

Strategic Management

(LCMB7003)

Assignment 1

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1. Executive Summary

The aim of this report is to examine central issues faced by Lucky Air, a Chinese low cost carrier based at Kunming Changshui International Airport. It focuses on analyses of external and internal environments and critical evaluation of emergent strategies applied by the company in order to achieve competitive advantage.

2. Introduction

As described in (Flouris and Oswald, 2006, chapter 1) Strategic Management design, implementation and execution is an essential part that determinates company success. Author describes strategic management as : “ a process that helps an organisation establish a plan in which to achieve and implement its objectives and which is necessary to take a company into the future”. (Flouris and Oswald, 2006, chapter 1).

The structure of Lucky Air has been modelled on Southwest Airlines, a low cost domestic carrier which is operating in United States. (CAPA-Centre of Aviation, 2015) In 2008 company started to seek for a competitive advantage in diverse Chinese airline industry. Adapting the western models of business like for instance increasingly popular at the time, e –commerce techniques seemed like a great opportunity for airline expansion however highly regulated Chinese airline industry has brought many challenges in implementation of those practices. This report is further exploring main issues in development of western ‘best practise’ model in Chinese local business environment. It is analysing internal and external environments of the area of company’s operations and evaluates strategies adapted by the business to achieve competitive advantage and provides recommendations for further growth.

3. Company overview

Lucky Air was founded in 2004 in Kunming, Yunnan, the company officially transformed to a low cost carrier in March 2016 (CAPA, 2020). The carrier is a part of Hainan Airlines Group the fourth largest airline carrier in China. In the beginning of its operations Lucky Air was a domestic airline carrier which routes included selected flights between Dali, Xishuangbanna and Kunming but soon expanded to other areas of China and added a few international routes. Currently Lucky Air is a joint venture of Hainan Airlines and Yunnan government; it operates flights between over 80 destinations in 9 countries. (Lucky Air, n.d.)

4. Industry Overview

Since many decades airline industry has a significant impact on global economy. According to (Statista, 2019) there is an increased growth in global air traffic each year (Appendix A). It is predicted by (IATA, 2018) that the number of aviation passengers between years 2019 and 2038 is expected to grow at the annual rate (CAGR) of 4.6 per cent and the global aviation industry is going to generate 29.3 U.S dollars in 2020. The same source reports that main factors that influenced positive growth in air travel demand in recent years are: introduction of low cost business model by low cost carriers and regional airlines and rising affluence of middle classes and their demand for travel in emerging markets. For instance Beijing's Capital international Airport was ranked among the busiest international airports for passenger's traffic in 2018. Similar view is shared by (Albers et al., 2017) according to author from strategic management perspective since 2001 three significant issues have influenced global aviation industry, these are: further spread of deregulation in Asia and its influence on airline alliance, technological advances and emerge of financially strong intercontinental carriers in the east. As mentioned by (Nunlist, 2017) over the recent two decades Chinese aviation industry has significantly improved and it is becoming a global force (Appendix B). (Nunlist, 2017) reports that with an increasing amount of affluent passengers flying in China has changed from

privilege to regular activity available for the masses. According to the same article number of air travellers in China rose from 4 million in year 1982 to 487 millions in 2016. This change had a major impact on increasing amount of Chinese commercial domestic airlines. According to the same source over the last two decades aviation has become one of the fastest growing industries in China. As reported by (Statista, 2020) China has built over a hundred new airports between years 2000 and 2019. As described by (Nunlist, 2017) there has been also a cultural change in Chinese societies that boost the aviation market. People become to travel abroad more frequently and a growing number of citizens have decided to spend their leisure time in foreign destinations.

For instance as stated in (Nunlist, 2017) over 50% of air passengers that are traveling between US-China route are now Chinese in comparison in year 2000 over 70% were Americans . Although China has become one of the global players on the international aviation market there are still issues that need to be resolved, like for example: growth in domestic air traffic demand, pricing policy for low cost airlines and fewer international destinations in comparison to other global key players. (Nunlist, 2017) Those issues currently still prevent Chinese aviation industry from becoming world's leader. Nevertheless as reported by (Xinhua, 2018) it is predicted by IATA research that China is going to overtake US as a world leader in aviation by 2022 placing India on the third place in global arena.

