Flyadeal: A Replicate of Southwest or Continental Lite

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Abstract

According to Michel Porter there are two generic strategies-cost leadership and differentiation. Using the case of a newly established Saudi airline company Flydeal we attempt to analyze how one of these strategies is selected and applied in real-life business, instigate how activities and business processes are used to support the selected strategy, try to identify sources of competitive advantage and discuss if the new company will be able to sustain it.

Keywords: Airline; Flydeal; Performance; Leadership strategy

Introduction

Strategic choice of Saudia Airlines: "Strategy is simply resource allocation. When you strip away all the noise, that's what it comes down to. Strategy means making clear cut choices about how to compete. You cannot be everything to everybody, no matter what the size of your business or how deep its pockets" by Jack Welch.

Overview of the regional market

The Middle East airline market is relatively new with a few dominating regional players such as Qatar Airways, Emirates, Etihad, Turkish Airlines and Saudia [1]. These full-service airlines compete in providing more routes and better services. However, the market potential for low-cost carriers is quite untapped. FlyDubai, Air Arabia, Flynas and Nesma Airlines are the major budget players. In 2015, FlyDubai and Air Arabia recorded more than 170 million dollars in net profit. Saudi Arabian carriers are not public companies and do not disclose profits. According to the General Authority of Statistics in 2016, Saudi airlines performed 219,482 flights serving around 55 million passengers. This is almost twice the cumulative numbers of trips and passengers of all foreign airlines operating from Saudi Arabia.

For Saudi Arabia the 2000s was a decade of prosperity and growth. The job market grew rapidly which was fueled mainly by the recovery in oil prices [2]. Consumer purchasing power and willingness to pay also had increased in 2006, when Flynas and Sama Airlines entered the Saudi airline market. Prior to their entry Saudia Airlines held full monopoly-it was the only Saudi air company. Sama Airlines, based in Dammam, ceased operations in 2010 with 266 million dollar loss. Flynas, on the other hand, still operates from two major hubs in Riyadh and Jeddah performing codeshare service with Etihad and Pegasus Airlines, offering baggage transfer and other services. The 2014 oversupply of oil pushed down GDP of Saudi Arabia from 756 billion dollars in 2014 to 654 billion dollars in 2015. In order to diversify the economy and decrease oil dependence, Saudi Arabia initiated large-scale transformation plan, Vision 2030. Tourism and logistics were identified as two sectors the Vision could contribute in building and expanding. The drop of in purchasing power increased the demand for low-cost carriers. And Saudia Airlines had to make a strategic decision on how to adapt to the new reality-loss of monopoly, availability of other carriers for some destinations, increased savviness of the customers who can now easily compare prices and book cheaper tickets via Internet. It became evident that the value airline market in Saudi Arabia had emerged and there is there is a growth opportunity there [3].

Learning from the US industry and making the choice

Saudia most likely had two major options for entering low-cost air market-create a cheap ticket product line or create a value airline offspring [4,5]. Interestingly, copying low-cost airlines along with operating regular flights in the region is considered a new strategy (Flynas, FlyDubai, Turkish Airlines); while it is well known that this strategy have failed in the United States [6]. For example, Continental Airlines and United Airlines attempted to replicate Southwest Airlines; another example was JetBlue and their new ventures Continental Lite and Ted. The new strategy did not work out for any of those companies. The essence of the problem was that both airlines lost their competitive advantage and could not duplicate Southwest business model despite their extensive experience in running commercial flights, strong brand recognition, well-established network and low transaction costs [7]. Research indicates that the failure is most likely to result from the weak strategy and its implementation [8]. It turns out that running low-fare airlines requires quite different structure, business model and targeted customer segments when compared to legacy airlines. Legacy airlines could not lower their operational costs via reducing waste. For example, their operational model largely depends on baggage transfer; while such service would never be demanded by low-cost customers since they travel short distance with no transfer. In lean management, waste is defined as the non-added value processes to the customers [9]. Hence, the customers dictate the value of services and processes that airlines provide. Airlines companies are able to reduce services that do not add values to the customers without losing customers [10]. Quite the opposite, they are able to attract more customers who mainly look at price when it comes to booking flights.

