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1 Introduction

This chapter is an introduction of the thesis. We have described the background of the subject, which is followed by a problem discussion and the main problem. The chapter ends with the purpose and the limitations of the work.

1.1 Background

The growth of low cost carriers around the world in general, and in the U.S. in particular, is argued to be the single most important factor shaping the airline industry today. This rapid growth during recent years has been cited as one of the primary causes of the financial crisis currently facing the traditional airlines (Harumi et al, 2003). While the major traditional airlines, in attempts to survive, embarked on rapid cost cutting initiatives during the months following the September 11, the low cost carriers remained strong with several airlines achieving significant growth (A.T. Kearny, 2002).

These facts have led some of the traditional carriers to consider the possibility of going in to the low cost segment. SAS, the Scandinavian airline company, is one of the traditional airlines that have done so. On March 30, 2003, SAS launched its private traveller program, Snowflake, with low-price flights to a number of destinations in Europe. The intention was to attract private travellers who want to travel inexpensively and simply in Europe to destinations that SAS normally did not serve, or served to a small extent (Snowflake, Feb. 18 2002).

1.2 Problem discussion

Some analysts argue that it is harmful for traditional airline companies to engage in the low price segment because of various reasons. For example, some argue that the traditional airlines have higher cost structures compared with the low-cost airlines and therefore, the traditional carriers should not engage in price competition. Furthermore, there is a risk that the customer will be confused regarding for example, expected and perceived service or prices. However, there are others that disagree with those arguments. These argue that it can be a good idea for traditional air carriers to implement a low cost brand or subsidiary outside their traditional

segments. According to Ulf Thorné (a reporter at Di.se), there exists a market for both low-cost flights and traditional service flights and combining these two can very well be a success (Di.se, “Lågpris inget nytt för SAS”, 16 of January, 2004). Throughout the thesis, advantages and disadvantages, as well as arguments for and against such investments in general and Snowflake in particular, will be discussed.

1.3 Main problems

Considering the previously mentioned arguments, should SAS have implemented the Snowflake program?

To support this question, the following sub questions need to be asked:

Was it a **good idea** to implement the Snowflake program or will it turn out to be a **bad investment**? Was the launching of the Snowflake program SAS's **best strategic option**?

1.4 Positioning the thesis

Several studies have been conducted within the field of the airline industry in the past. For example, comparisons have been made regarding which types of carriers, traditional or low-cost, have better future prospects. Furthermore, there have been studies regarding the affect that recent crises have had in the airline industry. The generalisation is limited in this study since we investigate only SAS. However, a wide description of the industry regarding the differences between the operations of traditional carriers and low-cost carriers will be given. This description combined with our research and analysis on SAS can be used to generalise, to some extent, and apply the study on similar companies operating in similar markets. Furthermore, the survey will also give a better understanding of SAS and the choice it made about entering the low-cost market.

1.5 Purpose

The purpose of the study is to try and evaluate if SAS **did the right thing** in implementing the Snowflake program. Furthermore, this research will try to evaluate whether or not SAS had any other options that could have been better to implement. The study will be a case study of SAS and its Snowflake program.

1.6 Limitations

The study will focus on SAS and its investment in the Snowflake program. When collecting primary data, it will be limited to only take into consideration the opinions and arguments from managers at SAS, managers at competing airlines, analysts, and other experts within the industry. This means that there will be no research done that examines the opinions of SAS's customers. The reason for excluding the customers from the sample is that we do not consider their opinions to have a significant impact on our findings. However, this does not mean that their opinions are not important to SAS.

The study will focus on passenger travelling and thereby not include other functions such as cargo transportation.

1.7 Disposition of the chapters

- Chapter 1 This chapter contains the aim of the thesis, the background, problem discussion and purpose.
- Chapter 2 The chapter describes the procedure of the thesis: method, data collection, validity and reliability of data etc.
- Chapter 3 In this chapter the airline industry's market environment is presented, how the market is changing with the low cost carriers entering the market and how it changed after the terrorist attack the 11th of September.
- Chapter 4 This chapter presents information about the deregulation of the airline industry and how low cost carriers have reinvented the industry, by introducing the no-frills model. Finally, reactions of traditional carriers to these changed market conditions are discussed.
- Chapter 5 SAS and Snowflake are well known for the Scandinavian people. But the history and changes within the company are not familiar to most people. This chapter gives a good description of both SAS and Snowflake.
- Chapter 6 This chapter presents the Porters Five Forces.
- Chapter 7 The analysis part contains the answers from the results from the interviews with professionals within this area. The answers are analytically presented in form of a case study.
- Chapter 8 The **conclusion** of the thesis and suggestions for further research subjects are presented.

2 The method of the thesis

This chapter presents the method applied on the thesis. The procedure used to collect secondary and primary data and also how to accomplish a high validity and reliability. In the end of the chapter drawbacks of the chosen method are presented.

2.1 Choice of subject

Since the liberalisation of the airline industry dramatic changes have occurred. Low cost carriers have invaded the industry causing the once protected flag carriers' severe difficulties. Traditional carriers have reacted to these changed market conditions in a number of different ways. Perhaps the most dramatic reaction was when traditional carriers tried to get involved directly in the low budget market by starting their own low budget subsidiaries or low budget products. So far most, if not all, of these attempts have failed.

Despite this fact, traditional carriers are still making entries to the low budget sector. One of the latest attempts was when Scandinavian airlines (SAS), launched their low budget brand, Snowflake. In this thesis an attempt will be made to evaluate if this reaction by SAS was their best strategic option and if Snowflake will prove to be a good investment.

2.2 Choice of method

There are two different ways to perform a scientific research, by a deductive or an inductive approach. The inductive approach is used when the researcher starts with the empirical findings, compares them with the existing theory in the field and thereafter makes his conclusions. The deductive approach applies when the researcher starts with a hypothesis based on existing theories and then tries to verify or reject the hypothesis with the use of the empirical findings (Hultin, 2004)

In this thesis the inductive method will be applied. To gain an in-depth understanding of the event with SAS and Snowflake, primary data will be collected through interviews with professionals within the area. The data collected by the questionnaires is qualitative data, which overall cannot be generalised. These characteristics are distinguished with an inductive approach.

2.3 Theory

Before an analysis of the Snowflake investment is made, its relevance, affects and future prospects we must first look deeper into SAS and Snowflake with regards to their market environment. In an attempt to do so, Porters Five Forces will be put in use. The model assumes there are five competitive forces that shape every industry and every market. These forces further determine competition, profitability and attractiveness of an industry. Porters Five Forces are given a distinct description in chapter 6.

2.3 Theory

In order to gain a better understanding of SAS and its investment in Snowflake, it is important to look at the external environment the company operates within. In our attempt to do so, the Porters Five Forces was used. The model assumes there are five competitive forces that shape every industry and every market. These forces further determine competition, profitability and attractiveness of an industry. A description of Porters Five Forces is given in chapter six. In chapter seven, this theory will be used to analyse SAS and its environment. The purpose of this is to gain an understanding of the situation SAS is in. Furthermore, this analysis will also be useful when trying to evaluate if SAS's best strategic option was to invest in the Snowflake program.

2.4 Data collection

2.4.1 Secondary data

In the theory part as well as chapters 4 and 5, discussing SAS, Snowflake, their competitors and market environment, secondary data of different sorts will be used. Secondary data is used to learn more about the subject but also to give a descriptive picture of the airline industry to give the readers necessary background knowledge to our research questions. The various sources of secondary data include books, scientific articles, airlines annual reports and research analysis.

2.4.2 Reliability and validity of secondary data

When working with secondary data it is important to be observant and have a critical attitude towards the literature (Saunders et al., 2003). It is particularly important to

look up the source when searching information via the Internet. For those reasons it is of high importance that the data is collected from reliable and trustworthy sources. By looking at the source of the data, a quick assessment can be made of both reliability and validity. (Saunders et al., 2003). For those reasons we have mostly relied on sources such as Lund University's database, Elin (Electronic Library Information Navigator), and similar sources as well as research analysis from independent financial banks and services.

2.4.3. Primary data

Primary data is required on an attempt to solve our main problems and fulfil the purpose of the thesis. The data was collected through questionnaires sent to financial analysts, managers at SAS and Snowflake, competitors and professors working within the industry. **The sample group were chosen by their different skills/areas and involveness in the airline industry. This to get a more broadened view and objective answers of the data collected.**

2.5 Case study

Case study is one of several ways of performing a social science research. Doing a case study means using a research strategy that involves the empirical investigation of a particular contemporary phenomenon within its real-life context, using multiple sources of evidence (Saunders et al., 2003). The distinctive need for case studies arises out of the desire to understand complex social phenomena, in this case the phenomena around SAS (traditional) and Snowflake (low-cost). In a case study questions like "how" and "why" are being asked about a contemporary set of events, over which the investigator has little or no control (Robert K Yin, 2003).

Walter J. Schramm (1971), defines a case study in the following way:

"The essence of a case study, the central tendency among all types of case study, is that it tries to illuminate a decision or set of decisions: why they were taken, how they were implemented, and with what result".

This definition explains well the aim of our case study. Will the Snowflake investment result to be a good investment? Before answering this question, it is of great necessity to know why the SAS invested in Snowflake in the first place.

A case study can be done either with one or several persons (Robert K Yin, 2003). In this case, the study is based on several financial analysts, managers, competitors and professors.

2.6 Interview form

The research sample is situated in both Europe and USA. Therefore the interview form used is self-administered questionnaires, which are completed by the respondents. The questionnaires are delivered and returned electronically using email. The great advantage of this kind of method is the confidence that right person has responded because direct addresses were used only. The method is also cheap and fast and the sample does not have to live near by (Saunders et al., 2003).

2.7 Questionnaires

A questionnaire is a method of obtaining specific information about a defined problem so that the data, after analysis, results in a better appreciation of the problem. It is an important element in the total research design. Research questionnaires can be applied in several ways, such as personal interviews, telephone, face-to-face interviews, and as in this case, emails (Chisnall, 1997).

The same questionnaire was sent to all respondents. However, few additional questions were added to questionnaires sent to financial analysts, professors and competitors.

2.8 Open questions

Open questions were used in the questionnaire. Open questions allow participants to define and describe a situation or event and **are** designed to encourage the respondent to provide an extensive and developmental answer (Saunders et al., 2003). This approach allows the respondents to write their opinions and what they

know instead of only allowing them to pick from pre-defined answers. In closed questions the researcher often seeks yes or a no answer (Saunders et al., 2003). In this case, opinions and arguments were preferred.

2.9 Quantitative method

A quantitative research methodology seeks to quantify the data and apply to some form of statistical analysis (Birks & Malhotra, 1999). Quantitative research is more formalised, structured and also more influenced by the control from the scientist point of view. The target of this choice of method is to be able to do a comparison based on the conclusion from the data collection (Saunders et al., 2003).

2.10 Qualitative method

The qualitative research method is chosen in this thesis. This method can be seen as an unstructured exploratory methodology based on small samples, intended to provide insight and understanding. In a qualitative method, the investigator is more subjective and seeks meanings through unstructured interviews, mostly open questions. The investigator has by this a great opportunity to understand the total connection in a certain situation (Saunders et al., 2003).

2.11 Reliability and validity of primary data

In any empirical social research including case study it is important to be able to establish the quality of the primary data. It can be established with three tests, construct validity, external validity and reliability (Robert K Yin, 2003).

2.11.1 Construct validity

Construct validity means establishing a correct operational measure for the concept being studied. For example in a study of competitors a reader can not tell whether the recorded changes in a case study genuinely reflect critical events of a competitor or whether they happen to be based on an investigator's impressions only. To meet the test of construct validity, an investigator must be sure to cover two steps. The first step is to select specific types of changes that are to be studied and relate them to the original objectives of the study. The second test is to demonstrate that the

selected measures of these changes do indeed reflect the specific types of change that have been selected (Robert K Yin, 2003).

We consider the construct validity to be high because the conclusions reflect the thesis purpose. This because the questions asked are based on the literature studied and asked to answer the main problems and fulfil the purpose.

There may exist some factors, which may have impacted on the validity. In our research a pilot test were not accomplished, which may have lead to answers did not correspond with the purpose of the questions. In some of the cases questions were asked as a complement. In some of the cases two respondents answered the questionnaire together, which may have lead to more detailed answers compared with the respondents answered the questionnaire by themselves.

Susanne said a couple of times that a main part of a master thesis is to have a critical sight against methods etc used in the thesis but if you do not like anything just take it away or change the sentence/sentences /Lydia

2.11.2 External validity

External validity deals with the problem of knowing whether it is possible to generalise a studies results beyond the immediate case study (Robert K Yin, 2003).

In this thesis a case study of SAS and Snowflake is made, and therefore our findings cannot be generalised on the whole airline industry. However, in this case, it may be applicable on other cases beyond SAS to a certain extent. Differences between the airlines will have to be taken into consideration. I took what you have written from the drawbacks so we have the same argument in both places.

2.11.3 Reliability

Reliability refers to the stability and consistency of the results derived from a research to the probability that the same results could be obtained if the measures used in the research were copied (Chisnall, 1997). In other words the objective to be sure that if a later investigator followed the same procedures as described by an earlier

investigator and conducted the same case study all over again; the later investigator should arrive at the same findings and conclusions. The goal of reliability is to minimize the errors and biases in a study (Robert K Yin).

60 questionnaires, attached to emails, were sent to financial analysts, managers at SAS and Snowflake, competitors of SAS and Snowflake and also professors working within this area. To avoid a large missing value, a follow-up email was sent to those that did not respond within a week. According to Saunders et al., respondents participating in this kind of method are an average of 10 per cent. In our case, 17 respondents answered, which are a total sum of 28 percent.

Even though if the sample answered the questionnaires honestly, it is important to have a realistic view against the data. The reader, as well as the researcher, must therefore have in mind that managers at SAS, Snowflake and their competitors cannot be considered to be objective in all cases. That fact increases the risk of a bias, as best- or worst-case scenarios might be presented depending on the respondent.

2.12 Purpose of the questions

There is an underlying purpose of each question that was sent to the sample. Every question is intended to take us one step closer of revealing the answers to our main problems. Overall, all questions are considered necessary for the survey. However, the importance varies between the questions since some questions are considered to be more important when conducting the analysis and deriving the conclusions from it.

Question 1

- Do you think SAS reaction to increased competition from low budget carriers, to start the Snowflake subsidiary was their best option?
 - o If not, how should they have reacted?

The purpose of this question was not only to get data about how many of the respondents believed implementing Snowflake was the best option for SAS or not. It was also intended to give us information about why they answered in the way they

did. The main objective was to receive the arguments that spoke for and against Snowflake as being the best option. Furthermore, to examine if there exist any common opinion about what SAS should have done instead of investing in the Snowflake program.

