# Prospects of Low Cost Carrier and Its Influence to Tourism Industry

**(Draft)**

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## 1 Significance of Low Cost Carrier in Air Transport Industry of Korea

The civilair transport industry of Korea started to develop in earnest at the moment when Korea Airlines Co., Ltd determined the privatization in Oct. 1968. KoreanAir overtook it in Feb. 1969 and repeated the rapid growth together with economic growth. In this period, international line including America, Europe continent, etc was expanded by a single carrier. Service by introducing the old airplanes of Japanesecarrier was improved by purchasing the newly made airplane, improving the self-maintenance capacity, airplane operation capacity, etc by our carriers' own strength. After 20 years, competition system of two carriers was introduced when Asiana Airlines entered the market in 1988. In this period, international competitiveness was possessed as it became large carriers through the competition. National aviation safety system was established together with the substantiality in management, safety, etc as large global carriers. After 20 years, it is entering the unlimited competition by multiple competition in earnest. Although Hansung Airlines and Jeju Air that are serving domestic routesis facing hardships, it has arranged the base to serve international line as well in this year. Although market occupancy of both carriers is about 2.17% (based on no. of passengers) as of 2006, it has presented three-fold growth with market occupancy of about 6.4% in 2007. In case of Air Korea operated by Korean Air at the end of July, Air Busan operatedby Asiana Airlines at the end of October, Incheon-Tiger Airlines is set to begin its service at the end of this year or beginning of 2009. Many carriers are waiting to enter the market thus it is expected to assist the expansion of new horizons in air transport industry of Korea.

Civilair transport industry of Korea is opening the new era of competition in cycle of 20 years. After the initial stage of stage 1 (from independence to 1967), stage 2(1968 - 1988) was the modernization period of air transport industry. In stage 3(1989-2008), international competitiveness of air transport industry in Korea was raised and support system for air transport industry provided by government was advanced as well. In this period, not only carriers and government but also the airport infra system was advanced so Incheon International Airport has opened and positioned itself as the world's no.1 airport. Also, regional airport has expanded and various international routes has opened. For next 20 years, demand of market within the Northeast Asia region that is rapidly increasing by the market participants providing the various types of air transport service shall be responded to. Although there hasn't been a fundamental competition due to limit in no. of carriers entering the market, market efficiency shall be promoted in fierce competition. In this aspect, it is very fortunate that Regulatory Reform Committee has recommended the withdrawal of regulation limiting 2 years and no. of services over 20,000 for new carriers to provide overseas service at April 2008. (attempt to revise the license of regular air transport business in enforcement ordinance of Aviation Law)

Domestic market of Korea is very small compared to China and Japan. Domestic carriersshall conduct business targeting Northeast Asia market not only the domestic market. It is the shortcut for Korean carriers to survive. Korean carriers are one of the most competitive carriers in Northeast Asia. It is result of participating in free aviation policy and strategic global partnership early compared to Japan and China. Now, market within Northeast Asia shall be occupied in-advance by new Low Cost carriers in Korea, etc. It shall be utilized as the opportunity to advance the open aviation area of this region. Competitive air transport business capacity of ours will occupy Northeast Asia market in advance. Resource in air transport industry of Korea shall be exported together with the accumulated management know-how in air transport industry, advanced management, supervision and safety related technology.

## 2 Introduction of Low Cost Carriers to the Market in Asia Region: Expansion in Extents of Tourism Market

Introduction of Low Cost carriers to the market is rapidly achieved in Asia region since 2001. Although 11 new Low Cost carriers entered the market in 2004, it has

Table 1 Growth of air transport and economic growth

| | Worldwide | | Asia(2005-2025) | | |
|---|---|---|---|---|---|
| | 1995-2005 | 2005-2025 | Asia-Pacific | Northeast Asia | China |
| GDP | 2.9% | 3.1% | 3.8% | 1.8% | 6.6% |
| Pax | 4.8% | 4.9% | 6.2% | 5.6% | 7.9% |
| Cargo | 6.3% | 6.1% | 7.0% | 6.9% | 7.1% |

