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**INVIGILATORS Please Note:**

Please circulate a copy of the “*Ryanair – the low fares airline*” Case Study to all students with the paper.

***Ryanair – the low fares airline***

*By Eleanor O’Higgins*

**INTRODUCTION**

***Ryanair*** was founded in 1985 by the Ryan family to provide scheduled passenger airline services between Ireland and the UK, as an alternative to the then state monopoly carrier, Aer Lingus. Initially, ***Ryanair*** was a full-service conventional airline, with two classes of seating, leasing three different types of aircraft. Despite a growth in passenger volumes, by the end of 1990 the company had flown through a great deal of turbulence, disposing of five chief executives and accumulating losses of IR£20 million. Its fight to survive in the early 1990s saw the airline restyle itself to become Europe’s first low-fares, no-frills carrier, built on the model of Southwest Airlines, the highly successful Texas-based operator. A fresh management team was appointed by Tony Ryan, headed up by Michael O’Leary. The new formula effected a turnaround in the fortunes of the company, and by 1997 the company was floated in an IPO on the Dublin Stock Exchange and on the NASDAQ.

The financial arrangements which surrounded the public offering were highly advantageous to Tony Ryan, his three sons, Cathal, Declan and Shane, and to Michael O’Leary. In effect, the Ryan family had sold the company for IR£56.7 million and repurchased a 61 per cent stake for only IR£3.1 million. Michael O’Leary was allowed to purchase 17.9 per cent of the company for IR£0.9 million, partly to compensate him for the cessation of an executive bonus scheme which had netted him IR£17 million over three years. Another investment group led by David Bonderman invested IR£1 million in equity and a IR£24 million loan to **Ryanair** through a vehicle company, Irish Air, for a stake of 19.9 per cent. Bonderman, an entrepreneur from Texas, chairman of Continental Airlines and a partner in a Washington law firm, provided credibility for the company in the USA and was made chairman of **Ryanair** at its flotation. The proceeds of the flotation of IR£58 million for just under 35 per cent of the shares were used to repay loans and to purchase aircraft. It left the Ryan’s with 33 per cent of the company, Irish Air with 14.7 per cent and Michael O’Leary with 14.1 per cent.

Since its flotation, the company has enjoyed a premium price/earnings ratio compared with other airlines. In July 1998, the company placed 9.1 million shares on the London Stock Exchange, while the principal shareholders (the Ryan family, Michael O’Leary and Irish Air) disposed of 12.6 million shares, thereby reducing the percentage of shares held by them from almost 62 per cent to 51.4 per cent. A further disposal of 10.5 per cent of the company by the Ryan’s for IR£117 million, 1.5 per cent by Michael O’Leary for IR£17 million and 3.1 per cent for IR£34 million by David Bonderman, was announced in May 1999. In 2000, O’Leary sold 6 million shares, reducing his stake from 10.8 to 8.6 per cent. Bonderman, together with associated investors in Irish Air, General Partners, sold 4m of their holding of 8.8m shares. O’Leary has been progressively selling his shares in **Ryanair** as the airline has returned to the market annually for capital. The disposed shares were sold in a public offering in the USA, and to institutional shareholders in Europe. The continuation of **Ryanair**’s licence as an EU carrier is conditional on a majority share ownership by EU nationals. This could limit the trading market in ordinary shares, especially in markets outside the EU. In 2001, **Ryanair** disclosed that not less than 54 per cent of its shares were held by EU nationals.

## THE LOW-FARES AIRLINE

**Ryanair**’s objective was to maintain its position as Europe’s leading low-fares airline, operating frequent point-to-point flights on short-haul flights, mainly out of regional and secondary airports (see Exhibit 1 for market share data). The heart of its strategy was based on providing a no-frills service with low fares designed to stimulate demand, particularly from budget-conscious leisure and business travellers, who might otherwise have used alternative forms of transportation, or who might not have travelled at all.

