

**A STRATEGIC ANALYSIS OF THE LATEST ENTRANT INTO THE SOUTH AFRICAN LOW-COST
AIRLINE INDUSTRY – MANGO**

A Working Paper

By I Staisch, University of Stellenbosch Business School

2007

ACKNOWLEDGEMENT

The concept of a Working Paper suggests something which is *in progress*, and as such serves as a basis on which to build for the further development and exploration of a topic. This Working Paper by Ingrid Staisch was originally submitted as a home assignment in the Strategic Management course at the USB and was awarded a distinction. It provides a clear application of an analysis of environmental influences and their impact on strategy development. It was subsequently reworked into a Working Paper format.

The paper explores the low-cost airline, Mango, its environments, business model and strategy. As such it provides an example of how secondary data may very effectively be utilised to construct a sound strategic case study. Future students in strategic management will certainly benefit from reading it and draw inspiration for their own efforts in this regard.

We thank Ingrid for her diligence and effort in writing this paper – at a time that she was both finalising her MBA research report and putting last touches to her doctoral dissertation in Polymer Science. We wish her the very best in all future endeavours, academically and career-wise.

Prof Hein Oosthuizen

Head: Doctoral Programmes

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Abstract

Over the past five years, the South African airline industry has grown by more than 50 per cent. In 2001, the domestic market comprised fewer than 7 million passengers, compared to almost 12 million in 2006 (Sobie, 2006). This increase in the market is mostly due to the rise of the black middle class, good economic growth, and the advent of low-cost carriers since 2001. The demand for the air tickets of low-cost carriers has been overwhelming and, consequently, the low-cost airline industry has managed to grab approximately 30 per cent of the domestic airline market (Mtshali, 2007). The future prospects for this early growth industry look promising, although it will be rife with competition, and a future shakeout is likely for the weakest players. Mango has recently entered the industry with a unique business model. Their competitive advantage is that they claim to have the lowest operating costs in the airline industry and can therefore offer the lowest prices in the market. They have managed to cause the change in the traditional business models of major airlines hereby causing dissonance in the industry.

Mango have had success upon entering the industry, mainly due to their large financial support. Customers in this industry shop according to price, therefore it is of utmost importance that Mango remain efficient in their value chain and focus on continuously improving the industry key success factors such as punctual and reliable service, good prices, and safety records. Customers in this market are not necessarily brand loyal as there are not many incentives to stay with one particular airline, therefore customers will base their decision on which airline to use according to the factors mentioned above.

Background

Flying is no longer the exclusive domain of high-income groups. This is largely due to the emergence of low-cost airlines which has provided healthy competition in the market and driven down prices for air fares. Low-cost airlines may typically offer lower air fares through lowering their operating costs relative to competitors. They may achieve this by directing customers to purchase tickets online in order to avoid commission fees to agents; making use of electronic tickets; making use of less congested airfields in order to reduce turnaround times and take advantage of lower landing fees; not providing 'free' meals / beverages on board; not making use of flyer lounges and frequent flyer programmes; offering a single class as well as a single type of aircraft (to lower maintenance costs); offering short-haul flights in order to maximise aircraft utilisation); and empowering staff to perform dual roles (e.g. cabin crew to clean the plane as well as serve the customers). Traditional major airlines, offering full-service features, have a higher operating cost structure compared to low-cost airlines and can therefore not compete effectively on price alone with their low-cost counterparts. The problem is that, in certain regions, the major airlines are realising that they need to become more cost-effective, as their customers are becoming more value-conscious and can easily go without the extra services and frills offered on short-haul flights.

Low-cost airlines have been operating since 1949 when Pacific SouthWest Airlines, a United States-based carrier, took to the skies (Wikipedia). In 1966, another successful low-cost airline, Laker Airways, became the

world's first *long-haul* low-cost, no-frills airline carrier (Wikipedia). Today there are many low-cost airlines in operation (easyJet, Ryanair, JetBlue, SouthWest Airlines, *etc.*), some successful, and some not very successful, but only time will tell whether their business strategy is truly sustainable. Not all these airlines will necessarily follow exactly the same business model, but it is probably safe to say that activities that cost the most are generally eliminated.

The aviation industry was rocked by problems during the period 2001–2003, mainly owing to the terrorist attacks that took place on 11 September 2001. Many people opted not to fly for fear of lack of safety, which resulted in many of the major airlines recording profit losses or filing for bankruptcy. It is interesting to note that the only United States (US) airline that did not record losses over this period was the low-cost SouthWest Airlines (Koenig, 2006). Owing to their lower operating cost structure, they were able to absorb the huge decreases in revenues much more swiftly than their major airline counterparts.

According to the OAG, in 2007 the number of flights worldwide for July increased by 5 per cent year-on-year (yoy), while the number of seats available on flights increased by 7 per cent yoy. Within this global figure, the low-cost sector showed an increase of 23 per cent yoy in terms of the number of flights and 27 per cent in terms of the number of seats available on flights. The low cost sector for this month now accounts for 16 per cent of all flights (up from 13 per cent a year ago) and 20 per cent of all seats (up from 16 per cent) (OAG, 2007).

While many propositions may be raised, it is broadly contended that a sound business strategy is at the very heart of attaining a sustainable competitive advantage and consequently an above-industry-average bottom-line performance (Thompson, Strickland & Gamble, 2007). It is thus the purpose of this Working Paper to explore aspects of the low-cost airline industry in South Africa (SA) and the business strategy employed by the most recent entrant to this highly competitive market, namely Mango.

The Low-cost Airline Industry in South Africa and the Launch of Mango

Before deregulation of the airline industry took place in 1991, South African Airways (SAA) enjoyed a monopoly unheard of today (95 per cent market share). This meant that SAA did not *need* to put as much emphasis on customer care and satisfaction. On the back of the deregulation in 1991, Trek Airways (already operating overseas as Luxavia) took up the challenge on 16 October 1991 to become the first airline directly to challenge SAA by launching Flitestar (Dubois). Its strategy was aimed at customer care and superior onboard performance, and, soon after the entry, Flitestar took 25 per cent of the domestic airline market and was carrying loads of 63 per cent (load factor refers to the percentage of seats occupied on a flight) (Dubois). Flitestar was not operating your typical budget airline business model, but it was certainly less expensive in respect of prices.

In South Africa over the past five years the domestic airline market has grown by more than 50 per cent and future growth is expected to remain in double-digit figures of 10 – 15 per cent through to 2010 (Sobie, 2006). This is largely attributed to the growth in the South African economy and, secondly, to the appearance of low-cost airlines which has led to an increase in the number of people who are 'new fliers' (Hogg, 2006). More people are choosing to fly to their destinations than in the past. Air transport used to be the primary domain of business travellers, but more South African holiday travellers are opting to fly. Also, with the rise of the black middle class, more people are shifting to air travel (Maposa, 2007). The South African airline market is far from saturated and has huge potential for growth, particularly in the low-cost airline market (Mtshali, 2007).

The total market value of the airline industry in SA is approximately R10 billion, and, according to statistics shown in 2006, the low-cost airlines have managed to take approximately 30 per cent (R3 billion) of this market (Flight, 2006). It is speculated that SAA launched its own version of a low-cost carrier, Mango, in November 2006 in order

to capture a share of this growing market. Currently, Mango controls 10 per cent of the domestic market (iAfrica.com, 2007).

Mango airlines is a South African government-owned Internet-based low-cost airline that was launched by a subsidiary company of SAA, namely Tulca Pty Ltd, on 31 October 2006. The start of Mango was seen as a related diversification strategy by SAA as they saw an opportunity in the low-cost budget market. Mango airlines is the third low-cost airline to be launched in SA, after Kulula's arrival in 2001 and 1time's arrival in 2004. Mango operates separately from SAA, having its own board and management and lease aircraft from SAA. Mango airlines was given a R100 million loan, plus interest to be paid back in five years, from its parent company SAA in order to start operations. CEO of Mango airlines is Nico Bezuidenhout. The following strategic intent, constructed by the author, was influenced by various sources researched.

Vision: To be the market leader in the low-cost airline industry in SA for leisure and business travellers and to bring air travel to those people who previously did not have access to, or were unable to, afford air travel.

Mission: Mango's mission is to grow the South African airline market and to be the airline carrier which can offer travellers the lowest air fares available by having the lowest cost structure in the airline industry. Mango will do this through focusing on operational efficiencies throughout the value chain in order to optimise cost savings in every activity so that the customer pays the lowest price for a ticket, as well as through finding clever forms of distribution in order to reach the majority of South Africans.

Goals: Sustainable low-cost tickets; increase market size; strategic alliances through innovative distribution channels; expansion of routes; profits.

