case study

Can the Netflix Business Model Actually Work for Commercial Aviation in Central Europe? It is Complicated!

By Thorsten Merkle, Kayhan Tajeddin and Andreas Wittmer

The Surfair Edge

One nice May morning, John Smith was waiting for British Airways flight BA 8760 from Zurich to London City airport. Even though his company paid for business class tickets, he had to be at the airport at least an hour before his departure at 7.40 am. Being a regular commuter on this route, he knew his way through the airport on busy days. While waiting in the line at security, he anticipated sipping a nice cappuccino in the business class lounge for his breakfast. John had taken a taxi from his house just before 6 am that morning so he could get to the airport on time. He was thinking of his wife as he took a seat in the lounge and enjoyed his coffee.

Pam Miller was bound for London that very same morning, as well. Her Uber driver drove past Zurich airport's large main terminal and stopped in front of the much smaller Executive Terminal. It was 20 minutes before the scheduled departure of SurfAir's flight 603 to London City airport. At the entrance to the Executive Terminal, Pam was greeted by a friendly assistant and cleared security a short while later. She had a quick coffee in the lounge and was soon informed that her flight was ready for boarding. After a very short walk onto the tarmac, Pam entered the 8-seater jet plane and was soon on her way to London. Only five other passengers were on the flight with her and she was happy to find a bit of extra space for herself and her bag in the aircraft's tightly packed cabin.

At roughly the same time, John sat back in his business class seat and was watching his fellow passengers boarding the plane. The flight on the 76-seater Embraer jet was going to be full again and he was happy that his fare class guaranteed that the seat next to him would be free. Being a senior manager in the company, the travel policy allowed him to book fully flexible business class tickets (seats), so the same day return to London came to about 1,100 Swiss Francs. Pam Miller, who was a self-employed events manager with clients all over Europe, paid a monthly fee of about 2,900 Swiss Francs, which allowed her to fly as frequently as she wanted on SurfAir's (admittedly limited) European network.

A New Business Model

SurfAir was founded in California by David Eyerly, Wade Eyerly, Peter Bi, Scott Porter, Cory Cozzens and Reed Farnsworth in 2013. Flight operations began in 2014 with brand-new Swiss built PC-12 aircraft, able to carry 8 passengers. Currently, SurfAir's United States operations cover destinations in California as well as in Texas. The company is privately owned and funded by venture capital; in the first round of financing, 9.5 million US dollars were raised from investors. In 2017, SurfAir launched their European operations between Zurich and London and soon expanded their network. The airline decided not to operate their own aircraft in Europe but instead opted to collaborate with strategic partners to operate their flights. The innovative approach of the business case lies in the company's subscription business model for air travel. In a subscription business model (cf. Rainer & Zimmermann, 2001), customers must pay a subscription price to have access to a product or service. The model was initially developed by various magazines and newspapers but is now commonly used by a large number of businesses (Massa, Tucci, & Afuah, 2017). In line with the sharing trend that can be found in other industries such as movies, e-books or music streaming, SurfAir has developed their network of regional and routes through a subscription-based payment system (for details, see Dai, & Grundy, 2007), similar to the programs offered by European rail providers to their very frequent travelers. Members pay a flat monthly fee and can make as many bookings for SurfAir flights as they wish.

In this approach, the route network is then developed on the basis of demand: SurfAir asks their community of members which routes they would like to have within the network, and then evaluates the commercial feasibility of them. Since tangible and intangible disruptive products alike generally pledge to decrease profit margin compared with existing products and services, they generate a conflict between the established, pre-existing business model and the model that might be needed to exploit emerging disruptive technology (Karimi, & Walter, 2016). SurfAir has disrupted traditional airlines' business models (cf. Christensen, 2006; Christensen and Raynor, 2003) and expanded our understanding of the sharing economy and network-based air travel. This disruptive business model appears to appeal to a diverse range of business travelers and fits into people's busy schedules. Besides operating an innovative subscription business model, SurfAir aims to fill the gap in European air travel that is located in the no-man's land between commercial business class and private jets. Arguably, on the one hand, business class on a commercial airline nowadays is hardly different from economy class, and, on the other hand, private jets are prohibitively expensive for many corporate flyers. Consequently, SurfAir is seen as a strategic fit for an airline's business

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model. Whilst other operators have tried to make private jets available through 'ridesharing' approaches as an important component of sustainable airline transportation (e.g., Bimpikis, Candogan, & Saban, 2019; Stiglic, Agatz, Savelsbergh, & Gradisar, 2018), SurfAir's model differentiates itself from the competition in that all members pay a flat monthly fee, irrespective of how frequently they fly.

