

MarketLine Case Study

Norwegian Air

How a market disruptor became a major player in aviation

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OVERVIEW

Catalyst

Norwegian Air (Norwegian) has become synonymous with low-cost, long haul travel, acting as a disruptor to both low-cost carriers and traditional long-haul giants. This case study analyzes Norwegian's success and expansion and offers an insight into the key reasons behind the company's rise to prominence.

Summary

- Established in 1993, Norwegian Air has since grown to become the sixth largest low cost carrier (LCC) globally.
 - Norwegian Air has expanded quickly and now operates around 500 routes around the world
 - The airline is predominantly known for introducing long haul low cost routes
 - The company has been recognized as both “Europe’s Best Low Cost Airline” and the “World’s Best Low Cost, Long Haul Airline” by Skytrax
- Norwegian Air’s success lies in its ability to combine competitive prices and good service.
 - A key competence of the airline’s business model is its new and fuel-efficient aircraft fleet which allows costs to be kept low
 - Similar to other LCCs, Norwegian Air charges for extras such as seat allocation, check-in baggage, and meals
 - However, the airline offers comparatively good leg room, free Wi-Fi on flights, and a modern airplane – small factors which allow it to stand out when compared to other LCCs
- The rise of Norwegian Air highlights the importance of innovation for the sustained success of airlines in an ever competitive environment.
 - The airline’s continued technological and strategic innovation is a key lesson for aviation players
 - As perceptions of air travel change, airlines must tailor their offerings to the needs of modern day travelers
 - Operating a young and efficient aircraft fleet is a good way of providing cheap flights, but relying heavily on debt is risky in the airline business

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“EUROPE’S BEST LOW COST AIRLINE” OFFERS LOW FARES WITHOUT COMPROMISING ON QUALITY

Norwegian Air is considered “Europe’s best Low Cost Airline” having won several Skytrax awards down the years. The brand positions itself as low-cost and offers alternatives to traditional flag carriers on long-haul flights. Despite this, the company does not cut back on service as much as some rival low-cost carriers and this has garnered it a loyal customer base that has helped it drive growth. However, its ambitious expansion has started to weigh on profits, although the future still looks bright.

Norwegian Air: Key Facts and Competitors

As figures 2 and 3 show, Norwegian has grown to become a sizeable operation capable of challenging the likes of Ryanair and SAS. The company enjoys a strong load factor and now serves 150 destinations worldwide.

