

# Competition from hubs in the Gulf and Turkey

Overview of academic and applied research

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17 October 2012



# Outline

- The Gulf and Turkish hub models
- Gulf carrier competition & pricing
- Answers from incumbent carriers
- Some further points for discussion

# The vertically integrated strategy of “Dubai Inc.”

- Dubai has prepared master plan to prepare for the post-oil era to establish Dubai as leading tourism, IT and financial destination
- Emirates Airlines essential instrument to achieve this goal
- Emirates part of Emirates Group: state-owned, globally active travel and tourism conglomerate, providing all kinds of aviation related services
- Emirates Group itself is part of a larger bundle of aviation-related activities, under responsibility of Sjeikh Ahmed bin Saeed Al Maktoum, including:
  - Dubai World Central Consortium (building of Jebel Ali airport city)
  - Dubai’s Department of Civil Aviation: regulator, operator of DXB, Dubai Duty Free and Dubai Cargo Village

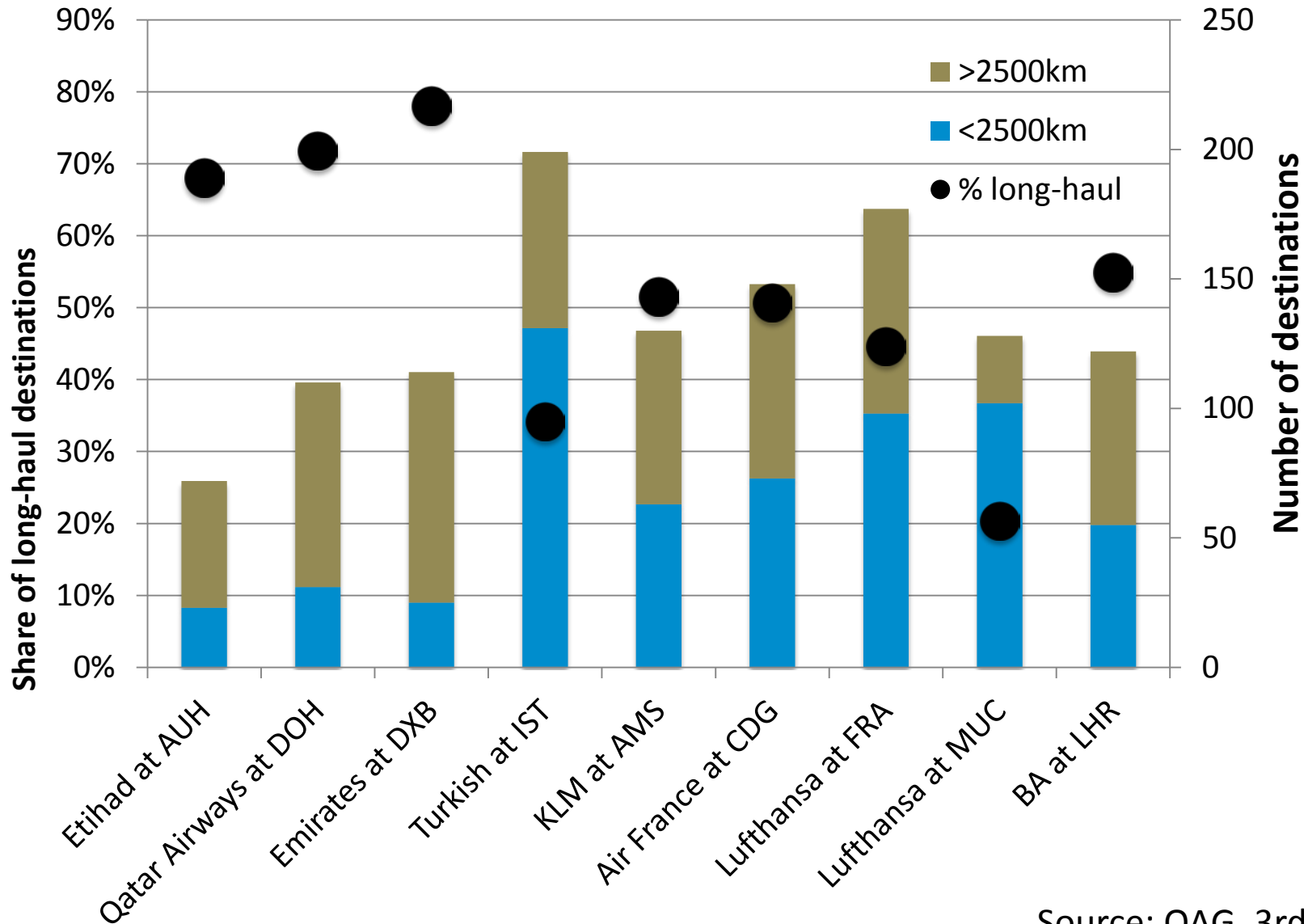
# The vertically integrated strategy of “Dubai Inc.” (cont.)

- Sjeikh acts as an entrepreneur
- Royal family involved in all parts of economy and public administration: Difficult to distinguish between private and public property, between political leadership and commercial management. Result:
  - significant financial resources and the ability of the state to allocate and control developments that would be impossible in market-led economies
  - Allignment of all stakeholders on the same goal: to increase the wealth of the emirate, its population and its rulers
  - Quick decision making