We would like to draw an analogy of copying a budget airline with copying an electronic text. Using copy-and-paste functions allows replicating the text very quickly. This works, however, only for copying the full text. Trying to copy only a piece of text and pasting it into another document often leads to loss of coherence and meaning. In this case the newly copied text would not deliver the same integrated interlocked message and will not add the same value it had added to the original document. Thus, in order to copy southwest and get comparable results, one would need to copy all their business activities that enabled them to provide low fares. For example, having cheaper

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and older planes is not enough to reduce the costs and yield low fares. It takes duplicating the whole interconnected realm of business activities. Continental and United who provide full service might have failed to copy-paste all of Southwest activities [11].

In business strategy, the more unique integrated activities a business has the harder it gets to duplicate it [12]. High integration of business activities enables the organization to achieve a good strategic fit between all of its actions and processes [13]. It also makes it easier to achieve operational effectiveness, decrease waste and, consequently, shrinks overall operating costs. Thus, southwest fully integrated interlocked strategic system of activities empowered them to vividly gain a competitive advantage over Continental Lite. The strategy of organizations is about making choices and allocating resources to serve these choices. Hence, it is sometimes hard to pivot away from a strategy as resources were already directed to serve that choice. In the case of Continental and United, they decided to compete in the low-cost market by lowering their prices without developing a network of activities that would empower them to achieve cost [7]. They introduced non-added values services to low-cost airlines travelers such as meals, baggage transfer, and business lounges. They competed only in operating excellence domain without reducing waste, this trade-off of (services vs. low price) was not easy to achieve. Eventually, they could not continue to profitability compete as low-cost carriers [6].

On the other hand, implementation is about closing strategy to performance gaps [6]. Hence, in low-cost airlines, this translates mainly the capability of the enterprise ecosystem to pass a low price to its customers as a result of achieving a cost leadership. In other words, the strategy derives the implementation [8]. Hence, setting the strategy to achieve a cost-leadership would relocate resources into implementing activities that support the cost-leadership. In the case of Continental and United, they attempted to lower implementation cost to achieve cost-leadership strategy which is quite hard task. In conclusion, strategy dictates implementation but not vice versa.

Saudia decided not to repeat mistakes of the US airlines and selected to leave the current business as it create a first in the market value airline separate company with its own set of business activities [3,4].

"Despite incredible growth, airlines have not come close to returning the cost of capital, with profit margins of less than 1% on average over that period." The Economist, 2014.

Look on the decision through the lens of Porter's 5 FORCES

Looking at the strategic choice of Saudia through the lens of the Porter's 5 Forces Model [6], we come to understand that the choice most likely was the right one to make:

New entry threat: The Saudi airlines market, as the most airline markets, is highly regulated. Barriers to enter and exit are very high [14]. A new airlines business cannot be established quickly without meeting many safety regulations and policies, etc. Moreover, the initial investment is very high as the entrant has to hire an experienced crew, lease planes and sign long-term contracts with airports. However, Saudi Arabia is a ripe market and becoming more attractive, especially with the swift implementation of vision 2030. As country becomes more attractive for foreign investments, one of the global players may decide to enter the market [15].

Buyer's power: The customers barely differentiate between different airlines [16]. The customers have a very strong power over the airline company; they can easily switch to a different provider. In fact,

our market research showed that 88% of passengers in Saudi Arabia were booking their tickets online mainly for convenience and to find cheaper fares. We also found that most passengers would not rank the brand name of the airlines as a factor in booking their fares.

Suppliers' power: There are very few suppliers of airplanes in the world. The list of commercial aircraft manufacturers is characterized as an oligopoly; where few big major companies dominate the market; mainly, Boeing and Airbus [17]. These factors make it unattractive for completely new players to enter airlines market. Manufacturers have the power to dictate prices. In the same time, this situation will not prevent an established global airline from entering the market. For example, Turkish airlines having all needed connections and experience in dealing with suppliers, as well as fleet to be soon retired, entered market of Kyrgyzstan via creating a low cost airline Pegasus-Kyrgyzstan which is recently branded as Air Manas [18]. This entry significantly affected all other players as they all were full-service airlines with higher ticket prices [19].

