

# Nok Air: Can It Fly Higher?

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## Abstract

Nok Air, established in February 2004, was a low-cost carrier in Thailand with a long-term goal of being a leader of low-cost airlines in the southeast Asia. Nok Air's business model for competing with other low-cost airlines in Thailand had both similarities to, and differences from, the "ideal type" of low-cost strategy pioneered by Southwest Airlines. Through brilliant strategies of being innovatively responsive to customers' needs, and doing so in a manner that provided convenience and added value, the Nok Air brand had become a well-recognized one in the country. The case discusses the adaptation of low-cost carriers' operations by Nok Air and its competition in the domestic market. Students were put into the shoes of Patee, the CEO of Nok Air who needed to make an informed decision about how to respond strategically to new competitive realities, including the question of how Nok Air could maintain its growth and the related question of whether the carrier would need to expand services beyond Thailand in order to assure its continued viability.

**Keywords:** Low-cost Carriers, Airlines Competition, International Expansion

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# นกแอร์: มันจะสามารถบินสูงกว่านี้ได้หรือไม่?

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## บทคัดย่อ

นกแอร์ถูกก่อตั้งขึ้นในเดือนกุมภาพันธ์ ค.ศ. 2004 โดยเป็นสายการบินต้นทุนต่ำที่ให้บริการในประเทศไทยและมีเป้าหมายระยะยาวในการเป็นผู้นำในธุรกิจสายการบินต้นทุนต่ำในภูมิภาคเอเชียตะวันออกเฉียงใต้ รูปแบบทางธุรกิจของนกแอร์ในการแข่งขันกับสายการบินต้นทุนต่ำอื่นในประเทศไทยมีความเหมือนและแตกต่างจากรูปแบบที่เป็นอุดมคติของการใช้กลยุทธ์ต้นทุนต่ำที่บุกเบิกโดยสายการบินเซาท์เวสต์แอร์ไลน์ จากการดำเนินกลยุทธ์ที่ชาญฉลาดโดยการตอบสนองต่อความต้องการของลูกค้าอย่างสร้างสรรค์และโดยการมอบความสะดวกและคุณค่าอย่างต่อเนื่อง นกแอร์จึงเป็นสายการบินที่ได้รับการยอมรับและเป็นที่รู้จักอย่างดีที่สุดสายการบินหนึ่งในประเทศไทย กรณีศึกษานี้อธิบายถึงการปรับเปลี่ยนการปฏิบัติการในการดำเนินการสายการบินต้นทุนต่ำของนกแอร์และการแข่งขันในตลาดประเทศไทย นักศึกษาถูกสมมติให้เป็นคุณพาทีซึ่งเป็นประธานเจ้าหน้าที่บริหารของนกแอร์ที่จะต้องตัดสินใจอย่างรอบด้านว่า นกแอร์ควรจะต้องตอบสนองต่อสถานะของการแข่งขันที่กำลังเกิดขึ้นใหม่อย่างไร โดยรวมไปถึงคำถามที่ว่านกแอร์จะสามารถรักษาการเติบโตอย่างต่อเนื่องอย่างไรและนกแอร์ควรจะขยายการให้บริการออกไปยังนอกประเทศไทยหรือไม่เพื่อที่จะมั่นใจได้ว่า บริษัทยังสามารถดำเนินการได้อย่างประสบความสำเร็จต่อไปได้

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In May 2015, while the sun was setting on the other side of the Chao Praya River, Patee Sarasin stood by his office window overlooking Sathorn Road, one of the busiest boulevards in the heart of the central business district of Bangkok. Patee had been the CEO of Nok Air since its inception about a decade ago. As of 2015, Nok Air operated 96% of its flights domestically in Thailand. In so doing, to date it had been successful in achieving comparable market share against its main rival, the Malaysia's Thai Air Asia, through its "premium" low-cost business model. Increasingly, however, Nok Air had found it difficult to compete on ticket price head-on with Thai Air Asia, which had much higher economies of scale. Additionally, the increased number of customer's complaints and the recent decline in on-time performance were worrisome, as they had the potential to render Nok Air's heretofore successful business model vulnerable to competitive inroads from either existing carriers or to new ones that might enter the market, or both.

Indeed, Patee was concerned that three new ambitious players -- i.e., Thai Lion Air, Thai VietJet, and Kan Air -- who had already begun to offer scheduled flights on domestic routes similar to those of Nok Air would be able to eventually carve away a significant part of Nok Air's domestic revenue. Patee foresaw that this competitive threat to its continued dominance of its domestic Thailand routes would almost certainly accelerate by the end of 2015, when ASEAN's "Open Skies" was fully implemented, thereby enabling member country carriers to operate flights between ASEAN international airports with no regulatory limit in terms of frequency and capacity. This prospect was of more than casual concern, given that Nok Air had posted a loss of 400 million Baht for 2014, despite its domination of domestic routes in Thailand. Increased competition on its routes, as well as the concomitant loss of passenger revenues, would only magnify such losses in the years ahead.

As he gazed absentmindedly at the cars stuck in the traffic jam on Sathorn Road, Patee was more than a little worried about the future of Nok Air. Had Nok Air reached and got stuck in a dead end already, he wondered. Might there be a way for Nok Air to maintain its competitive advantage and grow its business further? Would ASEAN's Open Skies be a threat or an opportunity for Nok Air? Should Nok Air expand to international destinations, and, if so, how? These were some of the questions that Patee knew needed to be addressed and resolved if Nok Air was to remain

a viable player in the ASEAN airline industry in general, and in the Thai market in particular.

## Background of Nok Air

Born out of a corporate planning project of Thai Airways undertaken in preparation for the ASEAN “Open Skies” agreement, Nok Air was founded on February 24, 2004, with Thai Airways as the major shareholder with 39% of the equity. Thai Airways itself had been established in 1960 as a state-enterprise providing full-service air travels for both domestic and international destinations. Notwithstanding its more than half-century of success as the national carrier of the Kingdom of Thailand, the growth and success of low-cost carriers -- particularly Southwest Airlines in the US and Ryanair in Europe -- in the latter decades of the 20<sup>th</sup> century indicated that Thai Airways’ future prospects could become much bumpier. In particular, Thai Airways executives felt that once air travel was liberalized, as was very much the trend at the outset of the 21<sup>st</sup> century, the carrier might not be able to maintain its advantage, especially for short-haul air travel services, due to its organizational culture, human resources, and cost structures. Thus, in line with the old adage, “If you can’t beat them, join them,” Thai Airways helped launch Nok Air as a proactive strategic move to contend with the threat posed by the growing number of low-cost carriers. The word “Nok” translated as “Bird” in Thai, and was intended to imply freedom to fly anywhere. The yellow color in the company’s logo intimated friendship and warmth (see Exhibit 1).

Although some of its board members were selected by Thai Airways, Nok Air operated independently of its majority shareholder and maintained managerial decision-making autonomy. From the outset, its *modus operandi* was to strive to imitate, as much as it could, the business model of low-cost carriers such as that of Southwest Airlines. Nok Air’s long-term goal was to be a leader -- and if possible, the leader -- of low-cost airlines in the southeast Asia. Nevertheless, as of mid-2015, about ninety six percent of seats sold by Nok Air were for domestic travel.