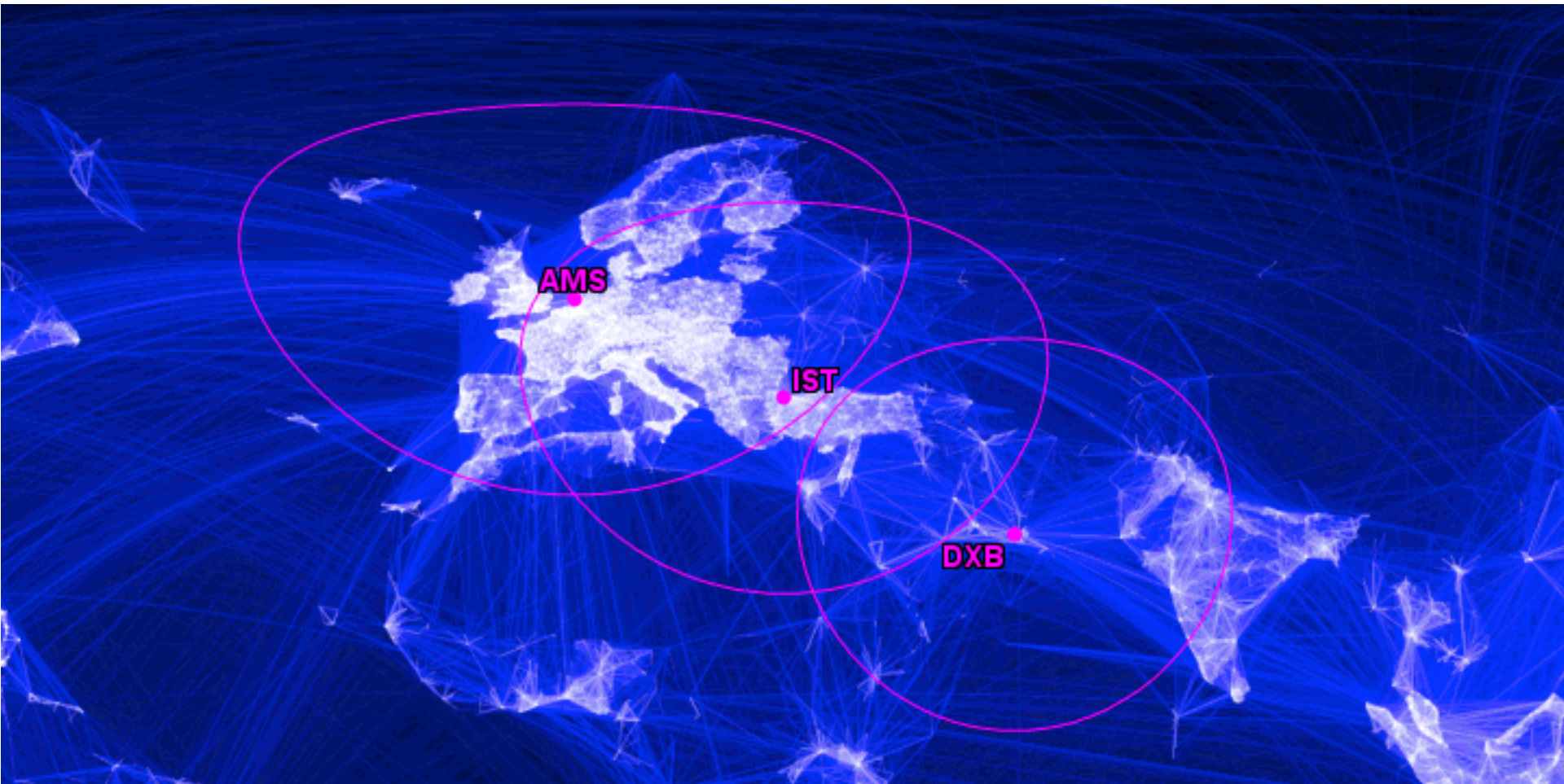
# Comparing cost structure Emirates to BA

Eurocents/ATK	Emirates	British Airways	EK vs BA (%)	
Fuel/ATK	8.12	11.40	-29	Young fleet, proximity to oil production+facilities
Labour/ATK	4.36	12.01	-64	Two-tier tax free salary system; cheap labour
Landing and Nav/ATK	1.45	2.93	-51	Joint airline-airport ownership; cross subsidation charges from duty-free
Handling/ATK	1.69	5.42	-69	Low labour costs; scale advantages in monopoly
Maintenance/ATK	0.50	2.50	-80	New generation aircraft
Depreciation/ATK	1.34	3.84	-65	New generation aircraft
Distribution and sales/ATK	2.80	1.99	+41	Travel commissions, sales in countries with low Internet penetration rate; aggressive branding
Operating leases/ATK	2.83	0.38	+645	80% aircraft financed through operating leases
Total cost/ATK	26.56	43.69	-39	
Total revenu/ATK	28.78	48.55	-41	

