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Towards a means of consistently comparing airline business models with an application to the 'low cost' airline sector

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ABSTRACT

Meaningful definitions of and distinctions between airline business models are not easily formulated, particularly when one considers the extremely dynamic nature of the industry. The paper outlines a *product and organizational architecture* (POA) approach to classifying and relating key elements of airline business models. Using indices to create benchmark metrics, the POA model is then used to examine and compare six European airlines. The analysis shows that there are important differences in the business models of airlines that are all commonly referred to as 'low cost carriers'. The paper demonstrates how differences in the business models adopted by the different airlines contribute to their relative profitability.

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1. Introduction

Much has been written about the low cost airline business model and what elements in the business model distinguish it from traditional full service airlines. Williams and Mason (2004) reviewed the group of strategies that together enable low cost carriers to exercise cost advantages over full service airlines (p.8) (see also Francis, Alessandro, & Humphreys, 2003). The review highlighted significant differences between low cost carriers in their business models. For some carriers it is not clear if they should be called "low cost carrier", "regional carrier", or some other term. When comparing airline performance it is useful to compare one airline with others of a similar business approach and contrast it with other airline pursuing alternative models. However, the fundamental problem is that is a lack of a consistent and standardised approach to analysing airline business models. This paper seeks to go some way towards rectifying this methodological gap.

2. Product and organizational architecture

Synthesizing complex airline business models requires the identification of key components of the product architecture – the service quality elements that define the product relative to consumer preferences, and organizational architecture – the vertical structure, production and distribution choices of the airline. A conceptual framework can be developed to consider both the product and organizational architecture of firms. Such a product and organizational architecture (POA) approach can be applied directly to airline business models. Fig. 1 illustrates the general POA approach to defining a firm's business model and its competitive environment. On the one hand, product architecture gives rise to a core product bundle that positions the firm in terms of consumer preferences (benefit drivers) and the competitive environment (as defined by the market structure). On the other hand, the product design also implies a choice set for inputs and possible organizational structures (cost drivers) which define the firm's cost position. Taken together, both product and organizational architecture contribute to the creation and sustainability of profits.

2.1. Applying the POA model to airlines

Fig. 2 shows an application of the POA approach to airline business models. By so doing we aim to develop a means by which airlines can be consistently compared. Product architecture is separated into three elements of service quality: *connectivity*, *convenience* and *comfort*. These three elements have the property that they follow a general ordering with respect to the degree with which costs are fixed or 'avoidable'. In particular, *connectivity* implies a choice of network design that distinguishes hub-and-spoke (airline-supplied connectivity) from point-to-point (passenger-supplied) networks. This is perhaps the most important

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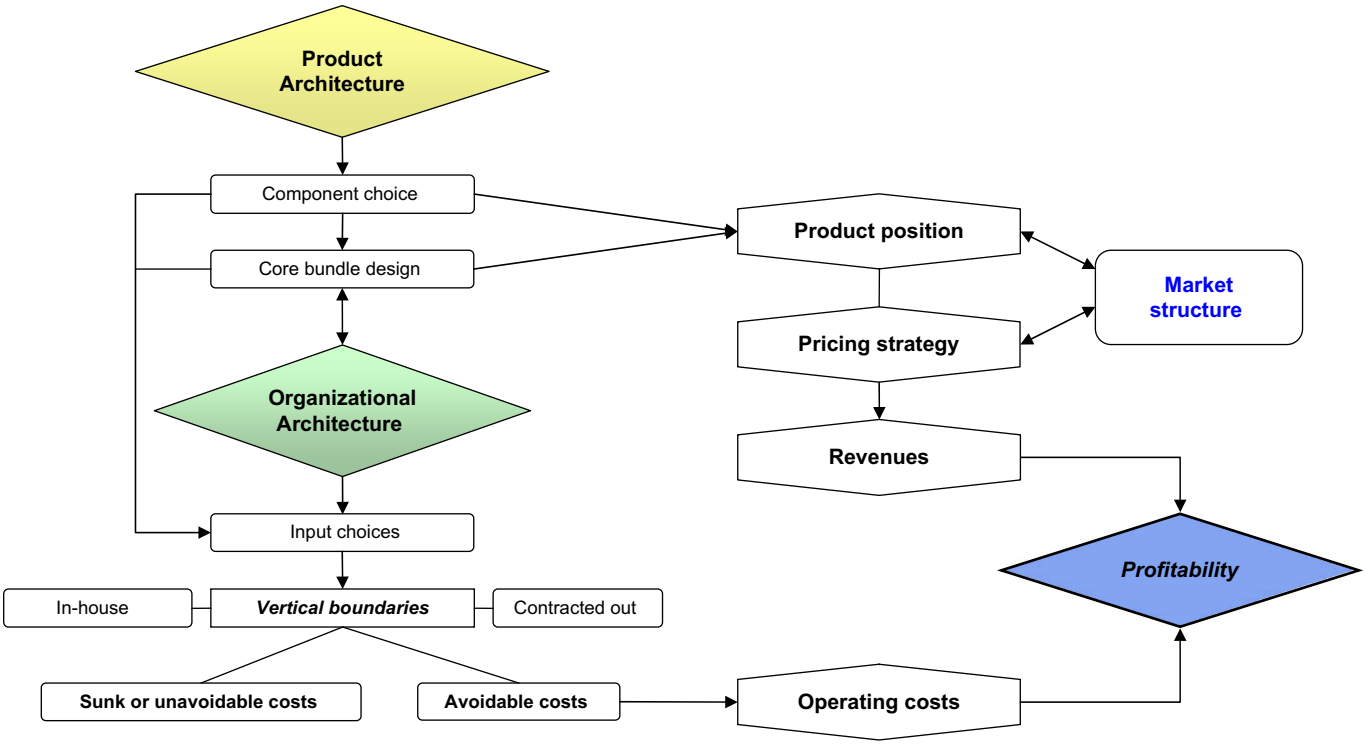

