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Case Study
easyJet's $500 Million Gamble

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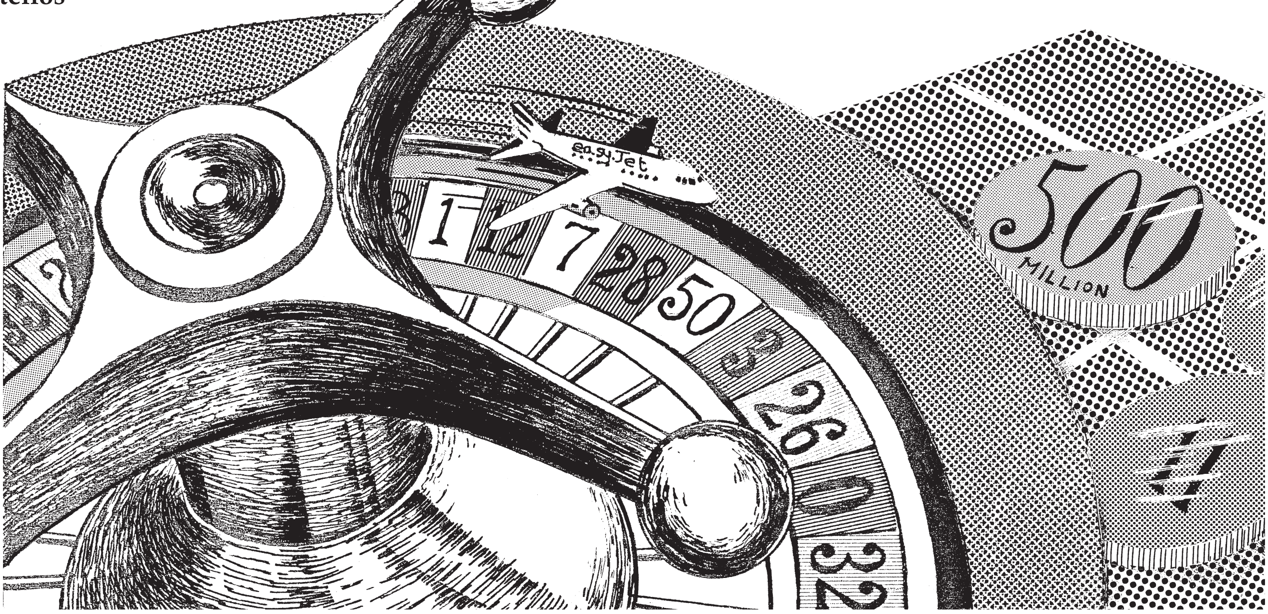
This Case Study details the rapid growth of easyJet which started operations in November 1995 from London's Luton airport. In two years, it was widely regarded as the model low-cost European airline and a strong competitor to flag carriers. The company has clearly identifiable operational and marketing characteristics, e.g. one type of aircraft, point-to-point short-haul travel, no in-flight meals, rapid turnaround time, very high aircraft utilization, direct sales, cost-conscious customer segments and extensive sub-contracting.

easyJet's managers identified three of its nearest low-cost competitors and the strategy of each of these airlines is detailed in the Case Study. But easyJet also experienced direct retaliation from large flag carriers like KLM and British Airways (Go). These challenges faced easyJet's owner, Stelios Haji-ioannou, as he signed a $500m contract with Boeing in July 1997 to purchase 12 brand new 737s.

The Case is followed by critical analysis from three Commentators in the field. **© 1999 Elsevier Science Ltd. All rights reserved**

It was July 1997, and Stelios Haji-ioannou — owner and chairman of easyJet — glanced at his $500m contract with Boeing to purchase 12 brand new 737s. As he signed the contract, Stelios steadied his shaking hand. The words of Richard Branson, chairman of Virgin Atlantic airline, flashed through his mind: 'the safest way to become a millionaire is to start as a billionaire and invest in the airline industry.'

With the Boeing contract, signed before easyJet reached its second anniversary, Stelios (as he was called by everyone) committed to triple the size of easyJet's fully-owned fleet from six to 18 airplanes in



the span of two years. When easyJet was launched with a party in London's Planet Hollywood two years earlier, no one had predicted the company's rapid growth. In its second year of existence, easyJet was widely regarded as the model low-cost European airline and had helped shake-up the once cozy European airline industry. With more than two million passengers, ten European destinations served, and sales of more than £60m in 1997 Stelios had ample room for celebration. And yet several challenges loomed.

Turbulence in the Airline Industry

Historically, the European airline industry had been heavily regulated by individual countries to protect their own national carriers, called flag-carriers. These flag-carriers, many of which were State-owned, dominated domestic travel in their national markets. Despite significant government subsidies, most flag-carriers accumulated losses due to high-cost structures and operational inefficiencies. Even in 1996, after several years of buoyant demand, most flag carriers provided disappointing returns (Table 1). The flag carriers' strong position had historically deterred new entrants, and there existed very few independent scheduled airlines, apart from charter-flight operators which catered to the needs of seasonal leisure travelers.

During the late 1980s the European Union (EU) initiated a liberalization program to increase competition in the European skies, with major regulatory changes beginning in 1992. By April 1997, any EU carrier was allowed to provide a passenger service without restriction in any domestic route of an EU member-State. This liberalization was modeled after industry deregulation initiated in the US by the 1978 Airline Deregulation Act. The US deregulation had attracted several hundred start-up airlines, but only two of the airlines founded in the 1978–92 period were still flying in 1997. European deregulation also opened the door to new entrants, and approximately 80 new airlines entered the market in 1995 and 1996

Table 1 Financial Performance of Major European Flag-carriers

Sales (million$)	1996	1995	1994	1993	1992
British Airways	$14,043	$13,036	$12,057	$10,589	$9350
Lufthansa	12,551	11,817	11,321	10,670	10,435
Air France	7656	7132	11,059	9170	n/a
KLM	5024	4625	4456	4205	3988
SAS	4667	4688	4464	4105	3181
Alitalia	4373	4325	4051	3425	3149
Swissair	3497	3333	3327	3534	3604
Iberia	3081	2907	2801	2720	2733
Pre-tax profit/(loss) (million$)					
British Airways	$1075	$983	$549	$506	$311
Lufthansa	377	416	220	(5)	(171)
Air France	6	(142)	(749)	(1131)	n/a
KLM	56	328	273	48	(282)
SAS	226	333	151	90	110
Alitalia	(165)	(190)	(93)	(175)	(25)
Swissair	1	3	2	5	14
Iberia	116	41	(242)	(363)	(252)
Profit margin (%)					
British Airways	7.7	7.5	4.6	4.8	3.3
Lufthansa	3.0	3.5	1.9	0.0	(1.6)
Air France	0.1	(2.0)	(6.8)	(12.3)	n/a
KLM	1.1	7.1	6.1	1.1	(7.1)
SAS	4.9	7.1	3.4	2.2	3.5
Alitalia	(3.8)	(4.4)	(2.3)	(5.1)	(0.8)
Swissair	0.0	0.1	0.1	0.1	0.4
Iberia	3.8	1.4	(8.6)	(13.3)	(9.2)

