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Development of LCC in Poland after EU accession.

Air transport law – general overview

The creation of a single air transport market in the European Union made substantial benefits for consumers and improved the competitiveness of the EU air transport industry. However twenty years ago the European air transport network was fragmented, with airlines being treated as public entities designed to serve largely national interests.[1]

Laying down the transparent, common and obligatory air transport law in all of the Member States in the European Union was imposed by the necessity of free, fair and undisturbed competition on the market of air transport services. The main issue was carrier's access to market, licenses, setting tariffs and scheduling time of operations in airports as well as access to ground handling service and rules of using computerized reservation systems.[2]

This considerable progress has been made notably by the three *'Packages'* of European Union legislation and removed barriers from air transport market: after deregulation fares as well as market entry are independent of national frontiers.

Liberalization process, air transport packages

The deregulation process, called *liberalization of air transport*, created competition on this market, that enabled carriers to make alliances, to sign agreements or to be assisted by Governments. Increase of efficiency, decrease of price were a consequence of free, fair and undisturbed competition. Cutting costs is what carriers have to do, but this can not be done by lowering standards of safety, passengers (consumers) or environment. So that, except for regulations on liberalization, we have also regulations putting stress on technical standards

[1] Source: Kenneth Button, Deregulation and Liberalization of European Air Transport Markets, Innovation: The European Journal of Social Sciences, Volume 14, Number 3, 1 September 2001, pp. 255-275(21)
[2] Source: Izabela Szymajda „Air Transport Regulations in the European Union – overview" European Studies 1/2002

harmonization and safety in air transport. There are settled special rules of procedure for examining air crashes and also for recognizing licenses of aircraft. [3] Having this in mind, it is clear, that liberalization gave a low basement for launching and developing *Low Cost Carrier (LCC)* in Europe.

Liberalization process of air transport in the European Union lasted 15 years and was divided into three stages. The very beginning of liberalization was in the 1987, when the adoption of the first "package" took place. Then in the 1990 the second "package" was adopted and two years later the third "package" was brought into life. Packages were regulating rules of competition, access to the market, procedure of setting prices and recognizing air carriages licenses. There were interludes and protection for weaker partners. Liberalization process in the European Union firstly concentrated on international carriages, then on cabotage.

The first "package" of measures adopted in December 1987, started to relax the established rules: it limited the right of governments to object to the introduction of new fares, some flexibility was allowed to enable airlines in two countries which had signed a bilateral agreement to share seating capacity. Until then, absolute parity had been the rule.

In June 1990 a second "package" of measures opened up the market further, allowing greater flexibility over the setting of fares and capacity-sharing. Moreover, the new provisions extended the right to the fifth freedom and opened up the third and fourth freedoms to all Community carriers in general. These measures, which were initially limited to passengers, were extended to freight by means of a decision taken in December 1990.

The last stage of the liberalization of air transport in the European Union was the subject of a third "package" of measures, which were adopted in July 1992 and applied as from January 1993.

However, this package gradually introduced freedom to provide services within the European Union and led in April 1997 to the freedom to provide cabotage, i.e. the right for an airline of one Member State to operate a route within another Member State.

The main measures are as follows:

[3] Source: Izabela Szymajda „Air Transport (…)"

1. Community licence: the market is open to all airlines which hold a Community air carrier's licence (*Council Regulation (EEC) No 2407/92*). This Regulation lays down the rules applicable in all Member States for issuing and withdrawing licenses to and from air carriers, thereby establishing the concept of Community air carrier without discrimination within the Community. It also spells out the conditions under which Community air carriers may lease aircraft registered outside the Community. For a company to obtain this licence, most of its capital must be held by Member States or nationals of the European Union. The latter must also exercise effective control over the company. The technical capabilities and financial capacity of the companies concerned are sanctioned by means of national certificates. The third "package" stipulates that companies must submit a two-year development plan to the authorities and provide proof that they will be able to cover their operating costs for a period of three months without income. Lastly, companies which use leased aircraft are required to take up adequate insurance.

2. *Freedom of access to the market is laid down in Regulation (EEC) No 2408/92,* which establishes the basic principle of free access for Community air carriers to intra-Community air routes and lays down rules on possible derogations from this principle, particularly for public service obligations and situations creating serious congestion and/or environmental problems. The same Regulation also contains criteria for defining an "airport system" and distributing traffic between the individual airports in the same system. This text opened up all international air routes in the European Union to all companies which hold a Community license without any restrictions as from 1 January 1993. Since April 1997, unconditional access to all domestic markets has been granted to all airlines in the European Union. The most important safeguard measure in the Regulation on access to the market concerns public service obligations, which enable Governments to maintain services considered essential for harmonious development within their territory.

3. *Freedom with regard to fares and rates was an essential part of freedom of access to the Community market. Regulation (EEC) No 2409/92,* that liberalizes air fares, while also putting in place a procedure allowing the Member States both to avoid excessively high fares detrimental to users and to halt any downward spiral which could jeopardise the financial balance of all carriers. It stipulates that airlines are no longer required to submit their fares to the national authorities for approval. All they have to do is to inform them forty-eight hours before applying the new fare. The Regulation does, however, provide for control mechanisms

to be reintroduced in exceptional circumstances. Generally, a fare increase can not be objected to if there is a high level of competition on the route concerned or if the arrival of new competitors is not hampered by legal provisions or practical contingencies, e.g. saturation at an airport. Conversely, if it is established that airlines are involved in a price war which has already led to two consecutive and general drops in fares and none of them is making any profit on the route concerned, the national authorities may object to a fare reduction.

