



## Do dedicated low-cost passenger terminals create competitive advantages for airports?

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### ABSTRACT

Traditionally designed for network carrier operations, airports are increasingly diversifying their services with new facilities being developed, specifically, to attract and accommodate low-cost carriers. In order to reflect the changing environment, some airports have built low-cost terminal facilities (or refurbished existing ones) for low-cost carriers. Applying a resource-based view, namely the VRIO framework (VRIO is an acronym for Value, Rarity, Imitability and Organisation), this paper analyses the potential of dedicated low-cost terminals in affecting the competitive positioning of airports. The research investigates for selected airports the potential benefits associated with the development of low cost passenger terminals and the factors which may help turning these benefits into a (sustainable) comparative advantage. It is argued that low-cost terminals offer a temporary competitive advantage which has so far not often been exploited.

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### 1. Introduction

As much as the airline industry has been transformed by liberalisation, which began in the US in 1978 with the Airline Deregulation Act, the airport business model too has undergone dramatic changes – some of them emanating from airlines. Prior to deregulation of aviation in Europe virtually all airports and airlines were owned by a local, regional or national government and run as public utilities. They were thus somewhat insulated from competition. Moreover, aircraft and passenger handling were the core competencies of airports and concerning revenue generation the emphasis was on the aeronautical business. However, with the deregulation of the intra-European travel markets, the final phase of which was completed in 1997, low-cost carriers (LCCs) took off and airports that previously serviced only network carriers (NCs) were now servicing LCCs as well (Barrett, 2004). The European LCC market has expanded in recent years and it seems likely that the trend will continue. These new airport clients have been reluctant to use existing facilities and have shown preferences for customised products that optimally fulfil their requirements.

Privatisation and commercialisation of airports combined with a slowly intensifying competition among airports have made airport management more profit orientated. As Graham (2010) acknowledges, airport owners and managers now need to develop strategies

to gain and sustain competitive advantages. In order to differentiate their positioning, some airports have developed dedicated low-cost terminals (LCTs), which is the removal of non-essential features to make the terminal more cost-effective and therefore consistent with the needs of low-cost carriers. The key objective of LCTs is to provide a minimalistic and efficient terminal facility at a reasonable price. This is achieved by cutting the non-core travel services to allow lower cost structures which in turn allow airports to charge LCCs low prices. The key question is whether this business strategy might create competitive advantage for airports pursuing it.

- Does the provision of low-cost terminals have any significant influence on airport profitability?
- What are the risks inherent in this strategy? Moreover, are dedicated low-cost terminals a successful solution model to the turbulent aviation environment?

The remainder of this paper is organised as follows. Following the **Introduction**, a short overview of the role and recent developments in airport terminals is presented in **Section 2**, and thereafter we describe the VRIO framework in **Section 3**. This is followed by an examination of the strengths and weaknesses of dedicated LCTs using the VRIO and Porter frameworks in **Section 4**. The paper offers three case studies in **Section 5** and discusses some managerial implications of dedicated LCTs for airports in **Section 6**.

### 2. Terminal developments

This section offers a short description of the role of the airport passenger terminal and shows how it has been affected by the

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emergence of LCCs. The airport passenger terminal constitutes one of the main elements of the infrastructure cost of an airport and can be defined as a building which facilitates connectivity between airside and landside access and where a complex interaction between airport operators, airline companies and passengers takes place.

The airport business has often been characterised by investments in expensive facilities which appear to be unsuitable for the needs and specific requirements of LCCs. Most modern airport terminals have been designed for maximum convenience and comfort, whereby high standards, expensive materials and sometimes architectural monuments are applied with the aim of delivering a prestigious image to represent the culture of the region or country. Such developments are associated with higher costs such as capital investment, operating and maintenance costs. Thus, some designs have little to do with the function the terminal is intended to achieve (Ashford & Wright, 1992). The incentives for over-investment may be attributed to the method used to regulate airports. In this sense, Niemeier (2009) argues that cost-based regulation is a major cause of the poor performance of airports, in that it results in incentives for gold-plating, high costs and high charges for airlines and passengers.

In today's airport business, two main terminal types can be distinguished, namely, traditional terminals and low-cost terminals. Whereas the traditional terminal can be defined as a terminal designed to process the flights and passengers associated with the operation of NCs with full service facilities, the low cost terminal can be thought of as an airport terminal that has been developed with low capital investment cost and with the aim of reducing costs and increasing efficiency.

