Open Skies Over Poland:

An Emerging European LCC Battleground

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Poland is perhaps best known in commercial aviation as the home of the Warsaw Convention, a 1929 agreement that regulates airline liability for international travel. Despite Poland's unintended notoriety in international air transport, the country has become a prominent market for the expansion of the low-cost carrier (LCC) business model into Eastern Europe, a model originally confined to the United States and Western Europe but one that has since developed around the world. This growth has possible largely due to the liberalization of the international air transport regime in Europe.

Prior to 1993, airline links between European countries followed the international bilateral structure in force since 1944. Nations negotiated with each other over the following 'freedoms' of its airlines (typically only the country's flag carrier) to serve the other's country: which companies could operate, what cities they could operate between, when they could operate, how much capacity they could offer, and how much they could charge.[1] In addition, domestic traffic was fully insulated from competition and was available only to that state's airlines. Revenue pooling in this cartel style became widespread between carriers in Europe (on the order of 75-80%)[2], ensuring similar operating results regardless of performance. Because countries sought to protect their flag carriers, which they viewed as a vital part of their national interest, any changes desired by the airlines would require renegotiation of the appropriate treaty.

Liberalization of the bilateral system in Europe began in 1987 by limiting government rejection of fare changes and was completed in April 1997, whereupon any airline from a European Union member state (plus Iceland, Norway, and Switzerland) could operate freely within any of the signatory nations, whether on domestic or international routes.[3] However, this

[1] Rigas Doganis, *Flying Off Course: The economics of international airlines* (London: Routledge, 2002), 30.
[2] Ibid., 37.
[3] European Union Directorate-General for Energy and Transport, *Opening the European market up to competition*, 22 February 2006, http://europa.eu.int/comm/transport/air/rules/competition_en.htm.

international freedom is limited to within the European Common Aviation Area; services to non-signatories are still governed by bilateral treaties with those countries.[4] While these new privileges have remained largely unused by the now-privatized national airlines (e.g. Air France, British Airways, KLM, Lufthansa, et al.), newer carriers that have adopted the LCC model, notably Air Berlin, easyJet, and Ryanair in Western Europe, and SkyEurope and Wizz Air in Eastern Europe, have eagerly taken advantage of the new 'open skies' regime and established bases across Europe, becoming pan-European airlines in an industry previously divided across national borders.

The basic LCC model, in contrast with the traditional airline model, is predicated on the following operating concepts:[5]

	Traditional Model	**LCC Model**
Primary Customers	business travelers	no preference
Fare Structure	higher fares, numerous fare types	lower fares, simplified fare types
Destinations	larger, closer, primary airports	smaller, out-of-the way airports
Distribution Network	travel agents, corporate contracts, global distribution systems, reservations numbers	own websites, reservations numbers
Service Levels	low to high	minimal to nonexistent
Route Networks	centered around major hubs, connecting service	spread out across numerous bases, focus on nonstop flights
Seating	first and coach class	all coach class
Fleets	numerous types	single type
Labor Force	unionized, high pay and benefits	nonunion, lower pay and benefits

Compared to the United States, the LCC model is still relatively new in Europe. The first scheduled low-fare operations within Europe (as opposed to charter operations) were in 1985 by Ryanair, today the largest LCC in Europe.[6] The new business model has seen the greatest development in the United Kingdom thanks to its lower labor costs and social charges,[7] although

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[4] Doganis, *The Airline Business in the Twenty-first Century* (London: Routledge, 2003), 45.
[5] Ibid., 128-135.
[6] Simon Calder, *No Frills: The Truth Behind The Low-Cost Revolution In The Skies* (London: Virgin Books, 2002), 75.
[7] Doganis, *The Airline Business in the Twenty-first Century*, 136-137.

higher economic growth rates in Eastern Europe, coupled with similarly low labor costs, led to the creation of new carriers following the multinational approach in the region in the last five years. Poland, the fastest growing aviation market in Europe, and third fastest in the world,[8] has especially benefited from this growth, with six carriers now operating from Poland compared to just two as recently as 2003.

