CASE STUDY

Ryanair: the low-fares airline – future directions?

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Ryanair, the first and largest budget airline in Europe, has enjoyed remarkable growth and success. However, are Ryanair's strategic business model and its implementation robust enough to withstand the challenges it faces in its environment, notably economic recession and uncertainty about fuel prices? The case illustrates how to analyse and deploy internal resources and capabilities to add perceived value to customers, thereby delivering sustainable strategic advantage. It also explores the difficulties that hamper achieving and retaining such advantage. The reader is invited to devise and evaluate strategic options for Ryanair, including elements of corporate strategy in relation to its attempts to take over Aer Lingus, the Irish national carrier.

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'The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines. Here a durable competitive advantage has proven elusive ever since the days of the Wright Brothers. Indeed, if a far-sighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favour by shooting Orville down.'

Warren Buffett, annual letter to
Berkshire Hathaway shareholders, February 2008

Source: Press Association Images

While the words of Warren Buffett were generally true, as airlines had seen no economic profit over a 40-year period to 2012, there were exceptions. Most noteworthy was Ryanair, the Irish budget airline, which had been consistently reporting earnings in excess of 20%. With 76 million passengers in 2012, Ryanair nominated itself as the world's favourite airline, since it carried more international passengers than any other airline.

The question was whether Ryanair could continue to defy industry trends that had caused so much distress to its competitors. In January 2010, CEO Michael O'Leary had observed: 'The environment is, from Ryanair's perspective, great, because it is awful. We're doing remarkably well because this is the time when the lowest-cost producer wins.'

Would this still continue to be the case?

Overview of Ryanair

As of July 2012, Ryanair ran more than 1,500 flights per day from 51 bases on 1,500 routes across 28 European countries, connecting over 165 destinations. It operated a fleet of 294 new Boeing 737-800 aircraft with firm orders for 11 new aircraft to be delivered over the next year.

Ryanair was founded in 1985 by the Ryan family to provide scheduled passenger services between Ireland and the UK, as an alternative to the then state monopoly airline, Aer Lingus. Initially, Ryanair was a full-service carrier, with two classes of seating, leasing three different types of aircraft. Despite growth in passenger volumes, by the end of 1990 the company had disposed of five chief executives and accumulated losses of IR£20 million.[1] Its fight to survive in the early 1990s saw the airline transformed to become Europe's first low-fares, no-frills carrier, built on the model of Southwest Airlines, the successful US airline. A new management team led by Michael O'Leary was appointed. Ryanair floated on the Dublin Stock Exchange in 1997 and is now quoted on the Dublin and London Stock Exchanges and on the NASDAQ-100.

This case was prepared by Eleanor O'Higgins. It is intended as a basis for class discussion and not as an illustration of good or bad practice.

Table 1 Ryanair consolidated income statement (€m)

	Year ended 31 March		
	2012	**2011**	**2010**
Operating revenues			
Scheduled revenues	3,504.0	2,827.9	2,324.5
Ancillary revenues	886.2	801.6	663.6
Total operating revenues – continuing operations	**4,390.2**	**3,629.5**	**2,988.1**
Operating expenses			
Staff costs	(415.0)	(376.1)	(335.0)
Depreciation	(309.2)	(277.7)	(235.4)
Fuel and oil	(1,593.6)	(1,227.0)	(893.9)
Maintenance, materials and repairs	(104.0)	(93.9)	(86.0)
Aircraft rentals	(90.7)	(97.2)	(95.5)
Route charges	(460.5)	(410.6)	(336.3)
Airport and handling charges	(554.0)	(491.8)	(459.1)
Marketing, distribution and other costs	(180.0)	(154.6)	(144.8)
Icelandic volcanic ash-related cost	–	(12.4)	–
Total operating expenses	**(3,707.0)**	**(3,141.3)**	**(2,586.0)**
Operating profit – continuing operations	**683.2**	**488.2**	**402.1**
Other income/(expense)			
Finance income	44.3	27.2	23.5
Finance expense	(109.2)	(93.9)	(72.1)
Foreign exchange gain/(loss)	4.3	(0.6)	(1.0)
Loss on impairment of available-for-sale financial asset	–	–	(13.5)
Gain on disposal of property, plant and equipment	10.4	–	2.0
Total other expenses	**(50.2)**	**(67.3)**	**(61.1)**
Profit before tax	**633.0**	**420.9**	**341.0**
Tax expense on profit on ordinary activities	(72.6)	(46.3)	(35.7)
Profit for the year – all attributable to equity holders of parent	**560.4**	**374.6**	**305.3**
Basic earnings per ordinary share (euro cents)	38.03	25.21	20.68
Diluted earnings per ordinary share (euro cents)	37.94	25.14	20.60
Number of ordinary shares (millions)	1,473.7	1,485.7	1,476.4
Number of diluted shares (millions)	1,477.0	1,490.1	1,481.7

Source: Ryanair Annual Report, 2012

After its makeover into a budget airline, Ryanair never looked back, as it added new bases, routes and aircraft. Despite the up-and-down cycles of the airline industry over the decades, Ryanair continued its upwards trajectory, being among the world's most profitable airlines and leaving almost all others behind.[2]

Twenty years later

In July 2012, some 20 years after its transformation, as other airlines struggled, Ryanair's results were typical for the company. Full-year profits had increased 25% to a record €503 million (£424m; $645m).[3] Revenue increased 19% to €4325 million (£3647m; $544m) and average fares rose 16%, with a 5% increase in traffic to 76 million passengers. Unit costs rose by 13% due to a 30% increase in fuel costs and a 6% increase in sector length. Ancillary revenue outpaced traffic growth, rising by 11% to €886 million (£747m; $1136m) or 21% of total revenue. Ryanair's financial data are given in Tables 1, 2 and 3.

Michael O'Leary called the outcome a 'commendable result', especially considering the higher fuel costs and a deep recession in Europe. However, his positivity was tinged with concerns over what lay ahead. Despite an expected 5% traffic increase to 79 million passengers, he warned that profits could fall by as much as 20%, into the €400 to €440 million range, due to further fuel price rises and other costs, recession, austerity, currency concerns and lower fares at new and growing bases in Hungary, Poland, provincial UK, and Spain.

