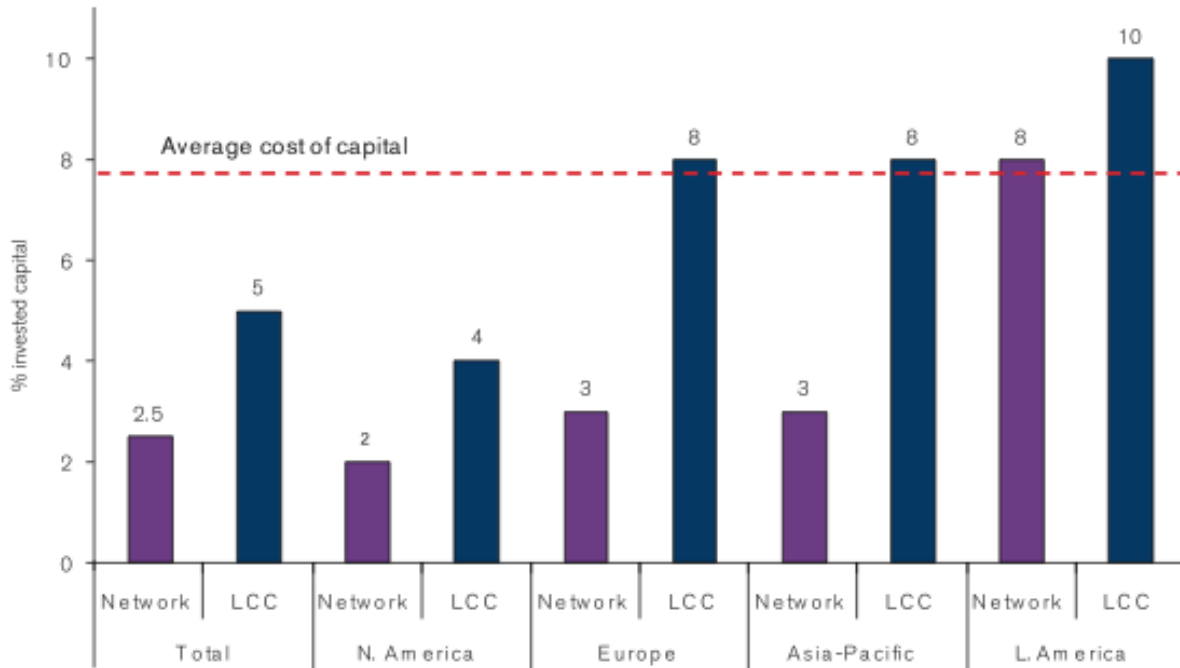


Figure 14 – Return on Invested Capital (ROIC) by airline in each region. Source: Vision 2050 Report (2).

Low cost airlines have been operating in Europe for the past decades. In this time they managed to gain significant market share in the European Aviation Market. LCCs transformed the concept of airlines, as the traditional distinction between scheduled and charter airlines disappeared, and LCCs have taken their place. LCCs are airlines that work with a business model of low fares, and charged extra services for the passengers (43). The LCC concept developed in response to the deregulations of airlines in the United States in the 70s, in Europe in the 90s, and later on the rest of the world. This gave a strategic advantage to LCCs, as on the newly deregulated markets they could choose which ever market they wanted to serve. LCCs have a business model that has lower operating costs and different debt structure when compared to network carriers.

Table 6 - Comparison between Network carriers and LCCs. Source: (43).

	Network carriers	LCCs
Business model	Global strategy and high costs	Niche strategy, Low costs
Network	Hub and spoke, Alliance memberships	Point-to-point, Regional airports
Fleet	Different types of aircrafts, moderate aircraft utilization	One type of aircraft, High aircraft utilization
Product	Full service, Branding focuses on full service concept, Complex fare structure	Self-service, Branding emphasizes price, Simple fares structure
Sales policy	Sales departments, Global distribution systems	Direct sales, Internet based
Operations	Traditional check in procedures, Multiple classes, In-flight service	e-ticketing and self-service check in one class, In flight extras available for purchase

This business model allows LCCs to maintain a lower price range for the customers, when compared to network carriers. Lower prices increase the load factor and allows LCCs to make profit on smaller operating margins. Based on the European Union Committee on Economic developments and Affairs (44) the main operating characteristics of LCCs are:

- Creation of new routes, often to secondary airports
- Concentration on short and mid-range distances
- Point-to-point flights between smaller airports. This allows them more rotations per day, with no regard of connectivity at the place of arrival
- Flexible flight time tables which allows them to seasonal changes in demand
- Pay levels are relatively lower

- Cabin crew is often used to clean the aircraft between flights
- The aircraft used often have the maximum possible number of seats
- All meals on board is purchased on relatively high prices
- Landing fees at the airports used are low or non-existent
- No onward baggage facilities are provided
- No provision is made for missed connections
- Web based reservation systems are employed, lowering costs for operations

In contrast, traditional network carriers have differentiated themselves on the basis of service and network. Thus, a network carrier may offer various classes of service (i.e. economy class, business class, first class) and serve major hubs or international airports. Network carriers normally develop a big coverage of hub and spoke networks providing high level of connectivity to its passengers (18). A traveller on board of a network carrier can expect a full meal and often free beverages including alcoholic drinks.

