



Adapting the Business Model

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Low Cost Carriers in Spain



Weekly frequencies Spain - UK Oct 2002			
Airlines	MAD, BCN, and North of Spain	Mediterranean, Balearic and Canary Islands	Total
Iberia			
Frequencies	94	28	122
% destination	23,5%	7,7%	16,0%
% airline	77,0%	23,0%	100,0%
Easyjet/GO			
Frequencies	113	191	304
% destination	28,3%	52,8%	39,9%
% airline	37,2%	62,8%	100,0%
Rest Scheduled Airlines			
Frequencies	193	143	336
% destination	48,3%	39,5%	44,1%
% airline	57,4%	42,6%	100,0%
Total			
Frequencies	400	362	762
% destination	100,0%	100,0%	100,0%
% airline	52,5%	47,5%	100,0%

Easyjet + Go have taken more share from non scheduled than from scheduled traffic

Low Cost Competition



- There is a fact: low cost competition is here to stay..... and to grow as much as they can
- Low cost carriers trend is to get a growing slice of network carriers traditional market segments, including corporate travel
- Large numbers of aircraft orders placed by european low cost carriers due to enter service in the forthcoming years
- Low cost carriers have created a new model for air transport: some of their features can be learnt and applied by stablished airlines
- Low costs carriers are expanding market size: opportunity for Iberia to share this market growth
- Doing nothing is not an option

Adapting the Business Model



- Iberia will continue being a network carrier but will implement changes in current model:
 - distribution costs reduction
 - service levels adapted to customer segments requirements.
ASK cost reduction
 - new pricing and revenue management model

- All these development lines must proceed together to be able to offer real competitive fares with profitability



■ New role of Travel Agencies

- Must charge the customer for their service
- Marketing agreements with IBERIA for added value
- Transition period planned for 2004

■ New role of direct channels

- Delivery services to be charged to customers
 - fee per paper ticket and reservations center call
 - basic fares without delivery fee available in IBERIA.com
 - increase share of IBERIA.com

■ Increase corporate agreements under management fee

■ Implement program for small companies and SOHO's

Service levels adapted to customer segments requirements. ASK cost reduction



- More service level segmentation:
 - improve service to business customers
 - adapt service to real requirements for the most price sensitive customers
 - CRM implementation
- Increase number of seats in A-320 aircraft. Densify the “behind the curtain” cabin
- Reduce one cabin attendant per short haul flight

Improve “value for money” perception

Iberia and British Airways new cooperation plans



The agreement will enable the airlines:

- To increase code-sharing services, giving passengers a greater number of connection options on both companies' routes.
- To enhance and widen frequent flyers programmes and services
- To co-ordinate sales and marketing programmes that offer passengers a wide choice and allow them to obtain Iberia and British tickets from a single sales point.
- To jointly plan route networks and to achieve greater operational efficiency and improvements in customer service.
- To improve flight connections in Madrid, Barcelona and London, to the benefit of customers
- To coordinate cargo services

