

## Air<sup>n</sup>eth Report 11

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### Air<sup>n</sup>eth workshop ‘The economic crisis and the impact on the network quality of hub airports’

22 September 2009

Crown Plaza Hotel Promenade - The Hague, The Netherlands





## Summary of the workshop

One of the key priorities of Dutch air transport policy is to maintain and strengthen the network quality of Amsterdam Airport Schiphol. One may expect that the current economic crisis will affect network quality of (hub) airports negatively. However, it is unclear to what extent the economic crisis will have a more structural impact on the network quality of airports.

On 22 September 2009, Airneth organized a meeting to disentangle the relationship between network quality and the economic crisis. During this workshop, several speakers gave their opinion about this relationship. The main conclusions of this meeting can be summarized as follows:

- The impact of the economic crisis on European airport traffic is severe. Until now, the impact on demand (e.g. passengers) is larger than the impact on supply (frequencies, destinations). By accepting lower load factors and lower yields, airport network quality is kept at an acceptable level.
- Until now, the economic crisis has not resulted in de-hubbing processes at European hub airports. Airport de-hubbing occurs when the hub carrier ceases to operate a wave-system structure, removing all or part of its operations from the hub.
- Moreover, no substantial difference can be observed between the traffic developments at primary and secondary European hubs over the period 2007-2009. This means that, at least for now, airlines do not seem to consolidate their operations at the primary hubs in their network.
- De-hubbing is possible in times of recession, but also takes place outside times of recession (due to merges, take-overs and bankruptcies).
- Decreasing network quality in times of recession seems to be a more cyclical issue, thus temporarily, than a structural development.
- However, if an airline decides to de-hub an airport, the traffic development history at de-hubbed airports around the world learn us that this is frequently an irreversible process.
- In other words, most de-hubbed airports do not recover in the short to medium term as an airline hubs at the same level as before de-hubbing. Instead, de-hubbed airports become a battleground for alliances or low-cost carrier entry.

**The presentations of this workshop are available through the Airneth website:**  
[http://www.airneth.nl/index.php?option=com\\_docman&task=cat\\_view&gid=90&Itemid=15](http://www.airneth.nl/index.php?option=com_docman&task=cat_view&gid=90&Itemid=15)

## Introduction

On 22 September 2009, Airneth organized a workshop about the impact of the economic crisis on network quality of hub airports.



One of the key priorities of the Dutch air transport policy is to maintain and strengthen the network quality of Amsterdam Airport Schiphol.

One may expect that the current economic crisis may affect network quality of (hub) airports negatively. It is unclear to what extent the economic crisis will have a more structural impacts on the network quality of airports.

Therefore, the economic crisis and the risk of a decreasing network quality call for a view of experts in both the air transport industry and the international academic world on the possible impact of the crisis on the network quality of Amsterdam Airport Schiphol and hub airports in general.

### **What is the impact of the economic crisis on the network quality of hub airports?**

Airneth organized a meeting to disentangle the relationship between network quality and the economic crisis. In this report, we have summarized the results of this workshop.

The views expressed in this document are not necessarily those of Airneth. Airneth has summarized the results of the meeting as accurate as possible. Any errors in this summary report remain ours.

## **The global financial crisis: Fall-out for Europe's airlines – Keith McMullan (Aviation Economics)**

The economic crisis spread almost instantly from the US to the rest of the world, and directly to the airline industry. All segments of network carrier traffic are down with 10-15% in 2009. Only intra-European LCCs still managed to have a growing traffic figures. The suffering airlines have developed two network strategies to maintain network quality: cost cut and/or adjust capacity and consolidate and/or rationalise. The stock market values of airlines have dropped by 8 billion euro.

European network majors face limited damage in the short run, but they suffered from severe cash burn, and still managed to have good liquidity. Consolidation in itself proves not to be a solution for the impact of the economic recession. The LCCs Ryanair and Easyjet proved to have a strong balance sheet. They even experience growth through geographical flexibility. All other LCCs are having trouble finding financing and thus, are vulnerable.

Other low cost subsidiaries (hybrids) such as Vueling/Clickair, must focus on an effective strategy, rather than economics of size.

The business model of specialist models have experienced failure of their concept (Silverjet, Eos).