| <b>EXHIBIT 1 European low-fares airlines’ market share 2002</b> |                             |  |                                       |
|---|-----------------------------|--|---------------------------------------|
| <b>AIRLINE</b>  | <b>PASSENGERS<br/>(000)</b> | <b>PERCENTAGE OF<br/>LOW-COST MARKET</b> | <b>PERCENTAGE OF<br/>TOTAL MARKET</b> |
| <b>Ryanair</b>  | 6,939                       | 34.6                                     | 2.3                                   |
| easyjet   | 6,262                       | 31.2                                     | 2.1                                   |
| Virgin Express  | 2,976                       | 14.8                                     | 1.0                                   |
| Go  | 2,823                       | 14.1                                     | 0.9                                   |
| Buzz  | 1,080                       | 5.4                                      | 0.4                                   |
| <b>Total</b>  | <b>20,080</b>               | <b>100</b>                               | <b>6.7</b>                            |

From the outset, as a budget carrier, **Ryanair** set itself vigorous but steady growth ambitions which it hoped to achieve in various ways. This included initiating additional routes from Dublin and London to other locations in continental Europe, new UK-Ireland routes, and new intra-UK routes, which were all served by high-cost, high-fare carriers. **Ryanair** also intended to increase the frequency of services on existing routes where warranted. The company's goal was to be profitable on new routes from their inception, by pitching their fares to be low enough to attract new customers but high enough to provide a satisfactory operating margin. This could be quite a challenge, given the steep marketing and advertising costs associated with the launch of a new route, especially in continental European markets where **Ryanair** was less well established than in Ireland. **Ryanair** would also consider making acquisitions, should the right opportunities become available.

In 1997, in the Ireland-UK market, **Ryanair** overtook Aer Lingus as the number one carrier on flights between the Republic of Ireland and the UK with 4 million passengers and a 37 per cent market share. The entry of **Ryanair** into the Ireland-UK market, originally dominated by Aer Lingus, was followed by more competitors, which led to substantially lower fares and significantly increased traffic on the routes serviced by **Ryanair**. At one stage, **Ryanair** put in a bid with the Irish government to carry civil servants to EU meetings in Brussels, offering an annual IR£1 million service contract instead of the IR£3 million it claimed Aer Lingus charged. This bid did not receive a response.

At first, **Ryanair**'s successful growth was based on a perception that it was an Irish ethnic airline, relying on reciprocal visits between the large Irish population in the UK and their relatives and friends in Ireland, availing of low fares to travel more often. In fact, the term '**Ryanair** generation' was coined to describe the younger educated Irish emigrant population in the UK. However, by 2001 fewer than 20 per cent of passengers originated from Ireland. By mid-2001, **Ryanair**'s route system had expanded from its primarily Irish-UK emphasis to serve various cities in continental Europe. It had shifted the emphasis of its expansion to mainland Europe, establishing a hub at Brussels South/Charleroi Airport. Exhibit 2 describes the **Ryanair** route network in 2004.

The carrier claimed that it generally made its lowest fares widely available by allocating a majority of seat inventory to its two lowest-fare categories. According to the company, this meant that its no-frills services allowed it to prioritise features important to its clientele, such as frequent departures, advance reservations, baggage handling and consistent on-time services. Simultaneously, this eliminated non-essential extras that interfered with the reliable, low-cost delivery of its basic flights. The eliminated extras included advance seat assignments, in-flight meals, multi-class seating, and access to a frequent flyer programme, complimentary drinks and other amenities. When the catering firm which supported **Ryanair** withdrew the provision of free ice, the airline sent a memo to cabin crew advising them that ice would no longer be available for passenger's drinks, a measure that has saved the airline €70,000 a year.

In 1997, **Ryanair** dropped its cargo services, at an estimated annual cost of IR£500,000 in revenue. Without the need to load and unload cargo, the turnaround time of aircraft was reduced from 30 to 25 minutes, according to the company. It claimed that business travellers, attracted by frequency and punctuality, comprised 45 per cent of its passengers, despite often less conveniently located airports and the absence of pampering.