New pricing and revenue management model



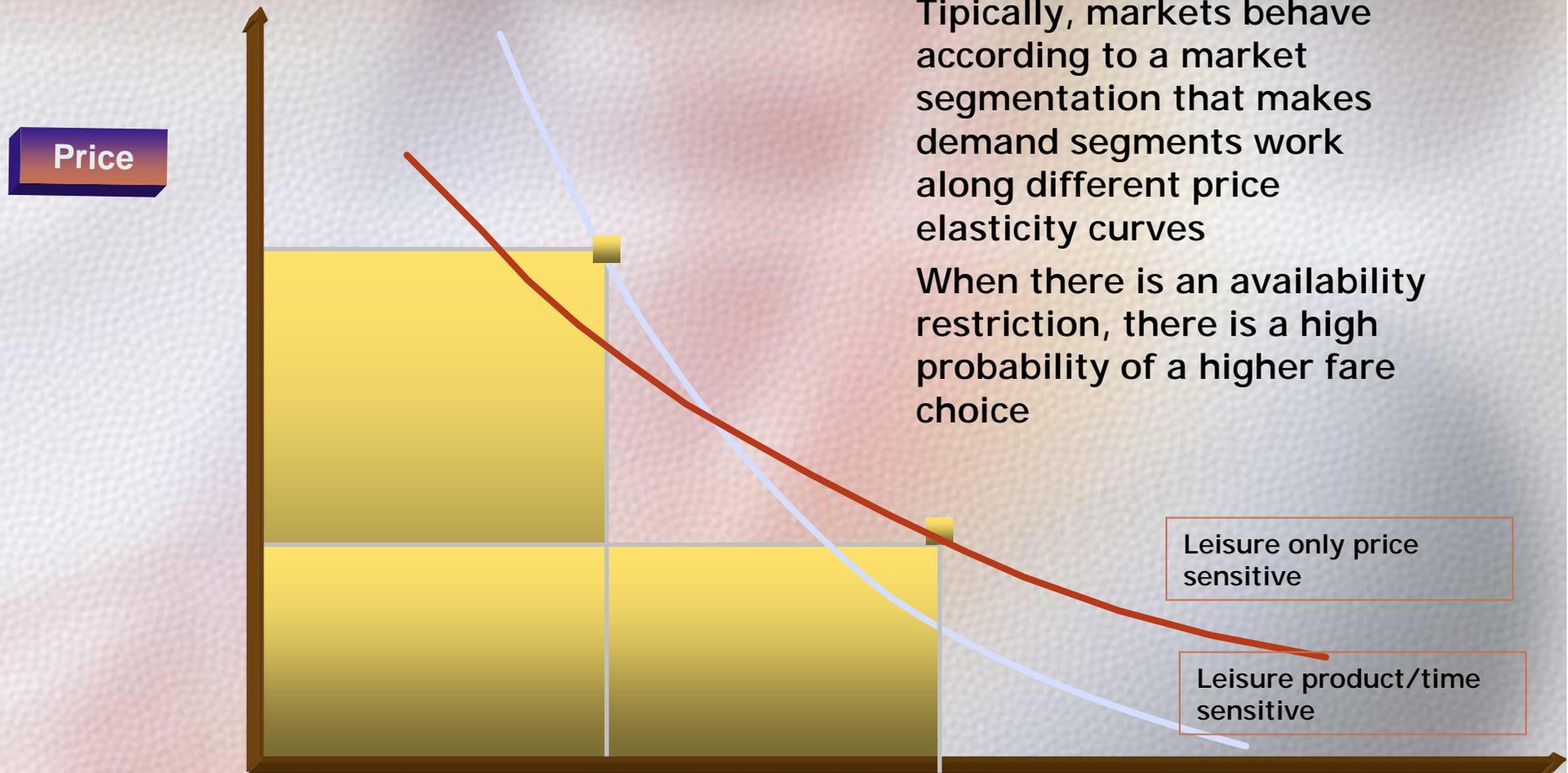
- As from august 29 2002, IBERIA has put in place a new pricing structure and inventory control model in the United Kingdom-Spain market
 - designed in coordination with British Airways
 - operating under full code-share with British Airways
- Target: to maintain revenue/ASK ratio, trading off yield reduction with load factor increase
 - getting back passengers from low cost competitors
 - putting difficulties to consolidation and therefore...
 - affecting their growth pattern in markets served by IBERIA
 - aligned to a unit cost reduction program

Basic principles: pricing structure



- The new pricing structure in price levels
 - starting levels lowered 30% approximately, reducing the gap with competitor's significantly
 - progressive steps (11 in total) up to full economy and business fares
 - full combinability across the fare structure, thus making possible the use of one fare on the departure trip and any other one on the return trip, subject to availability
 - far greater range of actual fares offered (65 combinations) but at the same time within a very simple structure
- The new pricing structure: simplifying the conditions
 - saturday night stay suppressed, as well as the rest of stay and advance purchase conditions
 - only refund or fare change penalties remain upon on the fare level

Why not doing this elsewhere?