The main advantage of the new service for travelers, therefore, is twofold: besides the convenience of a subscription payment program, travelers save significant amounts of time since SurfAir uses general aviation infrastructure, thereby avoiding large, congested passenger terminals. Since frequent travelers decide to travel at short notice and plans are subject to change, SurfAir offers great flexibility, allowing them to instantly make or cancel reservations through an app – all without any penalties being incurred. In this regard, their business model is clearly different from traditional airlines, where ticketing conditions are a key instrument of revenue management and price differentiation, with the aim of optimizing revenue and maximizing profits (Botimer & Belobaba, 1999).

Developing a New Service

Operationally, establishing a new airline in Europe is not an easy venture. The airline industry has always had relatively high barriers to entry and travelers' demand for the service is growing rapidly. One of the main reasons is that it is difficult and complicated to obtain an Air Operator's Certificate (AOC), the approval granted from a national aviation authority (NAA) permitting the use of aircraft for commercial purposes. The Air Operator's Certificate (AOC) requires the airline to have personnel, assets and systems in place to ensure the safety of its employees and the public. Thus, SurfAir decided to work with strategic partners when setting up their European operations. The European aviation market has high barriers to entry but low barriers to exit, with airlines ceasing to operate.

Nevertheless, business development often relies on innovation in terms of services (cf. Tajeddini, 2016), and SurfAir's bold new strategy, underpinned by a new revenue model, introduced a new service offering benefits that met their passengers' needs in what could be considered a highly competitive market. The new business model was based on offering added value to customers which, in turn, results in customers' being more willing to spend money, provided the right market segment is targeted (Bieger, Wittmer, & Laesser, 2007).

Whilst management had initially exclusively wet-leased an Embraer Phenom jet from an existing operator, SurfAir subsequently sought a commercial partnership with JetClass. JetClass is a start-up platform offering private jet travel using a different business model. It allows passengers to book single seats on private jets, similar to making a reservation on a traditional airline. As such, in the new model, the commercial risk could be divided between SurfAir and JetClass, enabling the network to be expanded more rapidly. Conversely, SurfAir members shared their trips with other passengers, since JetClass allows single segments to book seats at individual prices. As a result, SurfAir's brand recognition was lower in the new set-up, since the aircraft was not branded. As such, the subscription-based model was somewhat at stake, given that JetClass was selling individual seats on the very same SurfAir flights. For commercial reasons, SurfAir subsequently had to cancel their Zurich-London route. The management team argued that both London City and Zurich airports' charges were expensive compared with the rest of the UK and Switzerland, and that the company was unable to maintain that route within the existing pricing model; one of the significant setbacks for SurfAir.

Selling the Service

SurfAir's bundled products have evidently resulted in greater interest in promoting the development of new services and products, and the creation of value to meet the needs and demands of the market. Whilst SurfAir has identified the gap in the market that lies between commercial business class and private jets, calculating the size of this market segment is a difficult task. The airline's senior executives have estimated that between four or five percent of current travelers on traditional airlines may be potential SurfAir customers: those who are really seeking a premium service and those who find that their time is sufficiently valuable to pay a premium in order to gain increased flexibility and speed when traveling.

Their top management have learnt that European business travelers are culturally different from those in North America. Moreover, Europe does not have a homogeneous culture, either. SurfAir used a focus strategy to identify a niche in the business travel market. For instance, frequent flyers, such as holders of Star Alliance Gold status and American Express Platinum cardholders, were offered free test flights to experience the service. Offering these passengers a first-hand experience of this new, time-saving way to travel was an expensive (and as such, risky) approach. Since the flights had to be operated regardless in order to satisfy existing customers, the marginal cost of offering a free flight to experience the product, however, was considered manageable – especially in light of the entrepreneurial spirit that prevails within the company. Moreover, in accordance with the focus (or niche) strategy, i.e. differentiation-concentrating (Capaul & Steingruber, 2013; Porter, 1991; Shaw, 2016), the identification of potential customers was evaluated by the traditional methods of market segmentation. Using benefit segmentation, SurfAir identified a group of consumers in Europe who are willing to pay premium prices to travel with improved speed and comfort. Customers in SurfAir's original markets are perceived to be keener and more willing to try new products and services, and to establish new businesses. Hence, SurfAir has had a difficult start in selling subscriptions in Europe: it took more effort than anticipated to convince their potential customers.

