Air asias corporate and business strategies

Environment, Air

Air Asia is a low cost air carrier that charges the lowest fares per kilometre in the world. A PESTLE analysis indicated that liberalisation of the air market has improved international market access and supported the growth in the number of airlines and passengers in East Asia. A five forces analysis indicates that the airline industry is highly competitive, with a high threat of new entries and of substitutes in the domestic travel market. Air Asia is positioned at the low cost end of the spectrum of competitors that fly internationally. A SWOT analysis indicated that Air Asia has strengths in management, operational efficiency and marketing, but has weaknesses in staffing, customer care, and attractiveness to business travellers. The airline has been successful because it has taken an entrepreneurial and innovative approach to the market, leveraging its competencies to create automated ticketing processes and to reduce other operational costs. The airline should consider expanding into Europe and western Asia using Abu Dhabi as a hub, which would require additional aircraft or joint ventures with other low cost carriers. The firm should also consider introducing business class flights that charge a higher price, but provide the services including convenient scheduling that can attract the business segment of the airline market in East Asia.

1. 0 Introduction

Air Asia is a low-cost air carrier providing service between its main hub in Kuala Lampur, Malaysia and destinations in East Asia. The airline also provides service to Abu Dhabi and London. Air Asia has adopted a generic strategy of cost leadership by reducing the cost of operations and passing the savings through to customers with very low ticket prices. The firm was

founded in 1996 as a low cost domestic airline, and was purchased by Tony Fernandes in 2001. The firm was re-launched as a no-frills airline in 2001 with three aircraft. Air Asia entered the low-cost international market in 2003. The firm currently has revenues of $60 billion and provides services to 60 million customers a year. Air Asia is the first low cost airline to have formed a joint venture for the procurement of aircraft with a competitor, JetStar, which is based in Singapore (Quantas, 2010, 1). The airline currently has interlocking ownership through the Shin Corporation which holds a major equity position in both Air Asia and Thai Air Asia. The airline also holds a minority equity position of 30% of JetStar, which is a low cost Australian airline.

2. 0 Environmental and Industry Analysis

A PESTLE analysis provides an assessment of the industry environment, which is necessary to create a context for the airline industry analysis (Grant, 2008 p. 68). A Porter’s five forces analysis provides an indication of the competitive forces influencing rivalry in the airline industry.

2. 1 PESTLE Analysis

The PESTLE analysis is a qualitative evaluation of the political, economic, social, technological, legal, and environmental forces affecting the airline industry. The focus of the analysis is on the East Asian region, which is the primary market for Air Asia.

Political: The trend is toward liberalisation of the airline markets in East Asia to allow airlines access to markets without the need for a specific bilateral agreement concerning air transportation between nations. An ASEAN open

skies agreement, the Roadmap for Integration of Air Travel Services (2004) was ratified by member nations in 2007 and will be fully implemented by 2015. Nations in the region such as India and China that are not members of ASEAN are also liberalising air transportation regulations (O'Connell & Williams, 2006, p. 362).

Economic: The rate of economic growth in the ASEAN nations is variable, with the ASEAN member nations experiencing a growth rate of only 1. 5% in 2009 because of the global economic crisis. In contrast China's GDP grew at 8. 9% in 2009 while India's GDP grew at 6. 8%. Economic growth in 2010 and beyond in the region is likely to be strong because East Asia has largely recovered from the global recession.

Social: The social trend in East Asia is towards increased consumption including transportation consumption because of the economic growth in the region. Globalisation has also increased the propensity to travel in East Asia for both business and recreational purposes. The population in the region is also growing rapidly. Another social trend is the increased use of personal computing devices, which intersects with the technology drivers in the airline industry.

Technological: The air transportation industry is technology-driven, with information technology used to enhance marketing and engineering technology used to improve safety. Airlines use information technology systems such as internet ticket sales, paperless tickets and automated check in systems to improve customer care while reducing cost of operations

(Buhalis & O'Connor, 2005, p. 12). These systems are also used to maximise load capacity by controlling scheduling and use of aircraft.

