Emirates Airlines
In a League of its Own

By Prof Dr M. S. S. El Namaki

Is this the Right Strategy?

With the global economy booming, globetrotting is no longer a perk in the corporate world. With the advent of internet and rapid innovations in the field of communications and travel, the world has truly shrunk in size. Plastic money is passé. Time is the new global currency.

The airline industry, which plays a pivotal part in any country's economy, is one of the most volatile industries, plagued with excessive losses, restructuring and bankruptcies. There is a long history of bailout packages in the United States, and efficiency seeking mergers in Europe. The industry is cyclical.

Four or five years of poor performance precede five or six years of improved performance. But profitability in the good years is generally low, in the range of 2-3% (net profit). In times of profit, airlines lease new generations of airplanes and upgrade services in response to higher demand. Consolidation is a trend, though variable in shape. Airline groupings may consist of limited bilateral partnerships, long-term, multi-faceted alliances between carriers, equity arrangements, mergers, or takeovers.

Since governments often restrict ownership and mergers between companies in different countries, consolidation is restricted within the country. The Middle East is a textbook example of such weaknesses. Events such as September 11, the Iraq conflict, the conflict in Lebanon and Palestine, constitute to the socio-political imbalance in the region. These factors invariably affect the economy of the region. Directly or indirectly.

Emirates Airlines was conceived within this turbulent environment and has demonstrated an unfailing ability to grow in these unstable conditions. Moreover, it has been able to develop a global strategy that has taken it beyond the limits of the regional market. (New Nation Online, 20 May, 2006).

The following case study explores Emirates Airline's rise to success and questions present day strategies of the airline and their sustainability in the long run.

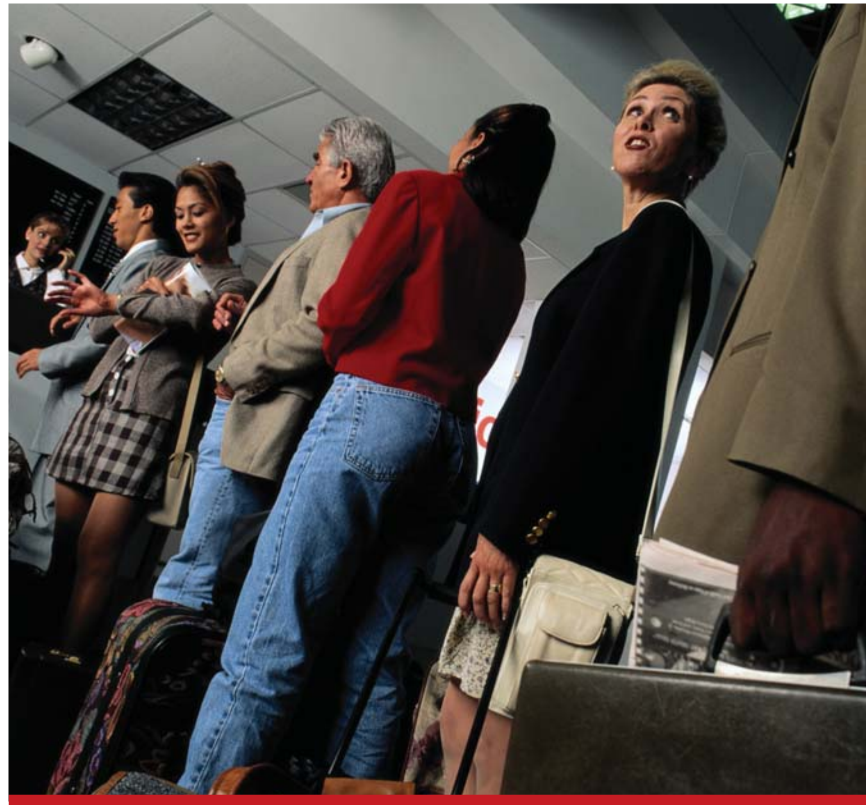
The Competitive Profile of Emirates Airlines

Emirates Airlines is the product of a search for effective key drivers for the Dubai economy. It belongs to a package

that includes air transportation, tourism, hospitality and real estate. Lack of oil resources and a search for alternative sources of economic growth induced the Dubai government to embark upon this venture. The launch of the airline came in 1985 with the Dubai government as the sole owner and the sole investor. Early services extended to 60 destinations in 42 countries throughout Europe, Middle East, Far East, Africa, Asia and Australia. Early strategies stressed quality in product, equipment, organization and services. A multi national crew was recruited, a modern fleet purchased and an overall quality image was promoted. The airline took off and managed within a fairly short period of time to expand its destinations network, achieve high returns, boost technology and enter new markets.

