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ANALYSIS OF STRATEGIC LOW COST MANAGEMENT BY USING THE VALUE CHAIN APPROACH AIR ASIA AIRLINES COMPANY

THESIS



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UNIVERSITAS ANDALAS

ECONOMIC FACULTY
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THESIS DRAFT

ANALYSIS OF STRATEGIC LOW COST MANAGEMENT BY USING THE
VALUE CHAIN APPROACH IN AIR ASIA AIRLINES COMPANY

Submitted in partial fulfillment of the requirement for
Undergraduate degree in economics

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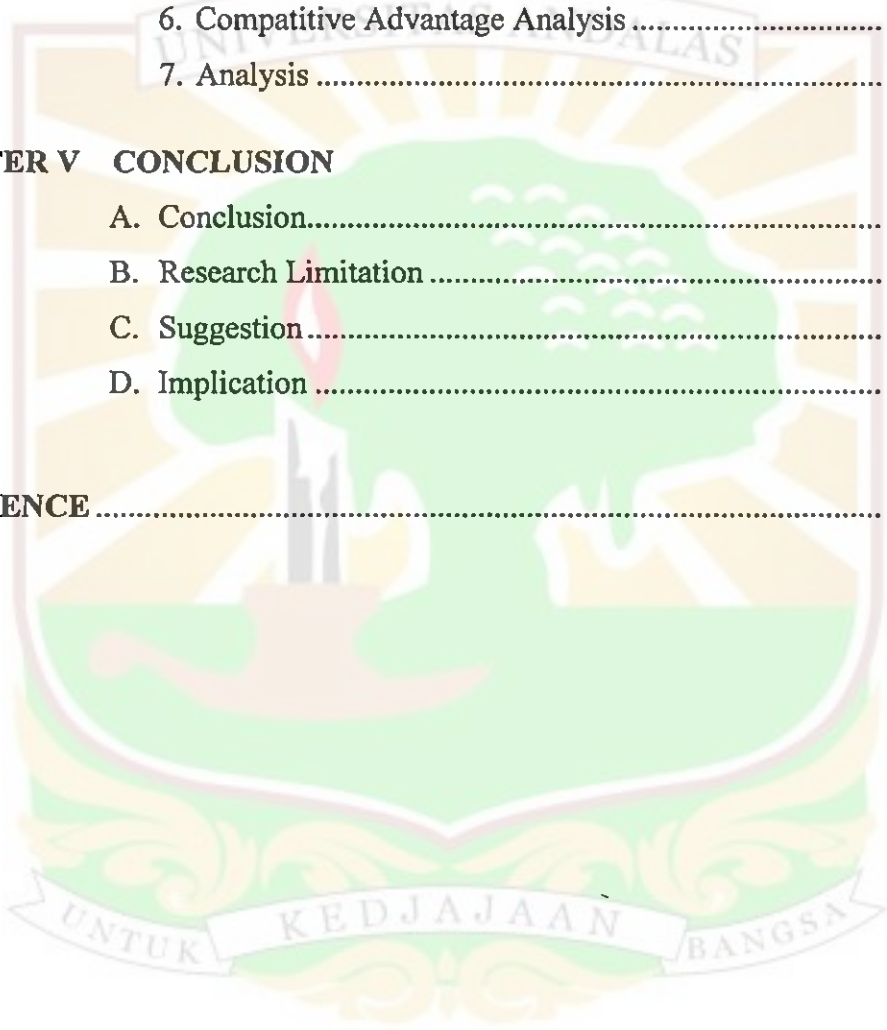
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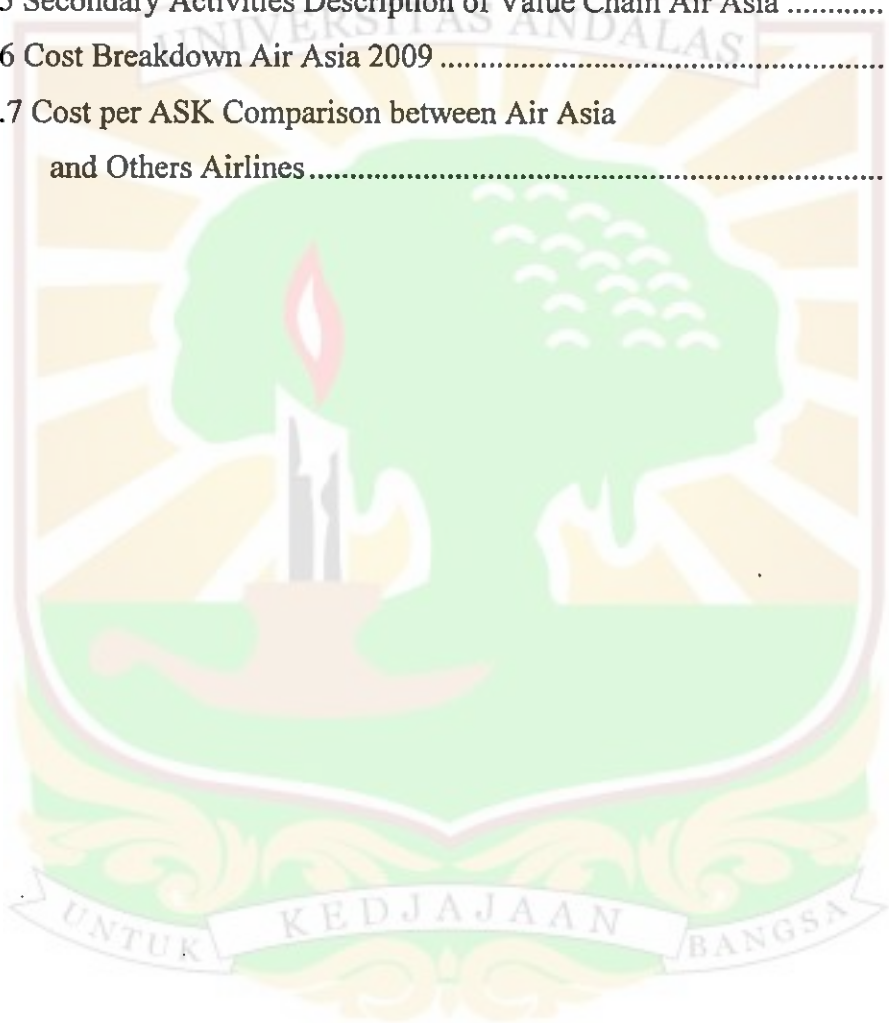
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CHAPTER I

