The Low-Cost Business Model

Idea In Short

The low-cost business model works by cutting costs to the bone and passing the savings to customers as low prices, then making up the margin through volume and fees. Spirit Airlines built its entire identity on this approach, charging rock-bottom base fares and unbundling everything else, from seat selection to carry-on bags, into separate charges. The strategy took Spirit from a niche operator into one of the biggest airlines in the United States by seat count. It also left the company with almost no financial cushion when fuel prices rose and competitors cut fares to match. Spirit filed for Chapter 11 bankruptcy protection in November 2024, exited five months later, and filed again in August 2025. Its story shows what the low-cost model delivers and what it exposes a company to.

What the low-cost model actually does

A company running the low-cost model competes primarily on price. It does this by removing costs wherever it can, whether that means smaller seats, self-service checkout, fewer employees per customer or standardized products with no customization. The savings get passed on as a lower sticker price, which draws in a wider pool of price-sensitive buyers than a premium competitor could reach. Spirit Airlines built its entire operation around this logic starting in 2007, when it became the first U.S. airline to charge separately for a checked bag.[1] Advance seat selection fees followed in 2008, and eventually Spirit charged for nearly everything beyond a seat and a seatbelt, including printed boarding passes and carry-on bags stored in the overhead bin.

> The base fare is not the product. The base fare is the door to the product, and everything behind that door costs extra.

This unbundling is the defining feature of what airlines call the ultra-low-cost carrier model, a term Spirit is closely associated with in the United States after adapting an approach pioneered in Europe by Ryanair Holdings. By 2024, ancillary revenue from bag fees, seat upgrades and other add-ons accounted for roughly half of Spirit's total revenue, a sign of how central fee income had become to the underlying economics rather than a side business layered on top of ticket sales.2

Why volume has to carry the model

Cost leadership only works at scale. A single flight with a low base fare loses money unless the airline fills most of its seats and collects enough ancillary fees to cover fuel, crew and airport costs. Spirit answered this by packing more seats into each aircraft than a full-service carrier would, running a young, fuel-efficient fleet, and keeping aircraft in the air for more hours per day than legacy competitors. The formula worked well enough that Spirit grew into one of the largest airlines in the country by passenger count during the 2010s, competing directly with Southwest Airlines, American Airlines and Delta Air Lines on the routes where its fares undercut them.

The same math explains why the model tends to concentrate in a handful of large operators rather than spreading across many small ones. Costco Wholesale, Walmart and IKEA all depend on the same principle: a thin margin per unit, multiplied by enormous transaction volume, produces a profitable business, but only if the volume actually shows up. When it doesn't, fixed costs like aircraft leases, store rents and payroll keep accruing regardless of how many customers walked through the door that week.

What happens when the price gap closes

Spirit's core vulnerability was that its price advantage was never permanent. Delta, American and United all rolled out their own basic economy fares in response to Spirit and its ULCC peers, narrowing the price gap that had drawn customers to Spirit in the first place.3 Once a full-service airline can sell a stripped-down fare close to Spirit's price while still offering its loyalty program, broader route network and more comfortable cabin as an upsell, Spirit's reason for existing gets thinner. A low-cost strategy depends on competitors being either unwilling or unable to match the price; when they choose to match it anyway, even at a loss on that particular fare class, the low-cost operator loses the one lever it built its business around.

Spirit tried to merge with JetBlue Airways in 2022 to gain the scale needed to compete more directly with the largest carriers, but a federal judge blocked the deal in January 2024 after the Justice Department argued it would reduce competition and raise fares for consumers.[4] With the merger dead and its cost advantage eroding, Spirit filed for Chapter 11 bankruptcy protection in November 2024, listing losses exceeding $2.5 billion accumulated since 2020.

Labor costs are harder to strip out than fees

Cutting costs on seat pitch or meal service is straightforward compared with cutting labor costs, and Spirit's workforce was more unionized than a pure low-cost model would ideally want. Pilots, flight attendants and dispatchers all negotiated contracts through their unions over the years, and new agreements reached during Spirit's growth period raised wage rates closer to those at larger carriers even as the airline kept ticket prices low. That combination squeezed the gap between Spirit's costs and its fares from the labor side just as legacy airlines were squeezing it from the pricing side. A true low-cost structure depends on keeping every major cost category, not just fuel and fees, meaningfully below what full-service competitors pay, and labor proved to be the category Spirit had the least room to maneuver on once contracts were signed.

Two bankruptcies in less than a year

Spirit emerged from its first Chapter 11 case in March 2025 with reduced debt, but the underlying pressures had not gone away. The airline lost close to $257 million between March and June 2025, despite having projected a net profit for the year, and it ended the second quarter with roughly $1 billion in negative free cash flow and $2.4 billion in long-term debt, most of it due in 2030.[5] On August 29, 2025, Spirit filed for Chapter 11 a second time, just five months after leaving its first restructuring, and announced it would cut service to 11 U.S. cities and reduce its workforce.

Fuel prices climbed further in early 2026, and a hoped-for federal rescue did not materialize, which forced Spirit to abandon its second reorganization plan. The airline shut down entirely on May 2, 2026, ending 34 years of operations and moving into a court-supervised wind-down rather than a second emergence from bankruptcy.[6] The collapse illustrates a specific risk in the low-cost model: because margins per unit are thin by design, a company running it has little room to absorb a shock like a fuel spike, an engine recall or a stalled merger before its cash reserves run out.