Emirates' foray into new markets was a subject of envy for major globals carriers, who had till then perceived Emirates as a global airline based in the Middle East and not an Arab airline operating abroad. This induced established carriers in Europe and Australia, such as Air France, KLM, British Airways, Lufthansa, and Qantas, to perceive Emirates Airline's strategic positioning as a global carrier, as a major threat.

Most of these carriers not only found it difficult to deal with Emirates' competitive cost advantage, but others such as, Air France and Qantas, openly accused Emirates Airlines of receiving hidden state subsidies and of maintaining a too cosy relationship with Dubai's airport authority as well as its aviation authority, both wholly state-owned entities. In addition, they also accused Emirates Airlines of taking unfair advantage of its government shareholder's sovereign borrower status. They claim that this masks its true financial performance and reduces its borrowing costs to below market rates. (The Economist Oct 5, 2005; The Financial Times July 19, 2006)



Emirates Airline's revenues totalled AED 22.7 ($6.3 billion) for the year 2006 or 27% above 2005 level. Passenger seat factor also reached 75.9%, 1.3% above 2005 level too.

Emirates Airlines competes directly with nearly twenty-three airlines operating in sixteen countries in the Middle East. They all share the need for good management and cost reduction especially when it comes to major cost items such as taxation, security, insurance and fuel. A major competitor in the Gulf area is Gulf Air, a partly government owned airline (government of Abu Dhabi) with strong support and wide network. Gulf Air posed a serious threat to Emirates thanks to the so called open skies policy, a policy that allows free access to Dubai airport and minimal entry restrictions. Yet profitability histories of both airlines diverge strongly. At a time when Gulf Air is facing negative results and is compelled to cut on routes, Emirates is experiencing one cycle of expansion after another.

Emirates have a fairly young fleet. The average age of the fleet is 5.4 years (February 2007). Favourable terms offered by both Airbus and Boeing during the post September 11 era encouraged the airline to embark upon a massive acquisition swing that included up to 150 long-haul wide-bodied jets. This order will make Emirates the world's largest 777 operator. Global aspiration undoubtedly stood at the heart of this decision. "By the end of the financial year (2005-2006) we had a fleet of 91 aircrafts, serving 83 destinations carrying 14.5 million passengers and one million tonnes of freight. By 2010 we will have 156 aircraft serving 101 destinations, carrying an estimated 26 million passengers per year. Such is the projected growth of Emirates". (Emirates Annual Report 2005-2006)

Emirates continues to shine in its share of glitter. It was awarded prestigious airline of the year award for the first time in 2001 and repeated the feat in 2002 to become a two-time award winner of the airline of

the year. It was also named, in 2007, the U.A.E.'s top brand among 25 other local firms. It has a base value of US$ 6.3 billion. Emirates was also labelled by some industry executives as "...one of the region's most forward-thinking and innovative organizations in the area of technology" for its acquisition of "the most innovative storage infrastructures in the Middle East". Emirates, finally, has also begun construction of its own luxury five star hotel and towers. And 2007 will witness the introduction of a docking capability for Apple Computer's iPod portable music and video player in Emirates fleet (Wall Street Journal, Nov 14, 2006).