The continuous growth in air transport during the last decade has increased pressure on the capacity available at airports for aircraft movements. There was therefore a need for a regulation on slots, which are defined as the scheduled times of arrival allocated at an airport. *Council Regulation 95/93/EC on common rules for the allocation of slots at Community airports* was the first step, based on the principles governing the then existing system of slot allocation, towards laying down a number of transparent, non-discriminatory rules. In particular, so as to enable new airlines to gain entry to the liberalized market, the allocation of slots had to be based on the rule that a maximum of 50% of slots used or newly created had to be reserved for newcomers on the markets. The slots allocated prior to the approval of the Regulation remained subject to the same rules as before: established companies were not deprived of their slots, however little they actually used them.

Ground handling services make an essential contribution to the efficient use of air transport infrastructure. A distinction can be made between airside and landside services, the latter being passenger-related services such as ticketing and baggage handling at the check-in desks. Airside services comprise services such as ramp handling, fuelling and defuelling operations, aircraft maintenance and the provision of catering services. The market in ground handling services is covered by a *Directive dating from October 1996 (Directive 96/67/EC) which gradually opened up the services to competition*. This decision is justified since the checking-in of passengers, baggage handling, the provision of catering services, etc. are a monopoly in many EU airports, and many airlines complained about the excessive costs. Until Council Directive 96/67/EC on access to the ground handling market at Community airports, which covers airside services only, became effective, the provision of ground handling services at EU airports was largely a monopoly controlled by a limited number of service suppliers. As so often in such cases, this led to relatively high prices for the services provided and sub-optimal efficiency. The Directive essentially stipulates that access to the market by suppliers of ground handling services is free and that for certain categories of services at the larger airports of the EU the number of suppliers may be no fewer than two for each category of service. Moreover, at least one of these suppliers should be entirely independent of the airport or the dominant carrier. Similar provisions exist with regard to self-handling, which means that airlines provide the services in question for themselves: for these services there should at least be two airlines admitted and they should be chosen on the basis of objective and non-discriminatory criteria.

Competition between airlines is also in evidence in the distribution networks, in particular through the computerized booking systems installed in travel agencies. These systems, which handle 70% of reservations, are the property of major airlines. A *1989 Regulation (No 2299/89)*, last amended in 1999, prevents these companies from being given preferential treatment as regards the manner in which their flights are displayed on the travel agencies' computer screens.[4]

LCC – the very beginning

As a result of liberalization process every carrier having license enabling to offer air transport services of passengers, issued by any of the Member States can fly on any route and offer his service in any price within rules of free, fair and undisturbed competition. These new conditions made air transport companies to restructure: carriers had to introduce more flexibility within both prices and flight destinations. In practice all above-mentioned regulations conduced to raise a new type of air carriers, so called LCC. The competition is much stronger in all this sector and prices changed in favour of consumers.

Because of liberalization “Packages” European aviation has moved from a highly regulated market, based on bilateral agreements and a duopoly and therefore having little or no competition, to a highly competitive single market. In this new situation the discretionary powers of the national authorities have been curbed and airlines have enjoyed greater freedom to set fares, open new routes and determine what capacities to offer, according to economic and financial considerations.

[4] the European Commission's "Transport" website http://ec.europa.eu/transport/air/index_en.htm

Liberalization has transformed the economic landscape of aviation by allowing more and more competition. The number of airlines has risen and there has been a general increase in the amount of traffic and competition on routes. The benefits of liberalization can be seen in the opening up of new routes and the increase in competition on routes previously operated as a duopoly within the Community.

Due to the competition it has engendered, liberalization has brought benefits to consumers as well, in particular with the considerable increase in promotional fares and the emergence of companies specializing in extremely low-budget fares which now represent about 10% of the traffic within the Community with a substantial margin for growth.

LCC's benefit from deregulation and rely on a simple business design: one kind of aircraft, one class of passenger, and more seats crammed into the airplane-as well as no airport lounges, no choice of seats, no newspapers, no food, no frequent-flyer programs, no connecting flights, no refunds, and no possibility of rebooking to other airlines. Also, there are no travel agents and expensive computer reservation systems. Some European low-cost carriers fly to and from secondary airports-located as far as 100 kilometers from city centers-thus minimizing landing and ground-handling fees. On intra-European international routes, this adds up to an operating-cost advantage per seat and kilometers flown (unit cost) of 40 to 65 percent as compared with major scheduled carriers. Lower costs and higher seat-load factors permit no-frills carriers to offer fares 50 to 70 percent lower than those of the incumbents. This approach attracts price-sensitive and flexible travelers, but the lack of convenience and flexibility makes the low-cost model unappealing for most passengers traveling on business. [5]

Situation in Poland - background

Poland's accession to the European Union was connected with necessity of adopting air transport law: since 2002 regulations within this sector are implemented and obligatory in Poland and, as a result of this fact, since December 2003 there are LCCs operating on the Polish air transport market.

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[5] Source: Urs Binggeli, Lucio Pompeo, McKinsey: Hyped hopes for Europe's low-cost airlines, 9 October 2002, http://www.euractiv.com/

Before this date the situation looked very different in Poland. The Polish air transport market was largely state-regulated. Domestic connections were provided only by Polish firms, maintaining a virtual monopoly over the market. Foreign connections are provided by Polish regular carrier or the second country's national carrier, but according to strictly defined rules of bilateral government agreements. After the accession the bilateral agreements with European Union countries that before were limiting the number of connections and favoured national carriers ceased to be binding.