## The Brilliance and Constraints of the Low-Cost Carriers Strategy

Central to the business model of nearly all low-cost airlines was a strategy of offering generally lower fares than conventional airlines while

providing limited service or charging extra fees for additional services such as meals, beverages or seat reservations. In this connection, Southwest Airlines had revolutionized the airline industry with the low-cost or “no-frills” air travel services that broke all the airline industry rules in the 1970s. First, in order to be able to charge a lower fare, Southwest Airlines needed to have low operating cost structure. This was accomplished through the operation of a fleet composed of a single type of aircraft, i.e., Boeing 737s, in contrast to the then industry standard of carrier fleets consisting of several (or more) types of aircraft. The fleet of a single type of aircraft – which soon became the standard for other low-cost airlines around the world -- greatly simplified the pilots’ training programs, spare parts inventories and maintenance, and plane and crew scheduling. By contrast, legacy airlines typically operated a diverse range of aircraft required by their hub-and-spoke network, thereby increasing their costs of training and maintenance.

Moreover, as an additional element of their business model, low-cost carriers flew point-to-point to secondary airports, thus avoiding busy and expensive hub airports that full-service airlines normally used. Use of secondary airports helped to reduce ground times and minimized delays because they were less congested and enabled a higher number of trips, which in turn led eventually to higher aircraft utilization and cost reduction. For example, in 2011, 71% of Southwest’s customers flew point-to-point with no layovers.

Several other elements of Southwest’s business model were also soon emulated by low-cost airlines around the world: limited in-flight amenities, high seating density, direct ticket sales, and human resources management policies. In-flight services of Southwest, and later other low-cost carriers, e.g., meals and beverages, were limited, although some of these services were available at extra charge on some carriers. High seating density with a single class, i.e., economy, was employed to increase efficiency. Then, to reduce the marketing cost of ticket distribution, most low-cost airlines sold their tickets directly through their websites. As the all-important final element of their business model, low-cost carriers’ strategy was to maintain a lean and productive personnel force, especially with regard to the flight attendants. For example, Southwest Airlines, once again the industry standard-setter, hired only people who only fit their carefully constructed profile of the “desired employee.” Southwest’s employees were also compensated at a higher level than their peers and

were encouraged to hold ownership shares in the airline. With such human resource policies and practices, Southwest created the “right” company spirit to encourage their employees to be innovative and productive in serving their customers.

Low-cost operations worked financially for short- and medium-haul flights, but not for long-haul flights. Long-haul flights was defined as a destination or a sector that could not be operated by an unconverted Airbus A320 or Boeing 737, which were the main aircrafts of low-cost carriers to date. With most low-cost carriers deeming short-haul flights to be no longer than 4 hours in practice, long-haul flights effectively meant flights of six hours or more. The operating cost advantage of low-cost carriers over conventional airlines had traditionally been estimated to be 50% on short- and medium-haul flights. However, this cost gap decreased by 30% between 2006 and 2011, as conventional airlines undertook restructuring initiatives during 2008 and 2009 in order to stay competitive. According to a study by KPMG, the unit cost of legacy carriers was 3.6 cents per Available Seat Kilometers (ASK) higher than that of low-cost carriers in 2006, but declined to just 2.5 cents per ASK in 2011.

Southwest Airlines had led the way in demonstrating the economic viability of the low-cost business model on short-haul flights. However, applying low-cost strategy for long-haul operations faced various challenges. Long-haul flights needed longer turn-around times for boarding, servicing, and fueling. Furthermore, longer flying hours might violate crew duty time regulations and run up against time zones and airport curfews. The use of secondary airports was impossible due to relative dearth of the necessary infrastructure, such as runway length, maintenance facilities, certified handling agents, and handling and ground support equipment for larger aircrafts. Therefore, the erstwhile savings from fast turnaround times and high utilization of aircrafts would not be realized on long-haul flights or would not offer low-cost carriers a lot of advantages over conventional airlines, whose average aircraft utilization and on-time percentages were already in the high numbers.

In addition, long-haul flights required a lean fleet of fuel-efficient modern aircrafts such as Boeing’s B787 or Airbus’s A350, or the extended range versions of narrow-bodied Boeing’s B737 or Airbus’s A320. With current production capacities of the two principal aircraft manufacturers, it would

take years before the typical low-cost carrier would be able to assemble a fleet of these aircrafts. Finally, a high passenger load factor, estimated to be of 80% or higher, was essential for long-haul operations to be profitable. In this connection, it was also questionable whether low-cost carriers could manage to gain market share directly from conventional airlines. The history of low-cost airlines industry included several low-cost carriers whose attempts to succeed in the long-haul segment of the business failed. The roster of the unsuccessful included the trans-Atlantic “Skytrain” of Sir Freddie Laker in 1970’s, the People Express Airlines in 1980’s, and the later Oasis Hong Kong Airlines and Air Asia X in 2000’s. Beginning in May, 2013, Norwegian Air Shuttle had become the most recent low-cost airline to offer low-cost fares for long-haul intercontinental flights, using a fleet of seven Boeing B787s, with 17-18 hours flying time per day. It remained to be seen whether the business was sustainable.

## **The Brilliance and Constraints of Nok Air’s Strategy**

First, true to the low-cost paradigm, Nok Air flew point-to-point. However, it did so not with a single aircraft type, but rather with a fleet of mixed types of aircrafts – i.e., eighteen Boeing’s B737-800, two ATR 72-500, and four Bombardier’s DHC-8Q-402. The aircrafts had different seat capacities. For example, the Boeing B737-800 had between 186 to 189 seats, while the Bombardier’s Dash-8 Q400 had 86 seats, which were designed to adapt to routes as a function of the number of passengers. Second, while some seventy five percent of the fleet consisted of Boeing jets, the current average fleet age was about 6.9 years – which, although an improvement on the 11.8 years average age in March 2013, was nonetheless older than the fleets of Nok’s main competitors. All Nok Air’s aircrafts were leased, with the remaining lease time ranging from 3.7 to 11.9 years as of March 2015.

In alignment with low-cost carrier operations, in 2007, observing the government’s policy to reduce congestion at Suvarnabhumi International Airport, Nok Air moved its main flight operations center to the preferred and less-congested Don Mueang International Airport. Secondary flight operations centers were located in the northern city of Chiang Mai where there were a large amount of tourist traffic. By strategic design, all current domestic destinations of Nok Air were within four hours flight time of these two flight operations centers. However, also within this



4-hour flight range were air terminals in countries such as India, Nepal, Bangladesh, Bhutan, Sri Lanka, Southern China, Taiwan, and most of the southeast Asian nations (except certain parts of east Indonesia).

The Department of Civil Aviation (DCA) classified domestic routes into three types. Primary routes were those with over 300,000 passengers per year, and where the DCA allowed all Thai airlines to operate commercial flights without restricting the number of airlines. Secondary routes had between 50,000 and 300,000 passengers per year. Only three commercial airlines were allowed to operate on the secondary routes. Finally, the feeder routes, which had total passengers of less than 50,000 per year, were allowed to have up to two commercial airlines operating the route. With its varied array of aircraft, Nok Air provided the widest coverage of all route types, while most of the competitors operated only on primary routes because operating on secondary and feeder routes with their larger aircrafts was not cost-efficient. Since Nok Air had smaller aircrafts in its fleet, it had taken advantage of this opportunity to develop an air travelers market in the smaller cities. This strategy had been instrumental in helping Nok Air to grow and maintain its share of the domestic travel market over the years. (See Exhibit 3 for a comparison of flight frequency for domestic routes.) Apart from its principal focus on domestic Thai flights, as of May 2015, Nok Air also offered a limited number of international flights – i.e., to Yangon, Myanmar (14 flights per week) and to Hefei, China (4 flights per week).