Question 2

- What do you think was the main reason for their investment?
 - o Do you feel SAS have achieved their goal with the Snowflake investment?
 - o Do you think Snowflake is a good investment?

In order to evaluate whether or not the investment can be seen as being successful, the motive behind the investment must be clear. It is only when you know the motive that you can assess the question of whether the investment can be argued to be a success or not. For example; if the motive was to defend SAS from low-cost competitors, then the fact that Snowflake might or might not show positive results should not play a large part when deciding whether or not the investment is a success. The main criteria that would have had to be fulfilled in that case would be if Snowflake has been able to actually defend SAS by for example gaining market shares from competitors or by keeping potential future competitors out of SAS markets.

On the other hand, if the main motive for the investment **had been** to exploit new opportunities by entering into new markets, then the results that Snowflake would achieve would play a large role in determining whether or not the investment is a success.

Question 3

- Consider the case of BA & Go fly and the case of KLM & Buzz. In both these cases the flag carriers failed to run these low budget carriers as subsidiaries. Eventually both these subsidiaries were sold to their main rivals on the low budget market, namely easyJet and Ryan Air.
 - o Do you expect that Snowflake and SAS will go the same way?
 - If not, why should this case be any different?

The purpose of the third question was to get the respondents view of SAS strategy with regards to their low budget operations, compared to BA and KLM. So far, most if not all, attempts by traditional carriers to start their own low budget operations in any form have been a failure. Given these failures in general and of BA and KLM in particular, respondents were asked to give their opinion on why SAS strategy should be a success while others have failed. Snowflake is not perfectly comparable with GO and Buzz. But then again, no comparison of companies is. SAS mainly differs from the other two carriers in the sense that Snowflake is not launched as a subsidiary. Even though the comparison is not perfect, it is still valid. The difference between the companies does not affect the field that is studied. A recently made statement by Michael O'Leary supports the argument that SAS's investment in the low-cost segment is comparable with British Airway's. "British Airways, who launched GO and then had to sell it to easyJet should be able to tell one or two things to their colleagues at SAS..." (Flygtorget.se, 2004-05-30).

Question 4

- Do you think running Snowflake as a subsidiary of SAS will affect the behavior of regular customers of SAS? For example:
 - o Do you think SAS will loose customers to Snowflake?
 - o Do you think customers will get confused in their expectations to either company; SAS prices will seem to expensive / Snowflakes service may seem to poor compared to SAS, etc?

Question 5

- In the long run, which company, SAS or Snowflake, do you think have better future prospects?

The intention with this question was to discover potential differences between the two parts that would argue that one part is better equipped to survive in the future then the other.

Question 6

- If Snowflake will be discontinued, do you expect that the gap Snowflake leaves behind goes straight to the competitors and leaves SAS worse of than before?

This question was intended to give us the possibility to determine what impact Snowflake would have on the rest of SAS if it were discontinued. The question is important in the sense that it allows us to investigate how important Snowflake is to SAS. For example: the marketing efforts that have been invested in Snowflake could have attracted customers that normally do not travel by flight, and by discontinuing Snowflake, the low-cost competitors may acquire these new customers and thereby profit from SAS's efforts.

Question 7

- Do you expect Snowflake to make a profit in the nearest future serving current routes or will there have to be structural changes?

The last question had the purpose of giving us the opinions and arguments of how Snowflake's nearest future would be like. Since SAS does not present separate financial accounts for Snowflake, this was a way for us to evaluate its performance, based on the expectations from the experts within the field. Furthermore, the question is also intended to provide us with arguments on possible changes that need to be considered before Snowflake will start making profits.

2.13 Ethical issues

The answers from the questionnaires will be analysed in chapter 7. The information used in the analysis part and taken from the questionnaires will have a reference in form of the respondents' name and title.

2.14 Reflection of the chosen method

It is important to beware of the drawbacks and have a critical sight against the chosen method.

One criticism against the method is that the answers may not be objective, which can lead to the respondents answered in their own favour. This is difficult to evaluate and therefore the data has been worked with as received.

The main drawback of the method is in cases when the questions are unclear to the respondent and chances are of misinterpretations. In the same way, the researcher can misinterpret the answers received. Using a personal interview reduces those risks. The respondents are situated all over Europe and the US and therefore personal interviews are out of question. Phone interviews are also an option, but when contacting a big sample severe drawbacks are detected do to difficulties in reaching the respondent and high costs.

Some of the respondents answered the questions with yes or no, which could have been followed up with phone calls to get more detailed answers. **As written above, it would be difficulties reaching the respondents and also high costs because the respondents are situated both in Europe and USA.**

The advantage with a case study is the ability to go deeper into a specific subject or event. The drawback is that in most of the cases it refers only to the case company and generalisation is therefore limited. In this case, it may be applicable on other cases beyond SAS to a certain extent. Differences between the airlines will have to be taken into consideration at the same time.

3 Airline industry's market environment

This chapter gives a descriptive picture of the industry's market environment. On top of economic downturn, the industry has faced continuous crises in the last years. The 11th of September was the first tragedy to shake the industry. In the following years the Bird Flu, SARS and the Iraq War further tormented the industry. This chapter explains how the industry has changed in demand and travel patterns.

3.1 Introduction

In the last three years the airline industry has had a decline in passenger traffic and airlines throughout the world are currently facing an unprecedented financial crisis. The current industry crisis was exacerbated by the events of the 11th of September in North America, which resulted in an inevitable decline in airline travelling. The airline industry was in serious trouble before the 11th of September event, however, because of an economic downturn that already had negatively affected the volume of travelling (MIT, 2003). The event led to a reduction in labour and costs. A survey conducted by A.T Kearney (2003), concluded that such reduction would have been necessary regardless of the circumstances. The catastrophe led to a first-time shutdown of all US air traffic. The shutdown halted all domestic traffic and also prevented all international traffic from entering the US (Johnson, 2004)

3.2 Market environment

Over the last decades the airline business has shown a stable long-term growth. Until the year 2000, world air traffic has been growing every single year with the only exception of 1991, which was triggered by the Gulf War and the explicit threat of airplane hijackings (Hätty et al, 2003).

Year 2001 was a disastrous year for the airline business. The conditions within the industry changed fundamentally for the worse. The total losses in the airline industry were enormous and tens of thousands of employees in the industry lost their jobs as the airlines struggled to survive. Behind the crisis lies a sharp economic downturn as well as unpredictable events outside the control of society or the business community (SAS annual report, 2001).

The airline industry is sensitive to changes in socio-economic development. The crisis in 2001 affected the industry by a clear economic slowdown in summer 2001. In the wake of the September 11th the terrorist attacks hit North America. The economic instability was welded to political and social unease as well as reduced confidence in air transport. The result was a dramatic fall in demand. Almost the whole industry had to think quickly and adapt capacity to lower levels by closing a number of destinations, reduce frequencies and take aircraft out of production. This negative traffic trend changed travel patterns including fewer travellers in the traditional business class. This emphasized the need to address both cost structure and earnings capacity in the airline operations, and a new competitive scenario was raised (SAS annual report, 2001). The insecurity people felt about travelling by air was further fuelled when flight 686 between Milan and Copenhagen crashed, October 8th, 2001, and 118 people died (SAS annual report, 2001).

The outbreak of the SARS disease, in mars 2003, further stimulated the slump in air travel. International air travel dropped by 18.5 per cent worldwide while Asian airlines dropped by 44.8 per cent (Aldred, 2003).

3.3 Current trends

The most current trend within the airline industry is the growth of low-cost airlines during the last few years (MIT, 2003). In the ensuing month after the terrorist attack a number of major airlines filed for bankruptcy, including Swissair, Sabena, U.S. Airways and most recently United Airlines. While the major airlines were having a difficult time a few low-cost airlines achieved significant growth, because of the aggressive strategy in cutting prices to attract new customers and increase the demand (Atkearney).

Because of the aircrafts available at low prices on the aircraft leasing market, new players appear in the market almost daily, leading to a stiffer competition. The weak global economy and external events, have led customers to change their travel patterns and become more cost-conscious (SAS annual report, 2003).

3.4 European market

The European airline industry is a competitive and dynamic industry whose fortune is closely linked to the performance of the overall European economy. Of all forms of transport, air travel has seen by far the most impressive growth in the European Union and has increased by 7.4 per cent a year between 1980 and 2001 (EU, 2004a).

In year 2002 the market in Europe slowed significantly in the wake of the terrorist attacks of September 2001 and the global economic slowdown. The European airline industry has achieved a recovery in passenger numbers quicker than their counterparts in the United States of America (EU, 2004a).

Over the last decade, the European airline industry has moved from a highly regulated market to an unregulated market. Therefore the market has changed from having little or no competition, to a highly competitive single market. In this new situation the discretionary powers of the national authorities have been curbed and airlines have enjoyed greater freedom to set fares, open new routes and determine what capacities to offer (EU, 2004b).

3.5 Industry Outlook

With no end to hostilities in sight, airlines can expect little relief from the current economic conditions. The industry will take many years to recover from the issues facing it at this time (KPMG).

Because of the network economies of scale available to large low cost airlines, among other factors, just two carriers, namely EasyJet and Ryanair, may eventually dominate the low-cost airline segment in the European market. **However, numerous start-ups will come and go (KPMG). Which is not a surprise because low-cost airlines are all the rage in Europe. They have introduced Europeans to a cheap, fast mode of transport to places like Barcelona, Nice and Rome (The McKinsey Quarterly, 2002 number 4- <http://www.euroactiv.com/cgi-bin/cgint.exe?204&OIDN=250681>)- The report you sent me this morning**

4 Strategic changes on a dynamic market

The airline industry has completely changed structure. From being a regulated market with high barriers to entry and almost non-competition has changed to a deregulated market with new players entering, mostly low cost airlines with aggressive competitive mind-sets. This chapter is describing the change in the industry, from regulation to deregulation and from traditional airlines to low cost airlines.

4.1 Deregulation of the airline industry

National “flag carriers” have historically dominated the airline industry. Through the years the airline industry was regulated between countries, with governments determining where airlines could fly and what fares to charge. In the last few decades the airline industry has changed dramatically, particularly in the last 10 years. Global deregulation of the airline market began in North America, where the US market was deregulated in 1978. First steps of deregulation in Europe were not taken until in the 1990’s (Schnell, 2004). In Sweden the market was deregulated in 1992, while the liberalisation of airline markets within the European Union was not finalised until April 1st 1997 (Business: The squeeze on Europe’s air fares, *The Economist*, May 26, 2001, Volume 359, Issue 8223, page 57). Moreover the European airline markets was liberalised step by step while the US airline industry was deregulated from one day to another. Consequently, the changes in Europe did not come into effect as suddenly as they did in the USA (Schnell, 2004).

Before the deregulation, competition barely existed in the state owned industry. Barriers to entry were high and competitors relatively weak and disadvantage, mainly because of government refusals to grant operating and/or route licenses. Consequently, the threat of competition was not of great concern to management of the flag carriers. Provision of service was merely the only field of operation where competition existed to some extent. This environment, where the airlines were often perceived as a mere extension of a state service, led to low efficiency in the provision of service. In fact it was often not even an area of managerial concern. Flag carriers were habitually regarded, and often by them self’s, as having as their primary

function the travellers of some public need, such as the provision of employment, an aim that had little to do with their own business. As a result, the airlines only way to survive was through periodic capital injections from the state (Kangis and O'Reilly,2003).

The European Community's decision to create a single internal market altered the status of the state protected monopolies. The liberalization gave opportunities for new entries to the market. Most barriers were either toned down or removed (Kangis and O'Reilly, 2003). However, certain barriers still exist today.

4.1.1 Remaining barriers today

The liberalization of Europe's civil aviation markets aimed at fostering competition among airlines by removing regulatory constraints on which airlines can fly which routes, and on pricing. This increased competition was expected to give passengers the benefit of lower prices, increased frequency of flights and the selection of routes. In order for those benefits to be realized there needs to be either competition on every route or at least the threat of new competition. This is not always the case and even today there are still a number of barriers for new airlines to enter a market. The remaining barriers are for example: (Riley, 2003)

- Availability of desired take-off and landing "slots" at airports. Availability is important in determining whether an airline opens a new route.
- The necessity of entering a new route on a large enough scale to achieve acceptable cost levels. This size of scale is important because of fixed costs.
- The costs of leasing new fleets of aircraft.
- The necessity of applying for and securing an air operator's license from the EU.
- Securing contracts with ground-handling companies who may already have contracts with other airlines.
- Retaliatory behavior by rivals. Rivals often react by an expansion in flight frequency, cuts in fares and increased spending on marketing and advertising.
- Overcoming existing customer loyalty achieved by companies who have exploited first-mover advantage on specific routes.

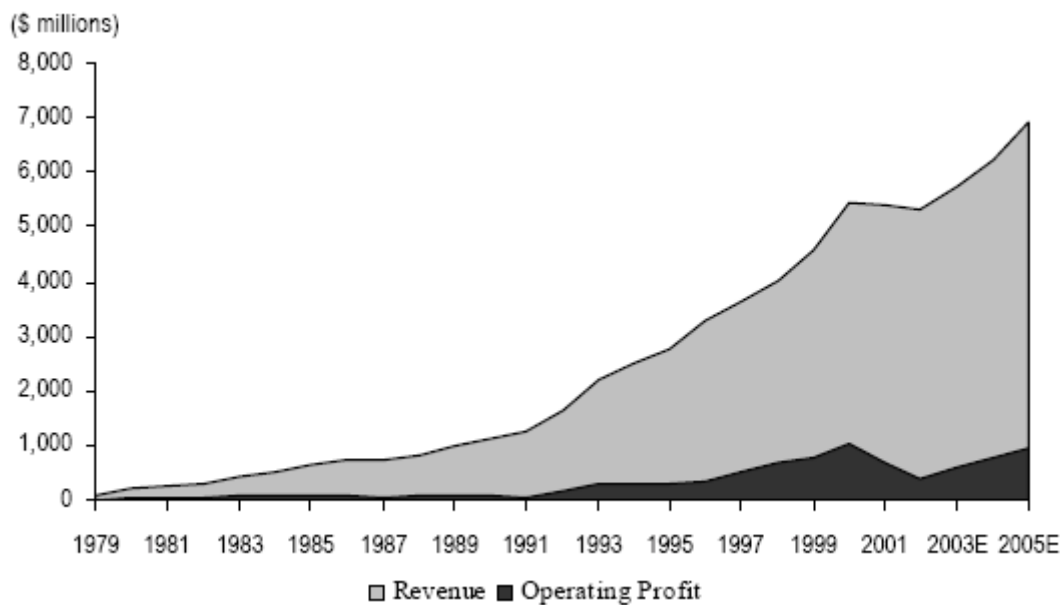
Despite existing barriers, the revolution in the freedom for airlines has led to many new entries to the industry, but with considerable carnage. New players with aggressive competitive mind-sets entered the market on a regular basis. This robust evolution was more than the market could handle. As a result, failure rates of new comers to the market have been extremely high. After deregulation, between 80-85% of the new carriers launched in the USA have already gone out of business. In the tough times of 1993–96, 75% of new European airlines failed. Developing efficient new strategies in this business is easier said than done. However, one approach to reinventing the airline industry stands out, the "no-frills" airline. The model for the "no-frills" airline is Southwest Airlines in the USA. (Piercy, 2000)

4.2 Low budget Airlines

4.2.1 The Southwest model

Southwest Airlines started operations in Texas in 1971 and it has declared a profit every year for the past twenty-five years, which is a boast that no other US airline can make. Although, it must be had in mind that the US liberalized its domestic markets back in 1978, Southwest had spent the previous 7 years flying in and around Texas, and was just mature enough to benefit from this sharp change in the industry's regulatory structure (Avery, 2003). From its humble beginnings as an intra-Texas carrier to its position today as the fourth largest carrier in the United States, Southwest has proven that its business and network models work (southwest.com, 2004). Southwest Airlines is the low-cost airline against which its countless imitators are judged.