In fact, Poland made the first step towards fully opening the Polish air market in December 2000, when negotiators from Poland and European Commission reached the agreement on liberalization of transport market shared by Poland and the European Union Member States and Candidate Countries within three years. There was quite long procedures to be fulfilled before this new law came into life in Poland, however already since the agreement was officially reached, Polish passengers could expect prices to be lower, choice of destinations to be wider and respect of consumers rights in the air transport market to be improved. [6] In February 2003, the agreement on common European airspace officially began to be obligatory - since then, every airline from each of the states-signatories was able to launch any connection not only to Poland, but also inside the Country. Polish air carriers from this date have similar rights in the other member countries of the agreement.

The Polish air transport market has been changing since 1990, but most significant changes began with the EU accession on 1st May 2004 and earlier as the EU legislation had come into force.

Market potential for LCC development

In order to comprehend the development of the sector in Poland it is needed to consider the situation of the market before the EU accession.

The high rates of LCC development in Poland in recent years were a result of a high market potential for air transport services. Like in many other accession states, the sector of air transport in Poland has been underdeveloped, which was mainly due to a lack of a real competition resulting in relatively high fares. Until the air market liberalization air transport

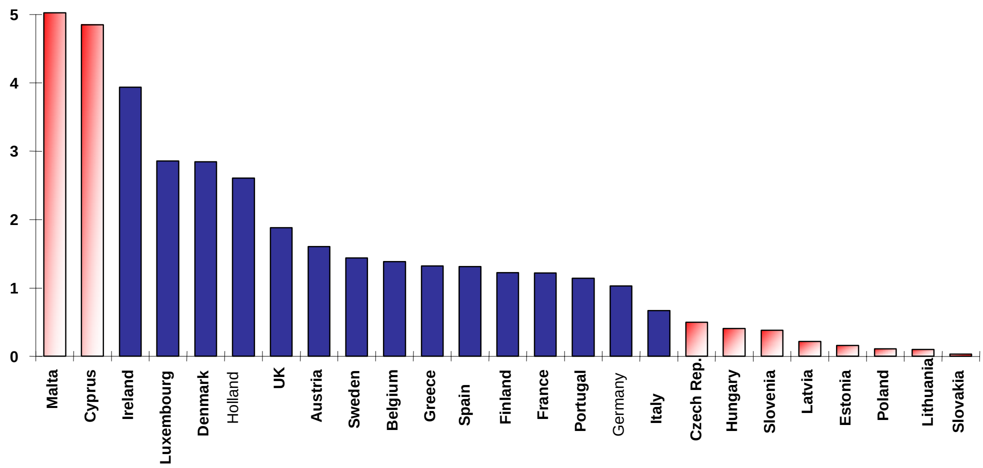
[6] Source: Polish Ministry of Foreign Affairs CLARIS NR: 1711, date: 2000.12.28, Economical Bulletin, nr 52

was considered to be a luxurious way of traveling, which was unavailable for the most of the Polish society.

Poland is considered to be a very attractive and promising market for air carriers. The society of 38 million inhabitants makes it the biggest country among AC-10 states. It is located in the geometrical centre of the continent and is often said to be the bridge to the Eastern Europe. The fast developing economy makes the citizens want to spend more money on travel. Also the inbound tourists are more and more attracted by such travel destinations like Krakow, Gdansk and Wroclaw, which have become trendy. As a lot of Western tourists have already visited all the popular destinations in Western Europe they may now wish to visit new sites, which until now were considered to have been exotic (e.g. in Poland). The quality of tourist services in Poland no longer discourages travelers to come. After all, the tourist facilities in Polish cities have been developing rapidly in the recent years, which persuades Western European societies to come to visit Poland and the whole region. The EU accession have even stimulated those trends.

The potential of the market before the EU accession can be described by the index of air mobility in Poland compared to other Member States. Poland was characterised by an extremely low air mobility index (see exhibit 1). In 2003 it amounted to approximately 0.2 passengers per capita compared to the accession countries average of 0.3 and 1.3 in case of EU15.

Exhibit 1. Number of air travellers per capita in EU.



Source: J.Naylor: *State of European Air Transport Industry: Trends and Forecasts.* Presentation at Airport Expo Gdańsk 2004 conference.

The potential of the market was appreciated by the "IATA Passenger Forecast 2005-2009", which lists Poland at the top of the group of the countries with the highest average annual growth rates in passenger traffic. It estimates the traffic in Poland to rise by 11.2%, which compares with an overall industry average annual growth rate of 5.6% for international passenger traffic between 2005 and 2009, and 5.1% within Europe.[7]

IATA also presented a forecast for the top European country-pairs with the highest average growth. All of those pairs include CEE countries on one end, particularly routes Poland-Italy, Poland-UK, Poland-Spain, Poland-Norway. The forecast has been proved as all of those routes have recorded a unique growth in passenger volumes in recent years. However, high rate of growth was a result of the relatively low passenger traffic in the past. Thus in absolute terms the growth is not so substantial. Still the traffic generated in the region accounts for a small part of the total EU traffic (approximately 15% with Poland as the largest country of the region). However, if to compare Poland to other EU accession states it turns out that there are only two countries with a lower air mobility per capita than in Poland (i.e. in Slovakia and Lithuania). This was even harder to be understood by the researchers as all the AC-10 countries except Poland do not have major regional airports. With this in mind it is easier to understand the weakness of the air transport sector in Poland before EU accession as well as the market potential that was unveiled at the time of liberalization processes and LCC entering the market.