In order to increase its customer value proposition, Nok Air further differentiated itself from its low-cost competitors in some of its marketing tactics and its innovations in customer service. For example, in contrast to traditional low-cost carriers, Nok Air not only sold its tickets directly to customers through their website, but also through its call center, and sales kiosk at the Don Mueang and Chiang Mai airports. Overall, about 15% of Nok's tickets were sold through distributors, corporate sales, and promotional events. Moreover, Nok Air developed new payment channels to provide convenience and peace of mind for its customers since online payment systems in Thailand were still in their early stages without wide coverage and high trust. In 2004, Nok Air became the first airline to allow passengers to pay for their tickets at a bank ATM, and in 2012, Nok Air became the world's first airline to enable passengers to purchase their tickets from a convenience store.



In addition, Nok Air strived to provide friendly, passenger-centric service, which included not charging extra fees for additional services such as prior seat selection, in-flight snacks and beverages, and a 15-Kg of baggage allowance. Nok Air had also taken the extra step as a pioneer in providing a seamless transportation service from airports in different cities to passengers' final destinations, such as from Trang's airport to islands in the Andaman Sea. Because of this strategy of being innovatively responsive to customers' needs, and doing so in a manner that provided convenience and added value, the Nok Air brand had become a well-recognized one in the country. Its brand awareness in 2012 was at 94%; and, in the same year, Nok was voted the best airline at the Thai International Travel Fair.

Conscientious devotion to these strategies had enabled Nok Air to maintain steady growth in its share of the domestic market relative to its competitors, as measured by the number of passengers carried. However, the airline encountered unexpected turbulence between 2012 and 2014, when Nok's performance on one of the primary determinants of passengers' choice of carriers and of repeat patronage – i.e., on-time performance -- suffered a serious deterioration. Hovering at around 78%, Nok's difficulty in meeting customer expectations concerning departures and arrivals could easily precipitate a gradual loss of loss of passengers to competitor flights unless action was taken to reverse the trend.

## **Competitive Dynamics of the Airline Industry in ASEAN and Thailand**

In 2015, the air travel industry was one of the fastest growing industries in the world. Indeed, between 1970 and 2010, the number of air travelers had grown four times more than the growth in the world's GDP. The high growth resulted from relaxation of air transport regulations in many nations and trade blocs, the growth of the global middle class, and the burgeoning of modern cities, especially in Asia-Pacific, Africa, and South America. With the compounded annual growth rates of the airline industry between 2001 and 2012 in North America, Europe, and Asia-Pacific at 5.0%, 20.1% and 32.4%, respectively, 82% of all airlines revenue came from these three regions as of 2011. Of particular note was the fact that the market share of low-cost carriers against the full-service airlines in Asia-Pacific was 24.1%, as compared with 30.1% and 36.6% in North America and Europe, respectively. And, all indications were that the future of the industry,

including the low-cost carrier segment, would soon be experiencing accentuated competitive dynamics, particularly in the rapidly expanding ASEAN market for air travel.

### **ASEAN's "Open Skies" Policy**

ASEAN's "Open Skies" Policy came into effect on January 1, 2015 and was expected to be fully implemented by the end of 2015. It was intended to increase connectivity among ASEAN member countries by allowing airlines from member states to fly freely throughout the region. Moreover, Open Skies required higher standards of safety and other regulatory measures regarding operating flights. International airports of member states were to be fully opened up under this policy, with the liberalization of aviation aimed at guaranteeing certain "freedoms of the air." The most important aspects of this liberalization in ASEAN market was the guarantee of the third, fourth, fifth, and seventh freedoms of the air. Essentially, the third and fourth freedoms of the air rights guaranteed the right of all ASEAN residents to fly from an airline's home country to a foreign country, and vice versa, without governmental approval. These freedom rights were already prevalent among ASEAN states. The fifth freedom rights guaranteed the right to land in a foreign country and board passengers from that country to travel to a third country where the passengers disembarked. For example, a scheduled flight from Thailand to Indonesia could stop and pick up passengers in Singapore to disembark all of them in Indonesia. The seventh freedom rights allowed airlines to fly and take passengers between two states to the third states without going through the home state of the airlines. For example, a scheduled flight of Thailand's Nok Air from Singapore could stop and take passengers in Cambodia to the flight's final destination in Vietnam.

In sum, the "Open Skies" policy was designed to increase competition in the aviation industry in ASEAN, thereby encouraging higher traffic growth and service quality while lowering air ticket prices. Among other expected outcomes, under Open Skies, fleet and network management for low-cost carriers would become more efficient and further reduce their operating cost. As ASEAN endeavored to ensure the materialization of these expectations, competition among all airlines in the region, including the low-cost carriers, was forecast to intensify – with likely winners and losers.

## Competitors in the Thai Air Travel Market

Thailand had long enjoyed a vibrant status as one of the top travel markets in Southeast Asia. As the second largest nation in the region by population (surpassed only by Indonesia), as one of the higher-income nations in ASEAN (with per capita income exceeded only by Singapore and Malaysia), and with a reputation as a tourist mecca (approached but not yet exceeded by her sister nations in the area), Thailand was serviced by a energetic cluster of airlines, ranging from the national carrier of Thailand to a number of smaller, but no less dynamic lower-cost competitors.

### *Thai Airways.*

Thai Airways was a full-service airline that had provided domestic air travel service in Thailand for decades; therefore, its brand was well-recognized for its excellent service. Reflecting its premium-quality service and considerable market power, Thai Airways set its prices higher than the low-cost carriers in the Thai market. However, by the end of the first decade of the 21<sup>st</sup> century, as Thai Airways began facing an increasingly fierce onslaught of competition from low-cost carriers, the “grande dame” of domestic Thai air travel decided to set up another lower-cost alternative to its high-cost, full-service business model. Thus did Thai Smiles airline come into existence in July 2012, operating – like its parent airline – only on *primary* domestic routes. The combined growth in the number of passengers for Thai Airways and Thai Smiles averaged 6.8% between 2010 and 2012. But, while as the longest operating airline in Thailand, the Thai Airways-Thai Smiles combo had the largest market share (40% in 2010), its market share was on a declining trajectory, having gone from nearly 40% in 2010 to about 21% in 2014. In the face of declining market share because of newer low-cost competitors, Thai Airways’ strategic response, beginning in 2009, was to sharpen its focus on its international routes as the more promising avenue for continued growth and profitability.

### *Bangkok Airways.*

Established in 1968 to provide chartered flights, Bangkok Airways became, in 1986, the first privately-owned, full-service airline in Thailand. Positioning itself as a boutique airline, Bangkok Airways offered premium service to popular domestic destinations, such as Krabi and Korat. In addition, the airline flew to more than 20 cities in Asia, most of which were popular

tourist destinations. To maintain its competitive advantage, Bangkok Airways had invested in building their own airports at Samui Island, Sukhothai, and Trat. The airline's passenger numbers grew at 16% on average between 2010 and 2013, with an average market share of 15%. Most of Bangkok Airways routes were the *primary* routes and *feeder* routes that were not flown by other airlines.

