IMPACTS OF LOW COST CARRIERS ON REGIONAL TOURISM

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ABSTRACT

Following the collapse of Ansett in September 2001 and the emergence of low cost carriers Virgin Blue and Jetstar, domestic air travel has experienced considerable growth. Aggressive marketing strategies, low fares and increased capacity by both Virgin Blue and Jetstar with B737 and A320 services have benefited many Queensland destinations such as Cairns. However as the research presented in this paper shows much of the growth in air travel attributed to Low Cost Carriers has occurred at the expense of modes such as drive, long distance coaches and rail. This paper examines the impact of LCCs on the modal composition of travel to Cairns with particular emphasis on aviation.

Keywords: low cost carriers, regional tourism growth, Cairns, Virgin Blue, Jetstar, transport modes.

INTRODUCTION

Deregulation of domestic aviation markets commenced in 1990 although it was not until a decade later that Low Cost Carriers (LCCs) became an established part of the Australian aviation market. Aggressive marketing and deep discounting by LCCs has stimulated significant growth in air travel as the public have been able to travel further and more often because of lower prices. The tourism industry appears to have has been a major beneficiary of LCCs particularly in regional Australia. However, instead of creating overall growth in domestic tourism the introduction of LCCs has encouraged mode substitution from cars and coaches to planes. The research undertaken in this paper indicates that in the period from 2001 to 2005 the growth in air travel to Queensland has been at the expense of other modes, particularly the drive sector. While largely unreported, the fall in drive tourism has had an impact on tourism dependent firms in the transit corridors that connect generating regions and regional destinations. In the future there is also a danger that the introduction of the LCC model to international aviation will further erode the domestic tourism market as domestic travel is substituted for international travel.

The current growth of air travel encouraged by LCC and the parallel decline in drive tourism can be described as the second wave of transport substitution caused by LCCs. The first wave occurred after deregulation in 1990 when Compass introduced low fares and had a significant impact on the national long distance coach network. Cheap air fares encouraged passengers to switch to air and within 12 months a number of national coach operators including Deluxe had collapsed. The shakeout continued over the next decade until by the time the second wave of deregulation occurred the number of national operators had fallen to one. After reviewing the characteristics and development of LCCs this paper examines how they have effected the model composition of tourism travel to Cairns in Queensland.

CHARACTERISTICS OF LCCS

Australia's two low cost carriers, Virgin Blue and Jetstar, operate a total of 74 aircraft (as at July 2006) and have developed extensive route networks. In the Queensland domestic market, for example, LCCs account for 60% of total seat capacity. The operational structure of a 'no frills' airline is not governed by any specific set of formulaic approaches (Childs 2000). Each airline has to assess the relative conditions of the market they intend to operate in taking into account a range of market factors such as which routes to enter, aircraft type, seat capacity, and competitive conditions. Overall however, there is a need to be adaptive in the short term and highly competitive in the long term (Donne 2000). All aspects of the operations of LCCs are directed to achieving a cost advantage, expressed in operating cents per passenger kilometer, and to maximize revenues. To reduce seat cost per kilometre a variety of operating strategies are employed including offering lower wages and less generous conditions than full service airlines, achieving fast turnarounds, cleaning of the interior of the aircraft by cabin crew, minimal crew expenses for overnight stays, lower marketing costs through Internet distribution and low administrative overhead costs. The importance of cost advantage was demonstrated by Jetstar when it was able to achieve a market entry cost base of 8.25 cents per available seat kilometer (ASK) compared to 8.72 for Virgin Blue (Creedy 2004). With an all A320 fleet, Jetstar expects its cost base to fall to 7.8 cents per ASK (Creedy 2004). LCC strategies are ultimately aimed at minimizing operating costs whilst maximising revenue and yield.

Globally, a key factor of LCCs success has been the operation of fleets based on one aircraft type or variations of the same marque such as the 700 and 800 series Boeing 737s and all economy class seating. This operational model is designed to minimise maintenance costs, reduce inventory and spares, simplifier crew rosters and achieve efficiencies in crew training. LCCs do not provide complimentary in-flight meals/snacks or free drinks or include in-flight entertainment in ticket prices. In most cases LCCs prefer to lease aircraft which gives them flexibility to respond to fluctuating demand between peak summer and winter traffic, acquire newer aircraft and achieve lower capital outlays with monthly fixed lease charges.