Figure 1: Norwegian Air – Key Statistics, 2017

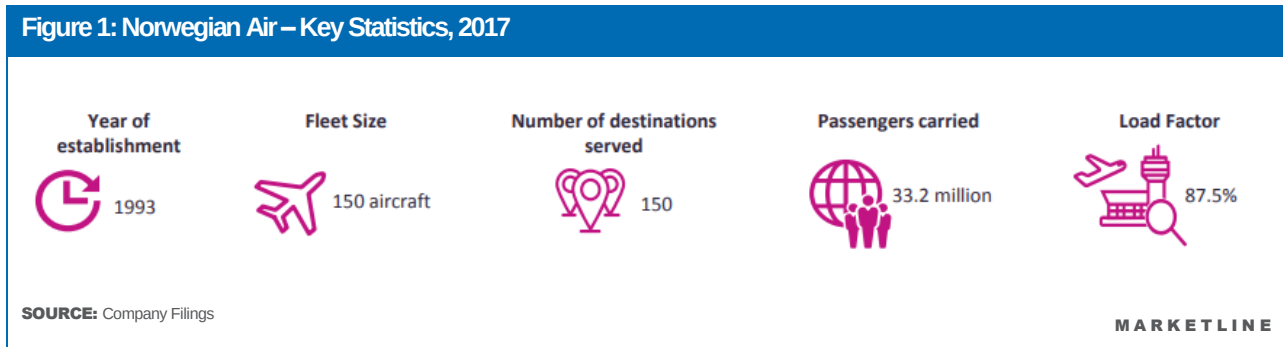


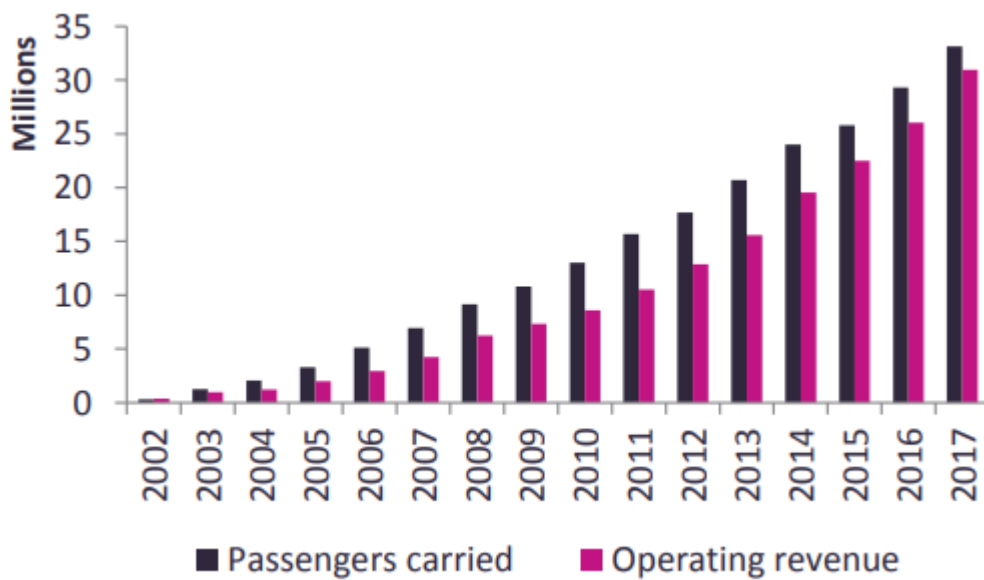
Figure 2: Norwegian Air's Key Competitors



Norwegian is widely known as one of the pioneers in the long haul low cost segment

Established in 1993, Norwegian Air is the sixth largest low cost carrier (LCC) in the world and one of the fastest growing airlines globally. The airline began with routes along Norway's west coast and now offers flights to more than 150 destinations in Europe, North Africa, the Middle East, Asia, the Caribbean, South America, and the US. The airline has been a predominant player in the long haul low cost market, launching its first long haul routes to the US in 2013.

Figure 3: Norwegian Air: Passengers carried and operating revenue



SOURCE: Norwegian

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The combination of high quality and affordable prices have rendered the airline among the top customer favorite globally

The company has been recognized year-on-year for its high-quality service, most recently winning both "World's Best Low Cost, Long Haul Airline" (for the fourth consecutive year) and "Europe's Best Low Cost Airline" (for the sixth consecutive year) at the 2018 Skytrax World Airline Awards. The airline was the first to offer free inflight Wi-Fi on European routes and the first to offer live TV on European flights. Combining low cost with service has allowed Norwegian Air to grow quickly in popularity among price conscious flyers.

Though an LCC, Norwegian allows passengers to enjoy more of an upmarket flying experience

The airline charges for the majority of extras, as expected with low cost carriers: seat-allocation, checked in baggage, and meals are all additional charges faced by the passenger. However, consumers flying low cost commonly expect to be charged for these items, so the fact that Norwegian Air offers good customer service, free Wi-Fi, inflight entertainment, and a modern aeroplane with a comparatively large amount of leg room makes a big difference. The modern aeroplanes Norwegian operates makes customers feel like they are enjoying a more upmarket flying experience. The company's policies have paid off so far, as Norwegian achieved load factor close to 90% in 2017, and has seen a general uptrend even with rapid expansion.

2017 saw growth in operating revenue but the airline's ambitious expansion weighed on profits

Norwegian Air has experienced exceptional growth; in 2016, it made a net profit of NOK1,135 million (USD146 million), a rise of 361% from the previous year. As for 2017, Norwegian Air experienced a 19% annual increase in operating revenue and carried 3.8 million more passengers than the previous year. However, the higher revenue was not translated into higher profit; the airline experienced a negative net profit of NOK1,794 million. The key reason behind the loss is the ambitious expansion plan that the company has embarked on as it seeks to effectively crack the transatlantic market.

Concerns surround the company's rapid expansion following the annual net loss in 2017

Yet, there are growing concerns that the airline has expanded too quickly and the rate of expansion is not sustainable, as the number of routes operated by the company has more than quadrupled since 2007 and Norwegian plans to add 25 new aircraft in 2018. The cost of this expansion caused the company to record a net loss of NOK919 million (USD117 million) for the last three months of 2017 and a 12 month rolling loss of NOK299 million (USD38 million) for the year as a whole. The company put this loss down to increased unit costs as well as a rise in the price of fuel. The increased costs (excluding fuel) have included higher personnel cost required for recruitment which the company expects to be a short-term rise, predicting unit costs excluding fuel to fall by 12% in 2018. However, the outlook for 2018 is more positive; though in Q1 earnings stood at -NOK46.2 million, in Q2 the company made a net profit of NOK300 million.