INTRODUCTION

A. Problem Background

Low Cost Carriers (LCC) or low cost airlines has been used for the first time in the United States in 1949. The first successful low-cost carrier was Pacific Southwest Airlines, which pioneered the concept. Often, this credit has been incorrectly given to Southwest Airlines, which began service in 1971, and is the only one airline to have been consistently profitable in every year of operations since 1973 (Grotte, 2005). Today, Southwest Airlines operates more than 3,100 daily flights to 62 cities across the United States, and registers yearly more than 80 million passengers. What began as a small Texas airline, Southwest now has grown to become one of the largest airlines in the United States.

According to the Statistics and Forecast (STATFOR) Service of Eurocontrol, there is no single best definition of low-cost carrier (Eurocontrol, 2006). However, it is general accepted that a low-cost airline, also known as nofrills or discount airline, is such carrier, which offers generally low fares but eliminate most traditional passenger services. The “low-cost carrier” business design could be defined by the following three key elements (MERCER Management Consulting, 2002), such as:

1. Simple Production: Catering on demand for extra payment; planes with narrow seating (but bigger capacity) and only a single class; no seat assignment; and no frequent flyer programmes.

2. Positioning: Non-business passengers, esp. Leisure traffic and price-conscious business passengers; short-haul point-to-point traffic with high frequencies; aggressive marketing; secondary airports; and competition with all transport carriers.
3. Low Operating Cost: Low wages; low airport fees; low costs for maintenance, cockpit training and standby crews due to homogeneous fleet; high resource productivity: short ground waits due to simple boarding processes, no air freight, no hub services, short cleaning times; and high percentage of online sales.

Based on those elements, one of the major characteristic of the LCC model is the Cost leadership that is distinguished it with the traditional airlines. Low cost positioning means choosing to perform a system of activities differently from that of traditional rivals and providing a coherent set of key activities that reinforce each other to achieve such position in a sustainable manner (Porter, 1996).

