

# Russian Airspace a Greenfield for Budget Carriers

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The flurry of announcements about possible cheaper ways to fly — including national carrier Aeroflot revealing details this week of plans to launch a budget airline next spring and No. 3 airline UTair's recent pledge to create a low-cost hub at a military airfield in Kaluga — underscore the potential for this aviation niche in Russia.

The most recent entrant to Russian skies, British-based EasyJet initiated service to Moscow this spring and has been ramping up what some passengers new to the low-cost format have termed a "flying elektrichka," reminiscent of commuter train rides where entrepreneurs constantly walk the aisle providing maps, toiletries and accordion serenades at bargain prices.

In the airborne version of this tradition, the carrier begins hawking its wares to you the moment you begin to select your flight and have to purchase any extras, such as baggage

and seat rights. It follows up prior to take off with a barrage of email advertisements for partner services.

But even budget carrier veterans say it remains to be seen if their model can overcome local geography and mentality.

Then, cabin staff — who seem to have undergone extensive retail sales training — takes over after boarding with a non-stop flow of offerings, including food, drinks and even tickets for the airline's own lottery — all of which add to the company's top line.

But beyond the unending sales process, there are many other subtleties to being profitable in the low-cost airline business that are not visible to the passenger's naked eye.

As journalists settled into their seats on an EasyJet aircraft ready to depart its gate at Domodedovo airport on the second day of the airline's regular flights between London and Moscow earlier this year, their apprehension was palpable. Those with checked luggage had already paid their additional fees, and anyone who planned to eat on board knew they would have to pay extra for that privilege.

But the biggest surprise was still ahead. The door to the cockpit opened slightly as a crew member engaged the pilot in a casual conversation.

"So this is what low-cost means!" a Russian male passenger exclaimed as he realized the pilot was female.

EasyJet is not the first to fly into Russia on the low-cost model, but this hardly makes its journey any less difficult. Aside from the stereotypes about what a budget airline means for passengers, there are strict state regulations that constrain how air carriers can operate.

## **New Style of Flying**

The word "budget" sounds ominous in Russia, and if in the West it has come to mean simply less comfort for less money, Russian passengers are well conditioned to fear the worst.

"In Britain, there are more progressive audiences, not like in the hinterlands here," said Oleg Panteleyev, head of the Aviaport analytics agency. "They are more familiar with the low-cost model. We just have a stereotype that it is very cheap."

Panteleyev added that Russian passengers were used to having basic services, such as meals and the right to check bags, included in the price of their airline tickets. But for budget airlines these are the main comforts on which they cut costs to keep the ticket prices down.

The formula for saving money is not a complicated one: fly to second-tier airports where landing fees are lower, maximize the number of seats by limiting space between to the bare minimum, serve no meals onboard, charge for luggage, offer no refunds, and cut waiting times in airports to maximize throughput and aircraft turnaround. At the same time offer as many of these formerly taken for granted privileges back at profitable add-on fees.

Europe's second largest "low-cost" — a term that has now become part of Russian flying lexicon —

EasyJet, which launched flights connecting Moscow to London and Manchester in March, knows everything about being efficient. The airline has even gone on a radical mission to lighten the weight of its jets with the aim to reduce the amount of fuel spent. This meant getting lighter carpets, lighter onboard equipment, and covering planes with a greasy substance that reduces friction as they move through the air.

"The reason we can have the low fares that we offer is because we have a very low-cost operating model, which means that we are highly efficient," said EasyJet chief Carolyn McCall, while giving an interview onboard the Moscow-London flight, thousands of feet in the air.

"We don't waste money, we don't waste time," she emphasized.

These efforts have allowed EasyJet to reduce fuel consumption by 1 percent, which is fairly substantial considering that the airline's spending on fuel last year was 240 million pounds (\$368 million) over budget.

However, while the EasyJet executives were mulling the pot of gold on the other side of the cloud cover during the promotional flight, Russian passengers were experiencing mild frustration as they sought non-existent recline buttons and headphone jacks on their seats.

EasyJet saved weight to reduce fuel consumption and maximized cabin occupation by installing seats without recline mechanisms. And until the return-on-investment model says otherwise, passengers shouldn't expect wiring for sound or entertainment systems of any kind in the cabin.

McCall managed to ease the mood of her bewildered passengers by moving along the aisle and personally collecting garbage from the guest travelers, having already provided complimentary champagne — not a standard offering on non-promotional flights.

