

CHAPTER TWO

REVIEW OF LITERATURE

This chapter reviews the literature in four main areas. Those, also, are applied to this research. The topics are shown as follows:

- The concept of low cost carriers
- The theory of liberalization or an open sky policy
- Theory of airline marketing
- Airline operating costs
- Relevant research

2.1 THE CONCEPT OF LOW COST CARRIERS

As clearly known by many people in recent times, the theory of low cost carriers is the offering of lower fares than regular airlines by reducing many services traditionally given by the operators. The strategy of the airline focuses on cost reduction as well as some services that sometimes are not needed such as the meals and beverages served on board and mileage programs as well. Suraphan Chaichana (2007) conducted related research and found a related concept that the carrier is comprised of many outstanding strategies such as using information technology in dealing with the airline operation, for example, ticket booking and company advertising. Aircraft utilization such as using a type of aircraft in accordance with the flight route and distance remains the significant characteristic of the carrier's operation. As a matter of fact, the number of workers employed and capital expenses normally depends on the route system. For the carrier, the underlying factors affecting the operating costs are not only the route system, but also depends on strategies where cost can be reduced such as the cutting of labor costs as well as the cost of some intangible services provided on board. In conclusion, the general characteristics of the carrier are as follows:

- Price is kept as low as possible
- A single passenger class is provided
- An aircraft has more seats

- Lower weight allowance for both hand carried and stored luggage
- No free meals or beverages are served on board, but they are available to buy
- Crew members fulfill multiple tasks (mainly stewardesses and stewards)
- Intensive use of air fleets. For instance, EasyJet flies an average of 10.7 hours a day, while British Airways flies 7.1 hours.
- Airport stops are shorter (with a faster turnover, usually 25 minutes between flights), and flights are shorter too.
- Expenditure savings through direct ticket sales, especially through the Internet and outsourced call centers, automated check-ins and, occasionally service fees.
- Certain offers are only valid for in-advance bookings or are limited offers, for a relatively low number of seats.
- Lean management (savings on staff) for instance, staff is going to work both on ground and on board simultaneously.

2.2 THE THEORY OF LIBERALIZATION OR AN OPEN SKY POLICY

Supachai Panichapak (สุภชัย ปานิชภักดิ์, 2544) said that the theory of liberalization is the usage of a marketing system as a guideline so as to be in accordance with the world's economic condition. In addition, it also reduces or waives some concerned rules, regulations, and requirements so as to enhance the competition. The policy is an attempt to provide full market access without restrictions on designations, route rights, capacity, frequency, code sharing, and tariffs.

The Thai government has a strategy to develop Thailand as one of the most popular destinations for business investment, tourism industry, and spa and health care centers. An open sky policy will be a catalyst and stimulate the growth in both international and domestic demand of Thai air travel and help Thailand to pass through the economic crisis.

As such, liberalization or an open sky policy was launched for the first time in the US on October 24, 1978 when the Airline Deregulation Act was introduced. In the

light of Thai air liberalization, the Civil Aviation Board announced the cancellation of both minimum and maximum air fares calculated per kilometer. The said policy led to the operation of low cost carriers.

As for the liberalization, some key elements of the bilateral agreements are as follows (Doganis, 1991):

- Open route access: airline from either country can fly to any point in the other with full traffic rights.
- Open access for charters
- No frequency and capacity control
- No tariff control (except if tariffs are too high or too low)
- Airlines are free to code share or make other commercial agreements.

