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VOLARIS:
LOW COST, HIGH VALUE IN OPERATIONS*

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In early June 2008, the price of oil rose to 134 dollars a barrel. The world's aeronautical industry started facing one of its most severe crises in history. Some analysts[1] estimate an accumulated loss of more than 10 billion dollars for the airline industry worldwide in 2008, even greater than the losses registered during 2002. Likewise, the international history of low cost airlines worldwide shows that less than 50% of such airlines develop successful business models, and only one fourth of them continue in operations three or four years later whether because they are sold, or go bankrupt.

Enrique Beltranena –Volaris' CEO– recalled the company's outstanding results obtained only two years after starting operations: 32% market share in its routes of operation, 99.7% accuracy in on-time schedules, direct selling over Internet or telephone –no middlemen– 96% of its customers recommending its services, sponsoring agreements with prestigious names like Coca Cola, Krispy Kreme and Sanborns, and in March 2008, some media published that the company was operating under a positive cash flow.[2]

*Special thanks in the elaboration of this case to Gilberto León Rosas.
[1] *USA Today*, June, 2008.
[2] Aguilar, Alberto, "Volaris takes over Mexicana's second place with 18% 2007, with a positive cash flow and more equity," *El Universal*, March 7, 2008.

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Yet, while facing the current high oil price scenario, plans to reach 35 destinations, having 2,000 employees and 48 aircraft[3] had to be reconsidered. On June 3, 2008, IATA (International Air Transport Association) reported that 24 airlines had claimed bankruptcy.[4] On June 20 Magnicharters' operations were suspended due to Boeing 737 aircrafts' poor conditions –23 years old in average–.[5] Other low cost airlines like Avolar had been downsizing,[6] and others were taking extreme measures like changing carpets for lighter materials, removing kitchens, carrying less drinking water on board, doing away with pillows and blankets, among others.[7] On June 13 Mexico's Finance Department –facing some of the Mexican airlines' request for the subsidy of turbosine– confirmed that there would be no changes in the price established.[8]

Volaris' Management Team is aware there is a need to take immediate action without impacting the promise made to its customers: "Volaris offers the best service experience with timely, simple and affordable operations."[9] The current situation demands urgent steps to reduce the impact of turbosine prices on the company's results. Volaris' economic assumptions for 2008 had considered the price of oil at 88 dollars per barrel. Also, competitors keep lowering prices, and the market is extremely elastic.

The challenge now is overcoming the industry's crisis. Enrique Beltranena called his Management Team with the goal to cut down 341 million[10] pesos within the next six months. Several ideas cross his mind to reach this goal: closing some of the routes, reducing capacity in other routes, postponing opening new ones, adopting the oversold-tickets model, charging for food, charging for additional baggage, do away with warranties, strengthening the multimodal system, opening international routes to California, rising prices, opening new routes departing from Mexico City, developing specific products (for small and medium-sized businesses, for instance). The Company's future depends by far on the actions carried out during the next coming 30 days.

With the objective of maintaining the same operating excellence that has differentiated Volaris in the market, some of the operational model's assumptions can be modified. Overcoming this crisis in the industry is vital for the company to stay on the right course: to continue being the most profitable company in the industry with the highest rate of customer referrals.

I. Background

Volaris started operations on March 13, 2006 (as the result of an agreement entered into between four partners: TACA, Discovery Americas I, Inbursa and Televisa). Defining itself as a high-efficiency airline, its purpose is to provide its customers the best traveling experience at fair prices.

