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## The lowest of low-cost carriers: the case of AirAsia

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In December 2001, just a few months after the terrorist attacks on New York and Washington left the international airline industry reeling, a new Malaysian company called 'Tune Air' purchased a small underperforming domestic Malaysian airline known as 'AirAsia' for 1 Malaysian ringgit and the assumption of 40 million ringgit in debt. Within 11 months of acquiring the company, Tune Air had fully repaid this debt and by January 2003 the company was operating six aircraft domestically. In 2006, AirAsia boasted a fleet of 35 Boeing 737-300 aircraft and eight Airbus 320 aircraft with orders for 100 more A320s (*Vietnam News* 2006) and was forecast to carry nine million passengers to 52 domestic and international destinations.

AirAsia's meteoric rise is the result of the confluence of opportunity and skillful application of the low-cost Carrier (LCC) aviation business model. This model, which has its origins in the success of Southwest Airlines (see Gittell 2003) and Michael O'Leary's 'Ryanair', has been implemented around the world and consists of a number of common elements such as reduced inflight service, point to point travel, high aircraft utilization, single fleet type, ticketless passenger reservation systems and considerable functional flexibility in staffing. In this article we trace the rise of AirAsia's success and the nuances of the low-cost aviation model it has pursued. We draw upon established theory from the fields of strategy and strategic human resource management to explain AirAsia's minimalist approach to human resource management. In particular, we apply Porter's (1985) well known theory of generic business strategies and Schuler and Jackson's model linking HR practices to competitive strategy, to argue that the airline's successful quest for market cost leadership has been supported by a strict focus on Legge's (1995) 'hard' variety of HRM.

It is further argued that while a number of the components of the Southwest Airlines model are evident, there are also significant differences in AirAsia's management of human resources. In particular, it is argued that the airline has adopted a far stronger cost minimization and 'hard' HRM path that is closer to Ryanair's model, which has proved highly successful for the airline in South East Asia.

**Keywords:** AirAsia; Asia; competitive strategy; human resource management strategy and practices; innovative branding; labor relations and management; low-cost business model; low-cost carrier

### Introduction

By all measures AirAsia has become the preeminent low-cost carrier in Asia and one of the most successful exemplars of the low-cost model in the airline industry. Under the stewardship of its charismatic founder and CEO, Tony Fernandes, AirAsia has become one of the most awarded low-cost carriers in the Asia-Pacific and its growth trajectory has been nothing short of remarkable. From humble beginnings operating just two aircraft domestically in early 2002 as a full service domestic carrier, AirAsia (recast as a low-cost

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carrier – LCC) now has a fleet of some 43 aircraft, and both domestic and international operations carrying over 4.5 million passengers per annum (AirAsia Annual Report 2005, p. 3). Since AirAsia's arrival in late 2001, a number of competitors have followed its lead in the South East Asian region. In Singapore, for instance, the low-cost carrier market has been especially crowded with the entry of three low-cost rivals in 2004 including Tiger Air (an LCC established by Singapore Airlines), Jetstar Asia (an LCC established by Qantas but owned jointly with the Singapore government's investment vehicle, Temasek Holdings) and ValuAir. In 2005, ValuAir was acquired by Jetstar Asia suggesting that the LCC market in South East Asia had already become saturated and was beginning to rationalize. Nonetheless, AirAsia seems to have met the competitive threat posed by these new entrants with relative ease and has continued to expand.

In this article, we begin by tracing the origins and development of low-cost carriers in Asia, noting the historical context and the nuances of the emerging industry. This discussion provides important contextual material for the particular focus on AirAsia. Drawing on interview data and secondary source material, we discuss the characteristics of AirAsia's business model with a special focus on describing and explaining its human resource management strategies and practices.

### Development of LCCs in Asia

In Asia, low-cost carriers saw their early development in the mid 1990s in Japan and the Philippines, both with liberalized domestic markets. Skymark Airlines and Air Do (now known as Hokkaido International Airlines after having entered into an alliance with All Nippon Airways and restructured in 2006) launched low-cost domestic services in Japan in 1996. In the same year, Cebu Pacific Air pioneered the 'low fare, great value' strategy in the Philippines' local aviation industry. These early-start LCCs offered primarily point-to-point services targeting price-sensitive leisure travellers flying within country borders (see Table 1).

With the tentative start of only a few operators in the region, LCCs have been developing fast in North, South and South East Asia since 2000 as more airlines, both no-frills ventures of legacy airlines and independent private low-cost start-ups, have emerged flying within and across different countries in the region. Table 2 sets out a chronology of development of the low-cost carriers in Asia since year 2000.

Table 1. Early-start low-cost carriers in Asia.

| <i>Name of LCC</i>                                | <i>Based in</i> | <i>Operated since</i>   | <i>Brief description on the LCC</i>                                                                                                                                |
|---------------------------------------------------|-----------------|-------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Skymark Airlines                                  | Japan           | 1996, flying since 1998 | Independent private start-up owned by Shinichi Nishikubo (President and CEO), H.I.S. Co., Ltd, the Bank of Tokyo-Mitsubishi UFJ Group and other private investors. |
| Hokkaido International Airlines (formerly Air Do) | Japan           | 1996, flying since 1998 | Independent private start-up owned by Mizuho Financial Group and individual private investors.                                                                     |
| Cebu Pacific                                      | The Philippines | 1996                    | Philippines' second largest carrier and biggest LCC wholly owned by JG Summit Holdings                                                                             |

Source: from the websites of various airlines and Peanuts! (2008).

