

Ryanair and the revolution in low-cost air travel

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The low-cost airline, pioneered by Southwest Airlines in the US, offers the passenger a 'no-frills' service at a lower price than the traditional service with food and entertainment which has been the mainstay of the major airline companies. The two companies which have developed the low-cost model most successfully in Europe have been easyJet and Ryanair. Both have enjoyed phenomenal growth, building market share at the expense of the major flagship carriers such as British Airways (BA) and Lufthansa, in effect revolutionizing air travel within Europe. Low-cost travel now enjoys a market share of over 10 per cent of intra-European air travel. Of the two companies, Ryanair has been the more radical in its low-cost strategy, charging as little as under 10 euros for a flight. But how sustainable is this strategy in the long term?

Ryanair relies on high volume, filling as many seats as possible on each flight, and also adding capacity to its network, which it has rapidly built up. Michael O'Leary, the CEO of Ryanair, says: 'This is Tesco. How is Tesco cheaper compared with other stores? They buy more and sell it at low prices' (Felsted, 4 November 2003). Ryanair flew 11.3 million passengers in 2003, 45 per cent up on 2002. 'Load factor' is the number of seats sold as a proportion of those seats available on each flight. Ryanair's load factor fell from over 80 per cent in 2002 to 77 per cent in 2003 (which is still high for the industry), partly because of a 60 per cent increase in the number of seats available. O'Leary looks for every possible means of reducing costs in the operation. Almost all seats are booked via the internet, saving costs in administration. Aircraft are operated on tight schedules with quick turnaround times of only 25 minutes, allowing more flying time in a day than rival carriers: it can run two more flights a day than rivals such as BA. Ryanair pilots fly 887 hours a year, close to the legal limit of 900 hours, and more than the 780 hours a year flown by easyJet pilots. The company has invested in older aircraft, for which depreciation costs are less steep. With its ambitious expansion plans, it has ordered 102 new Boeing aircraft, which will entail significant depreciation costs. This is one of the factors which might affect future profits. On the other hand, the new aircraft have greater capacity and are more fuel-efficient. Despite its older planes, Ryanair's maintenance costs are lower than those of easyJet, and lower than would be expected by industry experts, but the company denies that safety is being compromised.



Ryanair's major cost savings have come from its use of secondary airports, where fees are lower than those of major hubs. It is estimated that its landing costs per passenger are only £4.90 out of an average fare of £33, compared with £10.75 per passenger out of an average EasyJet fare of £46, arriving at a major airport. Moreover, O'Leary has been successful in doing deals with these underused airports, including, for example, provision of hotel accommodation for crews. However, this strategy suffered a setback with the European Commission ruling that such a deal with Charleroi airport in Belgium, which is state-owned, amounted to a state subsidy, which is disallowed under European law. While some observers saw this as a blow to the

Ryanair business model, O'Leary shrugged off such comments as unfounded, confident that cheap airport deals are still possible.

For Ryanair, 2004 was a calmer year, with slower growth, in which capacity increased only 16 per cent and passenger volumes increased 19 per cent. Profit margins were down, from 28 per cent in 2003 to 22 per cent, as shown in the figure. Is this a sign that the boom days are over? Ryanair, registered in Dublin, pays corporation tax in Ireland, where the rate has dropped to 12.5 per cent. A less advantageous tax regime would affect its position and, in particular, any future tax on fuel. Environmentalists have singled out the high level of emissions from short-haul flights as a cause of global warming. Other costs, such as operating costs, rising oil prices and higher airport charges, are also under pressure. O'Leary remains upbeat about Ryanair's long-term future, while pointing to likely casualties among the many newer entrants into the low-cost sector.

Sources: Dombey, D., Done, K., and Felsted, A., 'As regulators launch an inquiry into suspected illegal subsidies, is cheap air travel in Europe too good to last?', *Financial Times*, 12 December 2002; Felsted, A., "'Everyone is looking for the secret under the bed.'" Can Michael O'Leary sustain Ryanair's low-cost success?', *Financial Times*, 4 December 2003; Felsted, A., 'Budget airlines fly on a knife edge', *Financial Times*, 11 August 2002; Done, K., 'Ryanair talks of disaster, but the low-cost revolution flies on', *Financial Times*, 7 February 2004; Done, K., 'Ryanair suffers first net profit drop in 15 years', *Financial Times*, 2 June 2004.

Case questions

What are the essential elements of Ryanair's low-cost strategy?

What factors will affect its long-term sustainability?

@ Ryanair's website is <http://www.ryanair.com>

@ easyJet's website is <http://www.easyjet.com>

@ Southwest, the pioneer low-cost airline, is at <http://www.southwest.com>