Thinking through the meteoric rise of Middle-East carriers from Singapore Airlines' vantage point

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ABSTRACT

The rise of Middle East carriers in the past decade has been nothing less than meteoric. Based on the notion of generic strategy, we analysed the potential for competitors of the leading Middle East carriers to respond in terms of market scope and product characteristics, using Singapore Airlines as a reference. We found that it was generally difficult for Singapore Airlines to compete in terms of market scope, and thus it should concentrate on offering different degrees of differentiation in its products. While the latest small, long-haul aircraft could help increase Singapore Airlines' market scope, this impact would be marginal at best. We compared the product offerings and prices for the Business and Economy cabins, and noted the intensive competitive pressures the leading Middle East carriers exerted on Singapore Airlines. Improving specific product qualities such as guaranteeing a horizontally flat bed in Business and the overall quality in Economy helps competitors command higher prices, while other niches are still possible.

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1. Introduction

The rise of several Middle East carriers, namely Emirates Airline, Qatar Airways and Etihad Airways, or 'ME3', in providing full-service scheduled international air transport has been nothing less than meteoric. While there are subtle differences in strategy among the three, all expanded their capacity to cater to primarily passengers originating from and destined to places outside of their home bases (Carey, 2015). These three carriers flew a combined total of fewer than 20 million passengers in 2004. Only eight years later — definitely less than a decade, these three carried more than 75 million passengers in 2012 (Dresner et al., 2015). The aggregate passenger growth rate for these three carriers combined over these years was an impressive 24% per year. ME3's route network at the end of 2015 covered most primary and secondary cities in Europe, much of Africa, Asia, North America, an increasing number of cities in Latin America, as well as extensive trans-Tasman coverage (between Australia and New Zealand). In 2014, the number of passengers (70 million) flying out of Dubai, home of Emirates, surpassed that of London Heathrow (Critchlow, 2015).

Meanwhile, many competitors claimed that the rise of ME3 led to significant losses in traffic. Reports suggested that when Dubai overtook Singapore as the airport where most passengers on the London-Sydney route stopped *en route*, the rise in passenger numbers in Dubai coincided with a comparable drop for Singapore (Raghuvanshi, 2013). Thai Airways suffered losses since 2013 and Malaysia Airlines since 2010, with both seeing tremendous growth in capacity by ME3 to their home countries but little in their flag carriers (Jittapong, 2014; Kedmey, 2014; Nguyen, 2015). For travellers based in the home countries of these three South-east Asian carriers, ME3 offer flights both westward to Europe and Africa and eastward to Australasia — a compelling alternative to their respective flag-carriers. In Europe, Lufthansa claimed that its Frankfurt hub lost almost a third of its market share on routes between Europe and Asia in a decade since 2005 (Carey, 2015). Even U.S. carriers claimed that the growth of ME3 had begun to threaten the viability of the entire U.S. airline industry (Critchlow, 2015).

How can ME3's competitors respond? Porter (1980) proposed the notion of generic strategy as a way for companies to think through how they can position themselves relative to competitors. Once a company decides to be in an industry, 'the second really fundamental question on strategy is positioning within the

industry…because you can't be a superior performer in any industry without some kind of competitive advantage' (Porter, 1987: p.3). In other words, generic strategy lets competitors adopt different positions relative to one another, softening the need for direct, cut-throat competition − a prospect any for-profit entity would be loath to face. We examine in this paper how competitors like Singapore Airlines can apply the notion of generic strategy to differentiate themselves from the fast-growing airlines of the Middle East.

Generic strategy describes an array of positions firms can adopt in relation to two orthogonal dimensions: market scope (on the vertical axis) and product characteristic (on horizontal axis). Vertically, a broad market scope (higher on the axis for market scope) means that a company's products are offered to a wide swathe of customers. A narrow market scope (lower on the vertical axis) means that a company's products are offered only in certain market niches. Horizontally, a low-cost strategy for a product (toward the left on the axis for product characteristics) is one that translates certain advantages to low prices, and often with few or no frills for the customers. Alternately, a differentiated position for a product (toward the right on the horizontal axis), is one that is often associated with superior reputation, premium services and, often, higher prices.

Based on the notion of generic strategy, we examine the relative positions between ME3 and Singapore Airlines as a representative competitor. We first analyse the market scope that ME3 could potentially attain, and then their product characteristics relative to Singapore Airlines. In this paper, we focus on routes linking Europe to South-east Asia and Australasia, where ME3 and Singapore Airlines present the most direct competition.

