OAG

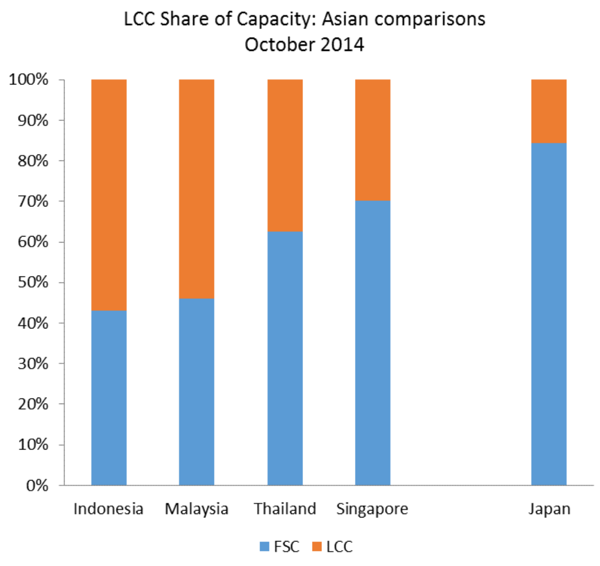
Absolute Aviation Advantage

LCCs: On the verge of making it big in Japan?

The announcement that AirAsia plans a return to the Japanese market in 2015 is symptomatic of the changes taking place in Japanese aviation. Low cost carriers (LCCs) have been growing rapidly, stealing market share from the full service carriers (FSCs), and some airports are creating terminals to handle this new type of traffic. After initial scepticism that the Japanese traveller would accept a low cost model in the air, can the same be said for low cost terminals? In this article we look at the evolution of LCCs in Japan and ask what the planners need to be considering now in order to accommodate tomorrow's airlines.

Looking back decades Japan was unusual in Asia in that it fostered competition between national carriers, allowing both ANA and Japan Airlines to create strong market positions. As elsewhere, though, competition is regulated and domestic carriers favoured. While low cost carriers (LCCs) have been given room to breathe in Japan their access to some of the major airports has been restricted, albeit by a lack of slot availability at airports such as Tokyo's Haneda International Airport. The fostering of a truly competitive Japanese aviation market requires the opportunity for LCCs to thrive and that almost certainly means new airport infrastructure to deliver those much needed slots.