**Ryanair** aimed to enhance its revenue through ancillary services offered in conjunction with its core airline business. These included on-board sales, charter flights, travel reservations services, travel insurance, car rentals, in-flight television, advertising services, and advertising outside the aircraft, whereby a corporate sponsor paid for the right to paint an aircraft with its logo. For example, passengers might have been surprised to find

themselves flying inside a giant beer-glass when Kilkenny, a beer brand within the Guinness Group, turned a *Ryanair* airplane into a flying billboard.

| <b>Exhibit 2 Ryanair Destinations</b> |                        |                        |                            |                       |                                     |
|---------------------------------------|------------------------|------------------------|----------------------------|-----------------------|-------------------------------------|
|                                       | Aarhus<br>Denmark      | Alghero Italy          | Ancona Italy               | Birmingham<br>UK      |                                     |
| Bournemouth<br>UK                     | Bristol UK             | Biarritz France        | Brescia Italy              | Brussels<br>Charleroi | Carcassonne<br>(Toulouse)<br>France |
| Cardiff UK                            | Cork Ireland           | Derry N.<br>Ireland    | Dinard France              | Dublin Ireland        | Esbjerg<br>Denmark                  |
| Frankfurt<br>(Hahn)                   | Gatwick<br>(London) UK | Genoa Italy            | Glasgow<br>Scotland        | Gothenburg<br>Sweden  | Hamburg<br>(Lubeck)                 |
| Kerry Ireland                         | Knock Ireland          | Leeds<br>(Bradford) UK | Liverpool UK               | Luton UK              | Malmo Sweden                        |
| Manchester UK                         | Nimes France           | Oslo Norway            | Paris (Beauvais)<br>France | Perpignan<br>France   | Pescara Italy                       |
| Pisa Italy                            | Salzburg<br>Austria    | Shannon Ireland        | Stansted<br>London UK      | St Etienne<br>France  | Stockholm<br>Sweden                 |
| Teeside UK                            | Trieste Italy          | Turin Italy            | Venice Italy               |                       |                                     |

In 2001, Michael O’Leary declared that by 2004, at least 10 per cent of the airline’s flights would be fare-free, because ancillary revenues would increasingly be used to substitute airfares. This was to include the availability of satellite television and Internet services on flights, allowing passengers to watch their favourite television programmes or play arcade games from their seats - for a fee. Market research suggested that these new services were expected to generate at least £1 per passenger, in addition to the average spend of £4 already being achieved, netting IR£9 million per year.

On within-country flights in the UK, merchandise was sold on a duty-paid basis. The company believed that longer flights encouraged higher per passenger revenues from in-flight sales, which should enhance such sales on newer routes to destinations in continental Europe, compared to the shorter Ireland-UK or within UK routes. The EU abolished duty-free sales on intra-EU travel from 1999, contending that it was a tax distortion. This could have been a triple blow to *Ryanair*, since it might have entailed an irreplaceable loss of revenue as well as a loss of incentive to flight attendants. Attendants could have earned as much as one-third of their compensation from commission on the sale of beverages and duty-free goods. Some Irish and UK airports increased landing charges by 20 per cent to make up the loss in revenue.

However, in the fiscal year 2001, revenues from ancillary services increased by 38 per cent to IR£42.7 million, reflecting an increase in the level of car hire rentals, Internet-based revenues and other ancillary products. These, together with on-board sales of food and beverages, helped to mitigate the reduction of revenue derived from duty-free sales.

The company continued to incur significant capital expenditures in expanding its aircraft fleet in order to realise its growth ambitions. This included the purchase of new aircraft for \$2 billion, refitting used aircraft, and hushkitting and rudder installation of existing aircraft to comply with EU regulations. *Ryanair* stated that it expected to retain all of its earnings for expansion purposes and not to pay any dividends.

Although headquartered in Ireland, *Ryanair* has had its operating expenses and revenues as well as assets and liabilities denominated in currencies other than the Irish pound. Fuel prices quoted in US dollars have been an especially sensitive issue. Also, the UK’s delayed entry into the European Monetary Union (EMU) has been problematic in *Ryanair*, with so much UK-based business, but offset by a weak Euro in 2001. However, its increasing operations in mainland Europe and the denomination of air traffic control charges in Euros

provided some currency exchange stability. *Ryanair* also engaged in some foreign exchange hedging in transactions involving the Irish pound/Euro, UK sterling and the US dollar.

