Little Airlines, Big Ideas
New models in the skies are flourishing

BY BILL SAPORITO

Photograph by Jeffrey Milstein
Getting a new airline off the ground isn’t all that difficult. Keeping one going, however, is a different story. Hence the decades-long casualty list of upstarts—everything from the bargain-basement People Express to the way-too-posh Eos—that had their wings clipped by competitors, the economy or management blunders. Bad business models don’t fly.

But three new or rapidly expanding airlines think the models they’ve developed can give them an edge—and even provide better service than some legacy carriers. Why now? Global deregulation has thrown open previously closed markets, allowing foreign airlines that could once fly only between their own nation and designated U.S. cities to touch down wherever they want. Technology has leveled the playing field for startup airlines, which no longer need sales and marketing offices everywhere they fly. Automated ticketing and check-in also eliminate the need for a big, costly ground staff. And consolidation among the mainline carriers means fares have increased while the number of available seats hasn’t.

That, a group of global entrepreneurs believes, leaves room for new entrants. They have another advantage: better planes. Advances in aircraft—they can run longer and leaner—change the competitive calculus. Boeing’s Dreamliner, which is flying again after a spate of technical problems, is $15 million cheaper to run on an annual basis than comparable older jets.

Frantz Yvelin, founder and CEO of La Compagnie, figures the gap between business-class fares and coach fares is so large, he can fly a 757 through it. Or two. La Compagnie, Yvelin’s new carrier, runs 74-seat, all-business-class 757s between New York City and Paris, charging about $2,000 round-trip vs. $5,000 to $11,000 for the same seat on a larger carrier. “We are trying to bring to the long-haul premium-transportation market what Southwest has brought to the low-cost, point-to-point short- and medium-haul market,” he says.

In Europe and the U.S., it’s now ultra-low-cost carriers (ULCCs) such as Spirit and Ryanair that have attracted new customers with à la carte pricing. You pay a cut-rate price for a seat, but everything else has an added fee: baggage, meals, seat location, even printing a boarding pass. Iceland-based WOW Air is trying to make that concept fly in the transatlantic market, albeit with a higher level of service. “The rise of the ULCC has been very successful when you look at Europe and the U.S. When you look across the Atlantic, there is none,” says Skúli Mogensen, a tech entrepreneur who founded WOW in 2011. “There is a great opportunity. You can offer much more attractive fares and still be profitable by offering this same model.”

WOW recently launched four-times-a-week service from Baltimore and Boston to Reykjavík for as little as $400 round-trip, with continuing service to 18 other European cities. Unlike some long-haul carriers, WOW uses narrow-body Airbus A320s for the five-to-six-hour trip. Using smaller jets means you need fewer passengers to fill them, so there’s less capacity risk; charging 400 bucks round-trip almost guarantees you’ll get all the passengers you need.

The WOW approach is the opposite of another Scandinavian carrier, the rapidly growing Norwegian Air Shuttle, although both are devotees of the ULCC model. Already a power in Europe’s short-haul market, Norwegian has taken advantage of global deregulation to take on long-haul, point-to-point service. The company is flying wide-body, 294-seat 787 Dreamliners to London from New York City and Los Angeles as well as Orlando and Fort Lauderdale, Fla. The company is also running from Oakland, Calif., to Oslo and Copenhagen. With 11 Dreamliners on the way, including the newest, longer-range 787-9s, Norwegian has big plans. “Everybody thinks that long-haul, low-cost is a different ball game,” says CEO Bjorn Kjos. “What drives cost is utilization and how you operate.”

All three carriers say they are taking advantage of the high pricing that has become a staple of the transatlantic market in the aftermath of industry consolidation. According to Kjos, 87% of transatlantic traffic is controlled by carriers belonging to three large airline networks: OneWorld (which includes American), SkyTeam (Delta) and Star Alliance (United). “The logic behind [Norwegian] is that we see the revenue per seat kilometer of these networks—the fares are extremely high,” says Kjos. People flying within the European continent, especially on long flights, pay a lot less per
2. La Compagnie

An all-business-class carrier that aims to narrow the huge gap that now exists between the front and the back of the plane.