	LOT / euroLOT	centralwings	FischerAir	SKY EUROPE	WIZZ
Headquarters	Warsaw	Warsaw	Prague	Bratislava	Budapest
Founded	1929; 1997	2005	2004	2001	2004
Hubs/Bases	Warsaw	spread out across four airports, seven in summer	Warsaw	Bratislava, Budapest, Krakow, Prague, Warsaw	Budapest, Gdansk, Katowice, Warsaw
Polish Destinations	nine	four	one	two	Five
International Destinations from Poland	48	25	23	16	17
Fleet	4 767-300 2 767-200 3 737-400 6 737-500 10 E-170 8 ATR 72 5 ATR 42	4 737-400 2 737-300	2 757-200	5 737-300 7 737-500	6 A320
2005 Revenue	€711.9 million	included in LOT	N/A	€112.7 million	N/A
2005 Profit (Loss)	€22.9 million	included in LOT	N/A	(€28.6 million)	N/A
2005 Passengers	4.1 million	included in LOT	224,000	1.7 million (all operations)	1.9 million (all operations)
Comments	Star Alliance member since 2003; EuroLOT is a wholly-owned LOT subsidiary	low-fare LOT subsidiary, partnered with Germanwings	part of Czech tour operator Fischer, privately owned	recently ordered 16 737-700s	privately owned

Figure 1. Airlines Currently Operating from Poland[9]

[8] "The Sky's the Limit," *Warsaw Voice*, 18 August 2005, http://www.warsawvoice.pl/view/9128.
[9] Author compiled from:
Centralwings, http://www.centralwings.com;
Fischer Air Polska, http://www.fischerair.pl;
LOT Polish Airlines, http://www.lot.com.pl;
SkyEurope Airlines, http://www.skyeurope.com;

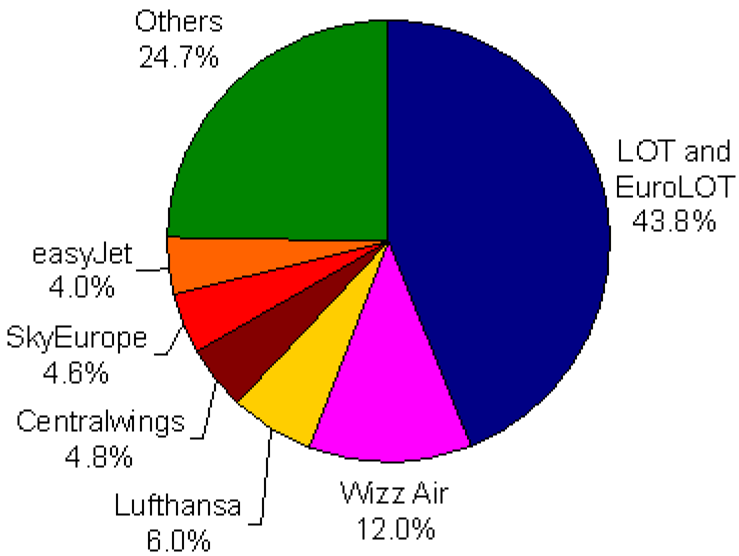

Figure 2. 2005 Market Share, Passengers in 2005[10]

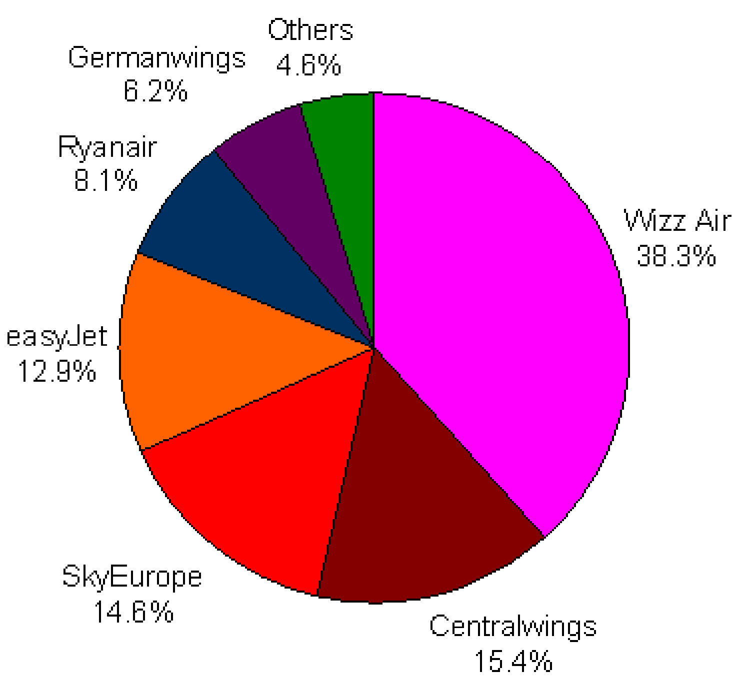

Figure 3. LCC Market Share, Passengers in 2005[11]

Wizz Air, http://www.wizzair.com.