Threats of substitutes: Saudi Arabia is building a network of modern rail transportation system [20]. It will link major metropolitan areas such as Makkah, Jeddah, KAEC, Yanbu, and Madina via Al Haramain high-speed rail project. In addition, there is a new project that would establish a new route between Riyadh and Jeddah. Travelers will be able to take the train all for the established routes between Dammam and Riyadh and all the way westward to Jeddah [21]. This new modern rail transportation system, along with a 627,000 km road transportation system could raise a threat to Flyadeal's competitive advantage. For example, opening a high-speed train line between Moscow and Saint-Petersburg in Russia dramatically reflected on the local airlines focusing on the transportation between these two mega polices [22]. Currently, the plane ticket is often cheaper that the train, as the fast train provides more convenience without much travel time difference.

Competitive rivalry: Flynas, Nesma Air, and Saudia Airlines are the only competitors inside the Saudi local market. However, Flyadeal could leverage its existing business network of sister companies to gain an edge on competitors in operational effectiveness. Saudia created its offspring low-cost sister company not to compete against it; but rather to integrate it with the bigger organization and increase its total market share.

In short, sitting exclusively in the "premium" airfare segment would be very risky for Saudia. The company had to find a way not to lose its market share to the rivals, potential newcomers and substitutes.

The Case for Flyadeal

Competitive advantage

"A competitive advantage becomes a sustainable competitive advantage when other companies cannot duplicate the value a firm is providing to customers" Chuck Williams (Founder of Williams-Sonoma).

Flyadeal was established in 2016 and began operations in the last quarter of 2017. It is characterized as a low-cost airline with major hub located in the busiest airport in Saudi Arabia, King Abdulaziz International Airport in Jeddah. Based on the market trends, we hypothesized that a low cost airline is competing based on the cost leadership strategy. In this case study, we are trying to analyze information available on Flydeal to see if its activities support our hypothesis and if the selected strategy well. To answer this question,

we will draw Flyadeal's activities map to assess its value proposition and the alignment between its key activities and its strategic goals. Then, compare and contrast its individual components to Southwest's business activities. Whereas, Southwest's model is well described in research [6], recreating the Flydeal's business activities is not a very straightforward task. Being a privately held company, Flydeal does not disclose full information. Nevertheless, our extensive research of their publications, business articles, and information available online provided sufficient data to establish the basis for the comparative analysis.

"Flyadeal will focus on "delivering value for money to cost conscious customers," Saudia Director General Saleh Bin Al Jasser said on the Twitter account (Appendix 1). He also claimed that "Flyadeal will be a single class low fare carrier which means we are focused on getting people from A to B for a fair price," says its Twitter account (Gulfnews). How is Flyadeal able to provide such a service while maintaining some certain standard which customers are used to in other airlines like Flynas (Appendix 2).

Flyadeal is focusing on servicing high demand domestic routes only. This approach insures high capacity and traffic on every flight which takes off and contributes to ability to charge cheaper fares; which is different than their cost leadership strategy as the former is a financial and operational result of the latter. At its launch in early Q4 2017, Flydeal launched direct daily routes from Jeddah to Riyadh, Dammam and Qasim. Hence, they are only capitalizing on busy routes and attempting to achieve low fares brand recognition to achieve market penetration.

Unlike its sister company Saudia, Flydeal targets the cost conscious individuals who are willing to give up on certain services in order to receive a cheaper fare (Appendix 2).

Flydeal introduced to the market "building your ticket" proposition. The company lets passengers opt-out of certain paid services such as extra carry-on baggage, baggage to be shipped, food, and option to choose a seat.