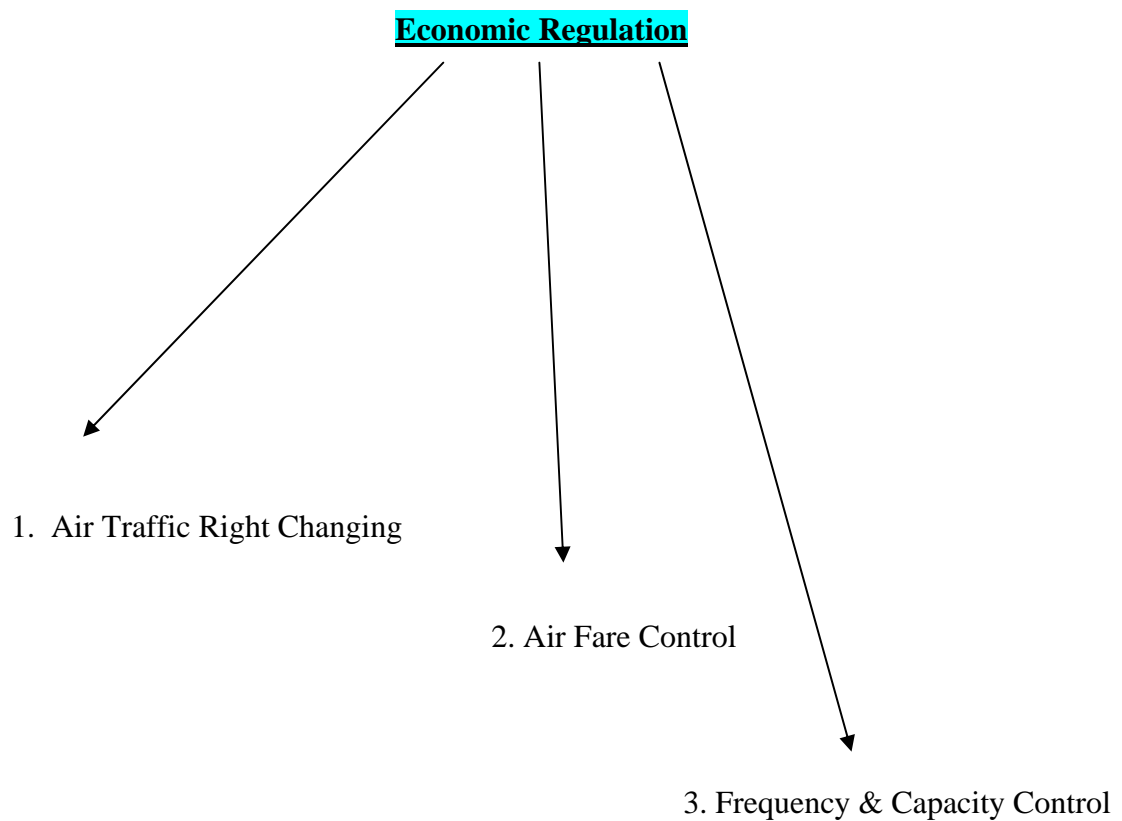
According to Veldhuis (2009), although the policy might develop any large risk to airline and airport industry as well, the open sky policy is going to provide big opportunities to some market segments. Moreover, passengers will gain direct profit from the policy by having more connections and lower air fares. Accordingly, some relevant competition that can facilitate any gain to passengers might then occur. He also indicates that the policy can provide good effect for society in terms of better international access. Then, further contribution to globalization and economic wealth will be met.

Moreover, he thinks that airlines will be protected by bilateral agreement. He also implies that the liberalization will develop some useful competition particularly in terms of proper services of the product. In addition, airline costs will be adapted to lower market fares. As such, low cost carrier will gain advantage from the policy and be popular among air passengers. However, it might develop risks for inefficient national airline. Thus, the opportunities for efficient and low cost carriers will increase.

The outstanding factor that pushes the open sky policy to be even more realistic is the airline deregulation. The airline deregulation, which is the removal of some strict controls in order to allow for a free and efficient marketplace, was designed to create a more competitive environment in commercial aviation. According to Air Transport Economics Division, Department of Civil Aviation, air

transport regulation, in aviation terms, is divided into two major parts: non-economic regulation and economic regulation (กรมการบินพาณิชย์, 2533) The latter term was first launched in 1999 according to Paris Convention on which bilateral agreements are focused. The following figure shows the composition of economic regulation in which air traffic right changing, air fare control, and frequency and capacity control are included.

