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Newlines Airways A

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ABSTRACT

In the summer of 2001, Julian Cook pondered the launch of his new business: a transatlantic airline supplying only business class service. Extensive research and meetings carried out by Julian and his team suggested that that market showed great promise and could grow into other areas over time. As Julian brought together his associates to discuss strategy over the summer, he wondered, what information was most pertinent to both potential investors and to the board?

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Newlines Airways

In the summer of 2001, Julian Cook, President and CEO of Newlines, a soon-to-be-launched business class-only airline, was contemplating the firm's imminent entry into the transatlantic airline market, with flights from Stansted (London) Airport in England to JFK in New York. Things had progressed over the past year on many fronts.

Within a year of his May 2000 graduation from Columbia Business School, Julian had raised nearly $2 million from private investors. He had secured a management team with experience at Virgin Atlantic, Warner Bros., British Midland, Aer Lingus, Cathay Pacific and CityFlyer Express. He'd landed hip designer Marc Newson to design the cabin interior and was talking to DKNY, Armani and others about uniform designs. Julian was also in advanced talks with the Schraeger Hotel group for joint-marketing and client list sharing, and a frequent flyer/staying program. The *Sunday Times* had even run a story on the company. And, as a sign of what might be possible, AT&T and Morgan Stanley were expressing interest in large commitments once Newlines launched.

The only sticking point was financing. Julian needed $38 million more to get Newlines off the ground. Investor resistance was not altogether surprising, since airlines had, historically, not attracted great sums and a crowded marketplace made reaching profitability a challenge. The few independent success stories—Virgin Air and easyJet—had been financed by the individuals launching those businesses themselves.

In his push for financing, Julian's final task consisted of presentations to the board prior to a visit to a promising investor in the autumn. Given his many accomplishments in a relatively short time, Julian was hopeful. What could he tell them about his plans and the various opportunities and threats that Newlines faced?

EUROPEAN AIR TRAVEL IN THE 1990S: FROM BUDGET TO BOUTIQUE

The hypercompetitive and connected European air travel market Julian embraced had evolved radically from its stagnant 1980s environment. Government-backed monopolies in most countries then kept airfares high, leaving the bulk of flying to the wealthy and to businesstravelers. Trains, buses and cars were the primary mode of transport in most countries, covering some 24 billion passenger-kilometers within Ireland alone in 1990, versus under two billion for air travel.[1] Though per-mile ticket costs varied from country to country, much of the middle class could afford only economy rail and bus tickets; those worse off traveled rarely, or not at all.

Enter Ryanair in 1985. The airline shook up the industry and forever changed European transport. The Ryan family spotted an opportunity in budget travel before the 12 initial countries of Europe came together in 1992 in a common market. Europe's planned Open Skies agreement promised fewer and lower tariffs and fatter profit margins for first movers, bolstered by still-complex rules and barriers that would keep a lid on competition for a few years. Initially Ryanair flew small 15-seater planes, shuttling business people between Waterford (Ireland) and London. Later, leasing Romanian planes and their crews helped cut costs.

Ryanair's fares undercut those of the two established players between Ireland and Britain, British Airways and Aer Lingus, by over half. Initially, it also offered business class and frequent flier programs. But, following a difficult financial period in the early 1990s, the airline abandoned those programs to focus only on the low-cost market and expanded service outside the British Isles.

[1] Source: OECD

BY NOEL CAPON* AND JULIAN COOK†

Ryanair's low fares not only took air passengers away from the majors—it also grew the market. In the Ireland to Britain market, for example, many people loathe to make the eight-hour trip by train and ferry. Additionally, those previously priced out of air travel—like teenagers and seniors—could now pay for the cheap 90-minute flight from Dublin to London. Travel to Britain for business or for pleasure was finally affordable.

Once Ryanair acquired a loyal following, it constantly challenged its larger rivals by pushing for permission from regulatory authorities to participate in the most frequently flown routes. Sometimes, in its quest for the lowest possible costs, Ryanair bumped up against unions or engaged in very public landing fee spats. Further European airlines deregulation in 1993 helped push Ryanair ahead. As a measure of Ryanair's success, its passenger traffic across Europe more than tripled from 1.1 million in 1993 to 3.7 million in 1997.

Ryanair could attribute much of its popularity to lessons it learned from its first mover American peer, Southwest Airlines. Southwest, launched as a low-cost Texas-only service in 1971, had concocted the perfect recipe of low-fares, no frills and one class of service. Its other cost-cutting approaches included using only one type of plane, for economies of scale; frequent service; quick turnaround times (as low as 20 minutes, compared with over four times that for its higher-priced peers); meal-free flights; simplified fare structures; no interline agreements on luggage; and secondary airports, to shave hefty landing fees.

Essentially, Ryanair copied Southwest's bare-bones approach. As a September 2000 *Wall Street Journal* article put it:

> "Frequent-flier plan? Forget about it. After all, someone has to pay for each 'free' flight. Want a snack or drink on board? You buy it. And Ryanair won't serve peanuts, because prying them out from between the seat cushions takes too long. In its no-frills fervor, Ryanair even refuses to use those extendable boarding corridors at airports because it's quicker to park a plane at the gate, roll stairs up to the front and back doors and let passengers hustle across the tarmac. The result: Ryanair can break even with its planes almost half empty—although its average flight is 75% full."

Others noticed the low-cost carrier opportunity. England's easyJet began service in 1995, fueling its growth on the rise of low-cost marketing and ticketless travel via wacky advertising and the lower-overhead bookings the Internet enabled. Me-too airlines including Go Fly followed, and their established rivals launched budget lines like Virgin Express and Buzz (KLM) in response. Together they helped the British budget air travel market alone soar 66% in 1999 over the prior year, to GB£607 million (Source: Euromonitor). Revenue and passenger numbers from 1995 to 1999 climbed sixfold over that time.