Source: .Boeing, 2006.

three-folded in 2006 with introduction of 32 new Low Cost carriers to the market. (CAPA, 2007) It is attributable to stabilization in political circumstances of Asia region, concentration of economic activity, effort for integration within region (ASEAN) and expansion in trend for open aviation between both parties or between regions. Therefore, movement of passenger within region is activated and Low Cost carriers are presenting outstanding performance in Southeast Asia as these countries concentrate to develop the tourism industry as their core industry.

According to the Boeing(2006), increase in air passengers for the world is estimated to be 4.9% but it is estimated to be 6.2% for the Asia-Pacific region in 20 years (until 2025). Such high estimate is attributable to not only economic growth of countries within region but also rapid growth in Low Cost carriers in next 5 years. Also, Airbus is estimating that occupancy of Low Cost carrier service will dramatically increase in Asia region. Although occupancy of Low Cost carrier service within Asia region was about 3% in Asia region in 2004, it is estimated to increase up to 15~20% in 2015. <Table 1> Also, proportion of airplane order by Low Cost carriers is dramatically increasing. Although proportion of airplane order by Low Cost carriers was 12% among total airplane order in Asia-Pacific region in 2002 and 2003, it has increased to 22% in 2004. Trend for continuous growth in Low Cost carrier plays main roles of basic infra that activates the human mobility within region and expands the extents of tourism market.

## 3 Opportunitiesin Air Transport Market within Northeast Asia

With the two airlines regimewith the economic growth, air transport industry of Korea repeated the growth rate of two digits in 70's and 80's. In 90's, it recorded high growth of 8.2% in international passenger and 9.3% in international freight each year even after experiencing the financial crisis of 98. However, domestic carriers are repeating the minus growth entering the 2000's. It is due to continuous expansion and opening of highways and high-speed rails[1]. Although, it has recorded plus growth of

Table 2 Low Cost Carriers' occupancy ration in Region

| Region | 2004 | 2014 |
|---|---|---|
| USA | 23% | 35-40% |
| Europe | 16% | 30-40% |
| Asia | 3% | 15-20% |
| Oceania | 35% | 45-50% |

Source : Airbus, 2005.

0.1% in 2006, domestic passenger recorded minus growth of -1.9% in 2007. However, international line recorded the high growth of 12.7%. Entering 2000's, international passenger has recorded the high growth of 10.4% in average that is 3.1%p higher than average (7.3%) of 90's. <refer to Table 3>

High growth in air transport industry of Korea, especially high growth rate in international line, is attributable to range of openness in China market.It is because supply is increasing with the conclusion of open aviation agreement with not only China but also Vietnam, Cambodia, etc that are maintaining the continuous growth in Asia. Although market within Northeast Asia has not been achieved of actualeconomic integration, range and depth of human and physical interchange are continuously expanding and it is continuing the growth of air transport industry together with the increase in mobility of Korean. Moreover, open aviation agreement was concluded with regional cities of Japan by concluding the aviation agreement with Japan in 2007. In 2012, ASEAN will integrate the air transport market as Europe. Policy relevant to air transport of Korea shall not remain in Korea. Open aviation is worsening the competition between carriers (suppliers) in short-term and

Table 3 The evolution of Korean Air Industry

| | Domestic | | International | | Domestic and International | |
|---|---|---|---|---|---|---|
| | Pax | Cargo | Pax | Cargo | Pax | Cargo |
| 60' s | 43.8% | - | - | - | - | - |
| 70' s | 11.1% | 17.4% | 27.2% | 20.5% | 18.2% | 20.2% |
| 80' s | 17.3% | 27.2% | 10.7% | 15.6% | 13.6% | 16.9% |
| 90' s | 9.0% | 9.8% | 7.3% | 9.2% | 8.2% | 9.3% |
| 2000' s | -2.8% | -2.7% | 10.4% | 7.8% | 4.5% | 6.5% |

Ref.: 2000's is from 2000 to 2007

Source: Korea Civil Aviation Development Association

1) It is attributable to generation competition between means of transportation with no construction of complex transportation system between means of transportation.