SufAir's key competitors are the commercial airlines serving European high-yield routes. Nowadays, potential SurfAir members travel on British Airways, Lufthansa, Swiss, EasyJet, etc., and SurfAir had to show their customers that they were able to combine different types of knowledge to re-engineer existing business processes and come up with innovative ways to create value.

Developing the Network

SurfAir's management is aware of the commercial risk of identifying and introducing new routes. Appealing routes are required to win new customers, but they are also costly. By analyzing aviation data from global distribution systems (GDS), SurfAir is able to identify so-called high-yield routes where passengers pay high fares and there is little competition in the market. Consequently, it is not surprising that destinations such as Geneva, Luxembourg and Munich were added to the network. Unlike traditional carriers, SurfAir primarily manages the distribution (sales) of their service through direct channels with very few intermediaries involved, such as in other disruptive business models (e.g., Dell, the computer manufacturing firm). Instead of aligning with certain target industries (such as Air France's Petroleum Club) when identifying new routes, SurfAir claims to listen to their subscribers when picking new paths for expansion. The argument is that if enough members request a certain route (and if the total member base is large enough), it can be added to the network.

Capacity Management

> "Our business model is based on booking up flights to about 75% full"
>
> – *Simon Talling-Smith (Chief Executive Officer)*

Traditional airlines often utilize revenue management and price differentiation in order to manage their aircrafts' capacity, i.e. to avoid under- or overbooking while optimizing revenue and maximizing profit (Lovelock & Wirtz, 2011; Shaw, 2016). In SurfAir's case, this is different, possibly because there is no price differentiation. All members pay the same subscription rate and, as such, expect to be able to take any scheduled flight they wish. Nonetheless, since there have to be more subscribed members than seats on the aircraft, conflict is likely to arise. While SurfAir encourages members to cancel reservations that they are not going to use, the airline operates on a strict "first come – first served" basis. This means that it is possible that a flight could be booked to capacity and that a member cannot travel on the flight they want to. As such, the business model is more similar to a value network than a value chain (Fjeldstad & Snow, 2018; Fliess, 2009). This, however, has certain implications and requirements for the scalability of the service (see case study question number 7).

The Road Ahead

As with all start-ups and new business ideas, it is uncertain whether SurfAir will be successful in the long term. Experts expect that the commercial aviation market is developing in a polarizing manner, whereby the mass of the market keeps moving towards cheaper prices and lower levels of service, and new entrants come in at the top, offering experiences that are more appropriate to the premium market. Other stakeholders have already entered that premium segment and SurfAir, of course, hopes to remain on top of the game with their unique disruptive business model. Opportunities remain in countries where it is expensive to fly internally for short distances and where the premium market is underserved.

Case Study Questions

1. Using an appropriate framework, such as the Business Model Canvas, critically analyze SurfAir's business model, pointing out the advantages and disadvantages of SurfAir's business model and identifying major risks.
2. When bringing SurfAir to Europe, their management learnt the unexpected lesson that Swiss customers are less open to new business models, compared to customers in North America. Using relevant theory, explain the variation in openness between these cultures.
3. Subscription models are not a new idea. However, they have not yet widely been applied to air travel. Develop credible and feasible ideas of how SurfAir could convince their target market segment to sign up for the service.
4. In light of revenue management and how traditional airlines use it to segment their markets and to maximize revenue, critically evaluate SurfAir's subscription model from a commercial standpoint.
5. Using SurfAir's price structures and comparing them with those of a full-service jet provider (such as NetJets), prepare a rough estimate. How many paying members do you believe SurfAir would need to serve a route like Zurich-London on a twice-daily schedule?
6. When marketing their service, SurfAir segmented the market by a number of criteria. Critically evaluate the approach chosen (appealing to Star Alliance Gold Status holders and American Express Platinum Card holders) and develop alternatives as to how the target population could have been approached.
7. Similar to a telephone provider, SurfAir sells subscriptions. Critically discuss differences in scalability by contrasting these services.
8. Using relevant literature or websites, briefly elaborate on barriers to entering the European Commercial Aviation industry. What are the main challenges when setting up a business in this context?