The outlook for the airline remains positive

Despite the loss in 2017, Norwegian Air's key executives remain optimistic for the company's performance in 2018, as the airline continues to expand quickly, serving more long haul destinations; such examples are the routes from London Gatwick Airport to South America and Asia served by the airline's new Boeing 787 Dreamliner aircrafts. CEO Bjorn Kjos stated: "Despite being at the peak of our growth phase, we have been able to present a profit and decreased unit costs during the second quarter. Going forward, the growth will slow down and we will reap what we have sown for the benefit of our customers, staff and shareholders."

Norwegian manages to offer such competitive prices largely because it has one of the youngest and most fuel-efficient aircraft fleets in the world; its aircraft have an average age of just 3.6 years, including Boeing 737-800s, Boeing 737 MAX aircraft, and Boeing 787 Dreamliners. Moreover, the company was named the most fuel-efficient airline on transatlantic routes by The International Council on Clean Transportation (ICCT). This helps Norwegian Air keep costs per-flight lower than its competitors and therefore charge lower prices. If the company can find a better balance, it should soon return to profit.

Norwegian is a disruptive force that reinvents the long haul travel experience

Norwegian has been able to shake up the market as it has targeted price-conscious consumers with low-cost flights that don't overly compromise on quality. This has intensified rivalry, leaving some competitors floundering. The company uses medium sized airports that are not necessarily 'Tier 1' airports but this allows it to charge lower prices and the fact that Norwegian is thriving suggests this is something passengers are willing to compromise on.

Increased competition has benefited consumers as air fares are decreasing

Norwegian's entrance into the short haul low cost market, but most importantly the long haul low cost segment, has resulted in the intensification of competition in aviation. The company's strong presence and rapid growth has urged both full service carriers (FSCs) and LCCs to reconsider their strategies and innovate. Though this has put immense pressure on legacy carriers, the increased competition has benefited consumers.

Norwegian's lower fares have made traveling, in particular long haul trips, accessible to more people and have enabled them to travel more for leisure, visiting friends and family and business. This is because the fares of the carrier are often substantially lower than the ones available from legacy airlines. Most importantly, Norwegian's entrance in the market has resulted in other airlines lowering the price of flights to put up with competition, hence creating further benefits for travelers.

The company chooses to fly from less popular, medium-sized airports that allow it to be more efficient and cut costs

Norwegian often flies to smaller, less popular airports. For instance, instead of flying to Miami International Airport, it has introduced routes from London Gatwick to Fort Lauderdale Airport, a slightly less busy airport in South Florida. This allows the company to be more efficient as it avoids long taxiing time – as is the case in many busy airports globally.

The launch of routes that serve less popular airports has not only benefitted the company, but also regions that were not well connected previously, or that were faced with high fares. For instance, South Florida has seen a positive impact since the airline launched flights to Fort Lauderdale. Prior to the introduction of the route, the region was served by three airlines; British Airways, American Airlines and Virgin Atlantic. The price of fares for a flight to London were very high, while fares from Miami to London Heathrow were equally expensive and required travelers from the city and its surrounding areas to first get to Miami. As a result, Norwegian's entrance to the market has highly benefitted consumers who are currently facing substantially lower fares.

Similarly, the company is considering pulling out of the New York Stewart International Airport, 100km north of New York City. Instead, it is planning to expand its presence in the Canadian market by introducing flights to John C. Murno Hamilton International Airport, which at the moment is only used by two airlines, Air New Zealand and Sunair, with flights to destinations across New Zealand and Australia.

Though Stewart Airport is far from Hamilton Airport in terms of distance, Norwegian's pulling out of the New York airport and the introduction of flights from and to Hamilton must be viewed more broadly. New York state is served by 13 airports and multiple airlines, which provide consumers with an array of travel options. However, by moving to Hamilton Airport – it is estimated that there is a market of nine million people from both the US and Canada that can access Hamilton airport within a two hour ride – Norwegian will be the only company offering direct flights to Europe from this region, hence, becoming a market leader. Flights from Hamilton are expected to commence during the spring of 2019 and are expected to highly benefit both the company, but also, consumers in the region, as it will provide them with more convenient and cheaper transportation links to Europe.