Table 2. A chronology of development of the low-cost carriers in Asia.

| <i>Name of LCC</i>                  | <i>Based in</i> | <i>Operated since</i>   | <i>Brief description on the LCC</i>                                                                                                                                                                                                                                                                                       |
|-------------------------------------|-----------------|-------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Lion Air                            | Indonesia       | 2000                    | Independent private start-up and the first LCC in Indonesia. The airline is owned by Rusdi Kirana                                                                                                                                                                                                                         |
| AirAsia                             | Malaysia        | 2001                    | An ill-performed legacy carrier in Malaysia which was relaunched as an LCC. The airline was previously owned by Air Asia Berhad. It is now listed publicly on the Malaysia Stocks Exchange.                                                                                                                               |
| Citilink Garuda                     | Indonesia       | 2001                    | LCC of Garuda Indonesia                                                                                                                                                                                                                                                                                                   |
| Skynet Asia Airways                 | Japan           | 2002                    | Independent private start-up owned by the Industrial Revitalisation Corporation of Japan, Mera Electric Industrial Corporation and All Nippon Airways                                                                                                                                                                     |
| Air Deccan                          | India           | 2003                    | Independent private start-up and the first LCC in India. The airline is listed and owned by public investors                                                                                                                                                                                                              |
| Thai AirAsia                        | Thailand        | 2003, flying since 2004 | AirAsia's first foreign joint venture set up with Shin Corporation (associated with family interests of then Primer Minister, Tasksin Shinawat). The airline is now 49% owned by Tony Fernandes (founder of AirAsia), 50% by Asia Aviation (which took over Shin Corp's shares) and 1% by AirAsia CEO, Tassapon Bijleveld |
| Indonesia Air Asia (formerly Awair) | Indonesia       | 2004                    | AirAsia – another foreign joint venture 51% of which is owned by Abdurrahman Wahid, former President of Indonesia (1999–2001) and 49% owned by AirAsia                                                                                                                                                                    |
| One-Two-Go                          | Thailand        | 2004                    | A spin-off of regional and charter carrier Orient Thai                                                                                                                                                                                                                                                                    |
| Nok Airlines (formerly Sky Asia)    | Thailand        | 2004                    | LCC of Thai Airways. The airline is 39% owned by Thai Airways, 10% by Krung Thai Bank, 10% by Dhipaya Insurance, 10% by the Government Pension Fund, 6% by CPB Equity Co., 5% by ING Funds, 5% by King Power and other minor shareholders                                                                                 |
| Valuair                             | Singapore       | 2004                    | Independent private start-up and the first LCC to begin operations in Singapore. The airline merged with Jetstar Asia in July 2005, giving the first sign of consolidation of LCCs operating in SE Asia                                                                                                                   |
| Tiger Airways                       | Singapore       | 2004                    | LCC of Singapore Airlines. The airline is 49% held by Singapore Airlines, 24% by Indigo Partners, 16% by Irelandia Investments Ltd (the private investment arm of Tony Ryan and family) and 11% by Temasek                                                                                                                |
| Jetstar Asia                        | Singapore       | 2004                    | Founded by Qantas in financial cooperation with the Singapore government and two local investors. Qantas holds 49% share of the airline, with the rest 19% held by Tamasek, 22% by Tony Chew and 10% by FF Wong. Its sister company is Jetstar which is based out of Melbourne and is wholly owned by Qantas              |

Table 2. *continued*

| <i>Name of LCC</i> | <i>Based in</i>  | <i>Operated since</i>   | <i>Brief description on the LCC</i>                                                                                                                                                                                                                                                                |
|--------------------|------------------|-------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Viva Macau         | Macau SAR, China | 2004, flying since 2006 | Independent private start-up owned by MKW Capital and local investors. It is the first Asian LCC airline to fly long-haul                                                                                                                                                                          |
| SpiceJet           | India            | 2005                    | The company was originally known as Royal Airways. Royal Holdings Services is one of the largest shareholders of the airline, also with investment from the Dubai-based Isthithmar (private equity arm of the Dubai government), Citigroup, and Ewart Investments (a division of the Tata Group)   |
| Hansung Air        | Korea            | 2005                    | Independent private start-up and the first LCC in Korea. The airline is listed and owned by public investors                                                                                                                                                                                       |
| Spring Airlines    | China            | 2005                    | The first LCC of China owned by Shanghai Spring International Travel Service Ltd, one of the country's largest domestic travel agency                                                                                                                                                              |
| IndiGo             | India            | 2006                    | Independent private start-up owned by Interglobe Enterprises, an Indian travel and hospitality group                                                                                                                                                                                               |
| Jeju Air           | Korea            | 2006                    | The airline is a joint venture between the Jeju Province (holding 25% share) and conglomerate Aekyung Group (holding 75% share).                                                                                                                                                                   |
| Oasis              | HKSAR China      | 2006                    | Independent private start-up owned by Rev. Raymond Lee and other shareholders. The airline was liquidated in April 2008, after only a 15-month operation.                                                                                                                                          |
| AirAsia X          | Malaysia         | 2007                    | A long-haul LCC operated by FlyAsianXpress (FAX). The airline is 48% controlled by Aero Ventures Sdn. Bhd. (a company owned by Tony Fernandes and his associates), 16% by Richard Branson of the Virgin Group, and 10% each by Japanese leasing firm Orix Corp and Bahrain-based Manara Consortium |
| Pacific Airlines   | Vietnam          | 2007                    | Vietnam's first LCC which was transformed from the country's second largest legacy carrier founded in 1991. The airline is owned by the Vietnamese government's State Capital Investment Corporation (SCIC), Saigon Tourist Corporation and, its strategic partner, Qantas Airways                 |

Source: from the websites of various airlines and Peanuts! (2008)

There are several important reasons accounting for the fast development of LCCs in Asia since the beginning of year 2000. First, the outbreak of the Asian financial crisis in 1997 created a demand for low-cost air travel for business travellers funded by cost-conscious finance departments of private firms (Condom 2005). The sharp decline in air travel after the Asian Financial Crisis also placed pressure on the governments in some Asian countries, which were previously reluctant to grant the right to fly international routes to airline operators other than national flag carriers, to open up both domestic and international aviation market for independent low-cost start-ups. The Indonesian

government, for instance, issued 10 licenses to new airline operators in 2000 to encourage market expansion (Thomas 2002).