5. Internal Analysis

5.1 Resources and Competence Analysis

In order to stay competitive it is important for company to establish the strategic Intent of the organisation which differentiates it from competitors. In addition company needs to establish clear strategic objectives that set a specific standards of performance .For instance if the company intends to be a leader in domestic market its strategic objectives must aim at providing the best service and prices on this

market (Flouris and Oswald, 2006, chapter 2)

According to (Principles of Management, 2015) competitive advantage of the company can be measured by analyses of its capabilities and resources which according to (Prahalad & Hamel, 1990) are labelled as core competencies of the business. Core competencies determine company's personality and usually emerge over time through the process of various activities performed by the business. In addition company achieves its competitive advantage through unique value added to its products and services.

In the process of analyses of company internal resources (Principles of Management, 2015) distinguish two important factors: capabilities and resources.

Resources:

Resources can be grouped on tangible and intangible. As described in (Principles of Management, 2015) tangible resources are all the assets that can be seen and quantified whereas intangible resources are more concerned with the unique value in which company operates, it might be for example company reputation or the way of cooperation between company employees.

Capabilities:

Capabilities are mainly the way in which company choose to deploy its resources. For example it might be a business tactic that company chose for its operations. In most of the cases capabilities are intangible however some of them can be also tangible like for instance: automated business process. (Principles of Management, 2015)

5.2 Value Chain Analysis

Value chain is a business model introduced by Michael Porter in his book Competitive Advantage (1985). Porter explains that the concept of value chain

analyses is useful tool to establish which operations are profitable for the organisation. In other words it is a collection of activities performed by the company in order to achieve competitive advantage. Eventually higher value creates higher profitability for the organisation. (Lynch, 2006)

As explained in (Lynch, 2006) Porter's Value Chain Analysis consists of various activities that have an effect on organisation performance. These are divided into primary activities that have an immediate effect on organisation and support activities like infrastructure of the company, human resource management or technology development. Primary activities are concerned around areas like:

Inbound Logistics- include processes that are related to raw materials or basic components of product or service. In addition in airline industry these can be for example: route selection, aircraft acquisition or flight scheduling. (Dudovskiy, 2016)

Operations- are associated with the stage of business in which goods are prepared for sale to customers. In addition in aviation industry it is related to ticket booking process, check in services or up sale of other goods or services through online platforms. It also includes other factors that might influence company value like for example on board services. (Dudovskiy, 2016)

Outbound Logistics- are operations mainly concerned with manufacturing as term refers to a process in which products are sent to customers for consumption. However it can be also applied to airline services, for instance: through baggage handling at the destination. (Dudovskiy, 2016)

Marketing and Sales- are activities associated with the strategy that company use in order to target designed customers. It focuses on airline operations related to promotion and advertising. (Dudovskiy, 2016)

Service- these activities are mainly concerned with post-sale services like for example complaint handling system developed by airlines. It is an important part in the process for gaining competitive advantage on the market as it allows airlines to remain its existing costumers throws maintaining communication and loyalty programs. (Dudovskiy, 2016)

5.3 Core competencies, values and financial performance of Lucky Air

As reported by (CAPA-Centre of Aviation, 2015) since its opening in 2004 Lucky Air through successful management strategy has managed to establish strong position on Chinese aviation market. A major impact on company success had a smart routs selection concentrated on the southwest region and secondary cities. In addition Lucky Air has managed to offer its passengers more competitive prices than its rivals on Chinese aviation market. Another successful factor is according to (CAPA-Centre of Aviation, 2015) smart brand name selection that makes it stand out from other Chinese airlines mostly named after a geographical region. The same source reports that Lucky Air has been granted International traffic rights at Kunming and the airline management is constantly consider further expansion of the company. Lucky air fleet consist of forty five aircrafts operating 155 routes including 99 domestic and 16 international and regional. As reported by (CAPA-Centre of Aviation, 2015) most of the Lucky Air fleet consist of Airbus (A319-100 and A320-200) and Boeing (737-700 and 737-800) models. Additionally company anticipates 20% annual growth and aims at increasing its aircraft number to 70 by the end of 2020; see (Appendix C)