Collectively, budget airlines helped drive up air travel's slice of the transport market, particularly in countries like Ireland where low-cost carriers dominate. In 2002, some six billion passenger miles were covered by air in Ireland, up threefold since 1990, versus a doubling of passenger kilometers by rail and car over that time, according to the OECD. Euromonitor forecast the budget airlines market to double again by 2003 from 1999, led by Ryanair, which boasted a meaty 20% profit margin in 2000, said to be the best in the entire business.

By 2001, Ryanair had built its first continental European base in Brussels and carried more than one million passengers in one month for the first time, which beat passenger numbers for all of 1993. It was into this hypercompetitive, low-end focused and frenetic market that Newlines arrived.

TABLE 1: VALUE SALES BUDGET AIRLINES IN THE U.K., 1995-1999

	1995	1996	1997	1998	1999
GB£ (M), Current Prices	85.8	156	241.9	365.4	607.2
% growth		81.8	55.1	51.1	66.2
Index: 1995=100	100	181.8	281.9	425.9	707.7
LST, constant	85.8	152.3	229.1	336	546.9
1995 prices		77.5	50.4	46.7	62.8
% growth	100	177.5	267	391.6	637.4
Index 1995=100					
Million passengers	2.2	3.9	5.9	8.7	13.8
% growth		77.3	51.3	47.5	58.6
Index 1995=100	100	177.3	268.2	395.5	627.3
Budget airlines value sales as percent of air travel	0.8	1.4	2.1	3	4.7

Source: Euromonitor International

JULIAN COOK

Julian Cook had always been interested in the airline industry. After earning a Bachelor in Science degree from the London School of Economics in 1995, he joined Chase Manhattan Bank's Corporate Finance Group that specialized in airlines. There, he worked on aircraft financings and airline privatization and restructuring in the Europe, Middle East and Africa regions. In 1998, he decided to leave Chase and earn an MBA at Columbia Business School. He felt he had learned a great deal at Chase. But, long term, he wished to work for a smaller organization, in something more entrepreneurial.

Between his first and second years at Columbia, Julian worked for Southern Winds, a successful three-year-old Argentine airline that operated a fleet of 12 regional jets and turboprops. While there, he helped the company's CEO raise equity to further grow the airline. In Argentina, Julian was impressed by the economics of regional budget jets and, in particular, how well-run ones like Southern Winds reduced the overall airline risk by cutting the break-even number of passengers for each flight. As a result, Julian became keen to develop a model incorporating this feature and began thinking about opportunities in the airline industry that would allow him to leverage his knowledge. One opportunity he identified was the growing gap between business and economy class fares on transatlantic routes.

Back at business school for his second year, Julian began researching the possibility of starting an airline that would seize this opportunity. By December 1999, he had written a business plan for Newlines.

Newlines Overview

Newlines was the project name for a new airline company that would focus on single-class, long-haul scheduled flights. It aimed to capitalize on the growing comfort and price spread in long-haul travel between business and economy class.

Based at London's Stansted Airport, Newlines would initially focus on the busiest transatlantic route—London to New York—by offering a Stansted-JFK service. It would operate Boeing 757-200 aircraft with 80 seats, for a spacious and pleasant environment. Exhibit 1 shows the planned cabin layout. Continental Airlines operated a B757-200 across the Atlantic with 174 passengers in a two-class configuration. Newlines planes would also incorporate the latest technology, enabling the business traveler to optimize his or her time while in transit. The company planned to begin by leasing two aircraft and to expand its fleet to six aircraft in its second year of operations.

Newlines would be a "business to business" airline, focusing exclusively on the premium/business market segment. It would offer customers a compelling value proposition: A high level of service and comfort at 54% of the then-current published business class fare. It planned tickets priced at roughly $2,500 for a roundtrip ticket, versus the $5,500 competing major airlines charged (Newlines also planned further discounts to $2,000 for bulk purchase by companies that committed to high volumes). Finally, Newlines envisioned considerable time-saving, convenience and lifestyle-oriented services for passengers.

The business model envisioned the company breaking even with 40 passengers per flight (see table below), thus significantly reducing the risks associated with typical airlines that needed far greater number capacity utilization to cover their costs. In many ways, the Newlines model replicated the benefits of the very successful regional budget jet model on a long-haul basis.

TABLE 2: BREAK-EVEN ANALYSIS OF SINGLE TRIP, LONDON-NEW YORK, FOR A NEWLINES' BOEING 757

Revenue	
No. of Passengers	40
Average Fare (one way)	$1,000
Total Revenue	**$40,000**
Variable Costs	
Fuel	$7,731
Maintenance	$4,536
Landing Fees	$468
Navigation Fees	$1,717
Passenger Fees*	$5,920
Ground Handling	$2,192
Total Variable Costs	**$22,564**
Total Fixed Costs	**$16,739**
Total Costs	**$39,103**

*Passenger fees include catering, lounge access at airports, inflight entertainment and amenity kits.

MARKET POTENTIAL

The London-New York route was the busiest transatlantic route with over 3.8 million passengers in 1998. Approximately 30% were business travelers, for a total of 1.14 million passengers. In addition, the market was growing 4% a year and forecast to continue at the same rate.