Second, restrictions on bilateral air services agreements were recently removed by many national governments in Asia to boost further growth of trade and tourism in the region. In 2004, China concluded a comprehensive open skies agreement with Thailand. A similar agreement was forged between Hong Kong and Malaysia (*Centreline* 2004). The Association of South-East Asian Nations (ASEAN) is working towards developing an 'open skies policy' targeted to give national carriers of the Association's member countries unrestricted intra-ASEAN access between capital cities by 2008 (Ionides 2005). Deregulation of aviation rules has enabled many LCCs, some of which presently enjoy access to the under-capacity hub airports in the Asian region, to offer multi-country flying services (Baker, Field and Ionides 2005; Interavia 2004, p. 25). Many LCCs which began by offering short-haul, 'single border services' have expanded to cover multi-country services within the sub-regions of North, South and Southeast Asia, and across them (Interavia 2004, p. 23). Even long-haul international services have recently been offered by some LCCs such as Viva Macau and Oasis, though with mixed results.

Third, low-cost terminals, such as those opened recently in Malaysia's Kuala Lumpur International Airport in 2005 and Singapore's Changi Airport in 2006, have helped foster further development of LCCs in the region. These low-cost terminals do not have the trappings of other terminals (such as airline lounges) and are designed for the mass rapid onboarding and disembarking of passengers. By cutting out value-added services offered by typical airports, these low-cost terminals were able to contain costs and pass the savings onto the airlines using their services. Tiger Airways, for example, signed an agreement to use the low-cost terminal opened in Singapore's Changi Airport in March 2006. Similarly, AirAsia has used the low-cost terminal opened and operated in Malaysia's Kuala Lumpur International Airport since March 2006 (*Hong Kong Economic Times* 2006).

LCCs took off initially in East and South East Asia, spread quickly to North Asia and, more recently, China as well as the Indian subcontinent. The huge population in ASEAN, China and India provided the needed demographic base to fuel further development of LCCs in the region. Growth of LCCs in the region will also be powered by an increase in the number of Asian impulse travellers who would like to fly to nearby holiday destinations (Interavia 2004, pp. 25–26; Voorhaar 2004). Growing regional affluence, coupled with the lack of transport substitutes for air travel due to geographical reasons, is expected to further boost the growth of LCCs in the region. Reflecting these expectations is the projected average annual passenger growth rates in South East Asia (see Table 3).

Compared with 4% average annual growth rate of airline passenger for the world at large, the rate of 8.6% growth for domestic travel and 9.9% growth for international travel in South East Asia is phenomenal (Airports Council International 2007). While further

Table 3. Average annual passenger growth rate in South East Asia.

|                 | 2003–2008 (forecast) |                 |
|-----------------|----------------------|-----------------|
|                 | Domestic %           | International % |
| South East Asia | 8.6                  | 9.9             |
| Malaysia        | 6.6                  | 9.2             |
| Thailand        | 10.1                 | 7.8             |
| Indonesia       | 13.2                 | 10.5            |

Source: Wang and Ricart (2005, p. 22).

growth of LCCs in the Asian region is beyond doubt, rising jet fuel prices and intense rivalry has placed pressure on existing participants in the industry<sup>1</sup> and kept potential entrants at bay. It is expected that LCCs in the region will continue to enjoy high growth, albeit with some degree of consolidation in the sector, as is evident in the merger of ValuAir with Jetstar Asia in July 2005.

### **AirAsia**

As one of the earliest LCCs to emerge in the South East Asian region, AirAsia provides a good case for examining the development trajectory of LCCs in this region. Beginning with the successful use of the low-cost business model, AirAsia has continued to experiment with more innovative branding and joint venture strategies to diversify its product market and extend its reach within an increasingly competitive South East Asian market. This analysis focuses on three central questions. First, to what extent are the airline's strategies an embodiment of those of established LCCs? Second, are there any links between AirAsia's competitive strategies and its human resource management strategies that have been neglected in previous studies of the company? Third, is the company's approach sustainable given the acute challenges of the LCC industry in South East Asia?

This study of AirAsia draws on published material on the company including publicly available material from its website, its 2005 financial report, industry journals and academic publications as well as newspaper and business publications. Our analysis of AirAsia also draws extensively from a series of interviews conducted with an individual who was involved at a very senior level in managing AirAsia's operations from its inception until 2005. This interviewee also has had considerable experience working with full service airlines. As a senior executive with AirAsia, this individual has intimate knowledge of every aspect of AirAsia's operations including its business strategy and people management systems and practices. To maintain confidentiality of information gathered from the interviewee who preferred to remain anonymous, this interviewee was referred to as Interviewee A. Interviewee A, formally interviewed during the period March 25 to 26, 2006, has also provided subsequent clarifications and further information. Interviews were carried out using the common protocol established by the MIT group and used throughout the global LCC study. Unfortunately further interviews with AirAsia staff were unable to be obtained and therefore the data are limited to this single source. Nonetheless, it is an important source whose insights have been triangulated (to the extent that is possible) through analysis of published material.

### ***AirAsia's origins***

AirAsia was created as a private corporate entity on December 20, 1993 and was then owned by two shareholders – HICOM Holdings (99.25%) and MOFAZ Air Sdn Berhad with the balance of the equity (0.75%). It commenced operations in 1996 and offered full service air transportation to domestic destinations with Malaysia. Interviewee A remarked that AirAsia did not perform well during the time it was a full service airline (FSA). Interviewee A (personal communication, March 25, 2006) claimed that the airline's management during this time:

did not have a clue with regards to airline commercial aspects. The aircraft were only scheduled for a 6–7 hour daily utilization charging the going domestic rate at that time. As a full service airline by the year 2001 it had accumulated losses amounting to RM140 million.

Another culprit for such losses were the travel agents who handled AirAsia flights. They constantly blocked seats which eventually were never sold. HICOM eventually wrote off RM100 million and negotiated the sale to Tony's Tune Air at RM1 – along with 50% of the remaining liability of RM40 million. The RM20 million was settled by Tune 11 months after takeover.

By December, 2001, Tune Air Sdn Berhad had assumed control of AirAsia. The explanation for Tony Fernandes' entrepreneurial foray in the LCC industry is not completely clear but it seems that he was always ambitious. The son of a medical doctor, Mr Fernandes grew up and was educated in the United Kingdom before working for Sir Richard Branson's Virgin Communications in London as a financial controller from 1987 to 1989. Prior to establishing Tune Air, he was Vice President of Warner Music in South East Asia. Interviewee A suggested that Tony Fernandes impressed the then Prime Minister of Malaysia, Mahatir Mohammed, who was enthusiastic about the prospect of establishing an LCC for Malaysia but required Tune Air to purchase an existing domestic airline rather than establish a new entity. As Interviewee A put it, Tune Air began with:

An existing Air Operator Certificate – an existing airline infrastructure – reduced aircraft leases from USD235,000/ month to USD145,000/ month (the 911 effect) – and blessings from the then Prime Minister.