Ancillary revenues

Ryanair provides various ancillary services, including in-flight beverages, food and merchandise, console entertainment sales and internet-related services. It distributes accommodation, travel insurance and car rentals through its website. Delivering these services through the internet enables Ryanair to increase sales while reducing unit costs. Ancillary revenue initiatives were constantly being

Table 2 Ryanair consolidated balance sheet (€m)

	Year ended 31 March		
	2012	2011	2010
Non-current assets			
Property, plant and equipment	4,925.2	4,933.7	4,314.2
Intangible assets	46.8	46.8	46.8
Available-for-sale financial assets	149.7	114.0	116.2
Derivative financial instruments	3.3	23.9	22.8
Total non-current assets	**5,125.0**	**5,118.4**	**4,500.0**
Current assets			
Inventories	2.8	2.7	2.5
Other assets	64.9	99.4	80.6
Current tax	9.3	0.5	–
Trade receivables	51.5	50.6	44.3
Derivative financial instruments	231.9	383.8	122.6
Restricted cash	35.1	42.9	67.8
Financial assets: cash > 3 months	772.2	869.4	1,267.7
Cash and cash equivalents	2,708.3	2,028.3	1,477.9
Total current assets	**3,876.0**	**3,477.6**	**3,063.4**
Total assets	**9,001.0**	**8,596.0**	**7,563.4**
Current liabilities			
Trade payables	181.2	150.8	154.0
Accrued expenses and other liabilities	1,237.2	1,224.3	1,088.2
Current maturities of debt	368.4	336.7	265.5
Current tax	–	–	0.9
Derivative financial instruments	28.2	125.4	41.0
Total current liabilities	**1,815.0**	**1,837.2**	**1,549.6**
Non-current liabilities			
Provisions	103.2	89.6	102.9
Derivative financial instruments	53.6	8.3	35.4
Deferred tax	319.4	267.7	199.6
Other creditors	146.3	126.6	136.6
Non-current maturities of debt	3,256.8	3,312.7	2,690.7
Total non-current liabilities	**3,879.3**	**3,804.9**	**3,165.2**
Shareholders' equity			
Issued share capital	9.3	9.5	9.4
Share premium account	666.4	659.3	631.9
Capital redemption reserve	0.7	0.5	0.5
Retained earnings	2,400.1	1,967.6	2,083.5
Other reserves	230.2	317.0	123.3
Total shareholders' equity	**3,306.7**	**2,953.9**	**2,848.6**
Total liabilities and shareholders' equity	**9,001.0**	**8,596.0**	**7,563.4**

Source: Ryanair Annual Report, 2012

introduced to raise extra revenue. It was the first airline to charge for check-in luggage and in-flight food and beverages. Virtually all budget airlines have followed suit, as they have with other Ryanair initiatives. It has continued to find ways of charging passengers for services once considered inclusive. Passengers are charged extra for checking in at the airport rather than online (which also incurs a charge). While avoiding pre-assigned seats, an extra charge procures 'priority boarding' purchased in advance for £10/€10 per flight, an initiative followed by many traditional carriers, such as British Airways, charging passengers to book seats online.

In the fiscal year 2012, Ryanair's ancillary revenues per passenger rose from €11.12 in the 2011 fiscal year to €11.69. Revenues from non-flight scheduled operations, including excess baggage charges, debit and credit card transactions, sales of rail and bus tickets, accommodation, travel insurance and car rental, increased 12.4% from €574.2 million to €645.6 million, while revenues from in-flight sales increased 6.4% from €100.7 million in the

Table 3 Ryanair selected operating data

	Year ended 31 March			
	2012	**2011**	**2010**	**2009**
Operating data				
Average yield per revenue passenger mile (RPM) (€)	0.059	0.053	0.052	0.060
Average yield per available seat mile (ASM) (€)	0.048	0.045	0.043	0.050
Average fuel cost per US gallon (€)	2.075	1.756	1.515	2.351
Cost per ASM (CASM) (€)	0.051	0.049	0.047	0.058
Operating margin	14%	14%	13%	5%
Break-even load factor	70%	72%	73%	79%
Average booked passenger fare (€)	45.36	39.24	34.95	40.02
Ancillary revenue per booked passenger (€)	11.69	11.12	9.98	10.21
Break-even load factor	70%	72%	73%	79%
Other data				
Revenue passengers booked	75,814,551	72,062,659	66,503,999	58,565,663
Revenue passenger miles	58,584,451,085	53,256,894,035	44,841,072,500	39,202,293,374
Available seat miles	71,139,686,423	63,358,255,401	53,469,635,740	47,102,503,388
Booked passenger load factor	82%	83%	82%	81%
Average length of passenger haul (miles)	771	727	661	654
Sectors flown	489,759	463,460	427,900	380,915
Number of airports served at period end	159	158	153	143
Average daily flight hour utilisation (hours)	8.47	8.36	8.89	9.59
Personnel at period end	8,388	8,560	7,168	6,616
Personnel per aircraft at period end	30	31	31	36
Booked passengers per personnel at period end	9,038	8,418	9,253	8,852

Source: Ryanair Annual Report, 2012

2011 fiscal year to €107.2 million. Revenues from internet-related services, primarily commissions received from products sold on Ryanair.com or linked websites, increased 5.3% from €126.7 million in the 2011 fiscal year to €133.4 million in the 2012 fiscal year. The rate of increase in revenues from all ancillary revenue categories exceeded the increase in overall passengers booked; they accounted for 20.2% of Ryanair's total operating revenues in 2012, compared to 22.1% in 2011.

Investor perspectives

Ryanair shares reached a high of €6.30 in April 2007 and plummeted to €1.97 in October 2008, as global equity markets tumbled. By mid-2009, the shares were trading in the €3.20 to €3.40 range, with an expected medium-term target of €4.20, based on expected earnings and a P/E ratio of 13. In February 2013, its shares traded at about €5.75 with a P/E ratio of 14.9, up from €4.75 three months earlier.