It is evident from the demand for Mango's airline tickets that there is a great demand for low-cost tickets in SA. According to Mango spokesperson, Hein Kaiser (*The Star*, 2006), and SAA chief executive Khaya Ngqula (*Mail & Guardian*, 2006):

"By 8am [on first day of going online], 10 000 tickets had been sold. The response has shown that there is obviously a demand for a truly low-cost carrier." – Hein Kaiser

"Quite honestly, within the first 10 days of trading, we sold in excess of about 150 000 tickets, bought and paid for by South Africans." – Khaya Ngqula

Competition in the South African Low-cost Airline Industry

SA is home to three state-owned airlines (South African Airways (SAA), SA Express (SAX) and Mango) and three privately-owned airlines (Kulula, 1time and Nationwide). Currently there are three competitors in the low-cost carrier market, namely Kulula, 1time and Mango.

There is a price war amid the airline carriers in SA because Mango has recently entered the market and changed the traditional business models of the major airlines (SAA, Comair, Nationwide), as well as undercut the prices of the other low-cost carriers quite significantly, hereby causing dissonance in the industry. For instance, Mango is offering a one-way trip between Cape Town and Johannesburg for less than R250. Luxury intercity buses for the same trip cost between R300 and R550. The poor road infrastructure, unreliable and unsafe train/bus operators are opening up new markets for low-cost airlines, allowing them to tap into the 'unflown' market. Currently, only 5 per cent of South Africans fly, and 15 per cent of urban adults (*Carte Blanche*, 2006), but owing to concerns such as time, safety and price, the market is steadily growing (Maposa, 2007).

As a result of the price wars that are currently taking place, profit margins are being squeezed, but profitability may still be reached through strong market presence and high volumes. The threat of large numbers of new

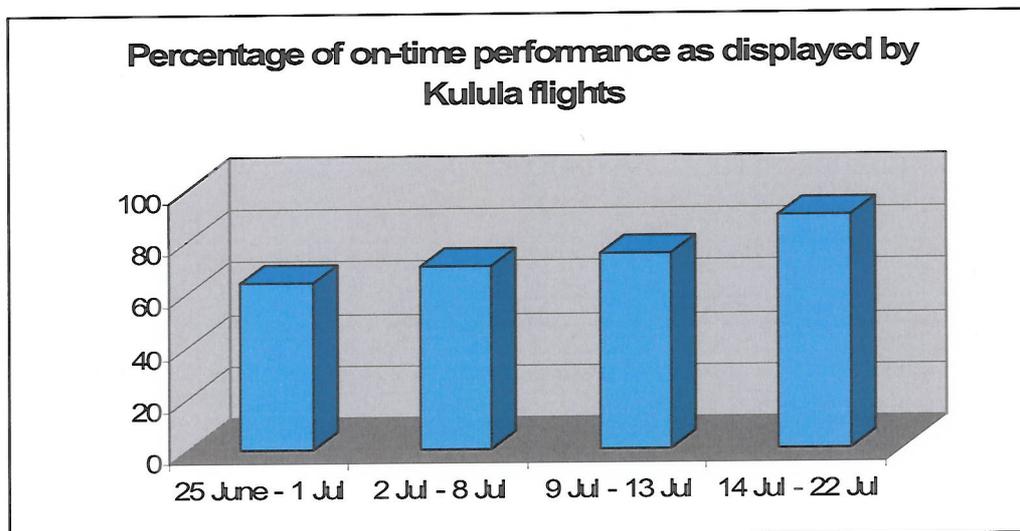
entrants is not very high, owing to the enormous amount of fixed costs that are required to enter this industry, as well as the low profit margins and high competitiveness already present. Buyer needs have changed and low-cost airlines are realising that they should only have services that add value for the customer and for which they would be willing to pay. A future shakeout may be possible if one or two competitors become industry leaders with greater than 50 per cent market share or form strategic alliances with one another.

SAA has steadily lost market share in the face of its low-cost counterparts. Prior to the August 2001 launch of the first low-cost airline in SA that is still in operation, Kulula, SAA had a market share of 65 per cent. In 2006, Kulula was reported to carry 1.8 million passengers (Sobie, 2006) and is the strongest player among the low-cost airlines. After the arrival of the second low-cost airline, 1time, in the South African skies in February 2004, SAA had a market share that was hovering below 50 per cent (*International Business Times*, 2006). In 2006, it was reported that 1time carried 1.2 million passengers (Sobie, 2006). Currently, SAA has a market share of 30 per cent, compared to the 49 per cent it had in 2004 (this excludes SA Airlink and SAX) (Sobie, 2006).

Kulula

The following information was obtained from the official website of Kulula.com (Kulula). Kulula was founded in 2001 and is a subsidiary of the South African airline Comair. It has created a joint chief executive officer position, with Gidon Novick and Eric Venter taking these seats. Kulula comes from the Zulu word meaning "easy" and it was one of the airline's primary aims to make travel more affordable to all. Kulula was voted "South Africa's biggest online retailer", generating some R3.5 million in sales daily – more than any other local website. It's fleet consists of McDonald Douglas 82s (150 seats on board) and Boeing 737-200s (118 seats) and 400s (165 seats). All aircrafts are maintained by Safair, the biggest and most reputable narrow body maintenance facility in Africa.

Kulula operates over 300 flights a week with 12 routes including three regional destinations. An important consideration for Kulula is reliable and punctual arrivals and departures. It has set itself a target of **getting 90 per cent of its flights to take off timeously**. Graph 3.1.1 shows the percentage of on-time performance as displayed by all Kulula flights for the period 25 June 2007 – 22 July 2007.



Percentage of on-time flights as displayed by all Kulula flights

1time

The following information was obtained from the official website of 1time (1time). 1time is a South African low-cost airline that was established in 2004 in Johannesburg. It was conceived by four businessmen who owned the

aviation holding company, Afrisource Holdings. 1time connects several domestic destinations and its main hub is Johannesburg International Airport. The expression "one time!" in South Africa means "for real!"

In 2003, the South African rand was stronger than it had been for a long time; aircraft acquisition costs were still low in the aftermath of the 9/11 terror attacks; and research proved that low fare, no frills, short-haul airlines had been the only successful business model for a number of years, while premium class short-haul and domestic airlines were fighting for survival. An important consideration was the cost of leasing or purchasing aircraft. Low aircraft values owing to the 9/11 terror attacks allowed 1time either to purchase aircraft or to secure long-term aircraft leases at extremely favourable rates. This opportunity was a key factor in the success of the business model and was augmented by a strong local currency.

Another key factor in the success of the business model was aircraft maintenance. Aeronexus, an aircraft maintenance company with vast experience on the aircraft types identified, was ideal for 1time. Having Aeronexus within the group provides transparency and control, ensuring the highest possible quality, reliability and safety standards.

1time chose to standardise on a single type of aircraft which ensures simplicity of overall operation, including a single flight crew pool. The airline operates six MD80 and four DC9 jet aircraft and it flies up to eight hours a day. It claims that its high utilisation is one of the secrets to consistently offering the lowest fares. A single type of aircraft further decreases costs by minimising the time that aircraft are in for maintenance.

1time also opted for ticketless air travel, utilising leading edge technology for its Internet bookings and service centre reservations. It claims to provide its employees with pleasant working conditions and incentive-based remuneration, ensuring motivated and productive workforce.

1time does not offer the traditional loyalty, or frequent flyer programmes as it considers these to rip off the customer with high airfares. Food and drink is for sale on board, ensuring that only those flyers who choose to make use of these services are liable for the costs thereof.