## **It's About Rules**

Even if the passengers are ready to relax, the low-cost carriers still have to contend with the Russian government and its strict controls on what supplementary services airlines are obligated to provide.

Russia's Air Code dictates that airlines must serve passengers meals, transport a set amount of their luggage and offer ticket refunds. Experts say these rules make it difficult to adopt the low-cost model in Russia.

Aeroflot chief Vitaly Savelyev told President Vladimir Putin last October that the airline

planned to create the first Russian budget airline within the year — but only if there are changes made to the Air Code.

"A low-cost carrier in the Aeroflot group of companies could be created half a year after the necessary changes are made to the Air Code and aviation rules," an Aeroflot spokesperson said in a statement last month. "Until then, it is premature to comment on the strategy of the future air carrier."

Officials from the Transportation Ministry are working on new legislation that would omit some of these obligations and have promised to deliver the revised rules by the end of this year.

Meanwhile, EasyJet managed to get around some of the current rules, including food and luggage requirements, though the British airline was still forced to offer refunds for flights from Moscow — a feature it does not offer in any of its other markets.

EasyJet's UK director Paul Simmons said the airline negotiated with Russian authorities to cancel some requirements of the Air Code, though he did not say what factors swayed the authority to concede.



*EasyJet's Andrew McConnell monitoring the fleet at the firm's operations center in Luton, outside of London. (Lena Smirnova / MT)*

## Crashing and Burning

So far, the experience of budget airlines on internal Russian routes has been a string of failures. The two most recent attempts, Avianova and Sky Express, ultimately went bankrupt.

No-frills Sky Express flights between Moscow's Vnukovo Airport and St. Petersburg, Yekaterinburg, Chelyabinsk, Kaliningrad and Sochi began in 2007. The 2008 economic crisis hit the company hard, and the Russian Federal Air Transportation Agency eventually annulled its certificate in 2011, citing a precarious financial situation.

Avianova, a joint project between the American investment fund Indigo Partners and an investment branch of Alfa Bank, started domestic flights in the turbulence of 2009 out of Sheremetyevo Airport. The airline stopped selling tickets in 2011 because its expenditures exceeded revenues by billions of rubles.

Avianova flew from Moscow to Sochi for 7,000 rubles (\$222) and Sky Express offered flights for the same route for 8,800 rubles.

Currently a handful of European and Arab budget airlines fly to Russia, including AirBerlin, Germanwings, EasyJet, Vueling Airlines, Air One, Air Baltic, Norwegian, Niki, Pegasus Airlines, Air Arabia and Flydubai.

The biggest European budget airline, Ryanair does not fly to Russia, although company head Michael O'Leary said several years ago that he had held talks with officials at Russian airports.

## **Finding a Home Abroad**

One of the main barriers for budget airlines when looking to expand here are the steep landing fees at local airports. The fees at Domodedovo and Sheremetyevo are twice as high as in Luton, from where Ryanair and EasyJet operate their European flights. All the while, Luton is 60 kilometers from London's center, just 20 kilometers more than the distance between Moscow's center and its airports.

"The network of alternative airports that can service low-tariff carriers is still not developed in Russia," said Gediminas Ziemelis, board chairman at Avia Solutions Group, an international aviation service provider. "Such an airport should be somewhat distant from the main transportation hubs, provide a narrower range of services and, perhaps, not be of as high a quality as the main airports."

There are no such airports at the moment in Russia, but UTair's announcement on May 22 that it would build a low-cost hub at a military air base in Kaluga, 100 kilometers from Moscow, could mark the start of a wave of such alternative and cheaper landing facilities sprouting up.

Aeroflot's chief Savelyev has asked Putin in the fall to consider providing federal funding to build special airports from which low-cost airlines would fly, though the economics of having lower landing fees at a modern airport built from scratch are not clear.

Another factor in whether airlines can offer flights at a discount price is how much they spend on aircraft, Ziemelis said. The catalogue price of an Airbus A320 is \$91.5 million, while a Boeing 737-800 costs \$89.1 million. The success of Ryanair and EasyJet, which Ziemelis said were the only low-cost airlines with significantly high profits, was from their ability to buy their planes at discounted prices — as much as 50 percent of catalog price — after the September 11th attacks and the economic crisis.

"It will be fairly hard to replicate the success of Ryanair and EasyJet," Ziemelis said, specifying that airplane makers like Boeing and Embraer are in a better financial situation now and don't need to offer the same high discounts.

Despite her company's high ticket sales, even EasyJet's McCall said she was yet unsure as to how well the budget airline approach translates to Russia nationwide.