After its flotation in 1996, Ryanair's policy was not to pay dividends on its shares. It retained earnings to fund its business operations, the acquisition of additional aircraft required for new markets, expansion of existing services, and routine fleet replacements. However, thanks to a healthy balance sheet and the suspension of its aircraft buying programme when negotiations with Boeing broke down, the no-dividend policy changed. In June 2010, Ryanair announced a special dividend of €0.34 per share, returning almost €500 million to shareholders. A second special dividend of €0.34 per share, totalling approximately €489 million, was paid in November 2012. With the second special dividend Ryanair has returned €1.53 billion in dividends and share buybacks to shareholders over a five-year period. This was almost three times the total amount the company had raised from its initial €559 million flotation and four secondary offers in 1998, 2000, 2001 and 2002.

Ryanair's operational approach

Ryanair has stuck closely to the low-cost/low-fares model. Ever-decreasing costs was the mantra, as it constantly adapted its model to the European arena and changing conditions. In this respect, Ryanair differed in its application of the Southwest Airlines prototype, and its main European rival easyJet, as these two were not as frill-cutting. One observer described the difference between easyJet and Ryanair as: 'EasyJet is classy cheap, rather than just plain cheap.'[4]

The Ryanair fleet

Ryanair continued its fleet commonality policy, using only Boeing 737 planes, to keep staff training and aircraft maintenance costs as low as possible. Over the years, it purchased new, more environmentally-friendly aircraft, reducing the average age of its 294 aircraft to less than four years – among the youngest fleets in Europe. The newer aircraft produced 50% less emissions, 45% less fuel burn and 45% lower noise emissions per seat. Winglet modification provided better performance and a 2% reduction in fuel consumption, a saving which the company believed could be improved. Despite larger seat capacity, new aircraft did not require more crew. While Ryanair's fleet size has continued to rise alongside its purchases, it has disposed of its older, less efficient planes.

In 2009, Ryanair sought to repeat its 2002 coup when it placed aircraft orders at the bottom of the market. However, talks with Boeing for the purchase of 100 aircraft between 2013 and 2015 broke down. Thus, after the final delivery of 11 aircraft in 2013 to complete its existing Boeing contract, Ryanair had no further aircraft on order in 2012. Notwithstanding previous strict adherence to Boeing 737 planes, in an attempt to extract greater discounts from Boeing, Ryanair sought to open negotiations with other manufacturers, such as Airbus, the European aircraft manufacturer. The latter rebuffed the Ryanair invitation, declaring this sales campaign would be too expensive and time-consuming. Even so, Ryanair hinted that it had an interest in Airbus's new generation of fuel-efficient aircraft, and that it had the economies of scale to run a mixed fleet between Boeing and Airbus models. More recently, in June 2011, the company signed a Memorandum of Understanding with COMAC, a Chinese aircraft manufacturer, to cooperate and work together in relation to the development of a 174–200-seat commercial aircraft.

Since 2009, in response to high fuel prices and lower winter yields, Ryanair has adopted a policy of grounding a portion of its fleet during the winter months (from November to March). In the winter of 2011–12, Ryanair grounded approximately 80 aircraft, and in May 2012 announced that it intended to ground approximately 80 aircraft during 2012–13.

Staff costs and productivity

Ryanair refuses to recognise trade unions and negotiates with Employee Representative Committees (ERCs). Its 2012 employee count of 8388 was slightly down on 8,560 in 2011, mainly due to 230 fewer cabin staff, with fewer aircraft in operation and staff laid off during winter. Therefore, staff costs decreased 1.7% on a per-ASM basis, while in absolute terms these costs increased 10.3% from €376.1 million in 2011 to €415.0 million in the 2012 fiscal year. The increase in absolute terms was primarily attributable to a 10.5% increase in total hours flown and a company-wide pay increase of 2% granted in April 2011.

Ryanair's employees earn productivity-based incentive payments, consisting of 47% and 37% of total pay for cabin crew and pilots respectively. By tailoring rosters, the carrier maximised productivity and time off for crew members, while none the less complying with EU regulations which impose a ceiling on pilot flying hours to prevent dangerous fatigue. Its passenger-per-employee ratio of approximately 8,500 was the highest in the industry.

Generally, on-board crew have to pay for their initial training and uniforms. Ryanair has licensed approved organisations in Sweden and Holland to operate pilot training courses, using Ryanair's syllabus, to grant Boeing 737-type ratings. Based on their performance, trainee pilots may be offered a position operating on Ryanair aircraft.

Passenger service

Ryanair pioneered cost-cutting/yield-enhancing measures for passenger check-in and luggage handling. One was priority boarding and web-based check-in. Charging for check-in bags encouraged passengers to travel with less or no check-in luggage, thus saving on costs and enhancing speed. Before checked-in bags were charged, 80% of passengers travelled with checked-in luggage; two years later this had fallen to 30%. From October 2009, Ryanair adopted a 100% web check-in policy, enabling a reduction in staff numbers calculated to save €50 million per year. Ryanair claims that 'passengers love web check-in. Never again will they have to arrive early at an airport to waste time in a useless check-in queue. As more passengers travel with carry-on luggage only, they will never again waste valuable time at arrival baggage carousels either. These measures allow Ryanair to save our passengers valuable time, as well as lots of money.'[5]

A logical next step announced by Ryanair was a move to 100% carry-on luggage. Passengers would bring additional bags to the boarding gate, to be placed in the hold and returned to them as they deplane on arrival. This would allow more efficient airport terminals to be developed without check-in desks, baggage halls or computerised baggage systems. However, the idea never took off, probably for security reasons, as it would have required passengers to carry hold baggage through security to the aircraft.