Macro-environmental Factors and their Impact on the Low-cost Airline Industry

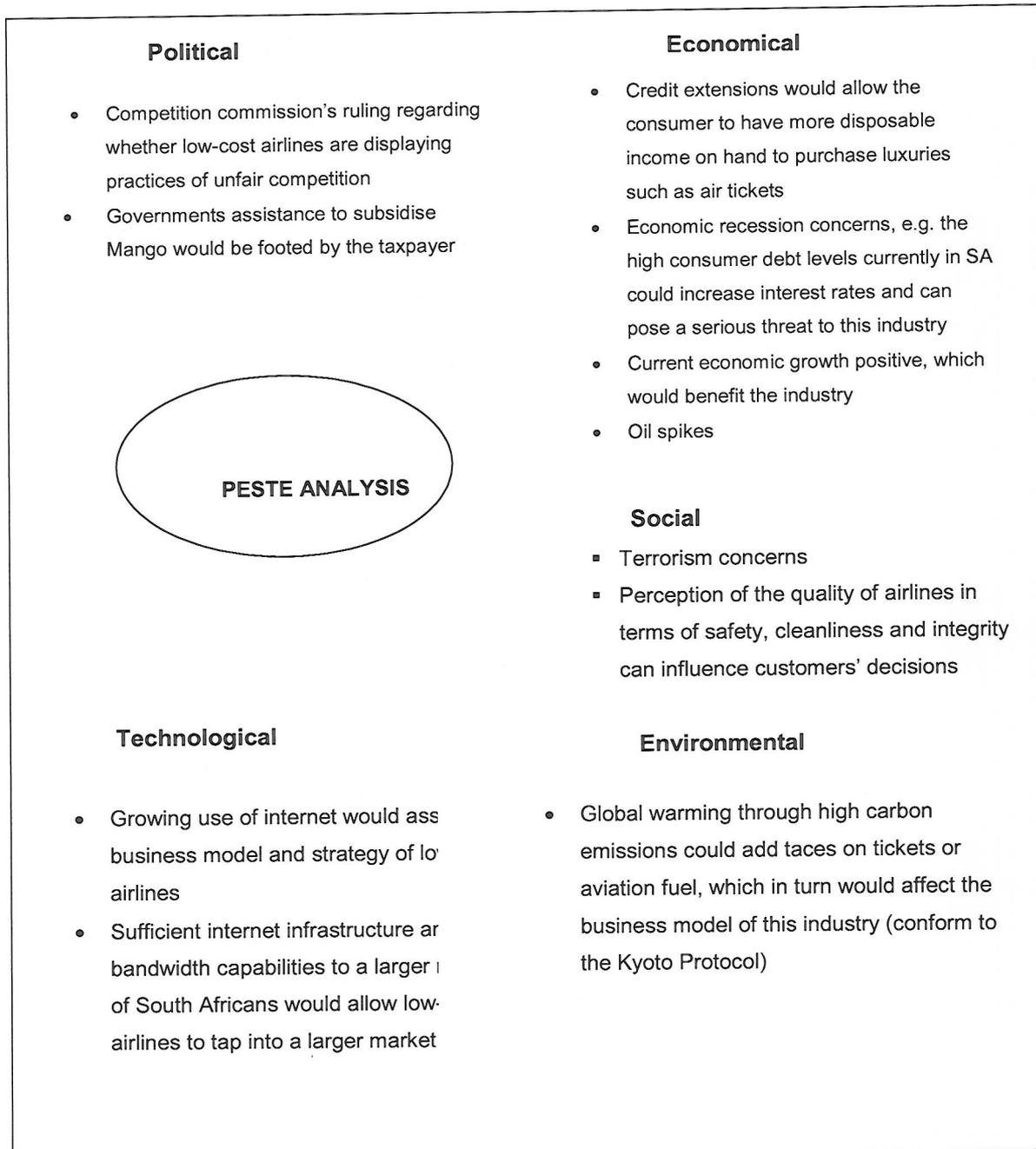
Figure 4.1 gives a brief description of the political, economic, social, technological and environmental factors (PESTE) which have an influence on the airline industry.

The conclusions that can be made from Figure 4.1 include the following:

- 1) The decision by the competition commission as to whether or not Mango is unfairly subsidised by SAA to allow below-cost fares for air tickets will have an important effect on other airlines (both low-cost and traditional airlines). If the airline is found guilty, this could potentially lead to the demise of Mango, and consequently a greater share of the market would be available for other airlines to grab a hold of.
- 2) Positive economic growth would benefit the airline industry.
- 3) An increase in oil prices would put upward pressure on airlines which need to decide whether they are able to absorb the costs, or pass them on to the customer.
- 4) Continuing terrorist attacks would dampen, or at least stabilise, growth in the airline industry. In addition, terrorist attacks have called for an increase in safety and security measures, which ultimately add to the cost of operations.
- 5) By making use of the Internet, airline companies are able to have tighter control over *who* their customers are, and potentially invest in software that caters for customer relationship management. In

addition to this, through reserving and paying for tickets online, airlines do not need to pay commission fees to travel agents and can pass these savings on to the customer.

- 6) Aircraft, as do many other forms of transport, contribute to polluting the environment. In the face of the management of the global warming crisis, airlines may be put under stricter control to ensure that their aircraft have minimum carbon emissions, or face the penalty of hefty penalties.



PESTE Analysis

The Low-cost Airline Industry in South Africa

The following sections describe the low-cost airline industry in general, as well as the driving forces, the competitive forces, the industry key success factors, as well as the positions of the other airlines in the South African competitive environment.

Current Dominant Characteristics

Mango should be seen as competing within the low-cost airline industry. Mango should not be seen as competing in the broad airline industry. Reasons for this can be seen on both the supplier and customer side. Not all customers would be willing to substitute tickets of the major airlines with the tickets of no-frills, low-cost airlines based on the large differences in price. Also, some customers may not be willing to substitute the all-inclusive services offered by major airlines with the no-frills, minimum services of the low-cost airlines. From the airlines (supplier) side, they cannot interchangeably offer services / no-services between flights, therefore, they are limited to the low-cost airline industry.

A Summary of the Characteristics of the Airline (Traditional and Budget (LCC)) Industry in SA

Current Industry Analysis	
Characteristic	Strategic importance
Market size	Relatively small (currently only five per cent of South Africans fly), but the
	airline market is not saturated, particularly the low-cost market. Owing to
	the fact that growth is expected, the entry of new competitors is possible.
Market growth	Airline market experienced rapid growth over the past five years and the low-cost market
	has experienced enormous demand and is expected to steal market share away
	from major airlines in the future. High growth will increase demand for air travel, and
	as a result of the intense rivalry, profitability could be squeezed even further.
Level of competition	Rivalry among low-cost airline carriers is very strong and it is expected to become
	even stronger in the future. This could lead to even further price-cutting. The industry
	has turned into a cut-throat environment. Currently, there are six airline carriers, three
	of which are low-cost airline carriers.

Industry Low, and is expected to become even more tight in the future owing to intense rivalry.

profitability	This will increase competition.
Entry / Exit barriers	High, owing to capital intensive assets and the rivalry can be a hindrance factor to
	potential entrants. High capital requirements raises the risk factor.
Brand loyalty	Relatively low, as there are practically no incentives for customers to remain loyal.
	Switching costs are low for customers as there are no strong loyalty programmes
	among the low-cost airlines. This means that carriers need to ensure that they
	meet industry key success factors fairly well.
Product type	Luxury item for many South African's, therefore they will shop according to price.
	This raises competition and reduces profits even further.
Economy of SA	Fairly good. Level of ease with which credit is extended will facilitate the ease with
	which luxury air tickets are purchased.
Terrorism	Global threat. Demand for air travel will subside, competition increase and profitability
	plummet. Airlines will have to ensure that the safety of their travellers is of utmost
	importance.

Government	If Mango is relying on taxpayer money to finance its operations, it will be able
influence	to ensure that it always offers the lowest price in the market, and hence the
	competition will increase further and profitability fall even harder. If Mango is found guilty
	of unfair competition, it may not be able to sustain its proclaimed efficient value
	chain.
Distribution	Growing use of the Internet will allow more people access to lower online sales prices.
	Demand for tickets, competition and industry profits will increase. Alternative methods
	of purchase and payment would increase the demand for air tickets.

Driving Forces

1. Changes in long-term industry growth rate or market size
2. Growing use of the Internet
3. Government policy and Competition Commission
4. Societal concerns

As more and more low-cost airlines enter the market, people who usually chose cheaper alternative forms of transport will be attracted to the speed, convenience, good price and better safety records that air travel has to offer. This would imply that the market size will grow as it is a new form of revenue. In the same sense, the market for low-cost tickets is currently growing at a rapid rate and this will create tremendous competition in the airline industry as the major airlines and other low-cost rivals could push their prices down in order to remain in the game. The question is whether or not this is sustainable and which airlines will be pushed out of the market as a consequence of inadequate business models.

As the economy is on an upswing and more and more South Africans are able to have access to and understand how to use the Internet, low-cost airlines will benefit from this advancement. Their primary means to sell tickets is through their websites thereby avoiding travel agent fees and adding to the cost of an air ticket.

Since SAA is a government-owned enterprise it has a lot of resources at its disposal. SAA may either support its low-cost airline Mango in order to regain lost market share or it may be told to make sure that Mango is run as a privately held company in order to ensure fair competition. If allowed to be supported by SAA, Mango would be able to sustain the low prices for a long period of time and force rivals into either bankruptcy, or lose market share.

Terrorist attacks have a negative effect on the total airline industry but, owing to the lower operating cost structures of low-cost airlines, such airlines would have greater chances of staying afloat during times of crisis. Southwest Airlines was the only US airline to post profits for the year 2001.

