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**MING KEI CHING**

HKCC, HONG KONG

## **A STUDY OF LOW COST CARRIERS (LCCS) IN HONG KONG**

### **Abstract:**

This main purpose of this study is to begin a preliminary investigation into low cost carriers (LCCs) models and explore more insights about their specific approaches and development in the region with focus on Hong Kong. After carrying out critical reviews on the LCCs operations in USA, Europe as well as other successful experience in the Asia Pacific region including Japan and Malaysia, a more detail analysis would be made in Hong Kong with particular reference to its unique environment and close proximity with PRC. Based on several case studies, key characteristics are identified and several significant factors are revealed and then discussed. In particular, the development of airport infrastructure as well as high speed rail (HSR) might also have an impact to the LCCs development in Hong Kong and could be further examined.

### **Keywords:**

Low Cost Carrier, LCC, Hong Kong,

**JEL Classification:** L93

## Introduction

Since the deregulation in the USA airlines in 1978, the low cost carriers (LCCs) was then evolved and had created a significant impact to the aviation industry. The International Air Transport Association (IATA) has also recently announced that global passenger traffic results that the revenue passenger kilometers (RPKs) of 2014 was increased 5.9% compared to that of 2013. In particular, the 2014 performance was therefore higher than the 10-year average 5.6% growth rate. It has also been predicted that number of air passengers will be risen by around 28.5% in 2016 (Lerrthaitrakul & Panjakajornsak 2014).

The low cost carriers will have strong potential to boom substantially in aviation world air transportation. Some 87% of travel experts suggested the low cost carriers would be adopted globally (World Travel Market Industry Report 2014)

### **Development of LCC in Asia**

With the success of Southwest Airline in USA, the concepts of LCC have swept through Europe, Australia and New Zealand (O'Connell & Williams, 2005). It is more and more common for LCC to launch its operation in Southeast and South Asia. In 1996, Skymark and Hokkairdo International started their operations in Japan while Cebu Pacific in Philippines. Among all others, the AirAsia of Malaysia operated since 2001 is very successful and now listed publicly on the Malaysia Stocks Exchange. However, on the other hand, the Oasis of HKSAR was liquidated in April 2008 after only 15 month's operation. It is therefore interesting to know if business model of LCCs will be different in different markets.

In 2007, there were only four LCCs which operate scheduled services at the Hong Kong International Airport (HKIA). They accounted for about 2% of the total annual passenger throughput at HKIA in 2007. The number of LCCs rose to 15 and contributed to 6% of the total passenger throughput in 2012. Moreover, one of the local airlines, Hong Kong Express Airways, changes its operation to run as LCCs as of 2013. Now, there are a total of 19 LCCs operated in HK and are listed as Table 1.1:

#### **Table 1.1 List of LCCs operated in HK**

Air Busan -

AirAsia

AirAsia Philippines

AirAsia Zest

Cebu Pacific Air

Eastar Jet

Hong Kong Express

Jeju Air

Jetstar Asia

Jetstar Japan

Jin Air

Orient Thai Airlines

Peach

SEAir

SCOOT

Spring Airlines

Thai AirAsia

Tiger Air

Vanilla

### **Research Objectives**

Hong Kong's success in developing a first-class airport and aviation hub has made a strong direct contribution to Hong Kong's economy. As competition among the region is very keen (Ching, 2014), it is crucial to study how HKIA could accommodate the growing demand from LCCs and/or LCCs could be better developed in the long run.

In order to be successful in the Asia-Pacific (HK) area, the LCC operators needs to build up and find out its competitiveness by knowing better on key performance information as well as knowledge on this specific market and environment. As a consequence, this study aims to begin a preliminary investigation into regional low cost carriers and also to explore more insights about the performance of Hong Kong based LCC so that successful business model might be developed in this area.

## **Literature Review**

First, there is no clear and legal definition of LCC. It is also referred as Budget Airline. According to the ICAO, a LCC is an air carrier that has a relatively low-cost structure in comparison with other comparable carriers and offers low fares and rates. Such an airlines may be independent, the division or subsidiary of a major network airline or, in some instances, the ex-charter arm of an airline group.

On the other hand, UNWTO (2007) suggests that LCC usually possesses the following characteristics:

### A. Reduced inflight service.

In general, there is no free in-flight entertainment provided. Moreover, no complimentary meal is arranged (Yeung et al. 2012). This not only saves unnecessary bureaucracy and management costs but also reduce the manpower needed.

### B. Rising the aircraft usage.

Higher utilization rate was found to lower the average costs of operation, which will enable the firm to achieve competitiveness by means of cost leadership (Nagendra et al, 2014).