TABLE 3: BREAKDOWN OF PASSENGERS ON THE LONDON-NEW YORK ROUTE IN 1998

	JFK	Newark	Total New York
Heathrow	2,499,983	709,104	3,209,087
Gatwick	134,226	492,547	626,773
Total London	2,634,209	1,201,651	**3,835,860**

Source: CAA

ADVANTAGES OF STANSTED AIRPORT

In 1998, over 1.8 million passengers in Stansted's catchments area traveled to the U.S. Because no airline currently served the North Atlantic route from Stansted, Newlines would be uniquely positioned to take advantage of that unserved demand. In addition, Stansted was the fastest-growing airport in Europe, with an estimated 8.2 million passengers in 1999. In particular, it served as hub for low-cost airlines Go Fly, Ryanair and Buzz. Of note was the tremendous growth they were experiencing from business travelers. Those airlines claimed that as many as 40% of their passengers were business travelers.

Stansted was the only London area airport that benefited from an Open Skies agreement with the U.S., enabling Newlines to operate flights to any U.S. city without requesting special landing rights. That was not the case for Heathrow and Gatwick airports. As a new airline, Newlines could obtain slots at Stansted airport with ease. Similarly, securing the necessary slots at JFK would be straightforward.

Total traffic from U.K. airports to the U.S. amounted to 17.1 million passengers in 1998. After launching the JFK route, Newlines could then expand to other attractive markets in the U.S. (e.g., Boston, Miami, Chicago and Los Angeles), and other continents, depending on the regulatory environment. With a break-even cost of 40 passengers per transatlantic flight, Newlines could also target medium- and low-density routes, which offered an enormous potential for growth, where it had a key competitive advantage.

TABLE 4: TOP 10 US DESTINATIONS FROM LONDON, HEATHROW, OCTOBER 1998-SEPTEMBER 1999

City	Airport	Business	Leisure	Total
New York	JFK	861,179	1,738,393	2,599,572
Los Angeles	LAX	313,806	1,073,360	1,387,167
Chicago	ORD	421,807	736,109	1,157,916
San Francisco	SFO	286,101	749,969	1,036,070
Washington, DC	IAD	358,403	654,786	1,013,189
Boston	BOS	286,406	525,556	811,961
Miami	MIA	158,855	459,399	618,255
Newark	EWR	171,880	492,303	664,183
Seattle	SEA	102,157	188,329	290,486
Philadelphia	PHL	107,265	181,572	288,837

Total	**3,067,859**	**6,799,776**	**9,867,636**

Source: CAA

PRODUCT AND SERVICE

Lifestyle. Newlines planned to introduce a single-class concept to long-haul air travel. The newly designed class involved a "high-tech," spacious and comfortable feel. In many ways, Newlines aimed to create a "boutique" airline, replicating the boutique hotel concept, and targeting the same sort of customer.

To meet this goal, Newlines planned to hire and partner with well-known designers and suppliers for various aspects of the business. The seats and aircraft cabin would be designed by Marc Newson, one of the most fashionable industrial designers. A June 26, 2000, *Time* article called him "a designer to watch." Newlines would also partner with a fashion designer for uniforms and with well-known restaurants for catering. Newlines' primary target was young executives (25-45) who were lifestyle driven.

Comfort. In addition to the standard airline seating configuration of four seats abreast, Newlines would also offer a closed meeting room environment enabling passengers to conduct business in an office setting while traveling. Seats would have a 52 degree pitch and recline to at least 150 degrees, an offering very similar to the business class standards of traditional carriers. The airline also planned to offer good lighting for passengers, a service that traditional airlines lacked. Moreover, with fewer proposed seats per plane, each passenger would enjoy better air quality than that offered by established operators, an issue attracting increased attention in the press.

Technology. Newlines would ensure that aircraft were equipped with the amenities business travelers needed to work while traveling. Again, Newlines strived to supply these services at a fair price, to encourage their use, rather than charging prohibitively high prices. Planned offerings included a plane-based business center with telephone, fax and printer services. Each seat would be equipped with a laptop power supply. Newlines would also provide e-mail access and a personal mobile phone to each passenger.

Convenience. Newlines planned to focus on a high-quality service offering from the time of booking straight through to the moment at which the passenger arrived at the hotel or home of his or her destination city. Passengers could book seats through the Internet, a call center or a travel agency. Options included:

- **e-tickets**. Tickets would be 100% electronic. The passenger would only need a passport and confirmation number to access the aircraft. They could print their itinerary from the Web site or obtain confirmation numbers from the call-center, for easily obtained proper documentation before boarding.

- **Free transfers** to/from airports. A free, shared limousine service would be offered between JFK and Manhattan upon arrival and departure. Similarly, on the Stansted side, passengers could benefit from a free rail ticket to/from Liverpool Street station, or a free car service to and from Cambridge.

- **Valet Parking Service**. Newlines would offer a complimentary valet parking service at Stansted, thus saving time for passengers wishing to drive to the airport.

- **Larger carry-on luggage**. The increased space on board would also allow for larger carry-on luggage. This was a sensitive issue for business travelers who did not wish to check in their luggage.

- **No more check-in**. Allowing larger sizes of carry-on luggage enabled Newlines to abolish the concept of check-in and to keep the gate open until just 15 minutes before takeoff. For those passengers with more luggage than the norm, Newlines would offer a door-to-door service for an extra fee. By eliminating the check-in process, Newlines hoped to avoid many delays and save money that other airlines spent on lost and damaged luggage.

• **Reduced overall transfer time**. Passengers working in London City and Canary Wharf areas would save at least one hour from the moment they left their office to the time of takeoff. On arrival in New York, they would gain at least 30 minutes, because they would not have to wait for luggage pickup or for a taxi. Boarding and disembarking the aircraft would also be much faster due to fewer passengers on each flight. Passengers traveling in the opposite direction could expect similar advantages over the competition.

• **Personalized service**. Newlines planned to provide individual DVD players to passengers to view the movie of their choice. As for catering, Newlines would offer a choice of cuisine provided by well-known brands. Time-saving services were also a priority. On the night flight from New York, for example, passengers would be offered the option of breakfast on the train into the Liverpool Street station, allowing them more sleep time on the plane. Newlines would accommodate passengers in its departure and arrival lounge. The arrival lounge in Stansted would also have shower facilities to accommodate business travelers going straight from a flight to work.