State of play



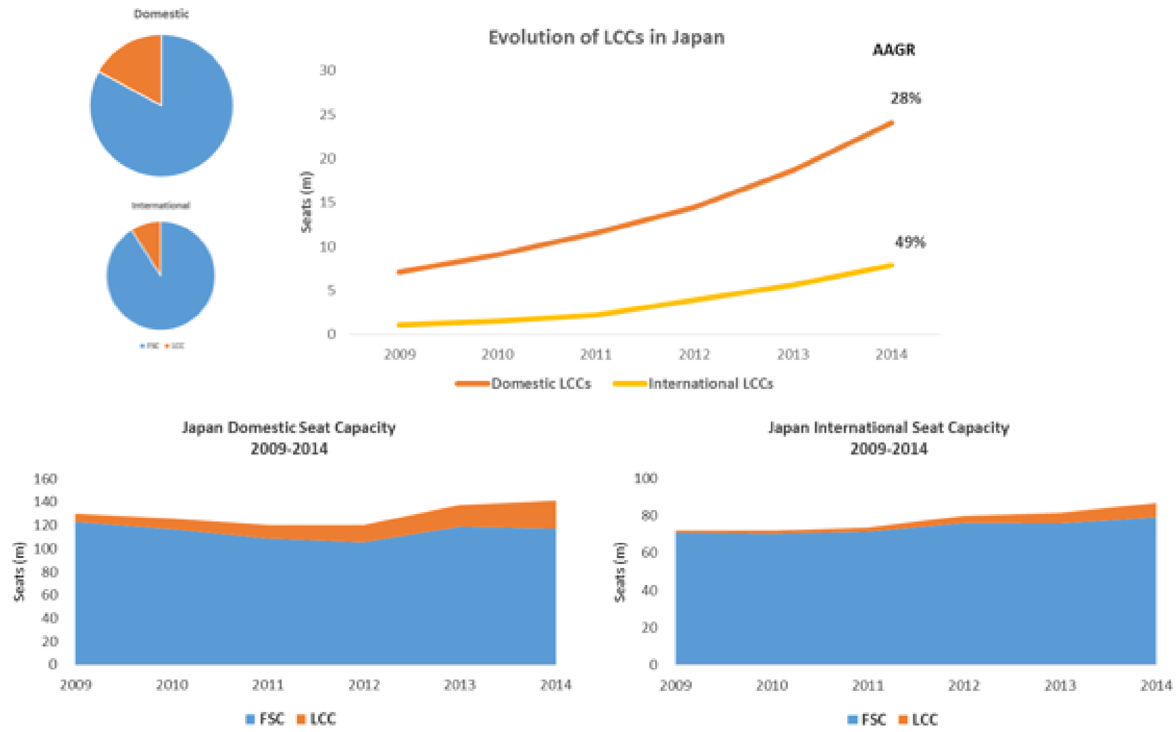
Source: OAG Schedules Analyser

In comparison to the wider Asian region, LCCs in Japan are still some way from reaching comparable levels of market share. In October 2014, LCCs accounted for 26% of scheduled airline capacity within Asia; in Japan they have just reached a 17% share of domestic seats and have yet to gain a strong foothold in the international market, with just 9% of seats, or 7.5 million seats annually.

Although there are marked differences in LCC share when comparisons are made at a country level with other Asian countries, this tells more of a story about the maturity of the Japanese market and economy, versus the very fast paced economic growth and changing levels of disposable income that is taking place in other parts of Asia.

Growth in Japan has been impressive, though. Domestic LCC seats have more than tripled in the last five years, from just 5% of the market in 2009. In 2014, carriers will have operated 141 million seats in the domestic market, of which LCCs will contribute 24m.

International LCC capacity is growing at an even faster rate, averaging 49% growth each year for the last five years in a period when overall international capacity growth has averaged just 4% per annum.

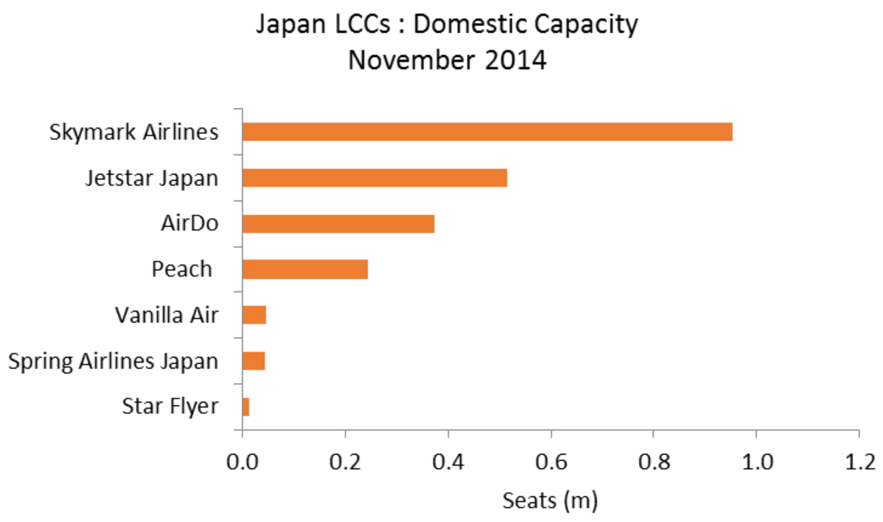


Source: OAG Schedules Analyser

The performance of LCCs stands in stark contrast with that of the full service carriers (FSCs). While growth in domestic LCC capacity has been averaging 28% each year over five years, FSCs have seen domestic capacity fall by 1% on average each year. The pace of LCC growth shows no signs of abating, with Spring Airlines Japan launching three new domestic routes in August and AirAsia announcing they would return to the Japanese market in 2015 after their initial foray in 2012 failed.

The stimulus for domestic LCC activity was a combination of relaxation of market regulation by the Japanese government and the availability of slots at several Japanese airports, following the 2010 bankruptcy of Japan Airlines. The arrival of Peach, Jetstar Japan and AirAsia Japan at Tokyo (Narita) and Osaka (Kansai) in 2012 gave a boost to Japan's LCC domestic market which was already served by Air Do (previously Hokkaido International Airlines), Skymark and StarFlyer, adding the equivalent of over 8,000 extra LCC seats every day.

LCCs are not as yet challenging the old guard of ANA and JAL – although for how much longer given the rapid growth in both domestic and international LCC capacity? How might these carriers respond?



Source: OAG Schedules Analyser

The chart above highlights LCCs operating in Japan's domestic market, in relation to each other. Skymark have the largest share of LCC capacity, with Jetstar Japan second largest.

In 2014, the new entrant LCCs operated 37% of all LCC domestic capacity (if Vanilla Air, the ANA owned successor to the first AirAsia Japan business, is included) and have been the major drivers for growth in the market, adding 4.1 million seats in 2013 and a further 2.9 million in 2014.

