Network Hubs vs. Point-to-Point, Is There a Problem?

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“The Basic Business Model of the Network Carriers is Broken”

- “They will have to reinvent themselves or go out of business” Why?
- WN, B6, FL have 30% cost advantage
- Non-unionized workforce
- Better business practices
  - Selling most tickets over internet
  - Higher utilization, shorter turns, no waiting at hubs, B6 redeyes
- Capacity share of LCCs in domestic U. S. is rapidly approaching 1/3

The Indictment of Hubs (Economist, 3/27/04)

- LCCs
  - Simple point to point
  - No transfers, no baggage transfer, no lounges
  - Charge for food and drink
- Network carriers
  - Planes sit around for a long time waiting for connections
  - Flight crews hang around, ground staff hang around
- Key flaw, budget airlines turn a plane around in 25 minutes while "it takes 90 minutes for a jumbo"

Some Observers have Predicted for a Decade that the future is point-to-point, the Network Hub is Doomed

- Why?
- Naïve observers mesmerized by the inexorable advance of Southwest
- Yes,
  - Southwest dominates short-haul point-to-point in markets where they compete. BWI, DAL, HOU
  - Oops, “dominance” is not true when a hub carrier is on either end
    - UA at SFO vs. WN at OAK
    - UA at ORD vs. WN at MDW
    - HP at PHX vs. WN at PHX

WN's Expansion has created A Hub and Long-haul Carrier

- Southwest is now a major hub and long-haul carrier. It supports its own flying by one-stops and connections through:
  - LAX, PHX, HOU, DAL, SLC, MCI, MDW, BNA, BWI
  - For WN's build-up at BWI, connecting is essential
- Does WN's operational difference in operating a hub predict a major change for network legacies?
  - WN planes turn in 25 minutes at hubs
  - Passengers wait for the connection, the planes don't wait for the passengers. Many waits are 2 hours+

Even constrained to the American Landscape, LCC's ≠ Point-to-Point

- Not just the evolution of WN into a hub carrier
- Look at the successful LCCs which operate a core, old-line, network hub operation
  - Air Tran at ATL
  - Frontier at DEN
- JetBlue is different
  - Huge local market at JFK
  - No need to connect, can fill planes with local
  - Connecting is gravy, so far upstate NY and BTV

How Can a Network Carrier Make Money Against a Massive LCC Attack?

- No network carrier more under assault than BA
- RyanAir, EasyJet operate most of their capacity ex-Luton, Stansted, etc. to Europe
  - "The European market is going the same way as U. S. but it is all happening much faster" (Economist)
  - Aviation Strategy: LCC account for 33% of UK domestic capacity, 33% UK-Europe
- Surely BA is reeling from this attack, on its knees?

Surprise! BA is not on its Knees

- BA: Predicted to make $1.1 billion profit (£600) in year ending March 2004, despite SARS!
- Emerging from recession and SARS, AF and LH are also highly profitable
- Why are Big European hub carriers successful despite the LCC invasion?

British Airways, what's the secret?

- $1.1 billion profits in past year
- The MOST affected of all European airlines by LCCs.
  - Ryanair, $9 to Barcelona, Charleroi, Pescara, Bergamo
  - Easyjet to major competing airports like AMS
- Yet major European hub network carriers are not battling for the traffic from Luton to Pescara

How European Hub Carriers Differ, Can we Count the Ways?

- Decades of Fighting the Charter Carriers
  - B6 15*JFK-FLL
  - Germany? *Urlaubsflüge*
    - 5*daily Paderborn/Lippstadt to Majorca
    - Many others all over the Mediterranean from Tenerife to Rhodes
    - More still from Hamburg, Berlin, Dusseldorf
    - These are on carriers you never heard of: Air Berlin, Condor
  - Britain? The same, “bucket shops”

More Ways Europe is Different

- Decades of Fighting the High-speed Train
  - Most Important France, then Germany and NL, least important Britain
- Less VFR Travel
  - Ryanair takes people to French villages (Pau) where they don't know anyone
    - Not Like U. S. where everyone has relatives everywhere
  - Ryanair, Easyjet are creating travel that didn't exist before, not just diverting from BA

European Network Carriers do what they do best, NETWORK!