Onboard Shopping. Newlines would offer enhanced shopping onboard through extensive product offerings. Exclusive products would be sold that were not widely available in traditional stores. It would highly train handpicked cabin crew, since the provision of premium onboard service was highly dependent on the quality of these people.

Frequent Flyer Program. Major airlines had been successful at retaining customers through frequent flyer mile programs. Customers with more miles also gained privileges including access to airport lounges, upgrades, free flights and other benefits. In addition, major airlines, through global partnerships, offered these programs on several different airlines.

Newlines planned to introduce a simple and easy-to-understand frequent flyer program of its own. Most airlines had complicated programs, which often made it difficult for customers to redeem their miles. Newlines would offer frequent flyer Internet cash/points that customers could spend on specific Web sites. It also planned to partner with selected e-commerce sites for this service. Newlines believed the combination of its value proposition, good service and a simple and innovative frequent flyer program would appeal to and help it retain customers.

The Global Airline Industry in 2000

MAJOR AIRLINES CHARACTERISTICS

To increase load factors, major airlines had adopted a hub-and-spoke strategy consisting of centralized flights at one airport, through which connecting, originating and destination passengers passed. This approach forced many passengers to make stopovers, which increased their traveling time. Already, airlines suffered from large overhead costs and rigid labor contracts that prevented them from cutting these costs significantly. Declining customer satisfaction was also an issue. Hubs and alliances helped airlines gain efficiencies. But these strategies were of limited benefit to customers.

CONSOLIDATION WITH MAJOR ALLIANCES: STAR ALLIANCE, ONE WORLD.

While most industries had consolidated in recent years through mergers and acquisitions, the airline industry's contraction was based predominantly on alliances and minority equity stakes. Global alliances ranged from code-sharing agreements to full partnerships. These agreements enabled airlines to cut costs and extend their reach through shared flight and distribution networks. While the airlines benefited, whether customers enjoyed better services or lower costs was debatable, since such alliances tended to reduce competition. Customer satisfaction usually fell following consolidation. This created an opportunity for Newlines.

The most successful alliance was the Star Alliance, comprising Lufthansa, United, SAS, Thai, Varig, Air New Zealand, Ansett Australia, All Nippon Airways, and, most recently, Singapore Airlines. Membership in its main competitor—One World—included British Airways, American Airlines, Cathay Pacific Airways, Qantas, Finnair and Iberia. Another important combination was Virgin-Singapore Airlines. Singapore owned 49% of Virgin Atlantic; the two carriers were strong competitors in the transatlantic market.

Following Swissair's acquisition of 85% of Sabena, other European airlines began to consider possible mergers and acquisitions. In the U.S., United and US Airways had announced a merger, spurring similar tie-up talks among major airlines. This consolidation was closely monitored by regulatory bodies, and it was uncertain how many would be approved.

LOW-COST AIRLINES GAINING MARKET SHARE.

Many start-up airlines emerged in the 1990s, both in Europe and in the U.S., inspired by the success of Southwest Airlines. They tended to focus on short-haul traffic and were key in stimulating demand by offering extremely low fares. These airlines initially targeted the leisure traveler. But, at the time, they also lured in a growing number of business travelers who were disappointed by the high prices charged by major airlines for business class seats. While low-cost airlines continued to thrive in the U.S., more recent European arrivals such as Ryanair, easyJet, Virgin Express and Go Fly were experiencing tremendous growth and seriously challenging major airlines' short-haul strategies.

REGIONAL AIRLINES INCREASING POINT-TO-POINT TRAVEL.

Regional airline travel was by far the most profitable segment of the market, with net margins as high as 15%. Regional carriers benefited from very fuel-efficient modern aircraft (regional jets) allowing them to focus on high-yield passengers by supplying point-to-point services and more flights per day. Smaller jets and shorter boarding and disembarking times enabled faster turnaround of the aircraft than those carried by their traditional peers. Companies like Comair and Atlantic Coast in the U.S. and Crossair, Air Littoral and British Regional Airlines in Europe had grown tremendously in the past five years.

PROFITABILITY OF AIRLINES.

Tables 5A and 5B show two main categories of airline companies: Regional/low-cost airlines, with healthy operating margins, and major traditional airlines, with poor operating margins. In 2000, Newlines needed to convince investors that its business model could produce margins similar to those of regional/low-cost airlines—not those of the majors.

TABLE 5A: OPERATING MARGINS OF REGIONAL AIRLINES

	1999	1998
REGIONAL		
Atlas Air	28.90%	32.20%
Ryanair	22.70%	24.10%
Southwest Airlines	21.80%	21.80%
GB Airways	19.20%	14.50%
Westjet Airlines	19.00%	11.20%
Skywest Airlines	18.30%	16.50%

TABLE 5B: OPERATING MARGINS OF MAJOR AIRLINES

	1999	1998
MAJORS		
Delta	9.00%	12.50%
Northwest Airlines	6.90%	-2.10%
Lufthansa	5.70%	9.00%
Air France	3.50%	2.90%
British Airways	0.90%	5.00%

Competition

The London-New York route was served by British Airways (12 flights per day), American Airlines (7 flights per day), Virgin Atlantic Airways (5 flights per day), United Airlines (4 flights per day), and Continental Airlines (2 flights per day). These airlines operated out of Heathrow and Gatwick with wide-body aircraft (B747s, B777s, B767s, and A300s) and a three- or two-class configuration. By targeting such a dense route, Newlines believed that its competition would be slower to respond to its presence because its small initial share of the market (2%) would not be considered a threat. Table 6 summarizes the flights and capacity on this route and Table 7 summarizes the airlines' product offerings.

