FORMULATING A STRATEGY OF LOW COST AIRLINE

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This article deals with formulating the strategy of low cost airlines. It is an integral function related to organizational success and competitive advantage. Many tools are available to managers helping to formulate and implement business strategies. There are several ways a strategy can be designed for a company. However, some methods are better than the others. There exist some theories that describe formulation of the strategy and the process of strategic control and ways how to analyze airline´s strategy creation. The analysis was focused on external and internal environment of a low cost airline. Results were summarized and then a typical strategy typology for low cost airline was identified .

K e y w o r d s: Low cost airline, strategy, internal environment, external environment

1 INTRODUCTION

Strategy of a company provides the big picture that shows how all the individual activities are coordinated to achieve the desired end result. It is through the strategy process that the overall direction of the business is set. This is based on the opportunities and threats in the outside world and the internal strengths and weaknesses of the business.

2 STRATEGY

Let us first define what strategy is and how an effective strategy is put in place, since there are many misunderstandings about the topic of organizational strategy, and let us define what it is not. Strategy is not about operational effectiveness - trying to be better, faster, or cheaper than the competitor. This is simply being more efficient than competitors. Nor is strategy about benchmarking or trying to do the same things as your competitor while doing them better. This may lead to short term advantage at best. Strategy is also not about trying to be number one in a given market. That is a statement of aspiration that simply defines how well you want to do, not what you want to do. So, what is strategy? It´s about uniqueness. Having a unique value proposition is not enough. It must be supported by a set of integrated activities that fit the strategy and contribute to the unique strategic positioning of the organization. This is called the value chain. There are four elements of an effective strategy

- A unique value proposition compared to competitors.
- A differently tailored value chain with activities that fit together and reinforce one another.
- Clear tradeoffs, and choosing what not to do.
- Continuity of strategy with continual improvement in realization [1].

3 STRATEGY FORMULATION AS PART OF THE STRATEGIC MANAGEMENT PROCESS

Strategic management is an ongoing process to develop and revise future-oriented strategies that allow an organization to achieve its objectives, considering its capabilities, constraints, and the environment in which it operates. The process comprises three phases:

- Diagnosis
- Formulation
- Implementation

Diagnosis includes: (a) performing a situational analysis (analysis of the internal environment of the organization), including identification and evaluation of current mission, strategic objectives, strategies, and results, plus major strengths and weaknesses; (b) analyzing the organization's external environment, including major opportunities and threats; and (c) identifying the major critical issues, which are a small set, typically two to five, of major problems, threats, weaknesses, and/or opportunities that require particularly high priority attention by management.

Formulation, the second phase in the strategic management process, produces a clear set of recommendations, with supporting justification, that revise as necessary the mission and objectives of the organization, and supply the strategies for accomplishing them. There are four primary steps in this phase:

- Reviewing the current key objectives and strategies of the organization, which usually would have been identified and evaluated as part of the diagnosis.
- Identifying a wide range of strategic alternatives to address the three levels of strategy formulation outlined below, including but not limited to dealing with the critical issues.
- Doing a balanced evaluation of advantages and disadvantages of the alternatives relative to their feasibility plus expected effects on the issues and contributions to the success of the organization.
- Deciding on the alternatives that should be implemented or recommended.

In organizations, and in the practice of strategic management, strategies must be implemented to achieve the intended results. Even the most wonderful strategy in the history of the world is useless if not implemented successfully. This third and final stage in the strategic management process involves developing an implementation plan and then doing whatever it takes to make the new strategy operational and effective in achieving the organization's objectives [2].

4 LOW COST AIRLINE STRATEGY

Low cost airline strategy is based on providing short haul, point-to-point routes with frequent and reliable departures at a low cost. There are many internal company practices that enable this strategy (see Figure 1):

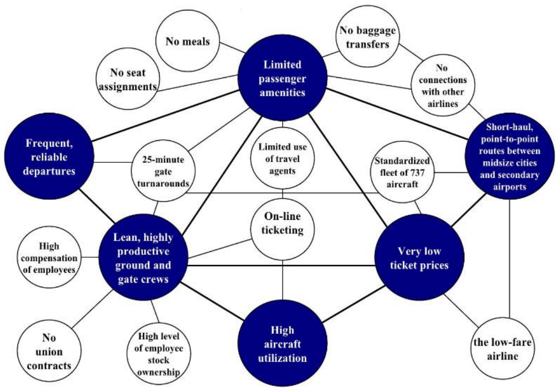

Figure 1. Activity map [3].

All activities of the organization must line up in support of the strategy and present a “value chain” that creates advantage in the marketplace. This is what makes a good strategy difficult to imitate or copy.

