

Review article

Flying for peanuts: the rise of low-cost carriers in the airline industry

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Simon Calder, *No Frills: the Truth behind the Low-cost Revolution in the Skies*, Virgin Books, London (2002), 290 pp., £16.95.

Barbara Cassani, with Kenny Kemp, *Go: an Airline Adventure*, Time Warner, London (2003), 320 pp., £12.99.

Thomas C. Lawton, *Cleared for Take-off: Structure and Strategy in the Low Fare Aviation Business*, Ashgate, Aldershot (2002), 236 pp., £46.50.

Lamar Muse, *Southwest Passage: the Inside Story of Southwest Airlines' Formative Years*, Eakin Press, Austin TX (2002), 262 pp., \$12.95.

James Wynbrandt, *Flying High: How Jet-Blue Founder and CEO David Neeleman beats the Competition*, Wiley, Hoboken NY (2004), 306 pp., \$24.95.

The 11 September 2001 attacks on New York and Washington DC accelerated a restructuring of the airline industry, whose net losers have been large flag carriers and whose net winners – so far, at least – the low-cost carriers. Economic prosperity was polarised: as the largest airline in the world, United Airlines, entered bankruptcy, low-cost JetBlue expanded; as the Belgian national carrier Sabena crashed, Ryanair aggressively redrew the aviation map of Europe. Airline analysts and executives now point to the low-cost model as the path of the future, and a plethora of books on the topic highlights an interested market among both academic and popular readers. These books offer an explanation for anyone wanting to understand how it is

possible to fly from London to Genoa and back for under £10. In the process they document the industry's development, providing context for a story that has been running for a good deal longer than the last ten years.

Attempts to provide cheap air tickets date back to the Second World War, according to Simon Calder, travel correspondent of the British daily, *The Independent*. With new holiday entitlement, workers returning from the war brought with them a thirst for foreign travel, a fact picked up by Vladimir Raitz, who began charter flights between Gatwick airport and Corsica in 1950. Over the next thirty years, charters became the inexpensive link between the tourist-generating markets of northern Europe and the Mediterranean sun. They were, according to Calder, the original low-cost carriers.

Two important links existed between charters and low-cost counterparts. First, both operated in the ambiguous spaces of an otherwise highly regulated system. Southwest Airlines, for instance, initially avoided the onerous federal route-bidding process by operating solely within Texas. Irish carrier Ryanair began flying domestic routes within Britain two years before full cabotage rights were established as part of the liberalisation of Western Europe's airline network. A dialectic operated between low-cost carriers and the protective regulatory structure of Europe and North America. Airlines such as Southwest and Ryanair, like Freddie Laker beforehand, pushed

the regulatory limits as far as possible and in doing so demonstrated the case for their removal. As Lamar Muse, Southwest's first CEO and president, documents, his airline was one of the major supporters of deregulation in the United States. Low-cost flyers rushed to fill the gap as the regulatory walls came down in the 1980s, although few of them actually survived.

The second link is that charters exposed a vast latent demand for cheap travel among sections of the population that would otherwise not fly. In their respective titles, both Thomas Lawton and Lamar Muse emphasise that cheap airlines did not poach passengers from bigger, established rivals: they created a new market. In the process, they provided a formidable argument for the deregulators: flag carriers did not need protecting from low-cost upstarts; indeed, in terms of expanding air travel to as many people as possible, the upstarts were doing a public service.

Unsurprisingly, Southwest looms over the pages of all these books. The Texas-based carrier began operations in 1971 and to this day remains the most successful airline in the United States and the most copied in the world. Calder tells how Ryanair's boss Michael O'Leary, who joined the carrier in the late 1980s, flew to Dallas to observe Southwest's operation. Go CEO Barbara Cassani mentions a similar pilgrimage, as does James Wynbrandt in his study of JetBlue head David Neeleman. Southwest's importance lies not just in its low cost structure. Its corporate culture is legendary and has provided a blueprint for companies both within and outside the airline industry. Indeed, according to Calder, the inability to replicate such a culture has been the downfall of many an imitator. It also provided low-cost carriers with their own pioneering aviation hero. Just as Howard Hughes, Juan Trippe and Eddie Rickenbacker became synonymous with TWA, Pan American and Eastern, so 'the Southwest way' is inextricably intertwined with the person of Herb Kelleher.