Nowadays, the development of the LCCs are very huge. Many airlines that are using the LCCs concept were existing around the world, including Asia Pacific. But, if we are taking a look at the historical background, actually the process of adapting LCC in Asia Pacific is moderately complicated. Prior to 2002, there were no significant low cost scheduled carriers operating in the Asia Pacific rim. The initial slow development was in part due to the perception that the low cost model adopted in the United States and Europe could not be replicated in Asia, because of the longer aircraft stage lengths, lack of secondary airports and regulatory restrictions preventing access to international markets. The latter being particularly relevant given that the bulk of traffic and revenues are drawn from

international markets in Asia. Thus, the low cost experience is a relatively new phenomenon in the Asia Pacific rim with much of the necessary management experience brought in from outside the region, for example, from Ryanair. Asian LCCs accordingly are in the initial growth phase of their development, while many of their American and European counterparts are approaching or have reached maturity (O'Connell and Williams, 2005).

Recently, the Asia Pacific has brought the new climate and models of LCC for the airlines development. One of the most powerful branded airlines that is adapting the LCC model is the Air Asia. AirAsia was initially launched in 1996 as a full-service regional airline offering slightly cheaper fares than its main competitor, Malaysia Airlines. Before 2001, AirAsia fail to either sufficiently stimulate the market or attract enough passengers from Malaysia Airlines to establish its own niche market. The turnaround point of Air Asia is in 2001, while it was up to sale and bought by Tony Fernandes. Tony Fernandes then enrolled some of the leading low-cost airline experts to restructure AirAsia's business model. He invited Connor McCarthy, the former director of group operation of Ryanair, to join the executive team. In late 2001, AirAsia was re-launched in Malaysia as a trendy, no-frills operation with three B737 aircraft as a low-fare, low-cost domestic airline. This concept was revealed to be succeed. In only seven months (December 2002), Air Asia got the Rp 282,5 billions income and record the profit margin around Rp 48,5 billions with 1,1 millions passengers. Since its turnaround point on 12 December 2001, Air Asia has been such a big phenomenon in Airlines Industry, especially in Asia. The history record AirAsia is one of the award winning and largest low fare airlines in the Asia expanding

rapidly since its establishment. With a fleet of 72 aircrafts, AirAsia flies to over 61 domestic and international destinations with 136 routes, and operates over 627 flights per day and growing from hubs located in Malaysia, Thailand, and Indonesia that already stated in Air Asia Report 2009. Today, AirAsia has flown over 55 million guests across the region and continues to create more extensive route network through its associate companies. AirAsia believes in the no-frills, hassle-free, low fare business concept and feels that keeping costs low requires high efficiency in every part of the business. Through the corporate philosophy of “Now Everyone Can Fly”, AirAsia has sparked a revolution in air travel with more and more people around the region choosing AirAsia as their preferred choice of transport (Cary, 2009) .

The fabulouds and rapid development of Air Asia low cost model already attract many parties to know more about the operation of Air Asia. It is also the thing that make Writer interested to learn more about their activities and strategy. But the implementation of the LCC models in the Air Asia airlines also has the challenge. So, That is why in this research, we will try to analyze about the strategic cost management that is implemented in Air Asia by using the value chain approach that already brought them to the succeed performance, and to recommend what is the thing else that shold be improved in the Air Asia Airlines company.

B. Problem Definition

Based on the background stated above, then the problems the writer would like to discuss in this research are:

1. How is the value chain analysis in the Air Asia Airlines Company?
2. How is the LCC model in terms of Cost leadership implemented in the Air Asia Airlines Company by using value chain approach?
3. How can the cost leadership affect the pricing strategy to improve the competitive advantage of Air Asia Airlines Company?

C. Purpose and Benefits of the Research

The purposes that the writer wants to reach by doing this research are:

1. To analyze the value chain of Air Asia Airlines Company.
2. To evaluate the cost management in LCC model implementation in Air Asia Airlines Company by using the value chain approach.
3. To get information on how LCC model and pricing strategy can effect the competitive advantage of Air Asia Airlines Company.

The benefits of this research are:

1. For the writer, to be able to define the Low Cost Carrier concept that affect the cost management in a company as one of the way to improve the competitive advantage, and to fulfill the requirement to get S1 degree at Economic Faculty of Andalas University.
2. For Academic, this research can be a reference for further research.
3. For the company, this research can be references to develop a better cost management and pricing strategy.

