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Taking your airline to new heights

EXTREME AIRLINE MANAGEMENT

A conversation with ...

**David
Siegel,
CEO,
US Airways**

INSIDE

Traditional carriers launch
low-fare subsidiaries

How airlines weathered
"the perfect storm"

Cathay Pacific Airways'
crisis management process



carriers that have started their own low-cost airline.

Despite a checkered history of such offshoots, in the past couple of years, several airlines have launched, or announced plans for, low-cost subsidiaries. Air Canada has launched Tango and Zip. Qantas is now examining the possibility of launching a domestic low-cost carrier. United Airlines recently announced it will launch a new low-cost operation from its Denver hub beginning in February. The low-cost operation, currently code-named Starfish, will begin by serving

five destinations with a fleet of four Airbus A320 aircraft. And Delta, with Song, and bmi, with bmibaby, have used their low-cost subsidiaries to aggressively compete in their dominant markets.

Although some consider such endeavors risky, early returns have been positive for Delta and bmi, who show that, perhaps, such a new venture is not quite the flight of fancy many people once believed. Although they share similarities – including drawing upon the resources of the parent airline –

they also have key differences in the way they operate. While both have a single fleet type, Song uses larger 757s compared to bmibaby's 737s. Song also has maintained the pay scale of the parent airline while bmibaby forged complete new labor agreements. Each also offers different amenities to its customers.

While their approaches to their low-cost carrier startup differ somewhat, both Delta and bmi are committed to using their new subsidiaries to compete strongly against the low-cost competition. 

You've Come a Long Way, bmibaby!

■ By Stephani Hawkins and B. Scott Hunt | *Ascend* Editors

Back in 2001, officials with bmi, the second largest carrier in the United Kingdom, predicted someone would eventually bring a low-cost carrier to the airline's East Midlands Airport home base.

So, they thought, why not do it themselves?

"It became fairly clear to us that our home base here in the Midlands was ripe for a low-cost airline," said Tony Davis, managing director of bmibaby. "It had all the attributes for an airport that a

low-cost carrier would identify as being attractive. Really, the decision for us was if we as a company had to start setting up our own low-cost carrier mindful of some of the pitfalls that people like British Airways with Go and some of the U.S. carriers had with their own 'light brand.' Could we set up a low-cost airline and learn from some of the mistakes before someone actually came into our home base airport and attempted to do that?"

In the summer of 2001, bmi began planning its new low-cost operation, but those plans were put on hold after the events of Sept. 11 of that year. As expected, however, a low-cost airline,

Go, announced that December it would begin operations at East Midlands.

"Because we had laid a lot of the groundwork, we were actually able to announce our own low-cost airline within three days of Go announcing it was coming here," Davis said. "The immediate reaction to Go's announcement was that we would stand and fight."

Although a radical move by a full-service carrier, Davis said the decision for bmi to start a low-cost operation made perfect sense.

bmi baby.com
the airline with tiny fares

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"The U.K. was at the forefront of the low-cost airline development in Europe," he said. "It became clear to us that it was going to become increasingly difficult to compete against low-cost airlines if they started expanding outside their London hubs.

"If we didn't adjust our model, we would effectively end up in a position where the bmi business at East Midlands Airport was unsustainable," he said.

In setting up the low-cost carrier, Davis said bmi transferred several 737s from its fleet and incorporated traditional low-cost philosophies, such as a point-to-point route network, a single cabin, a single fleet type, half-hour turnarounds, distribution nearly exclusively through the Internet and foregoing interline agreements.

"We took a very, very, very strict view of either it was low cost or it wasn't," he said. "And we resisted the temptation to end up with a hybrid. I think some of the companies that have struggled are the ones where the hybrid solution is preferred because it is perhaps not as challenging to set up."

To further maintain cost controls, all employees of bmibaby work under sep-

"We've tried to adopt the philosophy of under-promising and over-delivering where historically airlines have often over-promised and under-delivered."

arate contracts with terms and conditions more in line with a low-cost operation. The airline also provides different benefits, such as its own profit-sharing plan, separate from the parent.