Table 4 Statistics on passenger among Korea, Japan and China (2007)

| Countries | Nationality(Based on arrival) | Passenger | Increase Rate(%) |
|---|---|---|---|
| Korea | Chinese | 714,578 | 38.4 |
| | Japanese | 2,069,536 | -4.76 |
| China | Korean | 3,843,157 | 28.0 |
| | Japanese | 3,128,165 | 7.6 |
| Japan | Korean | 2,600,800 | 22.8 |
| | Chinese | 943,400 | 16.2 |
| Total | - | 13,299,636 | 15.3 |

Ref.: Arrival of Korea referred to (http://www.knto.or.kr/index.jsp) "2007~ 2005"; Arrival of China referred to (http:// www.cnta.com/wyzl/more.asp?flag=1&newsid=004001) "2007~2005"; Arrival of Japan referred to (http://www.jnto.go.jp/jpn/tourism_data/ visitor_data.html) "2007~2005".

relatively benefitting the chinese carriers in aspect of air-fare. However, carriers with international competitiveness will have advantage in the long-term. Expansion in open aviation of Northeast Asia is promoting the lowering of air-fare and human and physical interchange. In case of 2007, 13 million people visited each of 3 countries via plane. <refer to Table 4Paradigm shall be changed in air transport policy in the future. Competition shall not be limited. Foreign capital shall freely invest[2] to domestic carrier and our capital shall invest and participate in management of underdeveloped airport of China, etc..

With the active capital participation in air transport industry of surrounding countries, not only profit shall be acquired but also operation and management technology shall be exported. As a result, aviation demand can also be attracted to our airport. A little while ago, our government tried to limit new carriers from entering the international line in the name of activating the domestic airport. Efficiency and stability shall be possessed when new carriers enter the market and compete with one another. Differentiation in system relevant to previous customer service shall be performed to overcome the fierce competition in the market by new carriers to compete with previous carriers. In the process of competition, not only ceaseless reform shall be achieved to hurdle the obstacle of wall for one who enters the previous market but also competition shall be avoided by providing the service in regional airport[3]. Then, the problem of regional airport shall be resolved naturally. There shouldn't be regulation in entering by force. Although aviation safety, etc has

2) Based on current air law, Foreigners can posses up to 49% of stocks for domestic carriers. However, some has negative view in participation up to 49% and oppose to the participation of foreigners in management and technology field.

3) In case regional airport is taken as main airport

not been playing important role in selecting the carriers with the small range of selection in customers under the monopoly system, selection by customer is available when various suppliers appear and it is difficult to continuously maintain inthe competition system of market by customer when system regarding the aviation safety cannot be maintained. For us to achieve continuous growth for next 20 years as in the past, previous way of thinking shall be eliminated. For air transport industry to maintain the competitiveness and achieve continuous growth for next 20 year, it shall be dealt with open and flexible mind. With the closed mind, one cannot compete with the open world.

## 4 Growth of Low Cost Carrier and Air Transport Industry of Korea

Introduction of Low Cost carriers in Korea has great significance in various aspects. It has significance in movement of capital within air transport industry, change in previous role of Incheon and Gimpo International Airport, etc together with the conversion into fundamental competition base system and previous distribution customs of international line. Traditional Low Cost carriers of USA, Europe, etc used to secondary airport of main cities. However, direct competition between previous carriers and new carriers in same airport cannot be avoided in Korea. Budget Terminal of Changi Airport in Singapore, LCCT of Kuala Lumpur Airport in Malaysia, T4 of Melbourne Airport in Australia, mp$^2$ of Marseilles Airport in France, etc is expanding the demand and securing the demand of low-demand regional airport in the hub airport competition through terminal exclusive for Low Cost carriers together with previous large terminals. <refer to Table 5> In main