Typically, markets behave according to a market segmentation that makes demand segments work along different price elasticity curves

When there is an availability restriction, there is a high probability of a higher fare choice

Leisure only price sensitive

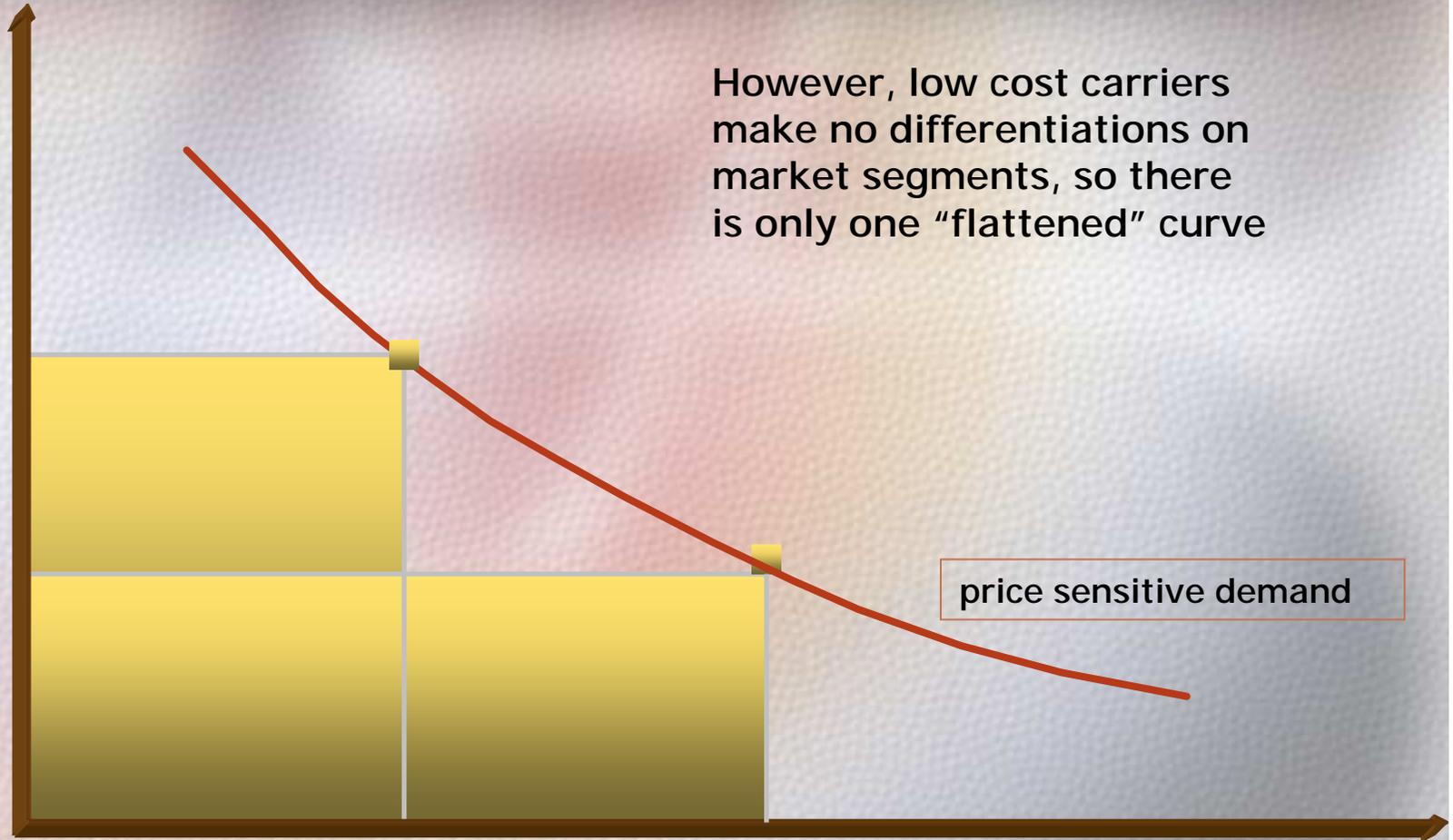
Leisure product/time sensitive

Demand

Why not doing this elsewhere?