- Misguided financial analysis, heard for years
  - “BA makes all its money on its intercontinental network, loses money in Europe”
- BUT BA could not have that intercontinental network without backup from Europe
  - Poor cost and revenue accounting
  - A network is a network, you can’t unravel it
- Pan Am in the late 1980s was the opposite
- By never becoming dependent on charter, rail, VFR traffic, European airlines do what they do best

BA and LH, Where are they Flying? (no code-shares, explain)

	LHR	LGW	FRA	MUC
Domestic	48	41	85	80
Western Europe	130	62	138	108
Eastern Europe	15	0	27	19
Middle East	10	0	11	4
Africa	10	0	7	1
Asia	10	0	13	3
North America	35	5	25	3
Latin America	3	4	3	0
Total	261	112	309	218
# not Dom/WE	83	9	86	30
% not Dom/WE	32	8	28	14

Contrast with U. S. Network Carriers

- Even the Most International of the U. S. Network carriers don't match BA or LH
- UA:
  - 13 international wide-body departures each from SFO, ORD, IAD
  - ORD: 13 out of 620, barely 2%
- Smaller planes (DL)
- More dependence on Florida, LAS, PHX, prime territory for LCCs, would have been charter decades ago in Europe

Other Accusations at Networking

- “New Longer-range planes undermine dominance of hubs in many regions”
  - Does SQ flying SIN-LAX undermine any hub or just strengthen SIN and LAX as hubs?
  - Does EW flying DXB-ORD undermine any hub or just strengthen DXB and ORD as hubs?
- On the contrary, smaller planes have strengthened hubs (they are not flying P-to-P)
  - 744 to 777 on Pacific (DFW-NRT, ORD-KIX)
  - 747 to 763, 757 on Atlantic (EWR-EDI)

The Future of U. S. Network Hubs

- The solutions?
- Network where the LCCs "aren't"
  - More international supports the domestic network
  - This year:
    - CO EWR-OSL, EWR-EDI
    - UA ORD-KIX, SFO-PEK
- The inexorable march of the RJs:
  - 35=>50=>70=>90=>100 seat RJs
  - RDU-ORD last week on a 100-seat RJ
  - RJs vs. the congestion problem: the compromise at ORD

It’s the COSTS not the CONCEPT

- No-brainer, any network carrier can make money at any hub with the right costs
- Efficiency? The rolling hub concept
  - WN’s achievement vs. AA’s attempt
  - AW&ST:
    - AA Shaved 4 min at hub, 8 min at spoke
    - Median connecting time extended 7 min, mean much longer
    - 4% loss of market share vs. UA at ORD
- The recipe for monopoly hubs? No hub is a monopoly

Technology is Steadily Attacking Costs

- The spread of technology helps the legacy carriers as much as the LCCs
  - Internet distribution
  - At-home check-in
  - Lobby e-kiosk check-in
  - In-concourse kiosk rebooking
  - At-gate bar-code readers, EGR
- Where Have the Lobby Lines Gone?
- Crandall’s comment about oil prices

The Real Problem: Legacy not Network

- We refer to “Legacy Network Carriers”
- The problem is:
  - The “legacy”
  - Not the “network”
- Any old corporation unwise enough to create defined benefit pension plans is saddled with them
  - LTV, Bethlehem Steel
- Vs. Defined contribution, 401Ks, profit sharing (in cash, not company stock, a secret of WN)
- Legacy carriers digging themselves out from outdated union contracts and lease rates. AA most successful by cutting costs out of bankruptcy. Still to come: NW, DL

The Future of Network Hub Carriers

- Escaping the LCC competition, inexorable drive to international routes that can only be fed from a network
  - Whether CO flying to 20 cities in Europe from EWR or to 20 cities in Mexico from IAH with RJs
  - Whether UA chipping away at China route rights, next to come, nonstop SF-Guangzhou?

Hollowing Out the Middle

- Current uniformly sized 737, M80 fleets concentrate capacity in 110-140 seat range
- Too large for domestic, too small for intl
- Wave of the future
  - EMB 170, 190
  - CRJ 70
  - Not a happy future for the 737
- AA reinventing east coast via ERJs with 35, 45 seats (BOS-LGA-PHL-DCA-RDU)

Legacy Carriers will Hunker Down to Hubs

- B6 will push AA and UA off transcons except for a few "movie star" routes and international connections
- Big hubs are favored over small hubs
  - More network connections
  - More ability to reschedule to rolling banks
- Hubs that may be doomed (too small, no international)
  - US in general, esp. PIT
  - DL at SLC
  - CO at CLE
- Can AA and DL at JFK survive B6 onslaught?

Hubs of the Future

- Any city with low local traffic generation should look like CVG, with RJ feed
  - Could STL have been saved?
  - Will NW at MEM be viable?
- Hubs that will be here 20 years from now
  - All of these
    - AA at MIA, DFW, ORD
    - CO at EWR, IAH
    - DL at ATL, CVG (but not DFW, SLC)
    - NW at DTW, MSP
    - UA at IAD, ORD, DEN, SFO (not LAX)
  - US? Silence . . . .