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The transformation of a legacy carrier — A case study of Turkish Airlines

Mehmet Erkan Dursun [a], John F. O'Connell [b], Zheng Lei [c,*], David Warnock-Smith [d]

[a] OnurAir, Atatürk Airport, Istanbul, Turkey
[b] Centre for Air Transport Management, Cranfield University, MK43 0AL, England, United Kingdom
[c] Centre for Aviation Research, University of Surrey, Guildford, Surrey, GU2 7XH, United Kingdom
[d] Department of Logistics and Hospitality, University of Huddersfield, HD1 3DH, England, United Kingdom

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ABSTRACT

This study examines the metronomic rise of Turkish Airlines into a global carrier in the period following domestic deregulation and part privatisation. Using a comparative assessment of the carrier's network and its competitive strategies during the 2003–2013/2014 period it was found that Turkish Airlines now benefits from considerable network, cost, service and brand advantages over competing European and to a lesser extent Middle-Eastern airlines. Its network operation based in Istanbul Ataturk airport enjoys strong geographic and demographic advantages, which enables it to optimise the use of its large and young short-haul fleet between a significant number of domestic and international points. This study has important implications for partially or fully state owned legacy carriers as to how to gain competitive advantages in an increasingly open and liberal airline industry.

1. Introduction

Turkish Airlines (TK) was founded in 1933 as a state-owned enterprise commencing operations with a fleet of 5 aircraft and a total seat capacity of just 28 (TK, 2006). After the Second World War, Turkish Airlines benefitted from the post-war US assistance programme which gave the carrier an upgraded fleet of Douglas DC-3s (Funding Universe, 2013). Its network scope was primarily domestic until the 1960s when its focus changed to international operations, in part due to a minority stake (6%) held by BOAC (British Overseas Airways Company) and started to operate a combination of Viscount, Fokker and later McDonnell Douglas and Boeing jet aircraft. The carrier's financial struggles commenced in the 1980s and ran through to the early 1990's partly as a result of its reputation for delays and a sub-standard safety performance. The country was also plagued by inflation at the time which made it difficult for the carrier to raise sufficient capital to purchase aircraft (International Directory of Company Histories, 2006). Political intervention as a result of continued state subsidy was also hindering the formation of a coherent and sustained competitive strategy at Turkish Airlines in the years preceding domestic deregulation and further privatisation (from 2003 onwards), which was partly down to the political influence of the government linked labour union — the Turkish Civil Union of Aviation (Yeditepe University, 2010). This type of experience was not unique but mirrored by the experiences of many other state-owned carriers at the time, as detailed in Doganis (2006).

The privatisation activities of the company dated back to the 1990s. With the incentive of encouraging productivity[1] and raising capital (Republic of Turkey Privatisation Administration, 2012), the government organised an IPO (Initial Public Offering), which was held in 1990 with 1.83% of the company's shares being offered to the public. In 2003, a new government came into power and accelerated the privatisation of Turkish Airlines. Subsequently, two SPOs (Secondary Public Offerings) were held in 2004 and 2006, with the share of the government's ownership in Turkish Airlines falling below 75% and 50% respectively. As a result of this privatisation process, the company ceased to be a state enterprise by May 2006 (TK, 2008) with further pushes for efficiency and productivity being among the main drivers for change.

* Corresponding author. Tel.: +44 (0)1483 686379.
E-mail addresses: merkandursun@gmail.com (M.E. Dursun), frankie.oconnell@cranfield.ac.uk (J.F. O'Connell), zheng.lei@surrey.ac.uk (Z. Lei), d.warnock-smith@hud.ac.uk (D. Warnock-Smith).

[1] At this time the airline's fleet doubled in size while the workforce stayed at around 8000 showing some early increases in productivity as a result of the initial stages of privatisation aircraft (International Directory of Company Histories, 2006).

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The new government expressed its desire to develop the aviation industry with its slogan "every Turkish citizen is going to fly at least once in his life." A series of aviation reforms has been implemented since 2003 with the aim of expanding the Turkish airline industry. One was to deregulate the domestic market. Another was to improve international competitiveness of Turkish Airlines. Illustratively, the number of international civil aviation agreements signed between Turkey and foreign governments was increased from 81 in 2003 to 143 by 2012 which has helped Turkish Airlines to expand its international network.

Coinciding with government change in 2003, a new executive board of Turkish Airlines was created in the same year. Major steps were taken to open up new routes and improve the network, renew outdated fleet with newer and more efficient aircraft. Fig. 1 shows that Turkish Airlines has experienced tremendous growth, particularly after 2003. The total number of passengers it carried increased from 10.4 million in 2003 to 48.3 million by 2013 with a combined annual growth rate of 16.6% – far outpacing the world average of 8.1% (ICAO, 2014; TK, 2014a). In recent years, Turkish Airlines has quickly risen to become a new global challenger in the airline industry. In addition to its outstanding traffic growth, Fig. 1 shows that TK has consistently achieved operational profits since 2002. This represents a successful turnaround given the loss making performance of the carrier in the preceding five years.

