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Low cost carriers in the Middle East and North Africa: Prospects and strategies

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ABSTRACT

We examine socio-economic indicators relevant to 'low cost carriers' (LCCs) in the Middle East and North Africa (MENA) and review the evolution of air transport liberalization and air service agreements in the region. We analyse the business strategies of MENA-based LCCs and using a benchmarking methodology, we compare the business strategy of Air Arabia Group with those of dominant European LCCs EasyJet and Ryanair. Our economic development indicators suggest future potential for LCC growth in Iran and Saudi Arabia while other MENA countries continue to face challenges. The lack of success in regional liberalization in air transport is restricting LCC growth although individual MENA countries have or will benefit from 'open skies' agreements. MENA-based LCCs while retaining some characteristics of the LCC model also deviate in significant ways. Benchmarking analysis shows that Air Arabia's business strategy represents a departure from the business strategies that have been most successful in Europe.

1. Introduction

The links between a firm's competitive environment and its business strategy date back to the seminal work of Porter (1979) and extend to present day research. For example, Teece (2010) states;

> Neither business strategies, business structures nor business models can be properly calibrated absent assessment of the business environment; and of course the business environment itself is, in part, a choice variable; i.e. firms can both select a business environment, and be selected by it: and they can also shape their environment.[1]

This paper explores the environment and strategies of so-called 'low cost airlines' (LCCs) in the Middle East and North Africa (MENA) region.[2] Specifically, we examine economic development indicators to determine the general environment facing LCCs, we review the evolution of air transport liberalization and air service agreements and we compare the business strategies of MENA-based airlines in the low cost sector with those of successful European LCCs.

The MENA region has recorded impressive growth in air passenger traffic in recent years. Much of this growth has been fuelled by the emergence of Middle Eastern carriers focused on international long haul flights. Between 2009 and 2013, passenger traffic between MENA countries and the Americas, Asia Pacific and Europe regions grew 18%, 33% and 22% respectively and over the same period passenger traffic within the MENA region also increased 22%.[3] While such growth is impressive, the MENA LCC sector currently accounts for a much smaller market share compared with LCCs elsewhere in the world. In 2014, LCCs accounted for 15% of available seat kilometers within the Middle East and 7% to/from the Middle East. Similarly, within Africa LCCs account for around 10% of total seat capacity.[4] These market shares are significantly lower than those for LCCs in Europe, North America and Southeast Asia. Why have LCCs in the MENA region not been more successful relative to their counterparts around the world? One potential reason is that the region is at stage in its economic development in which inhibits faster growth for LCCs. One might also consider whether a lack of trade liberalization in air services has created a more restrictive environment for the low cost sector in MENA countries. Thirdly, it is possible that MENA-based LCCs differ in their business strategies in ways that result in lower market shares. We investigate all of these potential explanations.

We begin with an economic overview of MENA countries that attempts to identify possible indicators of demand for air transport and

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[1] Teece (2010), p191.
[2] MENA encompasses Algeria, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, the Palestinian territories, Qatar, Saudi Arabia (KSA), Syria, Tunisia, Yemen and United Arab Emirates (UAE).
[3] See Amadeus (2014)
[4] Sources: OAG; CAPA (2013). Note that the LCC shares of capacity for within the African continent overstates the current role of LCCs in Northern countries as much of the LCC presence is in South Africa.

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for LCCs in particular. In section 3, we review the recent history and current state of intra-regional and inter-regional air transport liberalization agreements and in section 4 we examine the characteristics and evolution of MENA-based 'LCCs' and utilize a benchmarking methodology to compare the business strategy of Air Arabia Group with those of established European LCCs EasyJet and Ryanair. We offer some concluding remarks in section 5.

2. Economic indicators of LCC sector growth

Data availability for MENA countries is a challenge, however we have assessed the current environment and potential for growth in air transport (and LCCs in particular) using five indicators;

1. Macroeconomic (GDP) growth – a general indicator for air travel demand.
2. Median income per capita – a proxy for the size of the middle income class.
3. Urban development and geography - measuring the extent to which there are cities within a country that can support domestic LCC travel.
4. Internet penetration - a measure of the ability of airlines to sell directly to their customers via online distribution and sales.
5. The trend in foreign visitor spending - a proxy for the extent to which a country is becoming a destination for inbound air passengers.