### *Thai Air Asia.*

Thai Air Asia, established on September 19, 2003, just about six months ahead of Nok Air, was a joint venture between Asia Aviation, a group of Thai investors, and Air Asia Investment, which was wholly owned by Air Asia Berhad. Air Asia Berhad, a low-cost carrier listed in the stock market Bursa in Malaysia, pioneered the short-haul, low-cost model in southeast Asia with the launching of Air Asia in 2001. Having grown to become the largest low-cost carrier in terms of fleet size and number of passengers carried, Air Asia, a formidable competitor, was named the best low-cost airline by Skytrax for five consecutive years, from 2009 to 2013. Aiming to be a leading low-cost carrier with a high quality of service in Thailand with its slogan of "now everyone can fly," Thai Air Asia flew point-to-point from its three operating hubs -- Bangkok, Phuket, and Chiang Mai -- to other domestic or international destinations within four hours of flying time. Most of these domestic routes were *primary* routes that were almost identical to those of Nok Air; hence, they were direct competitors. Recently, Thai Air Asia had started offering flights on *secondary* and *feeder* routes with its Airbus's A320.

Following Air Asia Berhad's strategy, Thai Air Asia offered its lowest fare with no-frills, where customers could choose to pay for any extra services, such service as check-in baggage, in-flight food and drink, seat selection, etc. Operations of Thai Air Asia were supported by Air Asia Berhad and its subsidiaries, which provided aircraft rental and maintenance, management information systems, and ticket booking, etc. To lower its maintenance and training costs, Thai Air Asia used a 43-plane fleet of a single type of aircraft, the Airbus 320-200, all of which were configured to only 180 single-class seats. The current average age of Thai Air Asia's aircrafts was 3.8 years, and was expected to go lower because the carrier was scheduled to take delivery of five new A320-200's until 2018. With its comparatively young fleet, Thai Air Asia sought to provide customers with

enhanced services and maximum safety on all of its flights.

About 80% of Thai Air Asia tickets was sold direct through its website, while another 19% was sold direct through airport kiosks and call centers. Thai Air Asia trained and expected their employees to provide friendly and best-quality services “from their hearts” to all customers.

Within the low-cost segment, Thai Air Asia had the largest domestic market share of 49.5% in 2013, while Nok Air had 43.4%, based on the number of passengers. However, the number of Nok Air’s passengers was growing at a faster rate than that of Thai Air Asia. Thai Air Asia regularly offered discounts on their already low-price tickets to stimulate demand, especially when the demand was expected to be low. Of note, the on-time performance of Thai Air Asia was in the high level of 83% to 92% between 2010 and 2014.

#### *Orient Thai.*

Orient Thai, a low-cost carrier operating domestic flights with a one price policy, concentrated its business on chartered flights. Its two primary routes were flights to Chiang Mai and Phuket, major cities in the north and south. Because its market share had decreased significantly, from 6% in 2010 to 0.4% in 2014, its future viability as a competitor seemed uncertain, at best.

#### *Thai Lion Air.*

Thai Lion Air was a low-cost carrier, established in December 2013 as a joint venture between Thai partners and Lion Air of Indonesia. It flew point-to-point on *primary* routes to compete with other full-service and low-cost airlines. Thai Lion Air offered free 15-kg baggage allowance, free 15-kg sport equipment allowance, and free seat selection with its low-cost ticket price. Lion Air was a major low-cost carrier in Indonesia with a fleet of about 100 Boeing 737’s. In 2013, as it geared up to expand its low-cost airline business throughout the southeast Asia region, Lion Air signed a contract with Airbus for 234 Airbus A320’s. This came on the heels of its 2011 contract with Boeing for 230 Boeing jets. Additionally, in January 2015, Thai Lion Air expanded from two to nine Boeing’s 737-900ER, which were assigned to 7 *primary* routes that Thai Air Asia and Nok Air also flew.

Domestic capacity expansion of low-cost carriers for Thai Lion Air was more than 600% between February 2014 and February 2015, while those of

Nok Air and Thai Air Asia were around 20% to 25%. Thai Lion Air aimed to continue its expansion in Thailand's domestic market as it received more aircrafts from Boeing. Furthermore, Thai Lion Air expected to increase its aircraft utilization from 9 hours per day to a higher level of at least 11-12 hours per day, the current average utilization of Thai Air Asia's aircrafts. Competition in domestic market would be intensified since each airline competed to fill their over-supplied seats to stay profitable.

#### *Kan Air.*

Kan Air was a domestic airline based in Chiang Mai. It had operated since September 2010, with regional flights to destinations in the north and northeast of Thailand on *feeder* routes, such as Pai, Mae Hong Son, Nan, Phitsanulok, and Khon Kaen. Kan Air's fleet consisted of only two turbo propeller aircrafts, a Cessna 208B with 12 seats and a Beechcraft with 6 seats. Two additional ATR-72 with 66 seats were added to the fleet in early 2015. Kan Air planned to expand its operations for other *feeder* routes in Thailand.

#### *Thai VietJet Air.*

Thai VietJet Air, a start-up low-cost carrier with twenty Airbus A320s, was a joint venture between VietJet Air of Vietnam and a group of Thai investors. It planned to launch services in March 2015 with a main focus on international routes, although some domestic routes would be served. Four primary routes would be served initially from Suvarnabhumi Airport, in contrast to other low-cost carriers that served these routes from Don Mueang Airport. Thai VietJet Air expected to employ a minimum of three Airbus's A320s to serve Thailand, and more aircrafts would be added as demand increased.

### **Potential Partners in the International Air Travel Market**

Due to the high growth potential for air travel market in Asia-Pacific region, as indicated before, there were a number of airlines, both within and outside the southeast Asia region, that were known to be interested in expanding into this market. Some of them were already using a low-cost business model and were direct competitors of Nok Air. Some of them were cash-rich, full-service carriers looking for partners to expand into this high potential market.

### **Air Asia X**

Beginning in 2007, Air Asia Berhad had expanded its low-cost flights to longer routes, specifically from Kuala Lumpur, Malaysia to the Gold Coast, Australia. This low-cost, long-haul service, operated under Air Asia X in Malaysia, currently embraced 19 destinations in Asia, Australia, and the Middle East, utilizing a fleet of 19 Airbus A330's. The seat configuration on each aircraft employed on these routes consisted of both premium flatbeds and economy seats. Air Asia X unabashedly aimed to solidify its position as a market leader among low-cost airlines in the region. In the furtherance of this strategic objective, Thai Air Asia X was set up as a joint venture in 2013 and started to serve longer routes from Bangkok to Seoul, Osaka, and Tokyo in 2014.

### **Scoot**

In order to respond to the rising challenge from the low-cost carriers, Singapore Airlines established Scoot in 2011 as a low-cost long-haul subsidiary airline. Scoot started to offer flight between Singapore and Sydney and the Gold Coast in June, 2012 with Boeing 777-200s. It planned to increase its fleet to 14 wide-bodied aircrafts by 2016, with an expanding network to include destinations in north Asia, southeast Asia, and south Asia.

### **Jetstar Group**

Jetstar Group was a multi-national airline group consisting of a network of low-cost airlines including Jetstar Airways (based in Australia and New Zealand), Jetstar Asia Airways (based in Singapore), Jetstar Pacific Airlines (based in Vietnam), Jetstar Japan, and Jetstar Hongkong Airways. While Jetstar Airways was wholly owned by Qantas Group, the others were joint ventures between Qantas Group and partners in respective countries. Jetstar Airways was formed through Qantas's two-branded strategy and started to operate in May 2004 as a low-cost carrier. Currently, Jetstar operated across 19 Australian domestic destinations and 17 short- and long-haul overseas destinations.