Lucky Air is a second largest airline which operates at Kunnig Airport after China Eastern and its is categorised by CAPA as a low cost carrier (LCC) which mainly operates in domestic markets. Its operations are mainly concentrated around Yunnan's area which is a famous tourism destination. Second strategically selected area of Lucky Air operation is according to (CAPA-Centre of Aviation, 2015) Chengdu

city in western China which is a popular business destination. Although as reported by (CAPA-Centre of Aviation, 2015) CAAC is considering Lucky Air as a low cost airline operator, many Chinese airlines are still reluctant to fully adapt western low cost models. Similar view is shared by (Dennis, 2019) who states that in recent years some LCC's tried to adapt the full low cost airlines approach in their operations but eventually switched to Chinese generic-full service or hybrid approach. Lucky Air's strategy is a mixture of different tactics in approach to: checked luggage, serving on board food or to service recovery procedures in case of delays or cancellations. This mixture on different tactics can be summarised as hybrid approach. In addition some aircrafts that are operating on specific routes are in economy configuration while other routes are not serving free meals; passengers are welcomed to purchase meals and snacks on board at the additional charge and only non alcoholic drinks are served free of charge.

Lucky Air web page is characterised by modern design and it is easy to navigate. It provides not only services that allow purchasing of e ticket and online check in but also a link to mobile app. There is a 24hrs online chat that allows customers to contact Lucky Air employees in case of any query or complaint. Furthermore there is a variety of options to purchase additional services like for example: special tours to the most popular destinations in the region of its operation, extra luggage allowance or VIP rooms at the airport. It also provides additional links to hotel bookings and transportation in the region. (LuckyAir.net, n.d.)

6. External Analysis

6.1 Porter's Five Forces Analysis

According to (Hoskisson et al., 1999) Porters Five Forces Model provides useful analytic tools that assess the industry attractiveness and competitors analyses. In

addition according to the Porters model the company ability to gain competitive advantage strongly depends on the way in which company position and differentiates itself on the market. According to Porter competitive advantage can be measured by the following factors:

Bargaining power of Buyers – As reported by (Dennis, 2019) there is around ten low cost airlines operating in China, additionally as mentioned by (CAPA-Centre of Aviation, 2015) due to strategically allocated routes Lucky Air makes it hard for competitors to enter the domestic market in the region therefore bargaining power of buyers is relatively low.

Bargaining Power of Suppliers – according to (CAPA-Centre of Aviation, 2015) Lucky Air has been granted International traffic rights at Kunming airport and is the second largest operator in the region after China Eastern therefore bargaining power of supplier is quite high. However as mentioned in (China Power Project, 2018) research many represent ants of middle class that are traveling domestically choose train or high speed networks over air travel.

Threat of New Entrance- as described by (Dichter, 2014) over the last two decades the number of new airlines in China has significantly grown. Furthermore as reported in the same research it is predicted that it will still increase in upcoming years. Although Lucky Air position in Yunnan region is relatively strong with further expansion company will need to compete with competitors over the market share. In summary the threat of new entrance for Lucky Air is high.

Threat of Substitute Products- as mentioned in (China Power Project, 2018) there is still a large number of Chinese citizens who choose to travel by train or car however Lucky Air is constantly expanding its routes to more distance destinations therefore threat of substitute products is relatively low.

6.2 Pestle Analysis

Successful business strategy requires in depth consideration of internal performance of the company which include factors like financial and operational performance, company culture and capabilities. However as explained in (Flouris and Oswald, 2006, chapter 1) these are highly influenced by outside forces. Therefore in the dynamic aviation industry a successful business strategy should include the analyses of PESTEL external environments.

Political factors- Civil Aviation Administration of China is a special government body that oversees the industry. According to (CAAC, 2014) since many years authorities' main focus has been put on security and safety regulations of Chinese aviation. Chinese government is constantly monitoring air traffic and puts a lot of impact on safety policies and regulations. Those regulations are mainly concerned with new aircraft purchasing and pilot licencing. Another important political aspect that affects aviation industry in China is according to (Blomquist and Hughes, 2017) "domestic and bilateral" relation with other countries like for example US. As stated in the article although globalisation has influenced the growth of the aviation industry the protections policies between China and US are slowing the process.

Economic- According to (Dichter, 2014) Chinese aviation Industry is one of the fastest growing in the world and generates a large number of GDP each year. However as reported by (Blomquist and Hughes, 2017) the increased amount of airlines and strict government restrictions in regards to pilot licencing resulted in labour shortages. Another important aspect that affects Chinese aviation industry is discussed by (Zhang and Aizhu, 2019) price of the fuel. As stated in the article Chinese government is continuously supporting the profitability of Chinese airlines by reducing prices of fuel and operational costs. However as reported by (Dennis, 2019) the cost of fuel in China runs much higher than in other international markets. The same article reports that cost of fuel consist on average thirty per cent of airline expenses in China.