*Ryanair* expenditure is normally categorised under staff costs, depreciation, fuel and oil, maintenance, materials, repairs, marketing and distribution, aircraft rentals, route charges, and airport charges.

## **COSTS AND OPERATIONS**

The company realised that the achievement of its objective of being the leading no-frills airline in Europe depended on being the lowest-cost airline. This demanded a continuous concentration on driving down costs to sustain low fares and remain profitable, even on low yields. *Ryanair*'s cost reduction strategy focused on five areas:

- fleet commonality
- contracting out of services
- airport charges
- staff costs and productivity
- marketing costs

### **Fleet Commonality**

Initially, *Ryanair*'s fleet consisted principally of a single aircraft type – used Boeing 737-200s, currently the most widely flown commercial aircraft in the world, with a single class 130-seat configuration. Thus, the company was able to obtain spares and maintenance services on favourable terms, limit costs of staff training and offer flexibility in scheduling aircraft and crew assignments. In 1998, *Ryanair* ordered 45 Boeing 737-800 aircraft (189-seat capacity) worth \$2 billion, taking delivery of five aircraft in a year. The purchase of these new aircraft, to be financed by internally generated funds, borrowings and the proceeds of the July 1998 London flotation, would allow the airline to meet its goal of increasing capacity by 25 per cent. By 2001, *Ryanair* had a fleet of 36 Boeing 737s. The purchase of new, as opposed to second-hand aircraft may have reflected the growing scarcity of used aircraft on the market.

The newest aircraft would augment *Ryanair*'s existing fleet of 20 Boeing 737-200s with an average age of over 15 years, and a life expectancy of 25 years. The average age was considerable higher than that of the fleets of *Ryanair*'s current or potential competitors. Older aircraft entailed higher maintenance costs and were less fuel efficient. Moreover, 14 of *Ryanair*'s airplanes required the installation of hushkits to comply with the EU directive on noise requirements by 1<sup>st</sup> April 2002, at an estimated total cost of \$20 million. The increased weight due to the hushkits would potentially result in a higher level of fuel consumption. The company attempted to hedge out the price it paid for fuel by contracting for a large proportion of its needs in advance. The fuel cost difficulty was compounded by foreign exchange rate fluctuations that could not be predicted or controlled, since aircraft fuel prices were denominated in US dollars.

### **Contracting out of services**

Other than Dublin Airport where it maintained its own staff and services, *Ryanair* contracted out aircraft handling, ticketing, baggage handling and other functions to third parties. The company has attempted to obtain competitive rates and multi-year contracts at fixed prices, limiting exposure to cost increases. EU directives forbidding ground-handling monopolies at

European airports should enable *Ryanair* to continue to negotiate economical contracts in these likely competitive conditions.

While *Ryanair* engineering staff carry out routine maintenance, repair services and checks on aircraft, engine and heavy maintenance are contracted out to third parties. Contract work is carried out under supervision and planning of *Ryanair* engineering staff, enabling the company to retain control of quality and safety without incurring the cost of a specialised labour force for a modestly sized fleet. It has also allowed *Ryanair* to avoid the labour unrest the dogged the maintenance subsidiary of its rival Aer Lingus, before the national carrier disposed of this loss-making unit.

### **Airport charges and route policy**

Airport charges include landing fees, passenger loading fees, aircraft parking fees and noise surcharges. *Ryanair* has reduced these fees by avoiding the congested main airports, choosing secondary and regional airport destinations, which are anxious to increase passenger throughput. As with most of its continental destinations, these airports are significantly further from the city centres they served than the main airports. For example, *Ryanair* uses Torp which is 65 miles from Oslo, Charleroi which is 37 miles from Brussels, Beauvais which is 35 miles from Paris, and Hahn which is 75 miles from Frankfurt. *Ryanair* has chosen Stansted rather than the more congested and expensive Heathrow or Gatwick as its main London airport. Indeed, Stansted is *Ryanair*'s main UK headquarters. Since *Ryanair* has been typically able to produce high volume for airports, it has negotiated favourable access fees. Less expensive gate locations and outdoor boarding stairs rather than jetways (which also consume more turnaround time) help to keep costs down. Generally, less busy airports can be expected to provide higher rates of on-time departures, faster turnaround times and fewer terminal delays, all of which maximise aircraft utilisation and mean fewer restrictions on slot requirements and on the number of allowed take-offs and landings.