# The network model of Gulf carriers: long-haul to long-haul. Turkish exception



# Long-haul specialization partly driven by geography

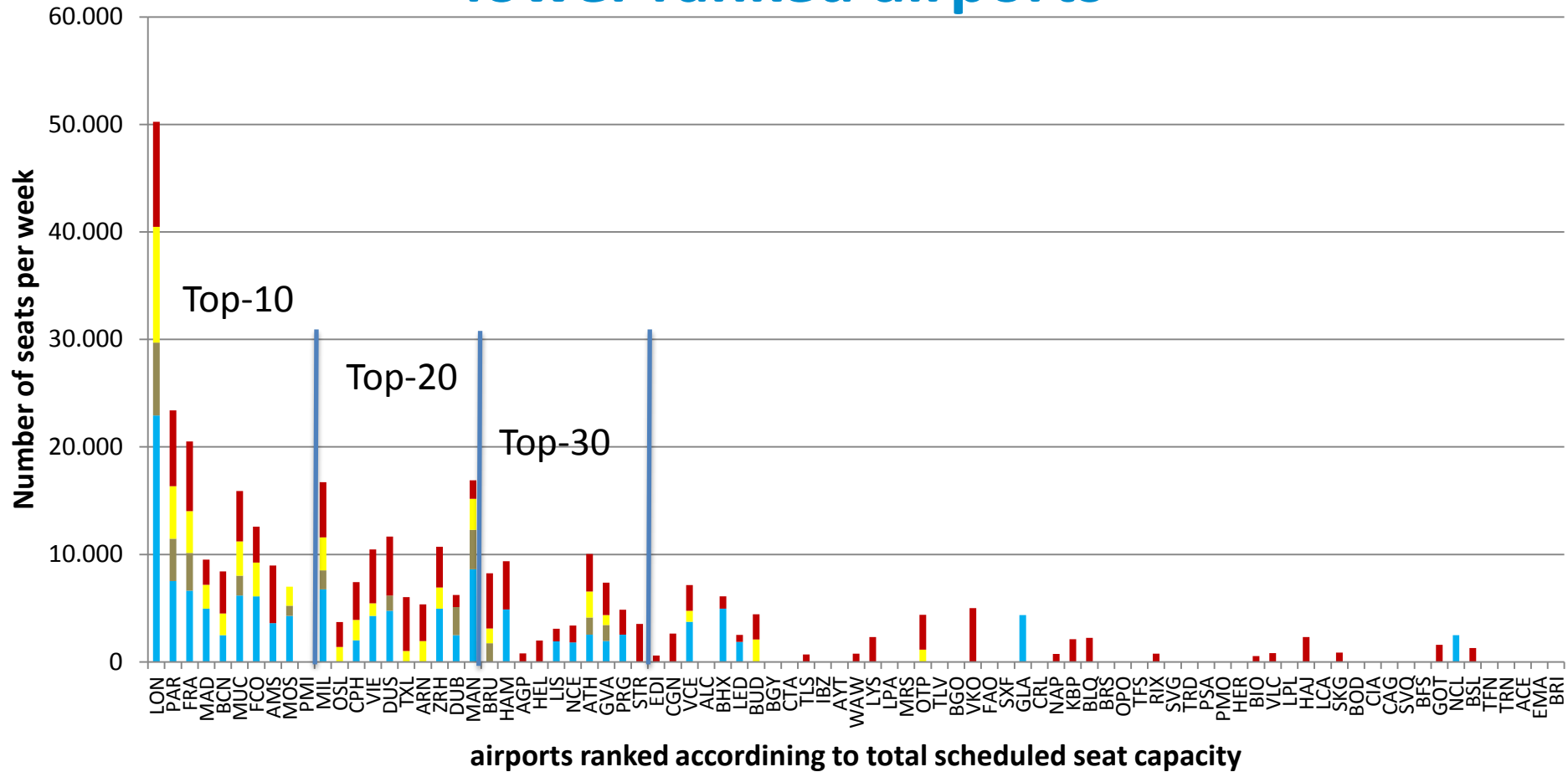


# Focus on primary and secondary cities

- Gulf carriers do not only serve primary, but also secondary cities
  - Important feeder markets for European network carriers
  - Newcomers from the Gulf do not have to compete against non-stop direct travel options (=better quality)
  - Entry easier for Gulf carriers than for European network carriers in relation to slot times and charges
  - Creates substantial competitive advantage in terms of travel time in certain markets
    - E.g. HAM-DXB-SYD with Emirates instead of HAM-FRA-BKK-SYD with Star
- Because Turkish can operate to Europe with a narrow-body fleet, it also feeders its hub from tertiary European cities



