

Lean Production in the Air?

Low Cost Competition in the Global Airline Industry and Implications for Employment Relations

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Jody Hoffer Gittell, Brandeis University
Thomas A. Kochan, MIT
and colleagues

Project:

To understand low cost competition in global airline industry

- MIT Global Airline Industry Program has global scope but so far primarily U.S. focused
- Our project looks beyond U.S. to understand low cost competition in the global airline industry
- Particularly the role of human resource strategies and the impact on employment relations
- Goal is to produce a book with multiple case studies and an overall analysis
- The following is a preliminary outline of book

Introduction

Jody Hoffer Gittel (Brandeis University)

Greg Bamber (Griffith University)

Thomas Kochan (MIT)

- Describe transformation of global airline industry
 - low cost competition by new entrants
 - also by incumbent carriers, either through internal cost reductions or through low cost subsidiaries
- Result is industry-wide reduction in fares and unit costs
- From managerial and public policy standpoint, a need to understand *how* these cost reductions are being achieved

Introduction (continued)

- Low costs achieved through
 - product simplification
 - from no frills (Ryanair)
 - to low frills (Southwest)
 - to moderate frills (Germanwings, JetBlue, VirginBlue, American)
 - younger employees and aircraft
 - reductions in wages and benefits
 - increased employee and aircraft productivity

Introduction (continued)

- What is the different mix of human resource strategies airlines are using to achieve low costs?
- Low road or zero/sum strategy
 - reduced wages/benefits
- High road, mutual gains or “lean production” strategy
 - increased employee/aircraft productivity

Introduction (continued)

- Analyze trends in unit costs from 1995-2005 for U.S., Canada, Europe, Australia and Asia
- Separate out “low cost carriers” from “incumbents”
 - where else do we see convergence in costs, other than U.S.?
- Assess alternative drivers of low costs
 - reduced wages/benefits
 - increases in employee and aircraft productivity
- Which is the driving force in different regions of world?
- Which is the driving force for “LCCs” versus “incumbents”?

Introduction (continued)

- Once we understand the broad context of low cost competition in the global airline industry, we will explore specific cases (will review only some in following slides)
- U.S./Canada
 - Southwest
 - JetBlue
 - AirTran
 - Continental
 - American
 - WestJet
- Europe
 - Ryanair
 - EasyJet
 - AerLingus
 - British Air/Go!
 - Lufthansa/Germanwings
- Australia/Asia
 - VirginBlue
 - Qantas/JetStar
 - AirAsia
 - Korean Air/Asiana

United States

Southwest Airlines

Jody Hoffer Gittel (Brandeis University)

Nearly every U.S. airline in the early 21st century is moving toward a low cost business model in at least a segment of its business. This trend poses an interesting challenge for airlines like Southwest that pioneered the original low cost business models, and who helped to launch this era of widespread low cost competition by competing successfully with traditional carriers.

SWA's approach has been to achieve low costs and high reliability through relational coordination among employees, generating high employee and aircraft productivity. Human resource practices have played a key role including: selection and training for teamwork, cross-functional performance measurement, conflict resolution, flexible boundaries between jobs, operations agents as team leaders for flight departures, supervisory coaching and feedback, and partnering with unions. Wages and benefits have been targeted toward the industry average.

SWA's business model is evolving to meet new competitive demands. Some of its human resource practices have also changed over time. This chapter asks whether the changes in human resource practices have been effective, and whether these changes are consistent with SWA's "high road" approach to employment relations.

AirTran

Nancy Brown Johnson (University of Kentucky)

Scott Droege (Western Kentucky University)

AirTran has emerged as one of the few consistently profitable U.S. carriers since 9/11. Marketed as low cost but with all “business class,” AirTran’s management has structured operations in a way that distinguishes this airline in many ways from the model set forth by Southwest. One difference is development of a hub at Atlanta Hartsfield Airport. Operating at a major airport in head to head competition with a major carrier differs from the traditional approach to low cost competition.

A second difference is AirTran’s approach to labor and employment relations. Like SWA, AirTran is highly unionized and offers wages that for the most part are competitive. Like SWA, AirTran management uses flexible work rules help to keep labor costs low. Unlike SWA, however, AirTran relies primarily on its flexible work rules for productivity and does not focus on achieving efficiencies through relational coordination. Our chapter explores how this model has led to success and at the same time will pose a challenge for the future as unions pressure AirTran to institute more stringent work rules and as the workforce matures leading to more senior, costly employees.

