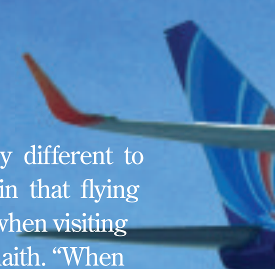
The middle ground

As the region's low-cost carriers continue to grow in popularity, another business model is emerging to fill the niche between full-service and budget airlines.

By Nadia Khan



Encouraged by the fast-paced growth of low-cost carriers (LCCs) in markets such as Europe and Northern America, Air Arabia became the Middle East's first budget airline in 2003, followed by the likes of Kuwait's Jazeera Airways, Saudi Arabia's Nasair and Sama Airlines, Bahrain Air and flydubai. Trying to find their place in a highly competitive environment, these airlines have battled with regional unrest, internal and external competition and rising fuel prices to carve out a niche for themselves in the sector. Whilst some have thrived, others have been forced to adapt and one – Saudi Arabia's ill-fated Sama Airlines – succumbed to defeat in 2010.

The rest of the region's valiant low-cost sector has grown steadily to reach a market penetration of around 7% – which compares rather dwarfishly to the enormous 35% market share enjoyed by low-cost carriers in Europe, and around 20% in the US. But as Adel Ali, board member and group CEO of Air Arabia, is quick to point out, unlike the much more mature markets of Europe and the US, the LCC model in the Middle East is less than a decade old. "Since inception, Air Arabia has transformed Middle East aviation by introducing the LCC model and taking it to new heights," says Ali. "Our success over the past eight years has helped the LCC sector achieve significant market share in the region." Air Arabia operates a typical no frills low-cost model, relying on a single type of aircraft to reduce extra maintenances costs. By the end of the third quarter in 2011, the carrier was demonstrating sustainable profitability and healthy seat occupancy levels. "In eight years of operations, Air Arabia has grown from serving just five cities to around 70 destinations in the Middle East, Africa, Asia and Europe, operating from hubs in the UAE, Morocco and Egypt," he says.

flydubai, launched in 2008 by Dubai's government to compete with neighbouring Air Arabia, also operates under a similarly typical budget airline model with customers choosing to only pay for the services they wish to receive. The carrier has an operational network of 46 routes across 27 countries, including most of the Middle East. As well as these intra-Middle East short-haul routes, flydubai benefits from being based in a country where 83% of the population is expatriate and mobile with a strong desire to travel. "The geographical location of the UAE is very different to that of Europe or the US in that flying is the only feasible option when visiting other countries," says Al Ghaith. "When these two factors are combined with the minimal penetration of low-cost carriers in the Middle East, budget airlines are well-placed to prosper in the years to come."

Whilst the future does indeed look promising for the LCC carriers, a new airline model has been emerging in the region to give the sector a run for its money. The past five years has witnessed the introduction of a number of carriers taking on this model which is neither full-service nor low-cost but falls somewhere in between. Bahrain Air is a classic example - defining its business model as that of a premium value carrier. "Our model is based on the premise that a large proportion of the population is looking for value for money from their airline," says Richard Nuttall, CEO of Bahrain Air. "But they do not want to be subject to all the additional fees for extras that come from a typical LCC." Passengers, he argues, want food on-board, a reasonable baggage allowance, flexibility and even a premium class option. "But for regional flights, they do not need the same product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> **JOHN STRICKLAND**

level as a long haul premium airline – just a service designed specifically for regional travel that flies on time," he adds.

As Nuttall is keen to clarify, Bahrain Air was primarily conceived as an LCC and never meant to be a full service long-haul carrier. "But to be a true LCC you need a base of point to point travel and large enough fleet to get economies of scale," he says. "With limited traffic rights and a relatively small home base this was always going to be difficult. At the same time our customers were telling us that, whilst they did not need all the frills, they wanted a certain level of service." In the long-term, privately-owned Bahrain Air plans to tap into markets further afield – another indication of its move away from a traditional LCC model. "There is considerable traffic that arrives into the region via a transit point or that visits multiple destinations," says Nuttall. "We are currently revisiting and upgrading our distribution capabilities to better sell in the long-haul markets or through partner carriers." He remains confident of the success of Bahrain Air's hybrid model, pointing to industry evidence as generally supporting this middle ground. "LCCs around the world are gradually upgrading at the same time as legacy carriers are looking to rationalise their product offerings," he explains. "In the future, we hope that Bahrain Air will be the airline of choice in its home country as well as a strong regional player connecting Bahrain to most major markets within five hours flying range."