### **Emirates Group**

Emirates Group, founded in 1985, had become one of the largest international full-service carriers in the world with its base in Dubai. Its fleet consisted of only wide-bodied aircrafts and was one of the youngest fleets



in the sky. As the parent company of Emirates Airline, it helped to set up a Dubai-based low-cost carrier.

### **Etihad Airways**

Etihad Airways was established as a full-service carrier in July 2003 and commenced operations in November 2003. It belonged to the Etihad Group, which was experienced in a large-scale expansion through both organic growth and acquisition. Its goal was to be “a truly 21<sup>st</sup> century global airline.”

### **ANA Holdings**

ANA Holdings was a Japanese airline group operating an extensive network of domestic and international air travel service. All Nippon Airways was a core full-service carrier within the group. ANA Holdings also contained regional airlines operated by ANA Wings, charter airlines operated by Air Japan, international low-cost airlines operated by Peach, and domestic low-cost airlines operated by Vanilla Air.

## **Ways Forward for Nok Air**

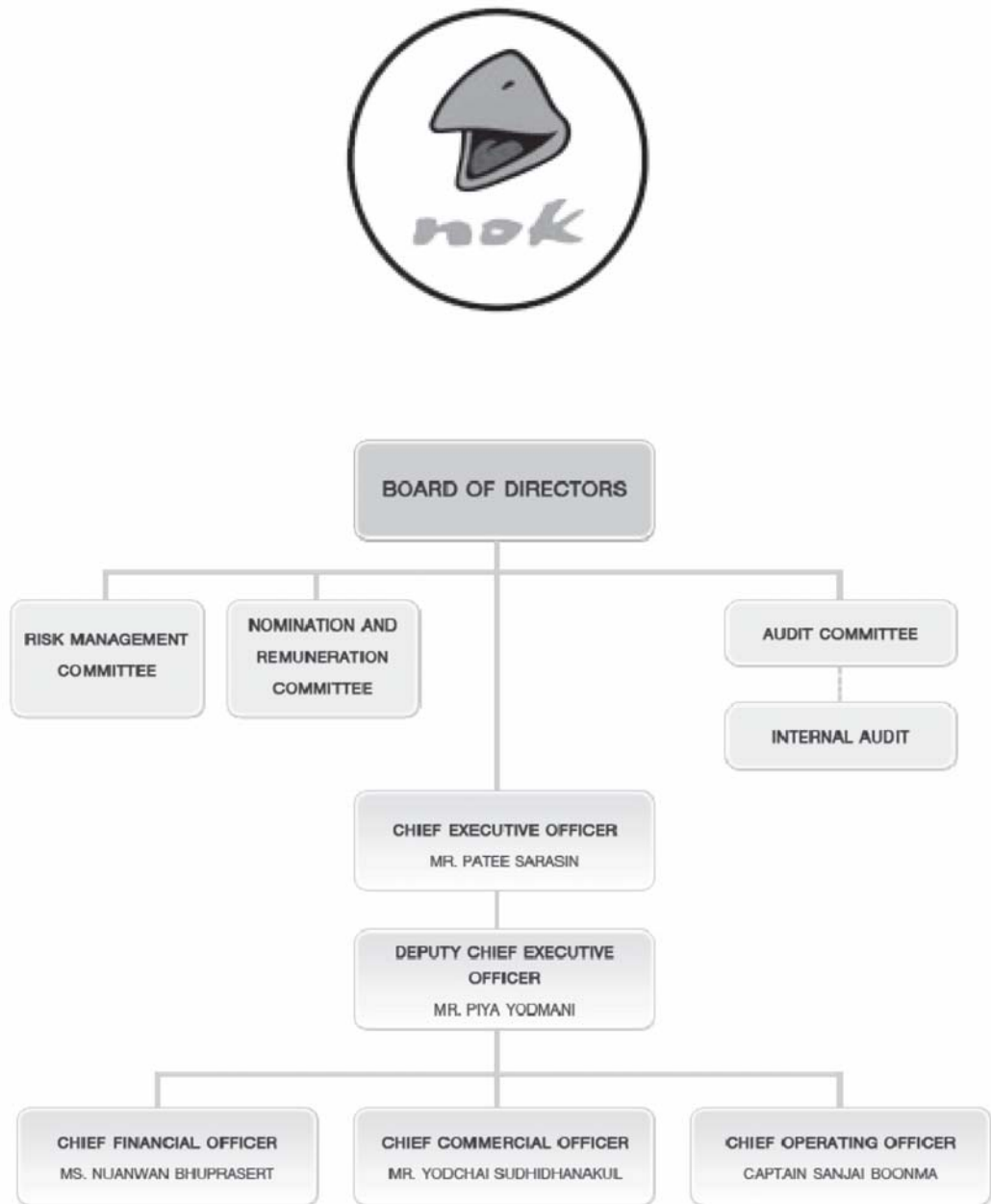
As he continued observing the long line of cars and trucks inching along Sathorn Road, Patee felt much satisfaction in Nok Air’s performance over the years. For the past ten years, its strategy had succeeded in growing its market share in the domestic market, enabling it to compete successfully with Thai Air Asia to gain approximately equal market share for domestic travel. But, the competitive situation was becoming considerably more challenging. Competition in the domestic market was increasing, seemingly without end, due to newly-added seat capacity from both old and new low-cost carriers, such as Thai Lion Air and Thai VietJet Air. As if that were not ominous enough, Thai Air Asia had started using their large jets to offer domestic flights for secondary and feeder routes, while Kan Air had begun expanding its fleets with larger aircraft with which to service the north and northeast feeder routes – some of the very routes that used to be the main source of profits for Nok Air. It was difficult for Patee to not feel that aggressive competition was amassing forces to assault Nok Air from nearly every possible angle.

Further, while fuel cost was relatively low at the moment, once the global economy picked up, the oil price would certainly increase. As fuel was one of the major costs of airline operations, higher fuel costs would heat

up the competition even more for the domestic market in which the seat capacity was in *growing* over-supply. Finally, ASEAN's Open Skies policy seemed likely to benefit most the larger low-cost carriers with international flights since it would simplify fleet management and offer higher economies of scale, both of which were absolutely crucial for low-cost airlines competing largely on price. In light of these realities, Patee wondered whether it was imperative for Nok Air to grow in size just to forestall losing out to those airlines whose size would afford them greater economies of scale.

With its "premium low-cost" business model, Nok Air had adapted its operations from the traditional low-cost-carrier model in order to compete in the domestic market against Thai Air Asia. But, in addition to the need to improve its operational performance (e.g., on-time service) to hold its own against intensified competition in the domestic-market, the more strategic question in Patee's mind was whether Nok Air needed to expand internationally in order to maintain its advantage and grow its revenue. If so, then Nok had a couple of options: expand its own capability to fly to international destinations or it could find a partner that was already flying international routes in order to grow internationally faster. The fundamental question before Patee was whether Nok Air could fly higher, and, if so, how.

## Exhibit 1: The Logo and Organization Chart of Nok Air



Source: Company web site [http://www.nokair.com/investor\\_relations/](http://www.nokair.com/investor_relations/), accessed April 16, 2015.