La Compagnie uses workhorse 757s outfitted with 74 seats. A typical 757 would have twice that many.

DESTINATION
The carrier is flying between New York City and Paris. It hopes to appeal to lots of leisure travelers looking for a little luxury.

$2,000
NEW YORK CITY TO PARIS
Compared with current business-class fares of up to $9,000 round-trip on the majors, it’s a relative bargain.

kilometer than they do going across the pond, he says.

But the truly big gap is between business class and coach. The typical fare between Paris and New York City is $5,000 to $9,000, vs. $1,000 in coach. That difference represents an enormous amount of revenue for the carriers. “There is one easy number for you to remember: business-class passengers are 15% of the total between Paris and New York,” says Yvelin. “Those passengers represent 50%-plus of the revenue. You don’t have to do very high-level economic studies to know where the money comes from.”

The folks riding in the front of, say, Air France’s jets tend to be business elites who aren’t paying the freight: their employers are. Part of Yvelin’s rationale is that there has to be a significant number of individuals willing to pay a reasonable premium—$500 to $800 round-trip—over coach to get the luxe treatment in the air. That’s been true in the four months La Compagnie has been operating. He’s also banking on the fact that even large companies are clamping down on travel costs. “You have two kinds of pain,” says Yvelin. “The first was traveling coach, especially on long haul. The second pain was a financial one, traveling business class. Now, traveling with La Compagnie, you have solved the equation.”

La Compagnie is promising everything the legacy carriers do, except a crowded jet. Passengers get fast-tracked through security and have access to a business-class lounge. Being that this is a French company, good food and wine are a given. Most important, La Compagnie has lie-flat beds with massage features similar to those of major carriers. The only thing missing is the angry crowd plowing into the coach section. With just 74 seats on a 757 that typically carries 150 to 180 seats, there’s no crush to board.

Yvelin says he knows the model can work because he’s done it already. In 2006 he created L’Avion, a premium coach and business-class low-cost model that ran between Newark, N.J., and Paris. But after he sold the company to British Airways for more than $100 million, the new owner began to change the product, now called Open Skies. In his second iteration, Yvelin thinks La Compagnie is more compelling because the price gap between the front and back of the jet has grown while coach service has deteriorated.

Better Planes

Any company can charge you less for an airline seat, but making money doing so requires a lower cost base and a lot of discipline. That’s why Norwegian has placed its chips on the Dreamliner. The composite-airframe Boeing jet has a lower fuel burn than a comparable Airbus A340. That means not only that the Dreamliner is cheaper to run but also that you can keep it in the air longer—a higher utilization rate, in the parlance. “You can’t be on the ground for four hours,” says Kjos. “You have to be on the ground for 90 minutes.” High utilization has helped keep Norwegian’s costs low: 6¢ per available seat kilometer, a figure bettered in the industry by only Ryanair.

As is typical of a ULCC, Norwegian is addicted to what the industry calls ancillary revenue—that is, money paid for anything not included in the basic ticket price. In Norwegian’s case, that amounts to 11% of the company’s $2.3 billion in revenue last year. The formula appears to be working. In its third quarter of 2013, Norwegian posted a 41% traffic gain and a load factor—the percentage of seats that are occupied—of 84.6%, up 3.2 percentage points compared with the previous quarter. Its average flying distance grew 14%, evidence of the focus on long haul.

WOW is focused on the same utilization ratios as Norwegian, a task made more important because most of its passengers are connecting. WOW’s scheduling keeps its A320s in the air for up to 20 hours a day. The planes are barely on the ground for 90 minutes. “You have to be in the parlance. “You can’t be on the ground for four hours,” says Kjos. “You have to be on the ground for 90 minutes.” High utilization has helped keep Norwegian’s costs low: 6¢ per available seat kilometer, a figure bettered in the industry by only Ryanair.