Images courtesy Jeff Vergara, Dubai

The Business Model

Emirates business model is based on the following premises:

• **Labour cost economies:** A mix of Emirates lean workforce and young fleet account for its remarkable low cost and a strong cost-based competitive profile. The labour-triggered low cost is created by a very lean workforce, comparable to the leading low-cost "no frills" airlines rather than other traditional "flag carriers". This, along with a simpler organisational structure, allows the airline to minimise overheads. Its low cost base is according to some industry analysts second only to Ryanair on a cash cost per seat basis,

• **Toothless workforce:** Emirates workforce is not unionised.

• **Government blithe support:** Emirates received and continues to receive direct and indirect financial and non-financial support from the Dubai government.

• **Fleet cost economies:** Emirates airline operates an all wide-body fleet resulting in lower unit costs compared with airlines operating mixed narrow/wide-body fleets. This enables Emirates to use these aircraft's cargo capacity to boost its overall revenues and total profits, especially at times when the passenger business passes through a seasonal trough or when an economic downturn adversely impacts the passenger numbers. Its Dubai hub also allows it to take advantage of increasing cargo business between China, India and West Africa.

• **Strategic distance:** Emirates has so far refused to join any of the major global airline alliances and questions the advantages such alliances bring for the airlines as well as their customers, especially after taking into consideration the high costs of compliance of alliance membership.

• **Opportunistic strategies:** Emirates' strategic behaviour can best be described as proactive and at times, opportunistic. Market segment gaps are sought and filled with speed. Price differentiation is oits forte.

• **Well positioned hub:** Dubai airport is an excellent hub that allows Emirates airlines to profitably serve secondary destinations as well as connect such places via its global Dubai hub.(The Economist 6 Oct, 2006)

The Strategies

Emirates' strategies are a function of the environment where it operates and the product of intrinsic strategic thinking from within the carrier. The environment could be viewed in terms of Porter's five forces i.e. threat of entrants, power of suppliers, and power of buyers, substitution effect and rivalry:

• **Threat of New Entrants:** It seems, to all appearances, that the airline industry is a low entry barrier industry. Finance, the prime entry barriers, is readily available in the Middle East and technology and expertise are purchasable.

• **Power of Suppliers:** Boeing and Airbus are the two main suppliers and competition among them is probable, observable but not abominable! Also, the likelihood of a supplier integrating vertically isn't very likely.

• **Power of Buyers.** The bargaining power of airline industry buyers in the Middle East is quite low.

• **Availability of Substitutes.** Threat is really limited given the distances in the Middle East and the fast pace that is becoming a symbol of the area.

• **Competitive Rivalry.** The airline industry is generally highly competitive and highly competitive industries generally, again, earn low returns because the cost of competition is high. This can spell disaster in low cycle times. The Middle East, however, provides a different story thanks to governments' readiness to cushion the shocks.

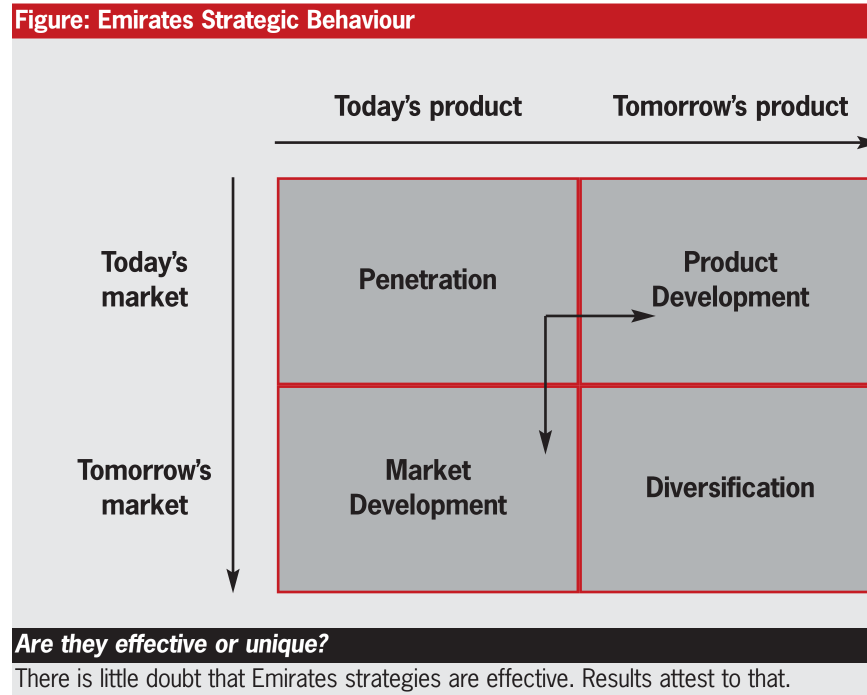
So the environment carries the threat of new entrants and competitive rivalry but not a real threat from substitution or buyers and suppliers for that matter.

