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INSEAD

Extending the "easy" Business Model: What should easyGroup do next?

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This case was written by Yves L. Doz, the Timken Chaired Professor of Global Technology and Innovation at INSEAD, and Anita Balchandani, Senior Consultant at Roland Berger Strategy Consultants. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

"The only quoted conglomerate I know that works on the stock markets is General Electric. easyGroup is not about unrelated ventures, but about developing a formula for success that can be replicated across seemingly disparate businesses."

Stelios Haji-Ioannou

easyGroup's Planned Entry into the UK Cinema Market

easyGroup was reviewing its plans to open a multiplex in May 2003, under the easyCinema banner to compete head-on against established national operators in the UK like Odeon, Warner Village and UGC Cinema. The group's CEO, serial entrepreneur Stelios Haji-Ioannou, aimed to replicate the success of easyJet, the low-cost airline that he had established in 1995, by creating a similar no-frills concept in the cinema industry. The millionaire businessman's stand was, "Nobody has tried to do this and I am told covert practices abound that prevent cinemas cutting prices. Current prices are far too high – they put people off going to the cinema."

easyGroup believed that it could create a successful cinema exhibition venture by applying the principles that had worked in the low-cost airline business. Firstly, the yield management capabilities that had served them so well in running an airline could be re-deployed in easyCinema. easyJet prices were closely linked to demand and how far in advance tickets were booked: a ticket booked three months in advance would be significantly cheaper than one booked a week before the flight. Likewise, peak-time tickets, like 6pm Friday, would cost more than at a less busy time. While incumbent cinemas in the UK typically operated at 20% capacity, they had never pursued the strategy of offering extremely cheap seats for advance bookings or at off-peak times, or of differentiating price by type or length of film. Several cinema operators had invested in refurbishing cinemas and upgrading seats in order to attract audiences back. Stelios viewed this as analogous to the business-class on airplanes and questioned whether people would be willing to pay for bigger, more comfortable seats. He believed a cinema operator "... should be thinking about squeezing another 30% in there. Why are cinemas charging so much money when they're so empty? It's like what airlines once were." By maximizing both capacity and the extent to which it was utilized, easyGroup hoped to grow cinema admissions well above current rates.

Secondly, the group planned to rely on technology to automate the process of serving customers, thereby reducing labor costs. All bookings would be made through the Internet or from a machine in the foyer, with fares for advance bookings down to 20p. The average cinema had a crew of 20 people. easyGroup's plan was to reduce that number to four primarily comprising security staff and projectionists. The easyCinema concept would dispense with the box-office and ushers. Consumers would purchase tickets on the Internet and print out a unique bar code which would activate an entry turnstile at the cinema.

Thirdly, as in the airline business, the concept would be strictly no-frills with a view to maximizing the number of films screened. The cinema would not show any advertising nor would it support marketing activities or promotional events associated with films. Customers would be allowed to bring in their own food and drink. The group thought that there was no danger of destroying the magic of the cinema-going experience by removing the box-office and the traditional concession stand – on the contrary, "what we're doing is taking away a consumer rip-off. Three quid for popcorn is a rip-off."

Stelios tasked Matthew Lee, part of the six-member New Ventures team, with responsibility for assessing the potential for easyCinema and developing the concept for this new business idea. The core management team comprising Stelios, Nick Manoudakis (Chief Operating Officer), Steven Hall (Chief Financial Officer) and the New Ventures Team, would meet in a week's time to discuss whether they should launch easyCinema.

The Market for Cinema in the UK

The cinema industry in the UK was experiencing a revival of sorts. Admissions in 2001 were at the highest level in decades – 156 million admissions generated £974 million in ticket sales (Exhibit 1) and were expected to continue to rise at an annual rate of 4% between 2003 and 2010.

One of the factors that had contributed to the steady rise in cinema admissions in the UK since the 1980s was the emergence of the multiplex – the first one in the UK was built in Milton Keynes in 1984 and was an instant success. These venues, with up to 20 screens, comfortable seats, superior picture quality and acoustics and free parking provided a classy alternative to their precursors, the cramped and poorly-furbished one-or-two-screen High Street cinemas often described as "fleapits". Multiplexes also offered consumers a wider choice of films and enabled cinema-going to become a more spontaneous leisure activity. A study by Euromonitor stated that "... the majority of the people decide at the last minute to go to the cinema because there is so much choice. Multiplexes are so big that if a film is full there is either another session starting in 40 minutes, or there is something else that they really want to see." Multi-screen cinemas had transformed film-going habits and were credited with luring people out of their homes. In its early years, a multiplex was typically the monopoly supplier to its local catchment area. However, as the number of multiplexes in the country increased (Exhibit 2), competition intensified and it became increasingly common for multiplex operators to compete directly against one another within a locality, giving consumers a wider choice of films and timings to choose from.

From an operational standpoint, multiplexes enabled better use of personnel. Staggered starting times allowed more efficient use of ushers and cleaning staff. Further, UK health and safety laws required that each cinema be manned by one employee per screen to handle emergency situations such as a fire. The multiplex environment enabled cinema operators to employ the mandatory number of employees to manage additional revenue-generating activities such as concession stands and ticket booths.

The Movie Industry

Film production, distribution and exhibition were the fundamental elements of the movie business.

Film Production

Film production was an expensive and very risky business with profitability reliant on the success of a small number of films. In 2001, the cost of making and marketing a Hollywood movie averaged $78.7 million, according to the Motion Picture Association of America. Over $14 billion had been invested in movie productions in the US, the European Union and Japan in 2000, a 12% increase from 1998. With the increase in old and new outlets such as cinemas, DVDs and the Internet, investment was expected to increase even more, according to a media research group in London. The commercial performance of films in most national markets could be best described as a heavy-tailed distribution, e.g. the top 20% of films in the UK earned approximately 85% of the revenue. The industry referred to this as "Murphy's Law" or alternatively as "the blockbuster effect".

The making of big-budget films for international distribution had long been dominated by the Hollywood studios: Warner Bros., owned by Time Warner Entertainment; Sony Pictures Entertainment; Disney Studios; Fox Filmed Entertainment, a Fox Entertainment company and VUE owned by Vivendi Universal. The production of a film would begin only when the necessary financial backing had been secured. In most cases this required an assurance that arrangements to distribute the finished product were in place. The Hollywood studios had vertically integrated into the distribution business and were usually able to finance production from their own resources. UK film companies, however, were not large integrated organizations and therefore had to pre-sell film distribution rights to a separate distribution company which contributed to the production budget either in the form of an advance against expected distribution profits or guarantees against which the production company could raise bank finance.

The Hollywood studios accounted for a high proportion of box-office receipts in the UK but there was vigorous competition between them and no one studio dominated. 2001 was a year of big-budget releases. Harry Potter and the Philosopher's Stone, Lord of the Rings: The Fellowship of the Ring, Spiderman, epitomized the shift in film-making towards bigger budget productions.