Figure 4.1 Southwest Airlines' turnover and operating profit record



(Avery, 2003)

Southwest started off by capturing the Texas market with its "no-frills" concept, flying between Dallas, Houston and San Antonio. The large carriers, more concerned with their intercontinental business, did not take the competition seriously. Consequently, Southwest manage to grow and prosper until they were financially strong enough to attack prime markets such as California. Southwest was no longer a small start-up operation and the incumbents had every reason to be aware. The revolution had begun. A new concept had hit the market and was about to change it. The Southwest model has been the model for many others ever since (Piercy, 2000).

The essential elements of the Southwest model are:

On the revenue side: (Avery, 2003)

- Very low fares by comparison with network competition, thus generating high load factors and hence good revenue per aircraft despite low fares.
- Low fares both win share from incumbents and create fresh demand for air travel.
- Simple, understandable fare structure.
- Very simple frequent flyer reward scheme – no spill or complexity.

On the cost side: (Avery, 2003)

- No-frills product keeps costs low.
- Wages are not low, but productivity is much higher than the network majors through having a strong company culture and the use of share options.
- Increasing use of Internet for bookings will drive distribution costs down in future.
- Economies of scale, particularly on aircraft. Southwest obtain the lowest 737 prices from Boeing of any customer in the world, with perhaps the exception of Ryanair, since their purchase of 250 jets in 2002 (ryanair.com, 2004).

Southwest did not only recreate the cost structure and price strategy of the industry. The airline took the idea that work can be fun to the extremes, creating the perfect atmosphere among their passengers as well as their employees. Different themes, such as the "Love theme", were adopted among with many fun elements like their in-flight announcement, which routinely was not spoken but sung (Piercy, 2000).

The phenomenal success Southwest Airlines has succeeded is much to thank huge efforts in building and sustaining a highly motivated workforce. High levels of dedication to the CEO and the company results in exceptional levels of productivity compared to the rest of the industry. For example, Southwest has got turnaround time between arrival and departure for its aircraft down to twenty minutes, less than half the time other carriers take to get the plane back in the sky. One reason is that flight attendants and even pilots are ready to help out in cleaning the passenger cabin, loading the bags or doing anything else needed to get back in the air. (Piercy, 2000)

Southwest has driven other elements of the cost structure for getting in the air to very low levels:

On the route network: (Avery, 2003)

- Point-to-point schedule, all-coach (economy) class and purely US domestic service.
- Favor high density of daily frequencies to win premium traffic share (e.g. 15 dailies Los Angeles/Oakland).

- Favor primary airports if available (9 of its 10 busiest airports classed as primary).
- Favor short, busy routes rather than transcontinental.
- "Connect the dots" expansion strategy (very few new cities each year).
- Good customer service, not through product but through staff attitude.

On the business operation (all to reduce complexity and therefore cost): (Avery,2003)

- No connections or interlining or international flights.
- No seat allocation.
- No frills (business or first class, meals, amenity packs or lounges)
- Single fleet type (although it does operate all three generations of B737, which have less spares commonality than generally assumed).
- Fast turnarounds, thus permitting high daily aircraft utilization, which reduces unit costs.
- Buy new aircraft, to benefit from their higher reliability in a fast turnaround operation, and to benefit from complete commonality of specification.

Despite the low cost structure and the no-frills offer, the customer service strategy remains extremely successful. In 1997 Southwest ranked first in customer service among major US airlines in a Money magazine survey (Piercy, 2000). Since then Southwest has received several awards and recognitions. An annual study of quality in the aviation industry, finds that budget airlines generally provided better service in 2003 than traditional airlines.

Carriers such as Southwest and JetBlue were more likely to arrive on time, less likely to mishandle baggage or generate complaints than the traditional carriers. Southwest, with 0.14 complaints per 100,000 customers, consistently generates the lowest complaint rate in the industry (Miller, 2004). Lorraine Grubbs, manager of Southwest's training program, the "University for People," says "the frills are not what's important for most people, it's the compassion and caring and the people" (Piercy, 2000).

4.2.2 Low budget airlines in Europe

Since the European market was deregulated, several low cost airlines have entered the market. In most cases their business strategy has been a direct copy of the Southwest model, offering low fares, no on board meals, no allocated seats, low cost of staff and often using secondary airports (David Gillen & Ashish Lall- [competitive advantage of low-cost carriers: some implications for airports, 2004, volume 10, issue 1, page 41-50](#)). Ryanair, for example, uses airports often situated far from their advertised destinations. One example is the Skavsta airport in Sweden, located 100km from central Stockholm (Williams, 2001). Furthermore, Ryanair among with more LCC use airports such as Beauvais (France), Charleroi (Belgium), Stansted (UK) or Hahn (Germany), that are located up to two hours from major city centers (CWT, 2003). The recognition that some market segments are willing to trade time for money and convenience have led LCC's to minimise the sum of airline and passenger costs. While a carrier can reduce access time by operating out of mainline airports, it is very expensive in terms of direct charges and the ability to use resources efficiently. Using secondary airports have allowed LCC's to lower costs and thereby reward passengers with lower fares. At the same time, the traditional airlines operate their "hub-and-spoke" system, with less time, higher fixed costs at overloaded airports. This is expensive since it requires more flights and schedule coordination, both of which are high cost. By creating connectivity rather than "hubbing", the LCC were using passenger time to lower the airlines costs and at the same time, lower fares were possible and profitable (Gillen & Morrison, 2003).

Through the years airlines have paid fees for using an airport. Today, some low-cost operators have sought to rewrite airport–airline economic relations with airports paying airlines to operate (Pilling, 2003). According to Michael O'Leary, Ryanair, there is a queue of airports with such offers. Furthermore, while simultaneously negotiating with up to 40 airports, which were seeking their services, enabled him to play one of against another and consequently get better deals (Dixon, 2002). Some of those agreements have acquired regulators attention. The agreement between Ryanair and Charleroi Airport, Belgium is under investigation by the European Commission on the grounds that the commercial assistance given to Ryanair by the airport could constitute an illegal state subsidy (Pilling, 2003).

The low budget market has grown fast ever since the liberalization. In the first two years low cost carriers gained 5 per cent of the market from UK to Europe. The low cost carriers undercut the big carriers by as much as 50% and focus mainly on high volume, short-haul, point-to-point trips.

It has been noted that savings mainly come from: (Piercy, 2000)

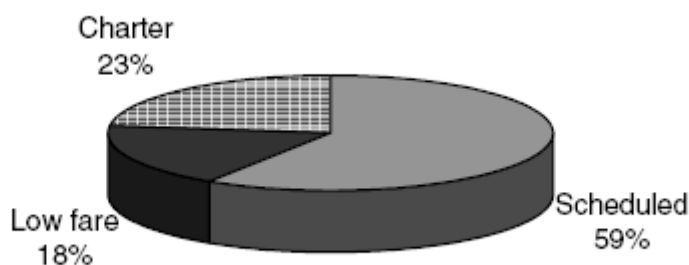
- **Distribution costs.** It has been estimated that as much as 25% of the cost of conventional air tickets comes from distribution, e.g. travel agent commissions and promotion, the computerized reservation system shared by major airlines and the coupon exchanges to reconcile passenger switches. Direct selling and ticket less travel avoid most of these costs.
- **In-flight catering and staffing.** Conventional airlines provide "free" meals and drinks in their ticket prices. Removing these services saves money. EasyJet estimates that while it has three-cabin crew on a short-haul flight, the equivalent BA flight will have six-cabin crew.
- **Fleet uniformity.** A fleet standardized on a single aircraft type drastically reduces maintenance and spares costs and crew training.
- **Regional airports.** Using regional airports instead of the major hubs has several important implications. It gives access to the underserved regional population in the regional airport's catchments area; fees are lower; less congestion allows the operator to be more efficient and to get better utilisation from the aircraft. (Piercy, 2000)

In the early nineties, European flag carriers, such as KLM and British Airways, encountered a lot of problems with the rise of British Midland. British Midland initially made profits from less bureaucracy, which manifests itself in a lower cost structure. While British Midland let their customers share in their lower costs by lowering prices, their competitors were forced to reduce their prices to. The appearance of British Midland made it increasingly clear that flag carriers will have to concentrate more and more on long haul routes, while smaller no frills airlines focus on the shorter routes. British Midland was the first to do so, followed by companies such as Ryanair, EasyJet and Virgin Express (Piercy, 2000).

4.2.3 The growth of the European market

The European low cost sector has been growing fast on last years but is estimated to being far from saturated. About 400m passengers use Western European airspace each year, taking off from more than 280 airports of which just over 100 now have low cost services. (Riley, 2003) Low cost carriers are expected to have an 18% share of the European air passenger market in 2004. In the US, The Air Transport Association calculates that the penetration level of low-fares airlines in the US is around 28% (CSER, 2004).

Figure 4.2 European market shares by airline type (passengers carried, 2004E)

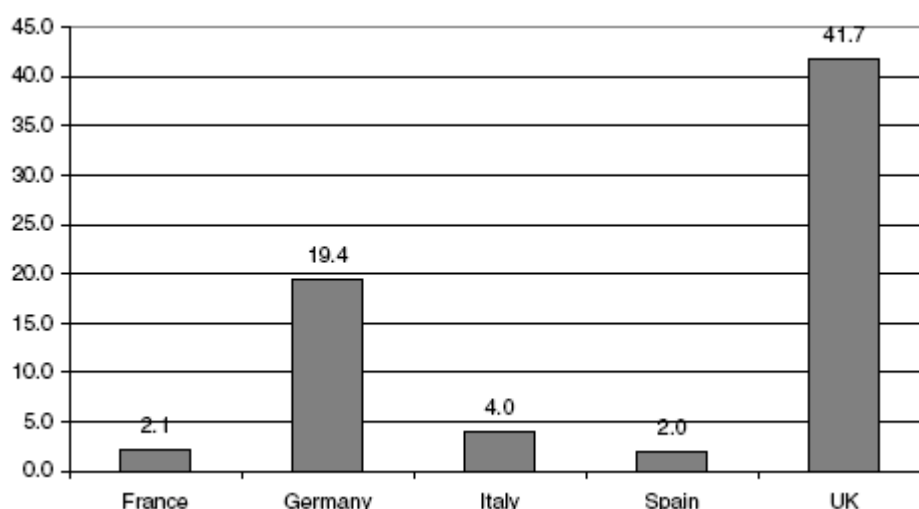


(H14 – Credit Suisse greining – (CSER, 2004))

Penetration rates for the low cost airlines in Europe expected to increase to US levels. Furthermore, forecasts expect European rates to exceed US rates, given its travellers market characteristics: a larger population base with more holiday time; an expanding European Union; greater cultural diversity and shorter distance between major cities (Davy, 2004).

The major European low cost market is the UK market. LCC have at least a 42% share of the domestic market and are still adding capacity within the UK. As can be seen in table 4.1 below some of the major markets in Europe have a long way to go to catch up with the growth in the UK. These comparatively low numbers in three of Europe's largest economies, namely France, Italy and Spain, give good prospects for growth opportunities (CSER, 2004).

Table 4.1 - Low-fare carriers: Domestic market penetration 2003



(CSER, 2004)

Overall the European market, including all sectors, is expected to grow steadily in coming years or by approximately 4,6% a year. The low budget market alone is expected to increase by 13,6% on average every year. At such growth the LCC market will in 2010 have 33% of the whole aviation market and 41% by 2015. Interestingly, according to those predictions, the traditional airlines should not lose passengers over the forecasted period. Their share on market decreases dramatically, from 60% in 2003 to 48% in 2015, but at the same time the number of passengers carried increases by 108 million, or 37% (CSER, 2004).

Table 4.2 – Forecast growth: Intra-European air passenger traffic

Passengers carried (m)	2002	2003E	2004E	2005E	2010E	2015E	CAGR
Scheduled	300	290	298	312	345	398	2.7%
Low fare	44	73	90	108	218	336	13.6%
Charter	118	120	117	114	102	95	(1.9%)
Total	461	483	505	534	665	829	4.6%
Change (%)	N/a	4.8	4.6	5.7	4.5	4.5	N/a
W European pop (m)	390	381	453	454	460	466	1.6%
Trips per person pa	1.2	1.3	1.1	1.2	1.4	1.8	3.0%

Table 4.3 – Low cost market developments 2004-2010

Carrier	Passengers (m)	Market shares (%)	Passengers (m)	Market shares (%)
	2004E	2004E	2010E	2010E
EasyJet	26.7	29.8	67.4	30.9
Ryanair	25.3	28.2	71.2	32.7
Other low-cost carriers	37.7	42.0	79.4	36.4
Total low-cost passengers carried	89.7	100.0	217.9	100.0

(CSER, 2004)

For the calendar year ended December 2003, easyJet and Ryanair carried 21.1m and 21.4m passengers, respectively. This makes Ryanair once again Europe's largest low fare carrier, having temporarily lost that title when easyJet acquired Go in 2002. The two airlines are by far Europe's dominant low cost carriers and between them should have a 58% share of the intra-European low fare market in 2004. This market share is then expected to reach 64% in 2010.

In that year forecasts show easyJet carrying 67m passengers (31% market share) and Ryanair carrying 71m (33%). Smaller low cost operators are expected to have more difficulties as the market matures and they come up against the relative strengths of easyJet and Ryanair. For this reason growth of other LCC is expected to be 5-8% lower than that of Europe's two largest low cost carriers (CSER, 2004).