According to Interviewee A, Tony Fernandes has been heavily influenced by Michael O'Leary and the success of his Ryanair, although he acknowledged that O'Leary himself was influenced by the Southwest Airlines model. In the words of Interviewee A, Tony Fernandes followed Ryanair's model of:

Point-to-point; high aircraft utilization; multi-tier pricing levels; small catchy adverts constantly; lots of publicity; high bullshit factor; CEO involved in publicity stunts – 'Have Mouth Will Travel' – seek opportunities to appear in the media as often as possible.

The influence of Ryanair's model is perhaps unsurprising given that Conor McCarthy is one of the company's non-executive directors (and a Director of Tune Air) who was the Director of Group Operations at Ryanair between 1996 and 2000 (AirAsia Annual Report 2005, p. 13). As the company's 2005 Annual Report makes clear, McCarthy was instrumental in assisting Fernandes to remodel AirAsia into a low-cost carrier.

Interviewee A identified a number of constraints that initially hampered Tune Air's operation of AirAsia, including a boycott by Travel Agents since AirAsia sought to circumvent them with its 'B2C' (Business to Consumer) approach. Moreover, Tune Air had some trouble raising capital initially as most financial institutions were not confident enough to fund the airline. Further, the national flag carrier, Malaysian Airlines System (MAS) saw AirAsia as a threat and was unsupportive in providing maintenance support – indeed they charged higher maintenance rates than those of Singapore-based aircraft maintenance company, ST Engineering. As the next section explains, however, these challenges were overcome and AirAsia quickly developed a reputation as one of the leading LCCs in Asia.

### ***AirAsia's competitive strategy and business model***

AirAsia's basic strategy was simply put by Interviewee A as making money through the forensic management of costs which he claimed were closely monitored on a daily basis at the airline. Interviewee A remarked that the strategy was fundamentally based on the theory of celebrated former CEO of General Electric, Jack Welch, who argued that the old economy was based on the notion that the selling price was a simple function of adding the costs of production with a sustainable profit level. In Welch's view, the new economy

demanded that profits were only determined after deducting costs from the selling price. Hence, the close management of costs is critical to maximizing profits at AirAsia according to Interviewee A. An example of this, our interviewee claimed, was AirAsia's daily reconciliation process at 2100 hours which allows for a report to be generated for review by the CEO and revenue manager the following morning and provides an opportunity to develop strategies to address any shortfalls. In contrast, Interviewee A suggested that many full service airlines tend to close their accounts every 60 days or more, which provides them with insufficient time to react to changing market conditions.

The ruthless focus on costs made AirAsia one of the most cost efficient LCCs in the world. AirAsia has been extremely successful in reducing operating costs. In 2001, the airline's operating costs in US cents per ASK (Available Seat Kilometres comparable with unit costs) was 4.6 but by 2005, this had fallen to just 2.19 (Air Asia Annual Report 2005, p. 3). AirAsia claims that this makes them the lowest cost listed airline in the world (AirAsia Annual Report 2005, p. 23).

Stringent financial management also extends to the way in which AirAsia deals with its suppliers and vendors. Approximately 80% of jet fuel purchases are hedged in an effort to reduce the airline's rising fuel bill. According to Interviewee A, jet fuel is also the only input which is paid for 2 weeks in advance to obtain a discounted price – AirAsia seeks to delay all other payments with vendors to ensure it maintains a strong cash flow.

Until 2006, aircraft were leased except for six aircraft that were purchased from failed Australian carrier Ansett and troubled US airlines in the months after September 11 – in the words of Interviewee A 'they came real cheap'. So did the aircraft that AirAsia leased in the aftermath of September 11 – leases fell from US\$235,000 per month to US\$145,000 per month. This is a fact that is sometimes overlooked in the business press and airline literature that, although the terrorist attacks resulted in reduced demand (especially in Western countries), it also enabled low-cost carriers to capitalize on the fall in aircraft leasing costs while FSA's were often burdened with higher leasing costs or debt servicing on purchased aircraft.

The heavy use of information technology to aid decision-making is a key element of AirAsia's operations. Interviewee A stated that AirAsia uses sophisticated crew management systems and Navitaire's 'open skies' integrated software (computer reservation, revenue and expenditure management system). He also claimed that AirAsia has 'a mathematician working for them who develops algorithms for trend analysis and basically the system tells you what you should price tickets at. It's very much an artificial intelligence system – looking at the trends and the situation – they price their tickets'.

Pricing of airlines tickets is generally 80% lower than the equivalent FSA price for early bookings while late bookings are generally 20% below the FSA price. Approximately 85% of all tickets are sold on a B2C (Business to Customer) channel involving extensive use of information technology to support the channel (Wang and Ricart 2005, p. 4). Aside from selling tickets through call centres and through the corporate website, AirAsia pioneered the selling of tickets via short messaging service (SMS). Approximately, 47% of the airline's revenue comes from ticket sales directly via the internet.

Like many other LCCs, AirAsia does not provide allocated seating or any kind of premier class. Indeed, Interviewee A described this as 'a well-herded cattle service involving a free seating scramble'. Similar to other LCCs, AirAsia does not provide any additional services on-board that are included in the price. Instead, food, drink and AirAsia branded merchandise may be purchased onboard. Their approach is typically described by the company itself as 'Low Fare, No Frills, High Frequency' (AirAsia Annual Report 2005, p. 8).