Distribution

The distribution companies operating in the UK cinema industry were of two types: studio-owned or independent. The top-five distributors – 20th Century Fox, UIP, Buena Vista, Warner and Columbia Tristar – were each owned by one or more of the Hollywood studios (Exhibit 3). Their market share fluctuated widely from year to year, reflecting the success of individual films, and their main role was to distribute the films made or acquired by their parent companies. They did not have to bid or pay in advance for the UK distribution rights to those films but acted as the sales and marketing arms of their respective parent companies. Their role was to advise on which films should be released across cinemas in the UK, to develop and execute release and marketing strategies, and to sell exhibition rights to independent cinema operators. In most cases, film release costs, e.g. advertising, promotion and the manufacture of prints, were undertaken by their respective corporate parents. In return the distributors would remit rental receipts to their parents after retaining a proportion of income deemed to be acceptable to the Inland Revenue as a fair reflection of the profits of the UK-based activity.

Independent distributors, on the other hand, did not have access to an assured supply of films. They bid for distribution rights to films made by independent producers and would finance all or part of the production in exchange for the rights to exploit the film. Independent distributors typically specialized in niche, art-house films.

Distributors determined the marketing plans and release strategies on a film-by-film basis taking into account several inter-related factors: type of film; estimated size and composition of potential audience; other films likely to be released around the same time; number of cinemas available and interested in the film; budget available to support the release. Discussions between distributors and cinema exhibitors regarding films that were expected to be popular, would commence up to 12 months before the film was expected to be ready for UK theatrical release. The two parties would agree upon a release date and reserve screens on a provisional basis (a process often referred to as "penciling in"). Distributors targeted exhibitors in three waves: leading exhibitors, followed by specialist multiplex operators, and finally the independent exhibitors. This advance planning enabled distributors to finalize plans for advertising and other promotional activity, expenditure that could be as high as £1 million on the promotion of a major release. Independent distributors, however, were not in a position to plan well in advance because, unlike the integrated distributors, they were not involved with the films that they handled from the outset. Further, they found it more difficult to convince exhibitors to "pencil in" their films before they become available for viewing and consequently had difficulty obtaining the bookings that they desired.

Distribution was essential for a film's financial success, as highlighted by the company that co-produced the film Trainspotting. UK box-office takings were just the "shop window" for their product. Investors could recoup their cash from sales to foreign territories, TV stations and, most importantly, from video and DVD rentals. A distributor usually released a film in successive periods to these different channels, beginning with the cinema release and proceeding through to pay-TV, video/DVD rental and sale, and finally free-to-air television. Therefore consumers keen to see new releases had no alternative but to visit the cinema. While cinema represented approximately one quarter of total revenues (Exhibit 4), it remained highly important because the success of a film in the cinema was viewed as being critical to its success in multiple other markets.

Competition between distributors heightened with the growing importance of advertising and promotional activities which played an increasing role in determining the commercial success of a new release. These included in-cinema marketing (such as "trailers", and point-of-sale promotions), television and radio advertisements, poster advertising and interviews with actors, directors and producers. Music from films was sometimes released simultaneously on CDs and cassettes. Merchandising agreements, such as those with fast-food retailers or consumer product companies, e.g. Coca-Cola's hugely successful campaign as the "drink of choice" with the movie Bridget Jones' Diary, and the launch of its special silver packaging at cinema venues.

Exhibition

Cinevan, with its flagship brand, Odeon, was the leading cinema operator in the UK, both in terms of market share and number of screens. Other key operators were UCI, UGC, Warner, National Amusements and Cine-UK (Exhibit 5).

Cinevan, a private equity firm, had purchased Odeon Cinemas in February 2000. It merged the company with ABC Cinemas, which had been acquired from Virgin in 1996. The company, with approximately 3,400 employees, was re-branding its portfolio of 106 sites and 600 screens, under the Odeon banner. Odeon Cinemas had developed a strong proposition as the film-lover's brand, with its slogan "Fanatical About Film". In keeping with these values, it also launched Alternative Odeon, a sub-brand that brought niche, alternative cinema to a targeted customer base. Odeon was also considering other ideas to grow its core cinema business. These included business conference hosting services in cinemas and exhibitions of alternative film content such as Broadway musicals, rock concerts, opera and ballet. In 2002, it showed the World Cup games beamed live from Japan and South Korea. "We will sweat assets going forward," said Richard Segal, CEO of Odeon Cinemas.

In 1984, UCI, an international specialist multiplex operator, pioneered the multiplex in the UK, operating 36 sites with 365 screens. It positioned itself at the leading-edge of technology by offering digital projection and IMAX screens. During the summer of 2002, it launched a website targeted at children. UCI also aimed to capture the premium-segment with initiatives such as "The Gallery", a private balcony where film-goers had access to an exclusive bar, free refreshments and luxurious seats. Both Vivendi and Viacom-owned Paramount had significant stakes in UCI.

UGC Cinemas, owned by Vivendi in conjunction with a private French multiplex operator, had 42 cinemas and was the only exhibitor to invest in customer retention initiatives such as a loyalty card. In July 2002, it launched an initiative to dramatically increase subscriptions to its month-long Unlimited Pass by reducing the price from £19.99 to £12.99 for West End cinemas and £9.99 for all other venues. By November 2002 they had captured 100,000 subscribers.

US-owned Warner Bros and Australian cinema operators Village Roadshow's joint venture, Warner Village, had a portfolio of 36 cinemas including the largest multiplex in the UK - a 30-screen multiplex in Birmingham with six screens dedicated to showing Bollywood films. The company's website, re-launched in February 2002, also included a Bollywood section. In May 2003, Warner Bros sold this chain to SBC International Cinemas, a little-known British exhibitor backed by venture capital investors, for £250 million. SBC intended to rebrand Warner's properties across the UK under the "Vue" banner over the next six months and planned to appeal to a wider film-going audience.

National Amusements, a subsidiary of a US company which belonged to media and entertainment giant Viacom, operated 19 cinemas under the Showcase brand. These cinemas had more screens than the average multiplex in the UK.

Backed by a consortium of venture capital firms, Cine-UK, with its portfolio of 28 Cine-World cinemas concentrated in small towns and suburban areas, had featured strongly in the Deloitte & Touche Indy 100 list of fast-growing companies and was reported to be up for sale.

Despite the growth in the market, several new cinema ventures had had to exit the market due to the high degree of competition, pressure on profitability and poor capacity utilization. "For the past 10 years there has been a seductive view that you made money by building cinemas. What I hope we are seeing now is a realization that you actually make money by filling them," said an industry expert.