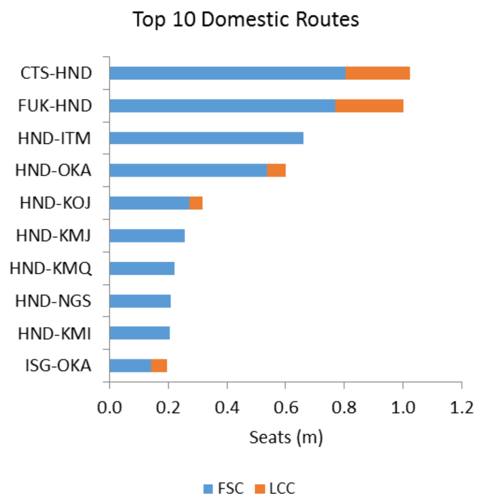
Unlocking Haneda

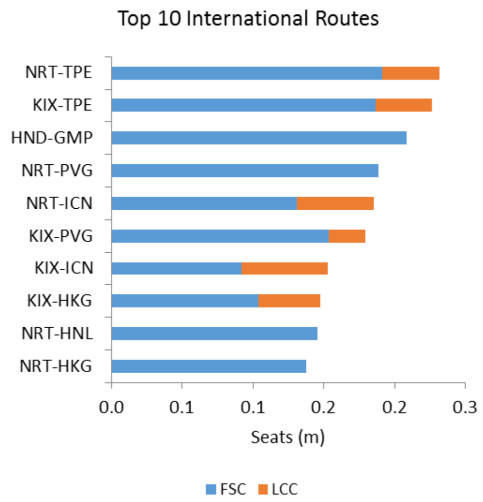
Of Japan's top 10 Domestic Routes, nine of which operate to and from Haneda, only half have an LCC presence. These routes account for 38% of all Japanese domestic capacity. The relatively low share of LCC capacity on these routes – an average of just 6% penetration across all 10 – originates in the lack of slots at Haneda.

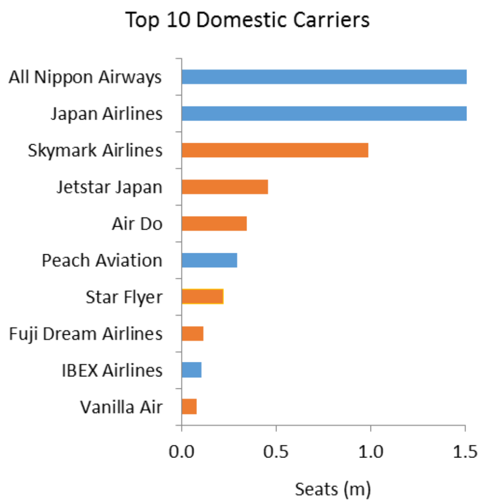
Almost all of the LCC capacity on these top 10 routes is operated by the older LCCs - Air Do, Skymark and Starflyer. There is also a wider debate on which of these carriers really do operate as LCCs given the nature of the markets they serve and the type of services they offer – Air Do who primarily serve the seasonal Hokkaido leisure market, and Starflyer with a product offering that goes beyond even that of a hybrid LCC. Despite our own official inclusion of Air Do and Skymark in the LCC category, we feel this is a subject worthy of further debate in the near future.

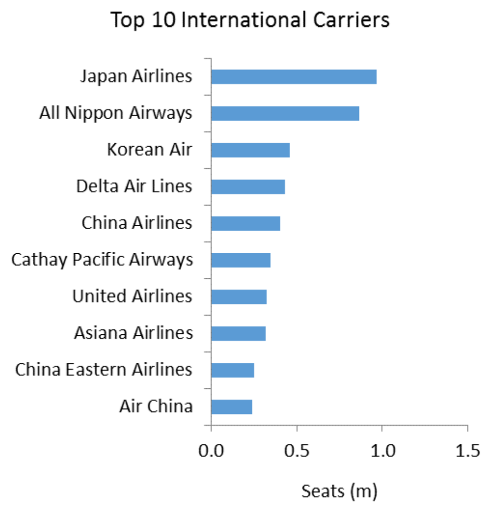
This suggests there is still significant potential, subject to regulatory issues and access to major hubs like Haneda, for the new entrant LCCs to compete on these big routes. In Europe, as LCCs approached 30% market share, the travelling public accepted the LCCs as viable alternatives to the FSCs and the more established carriers accepted the need to adapt their business models to the new paradigm.

Although different European LCCs took different approaches to their choice of airports from which to operate, no longer were they considered secondary airlines, belonging in secondary airports. They had earned the right to operate from the established hub airports. If the return of AirAsia to the Japanese market provides a stimulus to the market which then takes the LCC share up to near 30% in the next couple of years, then there will be new pressure on airports such as Haneda to find slots for LCCs.









Source: OAG Schedules Analyser

The evolving domestic duopoly

Looking beyond the top 10 domestic routes, LCCs operate on 66 of Japan's 195 domestic routes – just over one third of all domestic services.