D. Scope of Analysis

The writer limits the scopes of this research which are:

1. This research only evaluate the cost management of the LCC models in Air Asia Airlines Company by using value chain approach.
2. This research to evaluate the current cost and pricing strategy to affect the competitive advantage of the Air Asia Airlines Company in the year of 2009.

E. Writing Systematics

Chapter one is the introduction that explains about problem background, problem definition, purpose and benefits of the research, scope of analysis, and writing systematic.

Chapter two is theoretical framework that explains about the ingrated concept of the cost management stressing on competitive strategy that comprised of the low cost strategy and value-chain analysis. It is started with the explanation of cost and the theory about different cost for different purpose. Based on this thing, we will portray the product cost that assist for two purposes, decision making and external reporting. Then the next concept explain about the cost management for the competitive strategy that is using low cost strategy, differentiation and focus strategy. The value chain is explained as the tools for the company to attain the competitive advantage which also used as the main tools of analysis for the Writer to analyze the value-added activity for Air Asia Company.

Chapter three is research methodology that explains about type of the research, type of data used in research, variable, and data gathering technique.

Chapter four is analysis that explains about the cost mangement strategic impact toward the pricing strategy and company competitive advantage of the Air Asia Airlines Company.

Chapter five is conclusion that contains of research conclusions, limitation of the research, suggestions and implications for the company.



CHAPTER II

THEORITICAL FRAMEWORK

The objective of this chapter is to review relevant literatures concerning to Cost Management and value chain approach concept. This chapter explains what is the cost management, and value chain concept in determining cost management strategy.

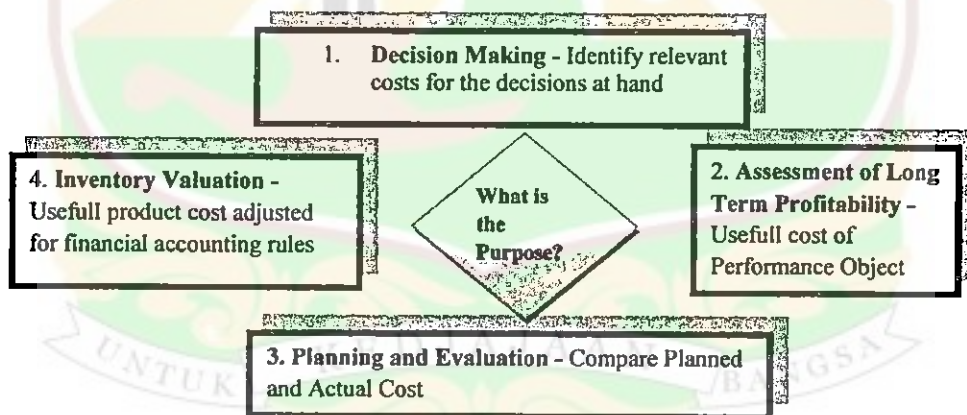
A. Cost Management Concept

1. Nature of Cost

a. Different Cost for Different Purpose

Cost is not just one number; it varies with its intended purpose. Costs are generally used for four main purposes as shown on the scheme below :

Figure 1. Different Cost for Different Purpose



Source: maleafd.com

1. The first one is to decide. Every time managers face a decision, they should apply the concept of relevant costs and revenues since they reflect expectations about the future cash flows of different alternatives. Relevant costs and opportunity costs go together. The cash flow of the second best alternative is an opportunity cost.

2. The second purpose of cost information is to evaluate the long-term profitability of product and services. This requires the use of a cost system because it estimates the value of the resources used to do something like performing a task, running a department, manufacturing and distributing products, or serving a customer. With cost information, managers are in a better position to make sure that the selling price of products and services pay for the variable (usually the only short term relevant costs) and fixed costs.
3. The third purpose is to plan for the future and evaluate how events are unfolding. Once the management team has decided on a course of action, periodic evaluations should be conducted to assess the situation against the plan and change the course of action if needed. In fast moving markets evaluation has also become crucial for encouraging learning.
4. The fourth purpose is to provide input to financial accounting. Companies have to value inventories and cost of goods sold in their financial statements. This requires the estimation of costs following financial accounting principles (rules). Actually, this purpose was very important during most of the twentieth century, and decision-making and profitability evaluation were basically ignored in managerial accounting training.