Social- an important factor in Chinese commercial airlines expansion over the last two decades was mainly driven by raising amount of middle class in society. It is reports that the number of Chinese air passengers rose from 62million to 551 million between year 2000 and 2017. There has been also a growing demand for domestic air travel. According to the same source a number of domestic air passengers has risen from 11 million to 426 million between 1990 and 2016. At the same time the disposable income among Chinese middle class. has increased. Accordingly the number of air passengers on the international routes increased from one million in 1990 to 52 million in 2016. Nevertheless it is reported that although the number of domestic air passengers increased many Chinese citizens still prefers high speed rail network and highway system over domestic flights. (China Power Project, 2018)

Technological- growing popularity of E-commerce in tourism has significantly influenced Chinese aviation. As reported by (Li and Buhalis, 2006) many business from IT industry took advantage of e commerce and become travel agents. According to the same author these new entrants success was supported by other technology companies and various tourism organisations. Moreover many airlines in recent years took advantage of e commerce as a marketing tool to advertise their products and attract specific target market. China Southern Airlines has revolutionised the e-commerce business among the domestic competitors with their introduction of online platform and e ticket. This innovation led to complete change in consumption process by Chinese customers, reduced operational costs and overall improved the speed of purchase (Huo and Hong, 2013) . However according to (Li and Buhalis, 2006) the behaviour of typical customer is different to online shopper and it is strongly connected with cultural values of each country and socio-demographics of customers. The report conducted by (Statista, 2018) demonstrates that e commerce popularity in China has increased in recent years. However a study conducted by (Li and Buhalis, 2006) demonstrates that popularisation of online payment in China was

relatively slow in comparison to other countries in Europe or to US. The same study suggests that a vast majority of Chinese older population prefers the traditional cash payment method to online alternative.

Legal and Environmental- As described by (Blomquist and Hughes, 2017) one of the main concern that Chinese aviation face is related to lack of air space and slots for new and established airlines. In order to tackle this issue Chinese government has been strongly supporting the growth of Chinese aviation through policies that allow more air traffic, an example is opening of airspace below 3000 for civilian airplanes. Furthermore Chinese government is constantly providing more airspace for commercial flights and invests in building more airports across the country. Chinese government is also supporting domestic aircraft production. As described by (Gabbatiss, 2020) Chinese aviation business is also highly influenced by the environmental concerns associated with carbon emission. Additionally Chinese approach to carbon emission regulations set by other countries might negatively influence their relation with other countries and global expansion within the industry.

6.3 Key Success Factors

Porter argues that an important part of company success is the right fit in the market and positioning . In order to gain a competitive advantage it is therefore necessary for the company to analyse its resources and best available options of using those resources in order to be successful within industry. (Lynch, 2015) According to (Fulton, 2017) in competitive and capital-intensive airline industry key success factors include wide range of aspects like: cost control and financial management, people, service product and route system. In addition as suggested in (Lynch 2015) SWOT analyses based on industry specific key success factors are providing a useful tool for measuring company competitive advantage.

Cost control and financial management- revenue and cost control strategy is one of the most important factors in developing strategy for business that is operating in highly competitive aviation industry. In order to attract and maintain a customer base it is necessary for airlines to introduce competitive and innovative pricing schemes. The measure of profitability in aviation is net-unit revenue which represents all revenues minus all costs divided by the number of total seats flown. In addition successful financial management allows airlines to seek for opportunities for further growth. (Fulton, 2017)

People- people are almost essential factor that determine success in service oriented aviation industry. Front line communication skills as well as problem solving abilities on management level are an important part of aviation business strategy. Therefore aviation companies should put a special focus on selection process and training opportunities. (Fulton, 2017)

Service Product- service product and promotion are also vital for airline business strategy. In order to gain a competitive advantage airlines need to consider aspects like aircraft type and its design, seating space, level of service on board as well as booking ease and promotional tactics. (Fulton, 2017)

Route system- as suggested by (Fulton, 2017 airlines route system might be the most significant success factor that needs to be considered. Route destinations and flights frequency need to be matched to customers demand. At the same time flights need to be scheduled in the way that allows maximizing utilization of the plane.