Davis said the current condition of the industry helped convince employees to "modify the way we work to replicate the operating properties of a low-cost airline."

Photo courtesy of bmibaby



Tony Davis, the managing director of bmibaby, has seen the airline grow tremendously since it began service in 2002. The airline anticipates carrying 3 million passengers this year.

"To some extent Go helped us in this because Go came into our backyard and said, 'We are going to take you on in your home base and effectively destroy the business you've built up over 35 years at this airport,'" he said. "It was easy for us on that basis, going to our staff (with the idea) that unless we approached this with a radical solution the alternative would be that we could not compete.

"I think people understood that we as an industry have to change the way we were going to operate in order to continue to grow our business," he said. "We're creating jobs because we're carrying a lot more passengers now than we did when the assets were deployed differently. What we're trying to do with our employee group is manage growth and not manage decline, which would have been the scenario potentially if we hadn't created a low-cost carrier. bmibaby is experiencing significant

growth at a time when the industry is contracting.

"So, it's really a case of saying, 'Do you want to be involved in something that's growing and has the potential to be successful or do you want to take your chances with the old model, which in these particular airports is not looking as strong as it had been historically.'"

The new model has proved to be a success. In June, bmibaby carried a record 266,035 passengers, a 153 percent increase year on year. It broke that record again in July, and in August, the airline broke the 300,000 mark. The carrier also helped the performance of the group. In July, the bmi group, which also includes bmi regional, set a record by carrying 905,000 passengers — 285,000 of which was carried by bmibaby — the first time the group exceeded the 900,000 mark.

After only 18 months, bmibaby became the largest airline in the

Midlands, surpassing British Airways, which has since slipped to third behind British European. With the phenomenal growth at East Midlands, 300 percent year on year, bmibaby now carries more passengers than the parent carrier ever did when it served the airport.

“The growth of bmibaby is very encouraging,” said Sir Michael Bishop, chairman of bmi. “We anticipate carrying up to 3 million passengers in the current year, firmly establishing

“We are experiencing 400 percent growth year on year because we are part of a group. We’ve gone from three airplanes in March of 2002 to 13 today. I don’t believe we could have done that as a complete startup.”

bmibaby as an important operation in the ‘no-frills’ market and the third largest operator in the sector.”

The key to setting up a successful low-cost carrier within a carrier, Davis said, was convincing everyone throughout the organization that “this has to be a different company.”

“You cannot just paint the airplanes and hope that this will function as a separate operating model,” he said. “We had to get buy in from the very top that said this is a different airline. It can benefit from a lot of the history, experience and financial stability of the parent company, but it has to conduct itself on a like-to-like basis with its primary competitor.”

Another key, Davis said, involves changing the way airlines view themselves and their product.

“The biggest thing we have learned is to stop thinking of ourselves as being a special type of business,” Davis said. “We’re in the retail business. We sell seats. Other people sell books or groceries.

I think for a long time airlines tried to convince themselves that we were a special case, a special kind of business. But in reality, when you get back to it, successful airlines are the ones that come through to the core product. We’re selling a commodity. We no longer view our business as the ‘Come fly with me’ 1960s glamour jet travel. It’s mass transportation.”

In setting up a carrier within a carrier, bmi officials worked to make sure the new low-cost operation would not siphon traffic from the full-service or regional airlines. The three airlines in the group have been able to differentiate their product to serve different segments of the traveling market, Davis said.

Although bmi began at East Midlands Airport, the parent no longer offers flights there. The parent airline has concentrated on London’s Heathrow Airport, where it is the second largest carrier with about 14 percent of the take-off and landing slots. And bmibaby, which doesn’t even fly to London, has concentrated on its bases at East Midlands, Cardiff and Manchester.

“bmibaby is competing against the traditional charter airlines and the low-cost airlines, so we go to Spain, Prague, Belfast — high-volume, leisure markets,” he said. “Whereas bmi is focusing on Heathrow, and our regional business is developing key business routes from Scotland, Manchester and Leeds/Bradford.