LCCs generally operate short haul flights between one and two hours in length although in Australia there are some exceptions such as coast to coast services and direct flights from Adelaide and Melbourne to Cairns. This enables LCCs to gain more operating cycles and achieve a higher number of flying hours per day than most full service airlines (Frawley 2004). However, because air fares are usually pitched below those of Full Service Airlines (FSA) a higher load factor is often necessary to achieve profitability but this is managed through sophisticated revenue management systems. LCCs also contract out a range of services including maintenance so that they keep costs variable rather than in high fixed cost assets and plant. Table 1 below shows the competitive strategies of low cost carriers.

Table 1
Competitive Strategies Adopted by Low Cost Airlines

Markets/Routes	Enter highly trafficked routes where market penetration strategy can be applied Alternatively, carve out niches by serving and growing leisure markets using non-major airports
Equipment	Generally operate one type of aircraft. Save on inventory, spares, training and knowledge required
Airport Terminals	Keep it simple and basic. No lounges, unnecessary space. Fast turnarounds, e.g. Southwest Airlines are 20 minutes.
Utilisation	Aim is to achieve 11 hours flying time per aircraft per day whereas full service airlines achieve over eight hours.
In-flight service	Minimal – customers can buy snack food and limited range of beverages. No need to have flight kitchens and associated overheads – contract out this service.
Labour costs	Employ pilots and cabin staff under schemes different to full service airlines

	Try to avoid overnight stays with scheduling and crews Use younger staff and more contract, casual employees Maintain a small head office and locate themselves near airport or in a lower priced rental area.
Distribution	Encourage direct business and web bookings versus widespread travel agency distribution. Save on selling expenses – servicing agents and commission.
Pricing Strategy	Keep fares below the full service airlines Tend to keep fare structures uncomplicated Offer prize draws and inducements to stimulate demand and maintain customer interest as well as publicity generated All one-class travel.

Developed by authors

LCC IN AUSTRALIA

Australia's early experience with a 'value-based' airline came soon after deregulation when Compass Airlines begun services in December 1990. Compass claimed to have a lower seat per kilometer cost than the two incumbent airlines (Qantas and Ansett) and quickly achieved a 10 per cent share of the market but a year later Compass ceased operations. A second Compass Airlines under different ownership lasted an even shorter time.

Although both Ansett and Qantas offered a range of advance purchasing fares aimed at the leisure market, both carriers were regarded as legacy airlines and their extensive route network costs was ill-suited to a low cost operation. A major change occurred in 1999 when the Federal government, perhaps recognizing that deregulation had failed to achieve one of its aims of having at least one new entrant, allowed Virgin to establish a 100 per cent foreign-owned airline to operate in the domestic market. Virgin's business model was a adaptation of the model used by other successful LCCs including Virgin Atlantic.

Virgin Blue became the first new entrant into the domestic market for almost a decade. Its start was initially small and it had only four aircraft. However, the carrier quickly gained momentum and its fresh brand and different style of doing things became widely accepted by the traveling public. Its fare structure was simple yet innovative and it advertised one way fares. In its first year of operation, Virgin only captured 5-6 per cent market share but it had a significant impact on Ansett. Following the collapse of Ansett in September 2001, Virgin was able to increase its fleet and quickly captured a 30 per cent market share. Its profits grew and its continued penetration into the leisure market forced a rethink of strategy within Qantas.

The Qantas response was to launch its own low cost carrier. Many aviation commentators and writers were skeptical about its success drawing their conclusions from the examples overseas where full service airlines had tried, usually unsuccessfully, to operate a low cost subsidiary airline. From the date that the Qantas Board agreed to establish a LCC, the time it took Jetstar to began operations was less than one year. A considerable amount of Qantas' resources were allocated to the creation of Jetstar although Qantas denied its start-up costs were as high as the $90 million reported (Frawley 2004; Sandilands 2004). The new carrier was headed by Alan Joyce who had learned the LCC industry with Ryanair, the airline on which Jetstar was modeled. It began services in May 2004 with a different livery and image and staff employed under different terms and conditions that were less costly than the Qantas model. To avoid direct competition between the two carriers, Qantas segmented the Australian market into: leisure routes where the majority of travelers were holiday makers or visiting friends and relatives (VFR) passengers; and high yield business routes. On the leisure routes Jetstar services have largely replaced Qantas services. As a strategy, Qantas created a pincer movement around Virgin. Qantas ceded its leisure market to Jetstar which then sort to increase it share of this market by capturing customers from Virgin.