TABLE 6: FREQUENCIES, SEATS AND CAPACITY, THE LONDON-NEW YORK ROUTE

Airline	Daily Frequencies	First Class Seats/Day	Business Class Seats/Day	Economy Seats/Day	% Total Capacity
British Airways	12x	360*	745	2,324	44.2%
American Airlines	7x	70	222	952	16.0%
Virgin Atlantic	5x	N/A	325	1,325	21.3%
United Airlines	4x	42	247	627	11.8%
Continental Airlines	2x	N/A	86	439	6.7%
TOTAL	**30X**	**472**	**1,625**	**5,667**	**100%**
Newlines	2x	N/A	160	N/A	2.0%

*Includes Concorde flights

TABLE 7: BUSINESS CLASS PRODUCT OFFERINGS

Business Class	AA	BA	UA	CO	VA
Equipment	A300/767	747	763	777	747
Pitch* (inches)	50	72	48	55	60

Recline (degrees)	127	180	135	153	150

*Pitch: distance between each row of seats

The London-New York route and, to an extent, all North Atlantic routes (from London) were extremely profitable for airlines (see Exhibit 2 for British Airways' geographical breakdown of revenues and profits). In business and first class, airlines acted in an oligopolistic manner. Access to London Heathrow from the U.S. was limited under the U.K.-U.S. bilateral agreement to four airlines (British Airways, Virgin Atlantic, United and American); this enabled those airlines to increase fares with a certainty that demand would stay strong. Other airlines were forced to fly to and from London Gatwick. This was less lucrative because of its location and access. At the time, no airline operated from London Stansted, but Continental was planning a service from Stansted to Newark. Exhibit 3 shows the location of airports in the United Kingdom.

BRITISH AIRWAYS (BA).

BA by far dominated the transatlantic market with nearly half of total capacity. But BA faced many difficulties in 1999, leading to disappointing results. To boost profits, the airline planned to focus on business and premium class travelers. It would soon introduce a full-sleeper business class. Newlines believed that BA was correct in focusing on the business segment, but by offering a full-sleeper business class, Newlines thought that BA risked losing its first class passengers to business class if they downgraded. Furthermore, by providing this higher quality product, BA appeared to be betting on continued price increases for business class tickets. The airline seemed to be simply widening the gap between business and economy class fares.

BA had also announced plans for a premium economy class category, similar to Virgin Atlantic's offering. Pricing would be similar to what Newlines planned to offer, but the product was merely economy class with more legroom. Although BA offered a good product, bad press, disappointing results, and unmotivated staff had hurt its reputation. BA's global strategy with American Airlines (AA) had also been delayed by regulatory hurdles, but the British carrier was pushing for a workable watered-down partnership. Still, though BA and AA combined appeared to be a powerful team, their cultures and products did not seem well aligned. (See Exhibit 3 for article on BA's new business class.)

AMERICAN AIRLINES (AA).

American Airlines had seven daily London-U.S. flights with B767 and A300 planes, for roughly one-sixth of total capacity. The quality of its services and products were below those of the competition. As mentioned earlier, AA's alliance with BA, if approved, would be a powerful combination of size and resources.

VIRGIN ATLANTIC AIRWAYS (VS).

Virgin was the second-largest player in the market with nearly 23% market share. It was by far the most innovative player. Virgin was the first airline to introduce a business-only service in the early 1990s and the only one that offered a premium economy section on long-haul flights. Its premium economy class product was not terribly popular among business travelers, because it was perceived to be much closer in quality to economy class than to that of its business class. The company did have a code-share agreement with Continental, enabling both airlines to sell tickets on each other's flights. The sale of 49% of Virgin to Singapore Airlines would also bring Virgin more connecting passengers from Asia.

UNITED AIRLINES (UA)

United was the fourth-largest player in the transatlantic market, with under 13% of total seats. It led the Star Alliance, which brought many connecting passengers. United's product was standard; it was viewed as a follower, rather than a market leader.

CONTINENTAL AIRLINES (CO)

Continental was more of a niche player in the London to New York market, with only two flights per day. It only operated out of Gatwick and Newark. However, its code-share agreement with Virgin gave it access to Heathrow and JFK. Continental was a strong player at Newark, where it controlled over half the slots. It planned to increase its presence at Newark with a new terminal for wide body aircraft.

BRITISH MIDLAND (BMI).

British Midland had been unsuccessful in obtaining traffic rights from Heathrow to the U.S. But it was determined to push into the lucrative market. British Midland had ordered A330s planes for delivery by summer 2001, for use on U.S.-bound routes. It had secured rights to fly to 16 U.S. cities from Manchester, but not from Heathrow.

Operating Strategy

Newlines' key objective was to establish itself as a niche player in the long-haul business travel segment by providing a high level of service and comfort at an attractive price. A simplified organizational structure, common aircraft type and systemwide common policy would significantly reduce operating costs below those incurred by more traditional airlines. This, coupled with its focus on premium long-haul passengers, would enable Newlines to achieve much higher margins than the competition.

FOCUS ON A SINGLE TYPE OF AIRCRAFT AND A SINGLE CLASS OF TRAVEL

Newlines opted for the B757-200 based on its capacity, range, operating costs, reliability and availability. Newlines planned to outsource flying the planes to a charter company that already had all the necessary airworthiness certification. Using a narrow body aircraft on long-haul flights allowed Newlines to significantly cut operating costs and offer more flights. Operating a single aircraft type would also enable Newlines to reduce training and maintenance costs. Pilot commonality, greater economies of scale in spares holdings and aircraft and technician interchangeability were some other benefits associated with single aircraft-type operation. Finally, a single-class service offering would allow Newlines to significantly reduce the complexity of serving three different classes (in areas such as catering, marketing, purchasing and systems).