6.4 SWOT Analyses

Strengths – Financial stability and successful revenue growth is definitely one of the strengths of Lucky Air. Since its opening in 2004 until 2007 company has managed to

successfully attract over 1.2 million of air travellers to Yunnan area, more than a double of the amount of passengers from previous years. A low-cost and high efficiency model build on Southwest Airlines example had a positive impact on revenue due to increased amount of airline passengers. Lucky Air structure has been built on Southwest Airlines model which use standardised aircrafts for its operations. As mentioned in (Flouris and Oswald, 2006, chapter 1) this is one of the factors that allows airlines to reduce costs of staff training and maintenance specialists which reduce the number of employees needed for aircraft operations. Another important aspect is modelled on Southwest Airlines catering to short-haul routes where flights leave spaced out during the day. As described by (Flouris and Oswald, 2006, chapter 1) this method is oppose to hub and spoke method used by large number of airlines helps Lucky air to avoid air traffic around popular routes at peak times.

Weaknesses-with growing popularity of low cost airlines in China Lucky Air had to seek for alternative promotion strategies in order to remain its customer base and attract the new ones. Highly regulated policy for low cost airlines in China enabled flexibility in adapting fully competitive pricing strategy. Additionally promoting strategy associated with low cost airlines might have a negative impact on perception by certain socio-economic groups which might negatively impact further expansion of Lucky Air. Furthermore by targeting a specific profile of e-commerce shoppers and moving most of the operations online Lucky Air might lose some costumers that are attached to more old fashioned methods.

Opportunities- growing popularity of e commerce that simplified ticket purchase and promotional campaigns. Successful alliance with Hainan Airlines allowed further expansion and increased a number of routes and destinations. Chinas economic growth and increased number of air passengers with disposable income.

Threats- with the growing popularity of low cost airlines new competitors entered the market which increased air traffic and overall competition to remain the existing passengers' base and attract new ones. Increasing prices of fuel and taxation. Growing air traffic associated with more airlines which might cause delays and overall dissatisfaction of customers.

7. Strategies to Sustain Competitive Advantage

(Flouris and Oswald, 2006, chapter 1) discuss the correlation between strategic management and operational effectiveness. In order to achieve competitive advantage in the area of its operations and stay ahead of competitors, Aviation Company needs to perform similar activities in a better way or at lower cost than their rivals. In addition financial profitability is one of the main factors that determine company success among different firms. However if similar activities are performed by the companies in a better way the strategy can be easily copied by the competitors therefore a differentiation is a vital part for the company to stay ahead of its competitors on the market.

7.1 Porter's Generic strategies

(Flouris and Oswald, 2006, chapter 2) suggests that competitive strategy strongly depends on company's business approach, initiatives performed to attract new customers and in the ability to remain strong position on the market. (Flouris and Oswald, 2006, chapter 2) refers to Michael Porter concept which classifies these competitive strategies into three generic categories: low cost leadership niche and differentiation.

Low cost leadership- this approach is characteristic to airlines like Ryanair who strive to gain its competitive advantage by providing the most competitive prices among other airlines.

Niche- is an approach used by airlines that target a specific group of customers and provide a tailor made products that are targeting a specific segment. In airline industry this can be for example: providing service tailor made to a specific destination (geographic niche) like Aloha Airlines; specific socioeconomic group (customer niche) like Etihad Airlines known for attracting more affluent passengers by offering luxurious on board services; or by specific design of their product (product line niche).

Differentiation- this approach is set to give an additional value to the product that customers are willing to pay extra for. An example can be Singapore Airlines.

Flexibility and competitive Advantage- as discussed in (Flouris and Oswald, 2006, chapter 2) in dynamic airline industry a successful company cannot rely simply on applying one of the generic strategies. Instead author suggests that companies should use a mix of techniques and marketing tools rather than depend on focusing their operation on one or one competency. Lucky Air is an example of the company that uses a mixture of techniques in order to achieve competitive advantage.