## **Recession and Network Quality (Demand and Supply) – Jan Veldhuis (Airneth)**

In times of recession and in a competitive environment, airlines pay part of the cost; revenues decline by more than 10%, but reduction of seat is limited to 4% only. There is strong pressure on airfares and airlines accept lower load factors. Therefore recession and demand reduction is not necessarily reflected in an equal reduction in supply.

**“In times of recession and in a competitive environment, airlines pay part of the cost. By accepting lower fares and load factors, network quality is kept at an acceptable level, at least on the short term”**

Airlines have buffers (such as the possibility of lower fares and lower load factors) to keep network quality at an acceptable level, at least on the short term. Veldhuis shows that declining European network quality mainly appears within Europe. Intercontinental network quality remains practically stable.

Although low-cost airlines/leisure airlines seem to be relatively immune for the recession on average over 2007-2009 in financial terms, they still had to reduce number of operations in 2009 by 11%. In other words, low-cost carriers /leisure airlines could not avoid a severe drop in supply in 2009.

Alliance airlines were best able to maintain network quality. Interestingly, Veldhuis observes no substantial differences between the primary and secondary hubs in terms of the change in the number of operations. This means that, at least for now, airlines do not seem to consolidate their operations at the primary hubs in their network.

## **The effect of the economic crisis on network developments at Amsterdam Airport Schiphol – Daniel dos Reis Miranda (Schiphol Group)**

Dos Reis Miranda shows that in 2008 and 2009, there was a negative growth at Amsterdam Airport Schiphol due to the economic crisis and the impact of the Departure Tax. In relative terms, the biggest drop in seat capacity can be observed in the European, low-cost and leisure segments. The intercontinental routes are hardly reacting.

However, the impact of the economic crisis on the network of Schiphol (supply) is smaller. The portfolio of European destinations at Schiphol has hardly been affected by the economic crisis, although there is some loss of (mainly) business destinations.



These losses have been compensated by new leisure destinations. Also the number of intercontinental destinations at Schiphol has hardly declined. Although the number of destinations stayed the same, the average number of weekly frequencies has gone down.

The outlook for the future traffic development at Amsterdam Airport Schiphol airport is very uncertain, as the outlook for the economic recovery remains unclear at the moment.

## **Is de-hubbing reversible? – Renato Redondi (ICCSAI)**

Airport de-hubbing occurs when the hub carrier ceases to operate a wave-system structure removing all or part of its operations from the hub. As a result, the hub suffers from substantial reductions in its traffic volumes. Reasons for de-hubbing are hub carrier bankruptcy, mergers and takeovers, and airline network restructuring. In recent history, there have been several cases of de-hubbing in Europe and the US, such as British Airways at Gatwick, Alitalia at Malpensa, Sabena at Brussels and American Airlines at Nashville.

Redondi identifies five possible scenarios for the traffic development of airports after de-hubbing.

- Decline: empty capacity available after de-hubbing is not being used by other carriers (Clermond-Ferrand, 2004). This is a form of irreversible de-hubbing.
- Re-hubbing: a new airline starts to operate a hub at the airport (Denver, 1994).
- Carrier recovery: De-hubbing is the result of the hub carrier having financial problems that could lead to bankruptcy. If the carrier recovers or is taken over by a new carrier, the hub network quality could also recover (partly). In this case de-hubbing is reversible (Zürich en Brussel, 2002).
- Low cost entrance: Low-cost carrier gradually fill the empty capacity available after de-hubbing, is by offering point-to-point services (Gatwick, 2002). This is a form of ir-reversible de-hubbing
- Battleground for alliances: The empty capacity available after de-hubbing is gradually filled by carriers that are feeding transfer traffic to and from other hubs with their services. In this way, the airport becomes a ‘satellite airport’ (downgrading) and reversibility of de-hubbing is not probable (Malpensa for Lufthansa (2008) and Barcelona for Spanair (2008)).

Although alternative scenarios are certainly possible, Redondi concludes that de-hubbing is not likely to be completely reversible.

One of the strongest effects of de-hubbing is the decrease of intercontinental direct services. However, this may not necessarily be too negative for passengers. There may be competitive alternative travel options via other hubs and passengers could



benefit from the entry of low-cost carriers In this context, passenger accessibility has to be distinguished from hub connectivity.