ENSURE SERVICE-ORIENTED PERSONNEL THROUGH PRODUCTIVITY AND PROFIT-BASED INCENTIVES

Newlines wished to keep labor cost flexibility by providing a portion of total compensation in a profit-sharing scheme. Management wanted to focus on maintaining high workforce productivity. Newlines believed that employee ownership would be fundamental to its success.

FOCUS ON LONG-HAUL, POINT-TO-POINT, NONSTOP SERVICES

Newlines planned to initially focus on the London-New York route, where it could operate profitably with a small share of the market. It would maintain this focus in the future by choosing routes where a large market already existed. Following New York, Newlines would start services to Boston, Chicago and Washington, DC.

OUTSOURCE NONPASSENGER-RELATED ACTIVITIES

Newlines would outsource many services to quality companies in areas requiring no direct contact with passengers. It aimed to offer a quality service to passengers and would therefore ensure that only its staff interacted directly with customers.

Pricing Strategy

SIMPLE AND TRANSPARENT FARE STRUCTURE.

Newlines planned to use a simple yield management system to determine the best price for every seat in the aircraft. It would use a simple fare structure with three different fares. Purchasing patterns would be monitored, to restrict the amount of discounted fares on certain flights.

TABLE 8: AVERAGE FARES, LONDON-NEW YORK

Fare Type	Restrictions	One way Fare	Round-trip Fare
Flexible	Changeable & Refundable No Fee	$1,250	$2,500
Advance	Two-weeks advance booking Nonrefundable Changeable with Fee	$1,000	$2,000
One month advance	One-month advance booking Nonrefundable Nonchangeable	$750	$1,500

- **Flexible**. This fare was designed for business travelers who made reservations at the last minute and who often had to change their travel plans. Tickers were fully changeable and refundable without fees or restrictions. The fare was half the cost of current published business class fares.
- **Advance**. This fare was designed for price-conscious business travelers with fixed engagements. It was priced close to that of a premium economy fare on Virgin.
- **One-Month Advance**. This fare aimed to inspire leisure travelers to travel on Saturdays or to book one month in advance. Business travelers rarely accessed these fares because of their booking and flying patterns.

To attract large corporations, Newlines offered one-way fully flexible tickets priced at between $1,000 and $1,200, depending on volumes involved. While large corporations could easily obtain fares for as little as $1,500 one way, small- and medium-sized enterprises (SMEs) were unable to secure significant discounts from the full-fare business class price ($5,500 round-trip). Newlines would offer very attractive alternatives to SMEs.

Newlines also planned special promotions in its first months of operation to attract as many customers as possible, for them to experience its service. Initially, Newlines planned to focus on load factors rather than yields, to penetrate the market and stimulate product trial.

Marketing and Sales Strategy

To be successful in the business travel market, Newlines needed to convince the following decision makers: 1) the travel manager, or person who made the travel policy for a company and 2) the traveler him- or herself. The travel manager and traveler made decisions based on different criteria; it was important to satisfy both decision makers to ensure success.

The travel manager's decision was primarily driven by price. His or her objective was to negotiate the best deal for the company. By contrast, the traveler's airline choice was based on frequent flyer programs, comfort, convenience and lifestyle concerns. Newlines' sales team planned to focus on travel managers of large and small companies, and a conceptual- and lifestyle-driven communications strategy to appeal to travelers.

SALES AND DISTRIBUTION

Large-Volume Companies (1,000+ sectors per yr.). Newlines would target large financial institutions and other companies with a major presence in both London and New York. London and Canary Wharf carried a greater concentration of the London-New York premium class traffic than the London suburbs. The top 20 purchasers of London-New York airline tickets accounted for nearly 100,000 premium sectors per year (in the one-way ticket segment). Those companies could negotiate discounts of up to 50% off published fares and were often tied into global deals with major airlines. While Newlines could offer more attractive fares to these large corporations, it did not anticipate obtaining primary carrier status. Nevertheless, Newlines could most certainly capture up to 20% of these companies' volumes, for secondary or tertiary status. It hoped to sign commercial agreements with these companies.

Table 9: NUMBER OF ONE-WAY TICKETS (SECTORS) PURCHASED ANNUALLY BY EACH FIRM

Name	Est. Sectors/Year*
Credit Suisse First Boston	10,000
JP Morgan	10,000
Goldman Sachs	9,200
Morgan Stanley	7,400
Deutsche Bank	7,400
Merrill Lynch	5,500
Chase Manhattan	5,500
UBS	5,500
Lehman Brothers	4,500
IBM	4,500
PricewaterhouseCoopers	4,500
Warburg Dillon Read	3,600
Seagram	3,500
Citibank	2,900
Reuters	2,800
Marsh	2,600
GE	2,200
Diageo	2,000
Barclays	1,500
Natwest	1,400
Cable & Wireless	1,400
TOTAL	**97,900**

* London originating only

Medium-Volume Companies (50-1000 sectors). Newlines had already identified over 200 medium-volume companies. These companies were the most attractive for Newlines for their weaker purchasing power than large-volume companies, meaning they rarely secured discounts of 30% or more off published fares.

Small & Medium Enterprises (up to 50 sectors). Newlines also planned to target SMEs. The Stansted catchments area of the City of London, North London, Essex, Cambridgeshire, Hertfordshire, Essex, East Anglia and the Southern Midlands areas had a large volume of SMEs, many of which were subsidiaries of U.S. companies. It would offer compelling value to these SMEs based on corporate discounts from an already competitive pricing structure. British Airways and other major transatlantic airlines did not offer corporate discounts in the SME segment.