Consistent with its policy of point-to-point flights on short-haul routes, *Ryanair* does not interline with other airlines. This allows that airline to offer direct non-stop journeys, avoiding the costs of providing through service (baggage transfer, passenger assistance) for connecting passengers, as well as delays often caused by the late arrival of connecting flights. Unavoidable services are contracted out and charged to passengers. For example, wheelchair services cost passengers at Dublin Airport an additional €15.

Many of *Ryanair*'s contracts were for a five-year period. The carrier asserted that it would quit any airport location that raised its charges to an unacceptable level when contracts were renegotiated. However, in the name of non-discrimination, the EU regulatory authority has prepared legislation that prevents airports from offering differential deals to different airline operators. This could have the effect of undermining the favourable treatment *Ryanair* had previously managed to negotiate.

Although *Ryanair* was able to avail of 90 per cent rebates offered by the Irish Airports Authority, Aer Rianta, on incremental traffic that it generated at Dublin and Cork Airports, Michael O'Leary continues to publicly attack the airport operator. This centres on a number of issues, including an increase in airport charges and inadequate congested amenities at Dublin Airport, with parking facilities described as 'a joke'. *Ryanair* claims that these inadequacies are stifling its growth plans.

### **Staff costs and productivity**

Since employee compensation costs are typically the most important component of total airline costs, *Ryanair* controls these costs through a performance-related pay structure. The

company believes that its labour costs are lower than those of many established airlines. Nevertheless, despite modest base salaries, pilots and cabin crew can earn total remuneration in excess of industry norms by, for example, maximising the number of sectors flown daily within regulation limits. However, EU social/employment legislation is always subject to change, and could eventually invoke further limitations on crew working hours. In May 1998, **Ryanair** announced an employee share option scheme worth up to 5 per cent of the shares of the company. In 2001, **Ryanair** pilots and in-flight employees received an apparently generous five-year pay, productivity and share options package, with other employees receiving a similar package. The agreement narrowly averted a threatened strike by pilots over working schedules and conditions.

**Ryanair** cabin attendants earn commission on on-board sales and in-flight services, but as outlined, EU legislation has abolished intra-EU duty-free sales. Nevertheless, cabin crew still make commission on duty-paid sales and in-flight refreshments. The absence of 'free' in-flight service, normally provided by full-service airlines, has beneficial spin-off effects – the opportunity for staff to earn commission for paid service, and a reduction in the extent to which the aircraft need cleaning between flights, so cabin crew can tidy up the cabin and allow a quicker turnaround time.

**Ryanair** has been a newsworthy and controversial company in Ireland with respect to its employment practices, most specifically in its refusal to recognise any trade unions. **Ryanair** asserts that it will only recognise trade unions when a majority of workers opt to join. The company regards the heavily unionised nature of employment in its rival Aer Lingus as a huge contributory factor to the airline's historical lack of competitiveness. **Ryanair**'s stance over union recognition has aroused strong feelings on both sides of the issue. The company was criticised by the EU Commissioner for Social Affairs, by members of the Irish legislature and in the press. Editorials and government ministers' statements were made, to the effect that **Ryanair**'s behaviour posed a threat to the series of tripartite agreements involving trade unions, employers' organisations and government that had created industrial peace in Ireland for over a decade, deemed to be an important factor in the creation of a vibrant and growing economy. However, those on **Ryanair**'s side claim that **Ryanair** is simply leading the way in facing the realities of international competitiveness and the growing irrelevance of trade unions to effective enterprise and workers' rights. Several hundred **Ryanair** employees issued a statement asserting that they are happy to work for the company.