Muse's *Southwest Passage* is an illuminating read for those well versed in the

hagiography surrounding Kelleher. An industry veteran, Muse was invited by Kelleher and Rollin King to become president and CEO of Air Southwest (Muse changed the name) in 1971. In tones that sometimes border on the scornful, Muse reminds us that most of the ideas in Southwest's early years were in fact his (a point confirmed by his replacement Howard Puttnam in Calder's book). Though the origin of Southwest's golden triangle of operations between Dallas, Houston and San Antonio lay in a sketch supposedly drawn on a napkin by King over lunch with Kelleher, it was Muse who was responsible for making this network profitable. In his account of Southwest, Muse relies on his personal files of correspondence with members of the board of directors. The reporting here seems fair, since some of the letters hardly paint him in the best of lights. It may well be that Muse was forced out of the company in 1978 due to a power struggle with those who resented his autocratic style. For the historian, however, such matters are less important than the fascinating nuggets of detail he reveals concerning the foundation of Southwest's success. Though the concept of low-cost point-to-point travel was at the heart of the airline's philosophy, Muse explains that achieving this goal was actually a matter of trial and error. Indeed, in the first few years, when load factors and cash flow were low, Southwest could have failed. That it did not was due largely to Muse's adaptability. First, he recognised Southwest's mistake in flying from Houston's new international airport as opposed to Hobby airfield, close to the downtown area. In switching, he also realised the importance of remaining at Love Field in Dallas rather than relocating to the newly opened Dallas-Fort Worth airport, a decision that led to litigation and ended in the US Supreme Court. Even today, the Wright Amendment limits the range of flights using Love Field. In using airports close to downtown, however, Southwest laid the foundations for its enduring appeal to the business traveller.

Muse took drastic measures to prop up the Dallas-San Antonio market by intro-

ducing two classes of travel – Executive and Pleasure. While the former catered to time-sensitive business flyers, the latter offered \$13 one-way trips, which saw load factors double to over 60 per cent in less than a month. By March 1973 the airline was profitable and has remained so ever since. Muse was also a major factor in the expansion of the airline into the Rio Grande valley and the introduction of ten-minute turn-round times (PSA previously had the record at twenty-five minutes), which enabled maximum utilisation of Southwest's tiny fleet of three Boeing 737s. Perhaps most important, Muse was crucial to the development of the Southwest 'culture', cultivating a happy work force and rewarding it with a profit-sharing plan.

In discussing Southwest and other low-cost carriers, the role of an airline's geographical base is too often overlooked. Though Muse talks of the problems of being an intra-state, as opposed to inter-state, airline, he does not make enough of this. Southwest was restricted to the Texas borders before deregulation in 1978, yet conversely its core markets were effectively protected from new entrants. That left Southwest to battle a troubled Trans Texas Air (later to become Texas International under Frank Lorenzo) and the ham-fisted Braniff Airlines of Harding Lawrence, whose attempts to stop Muse and Kelleher seemed only to deepen customer loyalty for the upstart. By the time deregulation came along, Southwest had built an impregnable base in Texas from which it could expand, largely through the significant leverage it had accumulated.

Geography was crucial to JetBlue also. As Wynbrandt mentions, the airline's early appeal was as a New York state airline, connecting JFK airport's under-utilised domestic facilities with the upstate cities of Buffalo, Rochester and Syracuse. This move turned David Neeleman, a Utah Mormon, into something of a local hero, winning the support of the state's political power group (including Governor Pataki) in the same way that Southwest had used lobbyists in Dallas and Houston.

Across the Atlantic, local geography

was also crucial to Ryanair, which took off in the late 1980s along with the Irish economy, using connections between the Irish Republic and Britain. Meanwhile EasyJet performed a similar act between Scotland and Luton (London). Go started to turn a profit only after its establishment as a cheap scheduled carrier between southern England and Spain. For all their talk of innovative techniques, successful low-cost carriers began by basing their growth on the kind of local support used by established carriers like Delta in Atlanta. This is an under-researched area and none of the books discussed here really gets to grips with the subject.

One of the common assumptions about low-cost carriers is that they practise, as Calder calls it, the 'black art of yield management'. Yield management allows airlines to sell seats at an optimum price and helps explain how the person sitting next to you has paid a tenth of the price you did. In fact, yield management is less integral to the low-cost model than one might suppose. Muse scorned it at Southwest, as does Ryanair chief O'Leary, according to Lawton. This is an important point, which allows Lawton to underline the presence of different low-cost models (though most of them claim direct lineage to Southwest). Ryanair, he suggests, replaces concern for optimal return on individual seats with a focus on filling as many seats as possible at little cost. Its impressive profit accumulation is a result of a consistent 15–18 per cent gap between break-even and actual load factors. As long as this gap is maintained, it can continue to charge low fares and not worry about yield management. The Ryanair logic – taken straight from Lamar Muse, rather than from Herb Kelleher – is that cheap fares produce more passengers, which means lower costs, which means lower fares. Ryanair epitomises the cost-obsessed operation dominant in the contemporary airline industry (see, for instance, an interview with American Airlines' Gerard Arpey in *Airline Business*, December 2004). Continually reducing costs means outsourcing as much work as possible, avoiding expensive and congested airports,

antipathy to trade unions and little attempt to promote the kind of corporate culture found at Southwest. Indeed, Ryanair occasionally appears hostile even to its passengers. Calder quotes Barbara Cassani of Go on this issue: 'It's like a flying pub . . . if a customer has a problem they enjoy telling you to piss off.' Retorts the Ryanair chief, 'Frankly we wouldn't lose five seconds' sleep over Go.'