Most industry participants expected consolidation in the market and felt that expansion would be more likely to result from mergers and acquisitions rather than new site development, owing to the difficulty of obtaining sites that fulfilled the space and planning-permission requirements of a multiplex. Further, the cost of building a new cinema was extremely high – a 16 to 18 screen complex could cost up to £15 million – magnified by the fact that operators would compete with each other for the best sites. The industry was at a stage where the cost of entry had "reached prohibitive levels for all but those with the deepest pockets".

The most significant operational cost incurred by a cinema exhibitor was the film rental paid to distributors. There were three main methods of calculating film rentals in the industry:

1. *Nut method,* whereby a monetary figure, the "nut", was agreed for each screen in the exhibitor's portfolio. The nut was intended to represent the screen's weekly operating costs plus an element for profit. However, in practice, the agreed figure was the result of negotiations between the exhibitor and the distributor. The rental fee was the greater of the two sums: 25% of the total box-office takings or 90% of takings above the nut.
2. *Sliding scale method.* Under this approach, the rental paid varied from a minimum of 25% to a maximum of 50% in steps of five percentage points as the takings rose above pre-determined break figures.
3. *Datum scale method.* The rental was 25% of the takings up to a break figure and 75% thereafter, subject to an overall maximum of 50%.

Other methods, such as a flat percentage, were used by a small minority of exhibitors. The exhibitor chose which method of calculation to use but the nut and break figures were agreed with distributors and these had to be negotiated for every film. Usually an exhibitor would agree figures with a leading distributor. If these were satisfactory, the exhibitor sought to persuade other distributors to align to the same method of calculation and terms. Typically, if a film ran well, distributors took the lion's share of the takings. However, if screens were virtually empty, the cinema got a bigger proportion to help it cover its costs. Rental costs varied considerably across what was referred to in the industry as "first-run", "second-run" and "third-run" films. The most expensive first-run films were those screened immediately upon release. After 10 to 14 weeks, an exhibitor could negotiate a lower rental on the film which was then classified as "second-run". Once a movie was released on video some exhibitors – typically small, independent operators – chose to run them as "third-run" releases.

Labor, facility lease expenses, utilities and maintenance were the other key cost elements (Exhibit 6). Labor costs had both a fixed and a variable component. During non-peak periods, a minimum number of staff was required to operate the facility. However, theatre staffing levels were increased to handle attendance volume increases during peak periods (Friday and Saturday evenings), as film-goers typically purchased tickets at the cinema box-office 10 to 15 minutes before the show commenced, except in the case of long-awaited blockbusters. Health and safety laws required movie houses to have a minimum of one staff member per screen to handle emergency situations. Lease expenses and associated property taxes were primarily fixed costs. Recent studies suggested that intense competition between operators had increased rents by up to 30%.

The Target Audience

Two broad categories of distinction were used in the industry: mainstream (also referred to as "commercial") and art-house. Mainstream films were those aimed at a wide audience, while art-house films were more special interest in nature. The term art-house, for example, was used to refer to most foreign-language films released in the UK. Films that started out as art-house but attracted a wider audience than expected were referred to as "cross-overs". However, mainstream films generated the majority of box-office receipts and rentals.

National cinema operators historically played mainstream, populist movies, while the smaller, independent venues typically focused on art-house films aimed at the more serious cinema goer. However, over the past few years, larger cinema operators were beginning to realize the benefits of targeting their product to niche customer segments. By bringing art and cult films to appropriate audiences they were able to widen their customer base significantly.

Film-goers in the UK visited the cinema three times a year on average compared with 5.2 times for their US counterparts. 15-24 year olds were the most prolific cinema-goers (Exhibit 7), and were targeted heavily by most cinema operators with special fares, timings and films. Families were another key segment for cinemas, with weekend offers designed around making the movie-going experience more affordable and enjoyable for a family: "We acknowledge that mum and dad don't really want to see Jimmy Neutron for the third time, so why should they have to pay for it?" quoted a multiplex operator in a study by Euromonitor on the market for cinema in the UK. Most cinemas marketed heavily to children – dedicated websites with interactive features from forthcoming children's films and giveaways in cinema foyers were standard. Increasingly, cinema houses were also starting to cater to an older audience, typically couples with no kids referred to as "contented couples" by the industry. These movie-goers were willing to pay a premium for a superior experience. For instance, The Electric Cinema, one of the UK's oldest cinemas, had reopened as a cinema with a brasserie, bar and private members-only club. The newly refurbished cinema, boasting leather seating, footstools and tables for food and drink, emphasized comfort, service and quality films.

Use of New Technology

Research showed that young, avid cinema-goers tend to be heavy users of mobile phones and the Internet. By nature, movies were amenable to content-rich advertising over the web. Most cinema houses had adopted the Internet as a means of reserving seats and purchasing tickets. Some let customers buy tickets using WAP mobile phones. Cinema houses also used mobile messaging services and e-mail to inform customers of special offers.

Pricing Strategies

There was little difference in average prices charged by the leading exhibitors but prices did vary by region. All operators used the simple strategy of varying prices by time of day, day of week, type of seating or customer segment – students, senior citizens and children obtained discounted rates.

The average ticket price in the UK during 2001 was £6.25 which compared with £5.95 in 1997. This represented a 5% increase over the 5-year period. However, prices in London – the highest in the country – were more likely to be in the range of £7 to £8.

The Film Distributors Association (FDA), the main trade association of film distributors in the UK Regulation, of which all major companies and several independent distributors were members, had established a set of Standard Conditions for the licensing and exhibition of films in cinemas in the UK. Under the Standard Conditions, the use of which was widespread in the industry, exhibitors could only charge the admission price for a film that had been agreed upon with the distributor. Consequently, distributors would sometimes refuse permission for price reductions and even take action against unauthorized promotions. Major exhibitors viewed this regulatory provision as being reasonable since a decrease in ticket prices could affect a distributor's rental revenues. The inclusion of this provision in the Standard Conditions had the effect of restricting exhibitors' ability to compete by cutting prices.

easyGroup: 1995 to Present

36-year-old Stelios Haji-Ioannou, son of a Greek shipping tycoon, joined his father's shipping company, Troodos Shipping, in 1988 after graduating in Economics from the London School of Economics and in Shipping Trade and Finance from the City University Business School. In January 1992, he founded his first venture, Stelmar Tankers, a fleet shipping company that was listed on the New York Stock Exchange in March 2001.

easyJet

In 1995, Stelios founded easyJet, Europe's first low-cost, no-frills, point-to-point airline, initially modeled on the successful US-based Southwest Airlines formula: a homogenous fleet, point-to-point services to short haul destinations, rapid turnaround times, high aircraft utilization, and no in-flight meal services. In addition to studying Southwest Airlines, Stelios and his team studied Valuejet, another US-based low-cost carrier, in order to understand why it was unsuccessful. The team regularly traveled to the US, spending time in the headquarters of both corporations to understand the reasons for success and failure in the low-cost airline business. Stelios believed that while they learnt from the low-cost carriers in the US, easyJet essentially "moved ahead of the Southwest business model" by entirely bypassing travel agents – initially reservations were taken over the telephone and subsequently customers migrated to the Internet for most transactions – deploying a more sophisticated yield management system and pursuing more flexible deployment of planes during the course of the day and from one day to another (unlike Ryanair and other low-cost competitors who dedicated individual planes to specific routes).

