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The carrier-within-a-carrier strategy: An analysis of Jetstar

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ABSTRACT

The carrier-within-a-carrier (CWC)—or "airline-within-an-airline" (AWA)—approach has become an integral part of many airlines' marketing strategies in the Asia–Pacific region where several full-service national airlines operate low-cost/low-fare subsidiary airlines. The CWC approach is a response to competition from low-cost carriers based on product differentiation, i.e., a 'two brands' business strategy aimed at defending market share. Most CWCs were established after 2001 as a response to deregulation and liberalization and generally adhere to the principals of low-cost/low-fare carriers. Typically, CWCs enter markets through new, point-to-point services and operate short-haul routes (one-to 2-h flying times) that might have been abandoned by full-service airlines (FSAs), whereas at other times they simply compete directly with FSAs on price. This paper analyses Jetstar, a subsidiary of Qantas, which has transitioned from a domestic CWC to an international medium- and long-haul carrier. In addition to its domestic Australian operations, Jetstar operates between Australia and the Asia–Pacific region and has established partnership arrangements operating within Asia, including Jetstar Asia (based in Singapore), Jetstar Vietnam and Jetstar Japan. Jetstar also has operations in New Zealand. The theoretical framework applied in this paper is based on the strategic windows concept, in which opportunities arise and a window opens, and Tregoe and Zimmerman's (1980) 'driving forces' model, in which nine attributes are listed and certain of these are exemplified by Qantas' strategy. The methodology adopts a case study approach that draws upon content analysis and 'events in the making' and features interviews with key respondents. The findings show that Jetstar disproved earlier criticism of the CWC strategy and further demonstrate that by careful planning, strategy and execution, Jetstar has been able to grow its capacity, maintain high load factors, increase revenue and (more importantly) increase profitability at a time when many airlines are consolidating or withdrawing services because of losses.

1. Introduction

Global aviation has been reshaped by powerful forces, including deregulation, liberalization, open-sky policies, the Internet, a rising middle class in many Asian societies with the desire to travel, modern fuel-efficient aircraft, new business models and more liberal collective bargaining agreements among low-cost airlines, unions and employees. The emergence of low-cost carriers (LCCs) is now well established in nearly all aviation markets (Gross and Lück, 2013); these LCCs typically operate as variants derived from the pioneering Southwest Airlines (USA) and Ireland-based Ryanair, which in 2009 was Europe's largest airline in terms of passenger numbers and market capitalization (Ryanair, 2009). The Centre for Asia Pacific Aviation Studies (CAPA, 2005) identified five key features that have attributable to the growth of low-cost carriers in aviation markets:

1. Rapid demographic and economic progress in many countries;
2. Current aviation market opportunities (and threats to the survival of conventional models);
3. Congested, high-cost hub airports alongside underutilized regional airports and growing difficulties in raising capital for new infrastructure;
4. Broader government policy objectives to stimulate tourism and trade outside of capital cities; and
5. Opportunities for soft liberalization that allow international access to smaller airports behind national gateways with limited risk to national flag carriers.

The aim of this paper is to analyze the Qantas/Jetstar growth strategy with particular emphasis on Tregoe and Zimmerman

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(1980) 'driving forces' model, in which nine attributes are listed and certain of these are exemplified by Qantas' strategy. In particular, this paper focuses on how these driving forces have contributed to Jetstar's performance in terms of profitability. Qantas is currently in the midst of a transformation strategy that includes discontinuing loss-making routes and efforts to better position Jetstar in Asia. The Qantas Group is under intense competitive pressure in all the markets in which it competes and announced an underlying pre-tax loss of AUD $252 million for the half-year ending 31 December 2013, which represents its worst fiscal performance since the airline was privatized in 1994 (Taylor, 2013). This performance has led the Australian Parliament to discuss a possible change in the Qantas Sales Act 1992, including the possibility of increasing foreign ownership.

The structure of the paper is as follows. The literature review discusses the limited number of studies of the carrier-within-a-carrier (CWC)—or "airline-within-an-airline" (AWA)—approach, in which researchers have identified the difficulties involved in establishing two separate airlines on different business platforms that share the same parent airline. The method adopted in this research is a case study approach that employs content analysis and data from newspaper articles, aviation publications and Qantas' semi-annual and annual reports. Semi-structured interviews were also carried out with Qantas' CFO and a director from the CAPA – Center for Aviation. The case study developed in this research describes Jetstar's route expansion, its rapid growth and market extension into Asia and its financial results. However, the study has several limitations, such as the difficulty of dissecting Jetstar's different operations, which are aggregated for reporting purposes.