7.2 Strategic Alliance

As described in (Aswathappa, 2008) strategic alliances are occurring between two airlines when internal resources of single airline are not sufficient for the company to gain its competitive advantage on the market. The same author stress that strategic alliance can lower the cost of development of new products; help airlines to access new markets; provides access to different distribution networks and new technology .Strategic alliance might also include joint research, technology, use of various production facilities, joint efforts to manufacture different components or finish products. (Aswathappa, 2008)

8. Conclusion and Recommendations

As described in (Flouris and Oswald, 2006, chapter 1) strategic management is an on-going process. Furthermore evaluation, monitoring and initiation of eventual corrections are the essential parts of successful strategic planning. Since its opening in 2004 Lucky Air has managed to establish its strong position on Chinese Aviation market. This success has been achieved mainly by successful evaluation of its resources and external environments, by setting strong corporate objectives and by implementing correct strategic decisions at the right time. In order to stay competitive on the market Lucky Air should constantly monitor latest trends in aviation market and analyse changes in external environments that might influence aviation industry in order to remain its strong position on domestic market. Furthermore Lucky air should continue its global expansion through successful strategic alliances.

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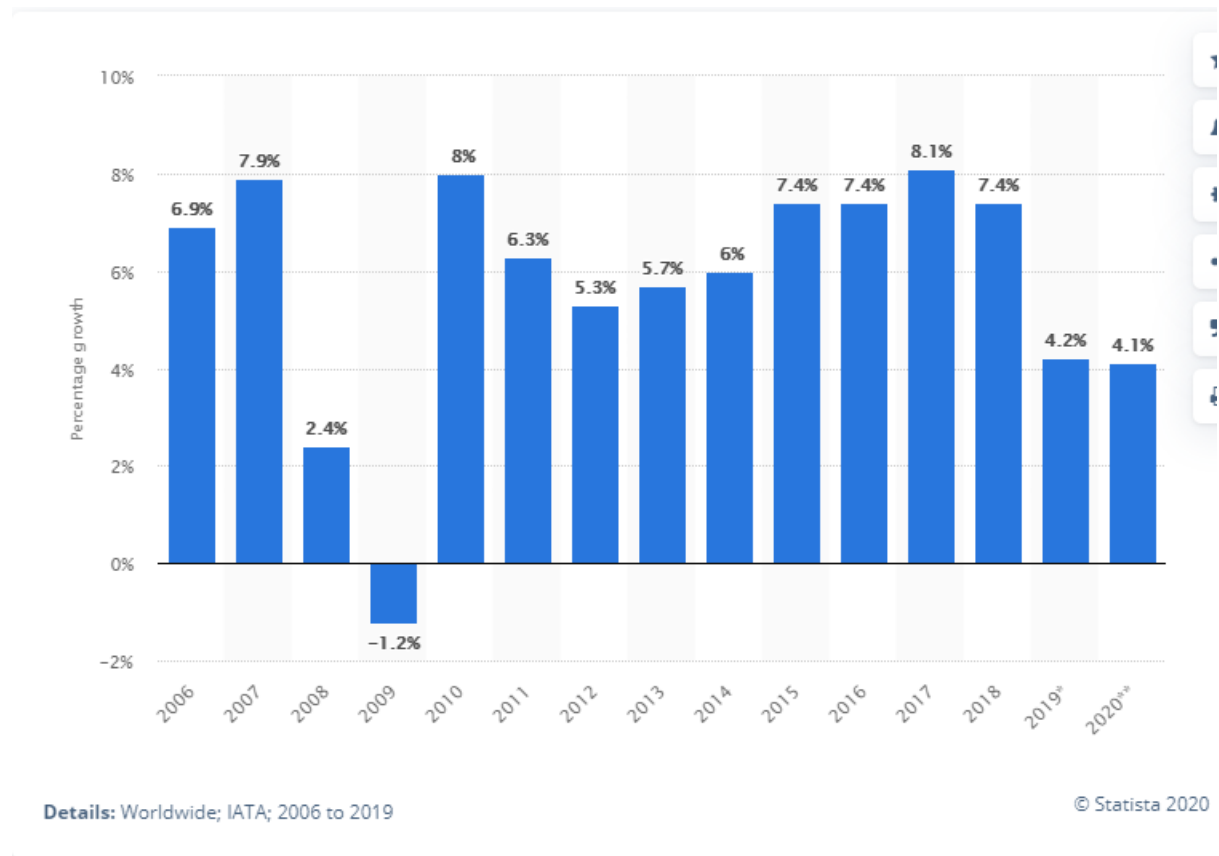
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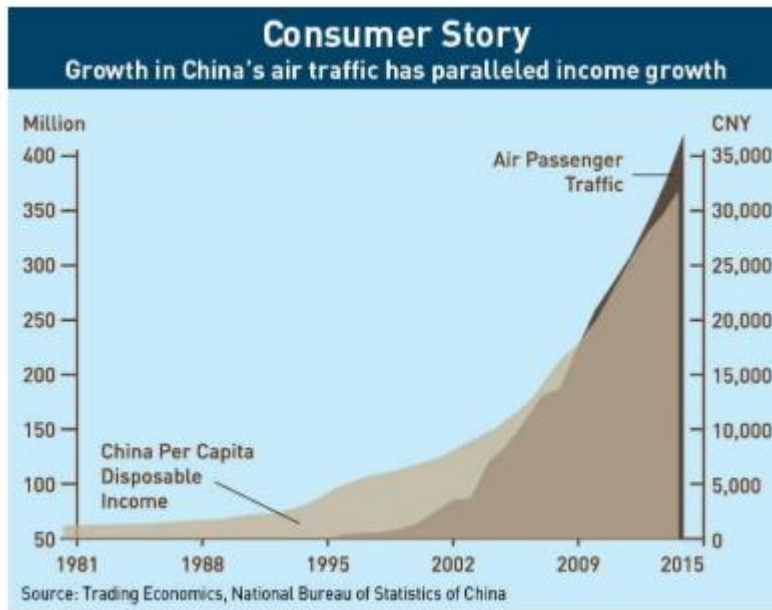
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Appendix A