Flyadeal's activity map

Using Flyadeal activity map, we could diagnose its competitive advantage in the market and how it is able to connect its value proposition to the activities while measuring the strategic fit and the boundary of activities (Figure 1). Based on our study and the publicly available information, we discovered 5 major strategic positions of Flyadeal: Limited passenger services, no airlines Alliance, based in King Abdulaziz International Airport, lean and cost effective crew and a provider of very low prices. We looked further into their operation model, provided services and overall business model to identify further minor activities (Figure 2). One may conclude that Flyadeal successfully duplicated the Southwest model; yet, the rest of the problems should remain in the implementation phase especially as they scale up their business from 3 planes as of Q4 2017 to minimum of 25 planes in 2020 according to their expansion plan, which is a result of Flyadeal's goal of decreasing running cost and leveraging the benefit of having unified planes, such as unified training for crew, lower maintenance and lower cost of switching planes even in the same route.

The following activities support cost leadership strategy chosen by Flyadeal. Unlike Nesma airlines and Flynas, Flydeal relies on a standardized fleet of Airbus A320; which means uniform maintenance procedures and the capability of swapping planes when needed without large operational loss. Smaller airplanes also lead to fewer passengers and less gate turnaround which, in turn, decreases some of the airlines' operational costs.

The concept of paying for baggage is new to the area but it could prove to be attractive to customers who are price sensitive and willing to give up that service to save money. This option could be executed in tickets sales as a cash-back at checking out to further stress that passengers save when not checking in baggage. Another example of positioning as an airline helping customer to save money is discount offered for buying tickets directly at the company's website and for buying tickets in advance. The colors, brand, marketing campaigns,
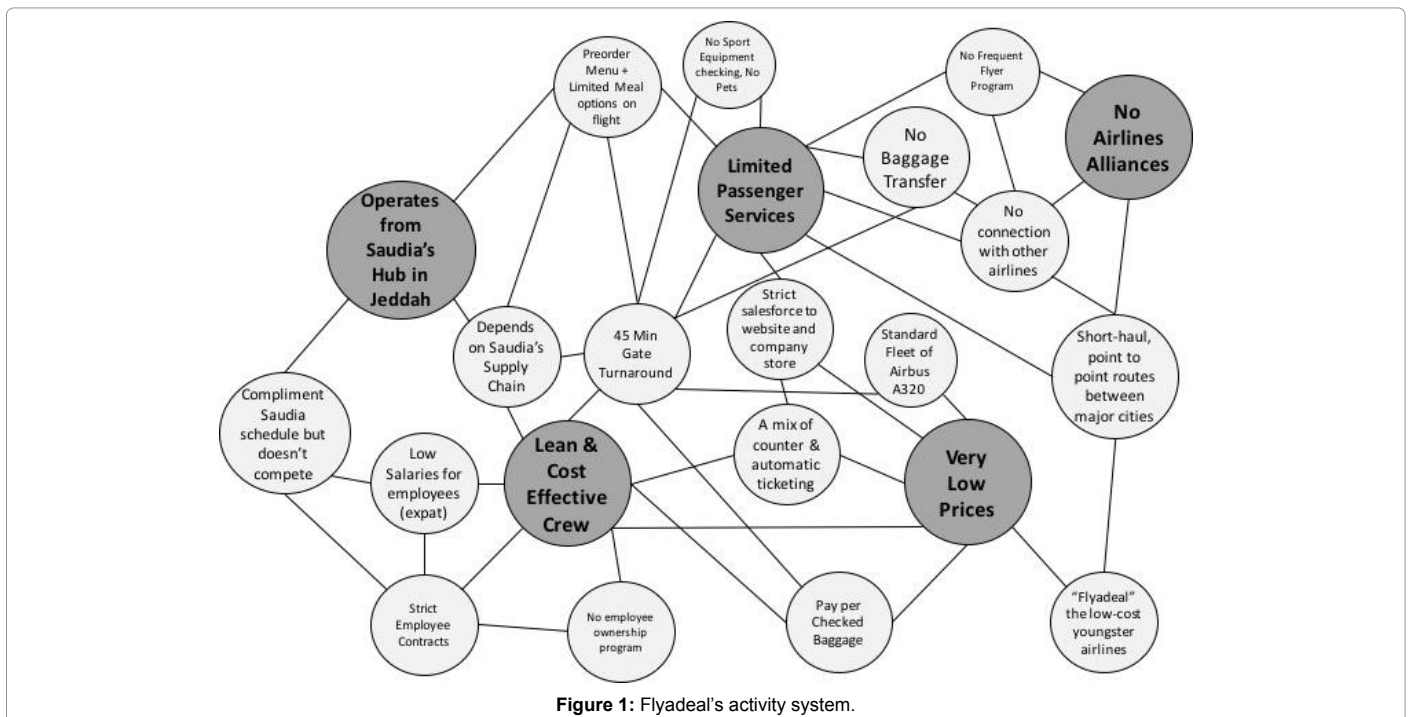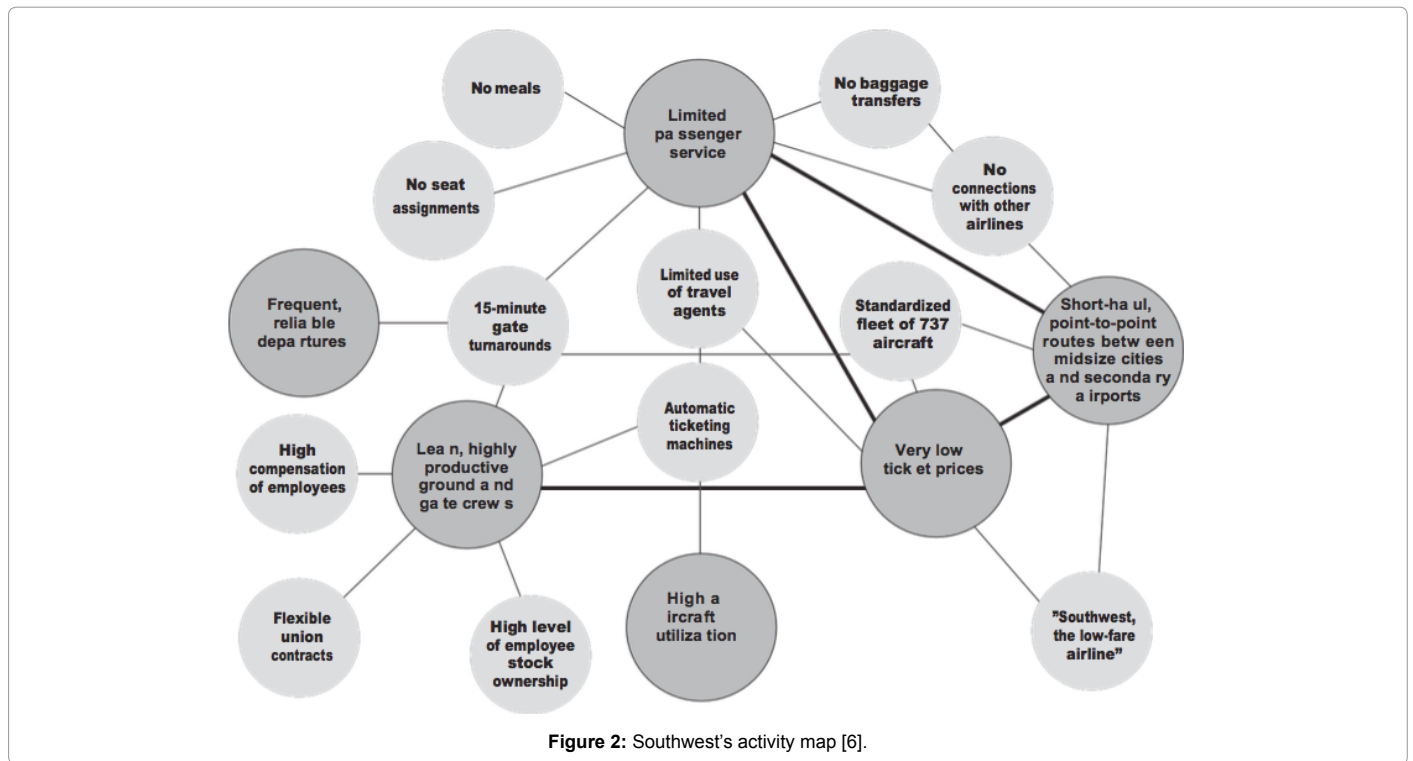

Figure 1: Flyadeal's activity system.