Since 2002 and post the Ansett collapse, growth in passenger numbers has increased from 30 million in 2002 to 42 million in early 2006. Much of this growth can be attributable to the emergence of LCCs. Capacity has grown strongly especially to leisure ports that are now served by B737 or A320 aircraft.

MARKETING STRATEGIES

A key marketing strategy for both LCCs has been seat sales. Seat sales are heavily promoted to a range of destinations with the total number of seats advertised (but not to each destination or on each flight). Seat sales apply for a limited period or until sold out. The lead times can be both short and long, for instance a seat sale advertised by Virgin Blue in September was for travel in February after the end of the school holidays. When Jetstar was launched it made an introductory seat sale offer of 200,000 seats at $29 that was immediately countered by Virgin Blue offering 300,000 seats on selected routes (Creedy 2004). In January 2005 Jetstar again initiated a fare war by offering 300,000 seats at a base fare of $9 plus taxes on 15 routes including Sydney- Sunshine Coast and Sydney-Gold Coast (Creedy 2004). Other routes on the airline's network were offered between $29 and $69 one way. Jetstar claimed they were trying to "incentivise" more travel during the traditionally lower patronised periods such as February. Jetstar also stated that they were determined to be the lowest fare operator in the domestic market (Owen-Browne 2003). Only a few days later after the Jetstar offering, Virgin Blue announced $1 flights when it launched what some viewed as a promotional gimmick with its "happy hour" perpetual sale on the Internet between 1300-1400 hours daily. The discount flights had to be taken within 30 days and routes varied on a day-to-day basis. On the first day the happy hour fares were released, about 1,000 people took advantage of the sale, twice the number expected given the lack of advertising.

IMPACT ON OTHER TRANSPORT MODES

The low fare environment has caused a shift in the modal composition of tourism transport in a number of destinations. The impact on Cairns in particular will be discussed later. Impacts include a fall in drive tourism and the near demise of inter-city coach travel which by 2006 had consolidated into one national operator operating under several brand names. Coach operators now focus on regional networks and special interest groups such as backpackers, although city to city services on a national basis are still operated. Passenger rail has also suffered as a result of LCCs. Train journeys between southern state capitals take about 12-13 hours but can be flown in a little over an hour for the same price or lower.

INCREASED DEMAND FOR AIR TRAVEL TO QUEENSLAND

The introduction of LCCs opened new markets for many regional destinations in Queensland however the overall increase in visitor numbers in some areas has not been as large. Destinations now benefiting from increased flights include Proserpine (Whitsunday Coast Airport), Hamilton Island, Hervey Bay airport (from July 2005), the Sunshine Coast (Maroochydore) and Cairns. LCCs operate into ten Queensland destinations from Cairns in the north to Coolangatta in the south. Table 2 illustrates the pattern of domestic travel into Queensland and for the Gold Cast and Cairns for the period 2001 to 2005 based on passenger modes.

Table 2 indicates that there has been substantial growth in domestic air travel into Queensland during the period (22% or 755,000 persons) however during the same time self drive has declined by 4.5%. In actual visitor numbers self drive arrivals have declined by 527,000 persons. In the same period declines have been experienced in coach travel by 129,000 persons (down 44%) and rail by 27,000 persons. Based on these figures it is apparent that the increase in travel by air has been at the expense of travel by self drive and coach. Thus, rather than increasing overall travel to Queensland, LCCs have created a substitution effect between modes. Given that the overall national domestic tourism market has been almost static for some time any increase achieved by one mode will almost always be at the expense of competing modes.

When the figures presented in Table 2 are analysed on a destination by destination basis a different pattern emerges. In the 5 year period 2001-2005 Brisbane has only experienced marginal growth (3%) in visitor arrival by air whereas Tropical North Queensland has experienced a 35% growth in arrivals by air while the Gold Coast has achieved an 18% rate of growth. In the case of Cairns, the growth in domestic arrivals by air (up from 421,000 in 2001 to 570,000 in 2005) has been largely achieved at the expense of self drive which has declined (26%) during the period from 832,000 to 610,000. Bus and coach also declined by 65% from an already low base of 27,000.