Volaris was born from identifying a market with great potential in a very attractive environment for the operation of a high-efficiency airline: high-priced airline tickets, 90 million people traveling annually by bus (average and high quality) as a mean of transportation, an average distance of 5.8 hours traveling

[3] Purchase orders made to Airbus according to route plans. Volaris has in total 56 purchase options.
[4] See "Black Clouds in Aeronautical Sector," *Excélsior*, June 3, 2008.
[5] www.fsmex.com
[6] See Barroso, Fernando, "Unjustified Layoffs at Avolar Airline," *El Sol de Tijuana*, April 28, 2008.
[7] See "Traveling Lighter: Airlines Lose Weight by Getting Rid of Dishes, Blankets and Even Pillows," *Excélsior*, June, 2008.
[8] See Ulloa, Aída, "SHCP Stops Airlines," *El Universal*, June 13, 2008.
[9] Meeting with Enrique Beltranena and his Management Team, April 3, 2008.
[10] Exchange rate: 11 Mexican pesos to 1 US dollar. September, 2008.

time, and the recent opening of the aeronautical industry to the private sector by the Civil Aviation's General Management –DGAC– of the Communications and Transportation Department.[11]

The project had as a frame of reference one of the primal principles of a low-cost airline (LCC[12]): 1) optimizing costs by using a standardized fleet sharing direct distribution channels, 2) growing in market share by covering underserved and overpriced markets, 3) simplified, convenient and transparent processes while increasing added value for passengers (in particular, timely services), 4) utilizing a secondary airport, 5) motivated personnel compensated according to productivity in a friendly and new culture, 6) absolute safety with last generation aircraft, 7) world class top quality and reliable maintenance processes, and 8) financial standing to thrive and meet unexpected conditions.

At present Volaris' fleet is constituted by 18 last-generation 319 Airbus airplanes, a virtual airport located at Mexico City's West Side, serving more than 21 cities across the country with a novel operating model, connecting cities bypassing Mexico City's busy International Airport. It has a warranty policy on timeliness and luggage claims. In addition, Volaris obtained the CAT II and III Certification (for landing operations under low visibility conditions at the Toluca Airport)[13] and was recognized by Airbus as the world leader in A319 aircraft operations.

II. The Low-Cost Aviation Market in Mexico

Volaris began operations when three low-cost companies had already been launched in the market (Click –in June–, Avolar –in August–, and Interjet –in December– 2005), but before the launch of other two new players in the market (Alma de Mexico –in June–, and Vivaaerobus –in December– 2006). See Exhibit 1.

In 2007, the aviation industry in Mexico was constituted by 52 airlines in operation (12 major airlines, 21 regional airlines and 19 freight airlines),[14] with a total of 678 aircraft, more than 25,133 jobs, an infrastructure of 85 airports (25 domestic and 59 international airports) operated by the Federal Government through ASA (*Aeropuertos y Servicios Auxiliares*) and by three private groups: OMA (*Grupo Aeroportuario Centro Norte*), Asur (*Grupo Aeroportuario del Sureste*), and GAP (*Grupo Aeroportuaro del Pacífico*) and in some other cases, other minor dealers. See Exhibit 2.

Click

Click is the low cost airline of *Mexicana de Aviación*. It started operations under the name of *Click* in June 2005. Its fleet is constituted by Fokker F100 aircraft with a 100 seat capacity. It became popular in the Mexican market because of its services offered at affordable prices. It is headquartered in Mexico City's International Airport.

[11] For more information on Volaris' Business Project and the beginning of its operations refer to case study, "Volaris: The Business Project", IPADE, 2008.
[12] Low cost carrier, a conceptual basis differing from traditional airlines operating principles (Legacy Carriers).
[13] Toluca's Airport became Mexico's first airport with Class II and III ILS (Instrument Landing System). It is the third airport in Latin America with this technology, after Santiago de Chile and Buenos Aires, Argentina's airports. It is also part of the group of 100 terminals in the world with this type of certification. Toluca's airport is planning to develop a second runway and a second terminal, and estimates to serve 45% the metropolitan area's market by 2010. It is also in the process of entering into agreements with Iberia, Spirit Airlines and Lufthansa for its international operations.
[14] Major airlines operate with a variety of sized fleets, covering a combination of short, medium and long term flights. Regional airlines operate with medium and small capacity aircraft, usually serving short distance routes with high demand. Fleet airlines are known as Charters, renting services to groups.