Figure 2: Southwest's activity map [6].

website user interface, business model and all of Flyadeal's strategic activity seem to target younger population which is a growing segment in Saudi Arabia, and traditionally is a price sensitive segment. However, we also identified six activities which if not addressed could undermine Flyadeal's cost leadership strategy (Figure 2). Those activities are:

1. Paid seating options increases boarding time and gate time expenses,

2. Current low aircraft utilization rate-is a negative factor, however, it is mainly due to the very young age of the company,

3. Operational effectiveness at Jeddah Airport-the airport is outdates and has a lot of delays [23-26],

4. Daily limited routes

5. Cannibalization of Saudia (Mother Company) market share which would raise a potential conflict of interest with the mother company.

As of last quarter of 2017, there were 103 Flyadeal employees registered on LinkedIn and only 8 of them were previously employed by Saudia. This indicates that Flyadeal is independent in its human resources. The senior management did not come from Saudia; rather, they were hired based on their experience in airlines consultancy and low-cost airlines establishment. For example, the current chief executive officer, Con Korfiatis, was responsible for the establishment of Jetstar Asia (LinkedIn). The rest of senior management also came with regional or international experience with focus on low-cost airlines business. Such team forming decision had important strategic implications as management with specific experience in low-cost airlines would be more capable of setting up the operations and in tackling the potential conflict of interest with Saudia while sustaining growth of an independent off-spring entity.

The current low aircraft utilization could be shifted as the

company push for more routes assuming demand remains strong. The operational effectiveness at Jeddah airport has been on the table of many airlines and would not be solved completely till the opening of the new airport, which is project to happen in 2018.

If we compare Flydeal's and Soutwest's activities map, then we may conclude that Flyadeal's value proposition and activities are quite similar to Southwest; which could indicate that Flyadeal has a good chance of delivering its proposed value proposition and sustain its competitive advantage in the budget airlines business as a cost leader in the Middle East region (Figures 1 and 2). Moreover, it could retain and sustain its competitive advantage if it leverages its relationship with its sister companies. For example, if aggregate accounting profit was positive but its cash flow was negative; then, sister companies could extend the maturity of Flyadeal's account balance.

One might be skeptic about the level of success such new carrier could achieve without the existence of true independent market share data. Based on our big data analytics, we found that Flydeal successfully captured 5-15% of the low-fares market based on the internet search index method (Appendix 2). Within its first quarter and with the current limited routes, Flyadeal celebrated its 100,000 passenger in December 2018 (SaudiGazette).

Growth opportunity

Flyadeal's CEO Con Korfiatis stated "Saudi Arabia and the region at large, has a very young and digitally savvy population, who has an increasing thirst for low fare travel domestically and across the region" (ArabNews). Recognizing the multiple options available a click away from their customers, Flyadeal's main strategy is to appeal to young Internet users as a provider for low-cost airfare. Saleh bin Nasser Al-Jasser, chairman of Flyadeal and director general of Saudi Arabian Airlines Corporation said: "Flyadeal is on track to provide a comprehensive network that reaches all customers in Saudi Arabia and

the region" (Arabian Business) In fact, we found that 88% of airlines' customers were booking their tickets online where 40% booked their tickets through mobile applications while the 48% booked them via their computers based on our market research (Appendices 3 and 4).

With increasing demand [27], Flyadeal is working to expand their outreach by creating more routes and recruiting more planes of different sizes. Despite current focus on dominating the domestic air travel market, Flyadeal also has an intention to expand and internationally. Recognizing the large number of people from the Indian subcontinent who reside in the Middle East, Flyadeal intends to tap into this international market in the near future. In fact, 20% of expatriates are of Indian subcontinent origins with a majority being of a limited monthly income of SAR 2,500 (Saudi Expatriate). This target segment would jump at the opportunity at low-cost airfare. This would also appeal to corporations and entities employing expats from those areas. Even with growth, Flyadeal intends to preserve its position as a low-cost airline.