The airline started operations with a loan of £5 million from Stelios' father and two leased aircraft operating out of London Luton airport. easyJet's first flight, from London to Glasgow, was priced at £29 one-way. An extensive public relations campaign and compelling advertising slogan – "Fly to Scotland for the price of a pair of jeans" – supported the launch of the service. Passenger figures were encouraging and over the next five years the airline owned and/or leased 18 Boeing 737-300s and covered 27 routes in Europe.

easyJet operated a simple fare structure. All prices were quoted one-way to allow customers the flexibility to choose where and when they would like to fly. Fares were based on supply and demand. The earlier passengers booked, the cheaper the fare would be. The booking system would review bookings daily for all future flights and predict how popular each flight was likely to be. If the percentage of seats sold, i.e., the load factor, was higher than normal, then the price would go up to avoid selling out popular flights months in advance.

In order to offer low fares, easyJet worked towards engineering out costs from its operations (Exhibit 8). £14 per passenger was saved by not offering an in-flight meal, £10 worth of savings per passenger resulted from the use of Luton airport instead of Gatwick. In other countries, however, easyJet operated from major airports, e.g., Charles de Gaulle and Nice in France, while competitors such as Ryanair focused purely on smaller airports, e.g. Beauvais (France). Overall seating capacity was maximized by not offering business-class seating. Travel agents were entirely eliminated because they added 25% to total operating costs – telephone and Internet sales were the primary distribution channels. easyJet also reduced the turnaround time of its aircraft and flew its planes more hours per day – 11.5 hours vs. an industry average of 6 hours, and negotiated progressive landing charge agreements with the airports. Cost efficiencies were also captured by operating a "ticketless airline" – passengers required only a confirmation number and passport in order to check-in. Corporate overheads were also kept to a minimum – the airline was based in "easyLand", a bright orange building adjacent to the main taxiway at Luton Airport that reflected the easyJet low-cost ethos.

Despite the emphasis on cost reduction, the airline ensured that passenger safety was not compromised. The fleet comprised only brand new Boeing 737s and experienced pilots were hired who were paid prevailing market rates.

By 1999, the airline had started receiving recognition. easyJet was voted "Best Low Cost Airline" by readers of *Business Traveller* magazine. *Marketing* magazine described the launch of easyJet as "one of the 100 great marketing moments of the 20th century". Given its low-cost focus, the company relied on marketing the brand through PR and sales promotions. Stelios was a skilled PR operator who was able to establish easyJet with minimum of marketing expenditure. He pulled off several publicity stunts such as distributing free easyJet tickets on the launch flight of rival low-cost carrier, Go Airline, while dressed in a bright orange boiler-suit. The company was able to attract an impressive amount of media coverage. Stelios' tongue-in-cheek advertising, positioning easyJet as the David against the airline industry's Goliaths, was highly effective. The company did not retain any advertising agencies – Stelios and his marketing team were the self-styled ad designers of easyJet's campaigns. The company also used its own aircraft as marketing tools to serve as airborne billboards sporting the Internet address, telesales numbers and marketing slogans. A similar marketing approach was to play a useful role in establishing easyJet's subsequent brands.

In 2000, easyJet seat sales over the Internet reached the one million mark (the first ticket was sold online in April 1998). That same year, easyJet went public and was formally admitted to the London Stock Exchange.

In 2002, easyJet's passenger numbers (Exhibit 9) continued to soar. It had a market value of £1.5 billion and, while most full-service airlines were making losses, it posted record profits of £71.6 million (Exhibit 10) and completed the acquisition of Go for £374 million from British Airways. The airline had a strong, stable management team led by Ray Webster, Chief Executive Officer since 1998, who had been with the company since its inception. However, following pressure from shareholders, Stelios stepped down as easyJet chairman and was replaced by Sir Colin Chandler, the former chairman of Vickers Defence Systems. At the time, Stelios said: "I intend to remain a significant shareholder of this company for a very long time," referring to his 21.9% stake, adding, "However, as I have made clear on several occasions in the past, I have no other source of income from easyJet other than disposal of shares and as I engage in new ventures, I may need to liquidate some of my stock from time to time." Stelios, his wealth estimated at £500 million, was keen to augment his position as Britain's 26th richest man and to expand the "easy" concept to a range of new businesses.

By 2003, against the backdrop of a weak global economy, easyJet announced its interim results (six months to March 31). Revenues were up 25%, the load factor was at 82.1%, average air fares were down to approximately £37, but losses were at £24 million. Despite this, the company was confident of its ability to succeed in the competitive low-cost carrier market. As a signal of this confidence, shareholders had ratified a move to augment the existing fleet of 65 Boeing aircraft with 102 Airbus A319s.

easyGroup

In 1998, three years after easyJet, Stelios had two assets in place – an airline and a brand. He decided to explore new ventures that would leverage the "easy" brand across new businesses, thus creating easyGroup, a "branded incubator" with a mission to "create long-term capital growth by selecting and incubating substantial, profitable and sustainable businesses that reduce the cost of living and extend the easy brand ("paint the world orange") while maintaining the core brand values."

In addition to the belief that that the "easy" brand could be "stretched", central to easyGroup's philosophy was the belief that, "the Internet and yield management techniques are here to stay" in the words of Nick Manoudakis, COO. All new ventures at easyGroup would be built around these three business fundamentals.

After the public offering of easyJet, the relationship between easyGroup and the airline became that of a brand licensor-licensee. easyGroup licensed the "easy" brand to easyJet, providing the airline with a set of Brand Standards – rules regarding use of the logo, color, and professional standards that the brand was required to adhere to. In the event of a breach of these standards, easyGroup could retract its brand license.

easyInternetcafé

easyGroup's first venture was to establish a chain of Internet cafés based on the application of the same no-frills, low-cost and yield management principles that had worked so well in the airline business. The first branch opened in July 1999 in London near the busy Victoria

Station, with approximately 360 PCs over two floors of rented premises. The café had a clean, uncluttered layout, high quality hardware and offered attractive prices.

The business deployed the principles of yield management developed for the airlines to vary prices dynamically based on demand levels. Customers would pay between 50p and £1 for an hour of Internet surfing. To aid yield management, the business deployed a particular "pricing curve" (relationship between occupancy level and price), from a potential set of 10 options. For instance, a steep pricing curve would be used at the Oxford Street store on a day with peak summer tourist traffic. Alternatively, when demand was expected to be low, a soft pricing curve would be used, i.e. rising occupancy levels would trigger small, non-aggressive price increases (Exhibit 11). The business had a Yield Manager whose role it was to monitor store occupancy levels, seasonality and historical demand patterns in order determine the pricing curve to be deployed in each store on a daily basis.