British Airways, KLM and Air France close the financial year in March, so their calendar year figures are those of the following March (e.g. March 1997 for 1996 figures).
SAS, Alitalia and Iberia accounts are unconsolidated, while all others are consolidated.
Swissair figures are for Swissair Ltd only, not the parent company SAir Group.
The exchange rates used were those applicable on 27 March 1998 (e.g. £/$ = 1.68, DM/$ = 0.55).

alone. Of the 56 airlines launched in 1995, 17 went bankrupt in their first year of operations.

Industry experts predicted that deregulation would spawn fewer new competitors in Europe than liberalization had in the US. Potential low-cost entrants faced significant legal obstacles to gaining regulatory approval from the Civil Aviation Authority (CAA), and also incurred 40 per cent higher costs on average than their US counterparts, due to higher airport charges and relatively inflexible labor conditions. As a result, low-cost competitors were slower to make inroads along European routes than they had been in the US. A 1996 EU report examining the impact of airline deregulation found that only 6 per cent of all routes within the EU were served by more than two airlines, with 30 per cent served just by two and 64 per cent still in monopoly status. easyJet and other low cost start-ups, however, planned to introduce competition along lucrative European routes.

Birth of an Airline

Stelios, 31, was the second son of Lukas Haji-ioannou a legendary Greek-Cypriot shipping tycoon. Lukas, who came from humble beginnings, began his career trading raw materials in Saudi Arabia, before moving to Athens to enter the shipping industry in the late 1950s. During a world-wide shipping crisis in the 1980s, Lukas accumulated a fleet of 52 super-tankers — then the largest such fleet in the world — which he later sold at significantly higher prices. Stelios, who grew up in Athens, moved to London in 1984 to obtain a Bachelor Degree from London School of Economics and a Master in Shipping from City University Business School. Upon his return to Athens, Stelios joined the family shipping business, and at the age of 25, created his own specialized tanker company, Stelmar, with a fleet of five tankers.

Stelios' first interest in the airline industry was almost accidental. In May 1994, on board an Athens – London flight of a Virgin Atlantic franchisee, he was approached by a shareholder in the franchise who tried to persuade him to invest in the company. Although Stelios decided not to invest in the company (which soon after went bankrupt), he remained intrigued by the idea of a European low-cost airline.

It was not until he flew on Southwest Airlines — a successful low-cost competitor in the US — that Stelios felt 'he had found the right concept' for a European airline. Stelios intensively researched Southwest, meeting with founder and CEO Herb Kelleher and buying 250 copies of *Nuts* — a book documenting Southwest's success — for distribution to potential employees and customers. In the summer of 1995, Stelios presented a business plan for a low-cost European airline to his father, who was won over by the idea and invested £5m in the venture. 'If I didn't bring the concept to Europe,' Stelios explained, 'someone else would.'

easyJet's operations clearly mirrored the model pioneered by Herb Kelleher at Southwest Airlines: one type of aircraft, point-to-point short-haul travel, no in-flight meals, rapid turnaround time and very high aircraft utilization. This concept promised significant cost savings relative to flag carriers (Table 2). However, easyJet's founder modified the model to benefit from Southwest's experience:

> 'The main reason for these modifications was that Southwest had been in the business for 25 years whereas I was starting from a clean piece of paper. You have better opportunities to do things differently if you start from scratch.'

For instance, Stelios completely avoided travel agents, and relied exclusively on direct sales, in contrast to Southwest which derives 60 per cent of its revenue through travel agents. Stelios also designed easyJet to completely eliminate tickets. Stelios

Table 2 Cost Comparison Between a Flag-carrier and a Low-cost Airline in Europe (Example of London – Paris Route)

Cost item (£)	Flag-carrier	Low-cost airline
1. Ticket sales costs	£3.50	£0.80
2. In-flight service costs	£1.30	£0.00
3. Pilots and cabin crew costs	£4.00	£1.50
4. Fuel, maintenance, insurance	£6.00	£7.50
5. 'En route' charges	£1.00	£1.00
6. Airport charges	£9.50	£7.00
7. Aircraft rentals	£7.80	£3.00
8. Overhead costs	£17.00	£5.00
Total costs	£50.10	£25.80

Cost assumptions

1. Include travel agent commissions, reservation agents commissions and/or computer reservation systems. Flag-carrier sells 80 per cent of tickets through travel-agents, low-cost airline 0 per cent.
2. Include cost of meal and other in-flight amenities.
3. Include salaries and benefits of pilots and air hostesses.
4. Flag carriers enjoy economies of scale and use their superior purchasing power.
5. Include costs of navigation etc. which are identical for all airlines.
6. Flag-carrier flies main airports (Heathrow – Orly); low-cost airline flies secondary airports (Stansted – Beauvais).
7. Flag-carrier leases new Boeing 747-400 aircraft; low-cost airline leases old Boeing 737-200.
8. Estimation of overhead costs is based (a) for the flag-carrier on allocating a proportion of BA overheads to the European region and (b) for the low-cost airline on Ryanair's total overheads.

General assumption

Load factor (68 per cemt) and aircraft utilization is the same for both airlines.

decided to fly easyJet's 737s using their maximum seat capacity of 148 seats. While Southwest offers drinks and its famous peanuts for free, Stelios reckoned that in-flight frills add very little to passengers' satisfaction and therefore developed the 'nothing for free, all for sale' idea. easyJet passengers even paid for soft drinks and snacks — only the in-flight magazine was free. Stelios summarized his philosophy: 'When someone is on a bus he doesn't expect any free lunch… I couldn't see why we cannot educate our customers to expect no frills on board.'

Stelios and Managing Director Ray Webster also tried to recreate Southwest's culture of teamwork and cooperation. Southwest pilots would often help cabin crew clean up an aircraft to ensure on-time takeoff. Stelios and Ray believed the easyJet's operational model could be copied, but that their corporate culture could create a sustainable advantage that competitors would have difficulty emulating.

easyJet Takes Off

easyJet started operations in November 1995 from London's Luton Airport, with two leased aircraft, 16 teenagers as reservation agents and another company's operating license. Stelios recalled the company's start-up.