Price

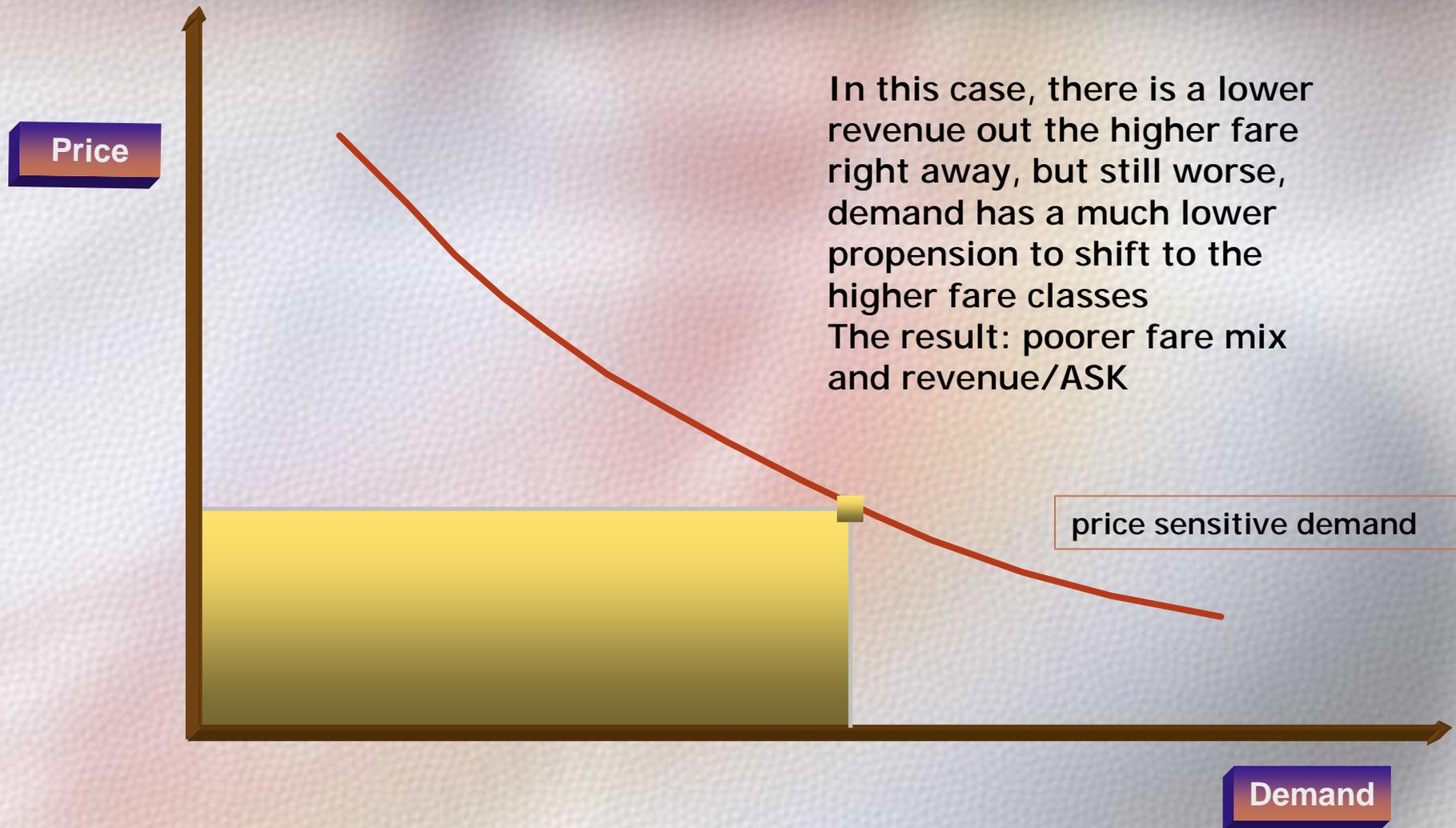


However, low cost carriers make no differentiations on market segments, so there is only one "flattened" curve