While not quite a duopoly, ANA and JAL have a dominant position in the domestic market with 76% of seats between them and if ANA's minority stake in Starflyer (18%), joint ownership of Peach and complete ownership of Vanilla Air are included, this rises to nearly 90%. ANA also has a strategic partnership/codeshare arrangement with Air Do, a hybrid carrier with a seasonal programme mostly serving the Hokkaido market.

Despite a recent statement about their intention to pursue international opportunities, partly through acquisitions, ANA is currently in talks with Skymark, one of the domestic LCCs. In the process, ANA would acquire six A380s which Skymark had on order with Airbus but were allegedly unable to pay for. [1]

ANA's approach to managing the threat from LCCs appears to be similar to some other established FSCs: creating their own LCCs and developing a range of subsidiaries and brands. However, as some European FSCs have discovered, as LCC market share grows it becomes harder to simply manage separate businesses and brands in the belief that they each have distinct target markets. The risk of cannibalisation from one part of the business to another becomes ever greater.

The management mind-set for LCCs is fundamentally different from FSCs and there are numerous examples of failure where FSCs – including BA, Continental, Delta and KLM - have tried to manage both business models within existing management structures and practices. Other carriers who have tried to operate low cost ventures and then reverted to the more traditional approach include Aer Lingus, Lufthansa, Alitalia and Air Canada.

The AirAsia opportunity

Competition is much stronger on international routes and ANA and JAL's combined market share is just 25%. LCCs operate on six of the top 10 international routes, and on three of them – NRT-ICN, KIX-ICN and KIX-HKG - LCCs offer 30% or more of available capacity.

The challenge of the LCCs in Japan is almost certainly about shifting the airline cost model over the longer term

AirAsia already operates to Nagoya, Osaka and Haneda from Kuala Lumpur under the AirAsia X brand. The new venture, AirAsia Japan, will have a 49% shareholding by AirAsia but the remaining stake will be split between several local investors so that the airline meets the Japanese ownership rules (but AirAsia will have the largest shareholding). This effectively gives Air Asia control over the strategic direction of the business and circumvents the obstacles that led to the failure of their first attempt at running a LCC in Japan as a joint venture with ANA.

CAPA[2] report that AirAsia Japan is likely to launch services in mid-2015 and will be based at Nagoya, thereby creating more potential for building connectivity and hub operations as they have started to do elsewhere across Asia Pacific with their Fly-Thru product. While the initial

[1] http://centreforaviation.com/analysis/all-nippon-airways-acquisition-of-skymark-and-its-a380s-would-be-difficult-but-with-upside-for-both-184574

[2] http://centreforaviation.com/analysis/airasia-japan-mk-ii-to-be-japans-fifth-lcc-since-2012-airasia-enters-better-informed-and-prepared-175679

services will be domestic, AirAsia Japan is expected to also operate international air services to markets such as South Korea and Taiwan.

It's clear from the charts above that LCCs are not as yet challenging the old guard of ANA and JAL – although for how much longer given the rapid growth in both domestic and international LCC capacity? How might these carriers respond?

The airport response

Some of Japan's airports have clearly anticipated the changing marketplace and will be ready to absorb some of the impending growth from LCCs. Osaka's Kansai airport, home to Peach, opened a simplified terminal in 2012 – Terminal 2 – specifically for LCCs. Tokyo Narita, home to both Jetstar Japan and Vanilla, is in the process of building a dedicated LCC terminal, due to open in April 2015.

Are low cost terminals the right solution?

But are low cost terminals the right solution? This is a problem that Okinawa's Naha airport is grappling with. The airport dilemma has always been getting the balance right between building shiny new marble palaces which provide aspirational first impressions for visitors but cost a lot, and putting up basic sheds which do the job and keep the charges that airports impose on airlines low. It could be said that Japanese travellers will baulk at low cost terminals if the facilities are too basic but they have come to terms with low cost air travel.

Compounding the problem is the fact that the LCC business model is changing, at least for some. As they have matured and their brands have strengthened, so too has customer loyalty. As they have saturated short haul markets they have started to fly further afield, and then develop connecting airline products. Low cost hubs are virtually here. Elsewhere in Asia Kuala Lumpur Airport has created dedicated LCC facilities but Singapore Airport has already moved away from this to provide a more integrated approach which doesn't place airlines so clearly into one camp or the other.

However, the challenge of the LCCs in Japan is almost certainly about shifting the airline cost model over the longer term. That is the change the airports need to respond to, rather than a structural shift in the level of service required from airport facilities.

This article was written using data and reports from OAG's Schedules Analyser. OAG is the global leader in aviation information and analytical services. Its flights status and airline schedules and capacity databases hold future and historical flight details for over 900 airlines and more than 4,000 airports. OAG has been trusted and respected within the aviation industry for over 80 years.

OAG's team of expert aviation analysts can provide ad-hoc aviation analysis or bespoke reports to exact specifications from one-off projects to regular reporting. For further information contact Mark.Clarkson@oag.com