Legal: The nations in East Asia have various ownership and anti-competition laws that affect the ability of airlines to merge or to acquire an airline (Hsu & Chang, 2005, p. 558). In addition some nations in the region have laws that affect the ability and the nature of joint venture agreements between domestic and foreign airlines.

Environmental:

The PESTLE analysis suggests that the implementation of the Open Skies agreement can increase access to markets for air carriers although the various national laws concerning ownership may hamper the use of a merger and acquisition strategy for expansion. The analysis also suggests that airlines implementing new technologies to improve customer care may enjoy a competitive advantage. The growing population and affluence in the region will produce greater demand for air transportation in the long run.

2. 2 Five Forces Analysis

The five forces analysis is an industry-based assessment of the factors driving competition to support the development of strategy (Peng, 2009, p. 35) (see Appendix A). If the competition in the industry is high, there is less likelihood that a firm in the industry such as Air Asia will gain competitive advantage through a strategic initiative.

Buyer Power: Buyer power in the airline industry is weak because of fragmentation of buyers and the large numbers of potential buyers. The

propensity of air travel in East Asia is relatively low compared to the global average of 2. 0 trips per year, with India at . 1 and China at . 3 (O'Connell & Williams, 2006, p. 362). At the same time, the large size of the East Asian market results in sufficient travel to support a growing airline market. Buyer power is somewhat strengthened by low switching costs in the industry, with buyers able to chose among many different competing airlines. Buyers can be segmented into business travellers and recreational travellers with different price sensitivities. Business travellers value flight schedule and convenience in an airline with price often a secondary consideration. In contrast, recreational travellers are more sensitive to price and the cost of the airfare relative to the total cost of recreation (Talluri & van Ryzan, 2004, p. 17).

Supplier Power: Suppliers in the airline industry consist of aircraft manufacturers, producers of fuel, and airports, with the power of these groups moderate. The manufacturers of aircraft have moderate bargaining power because of the high cost to airlines for switching aircraft types because of the need to carry additional parts inventory. Aircraft manufacturers, however, pose no threat of credible integration. The producers of fuel have relatively strong bargaining power because oil prices are established by global markets with airline consumption representing only a small portion of oil industry sales. Airports have moderate bargaining power through their ability to provide airlines with gates and ground services. Although airlines changing airports in a destination region face high switching costs, the increased development of regional airports intended to

reduce congestion at major airports reduces the bargaining power of airports because of gate fee competition (Hooper, 2002, p. 293).

Threat of Substitutes: The threat of substitutes is high in domestic markets because consumers in East Asia prefer rail and road transportation that is less expensive than air travel whenever possible despite the increase in time for travel (O'Connell & Williams, 2006, p. 362). The threat of substitutes in international travel within the region is low because of the absence of viable substitutes. Overall, the threat of substitutes in the industry is moderate.

Threat of Entry: The threat of entry is high in the industry. Although the cost of aircraft is high, a new firm can enter the market with only a few aircraft as Air Asia did in 2001. The liberalisation of the market environment is eliminating barriers to entry in the form of governmental restrictions on airline routes. As a result, a threat of entry also exists from established airlines from other regions seeking to expand routes in the East Asian region.

Competitive Rivalry: Competitive rivalry is high in the industry because of a diversity of rivals, high cost of fixed assets and operations, low switching costs, and low levels of product differentiation. Many airlines compete in the East Asian market, each of which has different strategies and different brand reputations. As a result, price rivalry is characteristic of the industry. Aircraft are expensive to purchase and operate, with a high load capacity necessary to cover costs. Passengers can switch airlines at a relatively low cost despite the use of incentive programmes by some airlines to increase customer loyalty. While air transportation can be differentiated based on the level of

amenities available to passengers, the fundamental attribute of transportation service is similar in all airlines.

