DECEMBER 2013
McKinsey Quarterly

The economics underlying airline competition

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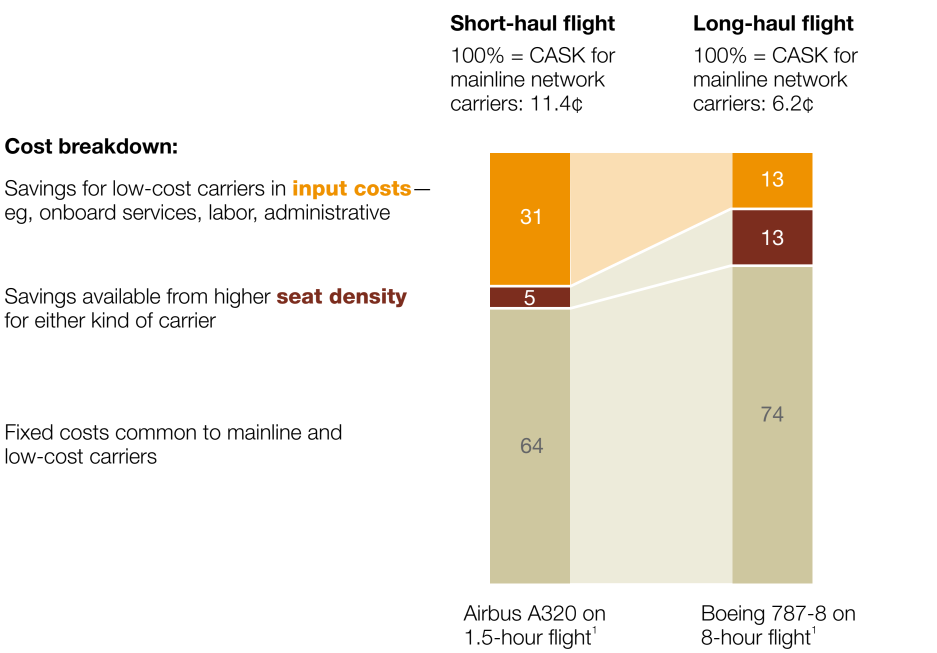
Budget carriers face difficult odds moving into the most profitable sector of the airline industry.

Over the past quarter century, low-cost-carrier (LCC) airlines have made strong inroads in a number of short-haul markets while largely shying away from the long-haul routes that generate over 90 percent of the mainline network carriers' operating profits. A comparison of the cost structures for short- and long-haul routes suggests an explanation: input costs, such as labor rates and administrative expenses—a sizable share of the LCC cost advantage on short-haul routes—are a much smaller share of the average cost per available-seat kilometer on long-haul ones (exhibit). At the same time, government taxes, fees, and surcharges account for around 80 percent of the ticket price in some long-haul markets—particularly in lower-fare categories—also leaving the LCCs with less maneuvering room to stimulate demand.

LCCs can reap savings on long-haul routes by squeezing more people onto the same types of planes, though this strategy is one that network carriers could imitate if they believed the volume would make up for lost margins from replaced business- or first-class seats. Given these realities, some LCCs are now turning their attention to medium-haul routes in Asia, where the economics are more favorable.

Low-cost carriers' input-cost edge is larger for short-haul flights than for long-haul ones.

Share of cost per available-seat kilometer (CASK), %



[1]Seat counts based on announced configurations by carriers that fit the respective archetypes; Airbus A320: 180 seats for low-cost carrier compared with 168 for mainline carrier; Boeing 787-8: 291 seats for low-cost carrier compared with 247 for mainline carrier.

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