Traffic and Fare Changes Resulting from New Nonstop Service—Recent Experience

By Eric Ford

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August 2005

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Synopsis:

An analysis of 82 U.S. markets where new nonstop air service was initiated provides a useful update of prior traffic stimulation studies. The period covered, between the third quarter of 2003 and the second quarter of 2004, provides some distance from the impact of 9/11 while also permitting the collection of adequate data subsequent to the start of the new service.

The analysis shows that on average, traffic nearly doubles (96%) between airports when new nonstop service is added. Much of this traffic growth, however, comes at the expense of nearby metropolitan airports. When the impact on surrounding airports is included, overall traffic grows at a much more modest 23%.

The amount of traffic stimulation varies depending on the size of the markets served—with the smallest markets showing the greatest stimulation. In addition, new nonstop service by low cost carriers (LCCs) generally creates more stimulation than new service by legacy carriers.

Regardless of the type of carrier providing the service, new nonstop service generally means lower realized fares. The amount of the airfare decrease varies depending on the size of the markets served—with the smallest markets showing the greatest airfare decreases.

In addition, for small and medium-sized markets, new nonstop service by LCCs generally means greater airfare decreases than new nonstop service by legacy carriers. However, for the largest markets, this is not the case. For the largest markets, new nonstop service by legacy carriers generally means greater realized airfare decreases than new nonstop service by LCCs.

These findings are explained in more detail in the accompanying report.

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I. Introduction

This report examines recent experience regarding the traffic stimulation and airfare decrease resulting from the introduction of nonstop service between U.S. airports that previously relied on connecting service. The differing impacts resulting from the introduction of service by different carrier types (legacy carriers versus LCCs[1]) are analyzed, as are the impacts of new nonstop service on markets of different sizes.

The analysis shows that the introduction of new nonstop service, whether by a network carrier or a legacy carrier, results in traffic stimulation in the airport-pair where the new service is added, as well as to a lesser degree in the city-pair in total (which includes the impact on nearby airports). As discussed below, the amount of stimulation varies depending on the size of the markets served and the type of carrier that introduced the service. Similarly, the amount of the airfare decrease accompanying new nonstop service varies depending on the size of the markets served and the type of carrier that introduced the service.

The markets analyzed in the study are those where new nonstop service started between the third quarter of 2003 and the second quarter of 2004. Markets where new nonstop service started prior to July 2003 are excluded from this analysis because the traffic "baseline" for the analysis (four full quarters prior to service) is too close to the 9/11 slowdown in traffic. Inclusion of those older markets would artificially depress the "before" traffic and potentially overstate the true growth in the market resulting from the new service. Markets where new nonstop service started after June 2004 are excluded because they do not permit analysis of at least two quarters of "post-entrance" traffic figures. If less than four quarters of "post-entrance" numbers were available, seasonally the same number of quarters were selected for the "baseline", and the resulting figures annualized.[2]

The analysis examines traffic between airport pairs as well as traffic between city-pairs, or more accurately metropolitan area-pairs. An example of the metropolitan area-pair adjustment is the following: New service from Oakland to New York JFK airport would be analyzed both as a new Oakland-New York JFK airport-pair and as new nonstop service in the San Francisco metro area to New York metro area market.[3]

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[1] For this analysis, network carriers are defined to include American, Continental, Delta, Northwest, United and US Airways. Low cost carriers (LCCs) are defined to include AirTran, Allegiant, America West, ATA, Independence Air, jetBlue and Southwest.

[2] For all markets selected, comparable quarters are compared before and after the new service is initiated. If only two quarters of "after" new service data is available, then those two quarters are compared with the same two quarters seasonally before the new service was initiated.

[3] Our standard approach to metro area adjustments groups the following airports into single metro areas: Fort Lauderdale and Miami airports; Boston, Manchester and Providence airports; Chicago Midway and O'Hare airports; San Francisco, Oakland, and San Jose; JFK, LaGuardia, and Newark; and Burbank, Long Beach, Los Angeles, Ontario, and Santa Ana.