## Marketing Costs

**Ryanair** advertises its low fares primarily on its website, in national and regional Irish and UK newspapers, on radio and on television. In 1997, **Ryanair** was one of the first European airlines to cut its rate of commission to travel agents from 9 per cent to 7.5 per cent. This led to a dispute with travel agencies in Ireland and the UK, which threatened a boycott on handling reservations for **Ryanair** flights. **Ryanair** subsequently won the backing of the Competition Authority in Ireland against the boycott. Travel agents remained disgruntled. Some individual agents stopped selling **Ryanair** tickets, claiming the low fares and low commission rates were not worth the effort. This unofficial boycott has been dubbed 'Anybody but **Ryanair**' in Ireland. Other airlines have since followed **Ryanair**'s measures vis-à-vis travel agents' commission rates.

In a move to capture more value from its operations and improve contact with its customers, **Ryanair** established **Ryanair** Direct Limited in Dublin in 1996, transferring its reservations operations from two locations in Dublin and London. The company benefited from a package of government grants and incentives in setting up **Ryanair** Direct. This

centralised reservations centre could be accessed by customers from anywhere in Ireland and the UK for the price of a local call. Passengers were charged IR£3 per each credit card booking. **Ryanair** Direct enabled management control over customer service quality and consistency and increased sales of ancillary services such as travel insurance, car rental, and connecting rail services.

In January 2000, **Ryanair** launched its [www.Ryanair.com](http://www.Ryanair.com) website. This has had the effect of saving money on staff costs, agents' commissions, and computer reservation charges, while significantly contributing to growth. Internet sales accounted for 65 per cent of all bookings, which, when added to **Ryanair** Direct, meant that over 90 per cent of bookings were taken directly. Travel agency sales accounted for just 8 per cent of bookings. By the end of 2000, the particularly strong performance of **Ryanair.com** contributed to a 24 per cent decrease in marketing and distribution costs.

**Ryanair** did, however, accept that it could not entirely dispense with some dependency on travel agents, especially when opening up new routes in unfamiliar markets. **Ryanair** recognised the potential loss of business that could result from a systems breakdown on the Internet of other adverse events affecting the operation of a single centralised reservation centre. Customers experiencing difficulties on the Internet could ring a special helpline. However, telephone booking lines were often continuously engaged, especially during special price promotions.

Independent customer satisfaction statistics are not available for **Ryanair**. In an annual report, Michael O'Leary cited on-time performance (defined as up to 15 minutes after scheduled time in UK Civil Aviation Authority statistics) and baggage handling as of key importance to customers. On the latter factor, **Ryanair** claimed less than one bag lost per 1,000 carried, even better than the best US airline, America West with 3.39 bags per 1,000 lost. On punctuality, **Ryanair** claimed a 74 per cent 'on-time' performance on the Dublin-London route in 2002, compared to a 64 per cent for Aer Lingus, 66 per cent for British Midland, and 77 per cent for CityFlyer operated by BA. It was unclear whether **Ryanair** included departure and arrival statistics, or departures only as it has done in the past.

## **RYANAIR'S COMPETITIVE ARENA – THE EUROPEAN AIRLINE INDUSTRY**

Even after deregulation, the European Commission was concerned that liberalisation had been ineffective, for several reasons. For example, advertised discounted fares are often so hedged with conditions and limited in quantity that passengers actually receive little benefit. Fares continued to rise on a large number of routes, operated as monopolies and duopolies. Further, strictly allocated slots at many major airports, such as London/Heathrow and Amsterdam/Schiphol, were retained by incumbent national carriers, which restricted the scope of new market entrants.

The European market continues to be characterised by higher fares and operating costs than the US, resulting from relatively high tax and excise charges on fuel, and higher landing, ground handling and air traffic control charges. These stem from less competition in services, fragmentation in air traffic control, and greater worker protection and benefits in Europe than in the USA.

Relatively short distances on intra-European routes also contribute to higher expenses on a per 'available seat mile' (ASM) basis, passed on to the traveller in higher fares. The European market is also rendered difficult for airline operators because the airports and skies of Europe are more congested than in the USA. This forces new entrants into smaller airports, which tend to be far from large metropolitan city centres, in contrast to the USA where the smaller airports are usually within 10 miles of major city centres.