Table 5.2.1 displays the positive or negative effect that each of the driving forces above will have on demand for airline tickets, competition in this market, and industry profitability.

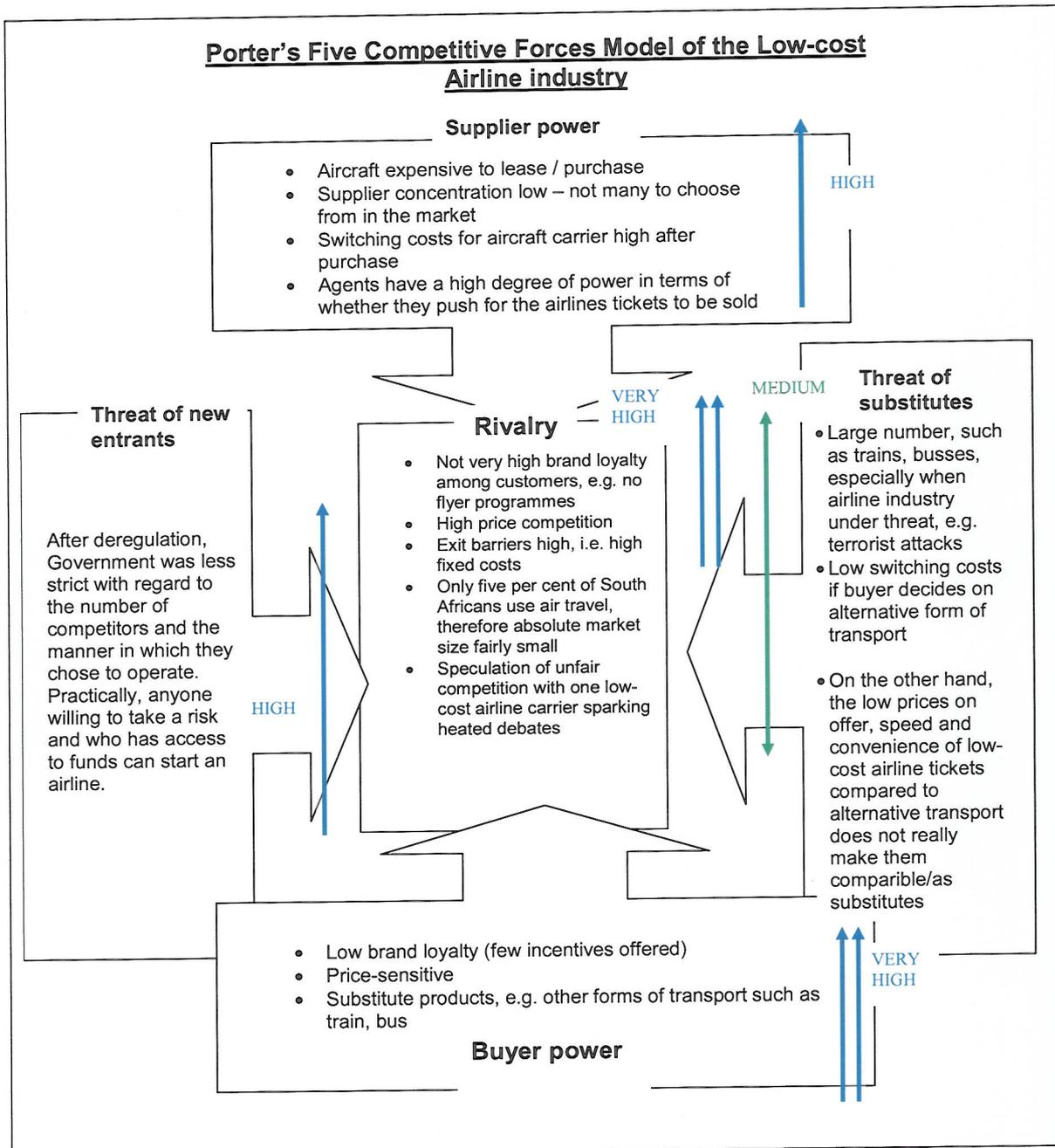
Positive or negative effect of the Industry Driving Forces on three variables

	1	2	3	4
Demand for airline tickets	↑	↑	↑	↓
Competition	↑	↑	↑	↑
Industry profitability	↑	↑	↑ ↓	↓

Global threats for all airlines include potential terrorism and oil spikes. In SA, the economic growth is fairly strong but the credit and debt levels are rather high. This would imply that the people are more acquiescent to spending on luxury goods, of which air travel is one.

Porter's Five Forces

Figure 5.3.1 is a diagrammatic representation of the influence of Porter's five forces on the low-cost airline industry. In summary, this industry is not a very attractive one owing to the fact that there is intense rivalry, which can sometimes be cut-throat. Most often, airline carriers have to rely on volume instead of decent profit margins to make a profit. Customers have a lot of power as they are not necessarily brand-loyal, switching costs are low, and often price ends up being the determining factor. Practically anyone with a passion for risk and access to funds can start an airline, as the government has taken a step back with regard to control after deregulation of the airline industry took place in 1991. Fixed costs are very high in this industry. Basically, whether or not there are one or 150 passengers on board, the flight is going to take off. Suppliers do have some sort of clout in this industry as their product and skill are somewhat specialised. The only way in which an airline is going to make a success is if it can convince the customer that the costs involved with air transport (including time, money, safety, etc.) outweigh the benefits (such as convenience, safety, time etc.) when compared to taking alternative forms of transport.



Industry Key Success Factors

Key success factors for the local low-cost airline industry include the following:

1. Punctual and reliable service
2. Good price
3. Safety records

Many of the international low-cost carriers have used similar key points for achieving lower costs and becoming successful airline carriers. SouthWest Air, the fourth largest airliner in the US (eCheat, 2007), has been successful owing to, among others, reliable departures, very low prices, and no seat allocations prior to check-in which ensures reliable departures as passengers will arrive early to obtain their seat of preference. In addition to these, SouthWest Air has followed a profit-sharing scheme with employees, totalling over 10 per cent of company

stock. It has on several occasions won the US Department of Transport's Triple Crown award of best ontime record, best baggage handling and fewest customers complaints (Thompson & Martin, 2005: 4).

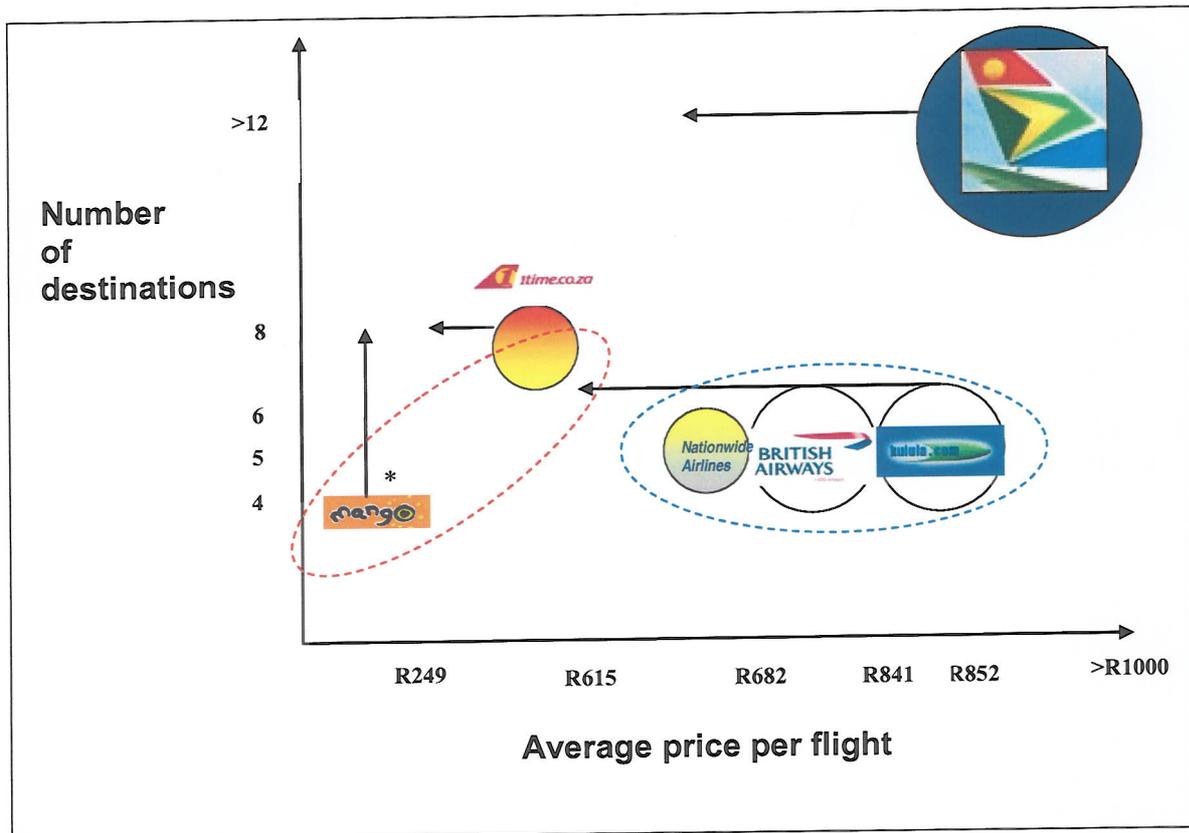
The cost leader in the European airline industry is Ryanair, which manages to keep its costs at two-thirds of its main rival, easyJet, has proved to be more profitable than its low-cost and full-service (traditional) carrier rivals. Ryanair has focussed on obtaining airports that have relatively low costs, regardless of their distance from central cities – which proves to provide significant cost savings for the airline. In addition, Ryanair is able to have a higher seat density (15 per cent) than other airlines operating Boeings (Thompson & Martin, 2005: 7).