[10] Author compiled from Civil Aviation Office, *Liczba obsłużonych pasażerów w polskich portach lotniczych w ruchu regularnym według przewoźnika faktycznego w latach 2005 / 2004*, 9 February 2006, http://www.ulc.gov.pl/download/pdf/ULC_przewoznicy_dane_stat_2006.pdf.

[11] Ibid.

Poland has eleven commercial airports, of which no more than nine are served by any one carrier. These airports are managed by Polish Airports State Enterprise, local municipalities, or private entities, and handles increased passenger traffic of 30% in 2005.[12] Although only 11.5 million passengers flew through Polish airports last year (compared to 67.7 million at London Heathrow), the number is projected to increase to 34-42 million by 2020.[13] Warsaw Okęcie Airport alone handles two-thirds of this traffic, although it is growing the slowest of the country's airports (a mere 16% in 2005).[14] Discussions of infrastructure improvement and expansion, especially for Warsaw in hopes of enhancing it as a gateway to Eastern Europe, are currently underway.[15]

The recent history of the airline industry in Poland is typical of many Eastern European countries: the national airline, LOT Polish Airlines (*Polskie Linie Lotnicze* in Polish) was partially privatized from 1991 to 1998 through employee stock ownership plans and international bidding to foreign airlines interested in a strategic partnership, with Swissair eventually selected.[16] Near the end of the privatization process, LOT set up a subsidiary, EuroLOT, in 1997 to handle domestic traffic and lower-traffic international routes,[17] with the advantage of lower operating costs. EuroLOT has since maintained its monopoly on domestic air service, as LCCs have focused solely on international flights. Meanwhile, LOT's emphasis on serving higher-yielding traffic has served it well: the airline has been recognized by Business Traveller as the

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[12] Civil Aviation Office, *Wielkość przewozów pasażerskich oraz towarowych w ruchu rozkładowym oraz czarterowym w latach 2004-2005*, 26 January 2006, http://www.ulc.gov.pl/index_1.php?dzial=wiadomosci&plik=26_01_2006.
[13] Ibid.
[14] Ibid.
[15] Andrzej Ratajczyk, "Airports in Holding Pattern," *Warsaw Voice*, 19 October 2005, http://www.warsawvoice.pl/view/9620.
[16] "Flying Toward New Horizons," *Warsaw Voice*, 28 November 1999, http://www.warsawvoice.pl/archiwum.phtml/4049.
[17] LOT Polish Airlines, "LOT History," http://www.lot.com/lot2/Portal/EN/aspx/411.aspx.

best carrier in the region for eight years in a row.[18] Following the collapse of Swissair in 2001, which owned 37.6% of LOT, new international partners were needed, and LOT joined Star Alliance, the largest airline alliance in the world, in 2003.[19] Star was a logical choice for LOT, given Lufthansa's membership and the strong economic ties between Poland and Germany. LOT is planning an IPO on the Warsaw Stock Exchange to take place later this year.[20]

The Polish LCC movement began in 2001 with the founding of Air Polonia. Operations began in April 2003 and expanded quickly. When Poland became part of the European Common Aviation Area the following January, numerous other carriers entered the market: Air Berlin, easyJet, Germanwings, Niki, SkyEurope, and Wizz Air. Ryanair was not far behind, adding Poland to its network the following year.[21] The dilution of passenger yields as a result of the heightened competition led to Air Polonia declaring bankruptcy and ceasing operations in December 2004, when it had insufficient liquidity to pay for its aircraft leases.[22] GetJet, another Polish LCC at almost exactly the same time, had a similar experience, albeit smaller and less noticed.[23] Despite this market turbulence, the Air Polonia ascent and collapse experience was not enough to deter future expansion in the Polish market, since the country's economy was growing faster than most of Western Europe (an average of 4.1% from 2003-2005 vs. a 1.6% average for the EU-15),[24] the skies over Western Europe were becoming filled, and Eastern European countries were an untapped market with passengers willing to pay, provided the fares were low