Airport charges and route policy

Consistent with the budget model, Ryanair's routes were point-to-point only. It reduced airport charges by avoiding congested main airports, choosing secondary and regional destinations, eager to increase passenger throughput. Usually these airports are significantly further than the main airports from the city centres they serve, 'from nowhere to nowhere' in the words of Sir Stelios Haji-Ioannou, founder of easyJet, Ryanair's biggest competitor.[6] For example, Ryanair uses Frankfurt Hahn (123 kilometres from Frankfurt), Torp (100 km from Oslo) and Charleroi (60 km from Brussels). In December 2003, the Advertising Standards Authority rebuked Ryanair, upholding a complaint of misleading advertising for attaching 'Lyon' to its advertisements for flights to St Etienne, 62 kilometres from Lyon.

Ryanair constantly denounced charges and conditions imposed by most governments at airports in the form of Air Passenger Duties (APDs). In 2009, the Irish government introduced a €10 Air Travel Tax on all passengers departing from Irish airports on routes longer than 300 kilometres but subsequently reduced it to €3 in 2011. The UK government had been gradually raising its APDs over a five-year period from £5 to £13 in April 2012. The German government introduced an air passenger tax of €8 in 2011, subsequently reduced to €7.50 in 2012. In Austria, the government introduced an ecological air travel levy of €8 in 2011.

Ryanair's special ire is reserved for Dublin and Stansted Airports, bemoaning a 40% price increase at Dublin Airport, largely to pay for a second terminal costing €1.2 billion and derided by Ryanair as a white elephant. The airline was:

> 'Deeply concerned by continued understaffing of security at Stansted which led to repeated passenger and flight delays . . . management of Stansted security is inept, and BAA has again proven that it is incapable of providing adequate or appropriate security services at Stansted. This shambles again highlights that BAA is an inefficient, incompetent airport monopoly.'[7]

When BAA appealed against its break-up, ordered by the UK Competition Commission in 2009, Ryanair secured the right to intervene in the appeal in support of the Commission, and applauded the loss of the appeal by BAA. In August 2012, BAA finally accepted the sell-off of Stansted and abandoned further appeals against the 2009 orders of the Competition Commission, having already complied with the orders to sell Edinburgh and Gatwick Airports.

In summer 2012, Ryanair disclosed that it was interested in taking a 25% interest in Stansted, as part of a consortium which wanted it as an anchor tenant. Ryanair's ownership would allow it to introduce a low-cost, quick-turnaround model at Stansted, and reduce the landing fees. However, commentators observed that other competing airlines might be deterred from using Stansted Airport if Ryanair had control, given its already dominant position. In fact, Ryanair later pulled out as it became clear that BAA would not sell to a consortium which included it.

Marketing strategy

Ryanair has promoted its website heavily through newspaper, radio and television advertising. Internet bookings accounted for 99% of all reservations. Ryanair minimises its marketing and advertising costs, relying on free publicity, by its own admission, 'through controversial and topical advertising, press conferences and publicity stunts'. Other marketing activities include distribution of advertising and promotional material and cooperative advertising campaigns with other travel-related entities and local tourist boards.

Ryanair's high profile has inspired both outrage and admiration among politicians, competitors, customers and observers. It has made controversial news: it annoyed the Queen of Spain by using her picture without permission in marketing material, it announced plans to charge passengers for using toilets on its flights, and it engaged in high-profile battles with the European Commission. Ryanair has made news for its achievements too, winning international awards such as Best Managed Airline and receiving a 2009 'FT-ArcelorMittal Boldness in Business' Award. This Award announcement said that Ryanair had: 'changed the airline business outside North America – driving the way the industry operates through its pricing, the destinations it flies to and the passenger numbers it carries'.[8]

The Aer Lingus saga

During 2007, in a surprise bid, Ryanair acquired a 25.2% stake in Aer Lingus, a week after the flotation of the Irish national carrier. It subsequently increased its holding to 29.8%, at a total aggregate cost of €407.2 million. By July 2009, the investment had been written down to €79.7 million. At the time of the initial bid Ryanair declared its intention to retain the Aer Lingus brand and:

> 'up-grade their dated long-haul product, and reduce their short-haul fares by 2.5% per year for a minimum of 4 years . . . one strong Irish airline group will be rewarding for consumers and will enable both to vigorously compete with the mega carriers in Europe . . . there are significant opportunities, by combining the purchasing power of Ryanair and Aer Lingus, to substantially reduce its operating costs, increase efficiencies, and pass these savings on in the form of lower fares to Aer Lingus' consumers'.[9]

However, according to a *Financial Times* commentator: 'Ryanair's bid for Aer Lingus was a "folie de grandeur".'[10] Even Michael O'Leary admitted it was: 'A stupid investment. At the time, it was the right strategy to go for one combined airline but it has now proven to be a disaster.'[11]

Aer Lingus rejected Ryanair's approach, stating that it had acted in 'a hostile, anticompetitive manner designed to eliminate a rival at a derisory price'. A combined Ryanair–Aer Lingus operation would account for 80% of all flights between Ireland and other European countries.

The bid was opposed by a loose alliance representing almost 47% of Aer Lingus shares. This included the Irish government, which retained a 25.4% holding, and two investment funds operated on behalf of Aer Lingus pilots and accounting for about 4% of shares. A critical 12.6% shareholding was controlled by the Aer Lingus Employee Share Ownership Trust (ESOT), which had the right to appoint two directors and a stake in future profits. Its members rejected the Ryanair offer by a 97% majority vote.

Faced with shareholder opposition and a blocking decision by the European Commission on competition grounds, Ryanair abandoned this bid but returned in December 2008 with an offer of €1.40 per share, a premium of approximately 25% over the closing price. In July 2010, the European General Court upheld the European Commission's decision to block the takeover of Aer Lingus by Ryanair. However, it did not go as far as forcing Ryanair to sell its stake in Aer Lingus, an action that Aer Lingus wanted the Court to impose.

Despite the European judgment, later in 2010 the UK Office of Fair Trading (OFT) announced that it would conduct a preliminary competition investigation into Ryanair's 29.8% holding in Aer Lingus. Unlike the European Commission, the OFT has the power to force Ryanair to divest its stake in Aer Lingus. Opposing the investigation, Ryanair argued that the UK OFT had no jurisdiction in the matter, and a four-month time limit after the European ruling for the case to be brought had elapsed. A failed appeal by Ryanair to the UK Competition Appeals Tribunal to suspend the OFT investigation in August 2012 was further appealed to the UK Court of Appeal by the airline.