easyJet, which began operations in 1995, became profitable for the first time three years later, in 1998. easyJet's emphasis has always been on enticing passengers to make bookings via the Internet (75 per cent of its bookings come via the Internet) (Thompson & Martin, 2005: 5). Just as with Southwest, easyJet does not offer seat allocations before check-in, which encourages punctual and reliable departure times. easyJet subcontracts many of its functions such as check-in and information services, snacks (for passengers to buy before they board the aeroplane), baggage handling and fleet maintenance (Thompson & Martin, 2005: 6).

Comparative Market Positions of Selected Airlines Operating in South Africa: Strategic Group Maps

According to the strategic group maps (Graphs 5.5.1 – 5.5.3), the nearest rival to Mango is 1time as this airline is positioned second in terms of price and offers more destinations than Mango. Mango's disadvantage at this point is its limited number of destinations compared to all the other airlines. Mango does however have the best aircraft utilisation (6.75 average flights daily / aircraft), compared to the second most efficient carrier Kulula (6.4 average flights daily / aircraft), and the third most efficient carrier 1time (4.1 average flights daily / aircraft).

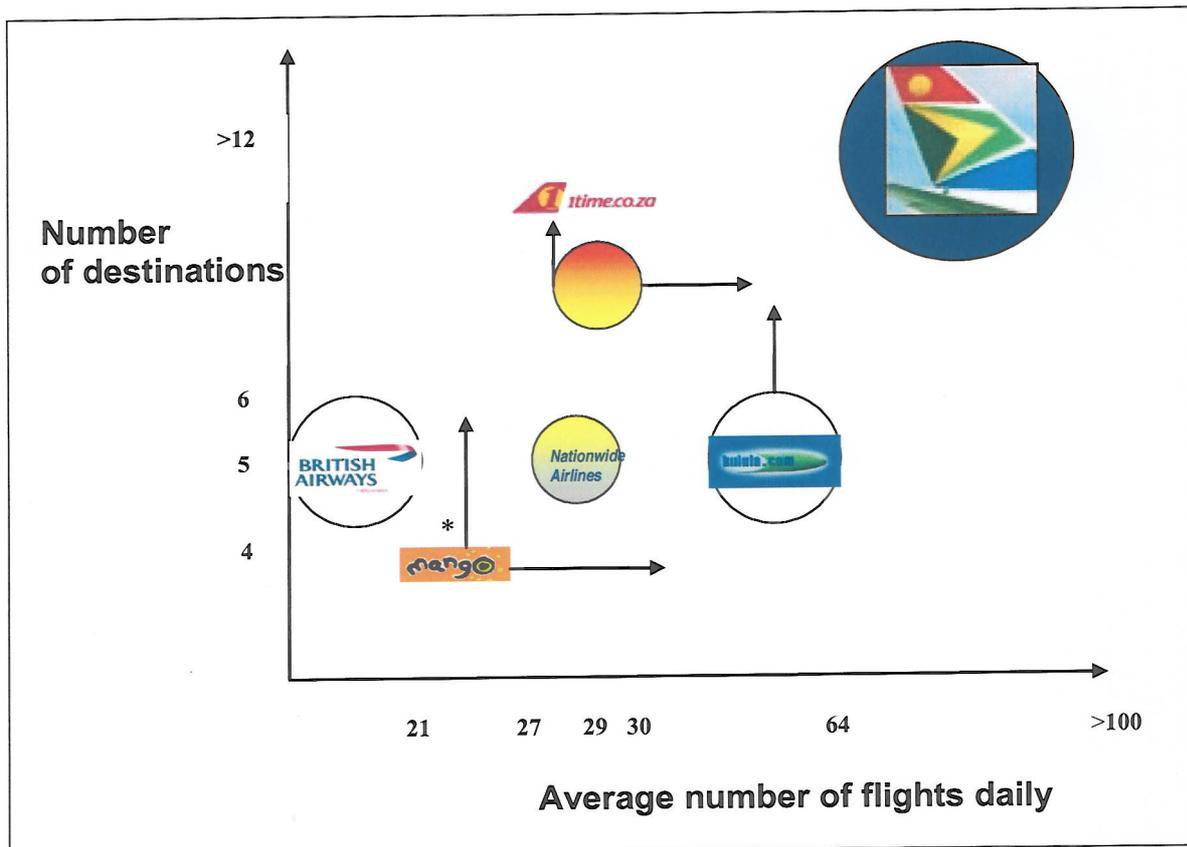
The other low-cost airline participants (Kulula and 1time) have given an indication that they want to compete head-on with Mango's prices. They believe they would be able to sustain the low prices offered over a short period and push Mango out of the market if Mango does not receive financial support from SAA. Mango's competitors believe they have a more efficient value chain. If these three competitors are in the same target strategic group offering very low prices, profit margins will be squeezed even further and an industry shakeout would be highly likely. SAA has also indicated that it may need to lower its prices if it wants to maintain its market share.



Strategic Group Map displaying the average price calculated per flight versus the number of destinations flown to for each airline

Average price per flight was calculated by searching for the lowest fare on three respective dates, namely 26 January 2007, 28 January 2007 and 1 February 2007. These dates were chosen to reflect weekend as well as during-the-week flights. The average of the sum total for lowest fares for each day was then calculated and plotted on the graph above.

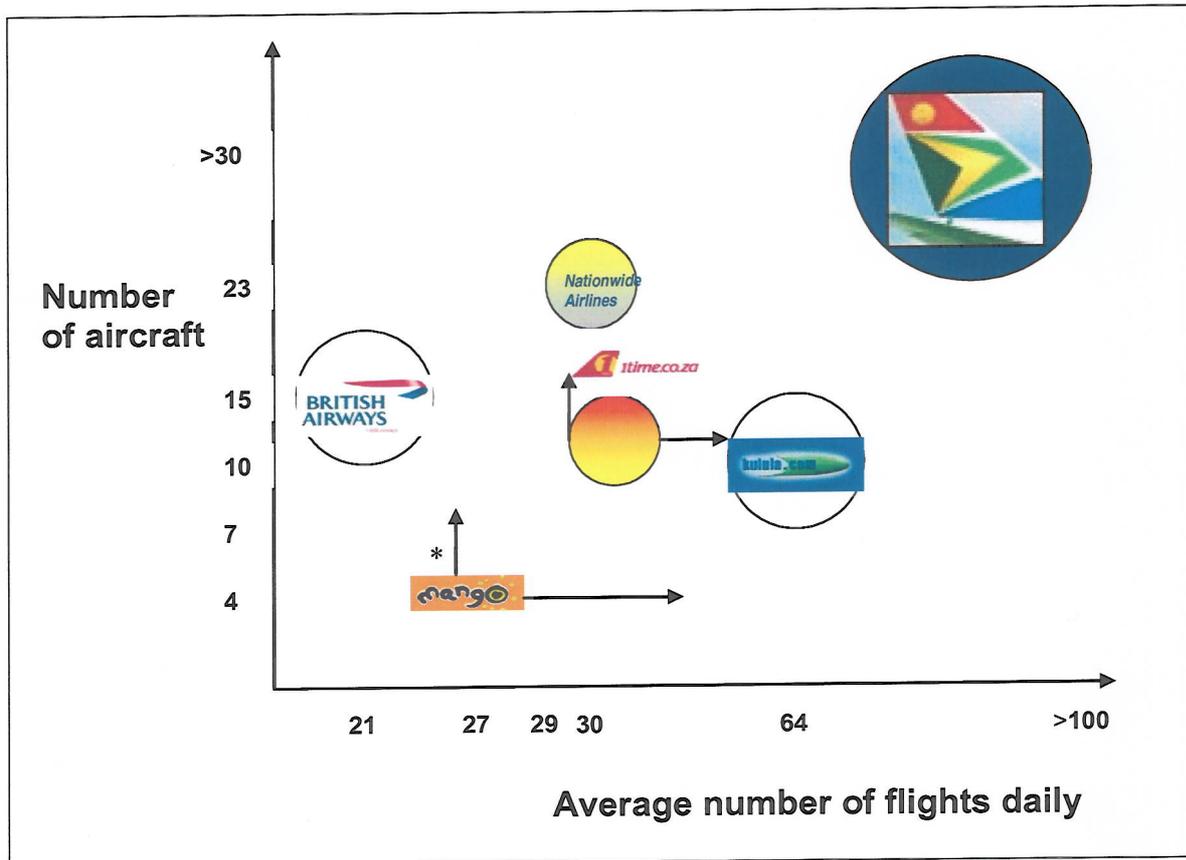
* **Take note:** The Mango depiction is not a true reflection of its market share as this cannot be assessed yet. Arrows indicate expected moves.