Figure 2: The supervision in terms of economics



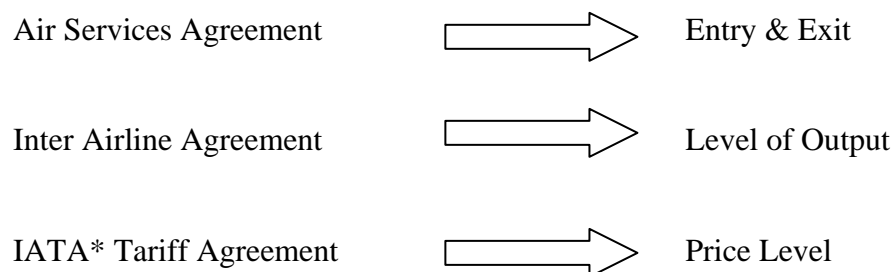
Source: *Airline Deregulation* by the Department of Civil Aviation, 1999, Bangkok.

Moreover, these three compositions as shown in figure 2 are the important factors on international aviation field that have to be emphasized from the previous time and now. According to the following figure, as considered in economic terms, the first composition is regarding the entry and the exit in the aviation industry which

is considered as the air service agreement. The second is pertaining to the control of costs as well as the control of frequency and capacity which is regarding the level of output. The output to occur will be negotiated by international airlines and each government. The last one is the control of air tariffs which is determined by IATA* and approved by each member government of the contracting states.

Those three parts eventually will become the major factors to be considered in the aviation industry. The following figure shows the economic considerations in the industry.

Figure 3: The consideration in terms of economics



Source: *Airline Deregulation* by the Department of Civil Aviation, 1999, Bangkok.

Note*: IATA is the International Air Transport Association which is the authority plays a major role in controlling the airline price level.

Again, according to the Department, the theory of perfect competition in terms of microeconomics is applied to the airline deregulation process. In economic terms, perfect competition should consist of the following characteristics:

- The product should be homogeneous,
- the entry and exit process of business can be done easily,
- any price and quality control should not be applied,
- consumers should have enough needed information; and
- the factors for production can be done easily.

Consequently, deregulation brought in a lot of low-cost new entrant airlines. The airlines had a dramatic effect on the structure of the airline industry. The airline costs and fares, consequently, were reduced while profit increased as airlines became more efficient.

2.3 THE THEORY OF AIRLINE MARKETING

Marketing has a variety of meanings defined by a variety of related experts. According to the Faculty of Business Administration, Rajamangala University of Technology (วัลลภ นิยมมานนท์ และคนอื่นๆ, 2547), the definitions of marketing are shown as follows:

- A scholar defines that marketing is the development and delivery of living standards.
- An economist defines that marketing is the cooperation between human and the market so that any changes are met in order to serve human needs and wants as well.
- A marketing man defines that marketing is a social and management process in which each person achieves his/her needs and wants by the act of creating, offering and exchanging of valuable products.

According to the definition used by the UK Chartered Institute of Marketing as cited by Shaw (2007), “marketing” is the management process responsible for identifying, anticipating, and satisfying customer requirements profitably. Shaw also indicates that in airline terms, successful airlines are likely to be those which anticipate changes and are ready for them to occur.

In the case of airlines, marketing is a dynamic discipline. Moreover, “Consumer” as well as “Industrial” marketing should be clearly distinguished. Consumer marketing is the activity targeted at individuals or the family while industrial marketing is the term used to describe business-to-business or firm-to-firm.

In principle, a low fare airline’s competitive strategy can be profitable only when the firm’s costs are also low. Each firm, thus, has to manage their capacity with the sufficiency in mind. Unfortunately, the low operating costs occur as reduction at the expense of a customer’s comfort and convenience. For instance, the operation of

Ryanair, Europe's first low fare and no frill airline, in which the cost for some services provided on board are clearly reduced. However, the airline is considered as Europe's largest and most profitable airlines even though the passengers not only have to find their way to and from small airports far from the big cities, but also have to carry and stow their own bags. Moreover, there are no meals, drinks, and other flight services as are provided freely by full service airlines. However, the promotion as well as advertising costs are among those areas where airlines do not try to cut costs more than competitors as both of these strategies play a major role in developing each airline and help the airline become well known in situations where some services are cut off compared to full service airlines (Mullins, Walker, & Boyd, 2008)

As airline product is an intangible term, customers cannot go to the showroom and the actual product cannot be shown in an advertisement to produce any psychological effect in the customers' mind except only for the quality and services they are going to receive later. As such, any advertisement regarding any good service and sales promotion is important so that the strongest points when compared to any other airline are shown.