Nevertheless the general tendency, some LCCs operate routes, which originate from major airports, but they only do so if the predictions show that it is going to be profitable. Therefore LCCs have the possibility to attract passengers from network carriers, thus offering competition and reducing load factors and profits for network carriers (20). In the recent years, several events were impacting the external environment airlines operated in, such as the big economic crisis of the late 2000s, the continuous low profitability of the airline industry, the rise of the LCCs as competitors, among others. NCs executives originally believed that the low cost model is restricted to a niche market sector, gaining only passengers who would have never flown otherwise, or whom the NCs would not like to attract as customers (23). Throughout the years it became obvious that LCCs expanded from their original niche in times of crisis and established a potentially sustainable business model, that is better prepared to adapt to changes in short haul flights than NCs. These factors pushed the network carriers to rethink their business model. According to Markus Franke (23), the way NCs have to restructure themselves in order to regain strong competitive power on short haul markets are:

- Restructure network/hub operations to remove scheduling constraints and reduce cost penalty of complexity

- Simplify customer interface at the airport and in distribution
- Create separate business systems for distinct customer segments

Restructuring of hub and network operations must be based on the re-evaluation of the compromise between hub connectivity and productivity. NCs used to try to maximize connectivity, and accept the high cost for scheduling limitations. Goedecking and Sala (45) pointed out that the tradeoff between increased productivity and revenue losses through reduced connectivity does not reach its optimum at complete ‘de-peaking’, but through a prioritization of connections (23). This means that high revenue traffic should be adjusted to connectivity and low revenue traffic to productivity. NCs are trying to adjust to this model by joining to alliances, whereby with reduced costs the connectivity planning is shared among different airlines.

Departure flights

Lisbon (LIS) > Budapest (BUD)







Flight	Flight operated by	Departure	Arrival
<u>TP0558</u>		08:10 Lisbon	12:15 Munich
<u>TP7982</u>		15:15 Munich	16:30 Budapest
Flight operated by: Lufthansa			
<u>TP0576</u>		14:15 Lisbon	18:25 Frankfurt
<u>TP7978</u>		21:20 Frankfurt	22:55 Budapest
Flight operated by: Lufthansa			
<u>TP0572</u>		08:25 Lisbon	12:35 Frankfurt
<u>TP7968</u>		16:20 Frankfurt	17:55 Budapest
Flight operated by: Lufthansa			

Figure 15 - Example of a cross-booking between alliance members. Source: TAP website (<http://flytap.pt>)

As this example shows from Star Alliance, TAP Portugal and Lufthansa managed to create a strong relationship whereby they use different hubs (Munich, Frankfurt) for optimizing connectivity and assure the passenger flow on the short haul market.

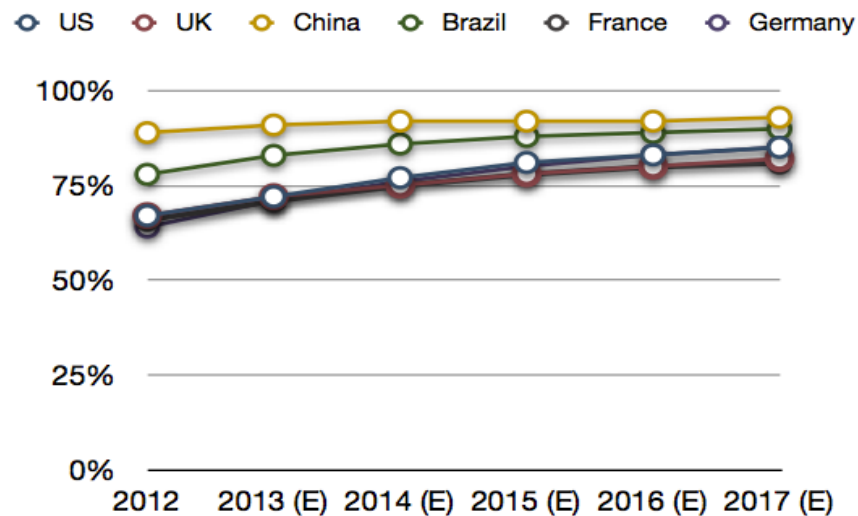


Figure 16 – Anticipated smartphone adoption among passengers. Source: Henry Harteveltdt (46)

Simplified customer interface is in regards of the passengers itself. Markus Franke (23) called attention for a differentiation in operations between high yield and low yield customers. According to him a more efficient model would offer a basic set of processes to standard passengers, provide premium treatment to high value clients (i.e. lounge, fast line in security check) while supplying special processes only to passengers that value them. In fact these predictions took effect. The development of user-friendly technology helped greatly in order to simplify the day-by-day technology interface from the moment of purchasing fares till check in at the airport. The use of online platforms increased immensely, giving the possibility to passengers to locate all deals in one place. NCs managed to pick up some of the operations attributes of LCCs due to cost cutting measures, and to facilitate clients' needs of fast passage throughout the airport facilities. Starting out with self-check in devices at the airport, today, online check-in platforms are available on most of the airlines websites giving the possibility for clients to reduce the waiting time at the airport at check in counters and also to reduce costs for the airlines (46).