In general, growth in air transport is correlated with macroeconomic growth and associated macroeconomic shocks.[5] Table 1 shows the size of MENA economies and macroeconomic growth over the last five years along with GDP per capita. In 2014, 75% of MENA economic output was accounted for by oil exporting countries and 22% by Saudia Arabia alone. With the exception of Iran, Kuwait and Libya, the oil exporting MENA countries have recorded higher GDP growth rates than the global rate of 2.49%. Among oil importing countries, Jordan and Tunisia also recorded superior rates of macroeconomic growth with Israel and Morocco growing at around the global rate. Per capita GDP varies wildly across MENA countries from $3036 (Egypt) to $96,732 (Qatar) however this tells us little about the distribution of income.

An important contributory element in domestic demand for low cost air travel demand is a growing middle class. As Schlumberger and Weisskopf (2014) argue, without a middle income class even low airfares are unaffordable to a large segment of a given domestic population. Measuring the size of a country's middle class is a non-trivial exercise that requires data concerning both the amount and distribution of income. Gini coefficient measures.

(which are available for some but not all MENA countries) provide some information about the concentration of income but not the distribution per se.[6] For example, according to World Bank estimates; Qatar has the same Gini coefficient (41.1) as the USA but these countries do not have the same income distribution or size of middle class.

Table 2 shows Median per-capita GDP measures for MENA countries obtained from on-site surveys carried out by Gallup in each country over several years. This measure of per-capita income is the best available proxy for the size and spending ability of a middle income class and provides a very different picture than that created by per capita GDP. For example, the study finds that median per capita income in Qatar is $5117 (expressed in PPP international dollars). Even if this dollar figure is biased downwards, it indicates a very large gap between per capita GDP and the actual incomes of many citizens and residents.

Table 1
GDP, GDP Growth and Per Capita GDP for the MENA Region by Country.
Source: World Bank.

	Average annual % growth	Annual % GDP growth	Annual % GDP growth	GDP (Current $US) millions	GDP per capita[1]
Oil exporting nations	2011–2014	2013	2014	2014	Current $US
Algeria	3.18	2.80	3.80	213,518	2013
Bahrain	3.90	5.41	4.48	33,851	$5484
Iran, Islamic Rep.	−0.11	−1.91	4.34	425,326	$24,854
Iraq	6.48	6.57	−2.12	223,508	$4721
Kuwait	3.95	1.15	−1.62	163,612	$6587
Libya	1.21	−13.55	−24.00	41,143	$46,841
Oman	3.20	3.91	2.89	81,797	$18,815
Qatar	6.70	4.58	3.98	210,109	$93,552
Saudi Arabia	5.37	2.67	3.47	746,249	$24,231
United Arab Emirates	5.25	4.32	4.57	399,451	$44,276
Oil importing nations					
Egypt, Arab Rep.	2.08	2.11	2.20	286,538	$3036
Israel	3.43	3.25	2.55	305,675	$35,373
Jordan	2.78	2.83	3.10	35,827	$5098
Lebanon	1.78	0.90	2.00	45,731	$9754
Morocco	3.85	4.73	2.42	110,009	$3060
Tunisia	1.94	2.89	2.70	48,613	$4274
USA					$52,980
Canada					$52,305

As a benchmark, the US and Canadian median per capita incomes in the same Gallup study were around $15,000. Of MENA countries, Israel has the highest median per capita income at $7847 followed by Kuwait. Incomes in Qatar, KSA and UAE are lower but approaching the income levels of the top three MENA countries. Elsewhere median incomes are very low; in Egypt the Gallup study indicates a median per capita income of $623. All of this suggests that a resident middle class is yet to emerge in the region as a source of demand for air travel.

2.1. Internet usage

The internet has played an important role in the historic development of LCCs because it facilitated a simplified pricing structure and online sales and distribution thereby eliminating traditional travel

Table 2
Per capita GDP and median income by country.
Source: Phelps and Crabtree (2013); *Estimate for UAE from Tong (2010).

MENA countries	Median per capita income[2] PPP international dollars
Oil exporting nations	2006–2012
Algeria	$1392
Bahrain	$4778
Iran, Islamic Rep.	$3115
Iraq	$617
Kuwait	$7487
Oman	.
Qatar	$5117
Saudi Arabia	$4762
United Arab Emirates	$4041*
Oil importing nations	
Egypt, Arab Rep.	$623
Israel	$7847
Jordan	$1559
Lebanon	$2960
Morocco	$1135
Tunisia	$1646
Developed countries	
USA	$15,480
Canada	$15,181

[5] See for example Hansman and Ishutkina (2009).

[6] The same Gini coefficient value can be obtained from different distribution functions. For example, a Gini coefficient of 50 could be derived from an income distribution in which half of the population have all the income and the other half have nothing or from a distribution in which 20% of the population are extremely wealthy, 60% of the population are quite poor and 20% have nothing.

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