Before 2003 the Polish air market was dominated by the flag carrier – LOT Polish Airlines and its market share accounting for more than 60%. Most of its flights LOT has been operating from its hub airport in Warsaw, however recently it has began to add more routes connecting regional airports (e.g. Gdansk, Katowice, Krakow) with Star Alliance hubs (Frankfurt, Munich, Vienna). Until April 2006 LOT was the only operator on domestic routes linking 10 regional airports with Warsaw. The domination of Warsaw airport within the LOT network has prevented the carrier from opening more routes from regional airports. Even until now for most passengers from outside Warsaw the offer includes inconvenient domestic connecting flights and transferring from one terminal to another at overcrowded Warsaw airport (60% of domestic passengers are connecting passengers).[8]

[7] C. Buyck, *Rising in the East,* "Air Transport World", May 2006, p. 24.
[8] *Wishing on a Star,* „Air Transport World", January 2004, p.44.

Apart from LOT Polish Airlines, most of European flag carriers have operated to the capital city of Warsaw. A small part of those airlines have been connecting their hubs with Polish regional airports (Lufthansa flies to Gdansk, Katowice, Krakow, Poznan and Wroclaw; Austrian Airlines fly to Poznan and Krakow; SAS flies to Gdansk, Poznan and Wroclaw; British Airways fly to Krakow). This means that regional airports in Poland and their potential was not enough appreciated until 2004. Passengers' choice was limited to either to fly via Warsaw with LOT Polish Airlines or to choose from a poor offer of some major European carriers. However, in case of 5 out of the 10 regional airports, the offer included only LOT domestic flights.

LCC development in Poland

The era of a dynamic LCC development in Poland began in December 2003 when Air Polonia launched its services between Warsaw and London Stansted. The offer also included domestic flights from Gdansk and Wroclaw to Warsaw. The carrier soon verified its strategy and withdrew from serving internal routes because passenger flows were insufficient to make those routes profitable as the carrier was using Boeing 737-400 aircraft. For the summer schedule Air Polonia was adding many new destinations in Europe to its network (e.g. Rome, Paris, Brussels Charleroi, Frankfurt Hahn, Athens, Madrid) and opened several routes from regional airports (Katowice and Gdansk, Poznan). Simultaneously in cooperation with major tour-operators Air Polonia was offering charter flights to the Mediterranean countries.

With the accession to the EU many new carriers have started their operations from Polish airports. Except for Air Polonia, also Germanwings and Wizzair began offering the cheap fares in May 2004. The next carrier, SkyEurope joined them in June 2004. Their offer for the summer 2004 schedule was limited mainly to Warsaw or Katowice airport and included most popular Western European destinations. Those were Amsterdam, Cologne, London Stansted/Luton, Paris Orly, Rome Ciampino. Moreover, as Wizzair and SkyEurope are originally CEE carriers, they launched some routes within the region, i.e. Warsaw-Budapest (Wizzair and SkyEurope), Warsaw-Bratislava (SkyEurope), Katowice-Budapest (Wizzair). Most of those flights turned unprofitable despite heavy advertising and flying a small turboprop aircraft (33-seat Embraer 120 – SkyEurope's case).

Wizzair is one of the first LCC that believed in the market potential of the region and from the very beginning concentrated its operations in Poland. Its first step to enter Polish market was done in Katowice where it has established a base. Afterwards Wizzair added another base in Warsaw and Gdansk. For the summer 2006 it is scheduled to fly to as many as 11 destinations from Warsaw, 10 out of Katowice and 6 out of Gdansk. Its wide offer constitutes a high market share of more than 35% of LCC in Poland.

The history of SkyEurope in Poland is different. At first SkyEurope decided to concentrate on flying to/from Warsaw and soon started to develop another base in Krakow. Due to unsatisfactory cooperation with the Warsaw Airport management, SkyEurope withdrew most of its operations from its Warsaw base and now flies only to Rome and Paris. As a result, SkyEurope has established a new base at Prague Ruzyne airport as well as expanded its existing base in Krakow. The carrier's strategy now pays off as Krakow is an attractive destination for foreigners which enabled him to strenthen its position in the southern part of Poland.

Soon after the first summer season for LCC in Poland, the market had gone through a shock as the Air Polonia went bankrupt exactly after one year of operations. The airline was benefitting from being the pioneer in the Polish LCC market as well as good timing of entrance (soon before EU accession). Its international routes turned out to be very successful with average load factors amounting above 90%[9], however, inability to finance its current operations due to a sudden withdrawal of a potential investor forced the first Polish LCC to discontinue its operations. The failure of Air Polonia did not discourage the passengers from cheap traveling by air. Moreover, it firstly persuaded them to air traveling benefits and tought them how to fly a LCC. The lack of the Air Polonia's supply of services was soon filled with other LCC which took over most of Air Polonia's destinations.

The summer 2004 offer seems very poor if to compare it with what LCC brought in the following months and years. Later on several new LCC, together with the European giants, i.e. Ryanair and Easyjet, entered the Polish skies. Eeasyjet has been very cautious with opening of the new routes thus it now flies only to one destination from Warsaw (London Luton) and four destinations from Krakow (Berlin, Dortmund, Liverpool, London Luton).