The success of the first opening led to an initial wave of expansion within London. Each store capitalized on a different mix of users but all were in high footfall areas. Demand drivers varied across the stores. Matthew Lynwood, Property Director of the business, remarked, "Tottenham Court Road is more 'techie-land' and very close to the universities. Oxford Street is retail, pure and simple. Victoria has a more backpacking, traveling, touristy profile. Kensington High Street is more upper-class retail with some residents and offices. Then you have the Strand, which is 24-hours and our busiest store overnight."

Over time, however, the business model of the venture evolved considerably. Initially, the cafés housed a "learning zone" with uniformed advisors who would help customers find things online and support the counter from which coffee and snacks were sold. In the second-generation stores, these features were abandoned in favor of a simple, no-frills concept that offered the basic service of Internet access and could be operated with minimal staff. Following this, the group moved away from the "gargantuan" stores and successfully experimented with smaller stores with approximately 100 PCs. In the third phase of expansion, easyInternetcafé began establishing smaller Points of Presence (PoP) within existing fast food establishments - primarily McDonalds, Burger King and Subway. Staff requirements were reduced by introducing computerized vending machines that allowed customers to buy Internet time automatically. As of 2003, easyGroup intended to drive expansion through franchises. Franchisees would take care of store establishment, local marketing and store maintenance, while easyInternetcafé would run the yield management/pricing system and ensure that franchisees operated under the rules of the "easy" brand license.

The group paid significant attention to international expansion as well – 21 Internet cafes were in operation in eight countries within two years. Its Internet café located in New York's Times Square was a symbol of the group's intention to expand into the US. Franchises were to be made available in 15 states across the US and in 10 other countries.

While easyInternetcafé grew considerably (Exhibit 12), it had been a loss-making (Exhibit 13) business since its launch. However, the efforts of the group to improve the cost structure of the business looked promising (Exhibit 14) and easyInternetcafé was expected to reach cash-flow break-even by mid-2003 and profitability by 2004.

easyCar

easyCar, a car rental service based on similar principles of dynamic pricing, yield management and online booking, was established in April 2000. The first few sites had a rental capacity of 500 cars each. Initially, easyGroup's entire fleet of cars comprised a single model – the Mercedes A-Class – that customers could rent for as little as £10 per day on low-demand days, as opposed to average daily rental charges of £30-40. Launching the business, Stelios said, "The choice of Mercedes reflects the easyGroup brand. easyCar will use brand new Mercedes cars in the same way that easyJet uses brand new Boeing aircraft. We do not compromise on the hardware, we just use innovation to substantially reduce costs. The car hire industry is where the airline industry was five years ago: a cartel feeding off the corporate client. easyCar will provide a choice for consumers who pay out of their own pockets and who will not be ripped off for traveling mid-week."

By May 2003, the car rental business operated from 50 sites across the UK, France, Spain, the Netherlands and Switzerland, with plans to expand that to 80 by the year end. Rental sites were not located directly at airports – seven sites were located close to airports while the rest were located in city centers targeting urban dwellers who would rather rent than own a car. easyGroup refined the operational model of the business in order to pursue innovative cost-saving measures. The average fleet-per-site was reduced because, as Stelios was known for saying, "The skill is never to allow utilization to fall below 90%." easyCar also departed from its policy of procuring cars from a single supplier by creating a competitive market for multiple suppliers. Economies of scale from a uniform fleet were realized only at site level. A particular site rented only one type of vehicle. Cars were no longer rented with full fuel tanks – customers were expected to fuel them – to eliminate the cost of checking and refueling them, thereby enabling quicker re-renting. The policy that cars be returned clean to avoid a £10 cleaning charge was another successful tactic to engineer out labor costs from operations and accelerate turn-around. Customers that picked up and dropped off vehicles at off-peak times benefited from lower prices. Essentially the business had migrated to a pit-stop concept, with car pick-up points situated within a mile of a petrol station. One means to accelerate growth was the establishment of pick-up points in car parks using mobile vans staffed by a single employee. By February 2003, sites had been established in two central London locations – car park owners were guaranteed revenue for 15 to 20 spots in return for permission to operate a car rental site on their premises. The complexity of managing operations at car rental sites had been engineered out by providing a user-friendly, foolproof software that would guide the employee. No transactions were handled on-site as customers would pay at the time of reservation via the Internet.

Yield management also played a critical role in ensuring that utilization rates in the business remained at 85% to 95%. Based on historical demand patterns, seasonality and capacity, the yield manager would vary the pricing curves deployed at site level (Exhibit 15).

The car rental business missed its target of reaching profitability in 2002 (Exhibit 16). However, the group believed that initiatives to reduce labor costs and expand both the size of the fleet and the number of sites (Exhibit 17) would enable it to do so in 2003. It was expected that easyCar would be the second business to go public and the group targeted an Initial Public Offering (IPO) in 2005.

Other Ventures

In November 2000, the group launched easyValue.com, an impartial online price comparison engine, and easy.com, a free web-based email service. A year later, easyMoney, an online financial services business, was launched. Its first product was a dynamically personalized credit card. It was estimated that Stelios had spent £100 million to expand his easyGroup empire. However, his non-airline businesses had lost £75 million in three years. Funding for all new ventures came from Stelios' personal wealth. In May 2003, all the businesses in operation or being planned, were financed personally by Stelios, with minimal investments from other members of the easyGroup management team.

New Venture Development

easyGroup was constantly in quest of new business opportunities – even visitors to the group website were encouraged to submit business ideas. The group had a New Ventures team comprising six employees tasked with championing and developing new ideas. At any given point in time two to three ideas were in the pipeline.

The company's very nature – described as being "information hungry"– led employees to surf websites and trawl through information about industries (size, growth, etc.) to identify potentially attractive opportunities. These ideas were presented and discussed informally, typically through conversation, debate and e-mail exchanges. Most business decisions were made on the basis of data available in the public domain.

Geographic expansion was also high on the group's agenda. The car rental and Internet café businesses were represented in Europe. A team of two was based in the US with a view to spearheading new opportunities in the region as well as growing the existing Internet café operations in the US.

In addition to the planned cinema venture, several new projects were being examined including budget hotels, gyms, budget cruises, bus transportation and home catering. The easyCinema project, however, was the one closest to decision point.