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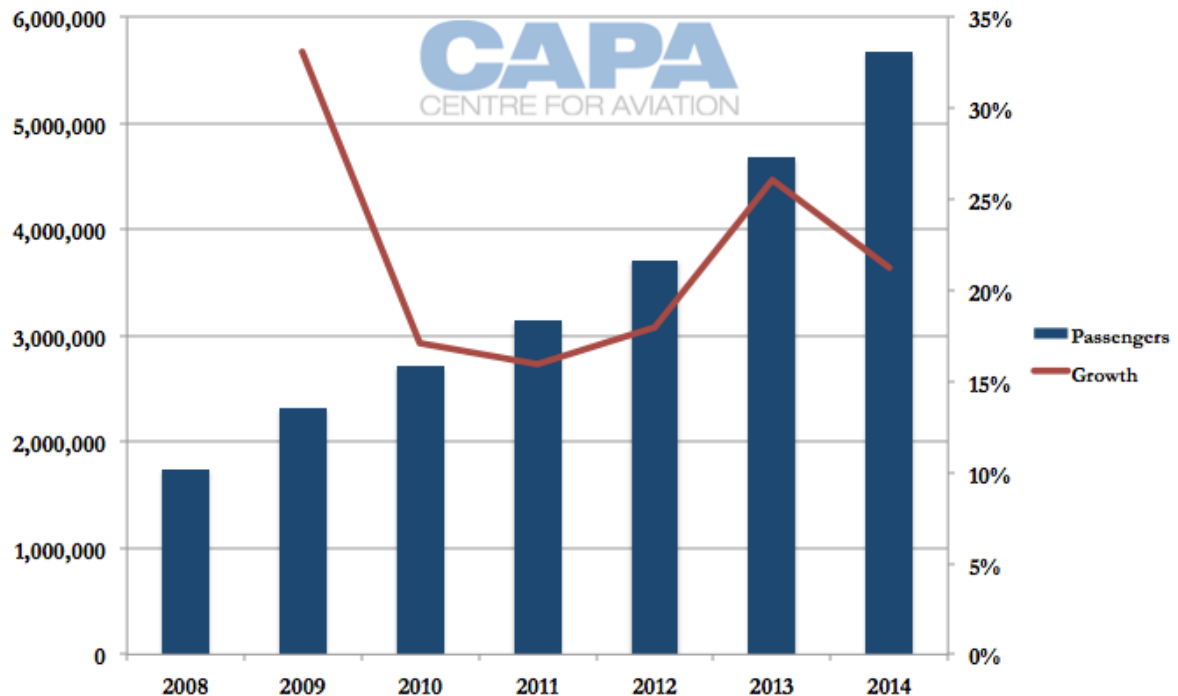
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Appendix C

Lucky Air annual passenger volume and growth: 2008-2014



Source: CAPA - Centre for Aviation and CAAC

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