2.4 AIRLINE OPERATING COST

Airline operation is generally concerned with pricing theory. According to The faculty of Rajamangala University of Technology (วัลลภ นิยมมานนท์ และคนอื่นๆ 2547), pricing is the amount of money used in any exchange in order to gain products. It also identifies the overall value admitted by consumers and they are willing to pay that amount of money so that they will get the said product and service. They also divide the role of pricing into two main categories, the role to business and the role to the economic system. Moreover, they also divide the factor to be considered when setting prices into two main types as follows:

- Internal factors which can be controlled and changed as well such as marketing mix and capital.
- External factors which cannot be controlled and price setting which will be emphasized such as demand, competition and other outside factors.

“Cost” is an underlying factor in price setting. In the light of airline operating cost, under the Chicago Convention of 1944, national governments agreed to control costs or fares for flight from one country to another. As a matter of fact, most significant airlines are owned by the government of each country. The government, thus, usually increases the air fare so as to gain as much profit as possible. The normal principle of air fare setting is usually agreed upon by the International Air Transport Association (IATA) which is a cartel made up of most of the world’s airlines (Mccoll, 1995).

However, the air fair specified by IATA is not totally accepted by some states. IATA faces some difficulties from some non-IATA carriers. They always charge one-third less than IATA carrier for some reason. The granting of excess mileage programs, the usage of private tour agents for which a rebate can be received later, and the bargaining of selling price are among the examples of the price setting difficulties that IATA has to face in fare enforcement.

As the attribute of low cost carrier indicated in chapter I, the reduction in air fares becomes the most significant point in passenger decision making that can be easily drawn. According to Kogi, Phoon, & Thurman (1989), the low cost concept is not technically unsound. The meaning of “low cost” is considered differently according to each circumstance of place and enterprise concerned. They indicate that the actual cost depends on local wages as well as material costs. Moreover, the labor required should be easily available, wherever possible within the enterprise itself. However, they said that the increase in productivity or work quality is still focused upon while the cost of production is reduced.

The low cost concept, then, can be adapted for use in the airline industry. It will provide an opportunity for passengers who have only less chance in using air transportation. The passengers do not have to pay as much as usual due to the reduction in the operational cost of the airline. It, consequently, reduces the air fare and customers will gain advantages.

Hanlon (1966) indicates that the factors effecting airline operating costs are various. One of the significant factors is the average stage length over which it flies the aircraft. The airlines with the lowest cost per seat or per kilometer are those operating large aircraft over long stages. Besides, variation in salary also places an important role

in defining each airline operating costs. Fuel cost is another major factor affecting airline operating costs. He also states that across the world's airlines as a whole, fuel can represent something between 10 and 20 per cent of total operating costs depending on the international price of oil. In the past, aeronautical innovation was among the factors that decrease the operating costs as the fuel cost is reduced. Advertising costs as well as the process of issuing paper tickets is also involved in adding to the operating cost. However, the sunken cost in the airline industry is very low by the standards of other industries.

2.5 RELEVANT RESEARCH

Thyn Lilavivat (2005) has summarized in his research that Thai Airways, which is a Thai national airline serving in a full time pattern, seems to have the highest score in every attribute, except price satisfaction, which is scored lower than others. The survey also indicates that among LOW COST CARRIER, Nok Air has the highest score in every attribute except price satisfaction compared to the other two LOW COST CARRIER which are Orient Thai airline and AirAsia.