4.2.4 Key players in the European low cost market

4.2.4.1 Ryanair

Ryanair was started by Tony Ryan in 1985, first as a conventional full service airline to compete with Aer Lingus, by offering lower prices. In the next four years the business was a disaster, they lost 18 million pounds and went through five CEOs (Piercy, 2000). It wasn't until current CEO, Michael O'Leary turned things around that success was first brought to the company. O'Leary adopted the Southwest model and extended the airlines service routes from Dublin to London to the rest of Britain. After EU deregulation in the airline industry in 1997, Ryanair was enabled to open a number of routes to continental Europe, for example Stockholm and Oslo.

The same year Ryanair was listed on Dublin and NASDAQ stock exchange. In the next years Ryanair grew fast. Since 1999, Ryanair more than tripled its number of passengers, number of aircraft and the number of airports it serves and increased the number of people it employs by 58%. In 2000, RyanAir launched their website, www.ryanair.com, and quickly achieved 70 per cent of its bookings online and 90 per cent direct (Rae, 2001). In 2002 the number of bookings online had reached 94%. In 2002 Ryanair entered a long term agreement with Boeing acquiring up to 150 new Boeing 737-800 aircraft over an eight year period from 2002 to 2010. In 2003 the company entered a new agreement with Boeing acquiring them 100 additional aircrafts (ryanair.com, 2004).

The same year the company announced they were taking over the low cost airline Buzz from KLM. Buzz had been losing 30m pounds a year and was Ryanair expecting to turn that around. According to Michael O'Leary, Buzz should turn a profit of 11 million pounds by March, 2004 (Miller, H, 2004). EasyJet's passenger traffic for the year 2003 grew by 42% to 15.7m as average load factors increased from 81% to 84%, primarily due to a 6% reduction in average fares. Total revenues in the year rose by 35%, however operating costs rose at a slower rate by 26%. Net Profit increased by 59% to €239.4million. (Ryanair AR, 2003)

4.2.4.2 easyJet

Stelios Haji-Ioannou, heir to a Greek shipping fortune, founded easyJet in 1995. He started the company with a little more than an office, a booking system and sub-contracts to provide the rest of the service. In 1998 he was operating on seventeen European routes with a rapidly expanding fleet of owned aircraft. The easyJet model was a pure copy of the Southwest model; point-to-point flights, short haul only, scheduled flights not charters, no frills, low fares and low costs (Rae, 2001). Mainly two things dominate Haji's thinking: keeping in touch with his customers and eliminating bureaucracy. His frustration with the formality and bureaucracy in his father's shipping company turned into a quest for informality and paperless office in his own company (Piercy, 2000). The easyJet model is simple, it achieves maximum aircraft utilisation at maximum load factor on point-to-point flights, minimising overhead costs. This is achieved through no-frills operation and an obsession in cost control (Rae, 2001)

To keep in touch with his customers Haji, among other things, flies his own aircraft three or four times a week. As easyJet doesn't serve meals on their flights, Haji is fond of reminding his customers; "If you want a meal, go to a restaurant". Passengers are fed jokes instead of meals. Passengers also have to face recycled boarding passes, no first class privileges and to fly from secondary airports often sited far from the city's they serve. (Piercy, 2000) EasyJet's slogan, "The webs favorite airline", goes to explain their remarkably high percent of tickets sold through their web page, easyjet.com. Currently easyJet sells on average well over 90% of their tickets online. (easyjet.com, 2004)

Today easyJet serves 153 routes from 44 European airports, operating 72 aircrafts. Its merger with Go-fly in August 2002 boosted the phenomenal growth of easyJet. The merger secured easyJet slots at Stansted airport, which were of great concern for the company. In October 2002, the airline signed a deal to purchase 120 Airbus (easyjet.com, 2004). In March 2003 the airline signed a deal for additional 120 Airbus jets which will facilitate the airline's ongoing growth strategy ([easyjet AR](http://easyjet.com), 2003). During the financial year to 30 September 2003, the company reported pre-tax profits of £52.0 million on a turnover of £932 million and carried 20.3 million passengers (easyjet.com, 2004).

4.2.4.3 Competitive advantages of easyJet and Ryanair

Most forecasts, if not all, expect the future domination of easyJet and Ryanair on the European low budget market. Many reasons can be found for these predictions. First of all both airlines can be considered to have the so-called first mover advantage. The key benefits of this advantage are as follows: (CSER, 2004)

- **Route domination.** Typically, easyJet and Ryanair prefer to dominate their routes, raising the barrier for potential new entrants and also to attract the frequency-sensitive (as opposed to cost-sensitive) travellers.
- **Market knowledge.** A key strength of easyJet and Ryanair is that they have been active in the low-fare market for significantly longer time than almost all their competitors, giving them a knowledge advantage in a number of areas. In particular, this is evident in pilot recruitment, airport expansion, growth into new regions and aircraft acquisitions.
- **Aircraft acquisitions.** Both easyJet and Ryanair were in a position to take advantage of the depressed aerospace market that followed the 11 September 2001 terrorist attacks in the United States. As such, both placed substantial orders for new planes at discounts of 40% below the list prices (easyJet ordered 240 Airbus A319s; Ryanair 250 Boeing 737-800s). This, in our view, places them both at a significant competitive advantage over their European low-cost rivals, who arguably may never achieve similar levels of discounts (for reasons of market conditions and order size).
- **Access to capital.** Expansion for both easyJet and Ryanair is made easier as a result of their both being quoted and thus more able to tap the capital markets. This manifests itself though both companies' strong balance sheets.

For those reasons mainly, newcomers and smaller operators can expect to have great troubles, struggling for survival. Major "hub-and-spoke" companies such as KLM, British Airways and Lufthansa have struggled a long time with the low cost model companies, mainly easyJet and Ryanair. In the early nineties, Stephen Wolf, former CEO of United Airlines, said that he felt that Southwest Airlines were responsible to a great extent for the problems United Airlines were facing (Jagersma & van Gorp, 2003). In Simons Calders book, "No Frills, the Truth Behind the Low-Cost Revolution in the Skies", published 2002, easyJet founder Haji was quoted

saying that “by 2008, no-one will be flying traditional airlines”. Exacurations or not, Michael O’Leary’s words in the same book could get some European flag carriers worried. “We are at 10 years; give us another 20 years and we will cover Europe”. We intend to double from seven to 14 million passengers in three years. O’Leary has already exceeded his own target, flying 14,5 million passengers in 2002. Ower time, according to O’Leary, there will be one or possibly two carriers, RyanAir and easyJet will grow at the expence of others. O’Leary further expects that by 2007, all others will have disappeared, been taken over or been absorbed (Miller, H, 2003).

A lot of traditional companies have tried over the last five to ten years to bring both business models under one hat, because the urge to do so is strikingly strong due to the success of low cost companies. However, it is certainly not easy for flag carriers to combine a “point-to-point” system with a “hub-and-spoke” system. Therefore most attempts so far have been a failure. (CSER, 2004)

4.3 Strategic options for traditional airlines

Since the liberalization of the airline industry new players with aggressive competitive mind-sets have entered the market. The old state protected industry has been reinvented, leaving he once protected incumbents forced to restructure for survival (Kangis and O’Reilly, 2003). Mo Garfinkle, CEO of GCW Consulting, believes some airlines still haven’t realized the increasing threat of the low cost airlines. Garfinkle said; “Some traditional airlines are still in self-denial with their heads buried in the sand. Many do not understand low cost airlines and consistently underestimate their management” (Jessop, 12.feb 2004).

The flag carriers first respond to the new competitive environment was to perfect their own “hub-and-spoke” system via alliances. By joining these alliances, incumbents were able to compete directly with other high cost companies by simply forcing a direct competitor out of the market through a co-operation concept. Secondly, flag carriers tried to bond with their passengers by offering frequent flyer programs (Jagersma and van Gorp, 2003).

Both alliance’s and frequent flyer programs have had no or little impact so far on the cost side of the margin and that is exactly the domain where no frills companies reign

today (Jagersma, 2000). Traditional carriers are still not able to offer similar low cost service at the same low price and margin as low cost companies (Jagersma and van Gorp, 2003).

According to Jagersma and Van Gorp, 2003, there are at least seven strategies available for the traditional carriers to play the competitive game with low cost companies.

- **The "cloning strategy"**. By cloning, the company needs to restructure completely and implement a low budget strategy, more specifically, the Southwest model.
- **Co-operation**. A second alternative for traditional carriers is co-operation instead of competition between the low cost companies and the flag carriers. The low-cost company would then primarily take on a feeder function and the transport of the price-conscious passenger, whereas the flag carrier would occupy itself with long distances. In this scenario, the flag carrier would have a guaranteed cheap and reliable feeder function, whereas the low-cost carrier can count on a definite number of passengers and facilities (to be agreed upon properly in mutual consultations) and the marketing knowledge of the flag carrier. The disadvantage of such a co-operation concept is that passengers must not have any objections to different service levels. The flight schedules will furthermore have to be co-coordinated meticulously. Both parties will also have to act according to the letter of the agreement and not be forced with the lapse of time to launch into the operations of the colleague-partner (Jagersma, 2000).
- **Get a grip of slots and gate capacity of minor airports**. The use of minor secondary airports is one of essential parts in LCC cost reduction strategy. When traditional carriers get hold of the same gates and slots, low cost companies have lost one of their competitive edges, cheap secondary airports. In the mean time the traditional carriers strengthen their network and are able to fly from a greater number of primary and secondary airports to several destinations. This strategy requires networks of alliances to compete against other networks or single operating carriers i.e., expanding the "hub-and-spoke" systems (Jagersma & Van Gorp, 2003).

- **Taking over new low cost companies.** This strategy few unavoidable risks. First of all, anti-trust authorities will have to agree to such a strategy. Secondly, both parties will have to be able to link up both in terms of infrastructure (IT/IS, route networks, etc.) and culture. They must at any rate not repel one another. Thirdly, in case of bad performance of the newly acquired company, there is a danger of deterioration of the existing brand. In other words if a low-cost carrier fails, it may influence the reputation of a flag carrier.
- **Franchising.** This is a risky strategy because outsourcing services involves risks in terms of quality and punctuality of the services provided and control over the franchisees. If the franchise results to be a failure, the bad publicity will be reflected upon the flag carrier who takes the blame. However, it does not prevent most national carriers to follow this strategy. British Airways was one of the first airlines to subcontracted BA products to someone with a more efficient business model. In exchange for the use of BA's computerized booking system, BA gets a previously agreed fixed fee.
- **Strengthen and re-build the core business** (Zook & Allen, 2000; Tenny, 2002). The companies branding in terms of service, safety, comfort, possibilities of flight connections and more frills, making the live on board more comfortable and exiting, are still of great importance to a number of both business and other travellers.
- **Treating the customers like kings.** The final strategic alternative presented, and perhaps a dying art, is treating the customers like kings. It seems that only the odd flag carrier, Singapore Airlines, knows how to offer its passengers the necessary high-quality services and overall service. Pampering passengers is an extremely serious trade (Jagersma & Van Gorp, 2003).

4.3.1 Reactions of traditional airlines

The traditional airlines have fought a defensive struggle ever since the low cost invasion. The US transportation department explains that when the new low cost entrants started services, the big airlines lowered their prices as well and offered more seats. Using its financial string the big airlines out competed the low budget airlines. Once the low budget carrier was out of business, the big airlines raised prices and withdrew the extra seats. Until only few years ago Southwest airlines

where the only low budget airline in the US, strong enough for that kind of fight (Piercy, 2000). The Low cost airlines were here to stay and the big carriers were despaired to take serious actions.

4.3.2 British Airways and Go Fly (is Go or Go Fly???)

The first dramatic response of a traditional airline to a growing threat of the low budget sector in Europe, was when British Airways launched its own low budget airline, Go Fly, knowing it could have huge effects on its core business. Before BA launched its own low budget subsidiary, the company had previously had discussions of take over with both Ryanair and easyJet. BA backed out of the easyJet take over negotiations, partly because of concerns that UK regulators would block it. A possible alliance was also discussed with Debonair (Piercy, 2000).

The fact that "The world's favorite airline", as British Airways claimed to be (Strategic directions, 2003), was entering the low budget market was of great concern to the "no frill" carriers. EasyJet reacted with hostility, threatening law suits because of information BA had gained from easyJet during take over discussions. Debonair and Richard Branson, owner of Virgin Express, both threatened legal actions on the grounds that entry by BA would be a blatant attempt to destroy the low cost competition. Michael O'Leary, CEO of Ryanair, was less worried about BA actions and simply said; "If British Airways think they can set up a discount airline, they must be smoking too much dope!" (Piercy, 2000) It does not matter if Mr. O'Leary thought that BA were not able to make a successful low budget airline or just that if they made one, it would destroy BA's core business. The fact is, that entering the low budget market was a major risk to BA, no matter what. They were now confronted with the risk of losing full fare passengers from BA's Heathrow flights to discounted fares out of Stansted, cannibalising, and damaging BA's brand position on the market (Piercy, 2000).

Nevertheless, in November 1997, BA went through with it and launched its new subsidiary. The new operation had a separate structure from BA, with its own brand and a different physical location to BA headquarters, to reinforce its separateness from the main airline. Go Fly offered seats purchased over the telephone, with no tickets issued, streamlined check in and no free in flight food and drink. Barbara

Cassani, the head of Go, described her vision as transforming the airline business: "We will be the IKEA of the airline business. What IKEA did to make cheap furniture tasteful, we will do to the low fare market. There will be more style to this market than has been seen before." (Piercy, 2000)

After Go attacked the market in May 1998, offering substantially lower fares, easyJet and Debonair accused BA of subsidizing the new operation, because this level of fare could not make a profit. In answer to the question of whether the low cost airlines can compete with this attack, Haji-loannou of easyJet said: "The short answer is that we can compete with them if they play fair. Fair competition means they are exposed to the same costs and risks of failure that we are. In other words, they get their aircraft, fuel and insurance at the same price, and not BA prices, which are substantially lower.

The second thing is the pressure to make money. My first reading of the situation is that I don't believe Go is run with the intention of making money. I don't believe that anyone can make money at the prices they have just announced" (Piercy, 2000). Go was facing constant legal actions ever from the beginning from many of their low budget competitors. EasyJet launched an advertising campaign, which was surprisingly not faced to their customers, but at BA's shareholders and airline regulators. The campaign was intended to raise questions if Go was ever meant to make any money. Was their only purpose to ruin the competition on the low budget market, using BA's financial strength as a backstop?

Despite all, Go Fly's strategy worked out and Go Fly became one of the most successful low budget airlines in Europe. Go Fly were awarded several accolades, including "New brand of the Year" 2000, "Best Low Cost Airline" in 2001 and 2002, and "Business Super brand" in 2002 (easyjet.com, 2004). Go Fly was making profits and the investment was paying off to the mother company, BA. However, despite Go Fly's success, was the launch of Go Fly a good strategy for BA? Was Go Fly doing well enough to pay off for the damage it did to BA's core business? According to Stefan Vilner, manager of marketing and international sales at Go Fly at the time, "people inside the management of BA hugely disliked Go and spend a lot of time

analysing the Go impact, in fact much more time than they spend on looking at easyJet and Ryanair” (Vilner, 2004).