"Our model is about relatively short-haul. Four hours, the route to Moscow, is about the outside of what we do. Because of the distances involved in Russia, it would be much more difficult for our model to necessarily be transferable to the rest of Russia," McCall said.

Aviation experts are also unsure if EasyJet's entry into the market will make the other airlines lower their fares. It is still too early to make predictions, said head of the Aviaport Oleg Panteleyev.

McCall said airlines that operated flights in France's regional routes did lower their prices when EasyJet came to the market, but this did not happen when the British airline flew to Germany. There is no guarantee that Russian competitors will lower their prices as well, she concluded.

EasyJet expects to transport more than 300,000 passengers on its Russian routes during the first year.

"London to Moscow is a very particular route," McCall said. "It's a highly profitable route. It's not got a lot of capacity so that tends to dictate pricing. If there were a lot of capacity on this route, we would think differently. But I'm not sure it's going to change pricing overall."

## **Efforts Grounded**

Where private investors faltered, the Russian government has stepped in, drafting an ambitious road map for boosting competition in the aviation industry. According to the road map, which was approved last December, Russia will get its first domestic low-budget airline carrier in 2013, and another could be added to the roster in 2014.

For the moment though, rules seem to hamper how quickly budget airlines can come to Russia.

A foreign-based international airline can not operate here until there is a bilateral agreement established for routes. EasyJet was only able to come to the market after British Airways bought up BMI, which opened up a spot for a new carrier on the London-Moscow route. The low-coster then competed with seven other airlines and won, but received the formal approval from Rosaviation just days before its first flight took off.

EasyJet managers said the aviation authorities took awhile to give them flight permits because in Russia such procedures tended to take longer — not because of opposition from other airlines on that route.

"I think we're just a bit of an unknown quantity," said EasyJet's UK director Paul Simmons. "You do have to come and explain what we're all about and that we're not trying to wreck everyone else's business."

Aviaport's Panteleyev said that, regardless of the current situation, the government should not interfere in the development of a budget airline market in Russia.

"There is no need to [force the development of] budget airlines. It's the same thing as trying to make the spring come faster," he said, adding that instead the government should aspire to increase people's disposable income so that they can fly more.

But for now, railroads are still the preferred mode of transportation in Russia.

When new player Sky Express came on the market, passenger flows on their routes increased 25 to 55 percent, Panteleyev said. Three quarters of the passengers using Sky Express had previously been using the railroad for such travel, rather than other airlines.

However, Panteleyev added that airlines started to take over passengers from railroads only when the route distances were 700 kilometers or more — and even then, it was 1st and 2nd class train passengers that upgraded themselves to air travel.

"It is hard to win over 3rd class train passengers," Panteleyev said. "Buses compete for them, not planes."

As such, the most profitable places for budget airlines to fly to in Russia would be Yekaterinburg, Tyumen, Surgut, Khanty-Mansiisk and St. Petersburg, Panteleyev said. These routes are up to three hours long, which fits within flight time norm of low-cost carriers, and can have daily passenger flows large enough to load two 170-seat planes.

But even with its unrivaled popularity, Russian Railroads still uses some tactics familiar to budget airline travelers, like turning a profit on sales of refreshments and snacks. Tea and accompanying sweets, for example, brought the rail monopoly over 585 million rubles in 2009 alone.

Though you can still get a cup of tea on a Russian train for 20 to 50 rubles, depending on the class of service and route, some passengers rage at the price and debate the injustice while onboard the train or in online forums — much like some passengers complain about food prices on budget flights.

### **Additional Costs of Flying on EasyJet**

<b>Service</b>	<b>Cost</b>
Round Trip Ticket Moscow-London	\$141-463, depending on purchase date
One piece of checked luggage	\$56
One piece of checked sporting equipment	\$40
Seat selection	\$5
Seat in front of the cabin with early boarding rights	\$13
Seat in the first or exit row with extra leg room	\$20
Lottery ticket	\$1.5
Mineral water bottle, 500 ml	\$2.70

Starbucks-branded coffee	\$3.80
Sandwich	\$6
Meal of potato chips, sandwich and bottle of water	\$8.70
Passengers have the right to buy tickets with luggage, seat rights and date changing rights in one package for a premium of from 15 percent to 75 percent more than standard ticket prices. Some budget airlines will even pass on their finance costs to fliers, charging an additional commission depending on which credit or debit card is used for payment.	

*Source: EasyJet*

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