II. Findings

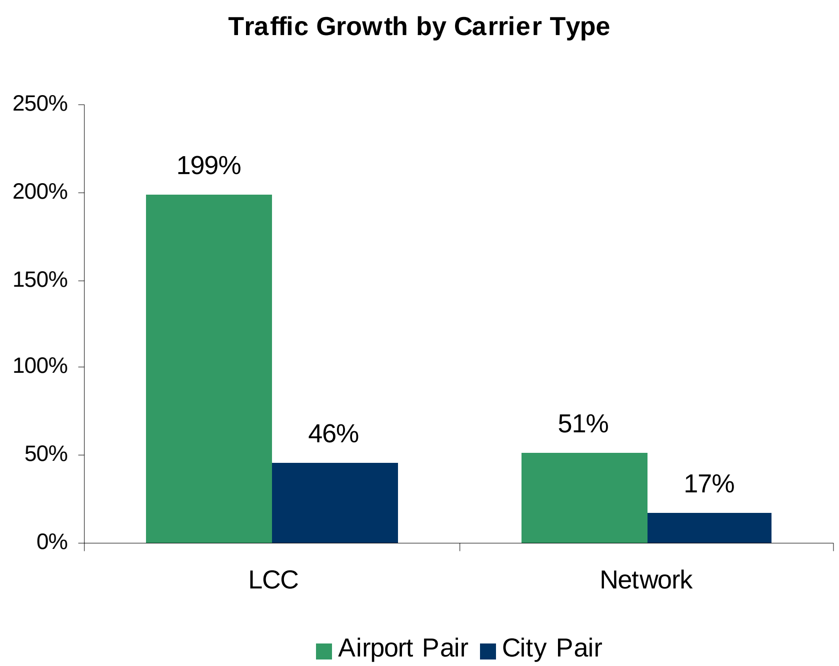
A. Traffic Stimulation

Growth in traffic is driven by a number of factors, including natural growth in the marketplace over time of a few percentage points on an annual basis. Price-driven traffic stimulation results when lower fares create new air travel demand or attract passengers from neighboring airports. And service-driven traffic stimulation results from the availability of convenient new service, which either creates demand or shifts it from neighboring airports. In the 82 markets chosen for this analysis, passenger traffic between individual airport pairs grew by 96% when new nonstop service was added. Because much of this growth came by diverting traffic between airports within the same metro area, the more important figure is that overall city-pair traffic grew by 23% following the commencement of new nonstop service.

B. Traffic Stimulation by Carrier Type

The type of carrier starting new service affects the amount of traffic stimulation. Because LCCs typically offer a lower, less restrictive fare structure than traditional network carriers, they tend to stimulate traffic (or shift it from neighboring airports) at a greater rate when entering a new market. New network carrier nonstop service also stimulates traffic, based not as much on an overall lower fare structure, but more on lower average realized fares and the service benefits of nonstop service.

In those new nonstop markets where the service is initiated by LCCs, the amount of traffic stimulation is greater than where the new service was initiated by a network carrier. The traffic growth results are:



Source: U.S. DOT O&D Survey 2002-2004

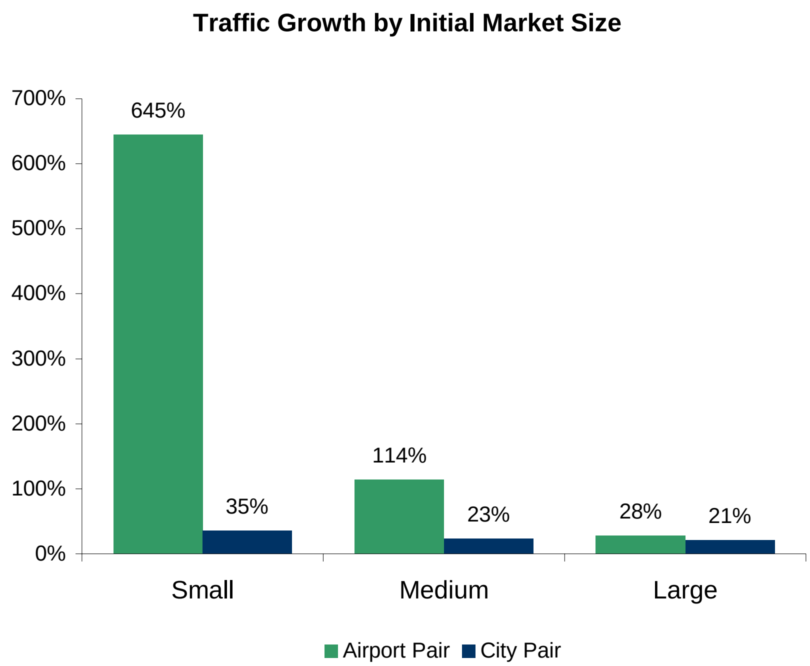
It is important to note that the average aircraft size on new nonstop flights added by LCCs is 121 seats, which is much larger than the average aircraft size on new nonstop flights added by network carriers (only 56 seats). While this may limit the amount of possible traffic stimulation by network carriers, it is more a factor of the market opportunities available for adding new nonstop service (generally small-to-medium size markets).

C. Traffic Stimulation by Market Size

The analysis also shows that the smaller the initial airport-pair traffic base, the larger the growth that occurs with the new nonstop service. This is a function of the small traffic size in the airport-pair prior to service. Note again, that the true stimulation results for the entire city-pair are much lower than for individual airport-pairs. This demonstrates that a majority of what is considered stimulation for a single airport is in fact more accurately viewed as the diversion of passengers from other airports within the same metropolitan area.

City-pair traffic stimulation rates following the initiation of new service range from 21 to 35 percent, depending on the size of the initial market. The greatest stimulation (35 percent) occurs in the small-sized markets. While medium and large markets experience stimulation of only 23 percent and 21 percent, respectively.