“The three airlines within bmi each have a particular cost base, market presence and a consumer proposition,” he continued. “Really, we have the best opportunity now to make sure we put the right vehicle into the right market, ensuring we can compete effectively against whoever else is incumbent in those markets.”

Although incorporating many low-cost principles, bmibaby’s ties to a larger group have caused it to modify some aspects of the low-fare model.

Photo courtesy of bmibaby



bmibaby employees have separate labor contracts from the parent organization, with terms and conditions more in line with a low-cost carrier. The separate contracts represent one of the methods the carrier utilizes to manage costs.

“We are looking to offer a slightly higher level of service than that of some of our competitors,” Davis said, “partly because we are part of a group and have other companies that use the same name. As part of a family, you have to at least uphold a level of presentation that’s acceptable to the whole family.”

While offering low fares, Davis said bmibaby’s enhanced level of service includes extras such as assigned seating rather than asking passengers to “make a fairly desperate dash toward the airplane to secure a seat” and giving passengers

an extra allowance to bring a laptop computer on board.

“The fares are still low, much lower than they historically have been on some routes,” he said. “But the level of service you get is perhaps a little bit better than you are expecting. We’ve tried to adopt the philosophy of under-promising and over-delivering where historically airlines have often over-promised and under-delivered.”

Davis said there are other benefits of having ties to a large international carrier. The carrier inherited aircraft without having to purchase them. It leverages the expertise of the group’s management, pilots and engineers. It works with the parent company in areas such as training and safety. It uses the economies of scale from making purchases in conjunction with the parent airline. It also benefits from ties to a strong, well-established brand such as bmi, which has received more than 50 industry awards since 1990, including repeated recognition as the best domestic airline in the United Kingdom.

Most importantly, Davis said being part of a larger airline group gives bmibaby the ability to grow at a much faster rate than it would have as an independent. With access to trained pilots and crew, aircraft, financial resources and know-how, bmibaby has significant advantages over a pure start-up, he said.

“We are experiencing 400 percent growth year on year because we are part of a group,” he said. “We’ve gone

from three airplanes in March of 2002 to 13 today. I don’t believe we could have done that as a complete startup. I don’t know that as a startup in this country we would have been able to fly 13 aircraft in 18 months.”

Building off the bmi brand has also helped create awareness for the new airline.

“We’ve gone from zero to 3 million passengers a year in an 18-month time scale. And to have penetrated the mar-

Photo courtesy of bmibaby



From its initial three Boeing 737s, bmibaby in 18 months has expanded to 13 aircraft serving more than 25 destinations throughout Europe.


ket sufficiently against some fairly big competitors like easyJet and Ryanair without at least some awareness of our parent company would have cost a lot more in advertising spend,” Davis said.

“Our expectation would have been that it would have been quite difficult for us as a new company to hold our own. But because we’ve got the history and support, and we believe we’re offering a much better product, we’re finding that the people who might have migrated are actually sticking with us.”

Because of the benefits of its association with bmi, the low-cost offshoot incorporated the parent company’s name into its own to give customers the “security and knowledge” that the airline was not a fly-by-night operation while building a separate identity that people “felt an affinity to and an understanding of,” he said.

“I think initially there was quite a lot of surprise within the industry that we’d go with a name like bmibaby,” Davis said. “It was a bold step, which airlines are not particularly good at doing — taking a marketing idea, not just trading on nationality or geographic location, and trying to come up with something that, if nothing else, is memorable.”

No matter how memorable the name, Davis said he knows that continued success will depend on how well the carrier sticks to its low-cost model.

“Really, it’s a lean, compact business model, which is all about volume, high occupancy, high utilization and making sure every flight is as full as you can possibly make it,” he said. “People talk about target load factors. You should be aiming to fill every flight, every seat. There’s no, ‘We’ll accept 65 percent load factors’ anymore.” 

+count it up

10 — Number of languages spoken by members of the Sabre Airline Solutions consulting team.

300 — Number of contracts signed with Sabre Airline Solutions during 2002.