According to Weil and Maher in their Handbook for Management Accounting at 2005, Since at least 1923, they have recognized that different purposes require different cost concepts. J. M. Clark, 1923 wrote:

The general idea of cost covers a number of different meanings. . . . A great deal of controversy [exists] as to whether certain items are properly costs at all. Most of this controversy will disappear if we carry our study far enough to recognize that there are different kinds of problems for which we need information about costs, and the particular information we need differs from one problem to another.

Simon, Guetzkow, Kozmetsky, and Tyndall, in their classic research on the control function, found that business uses cost data for various purposes: (1) as a *score-card* for the appraisal of an operating unit; (2) to *direct attention* to problems; and (3) to aid in the *solution of problems* (Simon, Guetzkow, and Tyndall, 1954).

They found that different purposes require different costs; moreover, they argued that different management levels require the same cost data in different forms. Information systems store and analyze data on multiple dimensions, but increased dimensionality has higher data accumulation, processing, and storage costs. Accordingly, the manager of the information system can make decisions about cost classifications only by balancing benefits against the price paid for them.

b. Alternative of Cost Definition

Cost has many meanings, differing among accounting, economics, and engineering. A charge to a cost account under traditional accounting theory debits an asset, whereas the expiration of a cost is an expense. For example, a purchase of raw materials is a cost, a number on the balance sheet, but the payment of current advertising is an expense. Think of *cost* with no further modification as an asset, or the amount of the sacrifice required to acquire the asset. Contrast with *expense*, an expired asset—one that has given up its future benefits.

Davidson, Schindler, and Weil express this dichotomy:

An expense is an expired asset. A firm acquires assets to obtain the services of future benefits that the assets provide. All acquisitions are acquisitions of assets, that is, of future benefits. As the services are used up, as the future benefits disappear, assets become expenses. Expenses may thus be described as “gone assets,” that is, as benefits or resources used up in the process of securing revenue. To decide when an asset (or its synonym, a cost) loses its power to provide future benefits and, hence, has become an expense is one of the most difficult problems in accounting (Davidson, Schindler, and Weil, 1975)

Thus, a traditional accounting definition of *cost* means the amount expended to acquire an asset. A more general concept equates cost with any sacrifice, past or future. It is the price paid for the selection of one alternative over another. Or, as Shillinglaw in his book *Cost Accounting: Analysis and Control*, 3rd states this broader economic/accounting definition: “A cost represents the resources that have been or must be sacrificed to attain a particular objective.” The concept of cost is multifaceted (Handbook of Cost Management 2nd edition; Weil and Maher; 2005 ; 176-177)

c. Product Cost

Product cost is a cost assignment that supports a well-specified managerial object. Thus, what product cost means depends on the managerial objective being served (Hansen and Mowen, 2009).

Accountants prepare product costs to serve two purposes: Decision making by managers, and external reporting. Decision making product costs approximate the marginal costs economists discuss, i.e., the unit costs includes the amount that total company costs increase when an additional unit is produced. Product costs for external reporting in contrast

include a portion of company costs that do not vary with units produced. These product costs include material costs, labor costs, and overhead costs.

2. Cost Management Tools

The essence of cost management is to utilize a group of tools to generate information regarding planning, decision making, and control at both short run and long run in order to help organization's management to create products or provide services with more effective and efficient way comparing with competitors [Horngren et al. (2003), Hansen and Mowen (2000), Hilton et al. (2000)].

Table 1. Tools of Cost Management

Tools	Nature
Value chain analysis	add value to customers _reducing costs, and understanding relation between business organization and booth customers
Activity based costing	an analytical tool aims to provide accuracy in allocating indirect costs.
Competitive advantage analysis	defining strategy that an organization could adopt to excel over rivals.
Target costing	cost that an organization is willing to incur according to competitive price that could be used to achieve desired profit
Total quality	adopt necessary polices and procedures to met

management	customers expectations
Just-in-time	a Comprehensive system to buy materials or produce commodities when needed in appropriate time
SWOT analysis	a systematic procedure to identify critical success factors of an organization
Benchmarking	a process performed to determine critical success factor and study ideal procedures of other organization in order to improve operations and dominate market
Balanced scorecard	an accounting report of critical success factors about the organization. It is divided into four major dimensions: financial performance, customers' satisfaction, internal operation, and innovation and growth
Theory of constraints	a tool to improve rate of transferring material into finished goods
Continuous improvement	conducting continuous improvements in quality and other critical success factors