'I was trying to start an airline without anybody who knew anything about airlines! On day one, it was me and my Finance director — everybody else was a subcontractor! We were the ultimate virtual airline!'

"Of the 56 airlines launched in 1995, 17 went bankrupt in their first year"

Stelios launched an extensive PR and advertising campaign with the slogan: 'Fly to Scotland for the price of a pair of jeans!' easyJet's £29 one-way fare for the 50 minute flight from London to Glasgow cost a fraction of the price charged by British Airways (BA) on the same route and was significantly cheaper than the rail fare. Most industry experts initially dismissed easyJet: 'Europe is not ready for the peanut flight,' one senior BA executive predicted. Despite initial skepticism, the first easyJet flight was full, and the company soon added two more destinations in Scotland — Edinburgh and Aberdeen. The routes between London and these three Scottish cities represented almost 30 per cent of the 14 million domestic UK passengers in 1995, allowing easyJet to rapidly reach critical scale.

To support easyJet's rapid growth, Stelios recruited several seasoned airline executives, including Ray Webster — formerly General Manager Strategic Planning in Air New Zealand — who joined easyJet as Managing Director with full responsibility for the day-to-day management of the airline. easyJet also hired several young professionals who were enthusiastic about the company's concept. Stelios and his family invested an additional £50m in the following two years to fuel expansion. At the end of 1996 easyJet purchased four second-hand aircraft to replace its fleet of leased aircraft.

easyJet in 1998

By early 1998, easyJet owned a fleet of six Boeing 737-300s, each of which was emblazoned with easyJet's phone number 0900 292929 painted in bright orange, and flew 12 routes in five countries (Table 3). easyJet's headquarters were in 'easyLand' a bright orange airplane hangar adjacent to the runway of London's Luton airport.

easyJet's management team occupied two Spartan rooms opposite the reservation center. Ray Webster and Stelios sat in one corner of the first room — dubbed 'commercial,' which they shared with marketing, finance, business development and IT staff. The other room, called 'operations' was occupied by the flight and cabin crew managers, the chief pilot, the quality and service standards manager, flight operations staff and two engineers. Fourteen easyJet managers reported directly to Ray Webster, who reported to Stelios (Figure 1). The easyJet staff consisted of 45 managers and administrators, 90 cabin crew and pilots, and 133 reservation agents.

Until early 1998 Luton airport served as easyJet's exclusive hub. Stelios initially chose the United Kingdom as easyJet's base because it offered lower labor costs and more sophisticated consumers than most Continental European countries, and he selected Luton airport as easyJet's hub because it was close to London (30 minutes from central London by train) and charged lower airport fees than London's major airports — Heathrow and Gatwick. Although Luton's convenient location and low costs had contributed to easyJet's initial success, the airline's

Table 3 easyJet Destinations

London (Luton) to:	Glasgow Edinburgh Inverness Amsterdam Barcelona Nice Palma Geneva
Liverpool to:	Nice Amsterdam

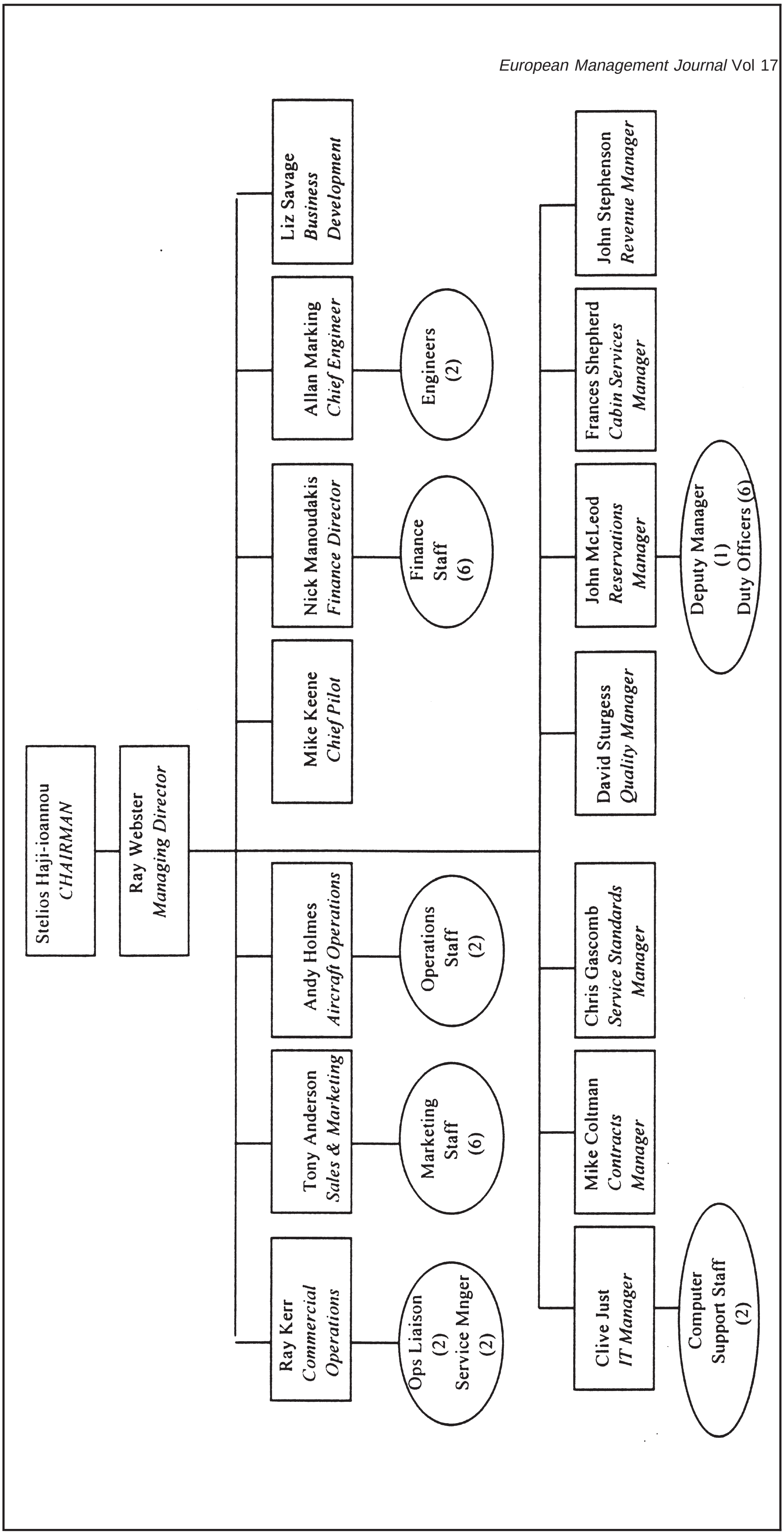


Figure 1 easyJet Organization Chart (Feb. 1998)

demand was beginning to outstrip Luton's capacity. In early 1998 easyJet opened a second hub in Liverpool, and Business Development Manager Liz Savage noted 'we could not fly more than seven to eight planes from Luton in the foreseeable future.'

easyJet defined its target customers as 'people who pay for travel from their own pockets.' In particular, easyJet targeted three cost-conscious customer segments: travelers visiting relatives, leisure travelers making brief trips, as well as entrepreneurs and managers working for small firms. While easyJet generally ignored the large market of business travelers, it did serve companies such as Vauxhall, Tesco, and ICL, which were located near the Luton airport. In addition, the company targeted route-specific customer segments such as English teachers in Spain, and the large British expatriate community in southern France.