Newlines planned to hire a strong sales team to target companies directly. It would also team up with a major credit card company and large business travel agencies to gain access to a large number of SMEs. It believed getting companies registered would be a critical success factor, to ensure that its value proposition was well communicated to businesses likely to use its service.

ELECTRONIC TICKETING.

Newlines would offer customers quicker, easier and more convenient ways to arrange travel through e-tickets, or "ticketless travel." An e-ticket entitled a passenger to all the same conditions of a conventional paper ticket in a paperless, electronically stored form. The customer simply received a paper itinerary/receipt to clear customs and immigration.

DISTRIBUTION & REVENUE MANAGEMENT.

Newlines planned integrated ticketless software (Open Skies by HP) with an online booking engine as an alternative to traditional airline distribution through Computer Reservation System (CRS). Open Skies also offered streamlined revenue accounting, airport functionality and a customer database function. The Open Skies system was used by Go Fly, easyJet, JetBlue, Buzz, CityBird and many others at the time.

TRAVEL AGENCY.

Newlines would form relationships with key U.K. business travel agents, giving them an opportunity to increase their commission by taking on some of the risk. Travel agents could thus buy advance tickets in bulk for commissions that would be higher than those earned from advance ad hoc ticket bookings.

At the time, travel agent commissions in the U.K. had declined from 9% to 7% and were set to fall further in 2001. Newlines planned to offer attractive returns for agency partners that were well above U.K. industry standards.

CALL CENTERS.

Newlines would operate efficient, customer-oriented call centers that were open 24 hours a day to serve individuals, corporate clients and travel agents. Fully trained staff would also respond to Web site inquiries.

DIRECT SALES THROUGH THE INTERNET.

Leveraging the Internet would be the key to Newlines' success. Newlines planned to promote its cost-effective Web site to attract direct passengers. A user-friendly Web site was planned to sell tickets, select seats, choose meals, check punctuality and for other services. In addition, the Web site planned to offer a service enabling passengers to choose connecting flights with European low-cost airlines such as Ryanair, Go Fly, Virgin Express, easyJet and Buzz, and their counterparts in the U.S. This offering would enable Newlines to expand its target market by capturing connecting and point-to-point passengers. An extranet corporate booking tool would also be developed for use by corporate clients.

Finally, Newlines planned to form strategic partnerships with leading travel, luxury goods and financial Web sites targeting similar audiences with hyperlinks between Web sites.

ADVERTISING AND COMMUNICATION

Newlines' customer base was well-defined. It enabled Newlines to focus its advertising efforts on specific locations, newspapers and magazines.

Growth Strategy

PHASE I: MARKET PENETRATION IN HIGH-DENSITY ROUTES.

Newlines planned to initially target the densest transatlantic market, beginning with New York. It would then expand to Boston, Washington-Dulles and Chicago. By targeting very dense markets, Newlines believed it would only need a small portion of the overall market to be profitable.

PHASE II: EXTEND SERVICE TO MEDIUM-/LOW-DENSITY LONG HAUL ROUTES.

Newlines felt there was more potential in medium- to low-density long-haul routes where traditional airlines were absent. These destinations included Stewart Airport (in New York, within easy reach of key businesses centers in Connecticut, including Greenwich and Stamford). This would allow passengers to bypass large hubs for long-haul flights, just as regional jets circumvented hubs on short-haul flights.

TABLE 10: TRANSATLANTIC FLIGHT FREQUENCY TO/FROM MAJOR U.S. AIRPORTS

Airport →	JFK	JFK	BOS	IAD	ORD	SWF	FLL	BDL
Launch Date	June 1	Oct. 1	Oct. 1	June 2	Oct. 2	Mar. 3	Oct. 3	Mar. 4
Daily Frequency	2x	1x	1x	1x	1x	1x	1x	1x

Airport Codes: JFK: New York; BOS: Boston; IAD: Washington, DC; ORD: Chicago, IL; SWF: Stewart Airport, Newburgh, NY; FLL: Fort Lauderdale, FL; BDL: Hartford, CT

OTHER OPPORTUNITIES

While scheduled long-haul flights were clearly Newslines' focus, it planned to take advantage of opportunities in the high-end segment of the leisure market, as well. This was a strong growth market. Such opportunities could complement the premium-priced market, which tended to be low on weekends and over the summer. Newlines also planned to consider ad hoc charters and corporate charters, on a case-by-case basis.

The Board Meeting

Extensive research and meetings carried out by Julian and his team suggested that the transatlantic business-only market showed great promise and could be expanded into other areas over time. As Julian brought together his associates to discuss strategy over the summer, he wondered, what information was most pertinent to both potential investors and to the board?

Exhibit 1: Cabin Layout

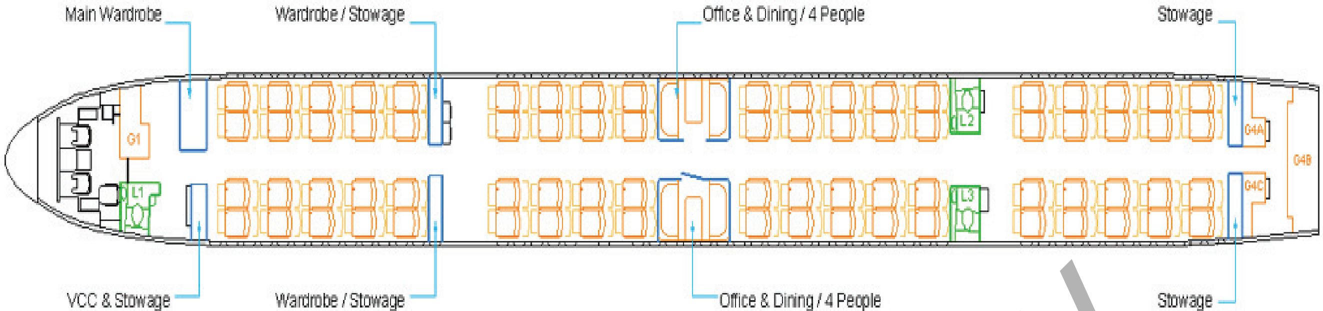

Exhibit 2: British Airways 1999/2000 Annual Report (Excerpt)