Here are the main components which make up low cost airline´s strategy:

- Low fares -These are used to boot-up demand, they target fare-conscious leisure or business travellers who might otherwise not travelled at all or user other modes of transport such as car, train, bus. Airline sells its seats on a one-way basis unlike most traditional full service airlines. It establishes its fares on the basis of the demand for particular flights and with reference to the period remaining to the schedules date of departure. 75% of seats on a flight are sold at the minimum available fare assigned for the route. Once the quota gets fulfilled, the price per seat rises.
- Frequent, point-to-point flights on short-haul routes are offered to secondary and regional airports in and around major population centres and destinations. The choice of flying only short-haul routes enables to offer frequent service, while eliminating the necessity to provide frill services otherwise expected by customers on longer flights. Point-to-point flying (as contrast to hub-and-spoke service used by the traditional carriers) allows to avoid the costs of providing through service for connecting passengers, including baggage transfer and transit passenger assistance costs. This is one of the key

differences between low-cost airlines and traditional carriers.

- Low Operating Costs - There are four key expenses which a company is able to control and or reduce:
    - Aircraft Equipment Costs: strategy for controlling aircraft acquisition costs is to use a single type of aircrafts. Strategy of limiting its fleet variety helps mainly minimize the costs associated with personnel training, maintenance and the purchase and storage of spare partsas well. It offers greater flexibility in the scheduling of crews and equipment.
    - Personnel Expenses: Airline controls its labour costs by continually improving the productivity of its already highly-productive work force. Remuneration for employees emphasizes productivity-bound pay incentives, including commissions for on board sales of products for flight attendants and payments also based on the number of hours or sectors flown by pilots and cabin crew personnel within limits set by industry standards or regulations fixing maximum working hours.
    - Customer Service Costs: Airline often has entered into agreements on competitive terms with third party contractors at certain airport for passenger and aircraft handling, ticketing and other services that management believe can be more cost efficiently provided by third party contractors. Management attempts to obtain competitive rates for such services by negotiating multi-year contracts at prices that are fixed or subject only to periodic increases linked to inflation. The development of its own reservations centre and internet booking facility has allowed to eliminate travel agent commissions.
    - Airport Access Fees: Airline attempts to control airport access and service charges by focusing on airports that offer competitive cost terms.
- Internet Booking - Online ticket booking system allows internet users to access host reservation systems and make and pay for confirmed reservation in real-time. As a result, internet bookings have increased drastically, accounting for in excess of 90% of all reservation on a daily basis.
- Commitment to Safety and Quality Maintenance- commitment to safety regulation is a primary focus of the company and its management. All that begins with recruiting and training of pilots, cabin crews and maintenance personnel and included a policy of maintaining its aircraft in accordance with the highest International airline industry standards [4].

5 BIGGEST AND BEST-KNOWN LOW-COST AIRLINE IN EUROPE

Ryanair's objective has been to establish itself as Europe's leading low-fares scheduled passenger airline through continued improvements and expanding offerings of its low-fares service. Ryanair aims to offer low fares that generate increased passenger traffic. Continuous focus on cost containment and operating efficiencies is a vital part of the Ryanair way of doing things.

However, Ryanair's growth and success is not based solely on price. In addition to the lowest fares in every market, company also offer:

- best punctuality. Last year 85% of all flights arrived on-time.
- fewest lost bags - last year we lost less than one bag for every 2,000 passengers carried.
- fewest complaints – last year we received less than one complaint per 1,000 passengers.
- youngest fleet – the average age of Ryanair's 272 aircraft is now just 3 years old.
- prompt response to passenger complaints – last year Ryanair replied to more than 99% of

passenger complaints within our 7 working day commitment.

- world's greenest, cleanest airline – the most recent Brighter Planet research confirms that Ryanair is the world's greenest/cleanest airline.

IATA's recent 2010 traffic statistics confirm that Ryanair carries substantially more international passengers than any other scheduled airline in calendar [5].

Rank	Airline	Pax
1	Ryanair	71.2m
2	Lufthansa	44.4m
3	easyJet	37.6m
4	Air France	30.8m
5	Emirates	30.8m
6	British Airways	26.3m
…	…	…
25	Aer Lingus	9.3m

Figure 2. IATA Intl Sched Passengers 2010 [5].

Among the 20 largest airlines by passenger volume, the cleanest, Ryanair, uses barely more than a third the fuel to transport its average passenger one mile compared to the least efficient, American Eagle. (see Figure 3). From business perspective, as from an environmental one, this nontrivial-higher efficiency is a boon that allows for airlines to pass financial and environmental savings onto their customers. It makes the Ryanair the greenest and cleanest airline of the world. [6]

Figure 3. Emissions per passenger per mile. [6]

6 RYANAIR´S STRATEGY- COST LEADERSHIP STRATEGY

Cost leadership is a concept developed by Michael Porter, used in business strategy. It describes a way to establish the competitive advantage. Cost leadership, basically, means the lowest cost of operation in the industry. The cost leadership is often driven by company efficiency, size, scale, scope and cumulative experience.