The five forces analysis suggests that the primary threat in the industry comes from competition among rivals, which is intensified by the possibility that new airlines will enter the East Asian markets. The analysis also suggests that opportunities may exist for smaller airlines to form strategic partnerships with other airlines to expand the schedule and destination options for passengers at a cost less than the amount necessary for direct investment in aircraft and terminal gate facilities. In the low cost segment of the industry, taking advantage of this opportunity would require Air Asia to adopt a strategy that restructured in the industry (Cockburn, Henderson, & Stern, 2000, p. 1127).

2. 3 Competitors and Competitor Groups

Competitors in the airline industry can be divided into the two main groups of full service airlines and low cost airlines. Full service airlines are large firms that have been in the industry for an extended period of time, with many of these airlines enjoying a monopoly or quasi monopoly on certain national routes prior to the gradual liberalisation of the airline industry in the ASEAN market, with full liberalisation taking place by 2015. These major airlines often use a hub-and-spoke routing system in which short-haul feeder flights bring passengers to a hub airport for transfer to other aircraft for long-haul flights or for other short-haul flights to reach their final destination (Burghouwt and Veldhuis, 2006, p. 107). Airlines in this competitor group use a differentiation generic strategy based on frequent flight scheduling and use

of airports conveniently located with respect to major urban centres, with a wider range of services justifying higher ticket prices. They also have a wider range of destinations including transcontinental flights. Competitors in this group include Singapore Airlines, Air China, Malaysian Air, and Thai Airways International. The low cost group of competitors focus on flights taking passengers directly from the point of origin to their final destination, although transfers may be necessary to consolidate passengers and maximize capacity utilisation. Airlines in this competitor group are regional airlines with destinations limited to East Asia. There are numerous competitors in this group including Jet Star, Tiger, Value Air, Firefly, and Maswings. Appendix B shows the positioning of firms in the two competitor groups.

2. 4 Developmental Stage of Market and Industry

The air transportation market in the East Asian region is in the growth stage of development, which is characterised by a rapid rate of increase in sales (Inglada, Rey, & Cote-Millan, 2006, p. 9). The economic growth in the region is allowing more individuals to afford air transportation, particularly for tourism. In addition, the increased commerce with the ASEAN region and with China as a result of the ASEAN Free Trade Agreement that was gradually implemented between 2004 and 2010 is producing higher commercial and business demand for air transportation between Southeast Asia and China (Wong & Chan, 2004, p. 509).

The low cost segment of the airline industry in East Asia can be viewed as at the point of emerging from the market penetration phase of growth. The low

cost airline industry is comparatively new in East Asia, with independent airlines entering this market segment in 2001 (O'Connell & Williams, 2005, p. 260). Many of the firms in this segment of the industry can be considered prospectors using the Miles and Snow typology because they adopt strategies to use entrepreneurial skills for developing new types of services and have strong marketing competencies (Wratschko, 2009, p. 71). In contrast, the major air carrier segment of the industry can be considered mature, but undergoing a period of transformation because of the elimination to governmental regulations that had given many of these airlines a competitive advantage in routes and airport access. These airlines can be considered as defenders because they focus on retaining market share despite the instability in the market created by new market entrants such as low-cost airlines.

3. 0 Resources and Capabilities

In the resource-based theory of the firm, the resources and capabilities of the firm should be the foundation of the firm's strategy. To use this approach, the firm assesses its resources, determines the capabilities that can provide it with competitive advantage, select a strategy that matches resources and capabilities with opportunities, and identify resource gaps that have to be filled (Grant, 1991, p. 115). A SWOT analysis can be used to identify the resources and capabilities of Air Asia and the way the firm can use these resources to take advantage of opportunities and counter threats (see Appendix C). A value chain analysis can provide an assessment of the areas in which Air Asia can add the most value for customers, which a gap

analysis identifies the resources that Air Asia must acquire to implement a selected strategies.