**“Although alternative scenarios are certainly possible, de-hubbing is not likely to be completely reversible”**

Finally, according to Redondi, the current economic crisis has not yet directly triggered a de-hubbing process at European airports.

## **The economic crisis and the position of European hubs in the STAR-Alliance network – Michael Stumpf (ECAD)**

In his presentation, Stumpf covers the hub system of Star Alliance, which is the largest multi-hub system in Europe in terms of connections.

Lufthansa has no mega-catchment area like Paris or London. Therefore, a multi hub strategy is important. Feed from all over Europe is essential. Fragmented market and demand patterns in Central Europe require a broad strategic approach: Multi-hub, multi-brand and multi-product.

**“Lufthansa has no mega-catchment area like Paris or London. Therefore, a multi hub strategy is important”**

The Lufthansa multi hub system is organized along three different pillars:

- Matching important traffic flows by maintaining high connectivity and high frequency.
- Regional complements: each hub has its own regional destination specialism. Traffic from FRA, MUC and VIE are complementary.
- By means of decentralization at each of the hubs, the airline is closer to the customer and the competition. The hub management has been converted to divisions with increased responsibility and core operational, service and management functions have been assigned to decentralised units.

The Star Alliance is coping comparably well with this economic recession. As a consequence, traffic at their hubs seems to recover quickly and follow the world economy's V-shaped recovery pattern, not the L-shaped permanent downturn observed in aviation after 9/11.



## The Air France-KLM dual hub system – Pieter Cornelisse (KLM)

Air France/KLM strategy with respect to their hubs is that of a dual hub system. Paris CDG and Amsterdam Schiphol airports each have their specialism in intercontinental destinations, although larger markets are served from both hubs. KLM and Air France also have a uniqueness in their European destination portfolio. KLM operates mainly to/from Northern Europe, whereas Air France operates mainly from Southern Europe.

**“Conditions to keep the network at Schiphol Airport at a competitive level, are a sufficient amount of origin-destination traffic, good landside accessibility and sufficient peak-hour capacity”**

One of the conditions to keep the network at Schiphol Airport at a competitive level is to maintain its position in the ‘peer’ group (CDG, FRA, LHR, SPL). To achieve this, a sufficient amount of origin-destination traffic is required. Landside accessibility is crucial in this respect. Furthermore, sufficient peak-hour capacity has to be available at the airport.

Another condition is the place of business, Amsterdam and its surrounding region have to be developed as an attractive settling ground for businesses.

### Main issues during the panel discussion

- Key issue of network quality

Most mentioned key issue of network quality is number of connections (hub quality) and quality of these connections (excellent, good etc.). In the coming years, the trend will be major hubs with sufficient frequencies for passengers with a good quality of connections.

- Common destinations at multi hub system with two hubs

A multi hub system, which operates with more than two frequencies, can always remove one frequency. In this way, it prevents removing an important destination. One must try to find other solutions before deciding to cut in destinations. Cutting destinations is always the last resort.

- External effects of international airports/airlines



One view expressed during the discussion is that the air transport sector is paying low taxes in comparison to other transportation sectors. The tax levels of airlines and airports could be raised. Full social costs of airports/airlines must be taken along with determining the taxation level. If Schiphol airport downgrades to a secondary hub or even a point to point airport, this would not be necessarily bad for the Amsterdam region.

- Network quality with regard to travel costs

The dominant view is that also airfares must stay low enough. This will help to maintain network quality. If Schiphol becomes a third class airport, other hubs will take over intercontinental destinations. In this case it will be very hard to reverse these effects. If Schiphol would only operate on an origin-destination market, only one third of its network will remain.

- Consequences of an eventual AF-KLM bankruptcy

Hub-and-spoke networks are airline systems, where the airlines make the decisions. If they were to be bankrupt, the hub traffic of a hub airport will disappear to other competing hubs. These abandoned airports will then be searching for new airlines who are willing to begin a base at their airport. The government should be careful with posing high taxes on airports as well as airlines. Generally airlines can relocate to another hub if taxes are too high.

- Schiphol listed number 4 in main division of European hub airports

Schiphol is the smallest airport in the primary division, but does not have to fear its position. As long as other airports who follow Schiphol remain in the second division and Schiphol maintains its current position, there is no risk.

**The program and presentations concerning this seminar can be found on our website [www.airneth.com](http://www.airneth.com).**