THE EMERGENCE OF LOW COST AIRLINES IN ASIA – INDUSTRY DISRUPTION OR GROWTH FROM THE CORE?

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ABSTRACT

This paper examines the emergence of Low Cost Carriers (LCCs) in Asia since 2002. After considering strategic frameworks for sustainable growth, the contrasting frameworks of Christensen et al (2003) and Zook (2004) are applied to the LCC experience in Asia.

FRAMEWORKS FOR LONG TERM GROWTH

There are numerous strategic frameworks available, such as Porter's perspective on positioning [9], Hamel and Prahalad's work in regards to 'core competencies' [8], and theories of hyper-competitiveness and opportunism [7]. Two recent frameworks, offered by Christensen and Raynor [5] and Zook [10], show very different perspectives on how best to achieve long term growth and, in many respects, capture the key principles proposed by other strategic writers.

Christensen and Raynor [5] expanded on Christensen's earlier work with regards to disruptive business models [1][2][3][4][6] and encouraged organisations to establish separate entrepreneurial business units to actively seek out opportunities to disrupt their own markets with innovative low cost offerings that attract non-consumers or existing consumers who are currently being 'over-served'. Failure to do this will leave an incumbent business vulnerable to competitive threat from a new market entrant. In their proposition, Christensen and Raynor [5] capture many of the principles of market segmentation and positioning espoused by Porter [9] and an opportunistic approach to new market entry.

Zook, on the other hand, presents a thesis in stark contrast to that of Christensen and recommends that growth is best achieved by systematically pursuing the most appropriate 'adjacent opportunities' from a strong core business [10][11]. To an extent, Zook's approach is an extension of the resource-based theory to strategy proposed by Hamel and Prahalad [8].

By considering the contrast of Christensen and Zook's frameworks, with reference to the Asian airline industry, it can be demonstrated that there are grounds for the mutual application of these models. More specifically, examples can be cited where disruption can be achieved, or an incumbent position defended, through a sequence of adjacency moves from a strong core business.

LOW COST CARRIERS IN ASIA

An LCC is best summarised as

> *A simplified and repeatable airline model, targeted at a specific market segment that focuses on minimising its cost of operations and exploiting this cost advantage to differentiate its services (on price) from full-service carriers.*

Key attributes of the traditional LCC model that achieved success in the United States (Southwest

Airlines) and Europe (Ryanair) include the relentless focus on cost minimisation, the use of a single type of narrowed bodied aircraft, exploitation of secondary airports, a focus on quick turn around times to maximise aircraft utilisation and simplification of direct distribution channels – typically via the Internet.

The rush of LCCs to the Asian market space began, at a regional level with the launch of AirAsia in January 2002. Since that time, Valuair, Tiger Airways and Jetstar Asia have been launched. In July 2005, Valuair and Jetstar Asia merged, creating Orange Star, and led to speculation of further consolidation. Aside from the regional LCCs, numerous other LCCs operate throughout Asia on a domestic basis and pose an ongoing threat of entry into the regional space.

Although it is 'early days', the regional LCCs have operated with varying degrees of success. The industry has been hampered by a number of external factors that distinguish the Asian market from Europe and the USA where some LCCs were successful. Among these environmental factors is the highly regulated nature of the aviation industry in Asia, coupled with the degree of Government ownership of key assets. This environment has made expansionary strategies (such as new routes, acquisitions and capacity increases) more difficult and this has hindered the growth of some carriers. Furthermore, the lack of available airport capacity, the low penetration of the internet in emerging countries and the impact of rising oil prices has also affected an LCC's ability to reduce its cost base.

There are doubts about the degree of growth of Asia's middle class. The flow-on effects of emerging Asia's economic growth to the population of countries such as China, India and Vietnam, partially underpins the long-term viability of LCCs. This transfer of wealth is yet to materialise and remains narrowly distributed among a minority of the population.

The expanded paper assesses the strategies of each of the key regional participants – AirAsia, Orange Star and Tiger Airways, as well as discusses the underlying strategies of QANTAS and Singapore Airlines (SIA), who have major shareholdings in Orange Star and Tiger Airways respectively. Emphasis was made on the evolution of each player's strategy with reference to Christensen's [2] and Zook's [10] frameworks for generating sustainable long term growth. At face value, each of these strategies appears to be the antithesis of the other. However, by using the Asian LCCs application, there are circumstances in which a complementary approach to disruption and adjacency expansion can yield benefits. Firstly, a disruptive business model (such as AirAsia) has achieved considerable success in a short period of time by disrupting a market and quickly expanding through a process of repeatable adjacency moves. In AirAsia's case, it achieved this by entering the Malaysian aviation space, expanding nationally and then regionally, firstly via additional routes and then by perfecting a joint venture approach into protected markets with large domestic operations.

Secondly, both QANTAS and SIA have demonstrated that an incumbent organisation can protect itself and prevail from the threat of a disruptive move. In both cases, this was achieved by segmenting its market and developing a business model that achieved leadership economics in that space. A defensive counter move to a disruptive (or competitive) threat through market segmentation is consistent with both Christensen et al [5] and Zook [10].

Finally, the launch of Jetstar Asia by QANTAS provides an example of how an adjacent move (from Jetstar Australia) into a new geography could prove disruptive. In this example, the move has the potential to be disruptive as a hybrid strategy (new market and low end) but the recent addition of code-sharing and multi-sector flights suggest it is quickly progressing into the high-end of the value network

to create an Asian hub for QANTAS and in doing so, a competitive threat for SilkAir (owned by SIA). Although the focus of this report is not to predict the likely success of each regional LCC's strategy, it does highlight the strong competitive position of AirAsia. Reflecting on the experience of LCCs in the USA and Europe, market leaders such as Southwest Airlines and Ryanair have prevailed and captured the majority, if not all, of the market's profit pools. History, coupled with a successful track record to date, suggests that AirAsia is well placed to dominate the LCC space in Asia in the future.

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