3. 1 Swot Analysis

Strengths: Air Asia has a strong management team, with operations managed by an ex-Ryanair director with extensive experience in controlling expenses in a low cost airline (O'Connell & Williams, 2005, p. 264). The airline has a good technology infrastructure that supports very low cost of operations from its use of technology to automate customer processing and to maximise load on flights. The company also has strengths in operational cost containment through very low staff levels, lack of amenities on flights, and standardisation of aircraft which reduces expense for maintenance and parts inventory. Only 8% of the airlines passengers are business travellers, indicating that the cost leadership strategy has been successful in attracting the recreation segment of the market (O'Connell & Williams, 2005, p. 268). Another strength of the firm is its marketing competency, which has effectively designed and promoted a service targeted to the underserved low-cost no frills segment of the market. The airline has a breakeven load factor of only 52% and the world's lowest airline unit cost of $. 23 per passenger kilometre (O'Connell & Williams, 2005, p. 265). The airline also has a strong brand reputation in the market for offering low fares. The airline also has strong information technology competencies.

Weaknesses: Air Asia has weaknesses in human resources, poor customer care in resolving complaints, and limited ability to attract business travellers. Because of its low cost approach to operations, the airline has lower staff

levels than competitors. The lower staffing creates issues such as delays in turnaround time that result in delays in departures, with inadequate communications and support for delayed passengers. The airline's business model also reduces its ability to attract the business market that values flight scheduling, on time flights, and convenience. Air Asia uses only the A320 aircraft, which has a range of only 4, 800 km with a full passenger load, which limits the destinations that the airline can serve (Airbus, 2010).

Opportunities: Opportunities for Air Asia are providing expanded service in the growing East Asian airline market, opening new intercontinental routes, and forming joint ventures or other strategic alliances with competitors in markets not currently served by the airline. A significant overlooked opportunity in the region is the potential of tourism from Northeast Asia to Southeast Asia (Winter, 2007, p. 28). Smaller airlines can gain greater access to markets in the region through joint ventures and strategic alliances that allows airlines to code share, which involves transporting passengers using aircraft from two or more airlines.

Threats: The primary threat for Air Asia is an increase in competition with some airlines adopting a similar operating model to Air Asia which reduces differentiation. A threat to the business model comes from cultural differences such as the preference of Indonesians to use heavy luggage that must be stowed in cargo compartments (The Low Cost, 2009). Another threat comes from the regulations in some nations setting minimum fares and airport usage limitations, which are not covered by the ASEAN Open

Skies agreement. The airline is vulnerable to the threat of an increase in fuel prices and the possibility of disruptions to travel caused by terrorist attacks.

The SWOT analysis indicates that Air Asia’s strengths in management, operational efficiency, marketing, and brand reputation would allow it to take advantage of the opportunities presented in the region from growth and tourism potential. These strengths could also support efforts to develop more intercontinental routes and joint ventures with competitors. The weaknesses of the airline in limited human resources and poor customer care could inhibit growth unless they are addressed. The weakness of insufficient staffing increases the firm’s vulnerability to the effect of cultural differences. At the same time, the firm’s strengths can help overcome the threats posed by increased competition. The airline’s difficulty with attracting business passengers because of its business model may ultimately have a negative effect on its market share as business travel in the region increases.

3. 3 Value Chain Analysis

The value chain analysis disaggregates the activities of the firm to determine which activities add the most value to customers (Grant, 2008, p. 145). The inbound logistics segment of the chain involves purchase or leasing of aircraft, fuel, and gate space at airports, which add some value through reducing overhead and by providing convenient or desirable routes. The airline adds significant value to the customer in its operations, which has reduced costs to allow the fares to be the lowest in the world. This segment of the value chain, however, does not add value for customers who desire amenities or assistance from airline staff because of insufficient support from

the human resources management function. Outbound logistics in the context of an airline involves factors such as airport turnaround time, which are related to operations. Marketing and sales also adds significant value to operations by the airline's ability to leverage its technology support function for internet ticket sales, paperless tickets and automated check-in. Because of the difficulties that the firm has with customer care and complaints, the after sales service segment reduces value for the customer. Based on this analysis, Air Asia adds primary value for customers in the operational and marketing segments of the value chain.