# Turkish also serves many tertiary European cities. Its service tends to be relatively better to lower ranked airports

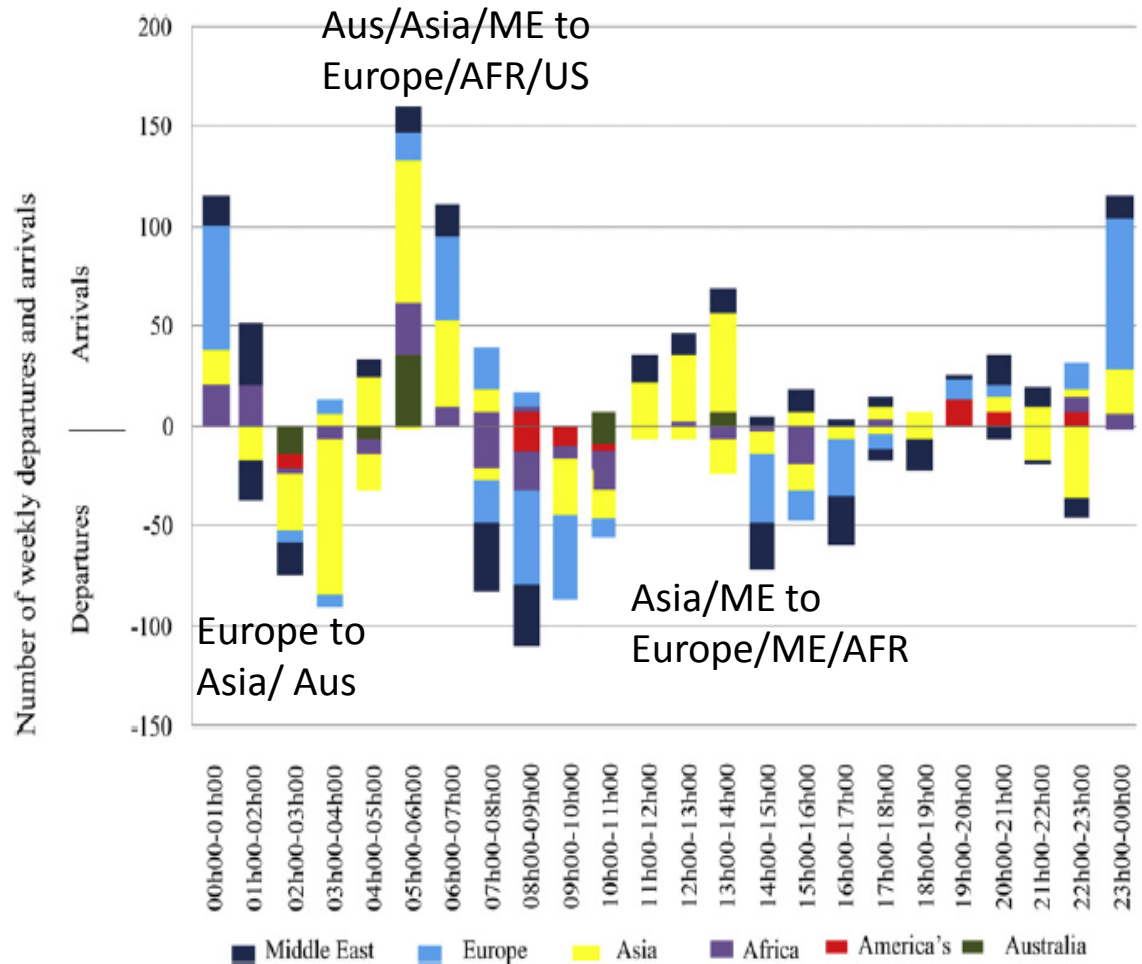


Emirates Etihad Qatar Turkish

Source: OAG

# The network model: connecting at night

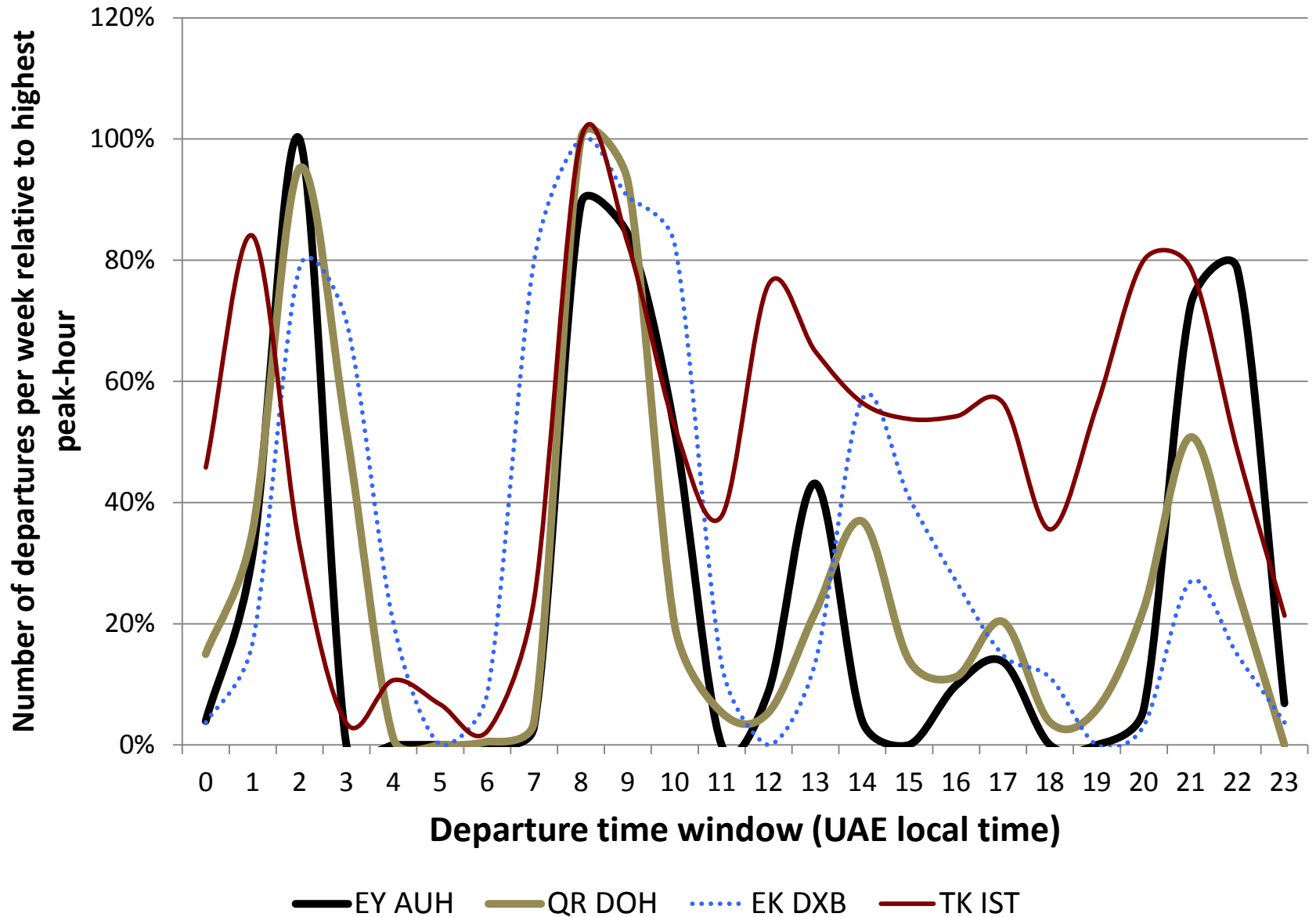
- Core of the wave-system is concentrated during night-time
  - Curfews and flight restrictions at destination airports
  - Meteorological conditions during daytime at the hub



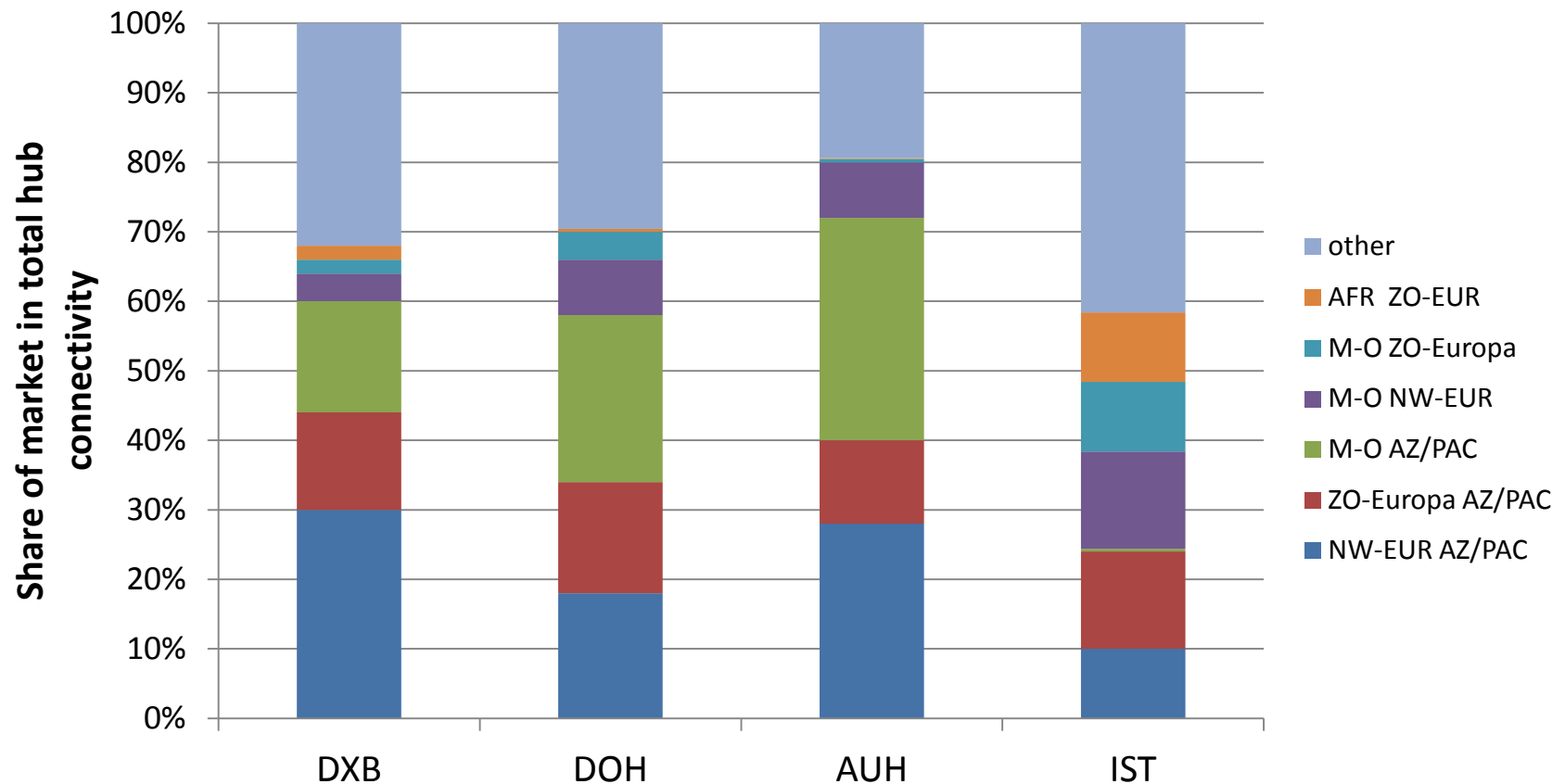
Wave-system Emirates at Dubai

Source: O'Connell 2011

# Remarkable similarity between the hubs. Turkish supplements night and early morning waves with intensive hub system during the day