Despite protests to the contrary, O'Leary presumably loses some sleep over EasyJet, especially after it acquired Go – much to the chagrin of Cassani, who had negotiated a management buy-out airline from Go's original owners, British Airways. The EasyJet model differs from Ryanair both in its stress on yield management and on high network density between expensive, major airports, a service that has proved extremely popular with cost-conscious business flyers. Regular service is crucial for this group of passengers and, in its multiple daily flights to places such as Amsterdam and Barcelona, EasyJet has built a loyal customer base and a fare structure not dissimilar to Southwest's between San Antonio and Dallas.

In assessing the reasons for low-cost carriers' success in a bitterly competitive industry these books challenge several popular assumptions while reinforcing a number of others. The first assumption is that low costs come from cheap, old (and therefore potentially unsafe) airplanes. Those knowledgeable about the airline industry know that this is false: Southwest's safety record is second to none; EasyJet has one of the youngest fleets in the world; while JetBlue deliberately acquired the technologically sophisticated Airbus A320. The second assumption is that low-cost carriers have low costs because they are anti-trade union. Again, this is inaccurate: Southwest has had union representation for some time; Cassani welcomed the trade unions at Go, while EasyJet is also unionised. It is true, however, that Ryanair is bitterly opposed to unions, as is JetBlue. Where low-cost carriers score is in labour productivity – Southwest's union contracts have a good deal of flexibility built into

them – and in delegating jobs like cleaning the cabin to outsourced workers or the cabin staff. Of Southwest, JetBlue, EasyJet, Go and Ryanair, only Ryanair has not instituted the 'fun and wacky' work culture regarded by management gurus as crucial to fostering staff loyalty.

These books do confirm other assumptions, however. First is the use of technology to lower costs. Wynbrandt discusses Neeleman's role in introducing ticketless travel at Morris Air, his first venture, along with sophisticated real-time data analysis packages. The Open Skies computer reservation system became the e-ticket model for the industry, besides being a major cash earner for Neeleman. JetBlue's founder also appreciated the importance of home reservation systems (i.e. people working at home on flexitime) to reduce costs. The second correct assumption is that low-cost start-ups need a lot of money to succeed. These books confirm it. Lack of cash flow almost grounded Southwest. Neeleman realised that undercapitalisation was the biggest problem facing new airlines and thus launched JetBlue with \$130 million behind him (including a hefty chunk from George Soros). EasyJet was launched with \$35 million amassed from Greek shipping, while Go was backed by British Airways to the tune of £25 million. As Muse notes towards the end of his book, 'the airline industry is a capital-intensive, high-fixed-cost business in which leverage can make or break you.'

One main question emerges: why is it that low-cost carriers have tended to proliferate in certain parts of the world and not others? Historically the United States and Britain have led the way. Canada, with Westjet (another Neeleman operation) and Australia, with Virgin Blue (Branson) are examples from other nations and a number of carriers have emerged in Europe, with varying degrees of success. As Lawton discusses, the concept of low cost can also be found in Asia, Latin America and Africa. Yet none has come close in either power or profits to the ventures launched in Britain and North America. The reasons are both geographic and politico-economic. As

Lawton suggests, the 'island' factor has meant that other modes of international transport, e.g. rail, were not viable in the way that they were in much of mainland Europe. In the United States, according to Muse, flying has been the obvious choice over distances greater than 200 miles. Equally, Lawton mentions Britain's 'first mover advantage', allowing its flag-carrier to be privatised (in 1986) and thus subjecting it to greater competition than its continental European counterparts. The United States, with its already-privatised industry, took the plunge with deregulation some fifteen years ahead of Europe; successful companies became entrenched before rivals could appear, although it is worth stressing the very high failure rate among airline start-ups, nearly always due to undercapitalisation.

Taken as a whole, the books deserve a place on any airline scholar's shelf. Calder gains access to better interviews than the others, though the minutiae of Muse and, to a lesser extent, Cassani, are fascinating. Wynbrandt's depiction of Neeleman verges at times on the effusive, while Lawton, for all the detailed discussion, falls short on analysis on occasion

and is especially prone to take company spokespeople at face value. The books also contain bizarre moments. Neeleman liked to tell potential recruits that Job, the Old Testament character, was 'the kind of person we'd like to have working for us at JetBlue.' There is a wonderful image of Cassani driving around the London orbital M25 listening to tapes of Ayn Rand's *Atlas Shrugged*, with its tales of a powerful woman facing dark forces. Meanwhile Calder is amusing in his description of getting a free flight from Florida to the Bahamas to interview Freddie Laker. These are colourful characters, and amid the odd expletive and general megalomania they remind us that airlines have historically been a playground for people with very large egos – until Cassani, almost exclusively male. Paradoxically, Lamar Muse, one of the 'original egomaniacs', comes across as rather unassuming when he is not sniping at Rollin King and Herb Kelleher. Anyone who in 2002 could cheerfully claim to be liberal and an admirer of Ted Kennedy must have some sense of self-reflection. Low-cost or high-cost, it takes a certain type of person to get involved in the airline business.