Emirates' strategic behaviour, within this

kind of environment, runs parallel to Ansoff's product market strategies Matrix. Actually the parallel is so close that one doubts whether the top management or those responsible for the strategy formulation function within the corporation have been working with this model in the back of their minds. Emirates' strategies include penetration strategies, product development strategies, market development strategies and even a recent element of diversification. Let us examine these:

• **Market penetration.** The Middle East is Emirates' prime market segment and the segment that justified the creation of the company in the first place. This market is being thoroughly penetrated by Emirates in a deliberate policy of market penetration.

Figure: Emirates Strategic Behaviour



Are they effective or unique?

There is little doubt that Emirates strategies are effective. Results attest to that.

Table: Emirates Performance 2005, 2006

	PASSENGER		CARGO	OTHERS	TOTAL			
	2005	2006	2005	2006	2005	2006	2005	2006
2006 Revenue	13.8	17.5	3.5	4.5	0.6	0.7	17.9	22.
Total assets	23.0	30.5	0.06	0.3	0.6	0.6	23.7	31.3
Capital expenditure	3.0	4.4	0.06	0.2	0.05	0.2	3.2	4.7

Source: Emirates Group Annual Report 2005-2006

• **Product development:** Emirates product development is of modest proportion. It related to product specifications and the type of services offered more than the introduction of changes in product mix.

• **Market development:** Emirates geographic expansion including the entry into the United States market is a typical example for market development.

• **Diversification:** Emirates' entry into the storage market is yet another example of its attempts at diversification. One has to state, though that these attempts are all at related product and market diversification.

Not only revenue, asset and capital expenditure performance improved over time, but also other measures of performance. Emirates Airline's revenues totalled AED 22.7 ($6.3 billion) for the year 2006 or 27% above 2005 level. Passenger seat factor also reached 75.9%, 1.3% above 2005 level too. And capacity increased to 15,803 million tonne kilometres. Breakeven load factor remained relatively low at 60.3%, and yield improved for the fourth consecutive year, to $0.55 cents per Revenue Tonne Kilometre. Introducing the 2006 annual report, the Chairman said: "These results clearly show that Emirates' customer-oriented approach and investments in providing a quality product - the best aircraft that money can buy; top-flight service and travel experience at a competitive price - has paid off in terms of retaining and winning new customers globally…It has been another tough year with pressure from fuel costs continuously dampening our robust net income production. Emirates has returned its 18th consecutive annual profit, and we are pleased to have achieved this solid performance while expanding our operations in an increasingly competitive environment."

There are strategic flaws, though. They boil down to the following:

• Is Emirates really the product of Arab strategic thinking? Emirates is managed by a board whose chairman is Sheikh Ahmed bin Saeed Al Maktoum and Vice chairman is Maurice Flanagan, an expatriate, who is also a President of Emirates Group. While there is little doubt that the broad strokes are Sheikh Al Maktoum's, there is equally little doubt that Mr. Flanagan is the strategic steward and the prime decision maker within the airline. "… While there is no pressure from his employers to retire, Flanagan, who is 77, explains that there is a succession plan in place. The carrier has a programme to bring along UAE nationals, and eventually a local will run the show. But there are no targets or timescales. .. Flanagan himself shows no sign of slowing down, nor is there any dimming in his enthusiasm for the carrier …"(Airline Business Nov 16, 2006)

Key vice presidents of the airline are all expatriate executives too. Those include the President of Emirates Airlines, the President of the Group Support Services and the President of DNATA and associated companies.