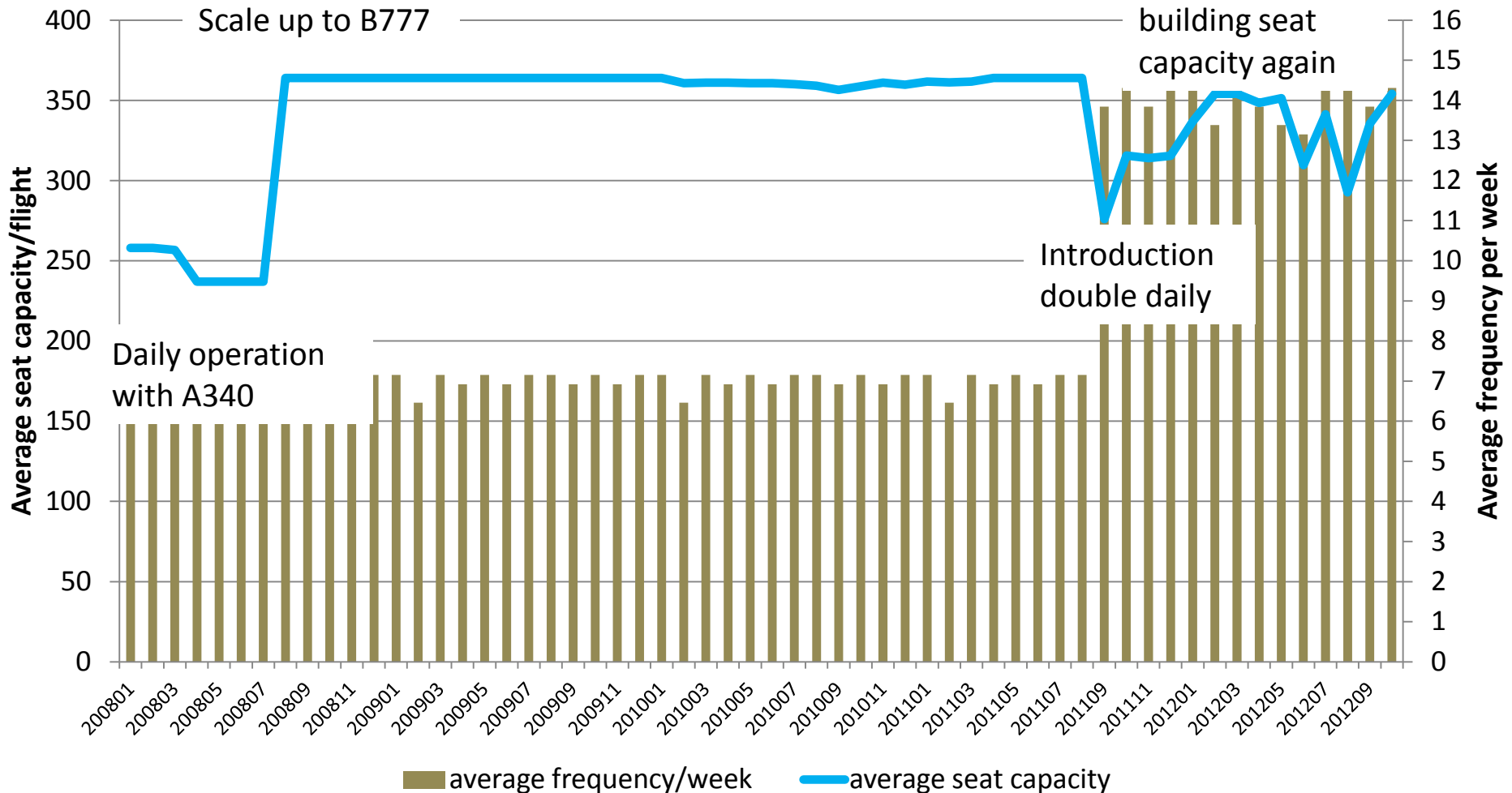
# Hub connections offered by Turkish via Istanbul more diversified than DXB, DOH and AUH



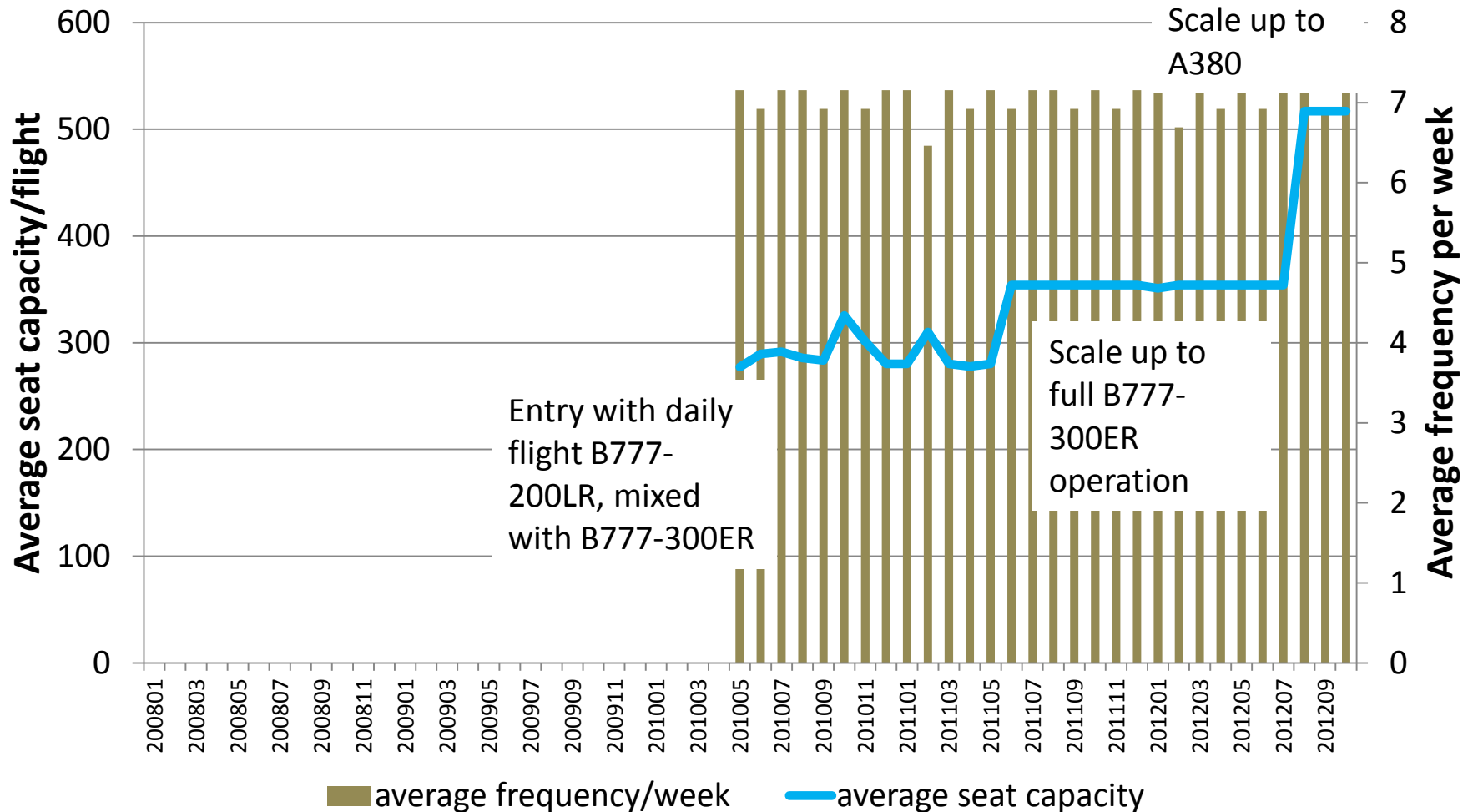
# Building a Gulf route

- Typical build-up pattern of an Emirates destination (Lohmann et al. 2009):
  1. Always enter a new destination with a daily flight
  2. When demand increases, scale up aircraft capacity
  3. Later, increase frequency, as this is important to attract high-yield business passenger
  4. Ultimate mid-term goal is double daily on almost every destination