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[18] Ibid.
[19] Ratajczyk, "Among the Stars," *Warsaw Voice*, 29 October 2003, http://www.warsawvoice.pl/view/3938.
[20] International Association of Airport Executives, *Civil Aviation Market in Poland*, August 2005, http://www.iaae.org/meetings/Budapest2005/Polish_Civilian_Aerospace.doc.
[21] "Fear of Flying," *Warsaw Voice*, 20 February 2003, http://www.warsawvoice.pl/view/1325.
[22] Ratajczyk, "Not Cleared for Take-Off," *Warsaw Voice*, 15 December 2004, http://www.warsawvoice.pl/view/7285.
[23] Ratajczyk, "Welcome to the Cheap Seats," *Warsaw Voice*, 28 August 2003, http://www.warsawvoice.pl/view/3316.
[24] Eurostat, *Real GDP growth rate*, http://epp.eurostat.cec.eu.int/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=Yearlies_new_economy&root=Yearlies_new_economy/B/B1/B11/eb012.

enough. Thanks largely to the new carriers and accession to the European Union, Poland's Tourism Institute predicted a nearly 5% annual increase in visitors from 2004 through 2007.[25]

In reaction to easyJet and Ryanair, LOT formed a low-cost subsidiary, Centralwings, with three of its own 737s, a number that has since doubled.[26] Centralwings began operations less than three months after Air Polonia's closing, and soon thereafter entered into a codeshare agreement with Germanwings, a subsidiary of Eurowings, itself a subsidiary of Lufthansa.[27] Creating an LCC with a company's own assets was nothing new; the strategy had been previously adopted by Air Canada, British Airways, Continental, Delta, KLM, United, US Airways, to name but a few. Some of these LCCs were formed to protect market deterioration, but all sub-brands of the aforementioned airlines were eventually shut down because, as then-CEO of British Airways Rod Eddington noted when closing Go, "as a no-frills operator…it does not fit in our full-service strategy."[28] Self-competing behavior, brand confusion among customers between two service levels, and higher costs creeping in from the parent company inevitably resulted to make these attempts unsuccessful. The LOT case, however, may be different: LOT may be able to successfully use Centralwings to stem market share loss because of the country's naturally lower labor costs.

The charter market, despite existing since the 1950s and also predicated on low fares, has, due to the recent LCC explosion, fallen to third place in Europe. The majority of charter flights are set up on behalf of tour operators, often with all-inclusive packages, most often to Mediterranean destinations.[29] Polish carrier White Eagle left the charter market in 2003, citing

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[25] Wanda Jelonkiewicz, "Not Cleared for Take-Off," *Warsaw Voice*, 12 January 2005, http://www.warsawvoice.pl/view/7396.
[26] Ratajczyk, "A LOT Cheaper," *Warsaw Voice*, 5 January 2005, http://www.warsawvoice.pl/view/7340.
[27] R.S., "Polish-German Alliance," *Warsaw Voice*, 19 January 2005, http://www.warsawvoice.pl/view/7451.
[28] Calder, 139
[29] Doganis, *Flying Off Course*, 154-5.

better opportunities in its cargo business.[30] LOT also operated some charters before handing over those operations to Centralwings. Fischer Air Polska began offering charter flights in 2005 connection with its parent company, the Czech tour operator Fischer.[31]

The first LCC in Eastern Europe came from an unlikely country: Slovakia. SkyEurope Airlines began flying a fleet of 737s in 2002 from Bratislava and quickly took advantage of the open skies, opening two bases in Poland following the country's entry to the European Common Aviation Area. While SkyEurope had a strong entrance into the Polish market, forcing Austria's Niki and Germany's Air Berlin out, it soon fizzled due to competition from another East European entrant, Wizz Air.