Eventually, in 2002, Go Fly was sold to easyJet, their main rival in the low budget sector. In hindsight, Vilner believes, “that the BA brass did learn a lot from the Go experience – especially on the revenue management side of the business. Today BA embraces a much more dynamic pricing strategy making them stronger in the market” (Vilner, 2004). Today BA focuses on routes that are successful and discontinues those that are not. BA now seeks to re-establish itself as the “airline of first choice” for high yielding traffic. The company has introduced innovations such as the Club World brand, beds in first class with semi privacy and arrivals lounges (Strategic direction, 2003).

5 Scandinavian Airline Systems (SAS)

SAS is a well-known and established airline company in Scandinavia. On March 30, 2003, the company launched its low budget brand Snowflake. Snowflake is competing with airline companies like Ryanair, Sterling and other low-cost carriers. **This chapter describes SAS and its snowflake program.**

5.1 SAS

SAS was founded in 1946 when the flag carriers of Sweden, Denmark, and Norway agreed to form a partnership. Initially, the members of the partnership handled intercontinental traffic to Scandinavia. In 1948, however, the companies started to coordinate their European operations and in 1951 they finally merged to form the current SAS Consortium (sas.se, 2004-04-23).

SAS AB is currently the largest airline and travel group in the Nordic region and the fourth largest in the European market, in terms of number of passengers and operating revenue. The SAS Group offers air transport and related services from its base in Northern Europe. **From ELIN database- (Plea for independence; SAS believes in the merits of medium-sized, stand-alone carriers, but not in consolidation- Aviation week & space technology, New York, January 5, 2004, volume 160, issue 1, page 41).**

The main focus is put on traffic flows in Northern Europe, between Northern Europe and the rest of Europe, and between Northern Europe and North America/Asia.

The company's main objective is to "create a vigorous Scandinavian Airlines that can grow profitably, regain market shares and capture new ones, emerging as Scandinavia's most efficient short and medium-haul operator and Northern Europe's leading intercontinental operator" (SAS A.R, 2003, 32)

Furthermore, the group's objectives for the coming five-year period are:

- To achieve an average CFROI of at least 20%
- To increase the group's share of the Northern European airline market
- For each unit to achieve its customer satisfaction, employee satisfaction and environmental impact objectives
- For airline operators to achieve their flight safety targets

- Consolidated balance sheet (Analyst material Q1, 2004)

During recent years, SAS has changed its way of pricing and uses now a demand-based pricing strategy. This means that the fare is set depending on the demand and availability. This allows the company to optimise capacity utilization by for example steering non-time-sensitive customers to departures with a lower demand.

The company's main competitors are Air France, KLM, British Airways, and Finnair (SAS A.R., 2003).

During the 1990's, SAS made two attempts to break in to the low price segments. In 1993, SAS Jackpot was launched and this program focused on travellers resident in the larger cities of Scandinavia. Customers were offered trips to larger cities in Europe at low prices. SAS Jackpot positioned itself with the SAS brand plus a Joker. In 1998, a similar concept was introduced, namely SAS Pleasure. The concept was similar in the sense that it offered lower prices to some specific destinations at specific times. Also in this case, the SAS brand was used to position the concept. These two concepts had in common the fact that SAS was trying to raise the load factor on the foreign destinations (Göransson et al, 2004).

5.2 Star Alliance

Star Alliance was founded in 1997 and is currently the largest airline alliance in the world. It consists of 14 member carriers, which together transport 309 million annually, to and from 673 destinations in 127 countries. SAS was one of the founders of the Star Alliance and the SAS Group has two members in the alliance, namely Scandinavian Airlines and Spanair (SAS A.R. 2003).

Members of the Star Alliance have access to each other's customers through so-called interlining. This means that other Star Alliance members supply passengers in those destinations they do not operate. Such extra passengers and revenues comprise approximately ten per cent of Scandinavian Airlines' total passenger revenue. The Star Alliance comprised 21.2 per cent of worlds RPK in 2002 (SAS A.R. 2003).

There are three major global airline alliances in the world and there are only a few major carriers in North America and Europe that are still outside these alliances today.

In 2003, Star Alliance won several awards and distinctions. For example, it was named "Best Airline Alliance in 2003" by Business Traveller magazine (SAS A.R. 2003).

Members of Star Alliance are planning to establish a separate jointly own company for purchasing and distributing jet fuel. The purpose of this company is to contract for the alliance's fuel needs in cost efficient manner by exploiting economies of scale.

5.3 Turnaround 2005

In autumn 2002, the SAS group implemented a restructuring program called Turnaround 2005. The main objective of the program is to achieve long-term profitability and competitive overhead and productivity levels in all the Group's airlines in 2005. Turnaround 2005's target is SEK 14 billion in total cost savings [From Elin database \(Hill Leonard , Air transport world, 2003, volume 40, issue 4, pages 26-31\).](#)

The SAS group has taken the following cost inflationary factors into account when planning the Turnaround 2005:

- Raise aircraft utilisation rate
- Raise crew utilisation rate
- Bring down sales costs as a proportion of revenues
- Technical maintenance with competitive prices per airborne hour
- Station services with competitive prices per landing
- Administration costs as a share of total operating costs (SAS A.R., 2003)

5.4 Snowflake

On March 30, 2003, Scandinavian Airline started its low-price program called Snowflake. The Snowflake program targets private travellers who want to travel inexpensively and simple to destinations in Europe that SAS normally does not serve, or serve to a small extent. The flights point of departure is Copenhagen and Stockholm. The program is conducted as a business unit within the Scandinavian

Airline and operates with four aircrafts. These aircrafts are painted in their own colours and have a unique identity (SAS A.R., 2003).

Scandinavian Airline offers a total of 85 destinations, from which 20 are Snowflake destinations. Approximately 80 per cent of Snowflakes total sales are conducted through the Internet. This is an important feature that allows Snowflake to cut costs because travel agencies are not needed to the same extent as in the case of traditional sales (SAS A.R., 2003).

Snowflakes main competitors are Ryanair, Sterling, and Maersk Air.

There are mixed opinions regarding the launch of the Snowflake program. According to Michael O'Leary, the CEO of Ryanair, the program is bound to fail. He argues that no traditional airline has ever succeeded with starting a low price carrier and that SAS is no exception. O'Leary goes on to argue that, in order for Snowflake to be successful, the company will have to compete with SAS at SAS own destinations and this will result in Snowflake out competing SAS. He gives an example of British Airways similar attempts, which resulted in British Airways selling their low price department to easyJet (di.se, 2004-01-14).

SAS, on the other hand, argues that it is most likely that its Snowflake program will be a success in the long run. Ulf Thorné, press chief of Scandinavian Airlines, states that there exists a market for both low price flights and traditional service flights and combining these two concepts can very well turn out to be successful (di.se, 2004-01-16).

5.5 Routes and competitors

In this part, Snowflake's destinations and the destinations in which Snowflake is in direct competition with its main competitors will be presented. We define direct competition as competition where two or more companies have the same point of departure and destination. For example, Snowflake flies from Stockholm to Alicante and since Sterling offers the exact same trip, these two companies are in direct competition with each other in that specific route.

Table 5.1 below presents the destinations that Snowflake offers to its customers.

Table 5.1

Snowflake destinations	
From Stockholm	From Copenhagen
Alicante	Alicante
Ankara	Ankara
Athens	Beirut
Beirut	Istanbul
Bilbao	Lisbon
Bologna	Malaga
Budapest	Malta
Inverness	Mallorca
Istanbul	Pristina
Lisbon	Sarajevo
Lyon	Skopje
Malaga	Split
Malta	
Nice	
Sardinia	
Mallorca	
Rome	
Split	
Venice	

Source: Snowflake.se

In Table 5.2, the routes in which Snowflake is in direct competition with its competitors are presented. From this table it becomes clear that the absolutely largest direct competitors to Snowflake are Sterling and Maersk Air. However, there is a difference between the competitors in the sense that Sterling competes with Snowflake in both Stockholm and Copenhagen whereas Maersk Air is completely focused in the routes from Copenhagen. In other words, Sterling is the main competitor regarding the flights from Stockholm and Maersk Air is the main competitor regarding the flights from Copenhagen.

The purpose of presenting these tables is to give the reader a comprehensive, but still, limited picture of Snowflake’s competitive environment. Table 2 shows only routes that SAS has chosen to compete in. For example, it does not follow that Snowflake has larger market shares than Ryanair in routes between Scandinavia and Europe. In this case, Ryanair is the market leader with its 8.29% share while

Snowflake only has 1.72% share of the market. Ryanair has eight destinations from Stockholm, from which Rome is the only destination where both Ryanair and Snowflake fly (Davy, 2004).

Table 5.2

Snowflake routes that are also operated by the main competitors		
Ryanair	Sterling	Maersk Air
Stockholm – Rome	Stockholm – Alicante Stockholm – Malaga Stockholm – Nice Stockholm – Mallorca Stockholm – Rome	<i>No destinations from Stockholm</i>
<i>No destinations from Copenhagen</i>	Copenhagen – Alicante Copenhagen – Malaga Copenhagen – Mallorca	Copenhagen – Alicante Copenhagen – Athens Copenhagen – Istanbul Copenhagen – Lisbon Copenhagen – Lyon Copenhagen – Malaga Copenhagen – Malta Copenhagen – Nice Copenhagen – Rome

Source: Webb-pages of Snowflake, Ryanair, Sterling, and Maersk Air.

6 Porter's five forces

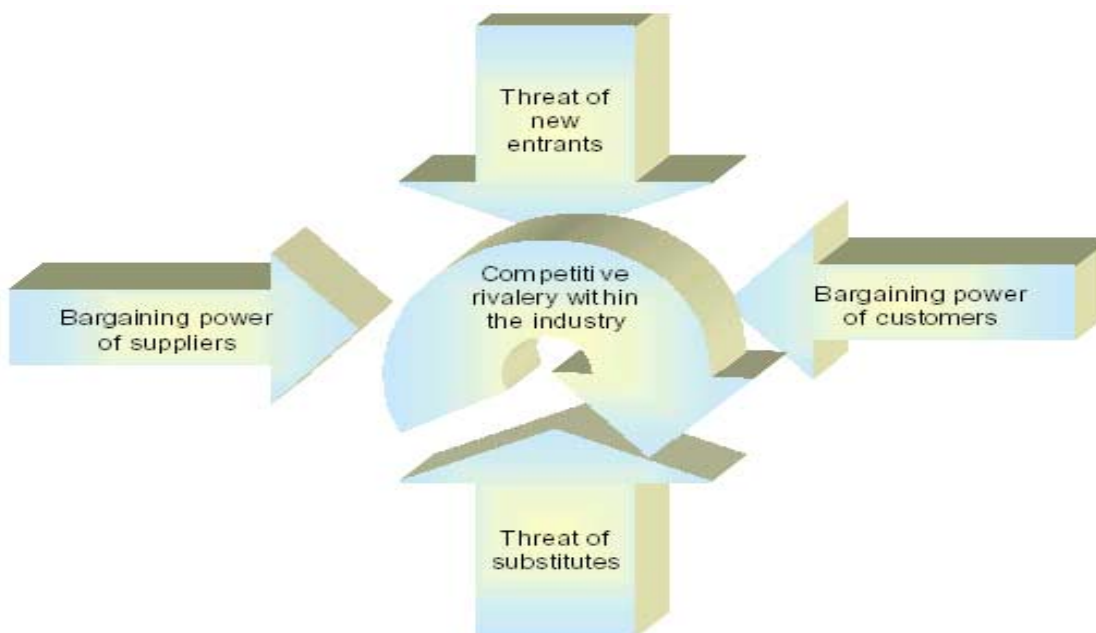
Porter's five forces is a well know and a highly used theory. In this chapter the theory is explained and then implemented on the airline industry in general and SAS in particularly.

6.1 Porters Five Forces

In 1980, Michael E. Porter, professor at Harvard Business School, developed the model of the Five Competitive Forces in his book "Competitive Strategy: Techniques for Analyzing Industries and Competitors". Since then it has become an important tool for analyzing an undertakings industry structure in strategic processes. The model is based on the idea that a corporate strategy should meet the opportunities and threats in the organizations external environment. In particular, competitive strategy should be based on an understanding of industry structures and the way they change.

According to Porters model there are five competitive forces that shape every industry and every market. These forces determine the level of competition and thereby also the profitability and attractiveness of an industry. With this model, Porter argues that the objective of corporate strategy should be to modify the competitive forces in a way that improves the position of the organization.

Figure 6.1 Porters Five Forces



6.1.1 Bargaining power of suppliers

Here, the term “supplier” includes all sources for inputs that are needed in order to provide goods or services. Bargaining power of suppliers is likely to be high when:

- The market is dominated by a few large suppliers rather than many smaller suppliers.
- No substitutes are available for the particular input.
- The supplier’s customers are small sized so their bargaining power is low.
- The costs of switching from one supplier to another are high.
- The supplier has the possibility of integrating forward in order to obtain higher prices and margins. This threat is especially high when:
 - The profitability is higher in the buying industry than in the supplying industry.
 - The supplier can achieve economies of scale by engaging in forward integration.
 - The development of the supply industry is hindered by the buying industry (e.g. unwillingness to accept releases of products).
 - The entry barriers are low in the buying industry.

In situations like these the buying industry often faces a high pressure on margins from their suppliers. An organization, finding itself in a situation where the supplier has a strong position, may run the risk of having reduced strategic options.

6.1.2 Bargaining power of customers

Similarly, the extent to which customers can impose pressure on margins and volumes is determined by their bargaining power. Bargaining power of customers is likely to be high when:

- They buy large volumes.
- There is a concentration of buyers.
- The supplying industry consists of a large number of small operators.
- The fixed costs are high for the supplying industry.
- The product that is offered is undifferentiated and can be replaced by substitutes.

- Switching to an alternative product is not related with any high costs and is relatively simple.
- The margins for the customers are low, making them price sensitive.
- Customers can produce a similar product themselves.
- The product is not of strategic importance to the customer.
- The customer has knowledge about the production costs of the product.
- The customer has a possibility to integrate backwards.