Another innovation pioneered by AirAsia due to the industry and regulatory circumstances it faces in South East Asia, has been the strategy labeled as 'Branchizing'. 'Branchizing' has involved AirAsia establishing low-cost airlines using its brand in Thailand and Indonesia. These are joint venture companies with AirAsia holding 49% of the equity in these operations. However, the companies also pay management fees to AirAsia for the use of its brand and systems. As explained by interviewee A, this method of expansion has proved useful since the regulatory regimes of Indonesia and Thailand make it easier to establish new enterprises with some local ownership. Moreover, it has enabled AirAsia to secure air travel freedoms that it would otherwise struggle to obtain. In November of 2003, AirAsia established Thai AirAsia with Shin Corporation (the family company of former Prime Minister of Thailand, Thaksin Shinawatra) with the latter holding 50% of the company's equity (which was later taken over by a registered Thai company, Asia Aviation). According to Wang and Ricart (2005, p. 3), within its first five months Thai AirAsia had carried more than 380,000 passengers.

However, it has not been the commercial success AirAsia had hoped for. In its Annual Report 2005, the company states that it was previously forecast that Thai AirAsia would contribute RM14 million to the Group's profit, but in the financial year to 30 June 2005, AirAsia had to equity account RM5.3 million in losses. The company explained that Thai AirAsia's poor performance was due to domestic competition in Thailand and softer air travel demand as a result of the Asian tsunami, earthquakes off Sumatra and civil unrest in southern Thailand (AirAsia Annual Report 2005, p. 51). In Indonesia, AirAsia has followed a similar strategy to its Thai venture by acquiring 49% of PT AWAIR International – an Indonesian airline that had suspended services in 2002 (Wang and Ricart 2005, p. 14). Together with its Indonesian joint venture partners, AirAsia operates an LCC from a hub at Soekarno-Hatta (Wang and Ricart 2005, p. 14). The ultimate objective of these joint venture arrangements was to position AirAsia as a major ASEAN brand.

AirAsia's business strategy seeks a targeted growth rate of 25% to 30% per annum and according to Interviewee A, the CEO is always seeking new ways to build revenue by seeking diversification of the products. As he explained:

This is where Tony goes into related and sometimes unrelated areas to get the revenue. For instance he has set up 'snackattack' – an inhouse catering department. Typically cheap meals. And then he has 'GoHolidays' which is related – a strategic business unit. Now he is planning to buy a hotel – there are so many cheap hotels you can get. These are the kind of activities he creates – for instance Stelios from easyJet started easyCruise. This is the game plan they do. The idea is you create the enthusiasm, you create the journalism... otherwise reporting of the company can be very dull.

Aside from venturing into related and sometimes unrelated services, AirAsia seeks growth through increasing frequencies on existing routes and through the establishment of new routes and hubs. Additionally, it relies on its 'branchizing' strategy to expand its operations.

These strategies, on balance, have proved highly successful as the company's financial results in Table 4 indicate. Revenue at AirAsia has climbed from RM167.7 million (US\$45.5 million) in 2001 to RM666 million (US\$181 million) in 2005. Net income in the same period rose from a loss of RM19.1 million (US\$5.2 million loss) to a profit of RM111.6 million (US\$30.32 million).

In 2003, the company sold 26% of the airline for US\$26 million to three partners (IDB Infrastructure Fund LP, Crescent Venture Partners and Deucalion Capital II Limited) to fund its further expansion. In November 2004 it raised a further RM717 million (US\$195

Table 4. Financial results of AirAsia 2001–2005.

| <i>(in RM million)</i>    | <i>For year<br/>ending<br/>31 March 2001</i> | <i>For the 15<br/>months ending<br/>30 June 2002</i> | <i>2003</i> | <i>2004</i> | <i>2005</i> |
|---------------------------|----------------------------------------------|------------------------------------------------------|-------------|-------------|-------------|
| Revenue                   | 167.7                                        | 217.4                                                | 330.0       | 392.7       | 666.0       |
| Total expenses            | 182.3                                        | 218.7                                                | 318.5       | 332.1       | 532.6       |
| EBITDAR                   | 58.9                                         | 75.3                                                 | 94.8        | 116.4       | 220.4       |
| EBIT                      | (14.6)                                       | (1.3)                                                | 11.5        | 60.6        | 133.4       |
| Associates' contributions | 0.0                                          | 0.0                                                  | 0.0         | (0.1)       | (5.4)       |
| Profit before tax         | (19.1)                                       | (1.6)                                                | 11.5        | 58.1        | 125.4       |
| Tax                       | (0.0)                                        | (0.1)                                                | 7.4         | (9.1)       | (14.3)      |
| Net income                | (19.1)                                       | (1.7)                                                | 18.8        | 49.1        | 111.6       |

Source: AirAsia Annual Report (2005, p. 3).

million) through an initial public offering. This was slightly less than the US\$200 million it had hoped to raise.

### ***Branding and marketing***

In South East Asia, AirAsia has become a significant and widely recognized brand thanks to extensive marketing and a charismatic leader – both of which demonstrate the influence of Ryanair and, to a lesser extent, easyJet. AirAsia's chili red livery and slogan 'Now everyone can fly' have become successful marketing icons in South East Asia. While the bright red livery and branding evokes the colour scheme deployed by Sir Richard Branson's Virgin airlines, Interviewee A remarked that Tony Fernandes's leadership style most resembled Michael O'Leary's:

I don't think he is following Richard Branson at all but he is following Michael O'Leary – you know. Because Michael O'Leary is another real bullshit artist. But you know it's all a colourful game and it's all about appearing in the media as often as you can and creating an image . . . . You know Tony will be in the media saying that he is going to give away 2 million [one-way] tickets free but, you know, how are you going to come back?

An example of the way in which AirAsia uses the charismatic style of its leader to build its brand was offered by Interviewee A who stated that:

When the fuel prices were going up the journalists said 'let's ask Tony Fernandes if he can maintain the low-cost tickets' – he immediately said 'I'm going to drop the fares further' [but] he was not able to do that – he's just all talk. That's what I say there is a lot of BS factor going around. Michael O'Leary, Stelios and Richard Branson you can put in the same group.

AirAsia's marketing strategy exhibits characteristics of a number of other LCCs. The 'giving away' of large numbers of one-way tickets or heavily discounted promotional fares are designed to create an excitement around the company and its activities and to promote the airline through 'word-of-mouth'.

