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Air Asia: What Has Made It Asia’s Largest Budget Airline?

Dr. Achinto Roy, Deakin University, Australia

ABSTRACT

The success of Asia’s largest budget airline, Air Asia is analysed in this paper with a view to gain an insight into the factors that have contributed towards it. Air Asia’s management has concentrated on costs efficiencies, attention to controllable variables that reduce total risk and replication of the multi-hub model that generates operational efficiencies along with the creation of a regional identity that has gone a long way in making this airline what it is.

INTRODUCTION

Air Asia has been voted as the world’s best low cost airline for five consecutive years based on passenger surveys by Skytrax world airline awards, an independent industry evaluation body based in the UK. The airline’s 2013 annual report states that Air Asia has flown 217 million passengers since its inception. Just three years before that, in 2010, Air Asia had flown its 100 millionth passenger and broken the 1 billion ringgit profit barrier (Air Asia, 2010). In a three year period 2010-2013, the airline has flown 117 million passengers, out of which 42.3 million flew in 2013 alone, making it Asia’s largest low cost carrier (Air Asia, 2013:3). As a testimony to the success of its low cost carrier (LCC) business model, Air Asia has consistently achieved better than industry averages in most operational and revenue areas.

In 2013, Air Asia reported flying 182 routes, out of which 62 were unique routes not served by any other airline (Air Asia, 2013:3). The Air Asia network covered 83 destinations (includes those flown by Air Asia X) in 17 countries with operations from 16 different hubs located in Malaysia, Indonesia, Thailand, Philippines (Air Asia, 2013:3) that connected all 10 ASEAN countries, with one Air Asia jet either taking off or landing every 3 minutes somewhere in Asia.

Air Asia started out as a low cost carrier (LCC) under Tan Sri Dr. Tony Fernandes in a very competitive industry with very little capital in September 2001 around the time of the 9/11 terrorist attacks in the United States when passenger aircraft were used by terrorists to crash land on key targets killing passengers and thousands of people. It was a critical event for the global aviation industry throwing up unique operational challenges in security of aircraft and passengers. The aftermath of 9/11 meant the airline industry was burdened with additional costs on security of aircraft and airport procedures, adding to the woes of the intensely competitive industry that was fighting to survive. Tan Sri Dr. Tony Fernandes had no experience in managing an airline, he had targeted the domestic market in Malaysia that was untapped and at a time when profit margins were under pressure in the airline industry. With these uncertainties in the industry environment, what is it that made Air Asia sustain growth and make profits almost every year since year 2001 and become Asia’s largest budget airline? This paper analyses the airline’s growth trajectory, its operations and thereby its operational strategies that contributed to its continued success. The first part of the paper discusses the airline’s vision, mission and the rebranding by CEO Tony Fernandes to connect with the chosen market i.e. The ASEAN region. This is followed in the second section of the paper by an analysis of how Air Asia operationalised its vision especially in the ASEAN region with a multi hub strategy. The next two sections discuss Air Asia’s success in the long haul sector and its relentless pursuit of cost efficiencies that spell a bright future for the airline.

THE ‘NOW EVERYONE CAN FLY’ CAMPAIGN: VISION

Air Asia started as a Malaysian government owned debt laden airline with two aircraft. Tune Air Sdn. Berhad promoted by Tan Sri Dr. Tony Fernandes signed an agreement to take over an almost bankrupt Air Asia from the Malaysian government on September 8, 2001. This was three days prior to September 11 events in the US that permanently altered operational costs and business conditions for the aviation industry making it more challenging than ever. However, Fernandes went on to complete the deal by buying debt laden Air Asia for 1 ringgit taking over liabilities amounting to 40 million ringgit and two old aircraft in the bargain. The airline under its new management commenced operation on December 8, 2001.