6.1.3 Threat of new entrants (keep in mind that we have discussed barriers in chapter 4... compare!)

The level of competition in an industry is to some extent determined by how easy (or hard) it is for other companies to enter the specific industry. The easier it is for other companies to enter an industry, the higher level of competition in this industry. In situations like this, new entrants could cause changes in the major determinants of the market environment like for example, market shares, prices, and customer loyalty at any time. In industries that have these characteristics there is always an underlying pressure for reaction and adjustment among the existing players. The extent to which there are barriers to entry will determine the level of threat of new entrants. Typical barriers to entry are:

- Economies of scale (minimum size requirements for profitable operations).
- High initial investments and fixed costs.
- Brand loyalty of customers.
- Protected intellectual property like for example patents and licenses.
- Important resources are scarce.
- Existing players control access to raw materials.
- Existing players control distribution channels.
- Existing players have close customer relations.
- Switching costs for customers are high.
- Legislation and government action.

6.1.4 Threat of substitutes

There exists a threat for substitutes if there are alternative products with lower prices but can be used for the same purpose. A significant proportion of the market could be

attracted to this product and thereby reduce the sales volumes for existing players. This category also relates to complementary products. The threat of substitutes is similar to the threat of new entrants. The threat of substitutes is thereby determined by:

- Brand loyalty of customers.
- Close customer relations.
- Switching costs for customers.
- The relative price for performance of substitutes.
- Current trends.

6.1.5 Competitive rivalry between existing players

This force describes the level of competition between existing players in an industry. High competitive pressure results in pressure in prices, margins, and thereby, on profitability on every single company in that industry. Competitive rivalry between existing players is likely to be high when:

- There are many players and they are about the same size.
- The player's strategies are similar.
- The players and their products are not much differentiated, hence, there is much price competition.
- The market growth rates are low, meaning that the growth a particular company is possible only at the expense of another.
- High barriers for exit. For example, expensive and highly specialized equipment.

6.2 Influencing the power of the Five Forces

After conducting an analysis of the current and potentially future state of the five forces, managers can search for options to influence these forces in a way that best suits their organization. The objective is to reduce the power of the five competitive forces. Table 6.1 provides some examples of how the power of the competitive forces can be reduced.

Table 6.1: Reducing the power of the competitive forces

Reducing the bargaining power of suppliers	Reducing the bargaining power of customers
<ul style="list-style-type: none"> - Partnering - Supply chain management - Supply chain training - Increase dependency - Build knowledge of supplier costs and methods - Take over a supplier 	<ul style="list-style-type: none"> - Partnering - Supply chain management - Increase loyalty - Increase incentive and value added - Move purchase decision away from price - Cut powerful intermediaries
Reducing the threat of new entrants	Reducing the threat of substitutes
<ul style="list-style-type: none"> - Increase minimum efficient scales of operations - Create a marketing/brand image (loyalty as a barrier) - Patents, protection of intellectual property - Alliances with linked products/services - Tie up with suppliers - Tie up with distributors - Retaliation tactics 	<ul style="list-style-type: none"> - Legal actions - Increase switching costs - Alliances - Customer survey to learn about their preferences - Enter substitute market and influence from within - Emphasize differences (real or perceived)
Reducing the competitive rivalry between existing players	
<ul style="list-style-type: none"> - Avoid price competition - Differentiate your product - Buy out competition - Reduce industry over-capacity 	

- Focus on different segments
- Communicate with competitors

7 Analysis

This chapter will be structured in the way it will begin with an analysis by using the Porters Five Forces model. This will be followed by an analysis of the answers that were received from the respondents. After this part, an analysis will be conducted by using the secondary data that has been presented earlier in the thesis. The chapter will end with a summary of the most important findings.

7.1 Assessing the Five Forces model to the airline industry

The different parts of the Five Forces model have different levels of importance, depending on which industry and which company you examine. The purpose of using this model is to give a more comprehensive picture of SAS and its external environment.

7.1.1 Bargaining power of suppliers (low)

In the airline industry, the suppliers can also be the competitors. Examples of this are travel agencies or competing airlines that have to book a flight for its customers on competitors' airplanes since they do not serve the specific route that the customer is requesting (Albertsen et al).

There are two major suppliers of aircrafts in the industry, namely Airbus and Boeing. This has created a somewhat strong position of bargaining for the suppliers since the buying industry does not have many options. However, since the buying industry does not change airplanes and air equipment so often, the suppliers of aircraft find themselves in a weak bargaining position (Albertsen et al).

Furthermore, the macroeconomic situation that prevails today has made it difficult for the suppliers to fully take advantage of their position. The recent crises in the airline industry have had negative impacts on the demand of travelling by flight, and this has made bargaining difficult for all levels of the value creating chain.

Suppliers of fuel can also be considered as suppliers to the airline industry.

As mentioned earlier, SAS is a member of the Star Alliance. The members of this alliance are planning to establish a separate jointly owned company for purchasing jet fuel (SAS A.R. 2003).

This new company will give the members a stronger bargaining position when it comes to jet fuel prices, thus lowering the bargaining power of the fuel suppliers.

7.1.2 Bargaining power of customers (high)

There are several reasons for why the bargaining power of customers is high in the airline industry. The airline industry is characterized by high fixed costs. This makes it very important for the companies to have a high and stable number of passengers in each flight. There are no major switching costs for the customers, making it easy for them to replace flight travel with other transportation carriers (Albertsen et al). This is especially true for short distance travelling.

As mentioned previously, the crises in recent years have had huge impacts on the airline industry. The demand has fallen for air travel and as a consequence of this, the customers have experienced a rise in bargaining power.

7.1.3 Threat of new entrants (medium)

In previous years legislation and government interference was one of the key factors that have shaped the airline industry. In Europe the airline industry was deregulated in the beginning of the 1990s. Prior to that, governments controlled the industry and they decided where and at what fares the airlines could fly. The threat of new entrants was almost non-existent. However, after the deregulation in Europe, the airline industry opened up for new entrants. This made it possible for other kinds of air carriers to enter the market, namely the low budget carriers. The airline industry had many new entrants during the 1990s. Thus, the threat of new entrants was high. However, the situation today is different since the market has to some extent matured and new entrants are rare. One of the factors behind this is that there are high initial investments and fixed costs associated with entry to the airline industry. This requires a strong financial position from a newly established airline company in order to be able to survive the initial period, which is characterized by high investments and no returns. Nevertheless, the risk of new entrants is still a threat to existing companies. The case of Snowflake shows just that.

7.1.4 Threat of substitutes (high)

When the airline industry was regulated, the air carriers competed mainly on service. Since the deregulation, the new entrants offered low price flights with minimum service. According to us, this can be seen as a substitute to the traditional offerings. For this reason, the threat of substitutes is considered to be high. Furthermore, there are no major switching costs for customers, making the threat of substitutes even higher.

Today, customers are allowed to choose the level of service and the price by choosing the company that best suits their preferences. Customers that only are concerned with travelling from point A to B will feel that the relative price for performance is lower when travelling with low budget airlines.

7.1.5 Competitive rivalry between existing players (high)

There are several reasons for why the competitive rivalry between existing players is high. The industry has many players that are about the same size. This creates an environment where the threat of competitors taking market shares is high.

There are two major strategies among the companies operating in the airline industry. This has put the airline companies in a situation where it is hard to distinguish themselves from the rest, and thus, created incentives to raise the competition among each other. From this, it also follows that the services that they provide are not much differentiated and this has created a situation where one part of the industry, the low budget carriers, mainly competes with prices.

Furthermore, the airline industry has suffered a drop in air travel, which has fuelled the increase in competition. The companies can only survive at the expense of other companies.

7.2 SAS influence on the power of the Five Forces

Table 1 presented the options that companies had in order to influence and reduce the power of the five competitive forces. The framework is of general nature but in the following it will be adapted to SAS. A description of the company's actions, regarding

the changes that have occurred during the last years, will be presented with the help of this framework.

Only the parts where SAS has acted according to the framework will be presented.

The threat of substitutes has tried to be influenced by SAS. As mentioned earlier, SAS is a member of the Star alliance and this has given SAS access to airports that other, non-members, do not have. In this way, SAS protects itself from direct competition with other airlines.

The Star Alliance also serves as a way to reduce customers bargaining power in the sense that customers can collect bonus and use it to travel with all members of the alliance. This is a way for the members to lock the customer to the companies (Göransson et al, 2004). The fact that members of Star Alliance are planning to establish a separate jointly owned company, who will handle the members jet fuel purchasing and distribution, is another thing that shows how SAS tries to reduce the influence of one of the five forces.

Furthermore, the Snowflake program is a way for SAS to enter the substitute market and influence it from within. By being in the low budget segment, SAS constitutes a threat to the companies within that segment and this can direct the competitor's attention towards the Snowflake operations instead of SAS's traditional operations. Another thing that SAS, and other airline companies within that segment, have tried to do is to avoid price competition. Instead, they highlight the level of service that is provided by them. However, the low budget airlines have done just the opposite and a way for SAS to avoid direct price competition with these companies has been to implement the Snowflake program.

7.3 Results from the respondents

As mentioned earlier, this is a qualitative survey and for that reason all questions that were sent were left open. In this way, we were able to go deeper into the subject and the respondents were able to argue for their statements.

Overall, the response rate was approximately 28 per cent, which is a satisfying figure. This translates into an amount of 17 respondents. However, in the following the reader must bear in mind that the opinions and arguments that are presented reflect only the opinion of the respondents that have chosen to answer our questionnaire.

The respondents can be classified into four categories depending on their backgrounds. Seven of the respondents are financial analysts that are involved in the airline industry, five of which are following SAS in particular. Three of the respondents are professors that have been studying the airline industry during the recent years. Two of the respondents are managers of competing low-cost carriers in the Scandinavian market. Finally, the last response that we received was filled in by two managers at SAS, namely the head of Investor Relations and the CFO.

All respondents can be considered to have expertise knowledge within the airline industry and are therefore considered to be reliable. However, the reader must bear in mind that all of them are not considered as being fully independent. The answers from SAS and the competitors run the risk of being partial. For this reason, answers might reflect best or worst case scenarios depending on the subject. However, this risk is considered to be small since respondents have all given arguments for their statements, arguments that deserve to be compared with the arguments of other respondents. Nevertheless, their answers will be reviewed with specific attention.

The questionnaires sent to SAS and the analysts included same questions in most cases. A few extra questions were added to the questionnaires that were sent to the analysts (compare appendix 1 and 2).

Was launching the Snowflake program the best option for SAS?

As mentioned earlier, analysts disagree in the discussion of whether or not it is wise for a traditional airline to enter the low-cost market. The results that were received from the respondents give further support to this statement.

Four out of fifteen respondents stated that it was the best option, while ten of the remaining respondents argued that it was not. One respondent had no opinion about it and one did not state whether or not it was the best option. She simply stated that it was the only option SAS had at that time.

Against the launching of Snowflake

Even though George H. Stinnes, manager of investor relations at British Airways, did not provide an answer that discussed SAS and Snowflake in particular, his statement is important for answering this question. He stated that, ever since British Airways started to completely focus on its core business, both the customers and the staff has experienced a total clarity of the company's activities. "It was only once we sold GO and focused on our core issues and how we positioned our short-haul product that we were able to turn around the business".

John Mattimoe, an analyst from Merrion Capital, supports the statements made by Stinnes by stating that flag carriers ultimately fail to succeed in the low fare market. He argues that the cost structures and cultures are too different. He continues by arguing that SAS should instead have reacted by reducing costs and focusing on their core strengths, namely being as efficient as possible and providing quality service to its major airports at reasonable prices. Furthermore, he also argues that SAS should simplify its core product and make it more flexible.

Finn B. Petersen, an analyst from Nordea, is also among the respondents that argued against the launching of Snowflake. He argues that Snowflake has the same cost structure, except for the Internet sales, as Scandinavian Airlines has. This means that Snowflake is operating with higher costs than its competitors. According to him, SAS is confusing the market with its different brand names. Instead its focus should primarily be in lowering the overall costs and keep it simple by just having one name, SAS.

Dr. Darin Lee from Cambridge argues that it would have been the best option, if Snowflake had meaningful cost advantages over SAS. Since this is not the case, he also feels that it was not the best option for SAS to implement the Snowflake

program. He goes on to argue that the only other option that SAS had was to lower its overall cost structure.

Harumi Ito, professor at the Brown University, shares the opinion that it was not the best option that SAS had when it implemented the Snowflake program. He argues that none of the similar attempts made by large hub-and-spoke carriers have been successful. Furthermore, he argues that the low cost brands tend to inherit the high operating cost structure while margins are diminishing.

Per Haagensen, analyst at Fondfinance ASA, also argues against Snowflake. He argues that the Snowflake program was a “quick and dirty solution” and says that the Turnaround 2005 is much more far reaching in terms of reducing the cost base permanently. However, he says that there are also positive effects that have emerged from the Snowflake program. It has given SAS some experience in the operations of low-cost carriers, even though Snowflake is not really a low-cost airline like Ryanair, etc.

Stefan Vilner, Commercial Director of Sterling, argues that the Snowflake program has been harmful for SAS since the “entire market bottomed out on prices and SAS was forced to lower their prices on traditional business routes as well “. He continues by arguing that SAS is now positioned in the middle ground, offering fares that often are considerably lower than Snowflake’s. This has, according to him, reduced the credibility in both brands.

Steven Furlong, analyst at Davy industries, states that SAS should have focused in bringing down the unit costs of the Group and remained focused on the core product. He goes on to argue “The number of successful low cost airlines within a larger organization to date is, frankly none”.

Désirée M van Gorp, assistant professor of International Business at the University of Nyenrode, states that it was not the best option for SAS. He argues that SAS should have focused on increasing its competitive advantage as a flag carrier, eventually through alliances.

Toni Schonfelder, states that this was another bad decision from SAS, even when you take into consideration the company’s agreements with its pilots and other agreements. He argues that it would have been better for SAS if it had used one of its subsidiaries instead. According to him, SAS should have taken for example Braathens or Spanair and profiled it as a low cost carrier and let it operate under its

own terms. He continues to argue that SAS now, have miss-matched its operations and, because of that, money are flowing out of the company.

For the launching of Snowflake

Brian Borsting, analyst at Jyske Bank, states that it was the best option for SAS to implement the Snowflake program. He has two main arguments for his statement. The first is that the Snowflake program will put pressure on the rest of the SAS Group to cut costs. The second argument is that Snowflake will help to defend the home market and the point-to-point flights and thereby keep other low-cost carriers away from this market.

Preben R. Olsen, analyst at Handelsbanken, also argues that Snowflake was the best option. His arguments are, however, different from Brian Borsting's. Preben argues that SAS wanted to show the unions that they were ready to make big changes unless the unions accepted the managers requests of lowering the company's labour costs. Since the unions had such a big saying, alternatives had to be in place. In other words, because of the strong position that unions had, SAS had to deviate from the original plan of strictly focusing on the Turnaround 2005 program. He also mentions that the Snowflake program has given, and will continue to give, SAS a valuable experience.

Steven Franck, analyst at Morgan Stanley, believes that SAS did the right thing in implementing the Snowflake program. He argues, however, that SAS did not really have much of a choice since the market has become very tough in Scandinavia.