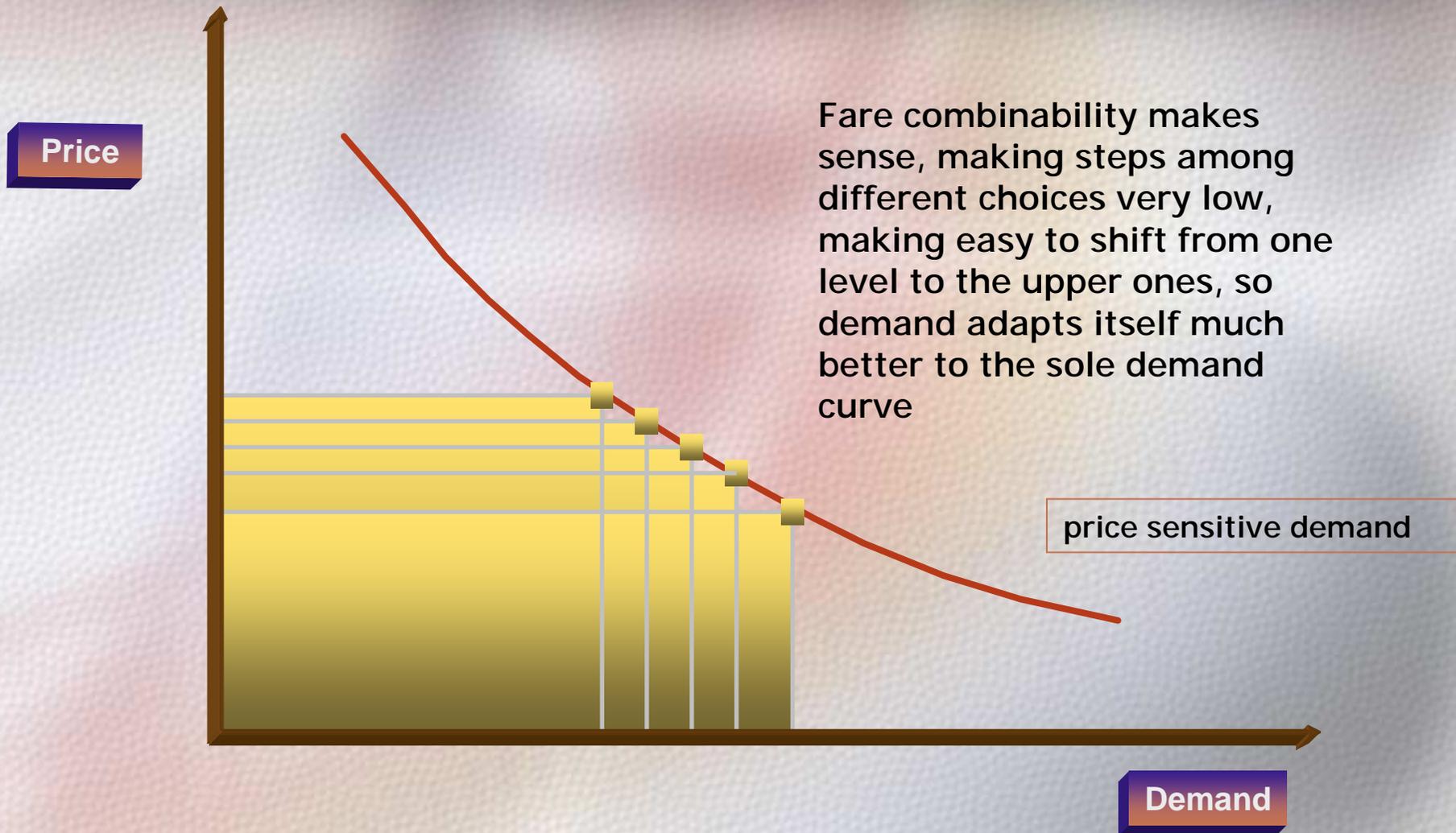
price sensitive demand

Demand

Why not doing this elsewhere?



Why not doing this elsewhere?



New pricing and revenue management model summary



- Price and inventory models redesign:
 - simple, robust models, to adapt to the changing situation
 - to maintain revenue/ASK in a cost reduction environment
 - to increase market share
- Price and inventory models make a difference in revenue margin over low cost competition
 - there is still a price premium considered along the structure. Total fare match is not necessary since product perception is neither matched yet
 - complex revenue optimization techniques apply, which are currently out of range of low cost carriers
 - business traffic still makes for a great difference. Templates work to prevent its dilution for the heavily demanded flights
 - network revenue optimization also makes a total revenue difference