Another airline sub-sector in Europe is the vertically integrated groups of tour operators and travel agents which use in-house charter airlines. Since deregulation, some of these charter airlines have entered the scheduled service sector, but are still sticking to leisure-dominated routes.

In Europe, high-speed rail travel and the construction of major tunnels and bridges, for example the Channel Tunnel across the English Channel, provide viable and often quicker transport alternatives to air travel for journeys of up to 500 kilometres. This has had a dramatic effect in some cases. For example, after a high-speed rail link was established between Madrid and Seville, the rail versus air split changed from 33 per cent rail/67 per cent air, to 82 per cent rail/18 per cent air. Airline seats sold on the route fell from over 60,000 seats a month in 1992 to under 20,000 in 1993. In the first three years of the Eurostar rail operation on the Channel Tunnel, air passenger numbers from Britain to Paris fell from 4 million in 1994 to 2.8 million in 1997. However, while high-speed rail links are being developed around Europe, it is an extremely capital-intensive business. Further complications arise because of the convergence criteria set by the EU for cross-border train links.

An issue for European airports has been the abolition of duty-free shopping within the European Union from July 1999. Aer Rianta, the state-owned Irish Airports Authority, derived a major part of its profit from duty-free retail sales, and has raised landing and other airport charges to recover the loss in revenues. The same held for UK airports, including Stansted. The loss of duty-free sales was a bigger blow to smaller regional airports whose travel was heavily dependent on intra-continental travel, as compared to larger airports which could fall back on duty-free sales to passengers travelling outside the EU. Having accepted the inevitable, some airlines put pressure on the airports not to pass on the loss of their duty-free revenues to the airlines in the form of increased airport charges. For example, *Ryanair* reversed its expansion plans at Dublin Airport, although it has continued its expansion programme at Stansted.

Nevertheless, on the positive side, growth in air travel in the European market is one and half times that of the more mature American market. A study conducted by the UK Civil Aviation Authority (CAA) in 1995 identified 34 intra-European international routes with potential for a new operator. This potential, along with deregulation, attracted new entrants, as many as 30 in 1996. However, most of them were small, undercapitalised, and subject to early failure. Vicious price wars were launched by major airlines serving the same routes. As soon as the new carrier was forced out of business, the big airline raised its prices and withdrew its extra seats. Nevertheless, between 1992 and 1998, national carriers' aggregate share of intra-European routes fell from over 80 per cent to under 70 per cent. However, on routes outside the EU, national carriers' share remains over 80 per cent.

A trend among national carriers has been to form alliances amongst themselves and/or with smaller airlines. It is predicted that, by 2010, the airline industry will form into a maximum of four groupings of national airlines. These alliances could themselves be networked to smaller airlines. For example, in 1998, American Airlines (AA) inaugurated a link with Air Liberte, a subsidiary of British Airways, to interline at Paris Orly airport to fly transatlantic AA passengers to seven provincial cities in France. (Air Liberte has since been sold off by BA to SAir, the parent company of SwissAir, and in 2001 was threatened with liquidation after incurring unsustainable losses.)

## **BUDGET AIRLINES IN EUROPE**

The 1990s saw the birth of several budget carriers in Europe, starting with *Ryanair*. Generally, these airlines use the tactics of offering low fares, no frills, and point-to-point routes to smaller airports. According to a 1998 UK CAA report, evidence suggested that the budget carriers were able to achieve costs as low as half those of a major network carrier. Generally, they have not confronted the large established airlines in head-to-head battles, by choosing airports that were not served by the large carriers, instead growing volumes on new routes. In instances of direct confrontation, the large carriers have reacted in a number of ways. For example, Sabena's action in response to Virgin Express' entry to the Brussels-London route was to arrange a pooling deal where VE flies Sabena customers into Heathrow, using Sabena's access to scarce slots at Heathrow. BA has responded by franchising out some of their short-haul routes.