AirAsia also seems to be following some of the marketing strategies of Richard Branson's Virgin airlines (and perhaps the strategies of FSA's more generally in Asia) with the extensive deployment of images of its flight attendants in advertisements. Most typically, AirAsia uses pictures of attractive female flight attendants occasionally with suggestive captions. One such advertisement was used by AirAsia in its efforts to promote the airline in Singapore which featured two smiling AirAsia flight attendants with the caption 'There's a new girl in town and she's twice the fun and half the price' (see Spiess and Waring 2005). The advertisement was clearly aimed at leveraging off the 'Singapore

Girl' icon historically used by Singapore Airlines in its marketing. However, Spiess and Waring (2005) argue that the advertisement demonstrates the airline's deployment of the aesthetic value of its employees and is designed to project a certain brand to its customers. This strategy, they argue has had implications for the type of flight attendant the airline has sought to recruit.

Interviewee A claimed that: 'Cabin crew selection, especially the ladies, must be video taped for final approval. Typically people will go for interviews and after the interviews the people are shortlisted and video-camered.' The aesthetic qualities of AirAsia cabin crew are also marketed to the public through the company's website which, under the link to its cabin crew, states:

no frills, plenty of thrills cabin crew

The ladies dress in chili red AirAsia suits. Perfectly applied makeup. Walk in confidence in fine court shoes. Smell like a garden of roses. The guys are smartly clad. Hair in perfect place. Shoes well-polished and shining. Winning smiles that promise impeccable service. AirAsia's cabin crew are not just good looks. Superior quality comes with the aesthetics, and every crew demonstrates skill and talent in carrying out his/her tasks efficiently.

AirAsia's cabin crew are thinkers too. How else can one conduct games and activities, then joke and laugh about it, and serve with a smile throughout, all onboard a soaring plane? Asia's first and only low fare, no frills airline boasts these good-looking, plenty of thrills and thinking cabin crew! (AirAsia 2006)

These marketing strategies are perhaps not completely dissimilar to those of some other airlines but they appear to have been accentuated at AirAsia.

### ***Route structure, fleet composition, scheduling and reliability***

Like other LCC's, AirAsia began with simple point-to-point routes and a single aircraft type operating primarily from secondary airports. As a general rule of thumb, AirAsia's strategy is to begin with a minimum of four frequencies for each new destination and then build frequencies as demand increases. New hubs are established to facilitate expansion. As the consolidated operating statistics above denote, AirAsia carried just over 610,000 passengers in the 15-month period prior to June 30, 2002 this had grown to almost 4.5 million passengers by 2005. During the same period, fleet size went from two to 27 aircraft. Load factors (calculated by dividing revenue passenger kilometres – RPK by available seat kilometres – ASK) had also improved from 62% to 75% in the same period (see Table 5).

AirAsia also follows the standard LCC model of seeking a high capital utilization rate through the rapid turnaround of aircraft. Typically, the turnaround time for a Boeing 737 or an equivalent aircraft (seating approximately 148 people) is 25 minutes with re-fuelling or 16 minutes without refuelling. Quick gate turnarounds demand significant functional flexibility and cooperative teamwork to be effective (see Gittell 2003). The growth in aircraft utilization is measured by the number of hours the aircraft is utilized per day – in AirAsia's case this figure has grown from 10.1 hours in 2001 to 12.1 by 2005 (see Table 3). Increasing stage length is one way to improve aircraft utilization, due to the time-consuming nature of ground time, but at AirAsia aircraft utilization has improved even while stage lengths have become shorter, suggesting that they have found ways to speed the turnaround process on the ground.

In terms of reliability, AirAsia's published record is impressive. However, according to Interviewee A the published data are rather superficial and open to manipulation such as rescheduling delayed flights so that published statistics do not reveal delays. As with other LCCs, AirAsia does not have a significant problem with lost baggage because of their

Table 5. AirAsia's consolidated operating statistics 2001—2005.

|                                         | <i>For the year<br/>ending<br/>31 March 2001</i> | <i>For the 15<br/>months<br/>ending<br/>30 June 2002</i> | <i>2003</i> | <i>2004</i> | <i>2005</i> |
|-----------------------------------------|--------------------------------------------------|----------------------------------------------------------|-------------|-------------|-------------|
| Passengers carried                      | 290,687                                          | 610,738                                                  | 1,481,097   | 2,838,822   | 4,414,069   |
| RPK (million)                           | 363                                              | 672                                                      | 1,539       | 2,771       | 4,881       |
| ASK (million)                           | 586                                              | 1,018                                                    | 2,086       | 3,592       | 6,525       |
| Load factor (%)                         | 62                                               | 66                                                       | 74          | 77          | 75          |
| Aircraft utilization<br>(hours per day) | 10.1                                             | 11.2                                                     | 12.5        | 12.8        | 12.1        |
| Average fare (RM)                       | 203                                              | 183                                                      | 147         | 131         | 143         |
| Yield revenue per<br>RPK (sen)          | 20.4                                             | 18.4                                                     | 15.1        | 14.2        | 13.6        |
| Cost per ASK                            | 16                                               | 12.8                                                     | 10.9        | 9.4         | 8.3         |
| Yield revenue per RPK<br>(US cent)      | 5.37                                             | 4.84                                                     | 3.97        | 3.74        | 3.59        |
| Cost per ASK (US cent)                  | 4.21                                             | 3.37                                                     | 2.86        | 2.47        | 2.19        |
| Number of stages                        | 3,346                                            | 6,521                                                    | 14,461      | 25,106      | 40,679      |
| Average stage length (km)               | 1,327                                            | 1,128                                                    | 975         | 967         | 1,024       |
| Average fleet size                      | 2                                                | 2.5                                                      | 5.5         | 9.5         | 16.3        |
| Size of fleet at year end               | 2                                                | 3                                                        | 7           | 13          | 19          |
| Size of fleet at year end<br>(Group)    | 2                                                | 3                                                        | 7           | 17          | 27          |
| Number of employees at year<br>end      | 241                                              | 322                                                      | 648         | 1,382       | 2,016       |
| Percentage revenue via<br>internet (%)  | 0                                                | 0                                                        | 29          | 43          | 47          |

Source: AirAsia Annual Report (2005, p. 3).

point-to-point operations. Baggage allowances are less than FSAs but AirAsia has yet to go to the extremes of Ryanair in charging for each item of checked baggage (Ryanair 2006).