Meanwhile, in June 2012, Ryanair made its third offer to purchase all the ordinary shares of Aer Lingus, at €1.30 per share, a premium of 38.3% over the then closing price. It gave a number of reasons for the timing and nature of its offer:

- Continued consolidation of European airlines, citing the takeover by the International Airlines Group (IAG, the parent company of British Airways) of BMI, whereby the Number 1 airline at Heathrow was allowed to acquire the Number 2.
- Additional capacity available at Dublin Airport and traffic decline from 23.3 million passengers annually in 2007 to 18.7 million in 2011, resulting in Dublin Airport operating at approximately 50% capacity.
- Under the terms of a bailout to Ireland provided by the European Commission, the European Central Bank and the International Monetary Fund, the Irish government was obliged to sell its stake in a number of state assets, including Aer Lingus.
- Etihad, an Abu-Dhabi-based airline, had acquired a 3% stake in Aer Lingus and had expressed an interest in buying the Irish government's 25% stake in Aer Lingus.
- The Employee Share Ownership Trust had been disbanded since December 2010 and the shares distributed to the individual members; Ryanair believed that its new offer was now capable of reaching over 50% acceptance, with or without the Irish government's acceptance.

Notwithstanding Ryanair's reference to it as a 'small and uncompetitive airline', Aer Lingus had made an €84 million profit in 2011, recording higher revenues, passenger numbers and yield per passenger, on both short- and long-haul flights. It had gross cash of €895m on its balance sheet.

Ryanair declared itself willing to offer the European Commission appropriate remedies to allay competition concerns, so that the efficiencies and synergies arising from the combination should convince the Commission to approve the proposed merger. Again Ryanair offered to keep Aer Lingus as a separate company, to maintain its brand, to grow its traffic from 9.5 million to over 14.5 million passengers over a five-year period post-acquisition by increasing Aer Lingus' short-haul traffic at certain major European airports where it currently operated and Ryanair did not, and to increase Aer Lingus' transatlantic traffic from Ireland. Was the latter reminiscent of Ryanair's 2007 announcement to offer €10 transatlantic flights, an idea which appeared to have been shelved in 2009? However, in August 2012, the European Commission announced a second-phase investigation into the bid, to be completed in early 2013, because its preliminary investigation raised 'potential competition concerns'.

It is noteworthy that, in 2011, Ryanair and Aer Lingus together accounted for 80% of traffic at Dublin Airport, 84% at Cork Airport and 64% at Shannon Airport. To placate the various competition authorities, Ryanair approached at least six airlines (Air France-KLM, easyJet, Etihad, FlyBe, IAG and Virgin) to operate competing services on some of the Aer Lingus routes. Notwithstanding a plan to engage FlyBe to take over 46 of Aer Lingus' short-haul routes, in February 2013 the EU Commission blocked the takeover bid on the basis that it would penalise passengers travelling in and out of Ireland with respect to choice and fares. Ryanair declared that it would appeal against the decision.

The *Financial Times* declared Ryanair's bid 'a waste of time and effort for both bidder and target', and voiced suspicions that it was 'a ploy to trump a UK inquiry into whether it should have to dispose of its 29.8% Aer Lingus stake'.[12]

An issue in the takeover was the entry of Etihad into the picture. While Ryanair was content for Etihad to purchase the government stake, and to remain a minority shareholder, it was mooted that Etihad was interested in buying Ryanair's existing 29.8% stake. However, there was no possibility of Etihad assuming a white knight position to rescue Aer Lingus from Ryanair's clutches, since rules barring foreign companies from owning a majority stake in a European airline would prevent Etihad from taking on the whole of Ryanair and the government's holdings with its own existing 3% stake. Moreover, Irish company law requires an investor with 30% of issued shares to make an offer for the whole group.

Risks and challenges

Apart from its foray into Aer Lingus, Ryanair faced various challenges in 2012, some specific to itself and some general to the aviation industry.

Fuel costs

Perhaps the greatest concern in input costs was fuel. Jet fuel prices are subject to wide fluctuations, increases in demand and disruptions in supply, factors which Ryanair can neither predict nor control. In such volatile circumstances, hedging is the only answer. As international prices for jet fuel are denominated in US dollars, Ryanair's fuel costs are also subject to exchange rate risks, exacerbated by a severe Eurozone crisis in 2012, when the value of the euro fell from $1.45 to $1.25. Ryanair's declaration of 'no fuel surcharges ever' and its reliance on low fares limit its capacity to pass on increased fuel costs. Oil prices increased substantially in 2011 and 2012 and remain at elevated levels. While Ryanair has hedged fuel contracts and currency, the volatility of oil prices and currency fluctuations make long forward hedging problematic.

Risks associated with the euro

Headquartered in Ireland, Ryanair's reporting currency is the euro. With its extensive route system within Eurozone countries, the company would be very adversely affected by a break-up of the euro, or if a number of countries, including Ireland, were forced to leave the Eurozone. A break-up of the euro or the exit of one or more members from it would jeopardise the value of Ryanair's euro-denominated assets. As with fuel costs, other operating inputs purchased abroad in non-euro currencies could become more expensive, further undermining profitability. With so much of Ryanair's business conducted in the UK, the collapse of the euro against sterling could be especially difficult.

Sharp economic downturn

The global recession commencing in 2008 created unfavourable economic conditions, high unemployment rates, constrained credit markets and reduced spending by leisure and business passengers. The continuing European recession had repercussions for Ryanair and other Europe-based airlines. Although it succeeded in achieving higher yields in 2012, continued recession limited the scope for raising fares to offset higher input costs. It could restrict the company's passenger volume growth in a highly competitive environment where other budget carriers, charter and traditional airlines competed on its routes. In addition, in Europe, road transport and high-speed rail put further competitive pressure on airlines.