Because easyJet completely eschewed travel agents, the company relied heavily on a variety of alternative marketing channels to raise awareness among potential customers. The company spent up to 8 per cent of revenues on newspaper, magazine, and radio advertising to reach customers directly. The company also sponsored special promotions, such as providing a dedicated phone line for fans of London's Tottenham Hotspur football (soccer) team. The company also actively sought public relations opportunities. 'Whenever there is an opportunity to make some news,' Marketing Director Tony Anderson explained, 'we do it.' easyJet's marketing focused on its low fares and punctuality, emphasizing both its low prices and impressive record of on-time departure. stelios summarized easyJet's marketing strategy, 'we make limited promises, but make sure we consistently deliver on them.'

easyJet's processes for buying tickets, checking in, and boarding were streamlined to minimize complexity for both customers and easyJet staff. To buy a ticket, customers called a local call-rate number, and were connected to one of easyJet's reservation agents located in a central call center in easyLand. Calls from non-UK customers were handled by Spanish-, French-, or Dutch-speaking reservation agents in Luton. Reservation agents were paid solely on commission (£0.80 per seat sold), and could expect to sell 60 to 90 seats in an average eight hour shift. All customers were required to pay by credit card, and received a six character booking reference number. This booking reference was the only information the passengers needed to board the plane, and no ticket was sent to them.

Passengers were requested to arrive at the airport one hour before departure, versus the two hours recommended by most other airlines. When a passenger arrived, easyJet ground agents simply confirmed the passenger's name and reference number, checked their bags, and gave them a plastic boarding card, which numbered from 1 to 148. There were no preassigned seats, and passengers boarded in order of their card number.

Sub-Contracting Entrepreneurship

In a typical airport where easyJet operates, as many as half a dozen sub-contractors would be involved in delivering the so-called 'easyJet product' (Figure 2). easyJet confined its role in providing the planes, the pilots and cabin-crew and managing marketing and sales. Everything else — from the check-in procedure to the on-site customer information desk — was handled by sub-contractors. As a start-up with limited resources, an uncertain future and serious diseconomies of scale, easyJet initially relied on sub-contractors out of necessity. Even in early 1998, however, after easyJet had acquired its own operating certificate and attained the size at which most airlines bring operations in-house, Stelios insisted as a matter of principle on employing as many sub-contractors as possible:

> 'We believe relationships with entrepreneurial companies out there to make a profit, are more efficient than having a bunch of employees yourself. By creating various profit centers, large companies are just trying to emulate the sub-contracting system. But our sub-contractors are real profit-centers with real CEOs trying to make real money! If they are not good enough they will be out of business. Market forces eliminate any inefficiencies in the sub-contracting system!'

easyJet's ability to meet its operational targets, such as ticketless check-in, the 20 minute turnaround, and the safety and punctuality of the airline all critically depended on the performance of sub-contractors. easyJet managers accordingly devoted significant time and energy to overseeing relationships with subcontractors. Alan Marking, Chief Engineer, explained:

> 'Our role really is to manage contracts and transport people. We do the cerebral activities, the sub-contractors are the fingers, and the contract is the communication

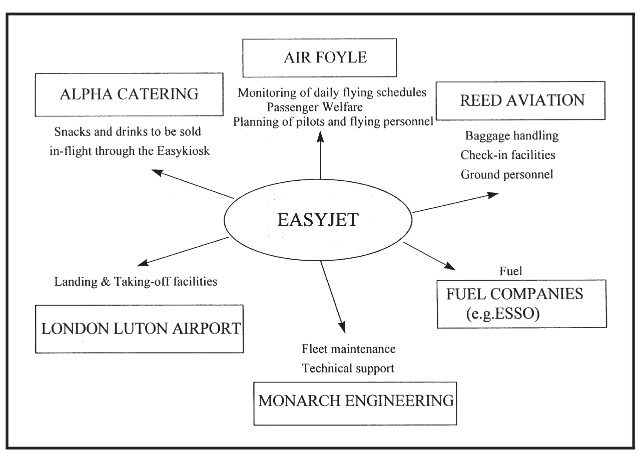


Figure 2 easyJet Sub-contracting System — The Luton Example

down to the fingers. We don't own the fingers, but we have some control over them. Arrogantly speaking, we are the thinkers, they are the doers.'

easyJet was generally satisfied with its suppliers, but some periodic disappointments did arise. In one case an aircraft was delivered late, at the very last hour for a scheduled takeoff and flight personnel consistently complained about their schedules, which were arranged by an outside company.

easyJet had initiated a number of programs to improve relationships with its suppliers. The company led regular workshops, role-reversal exercises, and simulations with sub-contractors to clarify easyJet's objectives and expectations. In addition, easyJet had designed an innovative system for evaluating suppliers' performance. Sub-contractors were evaluated not only on quantitative criteria (e.g. percentage of on-time flights), but also on qualitative factors such as their understanding of the easyJet concept. The results of these evaluations were incorporated into a rigorous rating matrix, which was then used to determine the suppliers' compensation. Marking noted:

'I am trying very hard to convert the contract with Monarch Engineering into a partnership agreement where they want to work with us rather than just doing what the contract says. We want them to understand our point of view, but we can only expect them to do that if we understand theirs… sometimes, however, you have to use the baseball bat technique to achieve your objective.'

The Competition

In 1997, easyJet managers identified Debonair, Ryanair and Virgin Express as their three closest competitors. Although all of these airlines offered low fares for short-haul flights, each pursued its own variation on the low-cost theme (Table 4). These four competitors generally avoided head-to-head competition with each other on routes, and most destinations were served by only one low-cost airline (Table 5). A few routes, such as London – Barcelona, however were apparently large enough to bear more than a single low cost carrier. In deciding whether to enter a new route, the carriers estimated the route's expected profitability based on incumbent competitors' (including trains and charter flights) offerings and load factor, demand patterns and other information on the possible destination. As all four rivals were aggressively increasing their aircraft fleet (Figure 3), they sought after to identify profitable new routes and to serve them first. In contrast to easyJet, its three low-cost competitors went public in 1997 and published detailed financial accounts (see Table 6 for each competitor's 1996 financial performance and Figure 4 for shareholder returns).

