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Strategic Windows: Australia- European Union “Open Skies” Agreement creates new entrant opportunity for Longhaul Low Cost Airline Model

Submitted for Doctor of Philosophy

School of Business
James Cook University
Submitted December 2011
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Name: Randall David Whyte
Statement on the contribution of others

The work in this thesis is entirely my own. Airline performance and financial performance data has been extracted from airline reports, annual reports, business plans and from documents and papers prepared by external consultants. The findings concerning a cost difference between a longhaul low-cost airline and full service airlines was verified by a senior manager in Virgin Australia and a Sydney-based specialist airline industry research organisation. The author is grateful for the information, comments and opinions of respondents interviewed to undertake the research.
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I would also like to acknowledge the understanding of my wife, Jenny, who has had to tolerate a mature-age student who has been studying continuously since first undertaking a Masters of Tourism in 1996 followed by a Master of Business by Research. This has been a long and at times arduous journey but in an industry that has always fascinated the researcher ever since his plane-spotting days and following his father into the airline industry.
Abstract

This research has studied the low cost airline sector and whether the well established short haul airline model (1-2 hours flying time) operating in domestic and regional markets can be adapted for low cost, longhaul airline operations. The research to date in this area has been somewhat generalised and speculative. Whilst there is broad agreement that cost reduction strategies applied by short haul low cost airlines are not all transferable to longhaul airline operations given its different characteristics, researchers have stopped short of determining whether the low cost concept can achieve a cost advantage compared to full service airlines. For this research, “longhaul” means Australia to Europe in a market served by more than 12 airlines. More recently, Australia and the European Union have concluded an open skies agreement which creates a strategic window opportunity for new airline entrants. The Agreement applies only to airlines domiciled in Australia or the EU with a majority shareholding held in the country – or bloc (EU). However, as this research shows, a number of Asian and Gulf State airlines operates from Australia via their home hub point into the EU and carry what is termed “fifth freedom” traffic (the freedoms of the air is discussed in Chapter 2) thereby circumventing the above condition. The growth and presence of Gulf State airlines permitted access into Australia is described in chapter 5 as “the elephant in the room” meaning that the capacity granted by the Australian government has placed Australia’s international airlines (Qantas, Jetstar and Virgin) under some pressure. Despite a move towards open skies in aviation markets, much of the industry remains highly regulated. Bilateral agreements between sovereign states still dictates much of international aviation in which government policymakers play a major role in the extent of regulation or opening routes and markets to greater competition.

The underlying theory for this research is the strategic windows concept which belongs in the strategic management and strategic marketing literature. The literature tells us that strategic windows “open” (and close) according to a range of factors and that organisations need to scan and monitor the external environment to detect changes in market conditions that create new opportunities providing the organisation has the capabilities and resources to compete
effectively. Strategic window opportunities in the airline industry arise from deregulation and liberalisation; new routes and new markets such as serving a tourist destination; airport development and incentives offered by airport companies to attract airlines; routes where full service airlines have withdrawn due to high costs or routes overlooked by full service airlines; new business models and new generation longhaul, fuel efficient aircraft.

The low cost airline industry has been described in the literature in many ways – from a concept, a philosophy, a business model, evolution and revolution to a “simplified value proposition to a wider market potential”. Most researchers agree that there are “core principals” that distinguish low cost airlines from full service airlines. The main difference is that low cost airlines have “unbundled” the product to its bare basics and charge passengers for an array of optional extras from using a check-in counter, to stowed baggage, food and beverages and in-flight entertainment. On the one hand low cost airlines adopt cost reduction strategies and on the other hand enhance revenue from ancillary charges and strive to achieve high load factors in all one class seating configuration that has more seats than full service airlines.

Longhaul, low cost is not a contemporary concept. It evolved from charter airlines that emerged post World War 2 predominantly in Europe and the late Sir Freddie Laker who first pioneered the “no frills” concept in the 1970’s carrying over 4 million passengers across the North Atlantic before the airline’s collapse due to a number of factors that all conspired against the airline. Some three decades later further attempts by independent entrepreneurs to establish the longhaul, low cost concept in different markets have also failed, for example Oasis Airlines of Hong Kong which flew from Hong Kong to London Gatwick in what one aviation critic described as “wrong aircraft, wrong model, and wrong management”.

In contrast to the rich abundance of literature written on the short haul model, the concept of low cost, longhaul has received very little attention from academic researchers. This research has used the case study method which is suited to “a
phenomena in the making” to gain novel and rich insights where the research is of a strategic, evaluative nature. This description was imminently suitable for the type of research investigated. Eisenhardt (1989) adds that case study research has legitimacy where there are situations where there are few theoretical foundations and exact measures for the key variables. The strength of the case study approach is that it enables one to capture reality in considerable detail; more than is possible with surveys, experiments or field studies. Two case studies on low cost airlines have been developed. Jetstar is a subsidiary airline of Qantas and has migrated from being a domestic airline to an international airline which has its different set of operating characteristics. Kuala Lumpur based Air Asia – now Asia’s largest low cost airline and with reportedly the lowest unit cost as measured by cost per seat kilometre has transitioned from short haul to medium and longhaul operations. In contrast to Jetstar, Air Asia is an independent airline which has established franchise operations but more recently has concluded a share swap with government owned Malaysian Airlines. Both airlines have competitive advantages in their respective markets.

The key findings from this research has determined that a longhaul, low cost airline entering the Australia-EU market could attain a minimum of 13 per cent cost saving (measured in terms of cost per available seat kilometre) compared to the lowest cost full service airline model (Emirates Air) and that a figure of 17 per cent differential is realistically attainable for a carrier such as Jetstar compared to its parent owner, Qantas operating between Australia and Europe. In order to build a longhaul low cost airline model a total of 20 different factors were examined and analysed – mainly operating characteristics and marketing issues. It was found that there are some important differences between short haul and longhaul, for example aircraft utilisation, airports required including major hubs, turnaround times, crew numbers and rest periods, the use of alliances, distribution and branding. Whilst some elements are transferable, others are not or would require some adaptation. The findings were verified by two external aviation sources and verified by comparing the cost differential established, vis. a vis longhaul versus shorthaul. One source observed that flight management is very critical for longhaul sectors because of its impact on fuel consumption, the highest
airline expense cost. Two further analyses were undertaken to validate the findings. First, a comparison of the data between Qantas and Jetstar’s operating cost on routes between Australia and Asia; and secondly, a comparison with modelling undertaken by the Boeing Airplane Company.

The findings from this research will develop a greater understanding of the commercial airline industry for future action on three levels. Firstly, an understanding of bilateral agreements that govern the operation of air services between countries and aviation policy settings and in particular where strategic window opportunities arise for new market entry. Secondly, a business model for longhaul low cost airline operations; and thirdly, markets where the carrier-within-a-carrier strategy supported by strong financial parent owners could be deployed in which a low cost subsidiary operation complements a full service parent owner operation. The research has illustrated the difficulty for independent; longhaul low cost airlines to have sustainable business models and operate in markets where there are well established full service airlines. Finally, aviation research in the Asia-Pacific region is relatively in its infancy compared to the depth and scope of airline research conducted in Europe and North America. From an Australian perspective, international airline services are vitally important as links to the world for trade and tourism. If inbound tourism is to grow and prosper and draw tourists from distant markets, the concept of a low cost longhaul airline operating between Europe and Australia could potentially develop new market segments. There has been much change in the aviation landscape in recent years in the Asia Pacific region, identified by IATA as the world’s fastest growing region for airline traffic. Therefore, this research provides invaluable insights and adds immeasurably to the body of airline literature from an Asia-Pacific perspective.
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