* Source: Blocher et al. (1999)

3. Competitive Strategy and Low Cost Concept

a. Competitive Strategy

Porter notes that a business can develop a sustainable competitive advantage by following one of two strategies:

1) Low cost strategy

The primary focus of a low-cost strategy is to achieve low cost relative to competitors (i.e.: cost leadership). Cost leadership can be achieved through:

- a) Economic of scale in production
- b) Experience curve effects
- c) Tight cost control
- d) Cost minimization in such areas as research and development (R&D), service, sales force, or advertising. (Shank and Govindarajan; 1992)

This generic strategy calls for being the low cost producer in an industry for a given level of quality. The firm sells its products either at average industry prices to earn a profit higher than that of rivals, or below the average industry prices to gain market share. In the event of a price war, the firm can maintain some profitability while the competition suffers losses. Even without a price war, as the industry matures and prices decline, the firms that can produce more cheaply will remain profitable for a longer period of time. The cost leadership strategy usually targets a broad market.

Some of the ways that firms acquire cost advantages are by improving process efficiencies, gaining unique access to a large source of lower cost materials, making optimal outsourcing and vertical integration decisions, or avoiding some costs altogether. If competing firms are unable to lower their costs by a similar amount, the firm may be able to sustain a competitive advantage based on cost leadership.

Firms that succeed in cost leadership often have the following internal strengths:

- a) Access to the capital required to make a significant investment in production assets; this investment represents a barrier to entry that many firms may not overcome.
- b) Skill in designing products for efficient manufacturing, for example, having a small component count to shorten the assembly process.
- c) High level of expertise in manufacturing process engineering.
- d) High level of expertise in manufacturing process engineering.
- e) Efficient distribution channels.

Each generic strategy has its risks, including the low-cost strategy. For example, other firms may be able to lower their costs as well. As technology improves, the competition may be able to leapfrog the production capabilities, thus eliminating the competitive advantage. Additionally, several firms following a focus strategy and targeting various narrow markets may be able to achieve an even lower cost within their segments and as a group gain significant market share.

2) Differentiation Strategy

A differentiation strategy calls for the development of a product or service that offers unique attributes that are valued by customers and that customers perceive to be better than or different from the products of the competition. The value added by the uniqueness of the product may allow the firm to charge a premium price for it. The firm hopes that the higher price will more than cover the extra costs incurred in offering the unique product. Because of the product's unique attributes, if suppliers increase their prices the firm may be able to pass along the costs to its customers who cannot find substitute products easily.

Firms that succeed in a differentiation strategy often have the following internal strengths:

- a) Access to leading scientific research.
- b) Highly skilled and creative product development team.
- c) Strong sales team with the ability to successfully communicate the perceived strengths of the product.
- d) Corporate reputation for quality and innovation.

The risks associated with a differentiation strategy include imitation by competitors and changes in customer tastes. Additionally, various firms pursuing focus strategies may be able to achieve even greater differentiation in their market segments.

3) Focus Strategy

The focus strategy concentrates on a narrow segment and within that segment attempts to achieve either a cost advantage or differentiation.

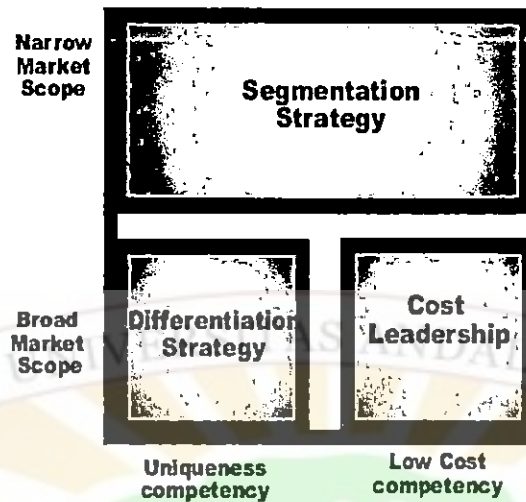
The premise is that the needs of the group can be better serviced by focusing entirely on it. A firm using a focus strategy often enjoys a high degree of customer loyalty, and this entrenched loyalty discourages other firms from competing directly.

Because of their narrow market focus, firms pursuing a focus strategy have lower volumes and therefore less bargaining power with their suppliers. However, firms pursuing a differentiation-focused strategy may be able to pass higher costs on to customers since close substitute products do not exist.