The shift from self drive to air can be expected to have a number of implications for tourism related businesses in the transit zones linking major destinations with their source markets. These may include a fall in visitation to small rural towns, loss of revenue for tourism dependent businesses and ultimately less demand for labour. In the destinations enjoying a higher arrival rate by air car rental businesses and tour operators stand to gain the most. These impacts have yet to be assessed.

Table 2
Transport Used by Domestic Overnight Visitors (Visitors)

Region	**Transport used on trip**	**Year ending December 2001**	**Year ending December 2002**	**Year ending December 2003**	**Year ending December 2004**	**Year ending December 2005**
Brisbane	Air	1,443,000	1,289,000	1,344,000	1,434,000	1,487,000
	Water	47,000	52,000	61,000	58,000	69,000
	Self Drive	2,711,000	2,672,000	2,909,000	2,894,000	2,646,000
	Bus or Coach	85,000	86,000	101,000	92,000	82,000
	Rail	142,000	194,000	140,000	237,000	213,000
	Other	83,000	90,000	100,000	116,000	71,000
	Not asked	6,000	7,000	6,000	7,000	15,000
Gold Coast	Air	985,000	991,000	845,000	1,111,000	1,161,000
	Water	16,000	12,000	33,000	20,000	10,000
	Self Drive	2,265,000	2,370,000	2,567,000	2,289,000	2,224,000
	Bus or Coach	88,000	56,000	68,000	51,000	51,000
	Rail	145,000	99,000	82,000	63,000	48,000
	Other	38,000	16,000	31,000	40,000	27,000
	Not asked	3,000	3,000	10,000	14,000	6,000
Queensland	Air	3,445,000	3,326,000	3,575,000	4,066,000	4,200,000
	Water	112,000	161,000	128,000	126,000	146,000
	Self Drive	11,614,000	11,693,000	11,364,000	11,833,000	11,087,000
	Bus or Coach	380,000	321,000	347,000	299,000	251,000
	Rail	439,000	480,000	362,000	458,000	422,000
	Other	179,000	222,000	294,000	262,000	224,000
	Not asked	27,000	31,000	55,000	31,000	40,000
Tropical	Air	421,000	389,000	606,000	642,000	570,000

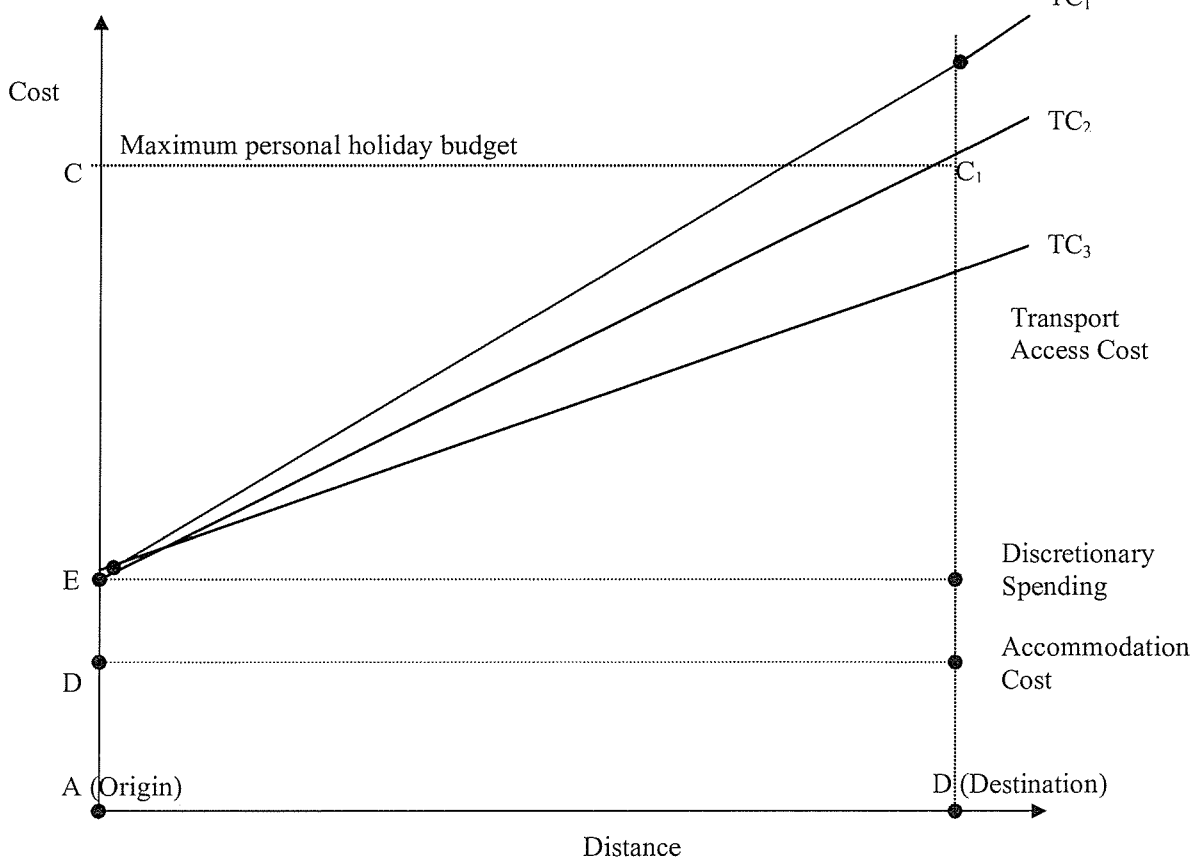
North Queensland						
	Water	9,000	20,000	13,000	26,000	2,000
	Self Drive	823,000	778,000	712,000	744,000	610,000
	Bus or Coach	27,000	45,000	38,000	35,000	12,000
	Rail	24,000	15,000	25,000	14,000	36,000
	Other	14,000	21,000	45,000	19,000	14,000
	Not asked	12,000	8,000	19,000	15,000	7,000