Applying the model without repeating Spirit's mistakes

The low-cost model still works for companies that pair it with genuine structural cost advantages rather than temporary price cuts. Ryanair Holdings has run a similar unbundled fare structure profitably for decades by keeping its fleet standardized to a single aircraft type, negotiating aggressively on airport fees and maintaining enough cash reserves to absorb bad years. Costco Wholesale sustains thin retail margins by charging a separate membership fee that covers overhead, decoupling its survival from retail margin alone. Both examples share a trait Spirit lacked at the end: a cushion that lets the company keep undercutting competitors even during a downturn, rather than a cost structure so lean that a single bad quarter turns into a bankruptcy filing.

Key Partners

A low-cost operator depends on suppliers willing to negotiate on volume rather than premium terms: aircraft manufacturers offering standardized fleets, fuel hedging counterparties, and airport authorities granting lower-cost gate access at secondary airports. Spirit relied heavily on Airbus for its A320-family fleet and on Pratt & Whitney for engines, a relationship that turned into a liability when a geared turbofan engine recall grounded a meaningful share of its aircraft. Distribution partners matter too; Spirit sold most tickets directly through its own website to avoid paying commissions to travel agencies and booking platforms. Labor unions are also a de facto partner whose contract terms directly determine whether the low-cost cost base holds.

Key Activities

The core activity is relentless cost control across every part of operations, from fuel purchasing to aircraft turnaround times at the gate. Spirit kept its planes flying more hours per day than legacy carriers to spread fixed costs over more revenue-generating flights. Pricing and revenue management is a constant activity, since the business depends on charging separately for services that would otherwise be bundled into a single fare. Fleet standardization and route planning around high-demand leisure destinations round out the operational focus.

Key Resources

The most important resource is the cost structure itself: lower labor costs per employee, a young and fuel-efficient fleet, and dense seating configurations that raise revenue per aircraft. Spirit's brand, even a polarizing one associated with fees, functioned as a resource because it signaled "cheapest option" clearly to price-sensitive travelers. Cash reserves are arguably the most critical resource of all, since thin margins leave little room to absorb a downturn, a lesson Spirit's two bankruptcy filings made explicit.

Value Propositions

The central promise is the lowest available base fare for a given route, stripped of any service the customer did not explicitly pay for. Customers who rarely check a bag, don't need seat selection and are flexible on schedule can fly for meaningfully less than they would on a full-service carrier. The model trades comfort and included extras for direct control over what a traveler pays for. This transparency, pay only for what you use, appeals to a segment that resents cross-subsidizing amenities they don't want.

Customer Relationships

Relationships are largely self-service, run through a website and mobile app rather than a call center or a loyalty-driven rewards program with the depth that legacy carriers offer. Spirit did operate a paid membership program offering discounted fares, but it remained secondary to the core transactional relationship. Customer service is minimal by design, since staffing a large support operation would undercut the cost advantage the entire model depends on. Complaints about fees and service are a known trade-off customers accept in exchange for the lower headline price.

Channels

Direct online booking through the company's own website and app is the primary channel, since it avoids third-party commissions that would erode thin margins. Spirit also sold through some online travel agencies to widen reach, though at a cost to margin per booking. Physical presence is limited mostly to airport counters and gates, with minimal investment in premium airport lounges or dedicated check-in areas. Marketing leans on price-driven promotions and social media rather than expensive brand campaigns built around loyalty or status.

Customer Segments

The primary segment is price-sensitive leisure travelers who prioritize the lowest possible fare over comfort, flexibility or amenities. This includes budget-conscious families, students and travelers making discretionary trips rather than urgent business travel. A secondary segment includes customers willing to pay for specific add-ons, like extra legroom, while still avoiding the higher base fare of a full-service airline. Business travelers were never Spirit's core segment, since corporate travel policies typically prioritize schedule reliability and loyalty benefits over the lowest fare.

Cost Structure

Fixed costs include aircraft leases, airport gate fees and long-term debt service, all of which continue regardless of how full a given flight is. Variable costs center on fuel, crew wages and maintenance, with fuel volatility posing the single biggest threat to a cost structure built on thin margins. Spirit's rising costs against a shrinking price advantage, combined with a debt load that reached $2.4 billion, illustrate how quickly a cost-leadership model can become unsustainable once expenses outpace the fare premium it can still command over competitors.

Revenue Streams

Base fare revenue covers the lowest tier of what the model can charge, deliberately priced to undercut competitors and drive volume. Ancillary revenue, from checked and carry-on bag fees to seat selection, priority boarding and onboard purchases, made up roughly half of Spirit's total revenue by 2024, making it a primary income stream rather than a minor add-on. A smaller paid membership subscription contributed a recurring revenue component. This split between a low headline fare and substantial fee income is the financial engine that defines the low-cost airline model.

- 1Spirit's fee unbundling history
- 2Spirit's ancillary revenue reliance
- 3Legacy carriers' basic economy response
- 4JetBlue-Spirit merger blocked by federal judge
- 5Spirit's second bankruptcy filing details
- 6Spirit's shutdown after failed second reorganization

Summary

Spirit Airlines did not fail because the low-cost model stopped working. Southwest Airlines, Ryanair Holdings and Costco Wholesale all run cost-driven strategies profitably. Spirit failed because its cost advantage narrowed as larger carriers began matching its fares with their own basic economy products, while its cost base stayed exposed to fuel prices, labor contracts and a fleet grounded by engine recalls. A blocked merger with JetBlue Airways removed the escape route that might have given it scale to absorb those shocks. The lesson for any company weighing this strategy is that cutting costs is only half the model. The other half is defending the price gap once competitors notice it works, and holding enough reserve capital to survive the periods when volume alone cannot cover fixed costs. Spirit's two bankruptcy filings inside a year show what happens when a company only builds the first half.