Fig. 1 shows that the company's total operational profit boomed rapidly in 2007 and 2008. According to Air Transport World (ATW) statistics, the carrier was ranked 25th in global net profits in 2007, but this quickly improved by reaching 4th position in 2008 and 6th by 2009 (ATW, 2008; ATW, 2009; ATW, 2010). By 2013, it carried more than 48.3 million passengers with 233 aircraft (TK, 2014a). An insight into its relentless growth is displayed by examining the data during the economic downturn in 2009 as the number of passengers across the whole air transport industry dropped by 3.5%, while it was more accentuated across the members of the Association of European Airlines (AEA) which decreased by 5.8%, while Turkish Airlines witnessed an 11% increase in passenger numbers. Since 2003 the company has expanded rapidly as its passenger Compound Annual Growth Rate (CAGR) recorded more than 15% – becoming Europe's fastest growing airline. Concurrently, Turkish Airlines also began differentiating and enhancing its products and services which were recognised in 2011 when it achieved the Skytrax award for Best Airline in Europe – it was now becoming increasingly evident that European incumbents were now facing a new threat. Although up to 2003 the carrier had played an insignificant role in the aviation market, however it is now fast becoming a major player in the industry.

The rise of Turkish Airlines provides an excellent case study of how a loss-making legacy carrier can be transformed to a highly profitable global player within a relatively short period. The purpose of this paper is thus to examine the two most critical aspects of the strategic transformation of Turkish Airlines, namely network development and competitive advantage. More specifically, the following two objectives have been set: (1) to analyse the network development of Turkish Airlines in the last decade and (2) to identify the main competitive advantages of Turkish Airlines over its international competitors. It complements the most recent case study on Turkish Airlines by Tan and Aksin (2012), which found a positive feedback between growth and cost as well as quality driven by scale economies at the carrier. Using a comparative assessment of the carrier's network and its competitive strategies during the ten-year period up to 2013–14 it is found that Turkish Airlines now benefits from considerable network, cost, service and brand advantages over competing European and to a lesser extent Middle-Eastern airlines. This study has important implications for partially or fully state owned legacy carriers as to how to gain competitive advantages in an increasingly open and liberal airline industry. The rest of this paper is structured as follows; Section 2 provides background information on Turkey and its air transport market, Section 3 examines the network developments of Turkish Airlines, Section 4 analyses the competitive cost advantages Turkish Airlines has developed, Section 5 contains a comparative analysis of Turkish Airlines' air fares, Section 6 examines the carrier's service and brand while Section 7 concludes.

2. Turkey and its air transport market

Positioned at the crossroads of Europe, Asia and Africa, Turkey is the third largest country in Europe both in terms of land area and population. With 8333 km of coastlines (including islands) on the Black Sea, the Mediterranean Sea, the Aegean Sea and the Marmara Sea, as well as favourable climate, natural beauty, and cultural heritage – Turkey is one of the world's top 10 tourist destinations in terms of international tourist arrivals and tourism receipts (UNWTO, 2014). Between 2003 and 2013 the number of international tourist arrivals in Turkey has increased from 13.7 million to 33.8 million with an average annual growth rate of 9.5% – the

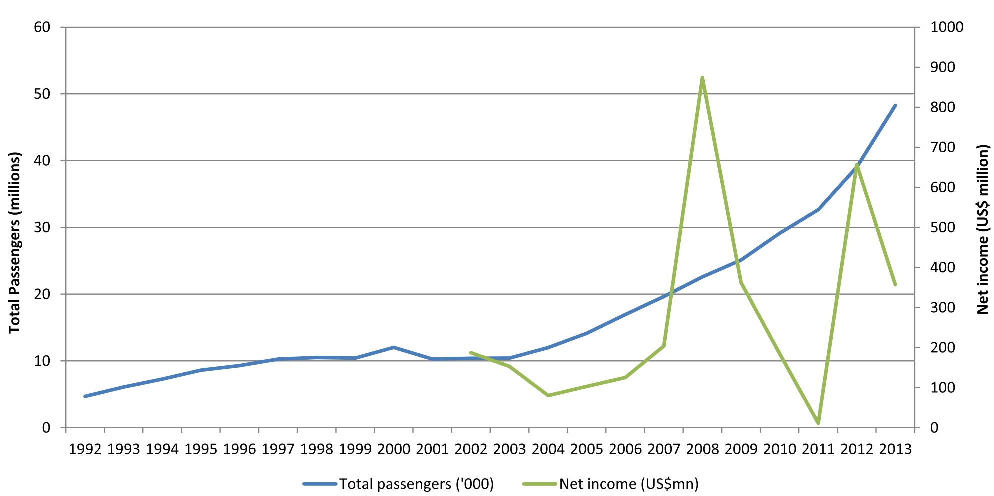

Fig. 1. Turkish Airlines total passengers and net income.
Source: Turkish Airlines annual reports (compiled by the authors).