Fernandes re-branded and relaunched Air Asia as Asia’s first low cost carrier with a marketing slogan “Now everyone can fly.” When Air Asia restarted operations in January 2002 only 6% of Malaysians had flown on a plane. The airline’s maiden flights based on low fares to Kota Kinabalu, Kota Bahru, Kuching, Labuan, Langkawi and Penang were an instant hit in Malaysia with its marketing campaign “now everyone can fly” slogan targeting the other 94% of Malaysians who had never flown before. The airline’s success started with a clear definition of the airline’s competitive positioning within
the market (Malaysia) in which it operated. This defined its industry position as a low cost carrier in Malaysia which did not have another competitor in the same market segment (low cost carrier) at that stage. Air Asia's strategy formulation, and effective implementation followed the chosen market segment position, conveyed through its vision and mission statements. The airline’s vision statement captured its intent “to be the lowest low cost airline in Asia and serve the 3 billion people who are currently underserved with poor connectivity and high fares.” This statement clearly spelt out the competitive positioning sought by Air Asia and thereby its business level strategy to be a low cost leader. This is in line with strategy formulation based on customers as proposed in Hamel (1998) and Markides (2000). Air Asia set its strategic goal as a quest for value beyond profitability supported with a service commitment to 3 billion stakeholders “who are currently underserved with poor connectivity and high fares.” Both these were complemented by a mission statement that aimed to create a work place culture of commitment, one that is likely to foster motivation to implement its strategy and build a global brand in the following words:

- To be the best company to work for whereby employees are treated as part of a big family
- Create a globally recognized ASEAN brand
- To attain the lowest cost so that everyone can fly with AirAsia
- Maintain the highest quality product, embracing technology to reduce cost and enhance service levels.

Strategy formulation in a service industry such as an airline has to typically start with questions proposed in Markides (2000) namely: (i) who are our customers or who should be our customers? (ii) What value can we offer them and (iii) how do we go about doing both these? Air Asia precisely asked those questions and connected with them effectively. Both the vision and the mission statements addressed all three questions by defining the customers, the geographical market from where they came, the value that would be offered in terms of air connectivity and low cost airfares, all with the vision of becoming the largest low cost airline offering a quality product/service.

**AIR ASIA’S VISION STATEMENT IS OPERATIONALIZED**

Setting out with the desire to serve an underserved market in the ASEAN region, Air Asia relentlessly concentrated on achieving cost efficiencies, customer conveniences, innovative practices, regional connectivity and a work place culture that offered unlimited opportunities for staff and best services for customers. Air Asia started domestic operations within Malaysia by providing air travel services to different destinations within the country that never had any air connectivity before and started linking them with the capital Kuala Lumpur. Every month during 2002 the airline added new destinations within Malaysia that connected with the airline’s main hub, Kuala Lumpur thereby generating traffic between different parts of Malaysia such as East Malaysia and the coastal parts of the west which never had air connectivity before.

To make things easier for its customers in regional Malaysia, the airline was the first to introduce ticketless travel in Asia during 2002. This enabled passengers to buy a ticket over the phone using their credit cards thus overcoming infrastructure problems in remote parts of Malaysia. Later in August 2003, Air Asia was the world’s first airline to introduce SMS ticketing. In December 2003, Air Asia inaugurated its first international flight to Phuket and established Thai Air Asia. This was followed in 2004 by introduction of domestic Air Asia services within Thailand, flights to Jakarta from Johor Bahru and Kuala Lumpur.

It is also during 2004 Air Asia made an initial public offering of shares, listing the company’s shares on Kuala Lumpur stock exchange. This, later, enabled Air Asia to purchase 40 Airbus A320 aircraft with option to buy another 40 aircraft thus setting the path for rapid expansion of the airline. By 2005, Air Asia had bought an additional 60 Airbus A320s; set up an Indonesian subsidiary that flew between Jakarta and Singapore; signed up with Manchester United as their official airline and introduced a comprehensive booking system for mobile and wireless devices as another world first.

Between 2006 and 2007, the airline set up the Air Asia Academy with Airbus full flight simulators to train its staff, set up new hubs both within and outside Malaysia, launched flights to Vietnam and placed firm orders for 175 Airbus A320s making it the world's biggest operator of this type of aircraft. By this time, the airline had successfully operated its low cost aviation model built on innovative solutions in the short haul destination (3 hours flying time) segment flying both point to point services between major cities and effectively using the hub and spoke system at its Malaysian hubs to connect with regional Malaysia, Thailand and other places.