**Exhibit 2: Nok Air's Fleet History**

March 31, 2013

<b>Aircraft Type</b>	<b>Number of Aircrafts</b>	<b>Capacity per Aircraft (Seats)</b>	<b>Average Aircraft's Age (Year)</b>
Boeing B737-400	3	150/168	21.0
Boeing B737-800	10	189	8.0
ATR 72-200/72-500	4	66/70	14.6
<b>Total</b>	<b>17</b>	<b>-</b>	<b>11.8</b>

*Source:* Registration Statement of Securities (Form 69-1), [http://www.nokair.com/investor\\_relations/](http://www.nokair.com/investor_relations/), accessed March 23, 2015

May 14, 2015

<b>Aircraft Type</b>	<b>Number of Aircrafts</b>	<b>Capacity per Aircraft (Seats)</b>	<b>Average Aircraft's Age (Year)</b>
Boeing B737-800	18	186 - 189	8.1
ATR 72-500	2	66 - 72	7.9
Bombardier Dash 8 Q400	4	86	0.8
<b>Total</b>	<b>24</b>	<b>-</b>	<b>6.9</b>

*Source:* CAPA, <http://centreforaviation.com>, accessed May 20, 2015

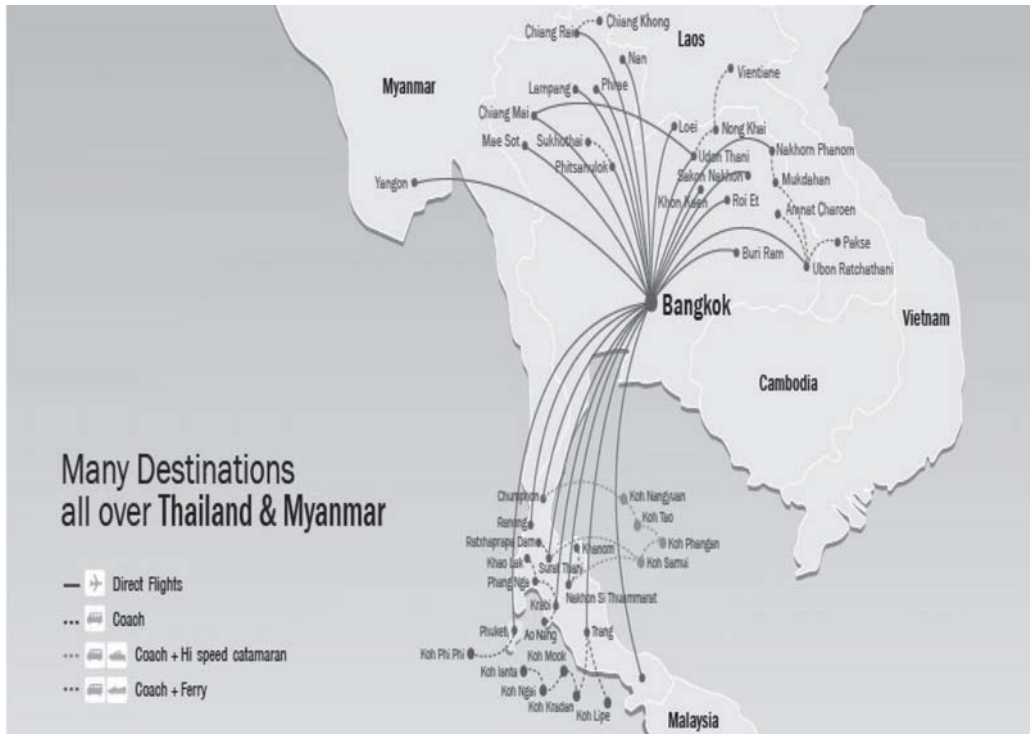
### Exhibit 3: Domestic Routes for Low Cost Carriers in Thailand

Primary Route	Number of flights (one-way) per week			
	Nok Air	Thai Air Asia	Thai Lion Air	Thai VietJet Air*
Bangkok – Chiang Mai	56	70	56	x
Bangkok – Chiang Rai	28	28	21	0
Bangkok – Hat Yai	49	63	61	x
Bangkok – Khon Kaen	21	28	0	0
Bangkok – Krabi	14	42	14	0
Bangkok – Nakhon Si Thammarat	42	28	0	0
Bangkok – Phuket	30	98	7	x
Bangkok – Surat Thani	35	35	33	0
Bangkok – Ubon Ratchathani	49	14	0	0
Bangkok – Udon Thani	46	14	25	x
<b>Secondary Route</b>				
Bangkok – Trang	21	14	0	0
Bangkok – Phitsanulok	21	14	0	0
Chiang Mai – Hat Yai	0	7	0	0
Chiang Mai – Krabi	0	14	0	0
Chiang Mai – Phuket	0	21	0	0
Phuket – Udon Thani	0	7	0	0
<b>Feeder Route</b>				
Bangkok – Buri Ram	7	7	0	0
Bangkok – Chumphon	7	0	0	0
Bangkok – Lampang	21	0	0	0
Bangkok – Loei	14	14	0	0
Bangkok – Mae Sot	21	0	0	0
Bangkok – Nakhon Phanom	7	14	0	0
Bangkok – Nan	25	14	0	0
Bangkok – Narathiwat	0	7	0	0
Bangkok – Prae	7	0	0	0
Bangkok – Ranong	14	0	0	0
Bangkok – Roi Et	17	14	0	0
Bangkok – Sakon Nakhon	21	14	0	0
Chiang Mai – Udon Thani	7	0	0	0
Hat Yai – Udon Thani	0	0	3	0

Source: Case writer based on information from company's websites, accessed on May 23, 2015. Information of Thai Lion Air flights frequency is from CAPA as of February 11, 2015.

\* Thai VietJet Air serves from Suvarnabhumi Airport while other airlines from Don Mueang Airport in Bangkok. "x" indicates that the number of weekly flights is planned but not known yet.

### Exhibit 4: Nok Air's Route Coverage



*Source:* Nok Air's website, <http://www.nokair.com>

### Exhibit 5: Thai Air Asia International Destinations

Origin	Destinations
Bangkok, Thailand	Bali, Indonesia
	Changsha, China
	Chennai, India
	Chongqing, China
	Guangzhou, China
	Hanoi, Vietnam
	Ho Chi Minh, Vietnam
	Hong Kong, China
	Kuala Lumpur, Malaysia
	Kunming, China
	Macau, China
	Mandalay, Myanmar
	Penang, Malaysia
	Phnom Penh, Cambodia
	Shenzhen, China
	Siem Reap, Cambodia
	Singapore, Singapore
Chiang Mai, Thailand	Wuhan, China
	Xi'an, China
	Yangon, Myanmar
Krabi, Thailand	Macau, China
	Hong Kong, China
	Hangzhou, China
Phuket, Thailand	Guangzhou, China
	Kuala Lumpur, Malaysia
	Singapore, Singapore
	Hong Kong, China

Source: Case writer based on 2014 Thai Air Asia Annual Report



**Exhibit 6: Market Share of Nok Air and Its Competitors**

Airlines	Market Share (%)				
	2010	2011	2012	2013	2014
Thai Airways	39.5	35.6	33.7	29.3	21.2
Thai Air Asia	23.2	23.5	25.5	27.8	28.2
Nok Air	16.2	19.7	22.3	27.2	29.1
Bangkok Airways	14.8	14.6	14.8	14.2	13.8
Orient Thai	6.3	6.6	3.7	1.4	0.4
Thai Lion Air*	-	-	-	0.1	7.23