Criteria for New Business Selection

The criteria for new business selection had evolved over time (Exhibit 18). Having learnt from past experience, easyGroup now had a more selective approach to the choice of business that it entered, i.e., understanding ex ante whether capabilities such as yield management could be truly powerful in a particular industry context. "Our eureka moments," said David Rawsthorn, who was involved in conceptualizing the cinema project, "come after days, weeks of being exposed to our principles and to how they apply in an industry." The group sought to operate simple businesses and to explore how it could engineer a complex business into a much simpler one. The "easy" formula essentially required consumer-facing businesses that displayed significant price elasticity, required a high fixed-cost base and low marginal-cost to service additional customers – factors that would enable easyGroup to effectively yield manage. Further, the group believed that industries with strong but complacent incumbents were particularly well suited for easyGroup's approach.

Businesses that easyGroup would not Consider

Based on the above principles of business selection, the group had developed a common understanding of some of the businesses that they would not enter. With characteristic humor, Stelios cited the example of the funeral business as one of these as funeral spending did not represent discretionary spending and therefore could not be yield managed!

Process of Entering New Businesses

Business models for most new ventures were developed by extracting out complexity from business processes, e.g., easyCar's policy that customers return their cars clean or pay a £10 fine was a way of eliminating significant labor costs incurred in washing cars: "Most car rental companies are a euphemism for car-wash companies," said Stelios. The focus on operational simplicity was facilitated by a conscious "de-skilling" of jobs at car rental sites and by a complete elimination of personnel in the Internet cafés. The newly-launched mobile vans that served as car rental pick-up points, for instance, were one-person operations enabled by a user-friendly computerized software to ensure that all "check-out" process steps were executed at the required service level.

Another approach that easyGroup used to develop its business model was to reverse engineer business operations with the target of arriving at a cost structure that would be half that of its competitors.

The mode of scaling up the business underwent a change from the early days of Stelios' entrepreneurship – from accelerated roll-outs, as characterized by the café and car business, to a phased roll-out. The company decided that, going forward, it would focus on piloting and refining new ideas before replicating them, caution that stemmed from Stelios' "reluctance to be railroaded by expensive mistakes".

Incubation of New Businesses

easyGroup operated with clear guidelines on what the role of the central group should be during the lifetime of a business. The group's involvement over time decreased as a particular business became increasingly self-sufficient and ultimately ready for an IPO. Until the time of an IPO, all businesses were located in the corporate office. After a business had gone public, it would be physically moved out of the corporate offices and into new facilities of its own.

The corporate office, The Rotunda, based in a converted piano factory in Camden, housed three functions:

- Brand protection, which ensured that encroachments on the "easy" brand were dealt with appropriately and that licensees were complying with brand rules.
- Incubation, which identified, screened, selected and developed new business ideas.
- Services, which supported the organization through functions such as Intellectual Property, Legal, Finance and Human Resources.

The Rotunda was a circular building and the easyGroup office was arranged in a wheel-like formation. Stelios and the core management team sat in open plan spaces in the center while the businesses and corporate functions were crammed along aisles that ran like imaginary spokes. "I like to sit in the middle of everyone else," said Stelios. "It sends a message that, first, you are more accessible, and second, you know what's happening. Luxury doesn't belong at the office, mainly because at some stage you will expect outside investors to invest in your company and these investors should not be funding your lifestyle." The Guardian newspaper described easyGroup's offices as follows: "The place looks as if it is just capable of turning out a student newspaper, but hardly the hub of an empire that now comprises a fistful of easy-branded, orange-hued, cheap 'n' cheerful businesses."

It was in the Rotunda that every evening at 5pm the company would hold a stand-up meeting in which all business units would provide a daily update on their respective Key Performance Indicators (KPI). The objective was to communicate performance figures, highlight strategic developments and address operational concerns. This meeting played an important role in reinforcing the group's ambitions for all its employees and in ensuring that each of the businesses were on track for profitability.

5-year Vision

The group planned to have two public businesses in its portfolio – easyCar and easyInternetcafé – over the next five years. The car rental business targeted an IPO in 2005. During this timeframe, it also planned to have five new start-ups in operation. Stelios aimed to build a cadre of people who would move across new ventures, sharing knowledge and competencies of the "easy" way of doing business.

The group invested in developing its managers. Some of them were about to attend conferences that addressed how franchises could be managed. COO Nick Manoudakis had just returned from the Advanced Management Program at Harvard and had shared his learnings with the entire organization.

easyGroup: Growth Choices

As easyGroup examined the opportunities of launching a no-frills cinema in 2003, another blockbuster year with big budget new releases including "The Matrix Reloaded" and part three of "The Lord of the Rings", its management team realized that it would face resistance from powerful distributors and incumbent exhibitors who worked in sync with each other. But this would not deter them. easyGroup believed that it would legally challenge the trading practices of these powerful companies, if required, in order to revolutionize the manner in which cinemas were operated. It had successfully targeted industries with strong but "fat, complacent" incumbents in the past. This would be another such opportunity.

The easyGroup team grappled with several questions. How should they roll-out the business? What payment structure for film rentals would be the most viable? Should they build a new cinema or acquire an existing chain? Most important of all was the fundamental question – Was this the right business for easyGroup?

Exhibit 1

Cinema Revenues and Admissions in the UK, 1997-2001

	1997	1998	1999	2000	2001
£ million, current RSP[1)]	826.5	811.2	841.6	879.5	974.4
£ million, constant 1997 RSP[1)]	826.5	784.5	801.9	813.6	883.7
Admissions (million)	138.9	135.2	139.1	143	155.9
Cinema revenues as % of leisure entertainment	1.8	1.7	1.7	1.7	1.8

1) Retail Selling Price

Source: Euromonitor: Global Market Information Database - UK Market Focus: Cinema; Published October 2002

Exhibit 2

Number of Cinema Sites and Screens in the UK, 1997-2002

	1997	1998	1999	2000	2001	2002
Sites	747	761	751	754	766	780
Screens	2,383	2,638	2,825	3,017	3,248	3,400

Source: Euromonitor.

Exhibit 3

Film Distributors in the UK, 2001

Film distributors	Number of films shown	% of all films	% of box office revenue
20th Century Fox	16	4.2	10.8
UIP	43	11.3	27.7
Buena Vista	31	8.1	21.4
Warner	23	6	6.3
Columbia Tristar	30	7.9	13.3
Total US majors	143	37.4[1)]	79.5
Pathé	22	5.8	7.8
FilmFour	16	4.2	0.9
All other independent distributors	201	52.6	11.8
Total	382	100	100

1) Rounding error

Source: BFI Film and Television Handbook 2002/British Video Association/Screen Finance.