By 2001, the other main budget airlines operating in Europe were Buzz (owned by KLM, hub in Amsterdam/Schiphol), easyJet (original hub in London/Luton, and almost continually loss-making since its inception in 1985, with an IPO in Autumn 2000), Go (sold off in 2001 by BA to a private investment group with a hub in Stansted), Virgin Express (hub in Brussels main airport) and Air One (out of Milan). However, *Ryanair* is by far the dominant player in the budget industry in Europe.

## **BUDGET AIRLINES IN EUROPE – THE CUSTOMER'S PERSPECTIVE**

The cheap flight deals offered to customers are frequently confusing. Often, when passengers attempt to avail themselves of advertised bargains, they discover that the deals are hedged with conditions, and that just a small proportion of seats are offered at the bargain fares.

In view of this, the *Sunday Times* carried out a study of four airlines – Debonair, easyJet, Go and *Ryanair*. Four writers each chose a route offered by one of the airlines. They were briefed to telephone for a price one month in advance of travel and then monitor fares up to the day of departure. It would be up to them as to when to actually purchase the ticket.

The results of the study showed that early booking was more likely to get a bargain, but it was not always a guarantee of the lowest fares, as prices could go down if sales stagnated, and airlines monitored each flight by means of a yield management computer program. Early Internet booking apparently resulted in the cheapest fares, and the best fares were usually available for flights that left at unsociable hours,

The survey rated the total experience, from booking through to check-in, on-board comfort, catering and punctuality. The especially poor rating of Debonair was due to a number of factors – confusing price information from the booking agents and inaccurate check-in instructions at both ends, which were deemed a 'fiasco'. Worst of all, Debonair put its own passengers on AB Airlines flights and charged them up to £160 more than the AB passengers paid. For the critic, these factors outweighed the relative comfort of the flight itself. Debonair went into liquidation in 1999. In all criteria used by the critics, *Ryanair* performed better than all other competitors.

## THE FUTURE?

**Ryanair** was the first airline in Europe to see an opportunity for a budget airline, and in 1998 was regarded as the leader of the pack. Others followed as deregulation opened the skies of Europe. The US experience suggested that not all of them would fly. However, Michael O'Leary was not worried. He blamed faulty management, not competition, for the collapse of many of the US low-fare airlines. He declared, "The majors would have never been able to put a lot of low fare guys out of business if the low fare guys hadn't tripped themselves up by overexpansion".

In a 1998 survey of the Irish equities market, **Ryanair** had the highest return on capital employed (ROCE) of all shares quoted on the Irish Stock Exchange. Moreover, the company was ranked number three of 60 Irish Stock Exchange companies by analysts on the criteria of 'strategic positioning' and 'capital structure' and number two for 'marketing' in 2000. The same year, **Ryanair** was awarded the 'Irish Company of the year' accolade by *Business & Finance* magazine.

In 1999 and 2000, **Ryanair** won the prestigious Best Managed Airline Award organised by *US Aviation Week* and *Space Technology* magazines. The award was based on six criteria – asset utilisation, productivity, financial stability, earnings protection, liquidity, and valuation. *Aviation Week* vice-president Kenneth Gazzola said, 'The best managed companies rankings are a report card for determining how well management is running the business in light of current and future competitive requirements'. Another international award won by **Ryanair** in 2000 is 'Airline of the Year' from *Transport World*.

By 2001, **Ryanair** had increased its profits for 10 years in succession. It derived 60 per cent of its business from UK operations, 18 per cent from Ireland, and the rest from Continental Europe. **Ryanair** had 45 routes across 11 countries in Europe and indicated it was focusing on intensifying competitive pressure on established European flag carriers and other low-cost airlines. By summer 2001, **Ryanair** had more European routes from Stansted than BA had from Heathrow. The new bases would shift focus of its next phase of growth to continental Europe, which was expected to be the source of 40 per cent of **Ryanair**'s traffic within the next two years. The achievement of O'Leary's target of 9m passengers by 2002 made **Ryanair** the fifth largest airline on intra-European routes. He predicts that by 2008, **Ryanair** will carry 20m passengers, taking it beyond BA in European traffic terms and contesting Lufthansa for the number one spot. The challenge now was to maintain focus on its niche and to keep costs under control.