The difference between the requirements of low cost carriers and those of NCs for terminal facilities (Echevarne, 2008; Mclay & Reynolds-Feighan, 2006) as well as the implications of the low cost-carriers' business model for airports (Barrett, 2004; Francis, Humphreys, & Ison, 2004) is well documented. LCCs usually avoid expenditures on services that are not strictly necessary for the provision of the core air transport product, such as the use of air bridges or escalators, the need for transfer and complex systems of the NCs. With regard to the implications for airports, Barrett (2004) argues that low cost and smaller secondary airports (i.e. those accommodating 0.5–5 million annual passengers) have been greatest beneficiaries of low-cost carriers' growth over the last two decades. LCCs triggered new demand and even shifted traffic away from congested airports to regional airports.

### 3. Theoretical framework

Looking back 20 years, the major source of competitive advantage stemmed from a firm's relative position in an industry (Porter, 1985). According to Porter, a firm can only be profitable by following one of two strategies: (1) cost leadership or (2) product differentiation.

*“Competitive advantage fundamentally grows out of the value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Value is what buyers are willing to pay, and superior value stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price.”* – Michael Porter, *Competitive Advantage*, 1985, p. 3

Following Porter's argument, a firm is said to have competitive advantage when it implements a strategy that creates value. Porter's emphasis on industry structure has been criticised for being too static and therefore not appropriate in today's more dynamic business environment. During the 1990s the emphasis in seeking the source of competitive advantage shifted toward internal factors attributing competitive advantage to the ownership of valuable resources. The possession of rare, unique and non-imitable resources is viewed by many as the source of competitive advantage at the firm level (Barney,

1991; Grant, 1991; Peteraf, 1993).<sup>2</sup> Resources and capabilities may include tangible assets, intangible assets and skills.

In this context, providing tailored infrastructure, such as dedicated LCTs seems to be a source of competitive advantage because the ability to develop and exploit dedicated terminals can be marketed as a differentiating and distinctive capability that provides customers with superior value. In fact, dedicated products respond to particular requirements and customers pay only for the products that satisfy their needs.

Barney (1991) offers a series of four tests for a valuable resource referred to as the Value, Rarity, Imitability and Organisation (VRIO) framework. The framework combines the internal and external perspectives on strategy. He points out that in order to lead to a sustainable competitive advantage, a resource or capability should meet the following criteria: (1) It must be valuable: that is, it enables its owners to increase revenue, decrease costs or exploit an opportunity. (2) It must be rare: that is, it is not widely possessed or controlled by other competitors. (3) It must be costly to imitate: do firms without a resource face a cost disadvantage in acquiring it or in offering a substitute in its place? (4) The firm must be organised to exploit its resources or capabilities.<sup>3</sup> In other words, the firm must be able to support the exploitation of its valuable, rare, and costly-to-imitate resources.

The listed criteria can be brought together into a single framework to understand the return potential associated with exploiting any firm's resources or capabilities (this is done in Table 1). If a resource controlled by a firm is not valuable, it will not enable a firm to choose or implement strategies that exploit external opportunities or neutralise environmental threats. Organising to exploit this resource will increase a firm's cost or decrease its revenues. If a resource is valuable but not rare, its exploitation and implementation will generate competitive parity. If a resource is valuable and rare but not costly to imitate, exploiting this resource will create a temporary comparative advantage. If a resource or capability is valuable, rare and costly to imitate, exploiting it will generate a sustained competitive advantage.

### 4. Application to dedicated low cost carrier terminals

This section discusses the strengths and weaknesses of dedicated LCTs by applying the VRIO framework. The discussion is based on evidence from a literature review.

#### 4.1. Internal – VRIO analysis

##### 4.1.1. The question of value

The question of value creation depends on the strength of the different factors, namely by how much costs can be reduced by building an LCT instead of a traditional terminal, by how much the charges must be lowered to attract LCC and by how much non-aeronautical revenues are generated.<sup>4</sup> The airport therefore enters the lower end of a demand curve by building an LCT served by an LCC. This part of the demand curve cannot be profitable if served by NCs

<sup>2</sup> A considerable amount of literature has been published on resource-based theory. Penrose (1959), Wernerfelt (1984, 1995), Collis and Montgomery (1995), and Kor and Mahoney (2000), for example, argues that a firm's performance is the function of its productive resources. Rumelt (1984) explains firm's performance in terms of isolating mechanisms. Selected empirical studies on the linkages between resources, strategy and performance include Zajac, Kraatz, and Bresser (2000), Kraatz and Zajac (2001), and Kor and Mahoney (2005).

<sup>3</sup> The components of a firm's organisation include the formal reporting structure, management control systems, informal management controls and compensation policies.

<sup>4</sup> It should also be noted that the airport gains also by reaping economies of density for example by a higher utilisation of the take-off and landing system. We have not analysed these rather complex effects which have not been extensively studied at all. See Tovar and Martin Cejas (2009) and Chow and Fung (2009).

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