Neither for nor against

Two of the respondents did not give any clear opinions on whether or not the implementation of the Snowflake program was the best option.

Anne Grete Ellingsen, information manager at Norwegian, stated that SAS wanted to compete on the low-cost market and that this was the only option SAS had to do so. However, she argues that Snowflake's cost structure is not on the same level as Norwegian's is.

Miguel F. Anjos, PhD from University of Southampton, did not answer the question clearly. His statement was "It is not clear what is "best" in this context". For that reason, we obviously cannot determine his opinion regarding this specific question.

What was the main reason for investing in Snowflake?

These answers are difficult to divide into different categories since they differ so much between each other. Some of the respondents chose to answer only a part of the question, making it even more difficult to categorise them. For those reasons, the answers will be presented in one part. However, four of the respondents had relating arguments concerning the main reason for implementing the program. According to these respondents, the main reason for implementing the Snowflake program was to protect the home market from other low-cost carriers.

The order of the answers intends to follow relating arguments. This will make it easier for the reader to follow the discussion.

Björn Tibell and Gunnilla Berg, manager of investor relations and CFO at SAS, stated two motives for the implementation of the Snowflake program. The main motive was that SAS wanted to test a new concept in the organization and challenge old business models. They wanted to see how customers react when they have to pay onboard, and how the new price concept drives demand. The secondary motive was that the Snowflake program was strategic in the sense that Snowflake's current market was not previously served by SAS and therefore fully open for competitors.

Petersen refers to what he has heard from SAS and states that the main reason was to do marketing testing. However, he is sceptical to that reason and wonders if marketing testing was the initial purpose of implementing the Snowflake program. He argues that Snowflake was not a good investment since the load factor is below the 80 per cent level, which is needed to make a profit if Snowflake would have the same cost base as other low-cost carriers. Furthermore, he argues that Snowflake does not have the same cost base as other low-cost carriers and, because of this, not even a load factor of 80 per cent is enough for Snowflake to make a profit.

When faced with this question, Haagensen gives us the following statement: "Snowflake does not report numbers separately and we really only know that Snowflake reduces the yield of the SAS Airline operation".

According to Ito, the main purpose of investing in the Snowflake program was to "counteract the low-cost carrier entries and expansions". He goes on by arguing that SAS probably wanted to isolate the high-end customers who are willing to pay extra for convenience and luxury. He suspects that Snowflake was intended to be used as a customer segmentation tool with marketing primarily focused towards the price

sensitive customers, while SAS would continue to charge higher prices to its high-end customers.

Anjos argues that the main reason for implementing the Snowflake program was clearly the need to compete with low-cost airlines.

Mattimoe also argues that the main purpose of the program was to counteract the growth of the low cost airlines. He argues that Snowflake can only be considered to be a success if it is sold early once it meets its initial success in attracting passenger volumes. He gives an example by mentioning British Airways, who did just that with its low cost subsidiary GO. The reason why SAS should sell Snowflake in an early stage is that “the low-fares subsidiary of a full-service airline in time gets contaminated by the bad practices of the parent”. An example of this is that the staff will look for the same terms and conditions as the staff from the parent company. Since low cost carriers are more concerned with cutting costs, the employees in those companies will never get the same conditions as the ones that work for a traditional carrier.

According to van Gorp, the main purpose for implementing the Snowflake program was to survive in a fierce competitive environment.

Borsting argues that the primary goal of the Snowflake program is to defend the home market against more low-cost competition and thereby support the network business within Scandinavian Airlines. For this reason, it is enough if Snowflake achieves a break-even result in order to call it a success. According to him, the fact that Snowflake has put pressure on the other airlines within the Group, especially Scandinavian Airlines, strengthens the statement that the program was a good investment.

Brooker argues that the main purpose of launching the Snowflake program was to get an insight into the operations of a low-cost carrier. He argues that SAS needed this insight since the company needed to benchmark. The managers at SAS wanted to compare ground handling, etc to market prices. Furthermore, he argues that, since SAS was able to structure a new deal with the unions on the back of best practise at Snowflake, the investment has been very successful for SAS, despite a loss.

Franck gives a similar explanation to Brooker’s by stating that the main reason for the investment was to learn about the operations of a low-cost carrier. Furthermore, he states that another reason for the investment was to try to stem some of the losses to others in the market.

According to Olsen, the main reason for implementing the Snowflake program was that, since the unions were so powerful, SAS had to find other ways to cut costs and show them that the company would make large changes unless they accepted the demands from the managers. Because of the strong position that the unions had, managers at SAS did not fully believe that the goals set for Turnaround 2005 would be achieved. For this reason, alternatives had to be in place. Based on the load factors, Olsen believes that Snowflake is close to achieving its goal.

Schonfelder says that the managers at SAS have missed the development of the airline industry since the deregulation in the mid 90's. And because of this, they got involved in the low cost market, a market in which they lack competence and a skilled management. He finally states that Snowflake has a load factor of below 50 per cent, which is an economic disaster.

Vilner argues that the main intention of the Snowflake program was to enable SAS to dump prices without damaging the SAS brand.

Grete did not answer the main question. However she states she did not believe that SAS had achieved its goal with the Snowflake investment. She does not give any arguments for this statement. Furthermore, she does not think that the Snowflake program was a good investment. The reason for this is that, according to her, the program confuses the market.

The rest of the respondents either had no opinion regarding this question or gave an inconclusive answer.

Why should SAS succeed when most similar attempts have failed?

Examples of British Airways and KLM's attempts were given in questions.

The answers from this question divided the respondents into two groups, one that thought that Snowflake would fail and one that did not agree with this statement. Ten of the respondents believed that Snowflake, in one way or another, is bound to go the same way as most similar previous attempts made by other traditional carriers, that is to say, it is bound to fail. The arguments for why it is bound to fail, however, differ from one another.

Snowflake will not succeed

Petersen answered this question by simply stating the Snowflake program is already dead.

Haagensen states that there is no reason to expect that this case will be different from previous cases.

According to Furlong, the Snowflake program will be closed. However, he argues that Snowflake will not be sold to its competitors since Ryanair and easyJet only wants to grow in the Scandinavian market organically. He states that the only reason Ryanair bought was to get access to slots at Stansted.

Vilner from Sterling states that Snowflake will fail. His main argument for this statement is that, since Snowflake is not a subsidiary to SAS, it cannot act freely and compete on the routes it may wish to do. For this reason, Snowflake will most probably fail.

Haagensen states that there is no reason to expect that Snowflake will be different than other similar previous attempts. In other words, the Snowflake program will probably fail.

Mattimoe also states that Snowflake will most probably fail. He refers to his first answer and says that the best option for SAS is to sell Snowflake as soon as possible.

According to Brooker, Snowflake will not be a part of SAS for long. The operation will close. To back this statement, he argues that more than two million passengers at SAS Airlines flew at SEK 600 or less per one-way ticket in 2003. Because of this, "SAS Airline is de facto the largest low-cost carrier in Scandinavia". In other words, Snowflake will not be needed in order for SAS to sell low price tickets.

Gorp expects that Snowflake will go the same way as other similar previous attempts made by other traditional carriers. However, he gives no arguments to why he expects this to happen.

According to Schonfelder, SAS has already passed British Airways losses when it comes to these companies' attempts to break in to the low-cost market. He argues that are few companies in the world, regardless of which industry they operate in, that have succeeded in keeping a high-price profile and at the same time run a low-price activity. He gives examples of the shoemaking industry and the grocery industry, in which there are companies that operates in both segments. However, in these cases there is no connection between the two activities of the company.

Frank states that he would not be surprised if Snowflake would be sold. He argues that, historically many of the large airlines have had difficulties to adapt to a small company approach.

Without giving any arguments for her opinion, Grete states that the Snowflake program is bound to go the same way as most similar previous attempts.

Snowflake will succeed

Anjos states that Snowflake appears to be reasonably successful but it is too early to tell whether or not Snowflake will be successful.

According to Borsting, SAS will not sell Snowflake. He argues that Snowflake is different from Go fly and Buzz in the sense that Snowflake is much more integrated in the Group than the other two ever was. Snowflake is more important to SAS than Go fly and Buzz was to respective parent company. Moreover, Snowflake is different in the sense that it focuses on short-haul European routes whereas Go fly and Buzz mainly focused on long-haul flights to the US and Asia.

Olsen states that British Airways is more affected by business travellers, especially on North American routes. For this reason, Go fly probably did not give the same benefits to British Airways as Snowflake does to SAS. He does not believe that Snowflake will be sold to competitors. In worst case, the brand will be translated back into SAS.

Will the Snowflake program affect the behaviour of the customers? If so, how?

There are two options on how to present the order of the answers. The first option is to divide it depending on whether or not the respondents believed that SAS has lost customers to Snowflake. The second option is to divide it depending on whether or not the respondents believed that the Snowflake program would confuse the customers. Since most of the respondents chose to answer the first question, the order of the answers will be presented by following the first option.

Nine of the respondents argued that SAS has lost customers to Snowflake. However, the degree to which it has done varies among them. Three of the respondents did not believe that SAS has lost customers to Snowflake.

SAS has lost customers to Snowflake

According to Tibell, manager at SAS, cannibalisation has been very limited since Snowflake does not operate on the same routes as the regular Scandinavian Airlines operations. He states that there have been cases with confusion on expected service levels with Snowflake, but that was mainly because Snowflake did not have a separate homepage. Since Snowflake introduced its own homepage and booking number, the cases of confusion among customers have decreased.

Ito believes that SAS could lose customers to Snowflake. However, he argues that this would be within a very limited level since most customers that usually travel on business/first class (or other preferred customer status) are likely to continue to do so.

Frank expects that SAS will lose customers to Snowflake. However, he does not believe that the conflicting brands will confuse customers.

Haagensen states that there clearly is room for cannibalisation although there are not many overlapping routes between SAS and Snowflake.

Furlong gives a similar statement to Haagensen's by saying that there is always some revenue cannibalisation in these kinds of projects.

According to Gorp, SAS has lost customers to Snowflake. Moreover, he also believes that the customers will get confused in their expectations on both parts.

Borsting believes that SAS has lost some customers to Snowflake. Furthermore, he states that SAS will have to lower the price in some Scandinavian Airlines routes as well because of Snowflake. He argues that SAS has no other choice if the company wants to defend the home market. Borsting believes that some customers will get confused with the different brands, but not to a large extent.

According to Anjos, it is very likely that SAS has lost customers to Snowflake. However, he argues that it is better to lose the customers to Snowflake than to lose them to competitors. He also states that it is very likely that customers will get confused by the different brands, but that could have both positive and negative effects. He does not provide with examples of what these positive and negative effects could be.

Mattimoe gives a similar answer to this question. He states that the customers that SAS has lost to Snowflake would probably have been lost to Ryanair or easyJet instead. Furthermore, he believes that customers will be confused and he refers to the previous attempts of GO and Buzz where the customers

Grete states that SAS has lost customers to Snowflake and she also believes that the different brands will confuse the customers. However, she does not give any arguments to support her opinion.

The same goes for Stinnes, who also agrees that SAS has lost customers to Snowflake and that the customers will get confused because of the different brands. He does not provide with arguments to why he believes that.

SAS has not lost customers to Snowflake

Vilner does not believe that SAS has lost customers to Snowflake since they operate different routes. However, he argues that there is a strong possibility of confusion between the two brands. Furthermore, he argues that he could not see any differences in service after having flown with both SAS and Snowflake.

Olsen states that he believes in the hybrid operation that exists between SAS and Snowflake. He continues by arguing that customers should be able to understand the difference between a low cost carrier flying to Europe and Scandinavian Airlines flying domestically and intra-Scandinavian. In other words, the different brands will not confuse customers. However, he argues that SAS still has a long way to go in order to both implement and communicate the strategy to customers and the financial community.

According to Brooker, SAS has not lost customers to Snowflake. He does not give any motivation for this statement. However, he believes that SAS will lose customer loyalty unless it changes its strategy and focuses only on one brand.

Petersen answered only the second part of the question. He states that the customers are already confused by different brand names within the company like Scandinavian Direct, SAS Pleasure, Snowflake, etc. He argues that all operations should be called SAS and instead, the company should focus on lowering the cost structure.

Which part, SAS or Snowflake has better prospects to survive in the long run?

The responses from this question are classified into three categories. The first category includes the respondents that believed SAS had better prospects to survive in the long run. Eight of the respondents were classified within this category. The second category includes the respondents that believed that both parts had good prospects of surviving in the long run. These constituted a total amount of two. The third category includes the respondents that believed that neither SAS nor Snowflake had any prospects of surviving in the long run. Three of the respondents were classified into this category.

SAS has better prospects to survive in the long run

Petersen states that SAS has better future prospects. However, he does not give any arguments for why this should be the case.

Brooker argues that SAS will be the one that remains after unit costs at Scandinavian Airlines have been reduced significantly.

Based on the Turnaround 2005 program, Olsen believes that SAS has better future prospects of surviving.

Ito believes that SAS will survive, but probably at a smaller scale. He states that he has not seen the operating cost spreadsheet for Snowflake but judging from similar ventures from other large carriers, Snowflake will not have a viable future.

Haagensen argues that SAS has better prospects to survive in the long run. He argues that Snowflake is only a small part of SAS operations and could very well be sold or closed in the future.

Furlong states that SAS has better future prospects. However, he does not give any arguments to his opinion.

Gorp also states that SAS has better future prospects without giving any arguments for his statement.

According to Grete, SAS has better future prospects. She does not explain, however, why she has that opinion.

Franck also believes that SAS has better future prospects, and as in the previous, he does not give any arguments to his statement.

Both SAS and Snowflake has potentials to survive in the long run

Stinnes argues that there exists potentials for both parts, but only if they do not operate under the same roof.

According to Lee, both parts have the potential to do well in the future. He argues that Snowflake can never replace SAS on its long-haul international routes and SAS will likely never achieve Snowflakes cost advantage on short-haul and medium-haul routes. Because of these reasons, both parts can coexist and feed passengers into each other's network.

Neither SAS nor Snowflake has potentials to survive in the long run

Schonfelder believes that neither SAS nor Snowflake have any positive future prospects. He believes that SAS will be gone in five to eight years, and Snowflake will be cancelled even earlier than that. He states that SAS has passed the point of no return and the whole company is faced with the risk of being closed. Schonfelder gives several arguments for these opinions. He argues that the struggle that exists among the different Scandinavian countries within SAS has hurt the company. The fact that SAS has been divided into different brands was a huge mistake according to him. The reason for this is that Snowflake could never be a competitor since SAS flies frequently to most destinations and is appealing to a completely different customer segment. Moreover, he argues that the managers at SAS are ignorant and lacks clear goals. The company has huge problems with the unions, who, according to him, are SAS main enemies. He concludes his arguments by stating, "Their (SAS) attitude that the government shall pay the losses is getting out of time".