2. Carriers-within-carriers (CWCs)

Several researchers have questioned whether full-service airlines (FSAs) might create distinct business streams on a single integrated production platform. Lindstadt and Fauser (2004) and Gillen and Gados (2008) assess the problems associated with mixing business models and suggest that AWAs use different operating parameters requiring a different type of culture that eventually results in a poor strategic fit with the parent airline's business model. Graham and Vowles (2006) posit that CWCs represent a strategic response to the growth of low-cost airlines that had tapped into the price-conscious leisure market. Several airlines that previously established subsidiary airlines have now reabsorbed those subsidiaries and created an 'economy lite' product that offers a certain number of seats on specific flights 'down the back' that require payment for food, refreshments and in-flight entertainment.

The emergence of low-cost/low-fare airlines is now well established in diverse aviation markets, including South America, Asia, North America and Mexico, the Middle East, Europe and Africa. These airlines operate idiosyncratically, that is, each airline adapting to its own markets and characteristics. Moreover, the CWC strategy has become increasingly popular in the Asia–Pacific region, in which up to 12 airlines are subsidiaries of parent airlines (Gross and Lück, 2013). This development has occurred in response to what CAPA (2012) described as 'soft' liberalization.

The low-cost airline industry, which accounts for 17% of global airline passenger traffic (IATA, 2013), has been described as a concept, as a phenomenon and as a business strategy. Jarach (2004, p.24) discusses the 'low-cost phenomenon' by contrasting the operating environment and outcomes between what he termed "LCCs on the attack and national airlines on the defence" and defined LCCs as having a "simplified value proposition to a wider market potential". Alamdari and Fagan (2005) acknowledge LCCs as a concept but then more fully describe the sector as an evolved business model that is being reworked and adapted to suit various types of operating environments in different markets. Moreover, these and other authors have observed that the original low-cost model has been modified over the years and that LCCs were tending to follow a product differentiation strategy as opposed to the cost leadership principles on which the original model was based (Hansson et al., 2003; Daft and Albers, 2013). A number of 'hybrid' low-cost models now operate in different markets in which CWCs also operate, which suggests that the LCC business model is not static but shifts according to the dictates of market and financial conditions (Lohmann and Koo, 2013). Jarach (2004, p.25) noted that low-cost airlines act as "flexible, dynamic and innovative players, eroding the advantages of network carriers". Alternatively, the CWC strategy might also be considered market cannibalization because passengers sometimes take advantage of a lower fare by switching from a parent airline to its subsidiary.

The CWC concept is used by more than 20 of the world's leading airlines, and approximately 58% of the world's CWCs are based in the Asia-Pacific region (Pearson and Merkert, 2014). However, the rise of the CWC strategy has received little academic attention. Pearson and Merkert (2014) provide a synopsis of past CWCs and, more importantly, evaluate the performance of CWCs presently operating in Europe, Asia and South Africa. Their study emphasized four key areas that contribute to the success or failure of a CWC: (1) ill-defined strategies and the need for decisive leadership, (2) late market entrance and the need to achieve market dominance, (3) excessive management control and insufficient dissimilarity from the parent airline, and (4) higher costs and less efficiency vis-à-vis LCCs. This synopsis compared the CWCs' yields (cents per seat kilometer earned) and load factors with those of their parent airlines. However, these measures do not assess profitability or return on capital.

With respect to Qantas, the case that is the subject of this study, its strategy exemplifies what Stahl and Grigsby (1997) define in the strategic management literature as a pattern or apparent behavior that emerges from a series of actions, i.e., a position or match between an organization and a product-market area, such as a product differentiation strategy. The Qantas Group complies with Stahl and Grigsby (1997) product-market area and product differentiation strategy in which one airline—Jetstar—covers the diverse market with a variety of airline products and routes that reflect different service levels (Homsombat et al., 2014). More specifically, Tregoe and Zimmerman (1980) established a framework for strategy and nine possible 'driving forces' (i.e., products offered, market needs, technology, production capability, method of sale, method of distribution, natural resources, size and growth, and return and profit) in this framework, although they urged executives to base their strategic decisions on a single 'driving force'. However, as opposed to having one dominant driving force, as suggested by Tregoe and Zimmerman (1980), strengths are required across a diverse number of driving forces to compete effectively. Mintzberg (1994) argues that strategy emerges over time as intentions collide with and accommodate changing realities. One might start with a perspective and conclude that it calls for a certain position, which is to be achieved by way of a carefully crafted plan, with an eventual outcome and strategy reflected in a pattern that is evident in decisions and actions over time. This pattern in decisions and actions defines what Mintzberg (1994) called 'realized' or emergent strategy. A plan is crafted (e.g., segment routes according to the predominant type of traffic and lower unit operating costs), and the outcome is determined over time through revenue and profit growth, route expansion and a focus on cost reduction strategies.

The 'planned approach' emphasizes a long-term, highly systematic and deterministic process of strategic planning that aims to