Ryanair's strategy was more risky as it entered eight airports at a time (almost all regional airports except Zielona Gora and Katowice) with daily flights to London Stansted. However, Ryanair's wide expansion took place in October 2005, almost two years after first LCC in

[9] K. Krupa., *Było tanie latanie, jest twarde lądowanie*, „Puls Biznesu", 7.12.2004, s. 2.

Poland. So far, it has added more destinations (Dublin, Nottingham and Shannon from Wroclaw; Frankfurt-Hahn and Stockholm from Gdansk; Dublin, Glasgow-Prestwick from Krakow; Dublin and Nottingham from Lodz; Dublin from Poznan). As the only LCC in Poland Ryanair continues not to fly to Warsaw as the airport charges there are said to be too high. The Warsaw airport was also considered to be too crowded and insufficient as to meet the Irish LCC's operational requirements.

Within less than three years since first LCC flights in Poland were made, there were other carriers trying to succeed in this market but due to the inappropriate strategy or bad timing for entering the market, they were forced to withdraw. These include Air Berlin, Niki and Maersk Air. Their cases proved that the market had not been ready yet to accept their offer. The other LCC have been penetrating the market in the way of trial and error and they also had to verify their strategies and networks. In many cases the routes they launched occurred completely unprofitable thus they were forced to refrain and to open a new route (perhaps as risky as the previous one).

The rapid development of the LCC segment caused the LOT Polish Airlines started loosing its market share which fell to 43% in 2005. The airline's board decided to launch its low-cost subsidiary Centralwings, which started operations in February 2005 with the flights mainly targeted at Poles working abroad (destinations like London, Dublin, Edinburgh, Cologne). Centralwings also offers routes which are totally new as for the Polish market, i.e. Lisbona, Malta, Bologna and Palermo. It took over LOT's charter flights to Greece, Spain and Italy and now offers them not only to the tour operators but to the individual tourists as well. Centralwings to some extent cooperates with Germanwings as an IT partner and sometimes both carriers launch common advertising campaigns.

Summer 2006 schedule for Poland is made up of 8 LCC with origins both from Poland and abroad. The offer includes connections between more than a hundred city pairs, to more than 10 European countries, however it does not contain any routes to the Commonwealth of Independent States. In total, LCC take off from 10 Polish cities connecting them with more than 46 European cities, i.e. 53 airports (compared with about 30 airports a year before). Almost half of a number of destinations, however, are located in Great Britain (8),Germany (7) and Italy (6).

Moreover, the LCC's offer include two countries (Malta and Portugal) and more than 20 cities which have no direct service from any Polish airport performed by a legacy carrier.

Activities of LCC seem interesting if to compare them by region. Western European countries hold most of connections (about 2/3 of flights). Second highest share belongs to the Southern Europe, and the rest to the Northern and Central Europe. London is the most popular city for Polish passengers with up to 6 daily flights from Warsaw (compared to another 6 operated by legacy carriers) and up to 17 daily flights from regional airports (compared to 1 flight operated by BA). Other most popular destinations are Paris, Rome and Cologne.

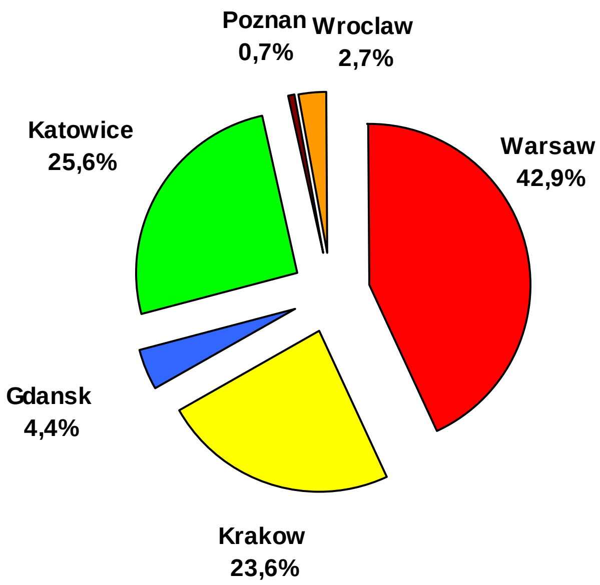
Market structure and traffic volumes

In 2005 Poland recorded a 31% rise in passenger traffic to 11.5 million after a 26% growth in 2004. The growth was more dynamic than an average growth of traffic in Europe, which in 2005 amounted to 6.3%. The market share of LCC in Poland increased by 18.3 points to 31.3%. The forecast for the coming years suggest it to increase further which means the role of LCC in Poland will be different than in Western Europe countries, where their market share hardly ever exceeds 25%. LCC contributed to 95.3% of the traffic growth generated in 2005. Thus it is certain that without LCC such a dynamic development of the sector in Poland would not have been possible.

If to consider the overall regular traffic in Poland for the year 2005, Wizzair has gained second biggest market share of 12% (7.4-point increase over 2004). The followers were Lufthansa, Centralwings and SkyEurope. This means that the list of top 10 airlines in Poland in terms of passenger numbers consists of five LCC (stated above plus Easyjet and Ryanair). In 2005 low-fare airlines carried 3.23 million passengers compared to 0.98 million in 2004, which states a 228% increase.