American Airlines

Andrew von Nordenflycht (Simon Fraser University)

In 2004, American Airlines made a 'promising start' down the path to significant improvement in the relationship between management and unions and between management and employees. American and its unions were able to negotiate significant concessions without going into bankruptcy, in contrast to several of its largest rivals. In addition, American has embarked on an attempt to change their basic employment relationship.

There are several promising signs. First, management seems to have a reasonably clear and comprehensive picture of the nature of the new relationship they seek and of the barriers to achieving it. Second, they have begun to institutionalize this improved relationship. Third, this effort is strongly supported by the CEO, who initiated it and is driving it. Fourth, the union leadership consistently expressed the view that management intentions and actions appear credibly different from prior leaders of American Airlines.

But so far it is unclear whether this new relationship has been strongly felt or absorbed by frontline management and rank and file employees, and whether human resource practices have changed to transform the way work is done. Thus, there remains uncertainty about American's ability to successfully complete this transformation.

Europe

British Air/Go!

Peter Turnbull (Cardiff University)

Geraint Harvey (University of Wales Swansea)

Go was established as a low cost subsidiary of British Airways that was subsequently sold to its senior management team and then bought by EasyJet. 'Matching' models of human resource management predict that in order to compete with their low cost rivals, subsidiary airlines need to create a similar low cost employment system that will be very different from that of the parent company. But cost is only one variable in the competitive equation, given the importance of quality and employee relations in a customer contact industry.

Although competing head on with well-established low cost airlines such as Ryanair and EasyJet, Go was able to forge a distinctive management style that combined low cost operations with high road employment relations. The airline's flight crew appreciated this style of management and 'bought into' the company's business strategy, moreso than their counterparts at other low cost airlines or indeed the parent company.

EasyJet

Judy Pate (University of Glasgow)

Phil Beaumont (University of Glasgow)

Despite increased competition in the industry with over 70 low cost carriers in Europe, EasyJet has consistently outperformed most competitors since its formation in 1995. Performance declined after its acquisition of Go, then recovered this past year with record revenues and profit growth. EasyJet differentiates itself from Ryanair by promoting safety, customer care and convenience in addition to low costs. To achieve low costs, EasyJet relies on high employee and aircraft productivity, and the internet to reduce distribution costs.

Using JetBlue and Southwest as role models, EasyJet has focused heavily on its human resource practices. These practices include values-based selection, cross-functional performance measures to avoid a silo mentality and promote systems thinking, cross-functional accountability for outcomes, flexible job boundaries, captains as leaders of the flight departure process, and supervisors as providers of coaching and feedback.

EasyJet is highly unionized relative to Ryanair, with moderately positive labor/management relations. Due to rapid growth, EasyJet has been able to provide job security and consistent promotion opportunities despite crises such as 9/11 and SARS. We explore current challenges and sustainability of the model.

Aer Lingus

Joe Wallace (University of Limerick)
Siobhan Tiernan (University of Limerick)
Lorraine White (University of Limerick)

Competition from Ryanair, along with the slump in the airline industry post 9/11, led Aer Lingus to shift operations closer towards the low-cost model while retaining some features of a legacy airline. Aer Lingus' cost reduction strategies, including layoffs, reductions in pensions, staffing levels and outsourcing, led to major disputes with its workers and their unions.

The decision to privatise Aer Lingus led to further negotiated change. The privatisation agreement provided for job restructuring, but also provided coverage for a pension deficit, a pay increase 4% above the national agreement, enhanced employee share ownership in the airline, guaranteed future working conditions and rights to union membership. This “employment pact” approach to industrial restructuring, which has been used in other state companies, is a consequence of Irish national-level partnership, which tends to rule out a “Thatcherite type approach.”

Lufthansa/Germanwings

Michael Barry (Griffith University)
Werner Nienheuser (Essen University)

Germanwings was founded in 2002 as an attempt by Lufthansa, Germany's traditional flag carrier, to respond to the challenge of low cost competition. Its motto is "fly high, pay low." However, it is not a classic no-frills carrier. Rather than attempting to compete on the basis of cost alone, Germanwings seeks to provide the best value, with outstanding reliability and an outstanding on-board product. *Capital* magazine has called Germanwings the best low cost airline in Europe. Germanwings has close operational ties with Lufthansa, which provides staff training and fleet maintenance.