# Route build-up Emirates at Hamburg



# Route build-up pattern Emirates at Amsterdam



# Strengths and weaknesses Emirates and Dubai

## Strengths

- Geographical location of the hub
- A380 allows for growth at slot constrained airports
- No legacy costs
- Low unit costs
- High labour productivity
- High service-level
- Strong brand (marketing)
- Open Skies policy by UAE government
- Favourable political environment (“Dubai Inc.”)
  - Strong vertical integration
  - Quick decision-making
  - Lack of NIMBY-culture
- Diversity of markets served

## Weaknesses

- Temperature and humidity constrain middle-of-the-day operations at DXB
- Limited short-haul feeder potential
- No alliance membership
- Related to destination development/OD growth:
- Sterility and homogeneity of the destination (Henderson 2006)
- Low level of repeat visits to Dubai
- Tourism depends on large extent on stop-over market. Average stay is short (2.5 days)



# Opportunities and threats Emirates and Dubai

## Opportunities

- 3.5 billion people within 8 hrs flying time
- Central to many emerging, underserved economies
  - Clark: “Africa is ripe fruit that only needs to be picked”
- Alliances?

## Threats

- World economy
- Political and economic instability in the region\*
- Terrorism
- Lobbying by competitors, calling for legal protection against unfair competition
- Aggressive competition from the neighbours; overcapacity?
- Dependency on expatriate professionals

\*Source: M. Levine (2013). Is the Gulf airline boom a bubble? Airneth column 12 June 2013. [www.airneth.nl](http://www.airneth.nl)

# Turkish Airlines and Istanbul compose a somewhat different story

- Turkish Airlines partly privatized in 2004-2006 49% of shares still held by Republic of Turkey
- Liberalization domestic market in 1996

## **Opportunities:**

- Benefits from domestic market of 70 million people, with a rapidly increasing propensity to fly
- Geographical location in some ways better than that of Gulf hubs:
  - Domestic market with over 70 million people, with a rapidly increasing propensity to fly
  - Short-haul fleet can cover large part of population centres in Europe, North-Africa, Middle East and Russia
- Strong Turkish diaspora in Western-Europe
- Part of STAR alliance

## **Major bottlenecks:**

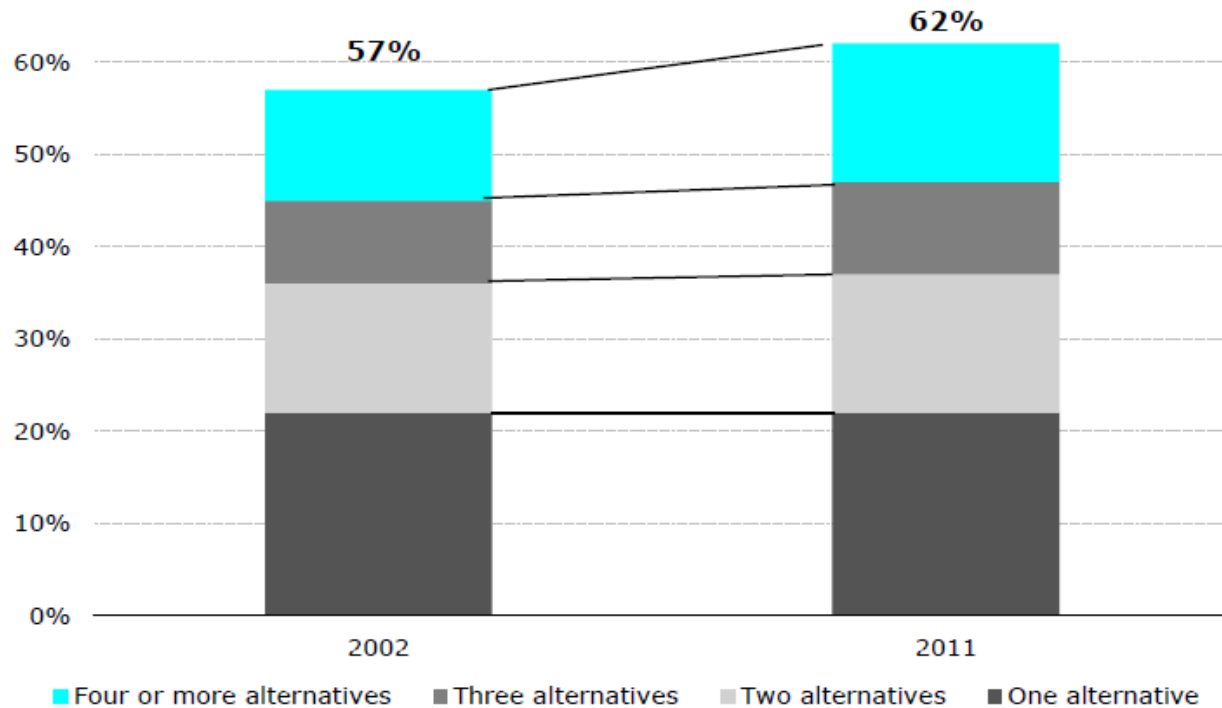
- fierce congestion at the Istanbul hub
- But third Istanbul Airport planned for 90-150 million passengers, scheduled to be opened in 2015
- Fairly restrictive bilaterals
- Landside accessibility