Ryanair's growth plans entailed investment in new aircraft and routes. If growth in passenger traffic did not keep pace with its planned fleet expansion, overcapacity could result. Related pressures were additional marketing costs and reduced yields from lower fares to promote new additional routes. In its drive for growth, Ryanair was likely to encounter increased competition, putting further downward pressure on yields, as airlines struggled to fill vacant seats to cover fixed costs.

Access to suitable airports, airport charges and government taxes

Ryanair's growth is dependent on access to a sufficient number of suitable take-off and landing slots at costs consistent with its budget strategy. In many cases, there is competition for these slots, along with the threat that airports will raise charges. Ryanair constantly rails against airport charges at Dublin and Stansted, redeploying aircraft to airports with lower charges. Recently it cancelled routes from Madrid and Barcelona following an increase of over 100% in charges at these airports. Indirectly, Ryanair is also vulnerable to extra taxes and charges, such as tourist taxes imposed by governments, discussed above.

Passenger compensation

From 17 February 2005, an EU regulation provided for standardised and immediate assistance for air passengers at EU airports for long delays, cancellations and denied boarding. Passengers affected by cancellations must be offered a refund or re-routing, and free assistance while waiting for their re-routed flight, specifically meals, refreshments, and hotel accommodation where an overnight stay is necessary. Financial compensation is payable, unless the airline can prove unavoidable exceptional circumstances, like political instability, weather conditions, security and safety risks or strikes. Until April 2010, the new regulation was largely ignored and had no material impact on Ryanair, despite the emergence of online 'advisors' to help passengers make claims against airlines when their flights had been cancelled or delayed.

However, the compensation issue was highlighted dramatically with the eruption of Iceland's Eyjafjallajökull volcano. Its volcanic ash forced the closure of much European airspace for six days in April 2010, with further disruptions in May. The losses to Europe's airlines from flight cancellations and compensation were estimated at €2.5 billion. The closures caused the cancellation of 9,490 Ryanair flights for 1.5 million passengers. Many airlines demanded government aid to make up for lost revenue and the cost of feeding and lodging stranded passengers. They contended that flawed computer models used by member states were partly to blame for grounding planes even after it was safe to resume services. The EU Commission noted that fiscal conditions prevented cash-constrained governments from offering aid to airlines, even if the rules could be bent to allow such aid. Ryanair argued strongly against offering aid to airlines, as did easyJet, on the grounds that it could be used as a back door to prop up ailing airlines, especially national carriers.

Initially Ryanair declared that it would not compensate passengers for food and accommodation expenses incurred from flight cancellations, although it would offer refunds. It argued that it was ludicrous that passengers could claim unlimited sums to cover their expenses, irrespective of the cost of their ticket, and that the compensation regulations were discriminatory, as competitor ferry, coach and train operators were obliged to reimburse passengers only to a maximum of the ticket price paid. It claimed that such a situation was not sustainable. However, several days into the crisis, Michael O'Leary said that Ryanair would reimburse 'reasonable costs' to passengers caught up in the chaos in April. Asked if Ryanair would make it difficult for passengers to make claims, O'Leary responded 'Perish the thought.'[13] In fact, in 2012, the company estimated that the non-recoverable fixed costs associated with the cancellations, as well as the reimbursement claims for the initial 20 days of closure of European aerospace, would amount to approximately €29 million.

Later in 2010, Ryanair was obliged to cancel flights to and from Spain during wildcat strikes by Spanish air traffic controllers in August, and again in December when severe weather forced the closure of some airports for several days. This meant lost revenue and more compensation.

Industrial relations

Following pay freezes in 2009 and 2010, Ryanair granted a 2% company-wide pay increase in 2011. It was criticised constantly for refusing union recognition and allegedly providing poor working conditions, as the British Airline Pilots Association (BALPA) tried to organise Ryanair pilots in the UK, maintaining the right to ballot Ryanair pilots to join the union. In July 2006, the Irish High Court ruled that Ryanair had bullied pilots to accept new contracts, where pilots would have to pay €15,000 for retraining on new aircraft if they subsequently left the airline, or if the company was forced to negotiate with unions during the following five years. Meanwhile, Ryanair was contesting the claims of some pilots for victimisation under the new contracts. By 2009, only 11 of the 64 pilots who had lodged the claim remained with the company and still had claims.

Ryanair was ordered to pay 'well in excess' of €1 million in legal costs after a court refused the airline access to the names and addresses of pilots who posted critical comments about the company, on a site hosted by the British and Irish pilots' unions. It claimed anonymous pilots were using a website to intimidate and harass foreign-based pilots to dissuade them from working for the company.

The company maintains its right to treat its crew operating from bases in other higher-paying countries as if they were on Irish territory, and therefore subject to Irish labour laws, which are less exacting than those pertaining in other European jurisdictions. Up to 2013, Ryanair was able to resist challenges to this approach.

Ryanair has conceded that winter lay-offs due to grounding of aircraft could have an unsettling effect on staff, disrupting full-time permanent employment. Notwithstanding the adversarial incidents in its industrial relations history, Ryanair appears to have no problems recruiting staff, including pilots.

Environmental concerns

Aviation fuel has been exempt from carbon taxes, but in 2012 the EU established an Emissions Trading Scheme encompassing the aviation industry, creating a new cost for airlines. Under the legislation, airlines are granted initial CO_2 allowances based on historical performance and an efficiency benchmark. Any shortage of allowances would have to be purchased in the open market and/or at government auctions. For Ryanair the cost of these allowances to cover the shortage that could arise in 2012 were estimated to be in the region of €10 to €15 million. Despite its young, fuel-efficient, minimal-pollution aircraft, the company estimates that the related cost could increase significantly over the coming years, depending on carbon credit prices and future decisions on growth. Therefore, it has contended that any environmental taxation scheme should be to the benefit of more efficient carriers, and that airlines with low load factors, generating high fuel consumption and emissions per passenger, and those offering connecting rather then point-to-point flights, should be penalised. Indeed, independent research by Brighter Planet ranks Ryanair first in the world among airlines on CO_2 efficiency.[14]

Sundry legal actions

Ryanair has been in litigation with the EU about alleged receipt of state aid at certain airports. An EU ruling in 2004 held that it had received illegal state aid from publicly owned Charleroi Airport, its Brussels base. Ryanair was ordered to repay €4 million. On appeal, in 2008 the original EU decision was overturned, and Ryanair was refunded. Never the less, the EU launched further investigations into allegations of illegal aid purportedly subsidising Ryanair at as many as 18 publicly owned airports, such as Paris Beauvais in France and Lübeck and Frankfurt Hahn in Germany. Competitors launched other legal challenges against Ryanair. Furthermore, Ryanair vigorously opposed French government attempts to protect Air France–KLM by forcing easyJet and Ryanair to move their French-based staff from British employment contracts to more expensive French ones.