Exhibit 4

UK Consumer Expenditure on Feature Films by Channel of Distribution (£ mil.), 1986-2000

	Box office	Video rental	Video Sales	DVD Sales	Total
1986	142	284	55	-	481
1987	169	326	110	-	605
1988	193	371	184	-	748
1989	227	416	345	-	988
1990	273	418	374	-	1,065
1991	295	407	440	-	1,142
1992	291	389	506	-	1,186
1993	319	350	643	-	1,312
1994	364	339	698	-	1,401
1995	385	351	789	-	1,525
1996	426	382	803	-	1,611
1997	506	369	858	-	1,733
1998	515	437	940	-	1,892
1999	535	408	882	68	1,893
2000	577	444	1,104	264	2,389

Source: Euromonitor.

Exhibit 5

Market Shares of Cinema Operators in the UK, 2001

Cinema operator	Market share (%)
Cinven (Odeon/ABC)	25
UCI	15
UGC Warner Bros/Village	15
Roadshow	13
Cine-UK National Amusements	10
Showcase	7
Others	15
TOTAL	100

Source: Euromonitor: Global Market Information Database - UK Market Focus: Cinema; Published October 2002

Exhibit 6

Typical Structure of the Profit & Loss Account of a Cinema Exhibitor in the UK

	%
Box office takings	73%
Concession income	22%
Screen advertising	4%
Other	1%
Total	**100%**
Film rental	27%
Staff costs	21%
Depreciation	9%
Concession cost of sales	8%
Advertising & publicity	3%
Other	19%
Operating profit	13%
Total	**100%**

Source: Industry analysts.

Exhibit 7

Frequency of Cinema Going in the UK

Percentage population	At least once a month	At least twice a year	Once a year or less	Ever go to cinema
Male	25	31	24	80
Female	23	40	20	83
ABC1[1)]	29	39	20	88
C2DE[1)]	19	31	24	74
4-14	31	48	13	92
15-24	50	35	11	96
25-34	29	42	21	92
35+	15	31	27	73

1) Refers to the hierarchy of socio-economic classes in the UK. This classification spans all dimensions of occupation skill. For example, A represents Professionals, while E represents Unskilled occupations.

Source: The Lifestyle Pocket Book 2002, UK.

Exhibit 8

easyJet – Reengineering the Cost Structure in the Airline Business

Costs borne by all airlines including easyJet	Costs reduced by easyJet	Costs eliminated by easyJet
– Telesales staff – Cabin crew – Pilots – Group handling – Insurance – Aircraft ownership cost – Air traffic control fees – Maintenance – Fuel	– Advertising – Airport and landing fees – Aircraft non-utilisation due to delays at congested airports	– In-flight catering – Business class cabin crew – Travel agent commission – Ticketing costs

Source: Company website.

Exhibit 9

easyJet Passenger Statistics

Year	Annual total ('000)
1995	30
1996	420
1997	1,140
1998	1,880
1999	3,670
2000	5,996
2001	7,664
2002	11,400

Source: Company website.

Exhibit 10

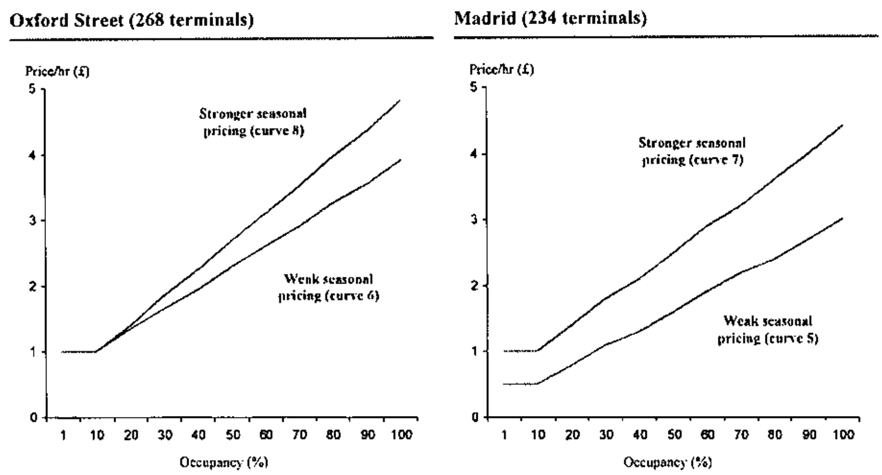
easyJet Revenue and Profit, Year to end September

	Revenue (£ mil.)	Profit (£ mil.)
1998	77.0	5.9
1999	139.8	1.3
2000	263.7	22.1
2001	356.9	40.1
2002	552.0	71.6

Source: Company website.

Exhibit 11

Pricing Curves used at easyInternetcafé - Sample



Source: easyInternetcafé.

Exhibit 12

easyInternetcafé – Growth Statistics

Fiscal Year (y/e September)	1999	2000	2001	2002	2003 (to 15/4/03)
Number of PCs in use, incl. franchises	**358**	**4,525**	**8,495**	**7,469**	**7,276**
Total number of sites	**1**	**11**	**22**	**23**	**28**
Legacy stores	*1*	*11*	*22*	*21*	*21*
Points of Presence (PoPs)	-	-	-	-	*5*
Franchises	-	-	-	*2*	*2*
Number of international (non-UK) sites	-	**5**	**14**	**14**	**16**
Legacy stores	-	*5*	*14*	*12*	*12*
Points of Presence (PoPs)	-	-	-	-	*2*
Franchises	-	-	-	*2*	*2*
Number of customer logons, incl. franchises (mil.)	NA	5.5	16.7	17.8	7.7

Source: easyInternetcafé.

Exhibit 13

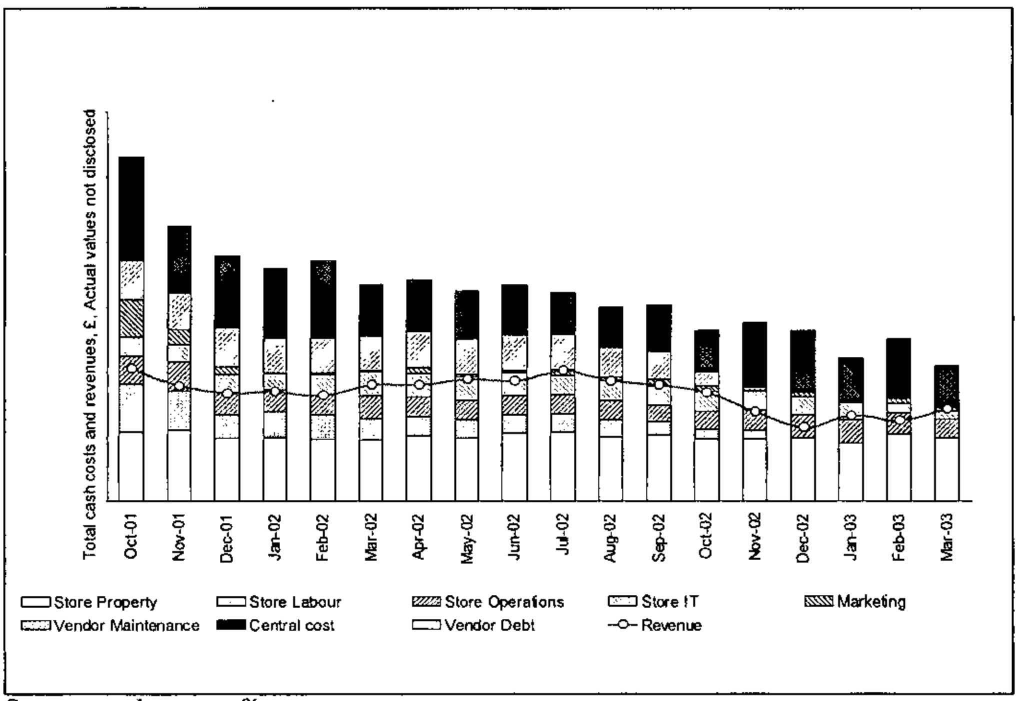
easyInternetcafé Limited - Profit & Loss Account