With increased government spending and interest from foreign investors an upcoming positive trend in the tourism sector is anticipated. Recent statistics reveal that annual visitors for Umrah amounted to 8 million people and additional 3 million people came for Hajj. According to projections by 2023 18 million will annually come for Umrah, thus indicating the need for year-round demand for flights (Wahbah). The number of inbound and domestic visitors will remain controlled at 8.8 million with a compound annual growth rate of 4.2% beyond 2016. It stands to reason for Flyadeal to position itself in providing affordable means of transportation especially within the MENA region where religious tourists hail from (Stats.gov.sa). "Religious tourism is set to grow at an increasingly high pace with the Kingdom investing around US$50 billion worth of project to upsurge the number of Hajj and Umrah pilgrims over the next three years" (Saadi).

A Euromonitor International Tourism Forecast report anticipates a growth by 2020 within the Saudi Arabian domestic tourism segment by 40%. According to the General Authority on Statistics, up to 94% of Hajj and Umrah pilgrims visit to Saudi Arabia via air. The Kingdom is actively increasing the airport's capacity to 50 million travelers in 2020 and 80 million by 2035. The government plans to double this number by 2020. Moreover, the tourism sector is experiencing a boom in investment and growth encouraged and facilitated by the Saudi Vision 2030. According to the World Travel and Tourism Council, the travel and tourism sector is expected to contribute 81 billion dollars to Saudi Arabia's gross domestic product (GDP) by 2026 (Arab News). Hence, the need for affordable transportation will be increasing dramatically in the next few years, which makes the Jeddah based low fare airlines Flyadeal perfectly positioned for growth.

The strategy alignment to customers' needs

An online survey was conducted and disseminated through social media to understand customers' needs. We found that Flyadeal, which has been around for 3 months only, achieved penetration rate of 2%. Interestingly, Flyadeal CEO's statement of a young online savvy population is in fact validated by our survey. Results display that almost 90% of the population make their bookings online through a computer or mobile application. This supports the Flyadeal's tactics of avoiding retail offices and travel agencies as a part of overall cost leadership strategy. 80% of the survey respondents stated that price and timings of flights were the main drivers of choosing one airline over another. Around 70% of our sample showed approval of the limited passenger's
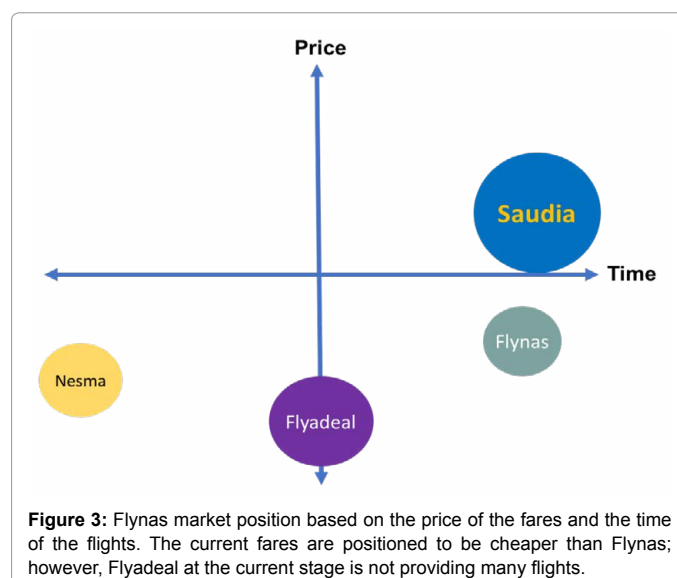
services in handling baggage in exchange for lower cost. We also found that overall 8% of respondents consider Flydeal as their preferred low-cost airline. Since price and time of the flights were the major factors in booking tickets, we analyzed survey results of preferred airlines versus price and time (Figure 3). The price-time analysis gave us an insight about the perceived customer value and suggested that Flyadeal's unique positioning in order to gain a competitive advantage over rivals might work out.