Frequently, Ryanair took the initiative on alleged illegal aid to rivals. It filed a complaint with the EU Commission accusing Air France–KLM of attempting to block competition after the French airline filed a case, alleging that Marseille was acting illegally by offering discount airlines cut-price fees at its second, no-frills terminal. In addition, Ryanair called on the Commission to investigate allegations that Air France had received almost €1 billion in illegal state aid, benefiting unfairly from up to 50% discounted landing and passenger charges on flights within France. Adverse rulings on these airport cases could curtail Ryanair's growth if it was prevented from making advantageous deals with publicly owned airports and confined to the fewer privately owned airports across Europe.

On another front, Ryanair was being sued by three airport authorities over alleged delays in paying airport charges. After it called for the presiding judge, Mr Justice Peter Kelly, to withdraw on grounds of bias against Ryanair in previous proceedings, the judge did indeed withdraw, not because he admitted Ryanair's charges but to avoid delay in the case. He stood by his previous comments that: 'Ryanair told untruths to and about the court and . . . that the airline and the truth made uncomfortable bedfellows'.[15]

Customer services and perceptions

> 'The customer is usually wrong. The only time you hear from a customer is when they're complaining because they want to break our rules. Why can't I get a refund for my non-refundable ticket? B***** off.'[16]

So proclaimed Michael O'Leary.

Ryanair's Skytrax two-star rating is the worst for budget airlines in Europe. There have been suggestions that Ryanair's 'obsessive' focus on the bottom line may have dented its public image. There was growing criticism of extra charges continually being imposed by Ryanair on passengers, many on unavoidable services, like check-in. In some instances, these extra charges made Ryanair allegedly more expensive than BA.[17]

Ryanair dropped its plan to charge passengers for using on-board toilets, but was pressing ahead with proposals to remove two of the three lavatories on each plane and replace them with seats. Michael O'Leary asserted that this move would lower air fares by about 5% for all passengers, cutting £2 from a typical £40 ticket.

Ryanair features on many consumer complaint websites. In a blog entitled '20 reasons never to fly Ryanair', extra charges for booking fees, overweight baggage and low baggage weight limits, premium-rate helplines, and the fact that 'you are always being flogged stuff', were enumerated.[18] When the *Irish Times* put customers' gripes on its *Pricewatch* blog to Ryanair's head of communications, he dismissed them as 'subjective and inaccurate rubbish' and even implied that *Pricewatch* had made them up to 'further some class of anti-Ryanair agenda'.[19] Among the complaints were: 'Customers want to be treated like a human being, to get to their desired destination (not 50/60 miles away) . . . *I'm sick of that miserable booking charge/service charge/admin charge system.*'

So, why are so many people willing to put up with an airline that, in the words of *The Economist*, 'has become a byword for appalling customer service, misleading advertising claims and jeering rudeness'?[20] Ryanair has responded, declaring that, in effect, customers vote with their feet by choosing it for the four tenets of customer service – low fares, a good on-time record, few cancellations and few lost bags. 'If you want anything more – go away', admonishes Michael O'Leary.[21] The *Financial Times* aerospace correspondent observed that Ryanair still offered relative value compared to rail alternatives, at least on a journey from London to Scotland, even when Ryanair's extras are included.

Unexpected disasters

In the airline industry, there is always the possibility that accidents and catastrophic events may occur, due to natural or human-made causes. Among these are accidents and safety-related incidents, terrorist hijackings, outbreaks of contagious disease such as epidemics like swine flu, and weather and natural phenomena that interfere with flights, such as the ash cloud occurrence in 2010. All these incidents can undermine passenger confidence and bookings.

In August 2012, Ryanair faced an investigation by the Spanish Ministry of Public Works after emergency landings of three Ryanair aircraft at Valencia Airport after the aeroplanes had run out of fuel. The aircraft had been diverted to Valencia when they were prevented from landing at Madrid, due to an electrical storm. The Ryanair flights, with others, were put in a holding pattern, but only the Ryanair flights had to instigate emergency procedures because they were running low on fuel. This incident raised questions about Ryanair's fuel policy – to take on the minimum possible to save money. A newspaper cited internal memos sent to pilots reminding them of Ryanair's policy against carrying more than the recommended amounts of fuel. However, Ryanair insisted that fuel levels never fell below the permitted minima during the Valencia incidents, and that all of the company's aircraft operate with required fuel levels. If irregularities were to be found at Ryanair, it could face the loss of its operating licence for three years, with additional fines of up to €4.5 million.

Ryanair maintains various insurances: aviation third-party liability, passenger liability, employer liability, directors and officers' liability, aircraft loss or damage, and other business insurance, consistent with industry standards. Ryanair believes its insurance coverage is adequate, although not comprehensive. This insurance does not cover claims for losses incurred when, due to unforeseen events, airspace is closed and aircraft are grounded such as the closures associated with the ash cloud. It is almost impossible to insure against what may be unlimited liabilities. For instance, EU legislation provides for unlimited liability of an air carrier in the event of death or injuries suffered by passengers.