As is typical of a ULCC, Norwegian is addicted to what the industry calls ancillary revenue—that is, money paid for anything not included in the basic ticket price. In Norwegian’s case, that amounts to 11% of the company’s $2.3 billion in revenue last year. The formula appears to be working. In its third quarter of 2013, Norwegian posted a 41% traffic gain and a load factor—the percentage of seats that are occupied—of 84.6%, up 3.2 percentage points compared with the previous quarter. Its average flying distance grew 14%, evidence of the focus on long haul.

WOW is focused on the same utilization ratios as Norwegian, a task made more important because most of its passengers are connecting. WOW’s scheduling keeps its A320s in the air for up to 20 hours a day. The planes are barely on the ground for 90 minutes.
Everything else is extra: you pay for baggage, food, assigned seating and any onboard luggage weighing more than 11 lb. You can also buy extra legroom. It’s Spirit Airlines over the water. “However you slice it, even if you pay for extra luggage, for assigned seating we still believe we can offer a considerably lower fare than the competition,” says Mogensen. More to the point, the success of ULCCs such as Spirit and Allegiant has made the flying public more aware of and accepting of the trade-offs involved.

Unlike Yvelin and Kjos, Mogensen is no airline veteran. He sold his telecom tech business to Nokia in 2008, but before he could find something else to invest in, the financial crisis arrived, crushing the economy of his native Iceland in the process. He sat on his money until 2011 to start WOW, first by buying a local operator. “I had no experience with airlines or running planes,” he says.

But he had a ton of telecom experience, and it was clear to him that Internet technology had changed the airline industry, effectively nullifying some of the scale benefits enjoyed by the big network carriers. Applying technology in reaching out to customers allows a small airline operating out of Iceland to compete with a huge one operating out of, say, Dallas. “The travel category is the single largest category online— I really felt that was a game changer. It’s become more technology-driven than people understand. I really did feel that I understood the dynamics of the marketplace,” says Mogensen.

That includes online marketing and managing customer relationships. For instance, some 80% of the company’s transactions are handled online, eliminating the need for sales offices. The Internet is its primary distribution channel, so there are no travel agents and almost no other intermediaries. Gate staff, catering and aircraft maintenance are outsourced, allowing WOW to operate with a staff of just 175.

So far, it’s working. The company quickly sold out its initial U.S. capacity, although the ultra-low promotional price had something to do with that. In Europe, though, where it knocks heads with other ULCCs, WOW has a 90% load factor and also lays claim to being Iceland’s most on-time airline, with 94% of its departures running on time. That’s not only good for passengers; it’s also essential to maintaining the high utilization rate. “It gives us confidence that we can offer this great pricing in the States,” Mogensen says.

The number of passengers has increased from about 90,000 in 2012 to 450,000 last year; in 2014 the company hopes to hit 720,000 passengers. WOW added two A320s this year to start its U.S. operations and will take delivery on four more jets in 2016. And Airbus’ new, extended-range A321neo will eventually allow WOW to reach just about anywhere in the U.S. Mogensen is aiming to add four more U.S. markets in 2016, perhaps even New York, which has more overseas traffic than any other city.

He also sees Iceland becoming more attractive as a tourist destination. Recession-induced currency deflation has made the nation a bargain, and tourism is growing at a 20%-a-year clip. One draw: an active volcano that Mogensen calls the most exclusive and unique theme park in the world.

Where to Next?
Can the European models really translate in the hypercompetitive U.S. market? The legacy carriers have a long record of not tolerating low-cost competition. In the past, they would drop fares and bleed money to protect a tenth of a point of market share. Today they are less inclined to defend share at all costs, particularly when they too are running at more than 80% of capacity. By the same token, Baltimore or Boston to Reykjavík is not exactly a highly contested route.

Yet when Mogensen looks at the ULCCs in Europe, he notes that they grabbed 30% of the market within 10 years. More important, the ULCCs have expanded the size of the market. Lower fares make it possible for more people to fly. WOW expects to introduce Iceland and Europe to a bunch of newbies. “That’s very important to this model,” he says.

The path laid down by Spirit and Allegiant, and before them Southwest and JetBlue, has demonstrated that some consumers are willing to try new carriers that promise something better, be it price, service or a little of both. Even if they have to give up something in return, say, a guaranteed seat assignment. Or legroom.