LCC activities are based on demographic and financial potential of local Polish markets. In 2005 greatest market share was spread among biggest agglomerations – Warsaw, Katowice, Krakow – their total share amounted 92% (see exhibit 2). Taking into consideration the recent development of LCC in other airports, i.e. particularly in Gdansk and Wroclaw, it is presumed that Warsaw airport's share will decrease further.

Exhibit 2. Airports shares in LCC according to summer schedule 2005.

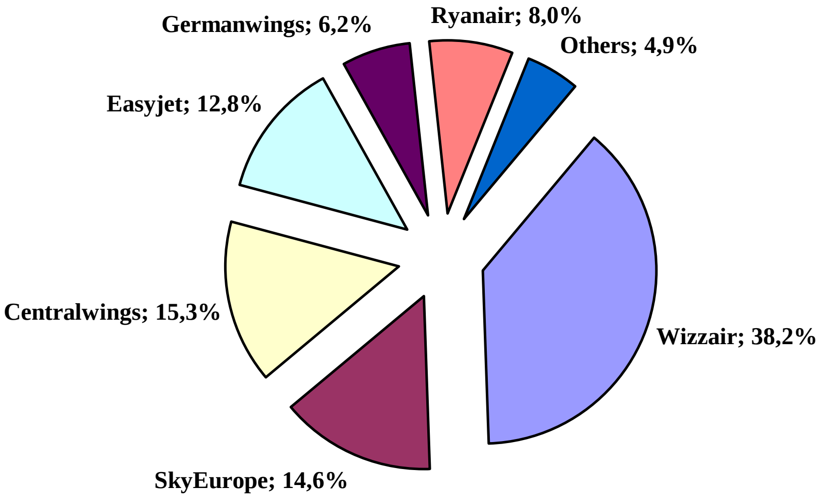


Source: Tomasz Dziedzic, *Rynek lotniczy w Polsce. Stan obecny i perspektywy,* Instytut Turystyki 2005.

Yet LCCs are more willing towards regional airports than flag carriers, which was mainly due to low airport services fares and better operational efficiencies. With only legacy carriers being considered the Warsaw airport's share amounted in 2005 to 77%, with regional airports taking the rest of the market. However, this structure is not supposed to change in 2006.

The analysis of LCC market structure concludes that highest market shares belong to the airlines with origins in the CEE region (exhibit 3). The top three carriers (Wizzair, Centralwings, SkyEurope) constituted 68% of passengers carried by LCC in 2005. However, a significant competitive advantage of Wizzair is not only due to a greater number of destinations and flights but also operating Airbus A320 aircraft with 180-seat capacity. Centralwings offer is featured by the dispersion of destinations (41 city pairs connecting 25 cities abroad with 7 Polish airports). This is because of the strategy consisting in supplementing of the network of its mother company (LOT) and simultaneous operating of scheduled and charter flights with the limited number of aircraft.

Exhibit 3. Market shares of LCC in Poland in 2005.



Source: Polish Aviation Council 2006.

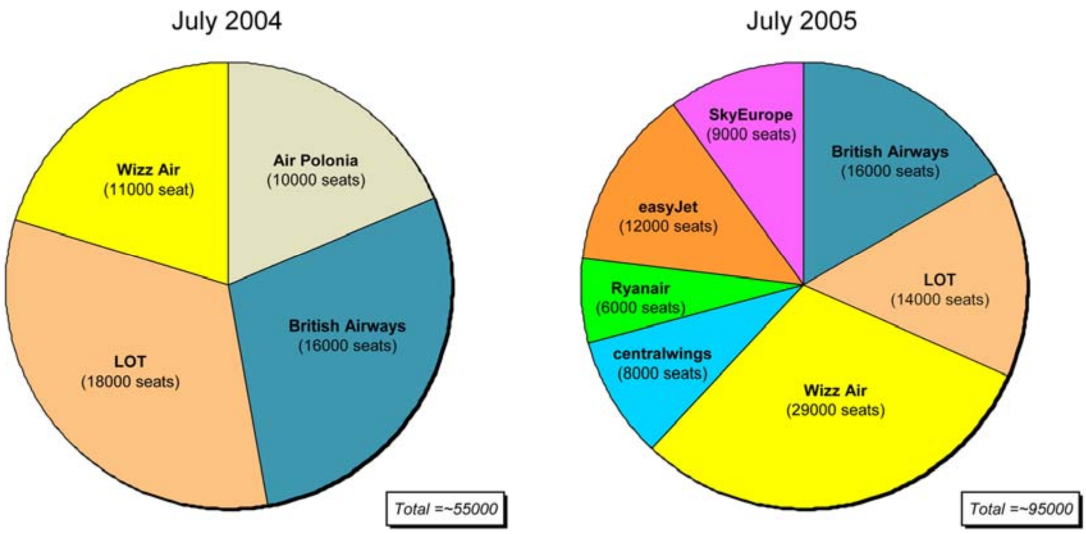
The market shares in 2006 are supposed to change in favour of the strategic position of Ryanair operating from most of regional airports. The Irish airline's impact on the market could not be seen in 2005 as it launched most of its operations in the fourth quarter of the year. The results for the first quarter of the 2006 year reveal a slight decrease in the market share of most of the airlines (e.g. Wizzair's share fell to 35.6%) and a strengthening of Ryanair's position (share up to 18.9%). All those changes suggest that the Polish market is not mature yet and that it is still likely to have to go through another shock again soon in the future.

Effects of the LCC in Poland

LCC have generated new demand rather than have stolen passengers from legacy carriers hence making air transport services available to the new groups of passengers. Young and well-educated people, tourists searching for opportunities to visit new European and sometimes non-European countries are usually their customers.