Debonair

Incorporated in England in October 1995, Debonair Holdings was easyJet's most visible competitor. Debonair used Luton airport as its main hub, and their headquarters were located only 500 m from easyLand.

Debonair was founded by Franco Mancassola, a 58-year-old American. Mancassola spent 25 years of his career in the airline industry, rising through a series of senior management positions in Continental Airlines, World Airways, Mid-Pacific Airlines and Discovery Airways. Debonair commenced operations in June 1996 under the simple philosophy of 'lower fares with minimal restrictions and no compromise on comfort.' Its first two leased aircraft served three routes; from London Luton to Dusseldorf, Munich and Barcelona. One month later, delivery of a third aircraft allowed the airline to add Madrid and Newcastle to its network. During the following three months Debonair continued its rapid expansion by leasing two more aircraft to bring its fleet to five BAe 146-200 aircraft. The larger fleet size enabled the airline not only to fly to Copenhagen and Rome, but also to take advantage of the EU's April 1997 deregulation and transport passengers within lucrative foreign markets, such as Germany where Debonair flew between Munich – Dusseldorf and Spain (Madrid – Barcelona). Debonair's rapid expansion slowed in the first half of 1997, however, when management discontinued two routes (Luton – Newcastle and Barcelona – Madrid) citing insufficient demand.

Debonair targeted business travelers, and attempted to combine high levels of comfort and customer service with low fares. 'Our strategy differs substantially from easyJet's,' Mancassola explained, 'our approach is low cost but definitely not no frills.' In early 1998, Debonair's fleet consisted of seven Bae 146-200s, which were considered the quietest passenger jets made. The aircraft were configured with a single class cabin, where all seats were separated by 33″, versus the 29″ seat pitch which was the industry standard in economy class. Inexpensive fares, more legroom, and quiet jets were three of Debonair's key selling points to business travelers, who made up 58 per cent of the company's passengers.

Debonair achieved the apparent paradox of low fares and comfortable service by focusing on operational efficiency. In particular, the airline concentrated on point-to-point markets, operated a uniform fleet of low-cost aircraft to minimize maintenance costs, concentrated service operations in the UK to minimize labor and operating costs and sub-contracted functions, such as maintenance and the check-in process. Moreover, Debonair tried to achieve high levels of aircraft utilization by operating its Bae 146s for 10 hours and 15 minutes a day on average, while BA was operating its own Boeing 737 for only 7 hours per day.

Debonair's strategy emphasized rapid expansion over short-term profitability. In fiscal year 1997, Debonair, reported a pre-tax loss of £15.7m. Debonair

Table 4 Comparison of the Four Low-cost Airlines (February 1998)

Airline	Size of fleet and type of aircraft	Capacity per aircraft	Selling method	In-flight frills	Hubs	Destinations
easyJet	6 Boeing 737-300	148 seats	Direct sales	No	Luton Liverpool	Scotland (4)* Amsterdam Nice Barcelona Palma Geneva
Debonair	7 BAe 146-200	96 seats	Direct sales (38%) and Travel agents (62%)	Yes	Luton Munich Rome	Barcelona Copenhagen Dusseldorf Madrid
Ryanair	20 Boeing 737-200A	130 seats	Travel Agents	No	Dublin Stansted	Ireland (3)** Glasgow England (9)*** Brussels Paris Stockholm
Virgin Express	12 Boeing 737-300s 4 Boeing 737-400s	148 seats 170 seats	Travel agents	No	Brussels Rome	Heathrow Gatwick Rome Barcelona Nice Madrid Copenhagen Milan

*Destinations in Scotland are: Glasgow, Edinburgh, Aberdeen and Inverness.
**Destinations in Ireland are: Kerry, Cork and Knock.
***Destinations in England are: Leeds, Liverpool, Manchester, Birmingham, Luton, Cardiff, Bristol, Bournemouth and Gatwick.

executives attributed the loss to one-time startup costs necessary to enter markets before rivals, and forecasted a profit of £3m in 1998 and £16m in 1999. 'We have moved ahead of deregulation to claim our territory in Europe,' Mancassola explained, 'profits will come soon.' Half-year results for fiscal 1998, however, failed to justify Mancassola's optimism: in early 1998 Debonair announced a pre-tax loss of £5.5m for this period, attributed mainly to the strength of Sterling and higher-than-expected advertising expenses.

Ryanair

Operating a fleet of 19 owned Boeing 737-200A jet aircraft, the Irish carrier Ryanair was considered by many industry analysts the best-established European low-cost airline. Based in Dublin and London's Stansted airport, Ryanair offered over 100 scheduled short-haul flights per day in late 1997, and served nine locations in England, four in Ireland and Glasgow, Cardiff, Paris, Brussels and Stockholm.

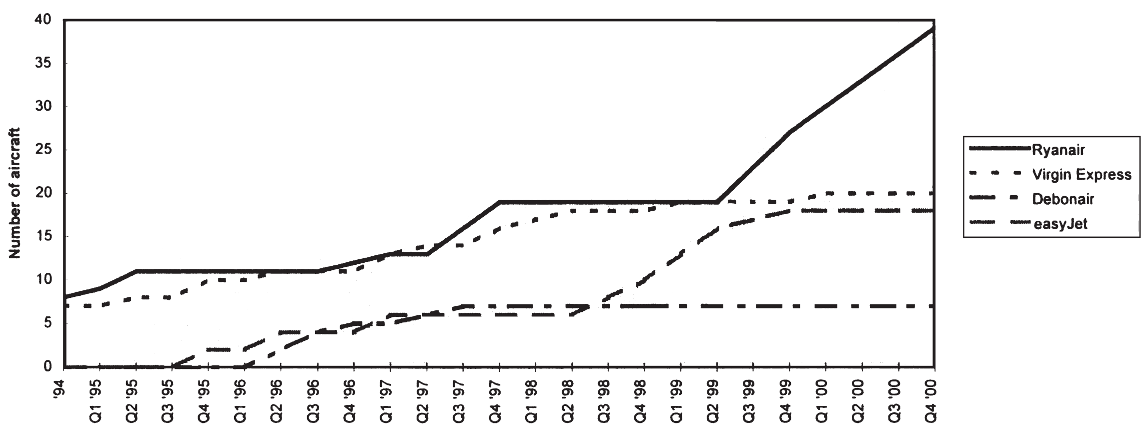
In 1985 Ryanair began operations by offering full-fare flights between Ireland and England. The company rapidly expanded its routes in the following six years and enjoyed substantial growth in passenger volume between 1985 and 1991. Despite its rapid growth, Ryanair suffered consistent losses resulting from poor cost control and inadequate information systems. In 1991 a new management team restructured the company to compete as a low-fare, no-frills carrier. Management focused operations on a few key routes, slashed fares to levels significantly below those of competitors Aer Lingus and British Midland, and introduced productivity-based pay for all staff, including pilots and flight attendants. In 1994, Ryanair began standardizing its fleet by purchasing used Boeing 737-200A aircraft to replace its leased fleet.