Lufthansa negotiated a restructuring agreement with its unions in 1992 and a more recent agreement in 2004 that was considered a success for the airline. Still, human resources remain critical to achieving cost goals, according to Lufthansa's Chief Executive of Human Resources. "Given the difficult outlook for our industry, which is beset by high fuel prices and aggressive competitors, we will be forced to continue to steadily improve our costs and productivity in all areas of the company...Competitive pay settlements specific to each individual business segment are necessary to enable the Company to keep pace with competing airlines, especially the no-frills carriers in Europe."

Australia/Asia

Virgin Blue Airways

Greg Bamber (Griffith University)

Ryan Shields (Griffith University)

In 1999, Richard Branson funded a new Australian low-cost carrier, Virgin Blue, challenging the duopolistic domestic airline industry. Within a few years, Virgin Blue had won a third of the Australian market, contributing to the failure of Ansett and to Qantas' decision to launch its own low cost subsidiary, JetStar. Virgin Blue began by adapting aspects of other low-cost carriers, providing a one-class “no-frills” basic service airline and substantially lower fares, enabled by unit costs that were 30-40% lower than its competitors.

Virgin Blue worked from the start to build constructive partnerships with organized labor, welcoming unions that were willing to organize multiple workgroups and negotiate flexible work rules. Virgin Blue also placed great emphasis on its human resource practices, including recruiting, training, motivating and retaining workers with a passion for customer service. More recently, to differentiate itself from Jetstar and to increase its profit margins, Virgin Blue has tried to move ‘up-market’ to become what it calls a new-world carrier, offering service with a flair and leading to further innovations in its human resource practices.

Qantas/JetStar

Sarah Oxenbridge (University of Sydney)

Russell Lansbury (University of Sydney)

Clare Yazbek (University of Sydney)

In 2004, Australia's main domestic and international carrier Qantas launched JetStar, a low-cost airline, primarily in response to the entry of Virgin Blue. Employment relations practices at JetStar reflect the low-cost business model and draw on practices pioneered by low-cost carriers such as Ryanair, including considerable functional flexibility, an emphasis on maintaining low labor costs, and continuous improvement of processes to generate cost savings.

JetStar's start-up was aided by the transfer of staff – and their collective agreements – from the takeover of another airline. Accordingly, JetStar domestic employees remain covered by a mix of union and non-union negotiated collective agreements. JetStar pay rates and benefits are much lower than those of Qantas employees, which is frequently highlighted by Qantas managers in attempts to exert downward pressure on Qantas pay and conditions. This chapter explores the relationship between JetStar and Qantas, and examines how JetStar is propelling Qantas towards adoption of strategies more commonly associated with low-cost carriers.

AirAsia

Teresa Shuk-Poon (The Open University of Hong Kong)

Peter Waring (University of Southwest Asia)

In December 2001, a new Malaysian company called Tune Air purchased a small underperforming domestic Malaysian airline known as AirAsia. By 2006, AirAsia had a fleet of 43 aircraft with orders for 100 more and was forecast to carry 9 million passengers to 52 destinations. AirAsia's rise is the result of the confluence of opportunity and skillful application of the low cost carrier business model including: reduced inflight service, point to point travel, high aircraft utilization, single fleet type, ticketless passenger reservation systems and considerable functional flexibility in staffing.

In this chapter we trace the rise of AirAsia's success and the nuances of the lean production aviation model it has pursued. We argue that while a number of the components of the Southwest Airlines model are evident, there are also significant differences in AirAsia's management of human resources. In particular, we argue that the airline has adopted a cost minimization path that in our view may undermine the company's sustainability and growth trajectory.

Conclusion

Jody Hoffer Gittel (Brandeis University)

Greg Bamber (Griffith University)

Thomas Kochan (MIT)

- What are the managerial and policy implications of these different strategies for achieving low costs?
 - Sustainability of performance over time
 - Outcomes for employees
 - Outcomes for customers
- What are the implications for other industries, like retail and telecommunications, that are also experiencing significant levels of low cost competition?

Anticipated timeline

- **January 2006:** Presented initial findings at LERA meeting
- **Fall 2006:** Submit case study drafts, edit and revise
- **January 2007:** Discuss case studies at LERA meetings
- **Spring 2007:** Edit cases, write introduction and conclusion
- **Summer/Fall 2007:** Publish edited book
- **Summer/Fall 2007:** Publish some case studies and related articles in management journals