Michael Porter provided a framework that models an industry as being influenced by five forces. The strategic business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm operates. Applying Porter five forces analysis to Ryanair´s external environment, its competitive advantages can be identified as:

- Supplier: Boeing is the main supplier, high switching cost, price of aviation directly related to the price of oil, regional airports depends on one airline, bigger airports have competitors of Ryanair.

- Threat of entry: High capital investment, restricted slot availability makes it more difficult to find suitable airports, immediate price war if encroaching on existing LCC route, need for low cost base, flight authorization .
- Buyers: Customers are price sensitive, high switching tendency, customers know about the cost of supplying the service, no loyalty.
- Substitutes: No brand loyalty of customers, no “close customer relationship”, no switching costs for the customer, other modes of transport: Eurolines, ferries etc.
- Rivalry: The LCC market is highly competitive, most cost advantages can be copied immediately, the two major low-cost airlines have avoided direct head to head competition by choosing different routes to serve, following Ryanair strategy will create heavy pressure on prices, margins, price is the main differentiating factor [7].

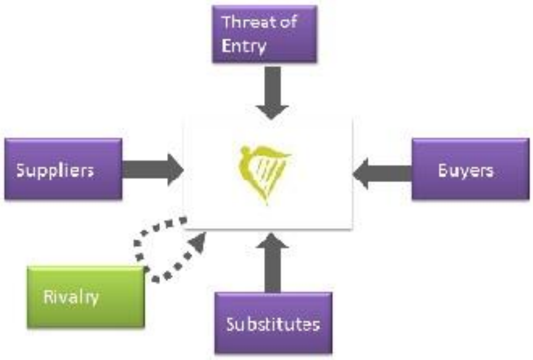

Figure 4. Porter’s Five Forces [7]

SWOT analysis can help identify the types of strategies typical for Ryanair. There are four types:

- S-O strategies pursue opportunities that are a good fit to the company's strengths.
- W-O strategies overcome weaknesses to pursue opportunities.
- S-T strategies identify ways that the firm can use its strengths to reduce its vulnerability to external threats.
- W-T strategies establish a defensive plan to prevent the firm's weaknesses from making it highly susceptible to external threats [8].

Result of analysis of Ryanair´s internal environment, as a part of strategy formulation process, indicates defensive strategy (ST) . There are some factors resulting from SWOT analysis:

- Strengths: brand name, low airport charge first mover advantage on regional airports E-ticketing reduce operating cost, high seat density, all Boeing aircraft make it low maintenance cost, fuel and other risk hedging, high service performance: punctual, low baggage loss.
- Weaknesses: prone to bad press, niche market: restricted expansion possibility, distance from some regional airports make inconvenience to the traveller, poor service, extremely sensitive to changes in fare.
- Opportunities: European Union expansion, scope of potential market to capture, benefits from less exposure geographical risk, economic slowdown helps Ryanair promote their strategy of low fare.
- Threat: oil market fluctuation, increase of low fare competition, limited growth in Southern Europe, customers are price sensitive, increase in air traffic charge [7].

Having performed the analysis, we can declare that strategy or strategy formulation process in Ryanair is almost perfect. But there are some deficiencies.

Our suggestions for improving the strategy formulation are concerned with three areas:

- Maintaining the level of low cost(see Figure 5
- Achieve satisfaction of staff
- Proposal to improve the quality of service

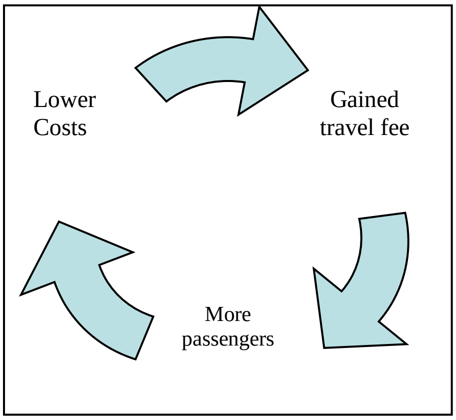

Figure 5. Process of maintaining the level of lower costs [9]

6 CONCLUSION

In a changing business environment reflects the importance of strategy. It is not enough just to think strategically but act. It is all about securing a competitive advantage, achieve market position and long-term prosperity. It is interesting to see competitors to air carriers fighting for their customers with all sorts of "weapons".

In terms of prosperity, low-cost airlines are ahead compared to other carriers. It means that the strategy is properly formulated and adjusted to current market conditions of air transport. Despite the negative impact of the economic crisis they have managed to keep their market and even achieved a profit that other airlines can only envy. However, high work commitment and savings causes have the price o on the part of the personal background. Staff dissatisfaction and frustration brings a negative light on the company.

Ryanair are still not aware of the importance of human factor and in the process of strategy formulation process they ignored it. May somebody remind them the notion in the introductory part: strategy is not about being more effective than others, nor about competing to be the best. It is about the competition and how to be unique in all directions.

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