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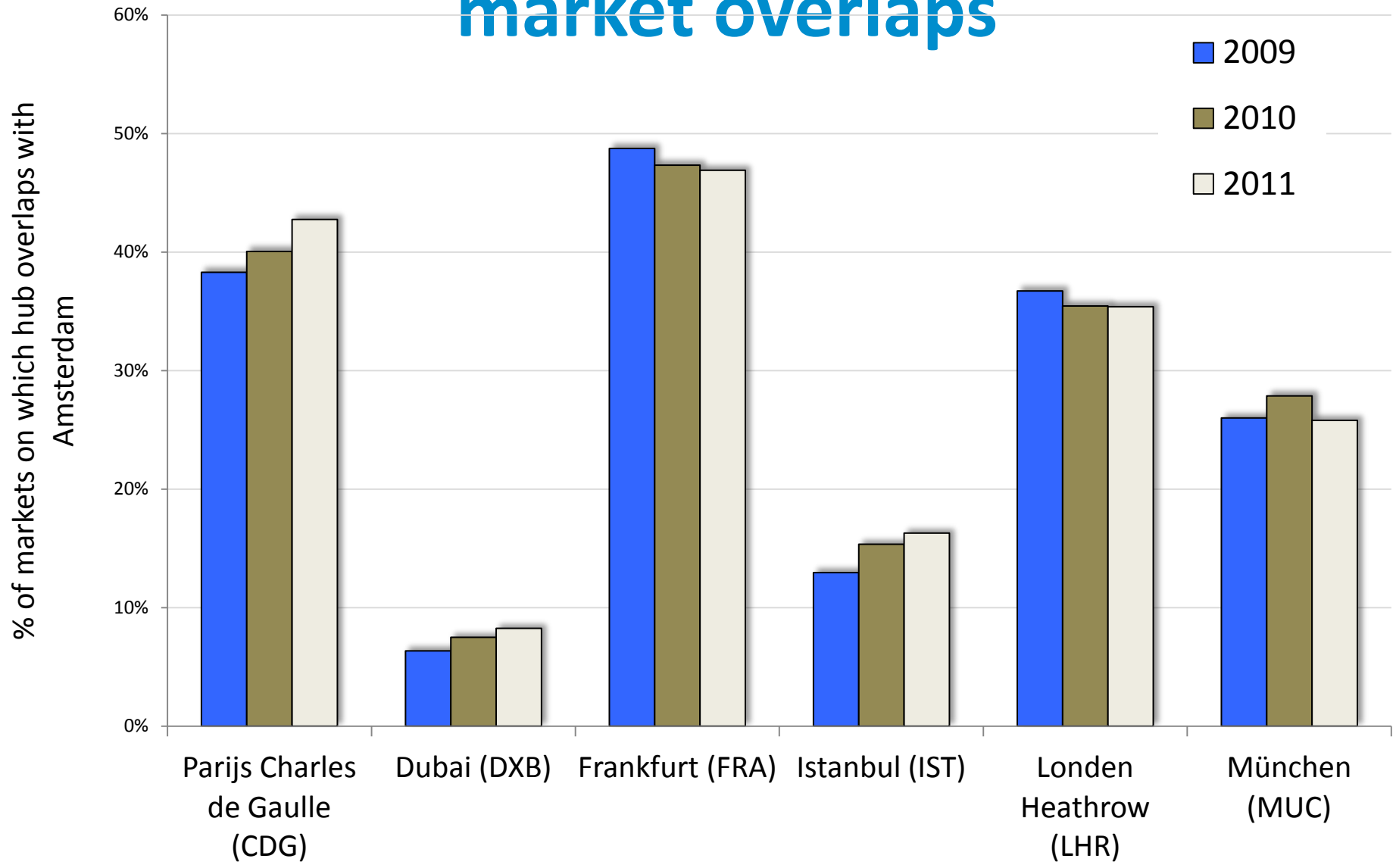
# Competition for European hubs in transfer market has increased during last decade

Number of alternatives for transfer passengers to best connection where European hubs offer at least one connection, 2002-2011



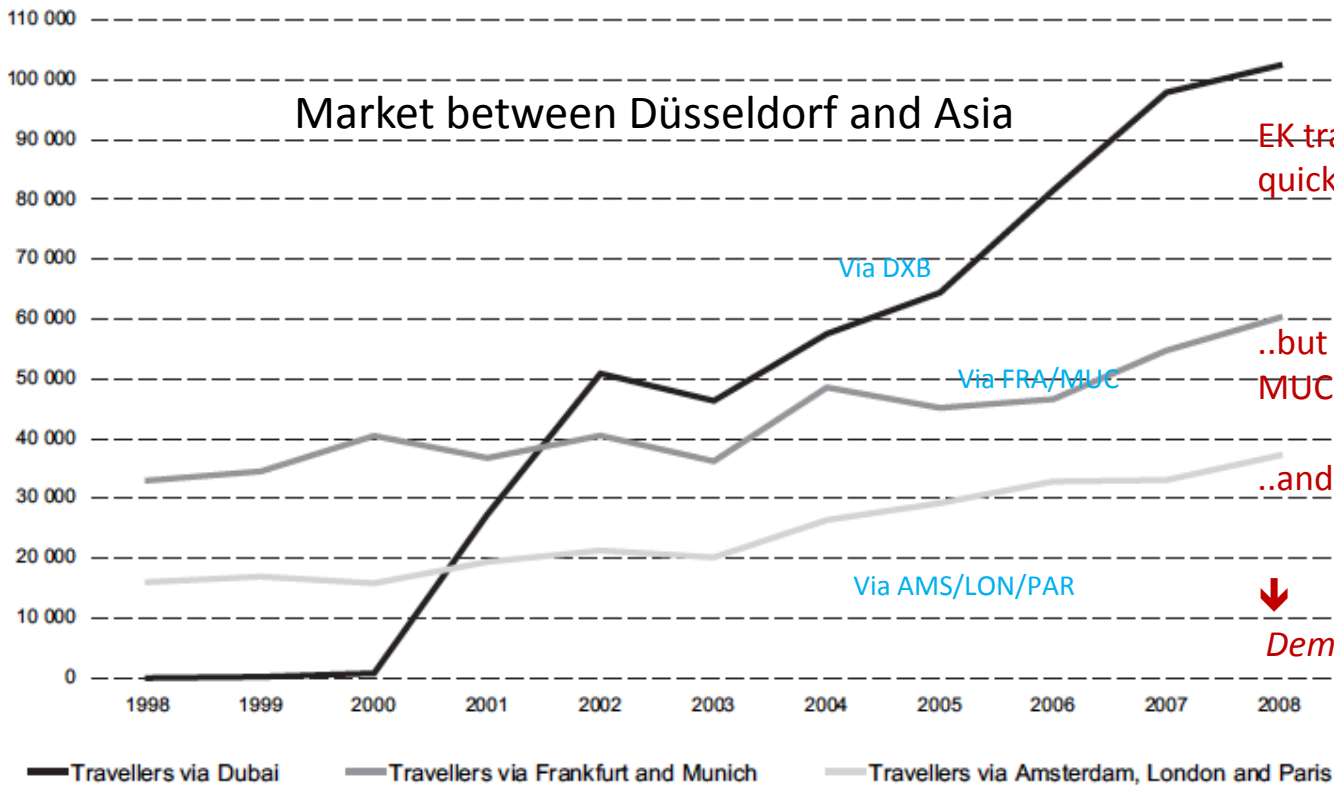
Source: Copenhagen Economics/SEO 2012

# Turkish larger competitor to SkyTeam at AMS than Emirates in terms of market overlaps



# New Emirates services to secondary cities stimulate demand to Dubai and beyond destinations, without only limited cannibalization of demand of incumbent airlines