Ryanair's low-cost service generated significant demand growth in every route it entered after 1991, and industry analysts dubbed this demand increase the 'Ryanair Effect.' According to the International Civil Aviation Organization, the number of scheduled airline passengers traveling between Dublin and London, for example, increased from 1.7 million passengers in 1991 to more than 3.3 million passengers in 1996. Ryanair's own annual scheduled passenger volume has increased from 945,000 in 1992 to

Table 5 Sequence of Low-cost Airlines' Entry into new Destinations

Destination	Daily flights from base	Range of one-way fares	easyJet	Debonair	Ryanair	Virgin Express
London Luton	2–4	$81–245			**Jan-86**	
Liverpool	1–3	$81–245			**May-88**	
London Stansted	9–11	$81–245			**Nov-88**	
Knock (Ireland)	1	$108–273			**May-91**	
Cork (Ireland)	3	$95–273			**Oct-91**	
Birmingham	3–6	$81–245			**Nov-93**	
Manchester	4–5	$81–245			**May-94**	
Glasgow	8–12	$66–200	Nov-95		**May-94**	
London Gatwick	6	$56–98			**Nov-94**	Mar-97
Barcelona	7–10	$99–234	Jun-96	Jun-96		**Nov-94**
Madrid	4	$69–217		Jul-96		**May-95**
Edinburgh	4–5	$66–200	**Nov-95**			
Milan	1	$69–136				**Dec-95**
Aberdeen	1	$74–208	**Jan-96**			
Amsterdam	3–4	$66–200	**Apr-96**			
Nice	5–7	$99–234	Jun-96			**Apr-96**
Leeds	1–2	$81–245			**May-96**	
Bournemouth	1–2	$81–246			**May-96**	
Cardiff	1	$81–247			**May-96**	
Dusseldorf	1	n/a		**Jul-96**		
Munich	1	n/a		**Jul-96**		
Copenhagen	3	$69–136		Oct-96		**Sep-96**
Rome	10–12	$69–137		Nov-96		**Sep-96**
London Heathrow	8	$56–98				**Oct-96**
Inverness	1	$74–208	**Nov-96**			
Paris Beauvais	3	$108–273			**May-97**	
Brussels Charleroi	2	$108–273			**May-97**	
Bristol	2	$81–245			**May-97**	
Stockholm	2	$136–341			**Jun-97**	
Kerry (Ireland)	1	$108–273			**Jun-97**	
Geneva	1–2	$99–234	**Dec-97**			
Palma	1–2	$99–234	**Dec-97**			

Dates in bold indicate first move into the specific destination.



Aircraft delivered from end-1994 to first quarter 1998 and scheduled for future delivery under firm orders, as of March 1998.

Figure 3 Low-cost Airlines: Increase of Aircraft Fleet

Table 6 Financial Summary of easyJet's Three Main Competitors

P&L	Ryanair (year ended 3/97) $000	Debonair (year ended 3/97) $000	Virgin Express (year ended 12/96) $000
Turnover	186,927	23,806	180,038
Operating expenses	155,854	50,156	178,172
Operating profit	31,073	(26,351)	1865
Other income (expenses)	1210	(1)	(716)
Profit (loss) before tax	32,283	(26,352)	1150
Taxation	11,433	66	874
Profit (loss) after tax	20,850	(26,418)	276
Minority interest	0	0	144
Profit (loss) for the period	20,850	(26,418)	132
Balance sheet	Ryanair (March 31, 1997) $000	Debonair (March 31, 1997) $000	Virgin Express (Dec 31, 1996) $000
Cash at bank and in hand	32,806	1714	13,304
Other current assets	18,762	11,084	50,963
Total current assets	51,568	12,798	64,267
Fixed assets (net)	68,792	3602	1865
Total assets	120,360	16,400	66,132
Current liabilities	52,648	12,993	60,456
Long-term debt	46,203	17,119	60,421
Other liabilities	17,278	n/a	2221
Shareholders equity	4231	(13,712)	(56,954)
Minority interests			(12)
Total liabilities and shareholders' equity	120,360	16,400	66,132