Strategic Group Map displaying the average number of daily flights flown per airline versus the number of destinations flown to for each

A search for the total number of flights flown to all destinations in South Africa on 23 January 2007, 26 January 2007 and 28 January 2007 was performed and the average taken. These dates were chosen to reflect weekend as well as during-the-week flights.

* **Take note:** The Mango depiction is not a true reflection of its market share as this cannot be assessed yet. Arrows indicate expected moves.



Strategic Group Map displaying the average number of daily flights flown per airline versus the number of aircraft for each

* **Take note:** The Mango depiction is not a true reflection of its market share as this cannot be assessed yet. Arrows indicate expected moves.

Summary

To remain competitive, Mango will need to expand. The airline would need to increase the number of destinations flown to, as well as its number of aircraft. Mango and its nearest competitor, 1time, have both stated their intentions to do just this. One of the most important factors in this industry is aircraft utilisation. By having aircraft standing idle at terminals, the carrier is actually losing money. Quick turnaround times are critical as well as ensuring high load factors (the percentage of people on the plane relative to the total capacity). Mango has based its cost structure on a conservative 75 per cent load factor.

If the low-cost market does continue to grow at the pace that the total airline industry has been growing over the past few years, the strategic group in which Mango currently finds itself could become more competitive in terms of the entry of new players. It would be highly unlikely though for more than two additional airlines to enter this space as the cost of entry is high. Government influence will play an important role in the future as well as whether or not Mango is found guilty of unfair competition by the Competition Commission. If found guilty, Mango will probably be pushed out of the market, and either new entrants will try and steal its market share, or 1time and Kulula will become the leaders and compete offensively among themselves.

The Low-cost Airline Industry's Value Chain and the Activities Performed by Mango Airlines

Current Strategy and Past Performance: Mango's competitive advantage is that it claims to have the lowest operating costs in the airline industry and can therefore offer airline tickets that are guaranteed to be the lowest in the market. Mango offers a narrow product (or service) – no frills airline transportation – and focuses on a broad

spectrum of the market; it focuses not only on business travellers or holiday / leisure makers, but both. The manner in which the airline is going to 'sell' its service to the market is by offering the lowest prices compared to competitors, as well as focus on other industry key success factors such as punctual and reliable service, and good safety records. After two months in the market, Mango was leasing four aircraft and flying to four destinations within SA. The carrier offers the least number of destinations for customers compared to rivals, but this is probably because it is still new to the market. Its future plans are to increase the number of destinations that are flown to. Mango manages to decrease operational costs by:

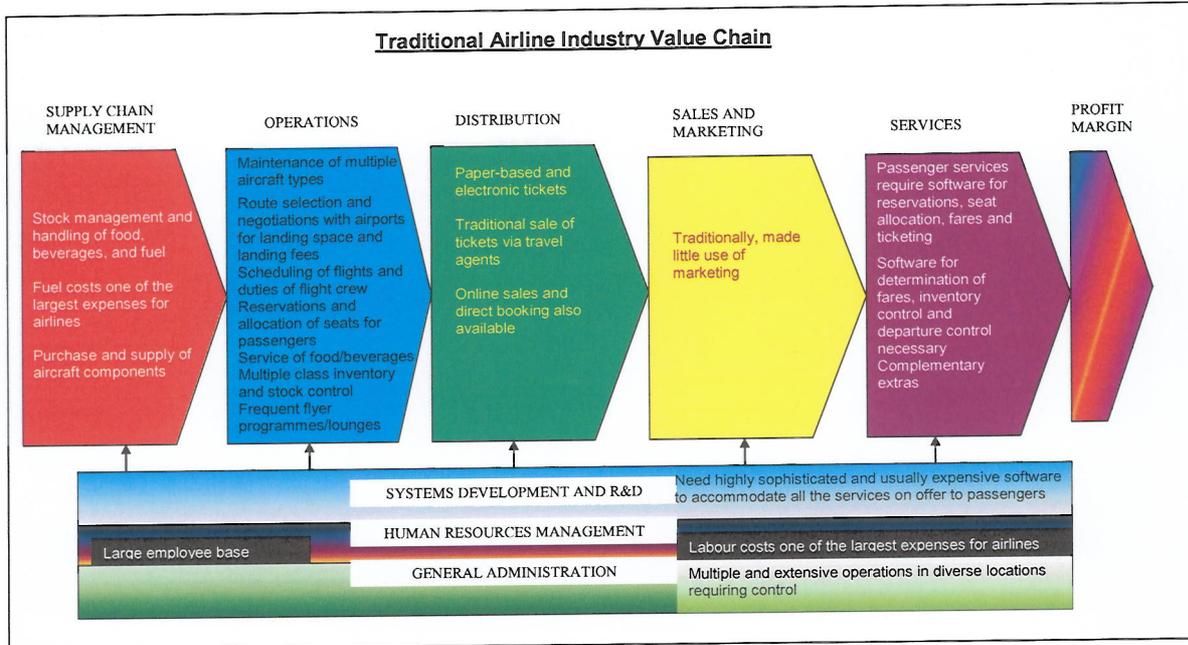
- purchasing new aircraft that are more fuel efficient and have lower maintenance costs than competitors,
- flying on average 12.5 hours a day compared to its competitors, who fly nine hours a day,
- having more seats on a plane (186) compared to competitors.

Mango claims that its business model is the first of its kind in SA therefore it is able to offer lower prices than its competitors. It plans to make its profits on volume rather than high profit margins. The manner in which Mango intends to do this is to offer the lowest prices on the market (Makings, 2006).

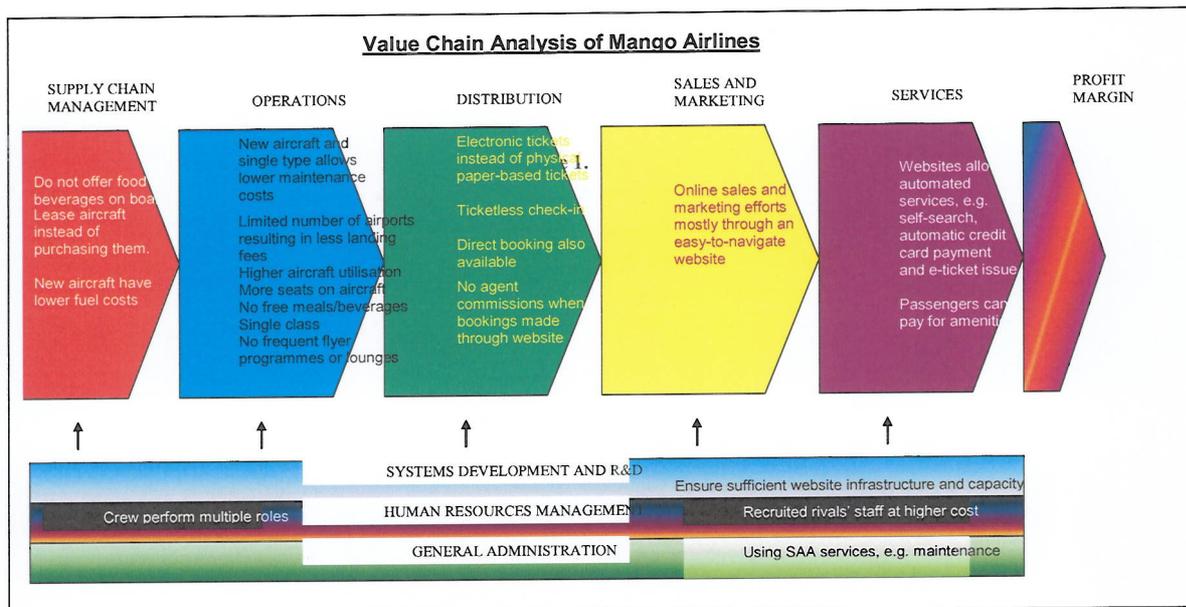
Mango has stated that it expects to be profitable within two years. Marketing director of 1time, Rodney James, claims that the airline was profitable since day one and cannot see why Mango would need to take two years to be out of the red in the income statement (Barron, 2006). Apparently, 1time turned a R20 million profit in 2006, and holding company Comair, which operates Kulula, and a local British Airways franchise, Comair, turned a pre-tax profit of R99 million in 2006 (Sobie, 2006). With regards to whether or not its current strategy is successful, it is difficult to tell this early whether Mango has satisfactorily reached its financial objectives. One needs to view this on a medium to long-term basis. Strategic objectives such as increasing its market share seem to be the right path to follow. Mango were flooded with ticket sales within the first day and managed to sell 80 000 tickets within the first five days of operating (I.T. Week, 2006). When the airline launched, Mango had a few problems such as delayed flights and its website crashing, although these seem to be under control now. But still, it is too short-term to form a well justified opinion on whether it has truly succeeded in the market.