Date of Accounts	30/09/2002	30/09/2001	30/09/2000	30/09/1999
UK Turnover	3,021,000	10,543,000	6,668,000	
Export Turnover	8,993,000	11,481,000	684,000	
Turnover	**12,014,000**	**22,024,000**	**7,352,000**	**392,000**
Cost of Sales	24,158,000	72,674,000	4,421,000	316,000
Total Expenses				
Gross Profit	**-12,144,000**	**-50,650,000**	**2,931,000**	**76,000**
Depreciation	6,104,000	44,619,000	2,331,000	132,000
Other Expenses	5,817,000	13,640,000	15,696,000	2,178,000
Operating Profit		-64,290,000	-12,765,000	-2,102,000
Other Income	187,000	196,000	525,000	293,000
Interest Payable	3,977,000	3,753,000	1,230,000	17,000
Exceptional Items	9,182,000	0	0	0
Discontinued Operations	0	0	0	
Pre-Tax Profit	**-12,569,000**	**-67,847,000**	**-13,470,000**	**-1,826,000**
Tax Payable	0	0	0	55,00
Extraordinary Items	0	0	0	0
Dividends Paid	0	0	0	0
Retained Profit	**-12,569,000**	**-67,847,000**	**-13,470,000**	**-1,881,000**

Source: easyInternetcafé.

Exhibit 14

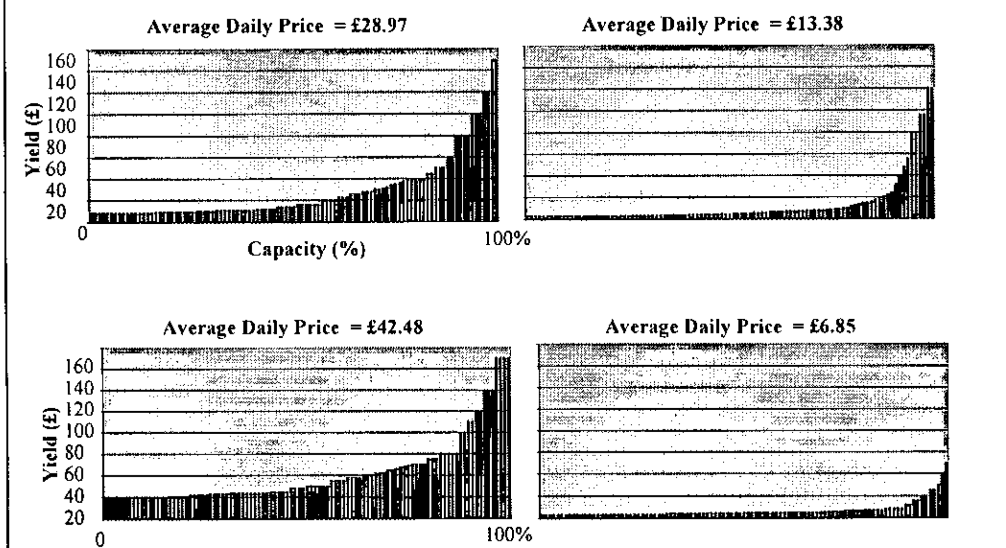
Evolution of Total Cash Costs and Revenues, easyInternetcafé



Source: easyInternetcafé.

Exhibit 15

easyCar – Illustrative Pricing Curves on Four Days, Location X



Source: easyCar.

Exhibit 16

EasyCar (UK) Limited - Profit & Loss Account

Date of Accounts	30/09/2001	30/09/2000
UK Turnover	9,430,000	2,007,000
Export Turnover	8,557,000	1,337,000
Turnover	**17,987,000**	**3,344,000**
Cost of Sales	11,019,000	3,273,000
Total Expenses		
Gross Profit	**6,968,000**	**71,000**
Depreciation	3,067,000	494,000
Other Expenses	19,196,000	7,496,000
Operating Profit		-7,425,000
Other Income	181,000	110,000
Interest Payable	1,356,000	163,000
Exceptional Items	-139,000	0
Discontinued Operations	0	0
Pre-Tax Profit	**-13,542,000**	**-7,478,000**
Tax Payable	6,000	17,000
Extraordinary Items	0	0
Dividends Paid	0	0
Retained Profit	**-13,548,000**	**-7,495,000**

Source: easyCar.

Exhibit 17
easyCar – Growth Statistics

Fiscal Year (y/e September)	2000	2001	2002	2003[1)]
Fleet size (Number of cars)	2,358	5,066	6,080	7,552
Total number of UK sites	4	8	10	28
Legacy sites	4	8	9	8
Pit stop	-	-	1	20
Number of international (non-UK) sites	5	7	10	22
Legacy sites	5	7	10	9
Pit stop	-	-	-	13

1) (to 05/03)

Source: easyCar.

Exhibit 18
Criteria for Idea Selection

Industry requirements - The idea proposed must be in an industry that:
- Is consumer facing
- Is a price elastic market with the opportunity to grow the market through lower prices
- Is a perishable commodity, e.g., something that cannot be sold again like a night at a hotel room
- Has incumbents with a high unit cost base
- Has no low-cost competitors in its market

Aligned with "easy" principles - A new venture must:
- Use, fit and build the "easy" brand
- Provide good value to the customer
- Use technology to cut costs and improve quality
- Sell direct to the consumer, e.g., internet sales
- Be a simple offering
- Not play by traditional market rules
- Not be a white-label
- Not bundle products
- Be easy-to-use

Business model requirements - The business model must:
- Have unit cost-savings of the order of 50% compared with the best in the market
- Have zero or very low marginal cost
- Be possible to yield manage the price
- Have the potential to significantly increase utilisation/occupancy rates compared with the industry

Financial requirements - The business must:
- Have the potential for floatation in c.5 years, typically requiring an annual profit of £10 mil. pre- floatation and strong growth potential

Source: Company website.

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