According to the OAG, with the entrance of LCC, flag carriers in Poland lost market share but not market volume. This thesis was proved with the case of Poland-UK market in the way of comparing seat capacity offerred by legacy carriers and LCC (see exhibit 4).

Exhibit 4. Airline seat capacity UK-Poland in 2004 and 2005.



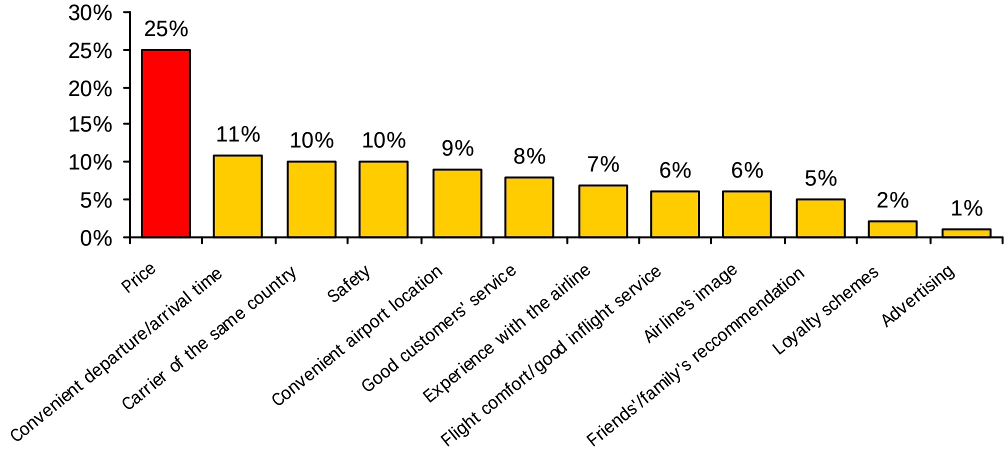
Source: OAG.

The research by OAG shows that there was a significant growth in seat capacity between 2004 and 2005 on the routes between Poland and UK. British Airways capacity remained at the same level whereas LOT as a parent company to Centralwings decreased the number of seats and moved a part of them to its subsidiary. Thus LOT benefits both from the traditional segment and the LCC. The total capacity on those routes in July 2005 increased by more than 70% campared to July 2004. A similar changes in the market structure took place on the routes connecting Poland with other countries, however seat capacity increase was highest in the case of Poland-UK flights.

Many LCC passengers in Poland never travelled by air before, and certainly most of them would not have decided to fly if it were not so cheap, i.e with legacy carriers. Before the LCC began to offer low fares in Poland people preferred to travel by train or particularly by bus. The network of bus carriers has been well developed and covered most of Western European cities. CEE region has also been well covered. The entrance of the LCC caused many passengers switched from buses to planes as the prices were comparable with travel time significantly shorter.

The main reasons for the popularity of the LCC offer are their low fares. Research made after the first LCC entered Poland reveal that Poles are very price-sensitive. According to the survey by TGT, SMG/KRC, the price is the most frequently pointed criterium considered while choosing an airline (see exhibit 5). Third most important factor (as important as safety) concerns in whether it is a national carrier or not. This explains the success of the LCC subsidiary of LOT – Centralwings. Other preferences of choice of an airline are shown below.

Exhibit 5. Airline of choice – preferences.

