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The rise of the Arabian Gulf carriers: An insight into the business model of Emirates Airline

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ABSTRACT

Middle Eastern airlines are changing the dynamics of international aviation as Emirates, Qatar Airways and Etihad Airways are quickly emerging as the new global challengers. The region's airports are also undergoing a rapid transformation to remain in line with the exponential traffic growth that is forecast. This paper examines the relentless growth of Emirates, and investigates the various strategies that underpin its core competencies, which are responsible for its 20 years of consecutive profitability. The paper establishes that the underlying formula for Emirates' success is largely attributed to its hub and spoke operation, competitive cost structure and the strong leverage of its brand.

1. Introduction

Over recent years, there has been a major shift in the global air transport market as the Middle East's carriers, and in particular Arabian Gulf based airlines, have altered the way traffic flows are being routed. In 2008, passenger growth rates (in terms of RPKs) for the Middle East were 7% – more than four times the global average. The Gulf based carriers are largely responsible for this growth and have capitalised on their geographical centricity by cannibalising the traditional traffic flows between Asian and European hubs, and by connecting secondary cities as a result of exercising their sixth freedom traffic rights. It is estimated that around 4.5 billion people reside within an 8-hour flight of the Middle East, providing the potential for a large part of the world's population to connect through a single stop. Emirates Airline is the dominant carrier, although Qatar Airways and Etihad Airways, combined, are roughly 70% of its size.

2. The rise of the Gulf carriers and the region's airports

Emirates, Etihad Airways and Qatar Airways are three of the fastest growing full service airlines in the world. Fig. 1 shows the meteoric increase in seat capacity across the different regions of the world for these three carriers. It shows that the seat capacity that has been deployed by the big three Middle East carriers to Europe, Asia and Australasia has increased four fold over the period 2002 to 2008, despite many of these markets having restrictive bilateral air service agreements constraining an airline's ability to grow. Within the Middle East alone, they have extended their capacity from 4.7 million seats in 2002 to 13 million in 2008. Collectively, Emirates, Etihad Airways and Qatar Airways transported around 44% of the traffic carried by the 24 members of the Arab Air Carriers Organization in 2007. They show no signs of cutting back on their services and are forecast to increase capacity by more than 15% per annum over the next five years. The Gulf based carriers have formulated their success on the following attributes: moving sixth freedom traffic through their respective hubs; by offering high quality in-flight products; and by stimulating passengers to travel with them because of their continuous brand awareness campaigns. They are beginning to set the new benchmark for airline standards.

The Arabian Gulf has formulated a master plan to prepare for the post-oil era by diversifying the region's industrial base, with aviation being an important contributor. The development of a mega-hub in the Gulf is seen as affecting: industrial development; the positioning of corporate headquarters; growth of light manufacturing; hosting of international conferences and trade shows; increased tourism receipts; and growth of a logistics and distribution hub.[1] Emirates turnover is almost 20% of Dubai's GDP, and the airline is regarded as the embodiment of Dubai's rapid rise to international prominence.

The Arabian Gulf airlines forecast that traffic will continue to grow at their hubs over the next few decades and, in anticipation, they have invested heavily by procuring large numbers of aircraft while the local governments are synchronously developing the

[1] Swan (2006) finds that integrating cities into global trade markets has a large positive impact on the economic prosperity of that city, which is the underlying formula that underpins the prolific growth of Dubai.

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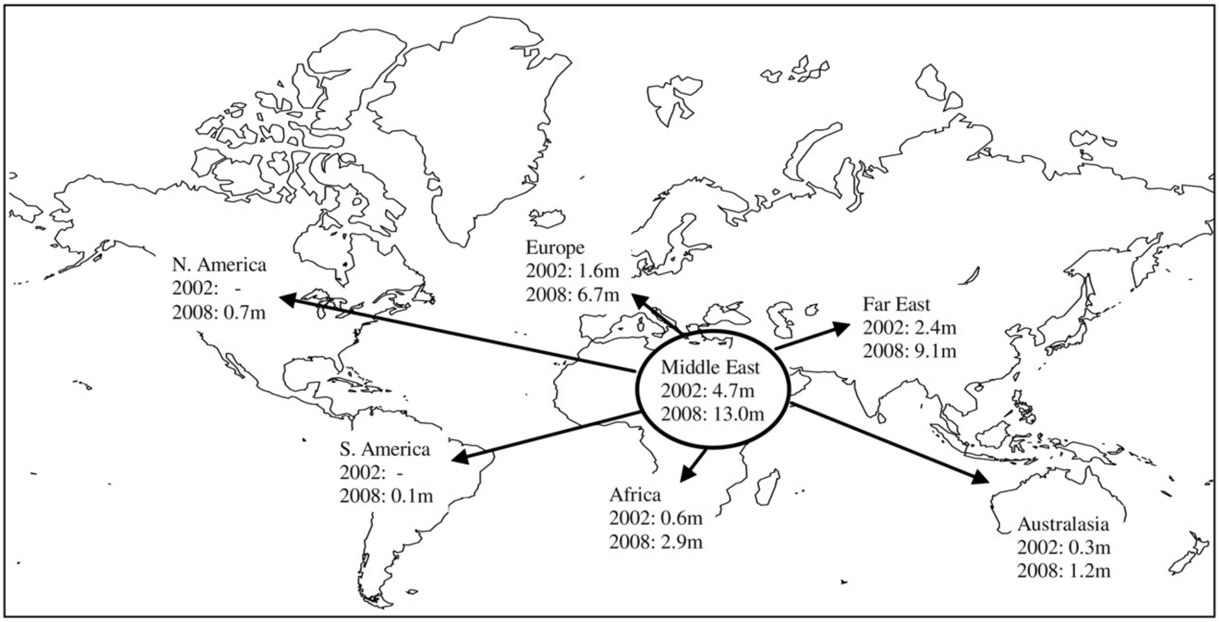