Over the next seven years Air Asia utilised the advantages of the hub and spoke model by introducing multiple hubs within the ASEAN region. The airline expanded its operations by setting up independent hubs in Thailand, Indonesia, Philippines and recently in India. In each of these countries Air Asia established hubs at key business centres or capital cities and connected them with regional destinations within the country that either had no air connectivity or very little air connectivity. This in turn gave Air Asia a regional identity in each of those markets operating with regional hubs that catered to local air passengers. In Thailand, for instance, Air Asia introduced flights from Bangkok to...
Kong Kaen and Phitsanulok, both with little air connectivity prior to the advent of Air Asia in that region (Air Asia, 2013:112). In 2013, Air Asia in Thailand flew 10.5 million passengers on 44 routes, out of which 7 are unique routes not flown by any other airline while another 7 were introduced during the year (Air Asia, 2013:111). Air Asia also achieved 83% load factor with 37 aircraft operating from three hubs in Thailand, namely: Bangkok, Chiang Mai and Phuket (Air Asia, 2013:111-12).

Similarly in Indonesia, Air Asia flew 7.9 million passengers using 37 aircraft on 39 routes, out of which 11 are unique routes not flown by any other airline along with 14 new routes that were introduced in 2013 (Air Asia, 2013:115). The airline’s Indonesian operations are managed from 5 hubs at Jakarta, Bali, Surabaya, Bandung and Medan. Some of these hubs have never been used by any other airline in the past thus giving Air Asia an edge of being identified as a regional airline serving local passengers and the scope to build customer loyalty.

Air Asia is replicating similar multi hub and spoke operations in India (Bangalore, Goa) and Philippines (Manila, Cebu). A closer look at Air Asia’s routes indicate the adoption of a multi hub and spoke model of flight operations. A hub and spoke model refers to a series of linear flights flown from various points that meet at a central point which becomes the hub. The flying time between each point to the hub is usually three hours. Air Asia appears to have used such short flight time linear services between different parts of Malaysia and Kuala Lumpur in its initial years and has, later, replicated similar patterns in other countries in the ASEAN region where Air Asia has created multiple hubs at key business centres in Thailand, Indonesia, Philippines and India. This strategy is in line with the conclusions drawn by Toh & Higgins (1985) in their study of the impact of airline profitability vis-a-vis the hub and spoke model of operations. The authors concluded that use of multiple hubs in key business centres without over extending them contributes to higher profitability of an airline along with a number of other operational and marketing advantages. Some of the key advantages of such a model noted by Toh & Higgins (1985:17) are: i) hubs generate traffic between two different places that otherwise would not have sufficient air traffic between them without the hub; ii) operations can be conducted with minimum number of aircraft of smaller sizes thereby achieving higher aircraft utilisation rates; iii) savings generated in apron and maintenance services by centralising them at each hub; iv) hubs can help an airline identify with a region thus providing certain unique marketing advantages.

**AIR ASIA’S LONG HAUL OPERATIONS**

Low cost or budget airlines typically fly short distances of around 3 hours between two airports using smaller aircraft and depend on the operational efficiencies gained through a hub and spoke model (Toh & Higgins, 1985). The low cost carrier structure and offering is considered as unsuitable for long haul destinations over 4 hours because long haul destinations typically need larger aircraft, more investment in marketing and ground maintenance infrastructure at distant airports spread over geographically diverse regions. Long haul destinations are typically point to point linear services that need a managerial and operational approach different to the low cost carrier model. Long haul services work well as a standalone operation when there are sufficient number of passengers to sustain the linear service on a specific route but cannot break even if sufficient passengers are not available. The best way of assuring that one will have access to sufficient number of passengers is to enter into a strategic code share or partnership arrangement with other airlines that will act as a feeder of passengers and cargo at critical transit points.

In 2007, when Air Asia entered the long haul budget flight segment of the industry, CEO Fernandes created a separate corporate entity called Air Asia X and roped in an international airline as a partner to assist. Air Asia, therefore, sold a ten per cent stake to Virgin Airlines, thus enabling Air Asia X to access Virgin’s expertise in the long haul sector as well as the opportunity to code share and act as a passenger and cargo feeder for each other at certain transit hubs such as Kuala Lumpur (Air Asia) and London (Virgin). Air Asia X launched point to point flights between popular destinations linking Asia with Europe, USA and Oceania and kept costs under control. During the first four years of its operations, the airline survived high fuel costs, economic crisis, natural disasters and bird flu scares while growing the number of international destinations that included London, Taipei, Tehran, Paris, Seoul, Tokyo, China (Tianjin, Hangzhou, Chengdu), Australia (Gold Coast, Melbourne, Perth), India (Mumbai, Delhi) and New Zealand (Christchurch). Air Asia X is considered a success achieving the lowest industry ASK (available seat per kilometre) with plans to expand. Air Asia thus has the rare distinction of having succeeded in both segments i.e. short haul and long haul using a LCC business model defying industry logic that LCC business models cannot be successfully applied for long haul destinations.