Table 5 Airports that offer dedicated low-cost terminals

| Airports | Date terminal inaugurated | Users |
|---|---|---|
| Singapore(Changi) Airport | March 2006 | Tiger Airways, Cebu Pacific |
| Kuala Lumpur (Malaysia) | March 2006 | AirAsia, AirAsia X, Cebu Pacific |
| Marseille (France) | October 2006 | Ryanair, easyJet, Myair, bmibaby (summer only), Jet4You |
| Bremen (Germany) | September 2006 | Ryanair (terminal purchased in full following an EU tender) |
| Austin (USA) | March 2008 | VivaAeroBus(only confirmed airline to date) |
| Lyon (France) | April 2008 | easyJet (only confirmed airline to date) |
| Melbourne (Australia)* | November 2007 | Tiger Airways |

Source: Airline Business, Dec. 2007
* The author add

airports of Korea, demand for construction of terminal exclusive for Low Cost carriers can be achieved by operation of regional airport as the terminal for Low Cost carriers. Regional airport of Korea facing hardships in securing the aviation should be able to secure the demand through putting effort for reduction in cost as terminal for Low Cost carriers in foreign countries or utilize it as the space to inform the culture of the region through new and creative idea. Main element in success of Low Cost carriers is none other than the byproducts of ceaseless reform in provision of general air transport service. Reduction of input cost is not the right answer. Carrier that continues the ceaseless reform changes the previous air transport market. Air transport industry of Korea shall achieve repeated development when such effort for reform influences the previous air transport industry. Introduction of new carrier (Low Cost carrier) is not limited to increase in no. of participants in the market. Therefore, there is need to resolutely withdraw the unseen regulation so that they can perform such role.

## 5 Development Trend in Low Cost Carriers in the Future: Direct Cause in Creating the Continuous Tourism Demand

Traditionally, Low Cost carriers, especially Low Cost carriers in USA and Europe region, has traits to run business mainly for tourists such as low fare, use of secondary airport in major city, minimization of service, short-distance line service[4], point-to-point, prompt service, effective management of flight attendants (in aspect of wage and range of service), operation of same types of airplanes, no provision of connecting flight, etc. Over 80% of flight reservation is completed through internet and seat assignment is not performed. With such traits, Low Cost carriers created new demand for low fare and attracted the tourist demand of previous carriers.

However, efficiency, low-fare, promptness, etc possessed by Low Cost carriers is attracting the business-class passengers of previous carriers nowadays. It is the state brought about bynot only the low-fare provided by Low Cost carriers but also the securing of low-cost operation system with efficiency in operating system of carriers, possession of reliability in line operation, specialization in limited market or economy of scale in certain region. Different from budge carriers in USA and Europe, Low Cost carriers in Asia region are competing directly with previous carriers in primary airport of major cities not in the secondary airport of major cities.

4) Recently, long-distance service is gradually expanding as well.

In case of Changi Airport of Singapore and Kuala Lumpur Airport of Malaysia, LCT (Low cost Carrier's Terminal) is established to attract more Low Cost carriers to their airport. It is to attract tourists with more inexpensive air fare (travel expense). Such LCT minimizes the ticketing lounge, performs the most of reservation and ticketing functions through Internet, induces the quick check-in with establishment of self check-in counter, changes the structure so that getting on and off the plane is available at once (sometimes no use of passenger boarding bridge and utilization of stand in remote-distance), maintains the lounge for general passengers without establishment of lounge exclusive for prestige passengers.

Southwest Airlines of USA was first introduced as the Low Cost carrier in 1971. At the time, only Texas and California had no regulation in air transport industry under the regulative air transport industry environment and it has opened up the blue ocean where there is no competition with previous carriers. Regardless of rise and fall of air transport industry, Southwest Airlines are recording continuous black-ink balance since its establishment and it is evaluated to be one of the companies with highest satisfaction and loyalty of staff among American companies.