UNDERSTANDING THE MODERN TRAVELER AND INNOVATION ARE KEY TO NORWEGIAN'S SUCCESS

Norwegian's success ultimately boils down to two key factors: it understands the modern traveler and what he/she looks for in air travel, and knows how to innovate both its customer offering and its aircraft to maximize efficiency. This innovation is stirring rival carriers into action.

Norwegian's success lies in its understanding of the modern day traveler

Norwegian has responded to the modern traveler's need for value and convenience and has taken steps to stand out from other low-cost carriers in what is a crowded marketplace.

Modern day consumers value cheap and convenient transportation

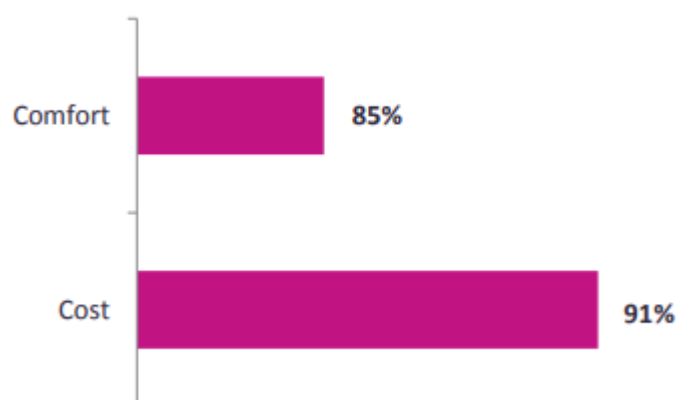
Norwegian has become one of the favorite low cost airlines of travelers as it has offered low prices without significantly compromising the quality of services and the flying experience as is the case with other LCCs. The company's success lies in the fact the company's offerings meet the needs of modern day travelers.

Changing consumer perceptions have been altering the way people see air travel in recent years. Historically, air travel has been more of a luxury treat. However, a growing number of people see flights just as a means of getting to a destination, where the actual adventure begins. Therefore, what really matters to travelers are cheap flights and a large variety of routes. GlobalData's consumer survey Q4-2016 also backs up this trend. According to the survey, cost is the most important factor when choosing an airline, with 90.2% of consumers globally considering cost important when choosing an airline; well above comfort (85.5% say it is important).

The 'Norwegian experience' stands out from other LCCs

Norwegian has achieved to set itself apart from its competitors. For instance, Ryanair and EasyJet, two of Norwegian's largest competitors, offer 30 and 29 inches of legroom, respectively compared to Norwegian's 31 inches. Additionally, extras such as free Wi-Fi helps Norwegian stand out, especially to young travelers who are after a good deal when flying long haul. For example, AirFrance's Joon is specifically targeted at Millennials, with cabin crew in smart casual attire welcoming you for a "stylish and relaxed" flying experience. Yet, Norwegian seems to have a better grasp of what Millennials actually want; competitively priced direct flights with a decent standard of service.

Figure 4: Millennials, globally: How important are the following factors when considering an airline when you go on holiday?



SOURCE: GlobalData's Q4-2016 consumer survey

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Norwegian's case proves that innovation has to be at the heart of an airline's strategy

Norwegian has invested heavily in innovation, be it innovation to improve the customer experience or to better the efficiency of the aircraft. This has helped to set it apart from the competition.

Innovation is fundamental to Norwegian's success

Norwegian Air is an agent of change within the aviation industry. Starting from a small airline with operations in Scandinavia, it has grown to fly to hundreds of destinations across continents, challenging legacy airlines and bringing a revolution in the industry.

The company's leadership has a deep understanding of modern consumers and has always sought to meet their needs through the employment of innovative technologies and strategies. From its fuel-efficient fleet, the provision of free inflight Wi-Fi and the modern design of its aircraft, to the excellent service and ambitious expansion strategy – the airline has become a notable player in aviation.