“The Civil Aviation Department has ordered One-Two-Go airlines to halt operations for 30 days due to substandard operations and revoked or suspended the flying licenses of nine of its pilots”. (Amornrat Mahitthihirook, 2008, p. 1)

The above-said piece of news might be a strong point in fulfilling the satisfaction of low cost carrier passengers in Thailand. It clearly shows that the aviation safety is not ignored by the related authority, The Department of Civil aviation is the only regulator of aviation in Thailand. The Department states that the airline had violated aviation safety regulations and lacked proper airline management. As such, the safety of low cost carriers is not low according to the so called low cost of operation. The Department claims that a so-called air carrier does not have to have low safety security standards. However, there are some news topics that are always stated in newspapers regarding the many flight accidents of low cost carrier such as with One-Two-Go Airline. It is time for relevant authorities to pay serious attention to

the safety of the airlines. It means that nothing can be assured that both conventional and low cost airlines are safe enough for passengers.

According to the article shown in *Airline International Journal* (Low-Fare Fever, 2006/2007) it indicates that there are examples everywhere of explosive growth in passenger numbers and economic spin-offs when low cost carriers start new services. This first started in the deregulated U.S. domestic market in the 1980s and 1990s, and the same thing has been seen more recently in the EU. Regarding low cost airlines in Thailand, AirAsia Berhad established AirAsia Thailand in January 2004 as a 49-51% joint venture, giving a Thai company the majority shareholding, according to the said article. It is expected that more AirAsia clones are in the pipeline. "AirAsia is looking for another base in Southeast Asia and has been looking at opportunities for similar joint venture operations in Vietnam and the Philippines," said Luc Citrinoc, an aviation research consultant with the Pacific Asia Travel Association.

According to a study by Malee Hirunyanurak (2005), a low fare airline is quite proper for price oriented passengers or customers. Most of them decide to buy the ticket as they want to save money. They, however, are willing to pay a bit more money, around 200-300 baht, for better services on board. It can be, then, implied that most of them still care about fewer services provided compared with the original full serviced airline but it is then ignored as a low fare is cheaper.

She also summarizes in her research, a case study of Thai AirAsia, that the strategy to attract the price oriented customer is a reduction in airfares. Although passengers always highlight high quality service, they think that service is an intangible product. It cannot be seen, heard, felt, and tasted before the services are purchased. Moreover, it cannot be stored for future use. Prior to boarding the airplane, airline passengers have nothing but an air ticket and the promise of safe delivery to the exact destination. The services provided on board have not been met until the boarding process is finished. They also think that some good services provided can serve the customer's need only during the traveling time, just one hour from Bangkok to Kon Kean, for example. In contrast, money which is tangible object can be kept for use. She concludes that the deviation from full services and the high influence of low prices stimulate many Thai passengers to buy Thai AirAsia. It means that if such

ideas belong to most passengers, full service airlines are negatively affected by the so-called airline.

According to Kotler, Bowen, and Makens (1999), service, upon which customer satisfaction is focused, is divided into four characteristics as per the following:

- 1) Intangibility: as previously said, it cannot be seen, felt, heard, and tasted.
- 2) Inseparability: it means that customers are a part of product. Moreover, customers and service providers must be presented for transaction to occur and both sides have to understand the delivery system.
- 3) Variability: service quality depends on who provide services, when and where they are provided. Services are produced and consumed simultaneously. The service consistency also depends on the service providers' skills as well as the performance at the time of the exchange.
- 4) Perishability: if the service providers want to maximize the revenue, they have to manage capacity and demand since they cannot carry forward unsold inventory.

Not only are the advantages of low cost airlines met, but also disadvantages are included in many research papers. According to Thyne Lilavivat (2005), the bad point of the carrier is related to services provided by the airlines, for example, the time delay that normally happens in the carrier's business. Some passengers complained that flight cancellations always occur without any prior announcement. As a result, nobody is able to assure that which airline is better. Therefore, some active research is still needed.