Travellers per Year

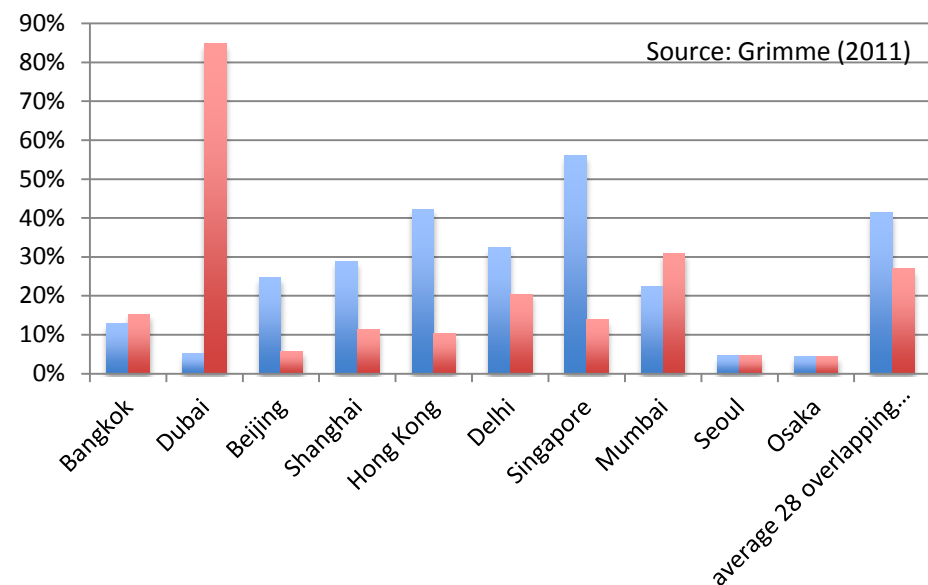


Source: Grimme (2011). The growth of Arabian airlines from a German perspective-A study of the impacts of new air services to Asia. Journal of Air Transport Management

# Emirates on average 22-28% market share on directly served overlap destinations in Asia; share increases with frequency to Dubai

Emirates has on average 28% market share on overlapping STAR destinations in Asia out of secondary city Hamburg

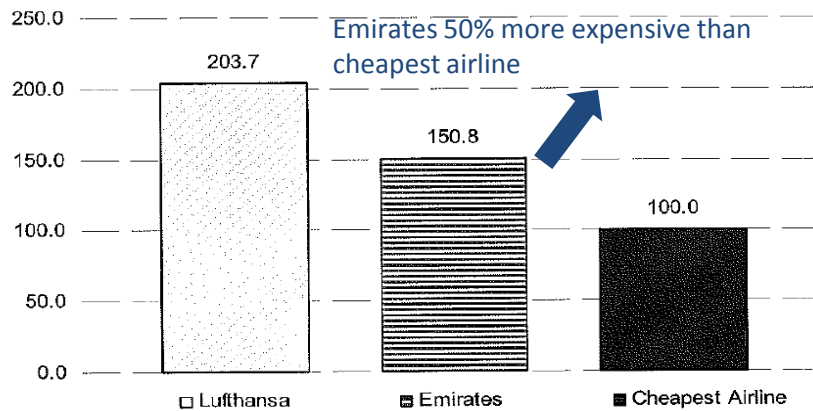
Market share Emirates of twice-daily services to Dubai on overlapping destinations in Asia 6% higher than for single daily Emirates service



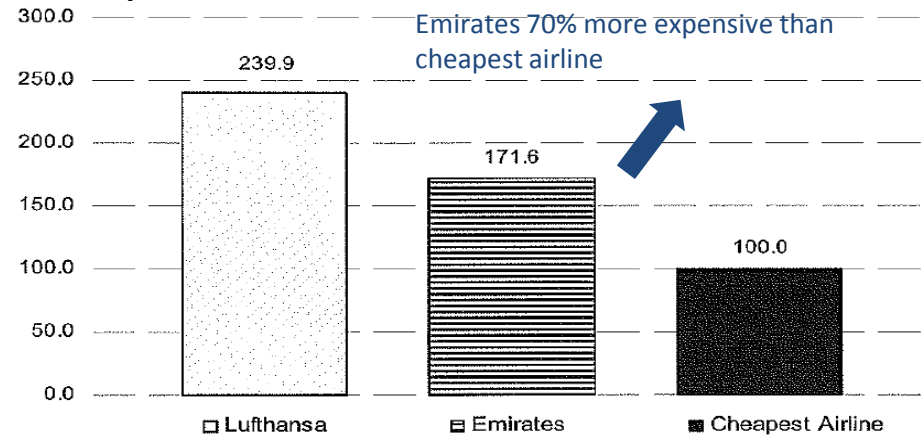
	From Dusseldorf		From Hamburg	
	via FRA/MUC	via DXB	via FRA/MUC	via DXB
Top 10 overlap	20%	32%	43%	27%
Top 28 overlap	20%	34%	42%	28%
Total Asia destinations	21%	28%	35%	22%

# DLR: Emirates rarely price leader in the market; no evidence of predatory pricing

Average fare from Dusseldorf, businessclass to top-10 Asian destinations



Average fare from Dusseldorf, economy class to top-10 Asian destinations



Source: Grimme (2011)

Note: Comparison between alternatives with different travel time and frequency characteristics



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- Conclusions & research agenda

# The answers from European network carriers

- Cost restructuring
- Focus on markets outside reach of Gulf carriers
  - Markets on which travel times via Gulf are substantially longer than via European hubs, (e.g. UK to China) or where Gulf is not an option (Transatlantic)
  - Market size: move towards increasingly smaller markets
- Searching for alliances and joint ventures “ If you can’t beat them, join them”
- Lobbying, limitation of traffic rights, fair competition clauses in EC external aviation policy

# Gulf carriers have entered the alliance game

- Turkish Airlines part of STAR-alliance since 2008
- Qatar Airways joining Oneworld
- Participation Etihad in Air Berlin
- Cooperation/codesharing Etihad with Air France-KLM
- Cooperation Etihad and Garuda (changing AMS operation from DXB to AUH)
- Cooperation Emirates and Qantas
- But: already many codeshare agreements and interlining, EK showing U2 beyond cnx'
- **Impact of alliances and joint ventures:**
  - Larger indirect network for European consumers into India, Asia and Australia
  - More efficient schedules, larger FFP
  - In case of joint ventures:
    - Price-coordination
    - Reduction of overcapacity on the Europe-Middle East market
    - Less competition
    - Better yields

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# Remaining questions and further points for discussion

- To what extent do Gulf carriers compete with EU network carriers?
- How do Gulf carriers price their flights in comparison to EU network carriers. Predatory pricing?
- What is the impact of Gulf carrier entry on ticket prices in the market?
- What will be the impact of aircraft deliveries on market shares and profitability?
- How will Gulf carrier competition impact networks of European carriers in longer-run? What role will alliances play? Will these impact outweigh the economic benefits associated with Gulf carrier service?