Fig. 1. General product and organizational architecture of a firm.

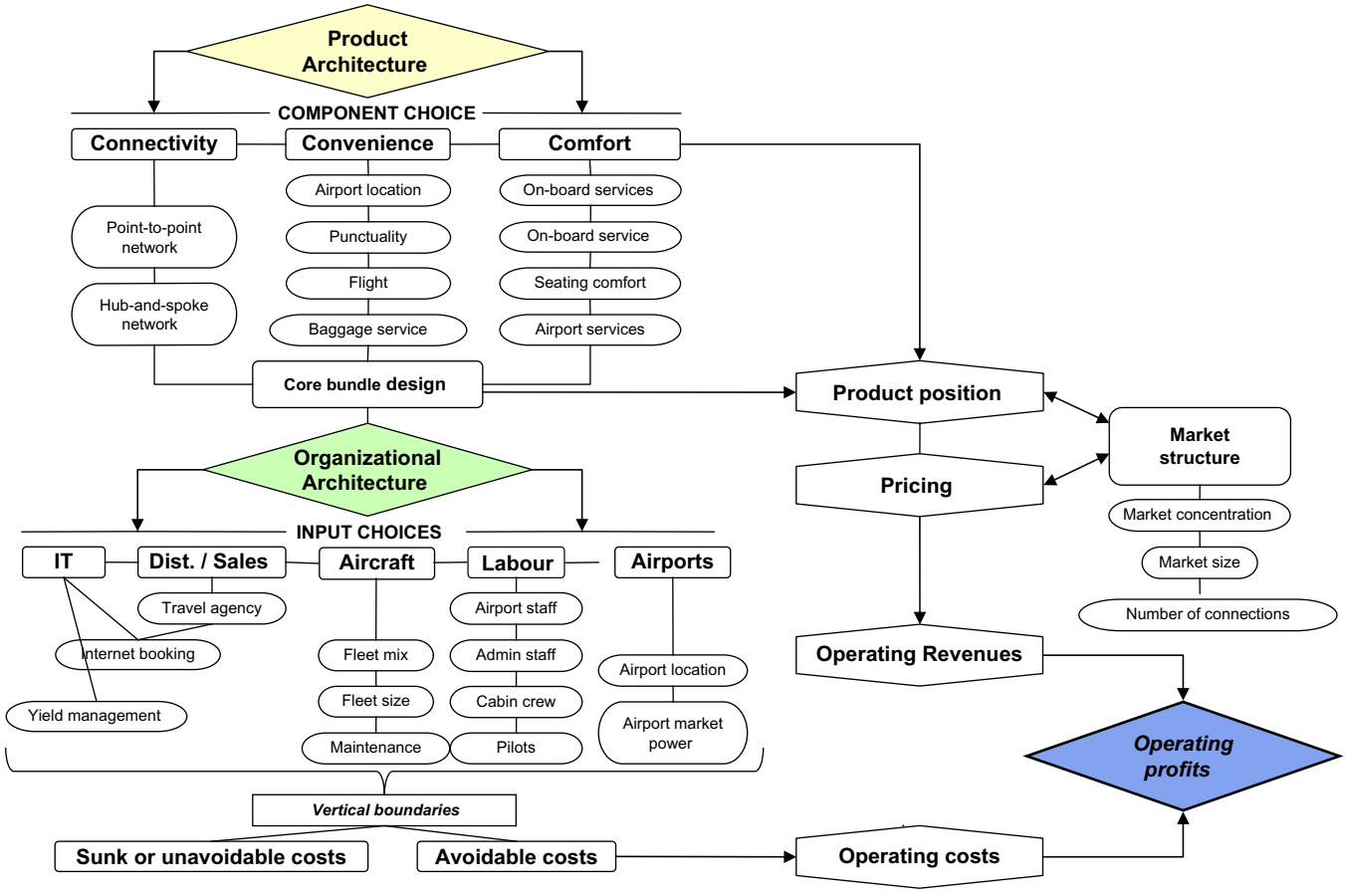

Fig. 2. Schemata of product and organizational architecture of airlines.

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