AirAsia uses two types of aircraft, which is a departure from the single type model that many LCCs strive to replicate. It uses Boeing 737-300 and Airbus 320 aircraft – the A320 aircraft were first used in late 2005.

### *Human resource management strategy, systems and practices*

The HRM infrastructure of AirAsia is minimalist with a 'hard' focus on cost containment and reduction rather than resource development (see Legge 1995). The airline (like a number of other LCCs) has dismantled the full service carrier model of rigorous selection systems, elaborate training and development high skill, high wage labour management and replaced it with a far leaner functionalist approach to HRM aimed not only at labour cost minimization, but also minimization of the firm's investment in HRM systems and practices. The company's approach to HRM is therefore more consistent with Europe's Ryanair than perhaps any other low-cost airline in its efforts to remain non-union and to pursue low-cost employment policies. HRM at AirAsia is consistent with, and 'fits' the company's successful pursuit of cost leadership in the way that Schuler and Jackson's (1987) theorize the strategic fit between competitive strategies and HR practices. In Schuler and Jackson's (1987) model, HR practices should reinforce and support the

firm's competitive strategy. Drawing upon Michael Porter's generic strategies of differentiation, cost leadership and focus, Schuler and Jackson (1987) demonstrated how the pursuit of a differentiation strategy, for example, might require high wage/high productivity approaches in which the firm would seek to attract, develop and retain high quality and skilled employees (see Boxall and Purcell 2003, p. 53).

AirAsia, by contrast, has specifically under-invested in HRM and maintained less than sophisticated systems and practices while retaining significant managerial prerogatives in a way that is largely supportive of its quest for overall cost leadership in low-cost aviation in Asia. HRM at AirAsia is typically informal, *ad hoc* and low-cost. Interviewee A suggested that the airline has a very 'wishy washy approach to employment where the boss decides most of the time'. Interviewee A further explained that:

They have an HR department but it is very lean and mean. People are not very orientated in HRM – they are what I call 'Human Remains'. There are no policies – many of the positions he [Tony Fernandes] decides and there is no system for pay [levels] or a pay scale because it's all designed by him. So it is very much a coercive setup. If you look at systems of thinking it's very much a prison approach you know.

Interviewee A claimed that the company's minimalist approach to HRM and labour relations is more specifically demonstrated in the number of dismissals that have been contested at AirAsia under Malaysian labour law. Interviewee A claimed that 'I have my connections with the labour department and they say "what's happening at AirAsia because this suit and that suit is being filed?"' AirAsia staff are not made aware of their rights and the airline remains union-free. Indeed, Interviewee A claimed that the word 'union' 'is a dirty five letter word to the CEO himself – he doesn't like to hear it. No effort has ever been initiated by the airline towards unionization'. However, when asked whether there might be a union one day at AirAsia, Interviewee A said, 'Oh, definitely it is building up to that.'

Interviewee A described the culture of AirAsia in fairly bleak terms where there is little trust between management and the workforce and where employees work well beyond the maximum number of hours per week permitted under Malaysian labour law. Remuneration for pilots is comparable with that at Malaysia Airlines although Interviewee A remarked that the company pays less money into employee's provident or pension funds. Moreover, there is no meal allowance for pilots. AirAsia, however, was successful in recruiting formerly retired pilots of MAS as a result of lobbying the Malaysian government to lift the retirement age for pilots. Wages have not changed significantly in the last 5 years. Indeed, Interviewee A remarked:

In the first year of take-over Tony gave staff an annual increment. That was the last so far – none during the last 4 years. I got a 7% increment after the first year but after that we never heard of any more because Tony said we were coming up to listing and fuel prices are on the increase, we are expanding and this is why I say the BS factor comes in a lot. And as Asians we are not the complaining culture unlike the Western people who will come and tell you off. Asians will tell you off behind your back.

Interviewee A claimed that when Tune Air took over AirAsia there was a plan to link remuneration to individual performance but the plan 'lost its heat' after the first year. There is however an annual group profit sharing scheme (a fairly common-place feature of remuneration policies in Malaysia and Singapore). However Interviewee A claimed that AirAsia had suggested that it might not be paid in 2006 because of rising fuel prices. In addition to this scheme, when AirAsia listed on the Main Board of Bursa Malaysia Securities Berhad on November 22, 2004 it established an Employee Share Ownership Scheme where the initial plan at least was to allow employees to purchase discounted

stock up to 5% of the firm's value. Other employment benefits are somewhat similar to the industry average.

In terms of promotion, interviewee A claimed that crew and staff promotions did not take into account seniority as was the case at MAS but rather was at the sole discretion of the CEO.

Beyond technical competency, AirAsia mainly looks for strong communication skills and 'good looks', according to Interviewee A. There is a minimum level of resources invested in hiring because of the high turnover rate the company experiences. According to Interviewee A, hiring policy is often based on 'get them in fast and now'. This would seem to correspond with the growth in staffing levels which have increased at AirAsia almost tenfold since its inception until the end of the financial year in June 2005 from 241 to 2016 employees (AirAsia Annual Report 2005). AirAsia's HR department is mainly, but not always, involved in hiring and there is a minimum of training resources invested in each new hire, according to Interviewee A. Training is only conducted to ensure the new hire has the functional skills required for the job and there is little in the way of training for soft skills such as communication, conflict resolution and other teamwork skills. Nonetheless, in discussing AirAsia's training academy, which was established in June 2005 largely for pilot training purposes, AirAsia's annual report states that 'there are comprehensive training modules to ensure that the AirAsia "culture" is instilled into every employee and to ensure our customer service quality maintains its highest standards' (AirAsia 2005, p. 26).

The model for functional coordination was described as being a 'split-egg' role where 70% of employee time is involved in a functional role and the remaining 30% is spent on situational issues where AirAsia staff are required to 'think on their feet'. This means employees are all expected to 'do what they can' to get the job done. An example of this is during the departure process when flights are delayed. Customer services normally coordinate departures but in the event of delays all employees assist in what Interviewee A described as 'fire-fighting'. However, there are currently no mechanisms in place to support cross-functional flexibility.