Source: Department of Civil Aviation, and Nok Air 2014 Annual Report

\* Thai Lion Air started to operate in December 2012

**Exhibit 7: Revenue Analysis of Nok Air excluding subsidiaries (Unit: Million Baht)**

	2013	2014
<b>Revenue</b>		
Passenger revenues	10,542	11,229
Other service revenues	638	914
Other income	135	152
<b>Total revenues</b>	<b>11,315</b>	<b>12,296</b>
<b>Expenses</b>		
Operating expense and cost of services	9,478	11,930
Sale expenses	252	272
Administrative expenses	485	502
Financial costs	-	2
<b>Total expenses</b>	<b>10,215</b>	<b>12,706</b>
Profit before income tax	1,099	(411)
Income tax expenses	33	(0.4)
<b>Profit (loss) for the year</b>	<b>1,066</b>	<b>(410)</b>
Actuarial profit	9	12
Income tax relating to components of other comprehensive profit (loss)	(0.2)	(0.2)
<b>Comprehensive profit for the year</b>	<b>1,075</b>	<b>(399)</b>
Earnings per share (Baht)	1.88	(0.66)

Source: 2014 Nok Air Annual Report

**Exhibit 8: Cost Structure of Nok Air (Units: Million Baht)**

	<b>2013</b>	<b>2014</b>
<b>Variable costs</b>		
Fuel cost	3,474	4,441
Aircraft maintenance	1,788	2,360
Airport fee & navigation	464	660
Ground handling & dispatch	427	504
Aircraft charter	384	106
Other variable costs	885	1,119
<b>Total variable costs</b>	<b>7,421</b>	<b>9,159</b>
<b>Fixed costs</b>		
Aircraft operating lease	1,331	1,901
Personnel & station expenses	586	755
Aircraft insurance fees	75	74
Aircraft delivery and redelivery	62	38
Other fixed costs	2	4
<b>Total fixed costs</b>	<b>2,057</b>	<b>2,771</b>
<b>SG&amp;A</b>	<b>737</b>	<b>774</b>
<b>Total operating expenses</b>	<b>10,215</b>	<b>12,704</b>

*Source:* 2014 Nok Air Annual Report

**Exhibit 9: Income Statement of Thai Air Asia**

	<b>2013</b>	<b>2014</b>
<b>Revenue</b>		
Passenger and service revenues	23,485	25,356
Other income	671	794
Gain on exchange rate	258	126
<b>Total revenues</b>	<b>24,414</b>	<b>26,276</b>
<b>Expenses</b>		
Operating expense and cost of services	19,928	23,708
Sale expenses	1,148	1,180
Administrative expenses	608	745
Financial costs	171	313
<b>Total expenses</b>	<b>21,855</b>	<b>25,946</b>
Profit before income tax	2,559	330
Income tax expenses	651	(1)
<b>Profit (loss) for the year</b>	<b>1,907</b>	<b>331</b>
Actuarial profit	16	12
Income tax relating to components of other comprehensive profit (loss)	(3)	(2)
Other comprehensive income for the year	13	9
<b>Total comprehensive profit for the year</b>	<b>1,920</b>	<b>340</b>
Earnings per share (Baht)	0.215	0.038

Source: Case writer based on 2014 Thai Air Asia Annual Report

**Exhibit 10: Operating Expenses by Nature of Thai Air Asia (Units: Million Baht)**

<b>Expenses by nature</b>	<b>2013</b>	<b>2014</b>
Fuel cost	9,386	11,272
Aircraft rental	3,279	3,751
Aircraft maintenance	1,477	1,502
Other repair and maintenance	477	360
Ramp and airport operating costs	1,605	2,292
Staff costs	2,481	2,800
Booking fee	88	105
Pilot training	97	85
Brand license	240	244
Other expenses	798	1,297
<b>Total operating expenses and costs of service</b>	<b>19,928</b>	<b>23,708</b>

*Source:* Case writer based on 2014 Thai Air Asia Annual Report

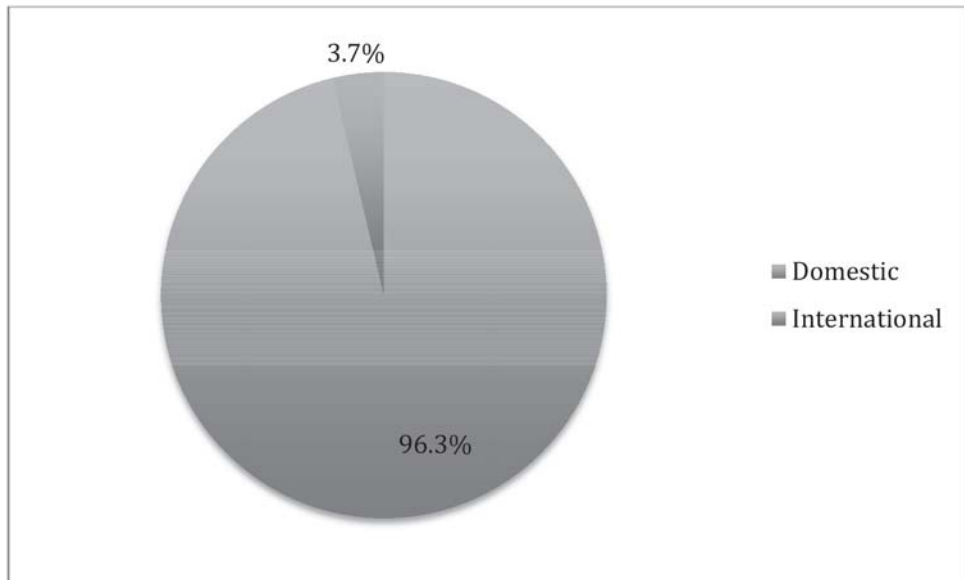
**Exhibit 11: Key Operations Statistics of Nok Air and Thai Air Asia**

	Nok Air			Thai Air Asia		
	2012	2013	2014	2012	2013	2014
Passenger Revenue (million THB)	7,634	10,542	11,225	13,162	19,726	20,971
Number of Passengers (million passengers)	4.16	5.89	7.62	8.3	10.5	12.2
Available Seat Kilometers (ASK) (million seat-km.)	2,916	4,247	5,375	10,499	12,951	15,419
Revenue Passenger Kilometers (RPK) (million seat-km.)	2,456	3,567	4,372	8,618	10,829	12,420
Cabin Factor (%)	84.2	84.0	81.3	82	83	80
Average Airfare (Baht) (VAT and Tax excluded)	1,884	1,788	1,473	1,977	1,885	1,726
Revenue per ASK (Baht/seat-km)	2.82	2.63	2.26	1.84	1.81	1.64
Cost per ASK (Baht/seat-km)	2.65	2.39	2.36	1.69	1.67	1.66
Number of Flights						
Domestic	36,813	51,247	56,553	32,843	41,512	51,191
International*	0	0	0	23,224	28,637	33,883
Average stage length (km)	591	605	574	1,040	1,026	1,008
On-time Performance (%)	78.0	89.5	77.9	83	92	91