Mattimoe states that none of the two parts have any good future prospects. He argues that Snowflake is not competitive enough to sustain as a low fare airline if it is as a brand within SAS. However, he believes that it might have a chance to survive, but only outside the ownership of SAS. Furthermore, he argues that SAS might have a better chance to survive, but only if the company radically tackles its cost base. Otherwise it will most likely be consolidated into Lufthansa.

Vilner also states that neither one of the two will survive looking the way they do today. However, he states that SAS is a company and Snowflake is a brand.

If Snowflake would be discontinued, will the gap it leaves behind go straight to the competitors and leave SAS worse of than before?

The respondents are classified into two categories, the ones that believe the gap Snowflake leaves behind will go straight to the competitors and leave the company worse of than before, and the ones that did not believe this would happen. A total of seven respondents stated that they believe the gap left by Snowflake will not go straight to the competitors. The remaining five respondents believed that Snowflake's old market shares would go straight to the competitors.

The gap that Snowflake would leave behind will not go to the competitors

According to Petersen, the gap that Snowflake leaves behind will not go to competitors and leave SAS worse of than before. "SAS just has to reduce costs so that they can offer low prices with a profit."

Olsen states that the market share Snowflake would leave behind would not go to the competitors. He argues that SAS Airlines would have a good chance to retain Snowflake's old customers if they launched a new website.

Ito states that SAS will have to lower its coach fares if Snowflake would be discontinued and thereby keep Snowflake's old market shares. Furthermore, he argues "such fare reduction may partly cut into their profit margin for the high-end customers as well".

Haagensen states that, since the competition is so intense in the low-cost market, he fears that there will be limited profitability in that segment. "A potential gap left by Snowflake will be filled given that there are enough customers willing to fly at profitable prices."

According to Furlong, SAS will not be in a worse situation than it was previous to the Snowflake program. He argues that SAS will instead be stimulated to lower costs in a lower yield environment.

Gorp does not believe that the gap that Snowflake would leave behind, if it were discontinued, will go to the competitors. However, he does not give any arguments for his opinion.

Without giving any specific arguments, Olsen believes that the situation will be pretty much the same as before if Snowflake would be cancelled. Franck believes that the gap will be filled by SAS.

The gap that Snowflake would leave behind will go to the competitors

Vilner expects that the gap that Snowflake would leave behind, if it were to be discontinued, would go straight to the competitors and leave SAS worse off than before. However, he does not provide with any arguments to these opinions.

Lee believes that SAS would be worse off than before, if Snowflake would be discontinued. He has two arguments to support this statement. The first is that SAS would then have spent a lot of resources to build a brand that no longer exists. The second argument is that SAS would have to reintroduce its traditional operations and this transition would be costly.

Mattimoe is also among the respondents that believe that the gaps will go straight to the competitors and leave SAS in a worse position than before. However, he states that this would not affect SAS to a large extent since short haul point-to-point routes will no longer be a target that is profitable for traditional service airlines. He argues that SAS and other traditional airlines should give up this end of the market and focus on connecting the short haul passengers with long haul services. Furthermore, they should also focus on time sensitive travellers who want to go to major airports.

Grete gives a short answer to this question by stating that a new competitor would enter the market if Snowflake would be discontinued.

Anjos believes that traffic loss is possible in case Snowflake would be discontinued. However, he argues that the magnitude of the traffic loss would depend on how much Snowflake's fares are cheaper than SAS.

Do you expect Snowflake to make a profit in the nearest future? If not, what will need to be changed in order to do so?

The answers from this question are classified into three categories depending on the nature of the answer. The first category includes the respondents that believed Snowflake never would make profits. The total amount of respondents that were classified into this category was five. The second category includes the respondents that believed that Snowflake would make a profit in the near future. Only one respondent was classified within this category. The third includes the respondents that thought that Snowflake could make profits in the near future, but certain things had to be changed first. The total amount of respondents that were classified into this category was two. Ito did not really answer the question. Rather, he gave his opinion

on the difficulties that exist among traditional carriers to make profits within the low-cost market in general. His answer is included in the last category.

Snowflake will never make a profit

Petersen states that SAS does not provide separate accounts for Snowflake, which makes it difficult to follow its development. But he does not believe that Snowflake will make any profits since he considers the brand to be “dead, already”.

As mentioned earlier, Schonfelder believes that SAS will be closed within five to eight years. Considering this statement, it is not so surprisingly that he believes that Snowflake will never make any profits.

Furlong answer to this question was: “I do not expect Snowflake to ever make a profit”.

Gorp does not believe that Snowflake will make any profits in the near future. He gives, however, no arguments for his statement.

Vilner argues that Snowflake operates under the SAS cost structure, selling fares at low prices with a low yield. For this reason, Snowflake will never make profits.

Snowflake will make a profit in the near future

Borsting’s regarding this question is that he believes that Snowflake will break even in 2005, and in 2006 Snowflake will make a profit.

Snowflake has possibilities to make profits but after changing certain things

Olsen states that Snowflake would reach breakeven in 2005, if SAS keeps it until then. Furthermore, he states that, by adding more routes to its operations, Snowflake will be able to become profitable.

According to Stinnes, the future potential profits for Snowflake depends on how many other low-cost carriers will enter the market.

Mattimoe argues that needs to lower its cost base and improve its efficiency in order to make profits.

Ito believes that it is very hard for a large network carrier to start a successful low-cost carrier. One of the key reasons for this is that low-cost carriers often have completely different labour relations and practises. The presence of large and powerful unions and relatively inflexible contracts and regulations, often make it

difficult for the traditional airlines to build different labour relations only for their low-cost operations.

7.4 Analysis of the arguments

As mentioned earlier, nine of the respondents believed that SAS should not have implemented the Snowflake program. The arguments that were received vary in strength since some are explained in more detail than others.

Even though Stinnes, the manager of Investor Relations at British Airways, did not refer in specific to SAS and Snowflake when he answered the first question, his arguments are considered to be relevant when discussing the first question.

Stinnes argues that, once British Airways started to completely focus on its core business, the customers and the staff experienced a total clarity of the company's activities. Only when British Airways sold GO, the company was able to turn around the business.

The first reason why we find these statements to be the most valid ones is the fact that British Airways has a lot of experience within the field of traditional carriers that try to enter the low-cost segment. The lesson that British Airways learned was that a network carrier should focus its complete attention on its core business. Otherwise, it will not be successful. Since SAS has done the opposite, we believe that this was not the best option for SAS. To strengthen our opinion, several other arguments are at hand. To begin with, no other company has succeeded with similar attempts in the past. The fact that Snowflake more or less has the same cost structure as SAS, but has to compete by selling tickets at low prices, speaks against the launching of the program. Furthermore, the different brands have, according to several respondents, confused the market. Because of this, SAS best option would have been to focus on lowering the overall costs and keep it simple by just having one brand. In other words, SAS should, according to us, instead have focused completely on the Turnaround 2005 program.

There are arguments that speak in favour of Snowflake as being the best option. The fact that Snowflake has put pressure on the rest of the Group to cut costs can be seen as a positive effect, which is an argument that Snowflake may have been the

best option for SAS. However, we disagree with this argument since we believe that Snowflake was not necessary in order for SAS to cut costs. SAS could have put cost cutting pressures on the Group without investing in the Snowflake program. Furthermore, the only difference that Snowflake has regarding the cost structure, compared to the rest of SAS, is the fact that it sells most of its tickets through the Internet. Since Snowflake has almost the same cost structure as SAS, it is not able to put any cost pressures on SAS. Another argument that has been stated to speak in favour of Snowflake is that Snowflake has helped defend the home market. We do not believe that Snowflake has done so since SAS sold two millions tickets for SEK 600 or less in 2003, from which only five percent were sold through Snowflake. This means that SAS Airlines sold almost all of the low-price tickets in 2003, making the fact that Snowflake is not needed more obvious. Based on the fact that SAS is offering prices that are the same or lower than Snowflake's prices, we do not believe that Snowflake is needed to defend the home market.

Even though the argument that SAS needed Snowflake to show the unions that they were ready and capable to take actions is valid, there are other arguments that speak against this statement. The fact that traditional carriers cannot expect to create or build new relationships based on the implementation of a new brand or subsidiary, speaks for the argument that SAS was not able to change its relationship to the unions. Furthermore, there is no reason to believe that SAS did not fully believe that it would be able to reach its goals for Turnaround 2005. A fact that argues for this statement is that SAS has reported that its Turnaround 2005 program is ahead of the plan (skandinavian.net, May 4 2004).

According to us, the main reason for implementing the Snowflake program was to enable SAS to dump prices without damaging the SAS brand. SAS has most certainly done just this, when the fact that it sold two million tickets for SEK 600 or less in 2003, is considered. By implementing Snowflake, we believe that SAS has focused the attention of the market on Snowflake and at the same time it has dumped prices itself. As Snowflake is not a subsidiary, it does not have to provide with financial results in separate accounts.

Some of the respondents argued that the main reason of the Snowflake program was to defend SAS home market. As stated in the previous part, we do not believe that this is the case. Snowflake constitutes only a small part of SAS overall operations and is thus not large enough to compete with the larger low-cost carriers. Furthermore, it does not have the low cost structure that the competitors within the low-cost segment have, meaning that Snowflake is not fit to compete and protect the home market.

The managers at SAS state that the purpose of implementing the Snowflake program was “to test a new concept in the organisation and challenge old business models” (answer from B. Tibell). We do not agree with this statement because of various reasons. To begin with, SAS did not have to implement the program in order to form an opinion about which advantages or disadvantages the program would create. SAS could have done an extensive research and studied other companies that had made similar attempts in the past. This would have saved a lot of time and money for the company and the possible advantages and disadvantages would be clear to SAS.

To begin with, we must consider how SAS and their Snowflake program differs from other attempts of traditional carriers, confronted with competition from LCC. In a broad perspective, SAS faces the same problems as other flag carriers. In our comparison we haven chosen to compare SAS and the Snowflake program to BA and KLM and their low budget subsidiaries, namely Go and Buzz. However, it must be noted that this comparison is not perfect. Then again, no comparison is. According to Björn Tibell, no perfect comparison can be found to SAS’s reaction and their low budget brand. Comparing the similar strategies, we can ask the question; is Snowflake more likely to be successful as a low budget brand compared to low budget subsidiaries? In prior attempts by other traditional airlines it has been considered to be a problem for both parties when a subsidiary is positioned to close to the mother company, more specifically the main brand. In the case of Go and BA, Go was situated as far from the BA as possible, leaving BA with no control of Go’s operations. Go operated freely and remained successful at the same time. However, Go’s operations affected BA and their core business in a negative way, leaving them no resort other than selling Go and re-establish their main operations. Hence, despite Go’s independency and location far from the mother company, BA’s core brand was

still affected. In the case of Snowflake, it is situated within the mother company, as it is only a low budget brand. Hence, Snowflake does not have the same independency as Go, reducing its ability to seek profits and become a success. Snowflake has to cope with the high cost structure of SAS, leaving them no chance of ever making profits. For that reason, our group expects Snowflake was never indented to make profits, presumably a “break-even” as their best-case scenario.

Ever from the launch of Snowflake, confusion of customers has been considerably high. Regarding to Björn Tibell, cases of confusion decreased since Snowflake’s own homepage and booking numbers were introduced. However, our group considers the fact that SAS itself, is offering same prices, and in some cases even lower prices than Snowflake, decreases the credibility in both products and at the same time confuses the customer.

The arguments that have been in this chapter have one main thing in common; they speak against the idea that Snowflake was a good investment. The arguments are considered to be valid and most relevant to the subject. For these reasons, our final conclusion is that the Snowflake program was not a good investment. SAS should have focused on lowering the overall costs instead of going ahead with the Snowflake program.

8 Conclusion

As mentioned in the very beginning, the task has been to determine whether or not the Snowflake program was a good investment.

The following conclusions have been used when deciding on whether or not the investment was good:

Launching the Snowflake program was not the best option that SAS had. The best option would have been to focus completely on lowering the overall costs of the SAS Group.

The main reason for implementing the Snowflake program was to enable SAS to dump prizes without damaging the SAS brand.

Since SAS offers flights to same or lower prices than Snowflake, the credibility in both brands has decreased and the customers have gotten confused over the conflicting brands.

To finalise, the concluding statement is, the Snowflake program was not a good investment.

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Appendix 1

Questionnaire sent to SAS

Main reasons for the Snowflake investment:

- What was the main reason for starting Snowflake?

- Consider the case of BA & Go fly, and the case of KLM & Buzz. In both these cases the flag carriers failed to run these low budget carriers as subsidiaries. Eventually both these subsidiaries were sold to their main rivals on the low budget market, namely easyJet and Ryan Air.
 - o Do you fear that Snowflake and SAS will go the same way?
 - If not, why should this case be any different?

Affects on SAS:

- Do you think running Snowflake as a subsidiary of SAS will affect the behavior of regular customers of SAS? For example:
 - o Do you think SAS will lose customers to Snowflake?
 - o Do you think customers will get confused in their expectations to either company; SAS prices will seem to expensive / Snowflakes service may seem to poor compared to SAS?

Future prospects of Snowflake:

Will Snowflake be discontinued if it fails to generate profits within the next two years?

Thank you for your time and effort!

Appendix 2

Questionnaire sent to financial analysts, competitors of SAS and Snowflake and to the professors.

Traditional airlines and their reactions to increased competition from low budget carriers

- Do you think SAS reaction to increased competition from low budget carriers, to start the Snowflake subsidiary was their best option?
 - o If not, how should they have reacted?

- What do you think was the main reason for their investment?
 - o Do you feel SAS have achieved their goal with the Snowflake investment?
 - o Do you think Snowflake is a good investment?

- Consider the case of BA & Go fly, and the case of KLM & Buzz. In both these cases the flag carriers failed to run these low budget carriers as subsidiaries. Eventually both these subsidiaries where sold to their main rivals on the low budget market, namely easyJet and Ryan Air.
 - o Do you expect that Snowflake and SAS will go the same way?
 - If not, why should this case be any different?

- Do you think running Snowflake as a subsidiary of SAS will affect the behavior of regular customers of SAS? For example:
 - o Do you think SAS will loose customers to Snowflake?
 - o Do you think customers will get confused in their expectations to either company; SAS prices will seem to expensive / Snowflakes service may seem to poor compared to SAS, etc?

- In the long run, which company, SAS or Snowflake, do you think have better future prospects?

- If Snowflake will be discontinued, do you expect that the gap Snowflake leaves behind goes straight to the competitors and leaves SAS worse of than before?

- Do you expect Snowflake to make a profit in the nearest future serving current routes or will there have to be structural changes?

Thank you for you time and effort!