Source: Decipher accessed 28 September 2006

CAIRNS

Cairns is both a major international airport as well as a domestic port and since the opening of an international terminal in 1984 international arrivals have grow rapidly and by 2005 had reached 538,614 (Cairns Port Authority 2006). Domestic arrivals have also grown particularly in recent years with the introduction of cheap seats by LCCs. As Prideaux (2000) pointed out the reduction in airfares to desirable destinations is likely to encourage destination and/or mode substitution. In the case of Cairns it appears that given the static nature of national tourism demand (almost no growth between 2000 and 2003), domestic arrival in Cairns by air has been at the expense of other destinations and at the expense of drive tourism. Figure 1 illustrates the impact that air fare reductions made possible by LCCs can have on destinations.

Figure 1



In Figure 1, the vertical axis represents the various costs encountered while holidaying, and the horizontal axis represents the distance of travel. Point A is the visitor origin point and D represents the destination that receives visitors from A. Accommodation cost is represented by

AD while discretionary expenditure is represented by DE (including shopping, tours and entertainment). Tourist may substitute between these expenditure categories thus a tourist may reduce expenditure on accommodation to increase expenditure on discretionary goods and services. The cost of transport to the destination is represented by EC. EC potentially has three components:

- The actual fare cost expressed in dollars,
- Time taken to travel from the origin to the destination. This is often not costed in specific dollar terms but is a real cost particularly where the tourist has limited time particulary if the individual tourist places a cost on the time taken to travel between the origin and destination, and
- The cost of comfort (an example in rail travel is first class air versus economy seats).

Transport costs may be treaded as variable because they increase with distance from an origin point and are tied to the various transport modes available. Tourists are also assumed to have a predetermined maximum personal holiday budget represented in Figure 1 as CC_1. In this paper, CC_1 is assumed to represent the travel budget of all travellers from origin A but in reality each individual will have their own unique budget which will determine their individual travel decisions. For purposes of illustration, travellers from origin A to destination D have a number of travel options with TC_1 being the most expensive, TC_3 the least expensive, where TC represents Travel Cost. To illustrate the options that become available to tourists when discount airfares are introduced to a destination a travel scenario is presented to show the interaction between the level of airfares charged and how tourists can adjust the budgeting mix for the three components of travel (transport, accommodation and discretionary expenditure). The scenario considers the impact of airfares and for the purposes of this discussion TC_1 represents the cost of airfares charged by a non discount carrier such as Qantas and TC_3 represents the cost of travel by a discount carrier. For the purposes of this scenario TC_2 represents another transport mode, in this case by road. On 30th October 2006 a standard fully refundable economy one way airfare from Sydney to Cairns by Qantas (TC_1) for travel on 18th December was quoted as \$782 while the lowest cost promotional fare was \$212. On the same date the cost of a fully refundable Virgin Blue fare (TC_3) was \$499 and the lowest promotional fare was \$179. If the cost of the full price air ticket exceeds the tourists total travel budget they are likely to see an alternative destination. The Virgin Blue fare is a more attractive fare for travel to Cairns and would make Cairns a suitable destination choice if the fare price fell within the person's travel budget. It is also clear that the reduction in air fares made possible by LCCs has an impact on other modes as illustrated in Table 2. By substituting air travel for road travel consumers also believe that they will incur a travel cost below TC_2 thus saving them money.