Whose strategies are those followed by the airline?

• Is Emirates' disregard for the rising regional competition strategically opportune? Competition, however, is on the horizon. Etihad Airways, a government of Abu Dhabi creation, is coming up with a different approach to regional and international travel in stark contrast with Emirates. In contrast to the low-cost airlines, Etihad is focusing on offering a product that appeals to travellers who want a premium service, at a competitive international price. Key to the Etihad's promise is a move away from the traditional classes, as it becomes the first regional airline to take the concept of premium economy and reworks it for the regional marketplace.

Etihad refers to passengers as guests and has guest zones rather than fare classes. The three zones - Diamond, Pearl, and Coral - do not correspond directly to first, business, and economy classes. Those are potent rivals working hard to change critical product features. Is Emirates able to meet this challenge?

• How far can a cost cutting strategy go? Emirates is under cost pressure. Fuel costs remained the top expenditure in 2006 accounting for 27.2 per cent of total operating costs, up from 21.4% the previous year. Like other airlines, Emirates was forced to increase the fuel surcharge component of the fare, which only covered 41% of incremental costs (New Nation, 20 May, 2006). This could lead to the question of how far a cost cutting strategy can go given the very lean staff and the sharp eye that the airline holds on other cost items.

• Why buy, why not integrate backwards? Emirates have been embarking upon a massive buying swing that will inflate the size of fleet and expand capacity. The volume of investment is sizable and the strategic implications are far reaching. The strategic question that could be posed here is why, buy? Why not integrate backwards? Put differently why not acquire equity into the aircraft building industry? Qatar is flirting with the idea. It may even be more than flirting but what is wrong with that? They seem to be following the

right track. Shareholding into Airbus or Boeing will have obvious long term advantages and may even transform the fortunes of Emirates altogether.

• Is it strategic growth or a windfall? Emirates' growth is impressive by any measure but is it genuine or it a by-product of Dubai's own economic upsurge. One can entertain the notion that the airline's growth was largely a windfall from Dubai's Economic bonanza. After all a GDP rate of growth of 8% for the UAE as a whole, and figures near that in earlier years, has a spill over. And if tourism is one of the drivers of this growth that spill over is very likely to reflect on the prime air carriers within the region.

• Is there a risk in shunning strategic alliances? Strategic alliances are one of main the business tactics that have dominated the airline industry for decades. It is rather surprising, therefore, that Emirates shuns this strategy at both regional and global levels. Arguments for this evasion are not spelled out in the airlines documents and ulterior motives may not be ruled out. The issue remains however that alliances within the airline industry have their justifications and benefits and an alliance aversion may not work to the advantage of Emirates in the longer term.

• Is Emirates' fleet composition congruent with market needs? Airline fleets are usually built around a mix of profiles and capacities. The mix is between international carriers, or 130+ seat planes that have the ability to take passengers just about anywhere in the world producing a company revenue of $1 billion or more; national airlines seating 100-150 people and have revenues between $100 million and $1 billion; regional companies with revenues less than $100 million that focus on short-haul flights and cargo airlines whose main purpose is to transport goods and whose revenues are well below the $100 million mark.

Emirates has strategically positioned itself, market wise, in the first and third category and technology wise, in the first. Whether this is strategically and operationally opportune remains to be seen.

Summary and conclusions

The airline industry in the Middle East does not differ from that elsewhere. It is volatile and subject to cyclical fluctuations. Emirates has risen within this environment and has been able to withstand this "air" turbulence in the most trying times to grow in recognition and become a global airline that is based in the Middle East.

Points of weakness within this very positive picture however relate to the extent to which the organisation's adopted strategies are really the result of Arab thinking and Arab management, the limits of the cost cutting strategy pursued by the airline, the prudence of buying instead of integrating backward, the wisdom of shunning global alliances and ignoring regional competition, and the asset composition framework maintained by the airline today. These factors amongst others makes one question whether this growth was really the result of genuine strategic thinking or the outcome of Dubai's impressive economic bonanza? You decide. ■

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