Figure 6.1 and 6.2 describe the value chains of traditional and low-cost airlines respectively. In summary, compared to traditional airlines such as SAA, the angles through which Mango Airlines plans to control costs are by not offering free food / beverages on board, not issuing paper-based tickets and making use of travel agents (who charge commissions) to supply the majority of their sales. The flymango.com website is easy to navigate with self-automated search, ticket issue and credit card payment facilities. In addition to the website, sales can be made directly via the call centre. Online and direct sales lower overall distribution costs. Mango has also negotiated good deals with the leasing of the aircraft and the maintenance thereof, both of which impact heavily on the final price of tickets. By operating a uniform fleet, standard and routine maintenance is a further angle through which the time that aircraft are in for maintenance is minimised.

Crew are expected to perform multiple roles, and are encouraged to be efficient in order to minimise the time between landing and take-off, thereby increasing aircraft utilisation. Mango's core competence is its aircraft utilisation. It has trained staff who contribute to quick turnaround times. Mango's efficiency throughout its entire value chain has allowed its price positioning to become its distinctive competence. The carrier is able to keep operating cost lower than that of its rivals. Mango believes in offering services to customers that they find add value and are willing to pay for. Whether this is a durable competence, only time will tell.



Diagrammatic Representation of a Traditional Airline's Value Chain.



Diagrammatic representation of the Value Chain of Mango Airline

Formulating a Business Strategy

Determining actions and strategic thrusts

This section includes three steps, namely a SWOT analysis, an analysis of the competitors' strengths and lastly, the strategic thrusts of the strategy.

SWOT Analysis

Refer to Figure 7.1.1.1 for an overview of the strengths, weaknesses, opportunities and threats facing Mango Airlines.

SWOT Analysis:

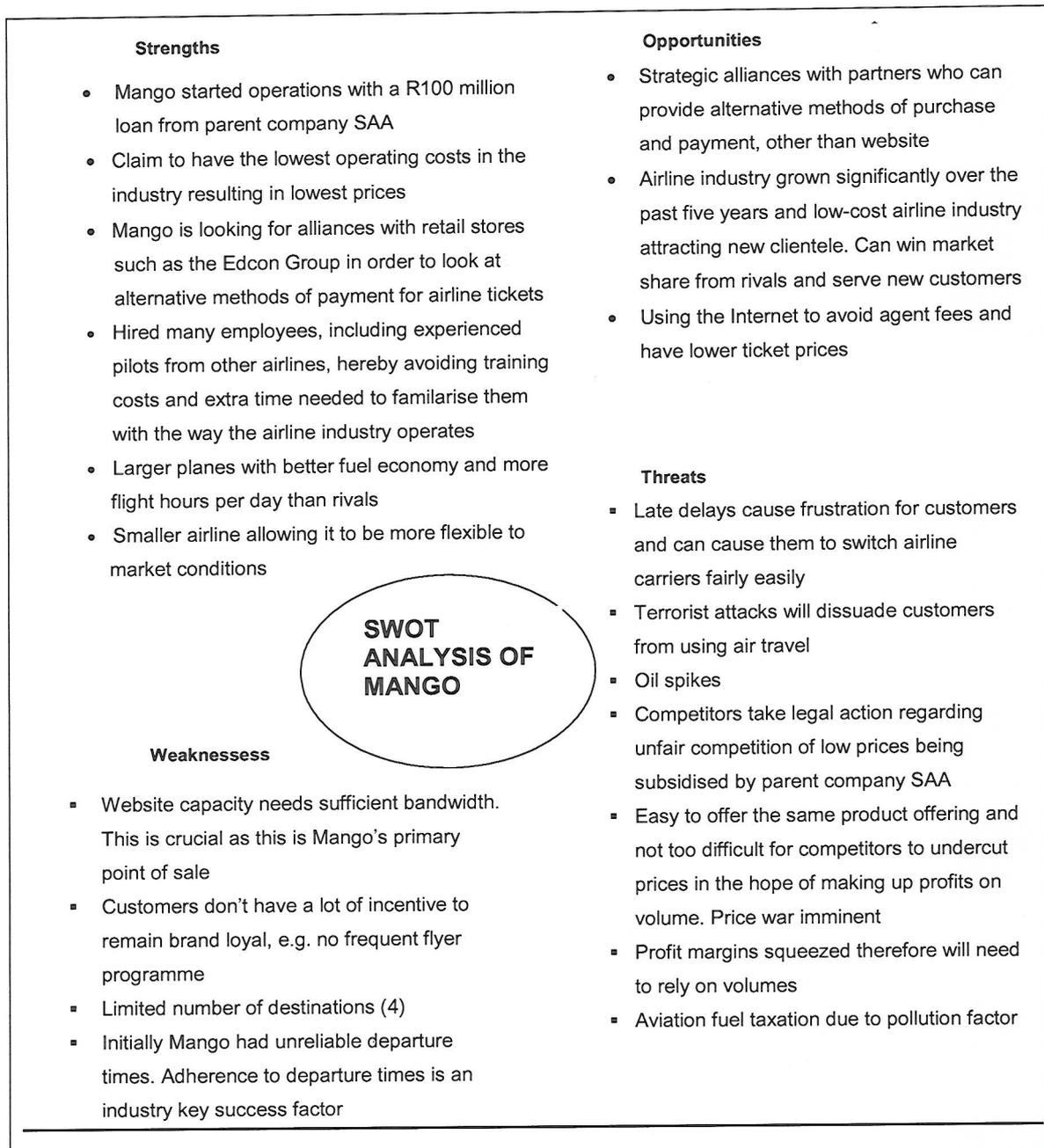
Strength / Opportunity: Mango has been more fortunate than the other low-cost airlines as a result of its large financial backing from SAA. This has allowed the carrier to enter the rapidly growing low-cost airline market quickly and with great impact. Mango claims that its value chain is the most efficient, allowing them to have the lowest price point. South Africans are accustomed to purchasing on credit and paying off their debt, and if Mango were able to enter into strategic alliances with retailers, or find other clever methods of allowing the ticket to be purchased and paid off over a few months, it would be able to reach people who were previously unable to fly.

Strength / Threat: Competition for customers among the low-cost carriers is based primarily on price, therefore, it is of utmost importance that Mango ensures that it offers the lowest price on the market.

Weakness / Threat: Customers in this industry are not necessarily brand-loyal. On experiencing one bad experience, they may decide to switch airlines. Mango would have to ensure that its website has sufficient bandwidth capacity, that it provides reliable service and punctual departure/arrival times, and that it places the highest priority on security, particularly from potential terrorist attacks.

Weakness / Opportunity: Mango's limited number of destinations at this point does not work towards its vision of reaching new people and growing the market. Its website has crashed in the past and it is imperative that it has a reliable website as it is the airline's primary point of sale.

Mango is competitively stronger than rivals 1time and Kulula. This is largely influenced on its pricing strategy. Price is arguably the most important consideration when choosing an airline. Before low-cost airlines entered the market, South Africans took the high prices as standard and as a result hereof, the majority could only fly seldom or never. The other factor in favour of Mango airlines is its financial assistance by SAA (R100 million loan) which has helped it to enter the market fairly quickly and with high impact. Mango has also been clever in hiring staff from competitors in order to avoid training costs and ensure that the staff understands how to deal with customers in this industry.