### C. Adopting electronic reservation systems and the utilization of electronic ticket.

Passengers usually make enquiry and booking direct with operator's website via internet (Graham & Vowles, 2006). In fact, passengers would receive an email confirmation and notification at once. This helps to lower the cost of issuing, distributing, processing and reconciling tickets and hence substantially lower the cost of operations

### D. LCC usually operates point-to-point service.

Unlike the traditional hub-and-spoke system (Najda, 2003), LCC tends to operate on point-to-point basis (Lordan, 2014) without the need of interlining demand and hence in cost saving. Moreover, the hub terminals might be congested due to popularity and caused delay issues. Furthermore, the usage of underutilized and/or secondary airports (Carballo-Cruz & Costa, 2014) might be cheap alternatives and providing better landing time slot.

### E. Simple fare scheme : Fares typically set at the lowest level where they would go up as the plane fills up (Thanasupsin et al. 2010), thus encouraging passenger to make

booking as early as possible in order to enjoy early-bird discount

F. LCC focus on short-haul. Routes less than 1,500 km or those with flights time less than 6 hours are usually classified as short-haul flights. Most LCCs are most particularly acute on short-haul operations in general (Graham & Vowles, 2006)

On the other hand, Graham & Vowles (2006) suggests following key principles of the low cost carrier model:

High-capacity seating

Minimum legal crew

Cabin service only at additional cost

Fast turnaround

On-board air stairs instead of airport air bridges

Operating procedures to minimize take-off thrust and braking on landing

Point-to-point traffic

No freight

Advantageous rates from airport

Generally sectors of less than 2 hours to maximize aircraft utilization

Online booking and Payment by credit card

Sophisticated websites with extensive information on destinations

One-size and type fleets

## **Results and Discussion**

Various sources of data were preliminary used and different cases were studied for this research.

During this section, the first HK-based LCC- Oasis would be studied. Afterwards, another operator JetStar would be reviewed. Finally, the environment for LCC including HKIA as well as HK air space would be discussed.

First of all, the Oasis case in HK was investigated with following details.

## **Oasis**

As the first Hong Kong-based LCC, the failure of Oasis has left a lot of learning points for both the Government and the HKIA; not only forcing keen attention on LCCs business model, but also on the need to ensure service reliability. Although Oasis was built clearly as a local carrier, and was well funded, an unfocused business model left it vulnerable from the outset. First, it did not have any cargo income stream and hence too much relied on the single passenger revenue stream. Second, as far as aircrafts' choice is concerned, it was unclear about its purpose whether it was targeted at both short-haul and long-haul services, despite evidence that LCCs everywhere find it hard to compete on long-haul routes. Third, the high operating costs from HK made it impossible to achieve the cost competitive advantages that are critical to the success of LCC.

As a consequence, Oasis went bankruptcy after accumulating losses in the hundreds of millions of dollars.

## **JetStar Hong Kong**

JetStar Hong Kong, a budget airline founded by Qantas and China Eastern, has renewed industry attention to low-cost air services in Hong Kong when it is said to apply for a license in HK. Clearly, the application resulted in more detailed attention in the context of LCC development in Hong Kong and raised several key questions concerning LCCs in HK. They are (a) would it develop as a "local carrier" for Hong Kong-based passengers? (b) Would it be added to the present range of choice available to passengers, in terms of routes served and price competitiveness on routes? (c) Is its business model good?

As a matter of fact, JetStar Hong Kong's own application to Australia's Australian Competition and Consumer Commission (ACCC) makes it clear that the airline will not likely to run as a home carriers in HK. In fact, the overall policy direction will mainly come from the group's Australia-based team indicated that the airline HK operation would be part of Qantas' regional business plan and its intention of not running as one of local HK carriers. Based on the JetStar's application, it is unlikely to offer service enhancement and create any impact to local aviation industry. However, the application reminded HK again that the importance of LCCs to develop a specific business model that optimize long-term value for the economy and the businesses based here or it might be another Oasis. In particular, the fragmented structure of Asia's aviation market may require different approaches than that of US.

## Hong Kong Airport

HKIA has made available airport facilities, mainly at Terminal 2, which are friendly to the typical operational needs of LCCs. Such facilities are commonly employed by LCCs including direct taxi-in and taxi-out parking stands that allow short turn-around time of aircraft, and reduced parking charges for parking stands. However, the capacity of the HKIA may be an issue in the long run.

Meanwhile, it should be worthwhile to point out that the airway directions of the three airports in Hong Kong, Shenzhen and Macau are basically identical. As a result, there is a need in flight path alignment for landing or departing from the three airports and depends very much on the collaboration among them or extra time would be demanded for taking-off and/or landing.

On the other hand, the impact of the introduction of high speed rail (HSR) needs to be considered. At present, Mainland transport planners do not think the national HSR network will have any pressure on HK air infrastructure. However, the ambitious HSR project may divert some of the air travel, particular for the city-to-city services, and change dramatically the patterns of air travel in the Mainland (One Country Two Systems Research Institute Limited, 2010). Of course, the effect to Hong Kong may be more limited as Hong Kong has already developed its strong role as a transit hub for travelers between the Mainland and regional destinations.

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