Other risks and challenges

As listed in its own report, Ryanair faced other risks, some specific and some generic to the industry:

- Prices and availability of new aircraft
- Instability in credit and capital markets which could impair efforts to obtain financing for new aircraft
- Potential impairments from Ryanair's 29.8% stake in Aer Lingus, especially if its latest takeover bid were to fail
- Dependence on key personnel, especially Michael O'Leary
- Dependence on external service providers
- Dependence on its internet website should it break down, even though there are robust backup procedures in place
- A potential rise in Irish Corporation Tax, since Ireland may be under pressure to raise its tax regime as part of its EU/IMF bailout conditions.

Ryanair's competitive space

Rising oil prices and EU-wide recession have accelerated the rate of change in the competitive landscape. The Association of European Airlines forecast a loss of €1.5 billion for European carriers in 2012. A number of EU airlines closed in 2012, including Malev (Hungary), Spanair (Catalonia), OLT (Poland), Air Finland and Cimber Sterling (Denmark). IAG, which purchased BMI from Lufthansa earlier in 2012, announced that BmiBaby would close in 2012 if sale negotiations were unsuccessful. Among many European airlines reporting losses were SAS, Air Berlin, Air France–KLM, IAG (BA and Iberia) and Virgin. Ryanair responded tactically to these developments by opening a new base in Budapest and expanding bases in Spain, Scandinavia and the UK. More European failures were expected as higher oil prices and recession continued to expose airlines already operating at the margins or making substantial losses. Furthermore, the predicaments of carriers such as British Airways were compounded by huge pension fund deficits.

Some industry analysts considered that the economic recession could offer an opportunity for budget carriers, as passengers who continued to travel were expected to trade down. By 2012, budget airlines accounted for over 37% of scheduled intra-European traffic. Ryanair was the clear market leader, with easyJet another dominant force. The two were often compared, since both operated mainly out of the UK and served similar markets. However, it was debatable whether easyJet, through its use of primary airports, would be better than Ryanair in capturing the traffic trading down from network carriers.

Other budget carriers, of diverse size and growth ambitions, trajectories and regional emphases, varied in levels of passenger services and the use of main or secondary airports. A comparison with the US budget airline market indicates that penetration in Europe was less than in the USA, which suggests scope for growth in the sector in Europe.

Leading Ryanair into the future

'It is good to have someone like Michael O'Leary around. He scares people to death.'

This praise of Ryanair's CEO came from fellow Irishman, Willie Walsh, CEO of BA.[22] O'Leary has been described as: 'At turns, arrogant and rude, then charming, affable and humorous, has terrorised rivals and regulators for more than a decade. So far, they have waited in vain for him to trip up or his enthusiasm to wane.'[23]

In fact, Michael O'Leary had been pronouncing his intention to depart from the airline 'in two years' time' since 2005. He declared that he would sever all links with the airline, refusing to 'move upstairs' as chairman.

In 2012, Michael O'Leary held 3.5% of Ryanair's share capital, worth €203 million. His pay topped €1.272 million after he received a bonus of €504,000 – a 24% increase on the fiscal 2011 bonus of €440,000, on top of basic pay of €768,000 which had increased by 29% from €595,000.

Although O'Leary consistently praised the contributions and achievements of his management team, Ryanair was inextricably identified with him. He was credited with single-handedly transforming European air transport. In 2001, O'Leary received the European Businessman of the Year Award from *Fortune* magazine; in 2004, the *Financial Times* named him as one of 25 European 'business stars' who have made a difference, describing him as personifying 'the brash new Irish business elite' and possessing 'a head for numbers, a shrewd marketing brain and a ruthless competitive streak'.[24] Present and former staff have lauded O'Leary's leadership style:

> 'Michael's genius is his ability to motivate and energise people . . . There is an incredible energy in that place.

People work incredibly hard and get a lot out of it. They operate a very lean operation . . . It is without peer.'

Tim Jeans, a former sales and marketing director of Ryanair[25]

O'Leary's publicity-seeking antics are legendary. These included his 'declaration of war' on easyJet when, wearing an army uniform, he drove a tank to easyJet's headquarters at Luton Airport. When Ryanair opened its hub at Milan Bergamo, he flew there on a jet bearing the slogan 'Arrividerci Alitalia'. He has dressed as St Patrick and as the Pope to promote ticket offers. Another provocative idea enunciated by O'Leary was the recommendation that co-pilots could be eliminated on flights, so aircraft could fly with just one pilot, since 'the computer does most of the flying now' and 'a flight attendant could do the job of a co-pilot, if needed'.[26]

A self-confessed 'loudmouth' whose outspokenness has made him a figure of public debate, he is called everything from 'arrogant pig' to 'messiah'.[27] His avowed enemies include trade unions, politicians who impose airport taxes (calling former UK Prime Minister Gordon Brown a 'twit' and a 'Scottish miser'[28]), environmentalists, bloggers who rant about poor service, travel agents, reporters who expect free seats, regulators and the EU Commission, and airport owners like BAA, whom he once called 'overcharging rapists'.[29] An EU Commissioner, Philippe Busquin, denounced Michael O'Leary as 'irritating' and insisted he is not the only Commissioner who is 'allergic to the mere mention of the name of Ryanair's arrogant chief'.[30] This history is not something that would endear him to the EU Commission in his quest to gain approval for Ryanair's bid for Aer Lingus.

An *Irish Times* columnist suggested that 'maybe it's time for Ryanair to jettison O'Leary', asserting that he has become a caricature of himself, fulfilling all 15 warning signs of an executive about to fail.[31] Professor Sydney Finklestein identified these signs under five headings – ignoring change, the wrong vision, getting too close, arrogant attitudes, and old formulae. However, having demonstrated the extent to which O'Leary meets the failure criteria, the columnist concluded: 'So, is it time for Ryanair to dump Mr O'Leary? It depends whether you prefer the track record of one of the most successful businessmen in modern aviation, or the theories of a US academic from an Ivy League school.'

So, how do these comments and his hands-on management style fit with Michael O'Leary's declaration to part company with Ryanair? Would he really go, and, if so, what would happen to Ryanair and its ambitions? No one really knows the answer to these questions, but it would certainly lie in O'Leary's propensity to surprise his admirers and detractors alike.

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