2. Market scope

2.1. Potential reach

The airline industry exhibits strong economies of scale in terms of traffic density (Gillen et al., 1990). Coordinating schedules such that flights from many cities arrive and depart at similar times at an airline's hub facilitates flight connections on many more city pairs than just the number of routes that the airline flies. This helps the airline better aggregate traffic to/from its cities served, in turn allowing higher frequencies to be deployed to these cities (Hansen, 1990; Adler, 2001; Gillen and Morrison, 2005). In the U.S. domestic airline network, such hub-and-spoke network designs have been shown to attract significant passenger traffic compared with isolated non-stop, hub-bypassing service (Hansen, 1990; Zhang, 1996). In a similar manner, the home-bases of ME3 and Singapore Airlines act as hubs for traffic between Europe and South-east Asia, and between Europe and Australasia (Oum et al., 1993). Thai Airways and Malaysia Airlines, with their home bases close to Singapore, and to a smaller extent Cathay Pacific Airways out of Hong Kong, also cater to this traffic.

The number of destinations and therefore city-pairs to which scheduled flights are offered is arguably the most representative measure of market scope for an airline. For an airline focusing on using its home base as a hub to facilitate flight connections to/from many other cities, cities around its hub naturally become part of its sphere of influence because passengers to/from these cities often do not have to detour significantly when making flight connections at that airport (Gimeno, 1999). Table 1 shows the flight distances between representative points in Europe and South-east Asia, and between Europe and Australia. These distances are similar whether or not the routing is non-stop or through Dubai, Singapore or Hong Kong. In other words, the detour necessitated by a flight connection in one of these three cities is small.

Because of geographical proximity, the focal airline can easily afford to operate higher frequencies to cities nearby, which in turn increase the attractiveness of its connecting services elsewhere. Meanwhile, cities within one airline's sphere of influence can provide important connecting traffic to that airline's hub, and in turn, that airline can seek to exert more presence and even higher pricing power for traffic to/from these cities (Borenstein, 1989; Brueckner and Zhang, 2001). In turn, serving many destinations within a region with frequent flights facilitates the focal airline to be marketed as a preferred carrier among corporate and individual customers from that region. In general, the larger the demand originating from an airline's sphere of influence, the easier it is to profitably increase its number of destinations.

With respect to traffic between Europe and South-east Asia, and between Europe and Australasia, the entire Europe, the Near East and the Middle East can be considered within ME3's sphere of influence. ME3 can serve most cities in Europe with a single aircraft on a daily rotation (e.g., flights between, say, Dubai and Paris would be about 7 h each way). This enables ME3 to aggregate traffic to/from a large number of cities in Europe. Likewise, airlines based in South-east Asia such as Singapore Airlines enjoy easier access within South-east Asia, and to Australasia (e.g., flights between, say, Singapore and Melbourne, Australia, averaged less than 8 h each way). This enables Singapore Airlines to aggregate traffic to/from cities in South-east Asia and Australasia, and consider cities in these regions as within its own sphere of influence.

The demand for air transport has long been shown to increase with the economic output of travellers' trip origin. In terms of Gross Domestic Product (GDP), the European Union alone reported a total of USD 18.5 trillion in 2014, other non-E.U. European countries like Norway and Switzerland reported another USD 1.2 trillion while near-East and Middle-east countries such as Turkey, Saudi Arabia and the United Arab Emirates contributed another USD 3.4 trillion (Wikipedia, 2016a). In comparison, Australia, New Zealand, countries in South-east Asia, plus Hong Kong and Bangladesh, added up to USD 5.2 trillion in GDP in 2014. In other words, the GDP for ME3's sphere of influence is more than four times that of the GDP for Singapore Airlines' sphere of influence: ME3 has a much larger economic 'hinterland' as a proxy measure of potential market scope than Singapore Airlines.

More specifically, studies have portrayed the demand for passenger air travel as a function of GDP per capita, and this relation occurs in logarithmic terms: halving a country's GDP per capita decimates its air travel demand per capita. Boeing (2015: 22) shows that on average, countries with USD $10,000 in Gross Domestic Product (GDP) per capita take about one trip per person per year by air. The European Union alone reported a population of about 500 million. Summing up the population in countries in Europe, the Near-East and the Middle East with a GDP per capita over USD $10,000 yields a total of 639 million. In comparison, Australia, New Zealand, and countries in South-east Asia with a GDP per capita over USD $10,000 yields a total population of only 71 million (Wikipedia, 2016b, 2016c). Even when Thailand and Indonesia (with GDP per capita between USD $3000 and $6000) are included, the total population for countries in Singapore Airlines' sphere of influence is only 387 million, about half of that of ME3. The much larger population and air travel demand originating from within ME3's sphere of influence, as summarized in Table 2, provides a much stronger support for ME3 to profitably offer a far higher level of market scope than Singapore Airlines. In other words, Singapore