The increase use of mobile devices also allows airlines to reduce costs on ticket/boarding pass emission, as many applications were developed already to serve passengers and airlines.



Figure 17 - Example of a mobile application boarding ticket. Source: Passbook iPhone application.

Separating business stream for distinct business segments provide the opportunity to offer more specific services offerings, without increasing the complexity. Therefore according to Frank Markus (23), a more tailored business stream is required to be implemented by NCs in order to achieve a more efficient industrialization of simple processes. Airlines are approaching to adapt this method by implementing some of the characteristics of LCCs business model.

Lowest price

Organise by:




	Basic	Classic	Flexible	Business Reduced	Business Flexible
08:45h Madrid (MAD) 10:40h Gran Canaria (LPA)  IB3924 Operated by Iberia Express	 <input checked="" type="radio"/> 87€	<input type="radio"/> 102€	<input type="radio"/> 260€	<input type="radio"/> 491€ <small>4 final places</small>	<input type="radio"/> 571€ <small>6 final places</small>
<p> The fare Basic includes</p> <hr/> <p>Baggage in hold Not included. 1st piece (max. 23 kg and 158 cm) Cost online 15€ Consult additional baggage</p> <p>Change Changes not permitted</p> <p>Refund Refund not permitted</p>					

Figure 18 - Example of different types of product in a Network Carrier. Source: Iberia booking website.

Some of the airlines in the process of separation of business streams are now offering “LCC like” fares, with reduced costs and reduced services (i.e. baggage not included).

By the analysis done, one can predict that NCs, by the pressure of industrial environment, and customer needs are increasingly forced to adapt some of the LCCs business model in order to capture customers back. As studies concluded show, customers will increasingly seek better value for money spent on short haul flights, and take advantage of low fares to vacation more frequently. The airline market is more likely to consolidate into a small number of large NCs and LCCs whereby half of the operations will be carried out by the surviving LCCs. As Frank Markus (23) forecasted it already in the early 2000s, a reformulation of business model is needed for NCs, and recent years changes in NCs activity prove that the changes are already in motion. The LCCs model is already present in the business offering of some of the biggest NCs, and it is expected that many more will follow.

Management Conclusion

As we have seen from the case study, Malév has been struggling for more than a decade before it finally ceased operations. The airline had its own internal issues, originated from bad governmental decisions, unsuccessful privatization attempts, always changing top management and a collection of state aid programs. Apart from all internal difficulties the airline was facing, there was a changing external environment in the airline industry what for several reasons the top management and government failed to foreseen, or act upon it.

Right after the fall of Hungary's flag carrier, competitors and ex-alliance members jumped on the empty slot created in Budapest airport and after a short decrease in operations, today Budapest airport operates on full capacity. Wizzair, its low cost competitor now holds the right to operate in many of Malév's key routes.

Across all over the world the tendency of maintaining airlines in public hand was decreasing, as in a profit driven world a politically influenced airline could hardly measure up to those in private hands. Today in Europe only 10% of the airlines remained governmentally owned, thus the era of flag carriers have ended.

We know now, that the airline industry overall is not profitable; many airlines are forced to bankrupt or to restructure their business model. Nevertheless the low profitability, the demand for travel is growing, therefore airlines need to find a way to cope with the changing demand of customers, to cut costs and to be able to provide low fare tickets.

The low cost expansion started out in the 70s in the states, and 90s in Europe with the deregulation of the markets, giving the possibility to a new approach of business model among airlines. Ryanair and Easyjet spread its wings around Europe rapidly, and with the extent of aggregator websites, the price war between LCCs and NCs became more vivid. Today, the remaining NCs have grouped into one of the big alliance groups in order to reduce costs by jointly operating some routes, or providing connection flights to one another, therefore focusing more on point-to-point connections rather than networks.

Nevertheless the efforts, forming alliances did not prove to be enough, and a serious of business model changes was called upon. Today on the short haul markets the network carriers and low

cost carriers operate on a very similar cost range, and with the reduction on onboard services, the service offered is also becoming 'low-cost like'.

In the future we can expect that the balance between NCs and LCCs is going to become even on the short haul market and the new fight will began for the long haul flights.

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