Despite the large growth on a small traffic base, LCC aircraft capacities probably remain "over-sized" for the smaller markets – they do not have the optimum equipment size to serve these markets. JetBlue, for example, is expected to use some of its newly-arriving smaller jets to substitute for the larger jets currently being used in some of its smaller markets. With larger airport-pairs, there is less traffic stimulation as those markets generally already have multiple connection opportunities available prior to the new nonstop service. The traffic growth results for different-sized markets are as follows.[4]



Source: U.S. DOT O&D Survey 2002-2004

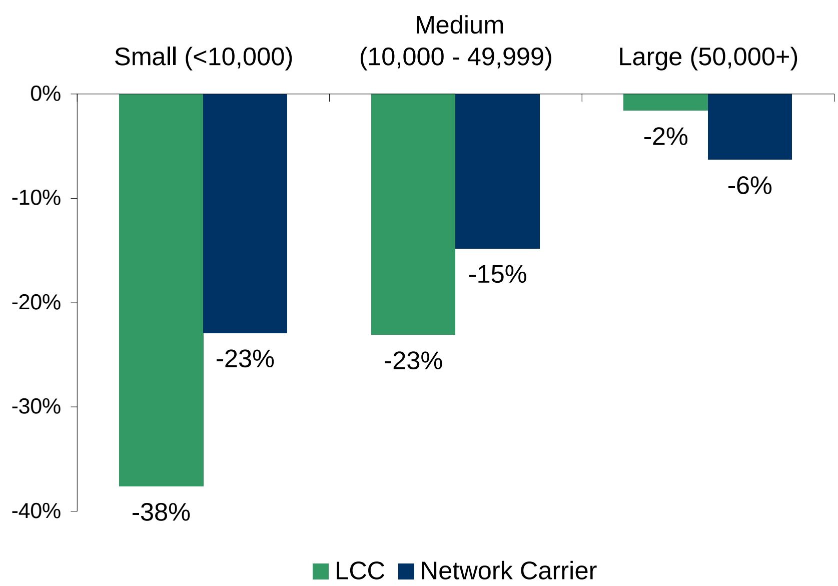
[4] For airport-pairs, small markets are defined as having less than 10,000 annual passengers prior to new nonstop service and medium markets are defined as having less than 50,000 annual passengers. For city-pairs, small markets are defined as having less than 100,000 annual passengers and medium markets are defined as having less than 300,000 annual passengers.

D. Fare Impact of New Nonstop Service

New nonstop service results in lower airfares, and there is a direct relationship between the amount of the airfare decrease and the size of the market. When airport-pair markets are divided into different market sizes based on the amount of traffic prior to the commencement of nonstop service, the smallest markets experience the greatest decrease in fares as a result of the new service. This is not surprising as larger markets already have significant amounts of competitive (connecting) service and therefore those markets already experience significant fare competition even before the addition of new nonstop service.

What is particularly interesting is the analysis of the fare decrease by both market size and by carrier type. As illustrated below, LCCs are associated with greater fare decreases for both small- and medium-sized markets. However, for large markets, the fare decrease associated with new nonstop service is greater for network carriers than for LCCs. While this may be a factor of small sample size for LCCs (4 markets versus 10 for network carriers), it is probably more a function of the type of market where new LCC service is added—most new large LCC markets already have a large pre-existing LCC presence on a connecting basis. Thus, when the LCCs add new nonstop service in large markets, they are "connecting the dots" on their networks where the individual airports already have access to their prevailing fare structure. Examples include Southwest providing new nonstop service in Manchester-Las Vegas and Hartford-Las Vegas (versus serving the same markets through a variety of connections), and AirTran providing new nonstop service in Akron-Canton-Tampa (versus serving the same market on a connecting basis through Atlanta).

Average Realized Fare Change By Initial Market Size



Source: U.S. DOT O&D Survey 2002-2004

III. Summary

The analysis shows that the amount of traffic stimulation varies depending on the size of the markets served—with the smallest markets showing the greatest stimulation. In addition, new nonstop service by LCCs generally creates more stimulation than new service by legacy carriers.

Regardless of the type of carrier providing the service, new nonstop service generally means lower fares. The amount of the airfare decrease varies depending on the size of the markets served—with the smallest markets showing the greatest airfare decreases.

In addition, for small- and medium-sized markets, new nonstop service by LCCs generally means greater airfare decreases than new nonstop service by legacy carriers. However, for the largest markets, the opposite is true. For the largest markets, new nonstop service by legacy carriers generally means greater realized airfare decreases than new nonstop service by LCCs.

The amount of growth a market realizes is dependent on the type of new service (LCC versus network), as well as how large the market is before service is added. It is particularly important to examine stimulation results from both the perspective of the individual airport and of the metropolitan area as a whole. While this analysis focuses on traffic growth, which is a very important metric for the airport community, for airlines, the key metric is revenue, which will be examined on a system basis as the gains from one airport may be offset by the losses from another. For new service to be successful, both the airport and the airline must be encouraged by the results.

EF/RH 8/2005

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