3. 3 Gap Analysis

Gap analysis involves determining the discrepancies between the current resources of the firm and the resources necessary to achieve the desired future state (Grant, 2008, p. 162). The generic future state for Air Asia is continued growth in its primary market in East Asia and expansion into secondary markets. To increase its share of the market in East Asia, Air Asia requires additional aircraft, additional staff, and additional access to airport gates. The airline has 78 planes available including aircraft owned by the firm and aircraft available through joint ventures, all of which are A320 models. Because these planes operate near capacity, additional aircraft would have to be acquired for expansion. To expand into intercontinental markets, the airline would also need larger aircraft with longer range. The firm would also require additional human resources to meet the operational and customer care needs with expansion, particularly to attract business customers. The analysis suggests that the firm does not have sufficient

depth and breadth of resources to support expansion and must acquire additional resources.

3. 4 Technical and Landscape Fitness of Air Asia

Air Asia has high technical fitness, but only moderately high landscape fitness. Air Asia has developed and implemented a proprietary yield management system, computer reservation system, and enterprise resource planning system. In addition, the firm makes extensive use of a front-end internet interface with its backend computer systems to support online internet ticket purchases and paperless tickets. The technology systems are flexible enough to respond to any change in customer requirements, and have been a factor in promoting the acceptance of paperless tickets in Malaysia (Sulaiman, Ng, & Mohezar, 2008, p. 149). Air Asia has been successful in attracting the low-cost segment of the market, but may not have sufficient flexibility to respond to a change in the environment such as a surge in business demand or a dramatic decrease in demand because of terrorist attack or high fuel prices.

3. 5 Competitive Scenarios

A likely competitive scenario is an increase in competition in the low cost segment of the East Asian airline market from new entrants and low cost subsidiaries of established major carriers. A FAR analysis of the scenario suggests that other carriers will adopt some of the functions used by Air Asia such as paperless ticketing, reduced staff level, and no amenities to become cost competitive. The assets required for these airlines to adopt this business model are generally available with their existing fleets of medium range

aircraft. The risk posed by this scenario is Air Asia's loss of competitive positioning as the lowest cost carrier in the market.

4. 0 Conclusion

The most likely reason for Air Asia's success has been its willingness to risk using innovative strategies to reduce costs while maintaining profitability. The firm was a pioneer in the use of internet reservation and paperless tickets in the market, with its marketing overcoming any passenger reluctance to use the electronic systems. It has also adopted the innovative strategy in the low cost segment of the market of forming joint ventures with competitors to gain entry into new markets and to reduce operational costs.

4. 1 Recommendations

Air Asia should expand into the intercontinental market by using Abu Dhabi as a hub for routes in western Asia, North Africa, and Europe. From the Abu Dhabi hub, the airline could offer flights to India and Southeast Asia. The business model would continue to follow the cost leadership generic strategy. To implement this strategy, the airline would have to expand the size of its fleet, with the possibility of adding some wide body aircraft designed for long haul flights in addition to A320s. Funding could be obtained from a seasoned equity offering, with the airline's historic performance supporting the offering. The airline could also form code sharing relationships with low cost airlines in Europe and western Asia. This strategy would offset some of the airline's vulnerability from additional competitors using a low cost business model entering the East Asian market.

Air Asia should offer some flights designated as “ business class” that provide a wider range of services for business travellers at a higher price than its normal flights. This strategy would be intended to attract a higher percentage of business travellers. Implementing this strategy would require modified A320s to provide passengers with additional seating space and may require additional staff for customer care. The business class aircraft would have priority in operations for scheduling and turnaround to ensure that they remained on time. The airline would use its marketing competencies to differentiate between low cost fares and business class fares. This strategy would address the problem of low market share in the business segment of the market and diversify the market base if competition in the low cost segment increases.