The most recent entrant to adapt this type of model has been Ras Al-Khaimah's national carrier RAK Airways. Suffering the biggest impact from the financial crisis out of all the UAE airlines, the carrier set off to an inauspicious start as a victim to economic recession when it was forced to close operations in 2009. A year later, it re-emerged, positioning itself between the well-established commercial airlines and the low-cost carriers with its 'value for money' model. "We aim to deliver a value offering that differentiates ourselves from low-cost carriers," says Omar Jahameh, CEO of RAK Airways. "Despite our consistently low fares, RAK Airways still offers a full baggage allowance, a shuttle service and serves a complimentary hot meal and beverages on-board all flights." Like Nuttall, Jahameh believes that there is a definitely gap in the market between the low-cost carriers and full service airlines. "It is the right time for us to grow our business as the Middle East's aviation industry has bucked the world-wide trend and has continued to grow," he says. "Our passenger loads have been encouraging – providing an endorsement of the demand for value-for-money flights across the region."

Both RAK Airways and Bahrain Air have been blurring the traditional boundaries between LCCs and full service airlines in order to find a model which fits both the needs of the local population whilst ensuring a healthy profit margin. And there is another carrier which has been leading the way with this airline model for some time now. Kuwait's Jazeera Airways has been around for what CEO Stefan Pichler terms a 'great' six years. "We have a strong market foothold, a solid reputation, and have become a great household brand in Kuwait and in the region," he says. "And over these years we have flown over 8.7 million people in a country with a total population of 3.3 million people." The carrier has been stretching the definition of a LCC as far as it can go. Pichler, however, remains somewhat non-committal about this definition — shrugging off the low-cost model as merely a label. Is Jazeera Airways a low-cost carrier? Of course, says Pichler, we work in an asset intensive industry and we have to have the lowest cost to grow. Is it a full service regional carrier? Yes, says Pichler again, we offer all inclusive meals, 40kg baggage allowance, free on-board entertainment, a business class, airport lounges and more. Does the carrier offer value for money? Definitely yes, Pichler states, otherwise we would not have enough costumers to make us operate a profitable operation. "People always to try to create boxes for business models, in order to help them understand the mechanics of those models," he concludes. "Reality is far more complex. In the end, everyone has to create a business model which suits the targeted customers and markets – and helps you make money – it's as simple as that."

But with both low-cost carriers and full-service airlines carving out their shares of the region's aviation market, is there really room for an intermediary service? John Strickland, director of UK-based JLS

Consulting warns that this type of 'hybrid' model might prove tricky. "If you start offering an extra level of services, you may not get that back in terms of the prices charged," he says. "This may mean that you are not likely to make money out of it." He points a cautionary finger to the experience of Germany's airberlin – the only European airline to operate as a hybrid – becoming a loss-making casualty of its own model. "The problem with airberlin is that it is neither a full service airline nor a low-cost airline," says Strickland. "Perhaps it is best to be clear which camp you are in."

Despite its hybrid image as an upper-cost airline, airberlin actually began operations as a successful low-cost airline before taking on the model of a full service carrier. This involved focusing more on the quality of its service and less on lower fares, and eventually taking on long-haul routes and joining an airline alliance. Financially drowning, the airline reported a third-quarter net income fall of 78%, bringing in drastic cost-cutting 'Shape and Size' plans to curb losses. Although other factors played a role, many experts have pointed directly at the hybrid strategy as being largely responsible as the airline battled against competition from both Germany's national carrier Lufthansa and the successful European low-cost operators. At the end of last year, Abu Dhabi's own Etihad Airways announced that it would be spending US$94.9 million to increase its stake in airberlin – from 3% to more than 29%. The deal also includes financing of up to $255 million over the next five years to the carrier.

It is clear that the lines between low-cost and full-service airlines are becoming more blurred as airlines try to find their own niche in the Middle East's aviation industry. Even the proud bearers of the traditional 'low-cost' mantle have been evolving to fit in with the demands of the region's travel market. "There is no doubt that Air Arabia and flydubai have adapted the low-cost model for the needs of the local market," says Strickland. "And this has been working very well." Air Arabia's Ali agrees. "As conventional carriers continue to grow their long haul operations, we will see low-cost carriers expanding their intra-regional network," he states. "Having said that, the dynamics of both the industry and the market are in constant change and so it will be interesting to see how all this will eventually evolve." AVB