



The Airline Dynamic That Could Change Everything

Description

The airline industry is facing a chaining dynamic that is forcing leading carriers like **Air Canada** ([TSX:AC](#))(TSX:AC.B) and **WestJet Airlines Ltd.** (TSX:WJA) to adapt and play catch-up.

The latest trend to befall the global airline industry is the emergence of ultra-low-cost-carriers (ULCCs) that threaten to undercut even the lowest cost economy fares of traditional airlines.

ULC's are a trend that first began in Europe. When the trend first began, many figured that ULCCs could never make their way to Canada.

That's because it is so much more expensive to fly in Canada already thanks to the country's vast geography and a low population density that only serves to make matters of air flight more challenging for the established carriers.

In fact, a 2017 survey that was put together by online travel agency Kiwi ranked Canada number 65 out of a total of 80 countries in terms of their affordability to book flights out of the country.

The cost to book a flight in Canada has become such a competitive issue lately that now there is mounting speculation that the federal government could – or at least should – do something to fix it.

But one of the great things about capital markets is that they do have a tendency to fix themselves.

This is essentially a version of the [“efficient market theory”](#) in action.

While Canadians wait for the government to address the excessive fees that regulators are stamping on their tickets, some of these ULCC have stepped in and seized the opportunity.

The list of ULCCs flying out of Canada is growing, and now includes Kelowna-based Flair Airlines, Wow Air and European-based Primera Air.

Travellers can count on these airlines offering fares that are considerably cheaper than their traditional counterparts.

But of course, there's a catch.

In exchange for discounted fares, passengers of ULCC are required to pay add-on fees for things that would regularly be included in a traditional flight.

Things like checked baggage, in-flight headsets, refreshments and beverages, for example.

Passengers can still save money on the discounted flights; they just need to do a little extra homework and organization – taking advantage of things like printing out boarding passes at home, eating ahead of a scheduled flight and packing an extra pair of headsets.

The response

But now that these low-cost providers having been gaining some traction in the Canadian market, carriers like Air Canada and WestJet are being forced to respond.

The airline industry is one characterised by high fixed costs; in order to stay profitable, it's critical that these airlines keep their planes full.

Both Air Canada and WestJet have since begun offering their own version – called basic economy – on a small number of domestic routes this year.

Bottom line

It's not unusual to see established company's respond in this way, [that is, dipping a proverbial toe into the water to see if it's a strategy they will be able to successfully adopt.](#)

If successful, we could see both airlines roll out the offering more broadly later this year or early next year.

But the real danger here is that in following suit with a more threadbare strategy, it will almost certainly have an impact on already razor-thin margins.

That may not be a huge problem for now, but if passenger volume were to decline in the future, this trend certainly has the potential to cause the airline industry to go into a tailspin.

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