British Airways 99/00 Annual Report

Notes to the accounts: Geographic analysis of turnover and operating profit

Turnover/Revenue

£ million	By area of original sale		By area of destination	
	2000	**1999**	**2000**	**1999**
Europe	5,898	5,936	3,400	3,409
United Kingdom	4,062	4,043	719	698
Continental Europe	1,836	1,893	2,681	2,711
The Americas	1,655	1,672	3,253	3,272
Africa, Middle East and India	687	624	1,220	1,133
Far East and Australasia	700	660	1,067	1,078
TOTAL	**8,940**	**8,892**	**8,940**	**8,892**

Operating profit

£ million	By area of destination	
	2000	**1999**
Europe	(310)	(166)
The Americas	308	451
Africa, Middle East and India	62	124
Far East and Australasia	24	33
TOTAL	**84**	**442**

Exhibit 3: Airports in the U.K.

Source: Webbreaks.com (http://www.webreaks.co.uk/airport.htm)

Exhibit 4: *Financial Times* Article

Financial Times 22 Nov. 1999

STRATEGY: INNOVATIONS COME AT A BUSINESS PRICE

BA claims to be the world's favorite airline - but it may soon have fewer friends among those seeking bargain fares

by Michael Skapinker

Once the world's most profitable airline, British Airways is this year heading for a loss of up to £200m before exceptional items. BA's profits have been hammered by increased competition on North Atlantic routes.

Some analysts doubt that the airline's strategy to deal with the loss would restore its fortunes. But it would certainly make flying more comfortable for business travelers.

BA plans to become the airline of choice for passengers who can afford to pay more. Some airlines have abolished their first class cabins. Many others fill their economy sections with cut-price travelers who have often transferred from other flights.

BA plans to keep its first-class seats. It also still wants to fly economy passengers who pay full fare. But it does not want the cut-price travelers who pay deeply discounted fares. They can fly with Go, BA's no-frills carrier. And what BA really wants are more business class passengers.

BA is preparing to unveil improvements to its business class cabin which, it says, would change the nature of airline flight forever. The key to the change is ensuring business class passengers on long-haul journeys get enough sleep.

BA wired up volunteers sleeping in their own beds at home and on business class flights. The research showed why business class travelers tend to arrive at their destinations feeling worn out, even if they have managed to get several hours sleep.

Jet-lag is one reason for the exhaustion. The other is that it is impossible to get a decent night's sleep in a conventional airline seat, no matter how well padded it is.

The problem with a seat is that you cannot move around while you sleep. The deep sleep which leaves us feeling refreshed requires us to shift around in our beds - something we do dozens of times a night at home and which we cannot do very easily while strapped into an aircraft seat.

BA's answer is to introduce beds on board the aircraft. It already has seats in the first class section that turn into beds. Those seats, which were introduced in 1995, were designed by Design Acumen, a London-based company which specialises in yacht interiors. BA promises that the new beds, in business class, would be even better.

The new seats have been designed by Tangerine, a company with a background in industrial products. The seats are grouped in twos, with one facing the front of the aircraft and one facing the back. Passengers travelling together would be able to sit facing one another diagonally. If the travelers in a pair of seats are strangers, they would be able to pull up a screen, giving them complete privacy.

The reading lamps on the seats appear to be a vast improvement on the lights traditionally available to business class passengers. Most business class cabins have lights overhead. The problem with these is that they disturb other passengers; keeping your reading light on when all other travelers are sleeping seems anti-social.

BA tried to solve the problem in its business class cabin by giving passengers individual lamps at the end of a snake-like protuberance fixed to the backs of their seats. These never really worked, refusing to remain in position.

In the new business class cabins, the lights would be fixed to the tops of the seats. They would swivel and would have three levels of brightness.

Another innovation would be the business class footstools. Unlike most business class footrests, which extend from the bottom of the seats, the stools would be entirely separate. Passengers would be able to move them around on a pivot fixed to the floor, or move them out of the way.

The seats would also have power points for laptop computers. And they would have telephones in their arm-rests. When the time comes to go to sleep, the seats can recline to become beds.

As well as improving its business class product, BA is planning to reduce the number of seats it offers by 12 per cent over the next three years, with most of the cuts coming in the economy cabin.

Would the new strategy work? It has its champions, such as Chris Avery, analyst at J.P. Morgan. "In an industry constantly in danger of seeing its product turned into a commodity, British Airways has always been an innovator," he said in a recent note to investors. "It is currently introducing its most radical change ever, with a major re-orientation of the passenger mix into higher-yielding premium markets and a key new product - beds in business class. There is much controversy over this, but we believe that it would work."

But many others are sceptical. "I don't see evidence that any other airlines are shrinking," says Peter Bergius, transport analyst at ABN Amro.

BA is also finding it difficult to stick to its plan to charge only full fares. With competition still intense, the airline continues to offer a range of cut-price deals.

The other problem with BA's innovations is that, if successful, they would be imitated. Virgin Atlantic, BA's great rival, already plans to introduce beds into business class. Indeed, BA rushed out its beds announcement early in an attempt to steal some of Virgin's thunder.

If passengers like BA's business class beds, they would probably become standard in all airlines over the next decade. BA would have a start over most other carriers, but it could lose its lead. While that might bother BA's shareholders, business class comfort on more airlines can only be good for passengers.