Air Asia’s entry into the long haul sector as a budget carrier defied industry logic. In the past, almost all long haul carriers who had chosen to position themselves in the budget category had failed and gone bankrupt. Air Asia could defy industry logic and succeed partly because of the airline management’s foresight of entering into a strategic joint venture with an experienced long haul airline, Virgin Airline (which had also operated budget segments) as well as Air Asia’s continuous effort to
keep costs down.

AIR ASIA LOOKS TO THE FUTURE

Air Asia has truly lived its vision and mission statement during the past decade by focusing on a relentless expansion of new routes to serve its target market. The airline is part of the Tune group which has forayed into discount hotels (Tune Hotels), mobile phone services (Tune Talk), financial services (Tune money), tied up with car rental companies and introduced a number of value added services/innovative products such as the ‘Big shot’ loyalty programme that doubles up as an air points collector and a prepaid charge card. All these link up to Air Asia’s core airline business and customer base within the region and contribute to the airline’s operational income by way of ancillary income streams.

Air Asia’s fleet has grown from 2 old Boeing aircraft in 2002 to a total fleet of 158 new airbus A320s making it the largest low cost carrier in Asia (Air Asia, 2013:3). This has been achieved largely due to the strategic foresight of its management and dedicated teamwork of its managers and employees. Unlike other organisations in Asia, Fernandes as CEO introduced a non-hierarchical system of work place interaction. He led by personal example and was found working alongside baggage handlers, counter sales and reception staff, at times as part of the inflight cabin crew attending to customers and as a mentor who encouraged his staff at all levels to excel and seek growth within the company. Air Asia is the only airline in the world where baggage handlers and customer service staff have worked their way through the organisation and acquired pilot training funded by their employer and become captains commandeering a flight.

Air Asia’s success lies to a great extent in its focus to reduce costs and keep them under control. Lee & Jang (2007:440) in a study of airline profitability formulated a model that found a correlation between total risk and firm-specific variables (debt, leverage, profitability, growth, and safety). The authors concluded that total risk that an airline is exposed to can be reduced by paying attention to a number of controllable firm-specific variables such as i) borrowing money at low cost ii) using equity funds as much as possible to run operations iii) using new aircraft to achieve fuel efficiency iv) regular and competent maintenance of aircraft to reduce possibility of air crashes. This in turn will not only lead to reduction in costs but also ensure elimination of controllable risks as well as contribute to the airline’s profitability.

In case of Air Asia, one notices a relentless attention to costs. The company uses the equity funding model as the principal source of finance. It operates new and medium sized aircraft of one type i.e. Airbus A 320 and its variations on all its routes. These aircraft achieve a number of cost efficiencies in fuel consumption, higher aircraft utilisation, higher load factor possibility due to smaller size of aircraft, easy maintenance, ease of transferability of flight personnel between aircraft besides the aircraft’s suitability for short haul routes. Add to all that the multi-hub model used by Air Asia in the ASEAN region with many of those hubs located in smaller airports where the overnight parking charges are less than major airports. The commitment to control costs is articulated in Air Asia’s Group CEO Fernandes’ statement, “before a business can grow, it needs to have its costs under control. It must be cost-efficient and profitable, and it must create value”. He asks a simple question “How much lower can your cost reduce?” and he goes on to answer that; “My direct answer is if we not strive to be more efficient and choose to be complacent - our days are numbered. This is a continuous task we have to face head on year on year; it is the critical ingredient to operate a successful business.”xxx This sums up the key driver of Air Asia’s success.

End Notes:


iv ASEAN refers to the Association of South East Asian Nations comprising of Indonesia, Malaysia, Singapore, Philippines, Thailand, Brunei, Vietnam, Laos, Cambodia and Myanmar.

v Tan Sri Dr. Tony Fernandes was the Group CEO for the company from December 2001 till July 1, 2012 when he was redesignated as Non-independent, non-executive director of Air Asia. He has received a number of awards and titles in recognition of his services including the title of Tan Sri from the King of Malaysia. (see http://www.airasia.com/my/en/corporate/irdirectorsbiography.page)


vii Ibid.

REFERENCES