Norwegian has urged legacy airlines to intensify technological and strategical innovation

Besides its own success, Norwegian's entrance into the long haul low cost travel has sparked a series of changes in this market segment, reminding legacy airlines that innovation must never stop. In particular, Norwegian's introduction of the first trans-Atlantic flights – which undercut the fares of its rivals between 20%-50% – urged well-established players such as Lufthansa and IAG (parent company of British Airways and Iberia) to reconsider their strategies. For instance, both Lufthansa and British Airways responded to the growing competition by launching no-frills flight offerings for trans-Atlantic flights. IAG went a step further, by creating Level, a long haul low cost subsidiary with a base in Vienna. Other players such as Air France KLM are also adopting no-frills elements in their long haul operations.

FUTURE LOOKS BRIGHT BUT RIVALS ARE CIRCLING AND LOW PROFITS LEAVE COMPANY EXPOSED

Norwegian's success points to a bright future but there are potential clouds on the horizon. There are question marks over whether Norwegian can turn its expansion into sustainable profitability and a combination of low profits and high debt leaves the company exposed to external factors.

Low profits and high debt leave the company exposed to external factors

A young and fuel-efficient airline fleet obviously helps Norwegian provide highly competitive long haul flights, this requires high investment – and borrowing – which is a risk in the highly competitive airline business. In 2016, the net debt stood at NOK21.1 billion (USD2.7 billion). If Norwegian's unit costs fall as the company expects and demand continues, then fast expansion should not be a problem.

However, if uncontrollable unit costs rise such as fuel costs, or demand falls unexpectedly, e.g. due to an economic downturn, then Norwegian's business model might not be sustainable. Additionally, rising competition from the likes of newly formed Level (from IAG) and Joon (from Air France-KLM), could also create problems if the losses Norwegian sustained turn out to be more than a one-off.

Competitors show interest in buying Norwegian

Following the net loss of the company in 2017, many European competitors, such as Lufthansa and IAG, showed increased interest in acquiring the company. Though Norwegian has turned down several requests and its CEO, Bjorn Kjos, has pointed out that he is not willing to sell his company – Kjos owns about a quarter of the airline – the future of the airline will depend on the decision of its stakeholders. Though the company's reported profits during Q2-2018 is a good sign for the future of the airline, much will depend on its performance until the end of the year.

A potential Norwegian takeover would intensify the consolidation of aviation in Europe

Big players such as Lufthansa and IAG are increasingly eyeing a Norwegian takeover. Such an acquisition would allow them to put a key competitor out of business, while expanding their low cost operations, both short haul and long haul. Though a takeover scenario remains a rumor, the outcome would result in the continuation of the US-style consolidation of the European aviation market. Europe is gradually entering a new period in which only a few airlines will dominate the industry – during the past year we have witnessed the bankruptcy of Air Berlin, Alitalia and Monarch. The chief executive of Ryanair, Michael O'Leary, predicted that five years from now "there will be just five European airlines, with Ryanair and its competitor EasyJet, of course, being two of them".

CONCLUSIONS

Norwegian's success stands it in good stead to progress further, but questions about sustainable profit must be answered

Within two decades, Norwegian has turned from a small regional airline with operations in Scandinavia into one of the largest and fastest growing low cost airlines globally, offering both short haul and long haul routes.

Norwegian, taking advantage of technological advancements as well as thorough planning, is now able to offer low fares without significantly compromising quality, hence, offering more of an upmarket flying experience to its customers.

From its fuel-efficient fleet, the provision of free inflight Wi-Fi and the modern design of its aircrafts to the excellent service and ambitious expansion strategy, the airline stands out from its competitors.

The company won the "World's Best Low Cost, Long Haul Airline" (for the fourth consecutive year) and "Europe's Best Low Cost Airline" (for the sixth consecutive year) at the 2018 Skytrax World Airline Awards.

The company's 2017 net loss made a growing number of industry players and analysts question the sustainability of Norwegian's rapid growth pointing out the risks underlying its high debt.

Norwegian's deep understanding of the needs of modern travelers, coupled with the never-ending adoption of innovation reminded legacy airlines that these two factors are essential for the sustained growth within a competitive aviation industry.

APPENDIX

Sources

GlobalData Consumer Intelligence Center

Further Reading

Norwegian Air Shuttle ASA – MarketLine Company Profile

Global Airlines – MarketLine Industry Profile

Airlines in Europe – MarketLine Industry Profile

Ask the analyst

We hope that the data and analysis in this brief will help you make informed and imaginative business decisions. If you have any questions or further requirements, MarketLine's research team may be able to help you. The MarketLine Research team can be contacted at ReachUs@MarketLine.com.

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