Based in Budapest, Wizz Air (or W!zz Air, if looking at their logo) was founded in 2004 by the recently ousted CEO of the state-owned MALÉV Hungarian Airlines, József Váradi. Wizz Air quickly usurped SkyEurope as the leading LCC in the region and established Polish bases in Gdansk, Katowice, and Warsaw.[32] SkyEurope countered by reducing fares, and as a result, lost €28.7 million on just €112.7 in revenue in 2005.[33] Due to Wizz Air's success in Poland, SkyEurope began cutting routes from Poland and announced a new base in Prague in February 2006. "In spite of being influenced by the low-cost revolution mostly from the U.K., the market in Prague remains underserved and missed a dedicated low-cost, low-fare airline based there," SkyEurope claimed as justification.[34] A media dispute between the two quickly broke out, with Wizz Air offering free tickets to stranded SkyEurope customers (having only to pay airport fees and taxes) and claiming in a press release that

[30] International Association of Airport Executives.
[31] Fischer Air Polska, *About Us*, http://www.fischerair.pl/site/index_en.php?id=o_firmie&idsub=o_firmie_en.
[32] Carol Matlack, "Wizz Air's Promising Flight Path," *BusinessWeek Online*, 11 January 2006, http://www.businessweek.com/bwdaily/dnflash/jan2006/nf20060111_8692_db039.htm.
[33] SkyEurope Holding AG, *Annual Report 2005*, 17 January 2006, http://www.skyeurope.com/pdf/investor_relations/annual_report_2005_en.pdf .
[34] ATW Daily News, 14 February 2006, http://www.atwonline.com/news/other.html?issueDate=2/15/2006.

> SkyEurope's drastic capacity reduction in Poland falls in line with earlier experienced performance issues of other low cost airlines including Air Polonia…leaving many passengers stranded. "Wizz Air is in Poland for the long run….As the leading low cost airline in Poland we step up to help stranded passengers. We are doing it for SkyEurope passengers as we have been doing it in earlier events. Passengers can count on Wizz Air," said József Váradi.[35]

The following day, SkyEurope retorted with:

> SkyEurope is outraged about the incomplete and misleading information by *Hungarian* [emphasis mine] Wizz Air after announcing the cancellation of some routes out of Poland….Moreover and to prove false Wizz Air's statements and its ridiculous campaigns, the airline just recently quietly reduced capacity on several routes [ten listed]….However, SkyEurope will always remain fair airline and brave to cut underperforming routes as the only listed and transparent low fare airline in Central Europe, which can be demonstrated also by not charging its passengers hidden surcharges: [sample fares of SkyEurope and Wizz Air follow][36]

Press tactics such as these are nothing new to LCCs, dating back to Southwest's early days,[37] and in Europe with easyJet and Ryanair frequently squabbling and trying to outdo each other,[38] mainly for the media attention, but also because airline leaders tend to be rather extreme characters: "calling them men of ego would be like calling Mount McKinley a rise in the landscape," one airline historian notes.[39]

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[35] Wizz Air, *Wizz Air offers free tickets to help stranded SkyEurope passengers*, 14 February 2006, http://wizzair.com/cgi-bin/news.cgi?Language=English#oA9rdVOV.
[36] SkyEurope Airlines, *Strategic expansion in Prague coupled with further growth in Krakow*, 15 February 2006, http://www.skyeurope.com/actualnews.php?lang=en&item=2&aid=2319&lang2=14.
[37] Thomas Petzinger, Jr., *Hard Landing* (New York: Three Rivers Press, 1995), 37.
[38] Calder, 102
[39] Petzinger, xix.

Poland's commercial aviation sector has, like numerous European countries before it, been transformed tremendously by the entrance of LCCs, which have grown to carry 31% of passengers in 2005, up from just 13% a year before.[40] They have passed on their lower costs to consumers, forcing the traditional airlines to reduce fares by over 40%.[41] Although LOT has not been able to maintain the growth as the rest of the industry (not unexpected, given their emphasis on business-oriented traffic), having its market share reduced from 2004's 58% to 44% in 2005, it has still been able to post positive results during a difficult time in the industry. Despite Poland not yet having a successful independent LCC of its own, and SkyEurope's possible disappearance from the scene given its poor financial results, the immense growth prospects of the Polish market still portend a bright future for commercial aviation in Poland.

[40] Civil Aviation Office, *Liczba obsłużonych pasażerów w polskich portach lotniczych w ruchu regularnym według przewoźnika faktycznego w latach 2005 / 2004*.
[41] Ratajczyk, "Welcome to the Cheap Seats."