Fig. 1. Regional distribution of seat capacity departing from the Middle East for Emirates, Etihad Airways and Qatar Airways. Source: Analysis from Official Airline Guide Airline Schedule for 2002 and 2008.

region's airports. Fig. 2 compares the number of wide-body aircraft seats on order in mid 2008, illustrating Emirates', Etihad Airways' and Qatar Airways' potential dominance in offering long-haul seat capacity by Middle East based carriers. The big three have 57% more long-haul seat capacity on order than the 35 member carriers of the Association of European Airlines (AEA) and 27% more than the 17 member airlines of the Association of Asia Pacific Airlines (AAPA).

The rapid increase in airline seat capacity will be synchronously catered for by a similar growth in airport capacity, as Governments in the region are also developing the airport infrastructure (Table 1) which will eliminate any air traffic bottlenecks over the coming years. Much of the investment is earmarked for expanding existing facilities, but six new airports are also being built; one, known as Dubai World Central, is set to become the world's largest airport, comparable in passenger numbers to the combined size of Chicago O'Hare, New York JFK and Los Angeles International, handling 160 million passengers per year when fully operational. It will have five parallel runways, allowing four aircraft to land simultaneously, 24 hours a day. The cargo facility is intended to handle 12 million tons per year – three times that of Memphis International Airport,

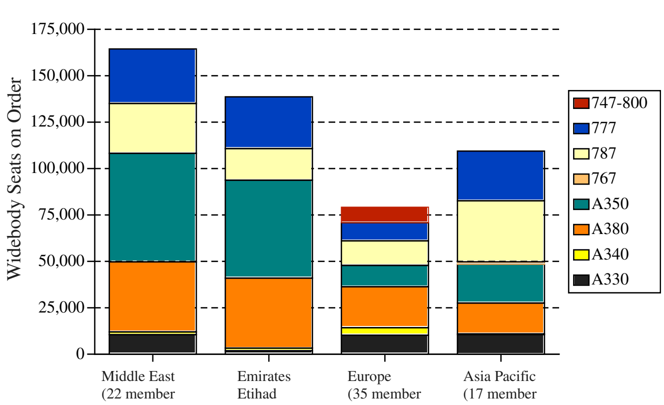

Fig. 2. Wide-body seats on order for Middle East, Europe and Asia Pacific (July 2008 data). Source: Analysis from ACAS data.

today's largest cargo hub. Dubai has also invested $4.5 billion in a new terminal at Dubai International, which is earmarked exclusively for Emirates, where the incumbent currently has almost 58% of the seat capacity, followed by the Air India conglomerate of Air India/Indian Airlines/Air India Express with 3.3%. Some 80 km along the coast, Abu Dhabi is investing $6.8 billion in the expansion of its airport to meet the growing demand generated by Etihad Airways, whose passenger numbers reached around 6 million passengers in 2008, and it accounts for almost 70% of the airport's seat capacity. In Qatar, a new airport is being built, designed specifically to accommodate the A380, suggesting that Qatar Airways may order additional units in the future. The incumbent presently provides 77% of the seat capacity at Doha airport, followed by Emirates with just 5%.

3. Emirates' growth

Emirates Airline is completely owned by the government of Dubai and operates in a tax free environment with no legacy costs. It has been profitable for the last 20 years, and by 2007/08, had become the world's fifth most profitable airline with net profits of $843 million. It had one of the highest operating margins of full service airlines, earning 11.6% in 2007/08 (Emirates Financial Statistics, 2007/08). In 2008, its traffic increased faster than its ability to add capacity, which resulted in its passenger load factor rising by 3.6% to an impressive 80%. By mid 2008, Emirates was operating an all wide-body fleet of 109 aircraft with a further 195 on order. It buys large blocks of capacity from both Boeing and Airbus to leverage the list price of aircraft when purchasing. It was also an early buyer of new generation aircraft, whose new technology and unproven economics creates risk, but as Bloomberg (2007) pointed out, early buyers of the A380 received as much as a 40% discount, with additional discounts being given for bulk orders.

Emirates' push to expand its territorial advantage is evident from Table 2. International liberalisation across global markets is increasing, and Emirates will be well positioned to take full advantage because of the large number of aircraft that will be joining its fleet into the future. The UAE and the US, for example, initiated an Open Skies agreement in 1999, and the airline has