It is clearly known that the so called airlines are based on reducing some unnecessary services such as meals and beverages served on board or e-tickets that replace conventional paper tickets. It has sometimes led to serious problems for passengers as indicated in the campaign poster of the International Air Ticket Association, August 2007. The detail in the poster pertains to the complaint of many passengers who booked the low cost airline's tickets without obtaining any booking confirmation after the booking. Then, some of the airlines' officers refused to allow them to get on board without any booking confirmation although the passengers had already paid for the ticket. As a consequence, it might imply that a conventional airline is better than a low cost airline in terms of service provided. As some passengers who

can afford the higher air fare prefer better service to that of the low fare, low cost carrier does not provide them with much of an advantage.

It is generally known that E-tickets and bar-coded boarding passes are playing a role in reducing the operational costs of airlines. The most positive result of E-tickets and the boarding passes has been in more direct relations with customers. Most customers want to know exactly what is going on, to be in control of their journey and to avoid the hassles of airport queues. Telephones and the internet are effective tools in e-ticket booking. Moreover, the booking, via internet or telephone, is helping to reduce the distance or gap between airline and customers. They come to the airlines' website and ask a question, get information and indicate preferences. So, the organizations concerned can detect and analyze trends and utilize the information in a useful way. Mr. Bhonlawit Hirunwiwatsiri (personal communication [interview], August 10, 2008), the Director of Air Transport Promotion and Development Bureau of the Department of Civil Aviation said that e-tickets has greater advantages over paper tickets as the latter ticket costs about 400 baht per ticket, so a large amount of the cost will be automatically cut.

Although Nok Air, which is a major low cost carrier in Thailand, is under Thai Airways International Public Company Limited, both ground service and on board service are totally different and they are isolated in terms of management as well. The gathering of traditional full service and low cost airlines goes against accepted industry wisdom: if you are a traditional full- service operator and you launch low cost offshoots, you must totally isolate them from your existing brand otherwise you will damage your reputation and cannibalize your business (The Dixon doctrine, 2005, p. 16). It seems that a low cost carrier is not as good as traditional airlines in various terms, except the cost of each flight, as the related philosophy has indicated.

However, in the research conducted by Punlop Sungsilert (พัลลภ สังข์ศิลป์เลิศ, 2547), it is stated that liberalization which is a big trend of low cost carriers in Thailand makes air fares a lot lower than traditional ones especially on the routes that are popular for tourists, such as Phuket, Chiang Mai, and Hat Yai. Moreover, it helps the airport business improve as the domestic flow of air passengers is much better than in the past.

From the above accounts this study will investigate whether or not the carrier has effects on the operation and management of the regular airlines especially on the national airway of the country in terms of passenger preference to the airliners and factors that may affect their preferences regarding the services of the carrier. This may more or less provide some insights into passengers' attitudes towards the carrier and in turn this will shed some light to the regular airlines for their management to improve services in the future.

Dr. Jaroon Meesomboon, Director of Airport Standards and Air Navigation Facilitating Division (personal communication [interview], August 18, 2008), said that some air routes provided by traditional full service airlines are sometimes forced upon them for political and social reasons without any regard for economic factors. In some cases, the airlines unwillingly have to undertake these services while reasonable profit is not met. He also supports his idea by saying that “Fortunately, when low cost carrier came and provided air services on the same route with traditional airlines where a big profit is not shown, the traditional airlines can cancel the air service such as when Thai Airways cancelled the flight to Narathiwat without any complaint from people in the area as Thai Air Asia now undertakes the air services aimed at reducing the cost of air travel.

In addition, he also states that though some relevant research agrees that low cost carrier has advantages other research states that the carrier has a bad effect on the Thai aviation industry. However it can have a good effect if both carriers are operated within some exact rules and regulations. As such, there should be some strict rules set by related regulatory bodies as well as the airline operators themselves so as to avoid any problems that might occur.

Accordingly, some related research from the various points of view of different persons is still required so as to perceive their views regarding the effects, both positively and negatively. Moreover, some concerned authorities can use these relevant views from a variety of research papers to improve and develop their businesses properly.