Building on the cost factors outlined above, it is clear that the purchaser of a low cost airfare has a surplus, based on the difference between the sum of the cost of the airfare plus AD + DE. This surplus may be used for a number of purposes including and extension of the length of time spent in the destination, an accommodation upgrade, additional discretionary purchases or they may select from a mix of these. As an alternative they may elect to use the saving for further travel at a later date. In the case of Cairns, the evidence outlined in Table 2 indicates that overall savings through cheaper airfares have resulted in additional air travel to Cairns.

When assessing the impact of LCCs it is possible to take several perspectives including an origin perspective and a destination perspective. From an origin perspective the normal rule is that as distance between the origin and destination increases the greater will be the cost of travel. As the distance increases destinations increasingly can be viewed as being on the periphery. Peripheries need not be only physical and can be based on perceptions of distance or on other factors, the principal of which is cost. In physical terms a periphery is a spatial concept that measures the location of a point of interest in a remote location by actual distance. A periphery can also be based on a perception of distance that separates it from the core. In this case the term 'core' refers to a tourism generating region (Oppermann 1993; Pearce 1995; Weaver 1998). The further the periphery is from the core the more difficult it is to generate visitor flows from the core. Peripheries are also based on cost of travel. The economies of aircraft such as the B 747 and Airbus 330 have reduced both the time and cost of travel thus reducing its degree of relative peripherality. On a small scale the introduction of LCCs has reduced the cost of travel from major domestic generating regions to peripheral locations such as Cairns.

DISCUSSION AND CONCLUSION

This paper highlights a largely unreported impact of LCCs on regional destinations. While air travel has achieved strong growth in the years following the start of the second wave of LCCs operations with Virgin Blue there has not been a corresponding increase in domestic tourism. Between 2000 and 2003 national overnight visitors to states and territories has fallen slightly from 73,771,000 to 73,612,000 (Decipher accessed 28 September 2006). Further analysis of national visitor data reveals that the shift in travel mode has been at the expense of drive tourism, long distance coach travel and rail.

It is therefore apparent that regional areas through which the drive tourists lost to LCCs previously traveled are experiencing a decline in visitor numbers. Irrespective of the recent issue of increase fuel prices regional areas in the transit areas between major tourism generating and destination centers are unlikely to regain this traffic if the pattern of model substitution experienced in the first wave of deregulation (1990) is repeated in the second wave of deregulation. Given the static nature of domestic tourism in Australia it is also likely that further growth in LCCs can only occur if international arrivals increase, Qantas loses market share or more travelers switch from road to air.

A further possible impact of LCCs on domestic tourism is likely to occur as a consequence of the growing demand for outbound travel. This will have a major impact on holiday/leisure destinations in Queensland and elsewhere. For example, for the year ended June 2005, Queensland resident departures for overseas destinations increased by 18.3 per cent (Tourism Queensland 2006). This is a worrying statistic for domestic tourism marketers. If the same growth is achieved in international LCCs services as has been achieved in domestic LCC services a number of popular regional destinations such as Cairns and the Gold Coast will face increased competition. Drive destinations in particular have come under increased competitive pressure.

LCCs have made a substantial impact on the way Australians think about travel and how they book it. With simplified fares, internet bookings, ticketless travel and relatively easy check-in, coupled and a good on-time performance, smart management and operating systems, LCCs now enjoy almost 45 per cent market share of all trunk route traffic and account for 60 per cent of seat capacity into Queensland. How much further can they can grow within Australia is an interesting question. Capacity may now have reached its peak as LCCs try to consolidate and concentrate on bottom line earnings. Clever marketing, including more co-operative marketing between destinations and LCCs, as well as investment in upgrading current infrastructure and building new infrastructure will need to be used to retain market share in the face of increasing demand for overseas travel.

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