Sustaining the Competitive Advantage

Flydeal's marketing includes efforts to educate customers about giving up some of the traditional airline services in exchange for charging lower fares. This approach might be mimicked by local and regional rivals. Such replication is very likely to increase the pressure on Flyadeal to reduce its prices in order to protect its slogan and market share as low-cost provider. This might trigger a price-war, when everyone is losing in a short term, and those who can sustain the losses survive and have a chance to thrive later on. It might be to the advantage of Flydeal that all other airlines in the region are not true low-costers. Being full service air companies, the rivals are not very likely to succeed in copying Flydeal's offering. We analyzed Flyadeal's value, rarity, costly to imitate and how those value are organized to capture values and organized our findings (Table 1). VRIO analysis were used to investigate the value creation and if Flyadeal is sustaining a competitive advantage.

They are likely to be running into the fallacy of copying one single aspect of Flydeal's activity, for example, replicating product offerings such as lower ticket price with baggage opt-out. It will be immensely difficult for the rivals to be sustainable with copied offerings. Copy-pasted offerings will not fit into the activity systems of the existing rivals and eventually they will have to raise prices. Flydeal on the other hand, might be in a position to maintain low fares for quite some time, because all activities and processes are intentionally designed for this mode of operations.

Another aspect which will help Flydeal to sustain its competitive advantage is relations with parent company Saudia airlines. This gives to Flydeal quite clear competitive advantage in the selected cost leadership strategy.

Figure 3: Flynas market position based on the price of the fares and the time of the flights. The current fares are positioned to be cheaper than Flynas; however, Flyadeal at the current stage is not providing many flights.

Resources and capabilities	Value	Rarity	Costly to imitate	Organized to capture value	Value creation
Network of sister companies (Saudia airlines, Saudia catering, Saudia ground services,	Yes	Yes-It is very rare to find or establish such conglomerate that is focus on airlines support.	Yes-The network involves ground services, catering, finance, crew training and airport management.	Yes-If those relationship were leveraged to support the cost leadership	Realized Sustainable competitive advantage
Jeddah based	Yes-Religious tourism	No-With vision 2030 and easing regulation, new airlines could enter this ripped attractive market.	No-With vision 2030; we expect new comers to uses Jeddah new airport as a hub which could reduce their seed cost	Yes - Working from Jeddah airport utilized most the sister companies leverage and increase route utilization.	Temporary competitive advantage
Limited passenger services	Yes-Contributes to cost leadership strategy.	Yes-Most regional airlines offer full services to some extent that includes FlyDubai, FlyNas and Nesma.	Yes-Full services airlines are not positioned to market themselves with limited services.	Yes	Realized competitive advantage
Standard fleet of Airbus A320	Yes-Supports controlling operational cost and time.	Yes-Most airlines in the region use heterogeneous fleets.	Yes-For existing rivals, switching and training costs are high.	Yes	Realized competitive advantage
No airlines alliance	Yes-It reduces obligations, dependencies, and gate turnaround.	Yes-Most regional airlines are engaged in alliances.	No	Yes	Realized temporary competitive advantage
Strict Website Sales force	Yes-Market research revealed that % prefer making their bookings online.	Yes-Most regional players use different channels (sales force, travel agents & retail offices)	Yes-It would require cutting contracts with sales forces and travel agents, close retail offices and lay off staff.	Yes-Support lowering operational cost which is a result of the cost leadership strategy	Realized competitive advantage

Table 1: Flyadeal's VRIO analysis.

Conclusion

Flyadeal carefully copied the low-cost business model while adjusting for the local market. The company selected cost leadership strategy; and consequently, passes discounted and cheaper ticket prices to their customers to maintain its competitive advantage. Its business activities, relationship and network support the selected strategy and suggest that the company will be able to sustain the competitive advantage over time. While Flynas and Nesma Airlines lost their identity with time and became squeezed between the world of full-service airlines and the attempt to deliver lower price, Saudia made the right choice of establishing Flydeal as a separate company where everything is set up to fit the cost leadership strategy.

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