Communication at AirAsia tends to be one way only with few channels for employee input. Aside from communicating to staff via email, Interviewee A reported that Tony Fernandes typically organizes a monthly staff forum which is typically catered for at a hotel. Interviewee A described these as 'fun events' designed to motivate staff but without any genuine attempt to seek out the views and suggestions of staff.

At AirAsia there is no systematic or formalized conflict resolution policy or procedures and Interviewee A remarked that AirAsia:

is not the big happy family that Tony talks about. You see you must understand that Tony is very Western so you have candiness and frankness. In the Asian culture no way is someone going to tell their boss 'hey you are an idiot' and so forth – they will tell others. So what kind of happy family are we talking about?

Consistent with staff reluctance to confront and complain, is Tony Fernandes's observation (reported in a published interview with the *Wall St Journal Asia*, 2006) that his biggest challenge is:

To get people to think. At AirAsia, we want 4000 brains working for us. My biggest challenge is to get people to talk, to express themselves, to get people to challenge me and say 'Tony, you're talking rubbish'. That's what I want, not people who say 'Yes, sir'. The senior management doesn't have all the answers. I want the guy on the ramp to have the confidence to tell me what's wrong.

AirAsia's corporate culture is infused with an obsessive focus on cost minimization and its weak HRM systems and practices across the functional areas of recruitment and selection, payment systems, training and development, communication and participation both reflect and 'fit' low-cost employment policies. Employee motivation and turnover, however, have perhaps not been as adversely affected by as they might otherwise be by this impoverished approach to HRM as a consequence of the airline's marketing efforts which emphasise glamour and excitement, and the airline's growth which has proved extraordinary.

The airline's marketing (described above), in which female flight attendants regularly feature, emphasize fun, glamour and an overt sexuality which some AirAsia staff may seek to identify with (see Spiess and Waring 2005). Moreover, the airline has offered its employees, if nothing else, a chance to be employed in a fast moving, ever-expanding firm that is regularly featured in the media. This may, to some extent, ameliorate the otherwise 'bleak house' approach to HRM that AirAsia seems to have settled on.

### **Conclusions: AirAsia – is cost leadership sustainable?**

AirAsia's remarkable success since it was taken over by Tune Air in 2001 was recognized on March 16, 2006, when the Malaysian government awarded the company the right to service all of the domestic trunk and non-trunk routes in Malaysia (*The Edge Financial Daily* 2006). This was a significant step for the Malaysian government to take in recognizing that Malaysian Airlines was perhaps not the most appropriate airline to service these routes. As a consequence Malaysian Airlines has been forced to restructure its operations and lay-off staff at the same time as AirAsia has continued to grow and significantly expand its fleet. New hubs have been established in Sabah and Sarawak while AirAsia has also established a small regional airline (Fly Asian Xpress) using turbo-prop aircraft to service short destinations in East Malaysia.

Aside from skillful application of the LCC model, AirAsia's dramatic growth can be explained by its first-mover advantage and entry into a domestic marketplace where there was only one (somewhat inefficient) FSA serving a growing market. This combined with the company's ruthless and enduring focus on cost leadership has led to the impressive growth in the airline's scale and reach in South East Asia. The company's 'branchizing' strategy has also been instrumental in accessing new markets in the region and circumventing restricted air freedoms.

Thus Air Asia has successfully exploited the favourable conditions in Malaysia and South East Asia more generally for an LCC to succeed and to grow rapidly within the region. Interviewee A, however, questioned whether its profitability and growth trajectory would be sustainable over the longer term without the company changing significantly. He explained that: 'What I said to Tony before I left was "Buddy, you have created something fantastic but the question is how long are you going to sustain it?"'

The sustainability of the company may well be undermined in the future by AirAsia's rather *ad hoc* and poorly conceived HRM practices. The Malaysian culture of not wishing to complain and the unwillingness to be direct, coupled with the company's astonishing growth has kept a lid on employee grievances (though these have occasionally bubbled over). However, with the growing complexity of AirAsia's operations, more formalized and sophisticated HRM systems and practices may be crucial. The current under-investment in human resource management (particularly training) poses significant risks for the company not simply from litigation and prosecution but in sustaining employee commitment and cooperation.

A common feature of low-cost carriers is their adherence to a relatively simple set of business practices – single aircraft type, point to point travel, no or few onboard services and so on. Yet AirAsia has drifted away from this level of simplicity in its search for growth. Its strategy of creating hubs and expanding its operations through joint venture arrangements has been successful so far and it seems likely that the company will expand further. The airline has dormant subsidiary companies in Hong Kong and Singapore which could be activated in the future (AirAsia Annual Report 2005) and Fernandes has suggested that he would like to expand AirAsia's operations to India – initially beginning with flights from Malaysia to India (Wang and Ricart 2005, p. 15).

In August 2006, the Singaporean and Malaysian governments touted the strong possibility of moving to open up the Kuala Lumpur–Singapore route to competition. Historically this route has been closed to shuttles run by Malaysian Airlines and Singapore Airlines. After the announcement, AirAsia issued a press release stating that it would be interested in flying the route if granted access. In a further announcement in January 2007, Tony Fernandes reported to media that AirAsia and the related Malaysian regional carrier, Fly Asian Express (FAX) (of which Tony Fernandes is the majority shareholder) would be offering long haul, low-cost flights from Kuala Lumpur to destinations in China, India and Europe from July 2007 (BBC News 2007). The strategy represents a significant break from the traditional LCC model of short haul only travel and a substantial re-scaling of the AirAsia brand.

These initiatives are designed to generate growth and revenue but they also significantly add to the level of operational complexity. Greater levels of business complexity will mean that AirAsia's management will face increased coordination problems in the future, which in our view may only be adequately addressed through increased investment in the airline's staff.

## Note

1. *The Business Times* (a Singaporean business publication) reported in 2005 that AirAsia, Tiger Air and Jetstar Asia would have to rationalize their operations due to over-capacity.

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