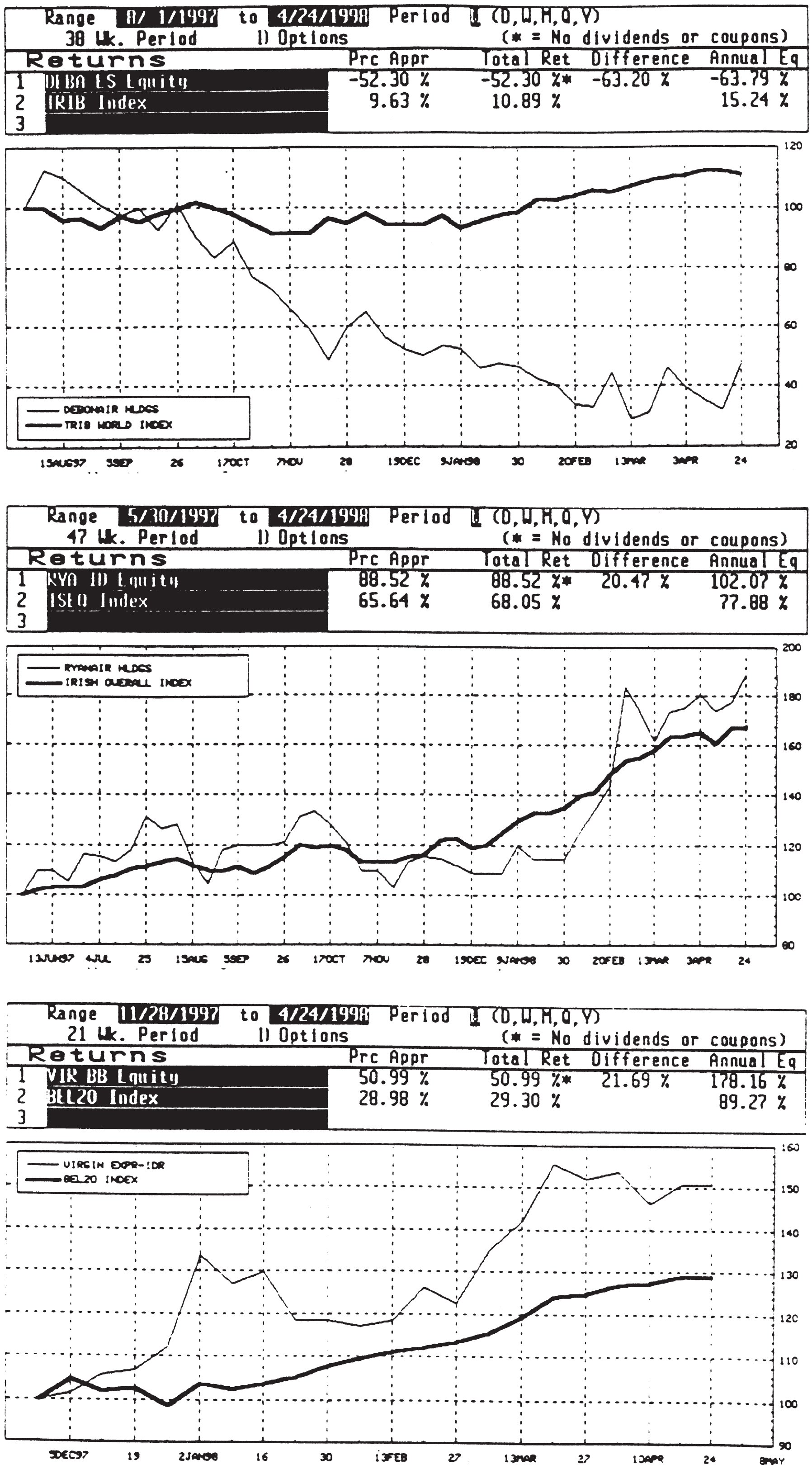
Exchange rates used to convert financial data to US$, as of March 27, are as follows:IR£/US$ 1.37; £/US$ 1.68; $/BEF 36.
Virgin Express' negative shareholder equity is mainly due to a $52m goodwill write-off.

3.1 million in fiscal year 1997 (year ending March 1997).

Under the leadership of its 36 year-old CEO Michael O'Leary, Ryanair aspired to establish itself as the leading European low-cost airline by adding routes to Continental Europe, increasing the frequency of flights along existing routes, and considering possible acquisitions. In March 1998, the Irish carrier ordered up to 45 new Boeing 737-800 aircraft worth $2bn. Ryanair placed 25 firm orders worth $1.1bn for the new 189-seat aircraft and took options worth $900m on a further 20 737-800s. The company intended to take delivery of five aircraft per year beginning in March 1999. O'Leary believed that the new aircraft would allow Ryanair to increase capacity 25 per cent per year and beat any low-cost competition from Europe's major airlines. It would also allow the gradual replacement of the old 737-200, which were approaching the end of their useful lives.

Virgin Express

Virgin Express began service as a charter airline in February 1992, operating under the name Eurobelgian Airlines S.A (EBA). In November 1994, responding to the deregulation of the market for air transport within the European Union, EBA initiated scheduled services between Brussels and Barcelona,



Source: Bloomberg

Figure 4 Shareholder Returns of Listed European Low-cost Airlines

Vienna and Rome. In April 1996, EBA was acquired by Virgin Express Holdings, which re-branded the carrier as Virgin Express, hired a new management team and emphasized scheduled service at the expense of charter flights.

The new management team — led by CEO Jonathan Ornstein who joined Virgin Express after two years as a top executive in Continental Express — actively pursued growth. As a result, Virgin Express grew from 338 scheduled flights per month in April 1996 to 1628 flights in August 1997. Virgin Express' early success was based on four core strengths: low operating costs, the Virgin brand name, a highly experienced management team and a steady revenue stream from its charter flights and its agreements with Sabena. Under these agreements, Sabena purchased a certain number of seats on each Virgin Express flight (generally more than 50 per cent of the available seats) on routes between Brussels and London's Heathrow and Gatwick airports, Rome and Barcelona. Based in Brussels National Airport, Virgin Express was flying, in early 1998, to 150 charter destinations and operated daily scheduled services between seven major European cities: London (Gatwick), Rome, Barcelona, Milan, Madrid, Copenhagen and Nice. It had a young fleet of 12 Boeing 737-300s and four Boeing 737-400s and enjoyed an impressive passenger volume growth rate: during the last quarter of 1997 Virgin Express reported 510,905 passengers, nearly double the number of passengers who flew Virgin Express in the last quarter of 1996 (272,939).[1]

Like his counterparts at easyJet and Ryanair, Jonathan Ornstein sees the airline as a European version of Southwest Airlines and admits that he imitated its operational model: 'We will emulate Southwest where we can and when we can — why reinvent the wheel?'

Sleeping Giants Awake

easyJet first encountered retaliation from a flag-carrier during its initial foray into Continental Europe in April 1996. When easyJet decided to fly to Amsterdam from its London hub, the route was already served by several airlines which together offered 50 flights daily, and officials at the Amsterdam airport bluntly suggested in their 'welcome' fax that easyJet select an alternative destination. Despite the obstacles, easyJet entered the route. The incumbent Dutch flag-carrier KLM — which had a 40 per cent market share in the route — immediately responded by matching easyJet's fares with a permanent price promotion called 'EasyChoice.'

KLM's aggressive response nearly grounded easyJet. The flights on the London – Amsterdam route were often almost empty, generating serious losses at the critical start-up stage. Stelios publicly stated that easyJet could not survive another six months on the route unless KLM changed its tactics. easyJet responded with a high-profile legal battle, and charged KLM with anti-competitive practices before the European Commission. Stelios seized the legal battle as a public relations opportunity: he flew to KLM headquarters, along with a television crew to personally hand KLM's CEO 1000 letters from easyJet customers complaining about the Dutch airline's actions. The story received extensive press coverage for many months in both the UK and Netherlands, boosting the fledgling airline's brand awareness. easyJet persisted and gradually established itself as a key player in the London – Amsterdam route, and in 1998 was contemplating a new hub in Amsterdam.