Continuous growth of Low Cost carriers not only broadens the class of passengers to travel via plane but also lowers the cost structure of air transport industry gradually. Namely, Low Cost carriers are not attracting the passenger of previous carriers with temporary low-fare policy within air transport market but improving the constitution of air transport market by creating the new passengers with introduction of low-fare policy and efficiency. As <Figure 1>, RASM (Revenue for Available Seat Mile) of air transport industry is gradually decreasing and cost started to exceed the revenue since 2001. Such structure of air transport industry demanded the

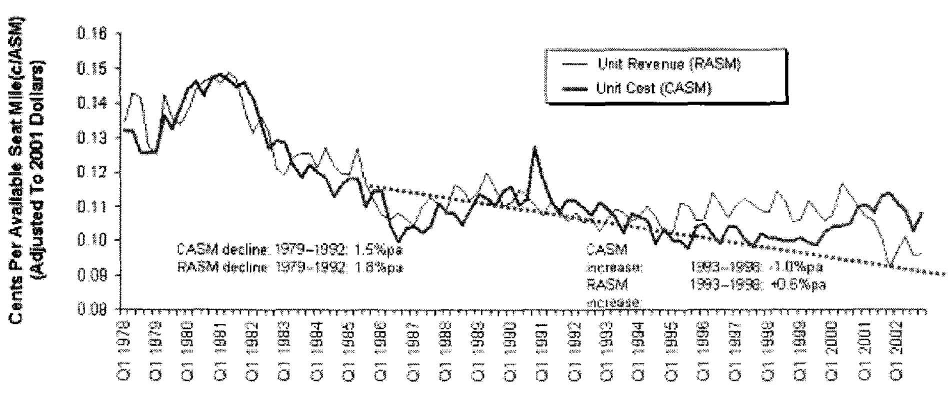


Figure 1 Unit Revenue and Cost Trend–U.S. Industry(Source, BoozAllenHamilton)

efficiency and reform to previous carriers and it became a opportunity for Low Cost carriers to gradually increase the market occupancy by performing strategy that meets the market circumstances and demand of customer and the trend of growth is estimated to continue in the future as well.

However, although the Low Cost carriers had tourist as main customer based on low-fare until now, Low Cost carriers are increasing the satisfaction of business-class passengers with the adaptability toward the change in market (Davies, 2005)[5] Therefore, success of Low Cost carriers lies in system that grasps the demand of customers and efficiently corresponds to it not in low-fare. In case of People Express Airline established in the east coast of USA in 1980, it went bankrupt in 1986 with the burden followed by low-fare although it has provided high-quality service of previous carriers with low-fare. It is the representative cases where low-fare was not accompanied by the efficiency in operation. Therefore, effort to minimize the service and maximize the efficiency meeting the demand of consumers shall be put into together with low-fare.

## 6 Low Cost Carriers and Tourism

Air transport industry is basic infra to maintain growth in tourism industry. Low Cost carriers with low-fare is playing major role in supplying the transportation of tourist that are increasing nowadays. Introduction of Low Cost carriers are also playing major role in creating the new tourism demand and it is inducing the competition within market inair transport industry as well. According to Bieger and Wittmer(2006), it is currently attracting not only low-fare passengers with high elasticity in price but also passengers depending on no. of flights with high elasticity in travel time. Low Cost carriers and tourism industry are the industry interdependent to one another. Therefore, pattern of travel is changing based on the development of air transport industry and pattern of provided service. Especially, introduction of Low Cost carriers induces the creation of diverse tourism demand. Therefore, there is need to put effort in developing the tourism industry together with fulfilling the various desires of human for movement by promoting the introduction of more Low Cost carriers to the domestic and overseas market, especially in Northeast Asia region where air transport market is integrated.

5) Requotation from Papatheodorous and Lei(2006)

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