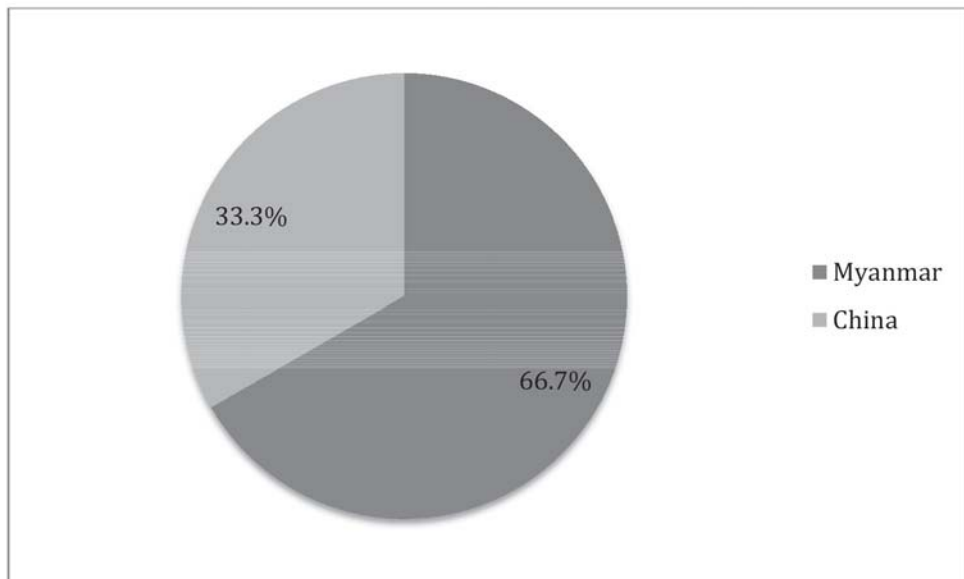
*Source:* Case writer based on 2014 Annual Report of Nok Air and Thai Air Asia.

\* The number of international flights for Nok Air is negligible. The number of flights for Thai Air Asia is inferred from the number of stages, which is the number of total aircraft departures performed.

**Exhibit 12: Nok Air Capacity Seats Share between May 11 and May 17, 2015**



Capacity Seat Share for Nok Air (Domestic vs. International)



Capacity Seat Share for Nok Air for International Flight

Source: CAPA, <http://centreforaviation.com>, accessed May 20, 2015

### Exhibit 13: Projected Fleet Growth for Short-haul Low-cost Carriers in Thailand

Airline	Fleet as of Dec-2012	Fleet as of Dec-2013	Fleet as of Dec-2014	Projected Fleet as of Dec-2015
Thai Air Asia	27	35	40	45
Nok Air	15	17	24	28
Thai Lion Air	N/A	2	8	18
Thai VietJet Air	N/A	N/A	N/A	3
Total	42	54	72	94

Source: CAPA, <http://centreforaviation.com>, accessed May 20, 2015

### Exhibit 14: Number of Domestic Passengers in Thailand and Average Growth Rate

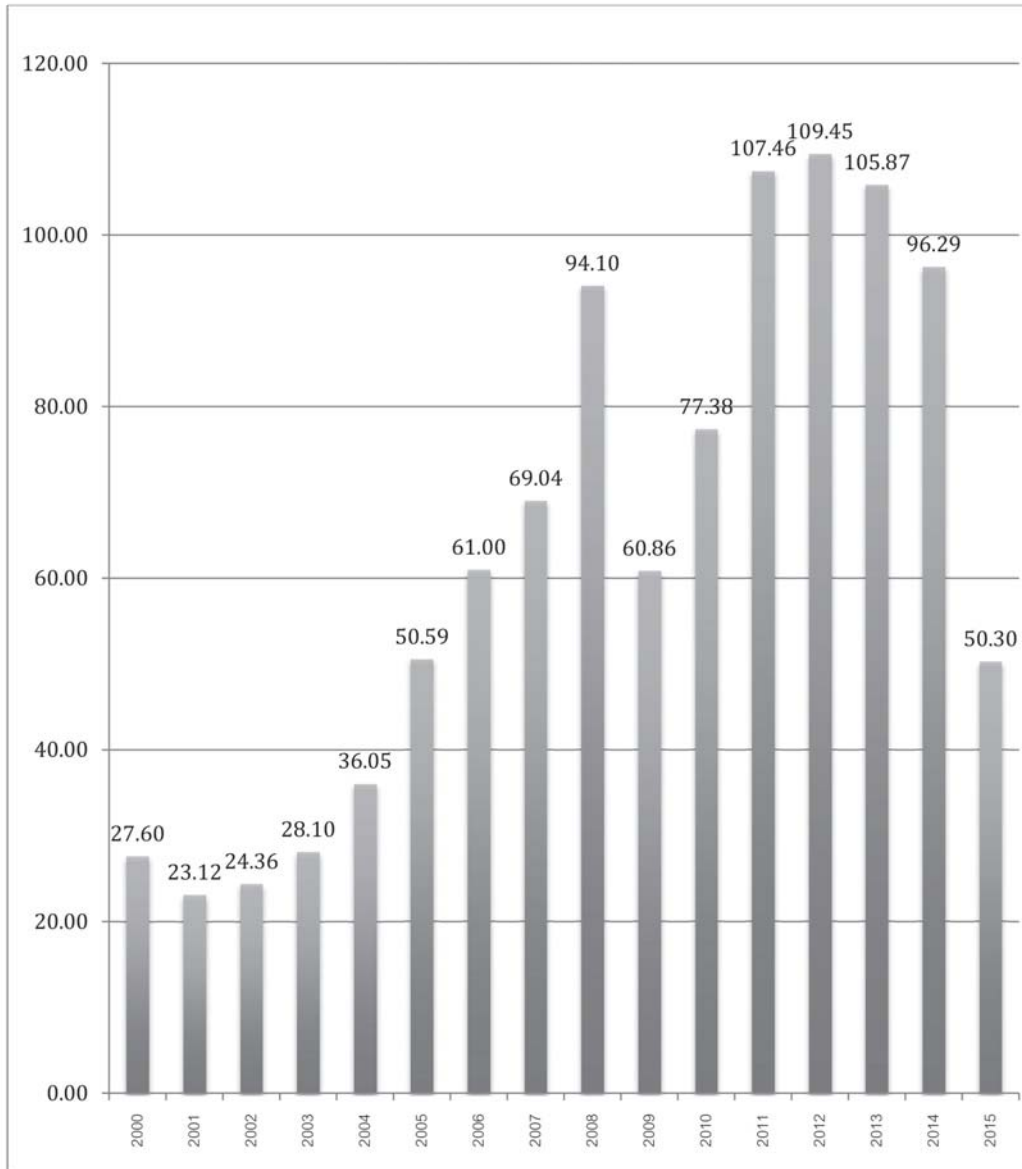
Airlines	Number of Inbound – Outbound Domestic Passengers (Person)					Average Growth Rate (%)
	2010	2011	2012	2013	2014	
Thai Airways	5,255,934	5,475,428	5,992,179	6,540,342	5,208,940	0.60
Air Asia	3,084,423	3,620,878	4,528,975	6,198,067	6,917,527	22.73
Nok Air	2,149,990	3,024,205	3,969,918	6,068,217	7,149,825	35.65
Bangkok Airways	1,968,685	2,252,810	2,632,374	3,175,720	3,394,389	14.70
Orient Thai	844,135	1,010,616	653,049	309,498	95,253	-34.37
Thai Lion Air*	-	-	-	22,504	1,775,467	7,789.56
Total	13,303,167	15,383,937	17,776,495	22,291,844	22,765,934	14.68

Source: Department of Civil Aviation

\* Thai Lion Air started to operate in December 2012.



**Exhibit 15: Average Oil Price of OPEC between 2000 and 2015 (Units: USD per Barrel)**



Source: [www.statista.com](http://www.statista.com)

The value of 2015 is based on oil prices from January 2015 to April 2015.

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