British Airways' Response: Go

In November 1997, British Airways (BA) announced its intention to launch a new airline with a hub at London's Stansted airport which would offer reduced in-flight service and much lower fares than its regular BA flights. The project — nicknamed Operation Blue Sky — had commenced six months earlier when Barbara Cassani, Blue Sky's would-be chief executive, conducted a feasibility study of the new airline's potential. Cassani's study projected that Blue Sky could turn profitable in its third year of operations in 2001. The new airline, named Go in early 1998, planned flights to Italy, Spain, Scandinavia, France and Germany from Stansted Airport. Go adopted most elements of easyJet's successful recipe: it planned to fly only Boeing 737-300s with 148 seats, bypass travel agents and sell tickets directly to customers, offer no frills on board and even use the same reservations software as easyJet. In its first year of operations, Go would create 150 jobs and grow from two leased Boeing 737-300 aircraft to eight. Fares on routes not covered by other low-cost carriers would be at least 30 per cent below standard fares on regular BA flights. On routes that were already served by easyJet, Debonair, Ryanair or Virgin Express, Go planned to match the low-cost carriers' price.

BA's announcement provoked an immediate reaction from the management of easyJet and Debonair, who expressed their concern that BA had formed the new airline to force the low-cost carriers out of the market through predatory pricing. Stelios responded aggressively in an attempt to turn public opinion against BA's move. easyJet placed a page-long advertisement in major UK newspapers expressing his thoughts about Go: 'Does the world's favorite airline really need a low cost carrier?' (Figure 5). A few weeks later easyJet launched an advertising campaign with the slogan 'BA is a copycat, fly the real thing!' Ryanair, on the other hand, welcomed BA's decision, presumably because Go's decision to locate at Stansted airport — Ryanair's existing hub — would enhance the airport's position in its fight with Luton for the title of London's dominant low-cost airport.

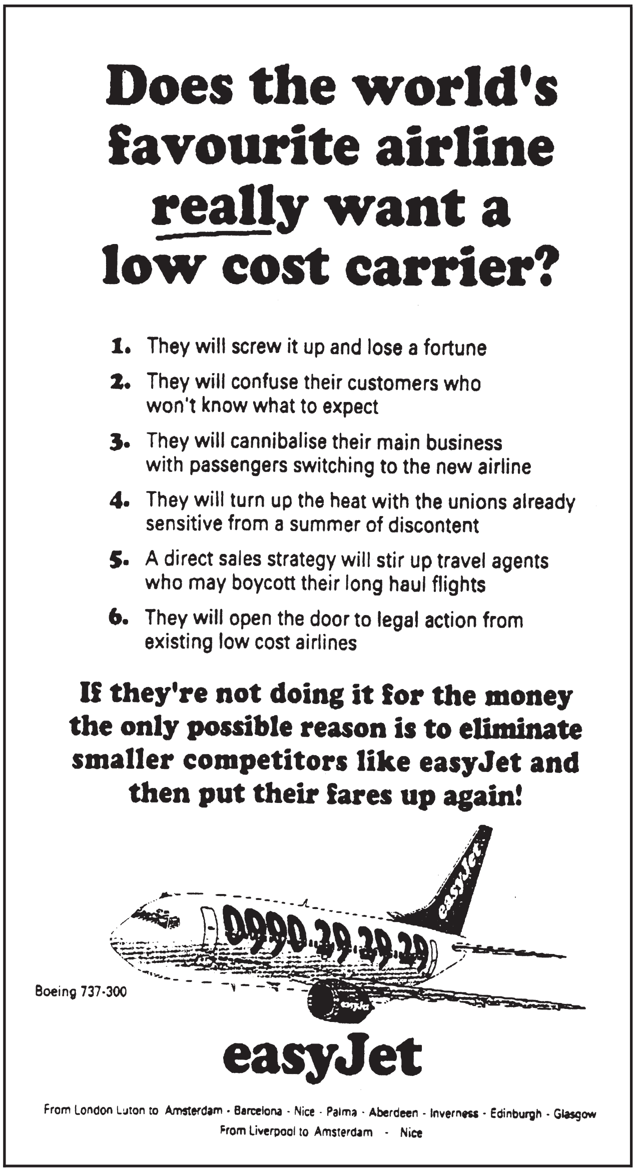


Figure 5 easyJet's Advertisement in Response to Go

'Lufthansa Light'

In 1997, the German flag-carrier Lufthansa faced huge operating losses on its domestic flights, and felt threatened by the entry of low-cost airlines, particularly Debonair which offered flights between German cities. Lufthansa's management board considered and rejected the options of dropping its loss making domestic routes or contracting them out to low-cost carriers. Instead the management board favored the option of launching its own low-cost airline, known informally as 'Lufthansa Light.'

'Lufthansa Light' was envisioned as an autonomous carrier offering direct flights between smaller German cities — thereby bypassing Lufthansa's hubs in Munich and Frankfurt. The new carrier would operate under its own brand, with its own management and personnel, although Lufthansa would retain 100 per cent ownership. A feasibility study of the new airline recommended an initial fleet of 6–14 aircraft. The study also recommended a subsequent fleet expansion of 16 additional aircraft to serve routes from non-hub cities in Germany to other European destinations, e.g. Paris – Leipzig. If pursued, this plan would result in a maximum fleet of 30 aircraft, in addition to the 150 aircraft that the parent company was already flying on European routes. To keep costs low, the aircraft would have extra seating, cabin services would be cut, and lower salaried personnel would be hired. Additionally, maintenance and repair would be contracted out. Managers estimated that these cost savings would allow Lufthansa Light to price at 20 per cent below current Lufthansa fares.

Although Lufthansa's management board approved the proposal in early 1998, the company's Executive Board delayed implementation because it felt that the proposal did 'not yet offer adequate attainable business improvements, and further investigations are required to settle outstanding issues such as automation and charges.'[2]

Growing Pains

'All I need to do now,' Stelios wrote in the December 1997 edition of easyJet's in-flight magazine, 'is find six million people a year to fly on my new planes.' some industry analysts believed that easyJet's strong brand recognition and momentum would allow it to capture share in the growing market for low-cost flight in Europe. Others wondered whether easyJet could maintain its low costs and quick turn-around times as the carrier expanded to new hubs in Europe, such as Athens and Amsterdam, and also speculated how rapidly the low-cost airlines would exhaust the pool of lucrative potential routes. Other commentators questioned whether easyJet could succeed in the face of competition from low cost airlines and incumbent flag-carriers. easyJet managers were undaunted, however: 'As long as we keep the formula right,' Ray Webster argued, 'we feel as a company that we don't have to worry about the competition.'

Acknowledgement

Donald N. Sull wrote this version of the easyJet case based on a teaching case study by Panagiotis Lekkas and Dimitris Vareltzidis, which was intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation.

Notes

1. Virgin Express website.
2. Flight International (1988).

Reference

Flight International (1988) 25 February – 3 March, p. 15.