SWOT Analysis

Competitive Strength Analysis

Table 7.1.2.1 summarises the important characteristics for the airline industry and gives it a rating and subsequently a score for each of the three low-cost airlines in SA. The weightings originate from the opinion of the author of this paper.

Weighted Competitive Strength Assessment for the Three Low-cost Airlines in South Africa

Success Factors	Importance Weight	Mango		Kulula		1time	
		Rating	Score	Rating	Score	Rating	Score
Relative Price Position	0.25	9	2.25	2	0.5	7	1.75
Reliable and Quality Service*	0.2	6	1.2	8	1.6	3	0.6
Reputation in Media	0.1	4	0.4	9	0.9	6	0.6
Website Ease of Navigation	0.15	8	1.2	6	0.9	6	0.9
Number of Routes on Offer	0.1	4	0.4	7	0.7	8	0.8
Financial Resources	0.2	8	1.6	7	1.4	6	1.2
			7.05		6		5.85

*Determined from letters in various newspapers

According to Table 7.1.2.1, overall, Mango fares the best in terms of the group of characteristics in question. Mango fared relatively high in terms of the price of tickets which appears to be the dominant (highest weighting) characteristic in this industry. Kulula fared relatively high in reliable quality and service, while 1time fared the best in terms of number of routes on offer.

Strategic Thrusts

From performing a SWOT analysis as well as a competitive assessment, the following points summarise the plans / actions that should be prioritised by Mango:

- Increase the size of the market.
- Expand the number of new routes on offer.
- Acquire new aircraft that are more fuel efficient.
- Strive for uniform fleet of aircraft to allow routine and standard maintenance procedures, which in turn will minimise the time that aircraft are not in flight.
- Focus on reliable and punctual service to ensure quick turnaround times and maximise aircraft utilisation.
- Encourage customers to make ticket reservations / purchases online.
- Economise on costs and only add service that passengers are willing to pay for.
- Achieve quick turnaround times as well as multi-tasking by crew.
- Place an emphasis on creating a culture of continuous improvement on performance.

Determining a Competitive Approach

In determining a competitive approach, there are two steps to consider: firstly, choosing a competitive approach, and secondly, choosing a particular stance to be adopted.

The industry is in the early growth phase with more than one competitor. Product offerings are constantly being fine-tuned, e.g. price and destinations on offer, and certain segments of the market are still underserved. Mango has the strongest position in terms of price and is very strong in its operations, and can therefore be seen as a 'Prospector' in this industry.

Mango has an aggressive posture and has attacked the market by using offensive strategies to secure and promote its competitive advantage. It has essentially used end-run offensive tactics by changing the rules of the traditional business models that airline carriers, as well as customers, have been accustomed to in the past. The entrance of Mango into the market in 2006 has caused many of the rivals to follow their price-cutting initiatives.

Summary, Conclusions and Recommendations

Summary

The prospects for the low-cost airline industry in SA look promising. It is expected that the size of the market will grow and that the growth rate will be quite significant. It is going to continue to be a very competitive landscape with the main driver of market share based on price. It is not easy to enter this industry owing to the high capital requirements and expected retaliation from competitors, but this is not to say that the market will be exclusive to the current competitors. Depending on the real growth rate, new competitors may find innovative ways of stealing market share.

Conclusions

The airline industry has changed, and flying is no longer considered an elite form of transport. The author believes that, today, people have the same attitude / perception of air transport that they had for rail transport about 30 to 40 years ago. The main reason that it is not considered to be elite anymore is the low prices that airline carriers have to offer. The author does not believe that passengers are too concerned about having the extra frills that airline carriers have been accustomed to offer in the past in order to be able to remain competitive in this market. In addition, the author does not believe that passengers, and this includes business travellers – are too concerned with the fact that meals on board are no longer complimentary. Since price seems to be the most important determining factor and travellers do not really care too much for luxury (as they would on board the Queen Mary), the LCCs fulfill these criteria, and they appear to be fulfilling them very well (much lower fares and a reasonably good level of comfort), compared to the traditional carriers. In the author's opinion, passengers are not willing to pay three times the price for a ticket when they can get it at a third of the price under good / reasonable conditions!

Recommendations

Within three to five years, the landscape will look quite different. In order to increase its market share, Mango may need to be an 'Analyser' in a more competitive industry in which a possible shakeout is likely. Mango will need to expand in order to compete effectively. It may even need to narrow its focus in order effectively to meet the needs of a specific target market better than competitors can. It is advised that the airline take on a more competitive posture and use its financial strength to increase its marketing and have a broader product offering (e.g. increase the number of routes and flights daily). It is also crucial that it invest in worker productivity as this is a factor that other airlines would find difficult to copy.

Mango should retain its offensive tactics to fend off competition, but include a few defensive approaches. Examples of offensive tactics that Mango should use include:

- Retain the lowest price tickets for another year in order to gain market share from competitors and grow the market.
- Increase the type and number of routes on offer, as well as include a few underserved regional routes.
- Focus on maximum utilisation of aircraft. Shorter regional routes (allowing more daily flights) and quick turnaround times to enhance this.
- Aggressive fuel hedging programmes.

Examples of defensive tactics which Mango should employ include:

- Create a highly motivated and incentivised workforce in order to increase productivity and quality service.
- Implement a frequent flyer programme to facilitate loyalty among fliers.
- Form strategic alliances with retailers who offer credit facilities for the exclusive sale of their tickets.
- Form strategic alliances with hotels in which packages are offered that include a Mango air ticket with a stay at the hotel.
- Take advantage of the World Cup in 2010 and offer packages with hotels, or promotions involving the purchase of a Mango air ticket and receiving a free World Cup ticket.

Being a smaller airline, Mango is more flexible to a changing environment. Since the airline was not the first low-cost airline in the market, it is able to learn from competitors' successes and failures. In order to take advantage of a growing market, it will need to expand its operations. It has managed to maintain an operational website which has been its primary point of sale, but future expansion would involve other forms of distribution, particularly to the low to middle classes.

Managers and executives of Mango need to promote operational excellence throughout the value chain in order to meet key success factors in this industry and perform them better than their rivals can. They should focus on best-practice programmes and continuous improvement programmes. Methods such as Total Quality Management (TQM) and Six Sigma are tools which managers can employ throughout the value chain. For instance, a key success factor for customers is reliable and punctual service of aircraft arrivals and departures. These tools can be used to measure the degree of success to which they are meeting these criteria and then benchmark themselves against competitors. By using these tools, management can instill in the culture of the company the need to be excellent at what it does. Another way in which this should be done is to communicate to all employees what the vision, mission and goals of the organisation are so that everyone has a clear understanding of *what* they are and *how* they can be working towards them.

In this industry, the employees are a crucial factor in whether or not the airline is a success. It is important to invest in the development and performance of employees in order to gain their trust and commitment to work towards the organisation's vision and goals. A better approach for Mango towards a sustainable competitive advantage would be the productivity of its workforce, rather than its pricing point. The culture and motivation levels of any organisation is one of the most difficult (if not impossible) characteristics to copy. A more motivated workforce would contribute to faster turnaround times and better quality service. All of these factors would essentially lead to more profits and as a result thereof, lower prices may then be sustained. A motivated

workforce can be achieved through consistent investments in the development of employees and the use of effective reward systems.

The author believes that the only disadvantage, at this point, against LCCs is their limited amount of air travel (routes and time schedules) compared to the traditional carriers. Once they have remained in the market for about one to three years, they should definitely consider expanding their routes in order to accommodate those travellers for whom time is money and who cannot consider flying at inconvenient times, and at the same time, hopefully, being able to convince them to switch brands.

In view of aspects referred to in this report, the author believes that the traditional carriers are going to be performing poorly in future. The standard of the LCCs will probably increase in order to outcompete their other LCC rivals, but, passengers are probably not going to be willing to pay the prices that traditional carriers need to charge in order to stay afloat. The author thinks that it would be a wise strategic move for the traditional carriers to admit that they will probably not be able to outperform the LCCs and consider 'downgrading' themselves in order to stay with the times. (Downgrading is not a good word to use, but it is used to illustrate that they should employ LCC tactics and truly operate as if they are LCC carriers). The author thinks that SAA should consider merging / integrating with the Mango brand and streamline their value chain in order to be able truly to operate as a low-cost enterprise. In March 2002, Delta Air Lines was faced with a similar situation when it had several options to consider in order to remain competitive in the future. One of its options was to reintegrate its Delta Express airline (LCC) with its primary Delta brand (2005, Rivkin and Therivel). Even if all the traditional airlines went bankrupt and we were to find ourselves in a similar situation as 15 years ago when SAA had a monopoly, the author is not of the opinion that SAA will have the same hold as it did back then. People have been used to having a choice and so far it seems that their choice is cheaper fares!

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