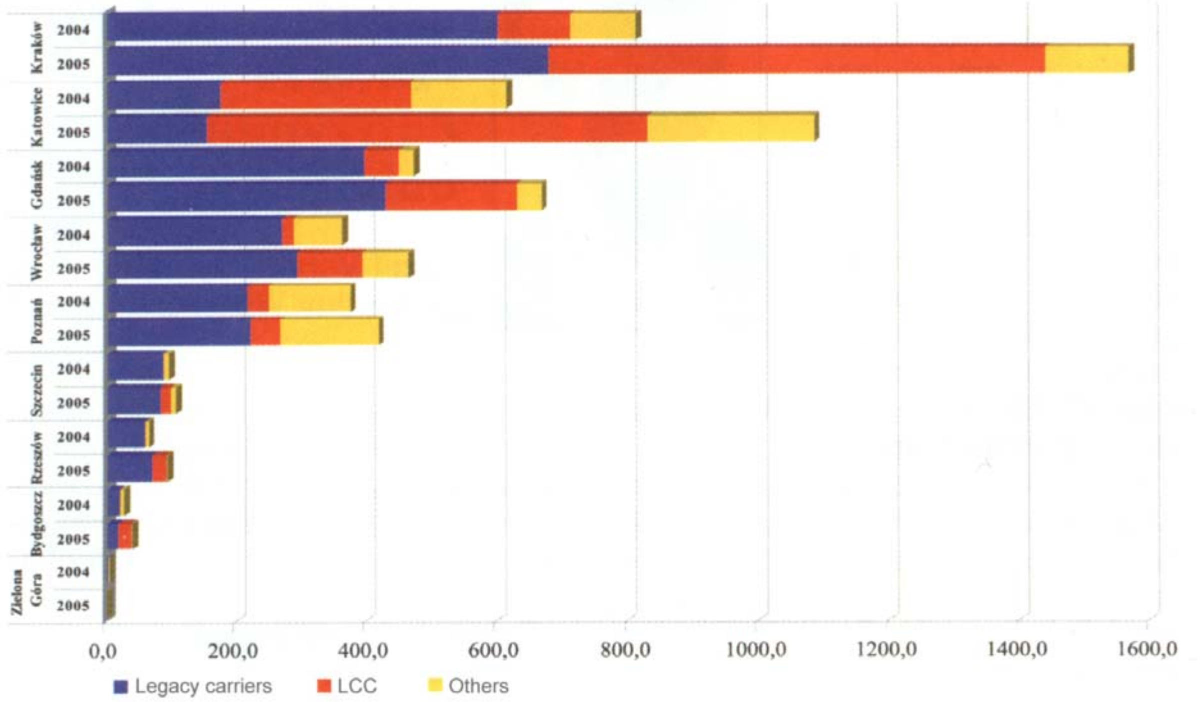


Source: P. Kociołek Presentation at the Porty Lotnicze 2005 conference (6th October 2005).

Another reason for the LCC to have gained so much interest is that they operate from the Polish regional airports thus passengers can take a direct flight without a need to transfer. This advantage means saving a lot of passengers' time as well as money.

It is clear that LCC increased air mobility of the Polish society. This could be observed particularly in the regional airports. LCC entrance contributed to a great extent to their development in 2005 (exhibit 6). The highest growth of traffic volume was recorded in Krakow and these were LCC that generated 87% of the growth. If we consider Katowice airport the LCC contribution to the growth was even higher (97%) and compensated a slight decrease in regular flag carriers traffic. Other airports also recorded dynamic growth in passenger numbers, which was mainly due to the LCC entrance.

Exhibit 6. Regional airports traffic growth and structure (2004/2005).



Source: D. Kalinski, *Czas wielkich zmian,* „Polska Gazeta Transportowa", 29 March 2006.

As it was proved above, LCC operations stimulate air transport development in the regions and support regional airports which perhaps could not survive without low-fare airlines. The case of a small Bydgoszcz airport is a good example for that. With only one daily flight served by Ryanair (to London Stansted) the passenger traffic more than doubled there and is a great chance for the airport and the region to develop.

Before the era of LCC in Poland began, Warsaw airport played a dominant role in the network and regional airports hardly had had a chance to develop. While in 2004 Warsaw airport handled 68% of air passengers in Poland, in 2005 the share decreased to 61% and is estimated to fall even below 50% in the coming years. LCC make the structure of the traffic change diametrically and the role of regional airports increase. However, such a development requires intensive investment supported by the EU funds. The rapid growth of passenger volumes caused the capacity of most of the airports to be insufficient and they were forced to construct new terminals and sometimes to lengthen the runways in order to meet the quality and safety standards of the airlines.

Another problem to be faced by aviation authorities concerned the lack of a LCC-dedicated airport in Warsaw. The authorities intend to rebuild the former miliary airport in Modlin (40 km north of Warsaw) to the requirements of the LCC but the deadlines for the project have been postponed many times so far. The opening of the second airport for Warsaw city would be very helpful to support the capacity of the existing F.Chopin airport which, with the Terminal 2 still being in construction, is now overcrowded. The solutions tailored for the LCC there seem to be temporary and inadequate. With the entrance of the LCC to Warsaw the unused Terminal Etiuda was dedicated to them and offered the lower quality product at lower charges. With the growing number of LCC travelers after two years the capacity of this terminal is now certainly not enough to handle all of them on time. This is another proof for how dynamic and unpredictable development the airport authorities had to face with.

The case of Warsaw airport seems to refrain the development of air transport in the region as it makes Ryanair hold up entering this market. According to Ryanair executives the development of LCC segment in Poland would have been even more dynamic if the competition conditions had been better. The Irish carrier is said to be willing to establish an operating base in Poland, but the decision has not been taken yet.

Summary

It is clear that an offer of LCCs has increased air mobility by creating and revealing new demand to be satisfied by a fast, safe and relatively cheap mean of transport. It is worth mentioning that the launch of LCC has improved the offer of air transport services, mainly by increasing the number of operators to choose from as well as a number of direct connections and destination airports including those previously served only by legacy cariers.

Among other benefits of LCC is an increase of inbound tourist traffic, which contributes to the development of tourism in the regions formerly left behind. Due to meaningly lower prices of goods and services in Poland many people from Western countries come to Poland with LCC for weekend shopping and entertainment. There is a growing number of the British arriving here to have their teeth cured at a Polish dentist on one hand and to organize a stag party on the other. The LCC fares together with cheap goods and services mentioned make all those travels profitable.

The growth in traffic has been recorded in all countries in the CEE region. The potential of the Polish society is still a great advantage. But on the other hand the competitive position of Polish airports remained almost unchanged as other regional markets are developing at comparably dynamic rates as well (particularly Czech Republic, Hungary, Estonia).

It is certain that the boom in passenger traffic in Poland is the result of the liberalization of civil aviation accompanied by EU accession and an economic growth. On the one hand, there has been a significant increase in demand for air travel, on the other hand improved supply thanks to the liberalization processes could perfectly meet that demand. The growth referred mainly to LCC, however legacy carriers have also benefited from it.

LCC achieved an essential market share in the Polish market yet in the first year of their activities (12% in 2004) and gained even more in the following year (31% in 2005). The number of passengers carried was far above the experts' expectations. The unprecedented growth is predicted to continue in the coming years.

These changes have forced the operators already existing to review their business strategies and enabled new operators to enter the sector. The latter are very effective competing with the flag carriers and contribute to a greater availability of air transport services to the public.

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