Firms that succeed in a focus strategy are able to tailor a broad range of product development strengths to a relatively narrow market segment that they know very well.

Some risks of focus strategies include imitation and changes in the target segments. Furthermore, it may be fairly easy for a broad-market cost leader to adapt its product in order to compete directly. Finally, other focusers may be able to carve out sub-segments that they can serve even better. (Porter, Michael E)

Figure 2. Competitive strategy by Porter



Source: www.ifm.eng.cam.ac.uk

b. Cost Leadership Concept

This strategy emphasizes efficiency. By producing high volumes of standardized products, the firm hopes to take advantage of economies of scale and experience curve effects. The product is often a basic no-frills product that is produced at a relatively low cost and made available to a very large customer base. Maintaining this strategy requires a continuous search for cost reductions in all aspects of the business. The associated distribution strategy is to obtain the most extensive distribution possible. Promotional strategy often involves trying to make a virtue out of low cost product features.

To be successful, this strategy usually requires a considerable market share advantage or preferential access to raw materials, components, labour, or some other important input. Without one or more of these advantages, the strategy can easily be mimicked by competitors. Successful implementation also benefits from:

- 1) process engineering skills
- 2) products designed for ease of manufacture
- 3) sustained access to inexpensive capital
- 4) close supervision of labour
- 5) tight cost control
- 6) incentives based on quantitative targets.

Cost leadership is reflected in a culture that, independent of macroeconomic circumstances, pursues a low-cost, high-quality, customer-centric approach to managing the business. Cost leadership is reflected in a culture that, independent of macroeconomic circumstances, pursues a lowcost, high-quality, customer-centric approach to managing the business. Cost leadership is characterized by four primary criteria:

(1) recognition as the lowestcost producer in one's industry, without compromise in quality or customer focus; (2) realization of a long-term cost-centric culture where cost consciousness is a *strategic and leadership reoccupation* across functional lines and independent of the vagaries of financial markets; (3) Dissemination of cost information with regard to customer, product, distribution channel, and the like that is timely, understandable, credible, and actionable and is made available to decision makers to fuel continuous improvement; and (4) aggressive and balanced performance targets are established across the value chain. Achievement of these targets is recognized, rewarded, shared, and celebrated (Jonathan B. Schiff, CMA, and Allen I. Schiff;2009).

Nowadays, the cost leadership is not only pursuing the efficiency in competitive advantage, but also produced improved "top line" results form better nad renewed customer focus.

4. Value chain Concept

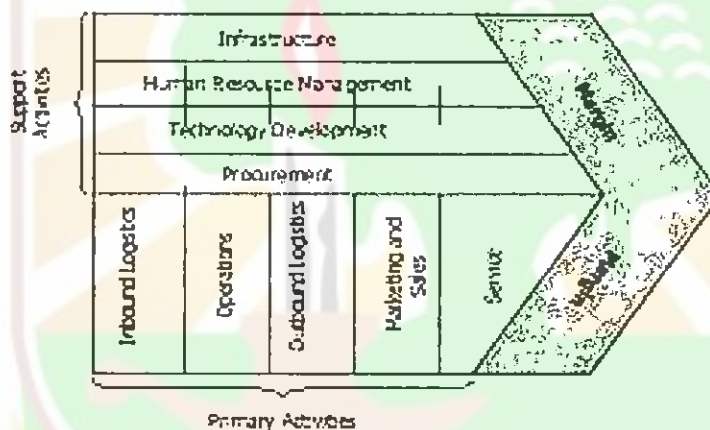
Value chain analysis is a tool that organisations can use to attain competitive advantage. This is realised by disaggregating an organisation into its strategically relevant activities so as to understand cost behaviour as well as sources of existing and potential sources of differentiation (Porter, 1985). Thus, gaining competitive advantage arises from the ability of an organisation to execute the value-creating activities in a more cost-effective way than an organisation's competitors (Hoque, 2001).

A value chain is defined as "the linked set of value-creating activities all the way from basic raw material sources for component suppliers through to the ultimate end-use product delivered into the final consumers' hands". The basic logic behind value chain analysis is that organisations should adopt an external focus in understanding and analysing costs arising from both intra-organisation and inter-organisation processes. This requires the involvement of suppliers and customers in understanding and exploiting sources of competitive advantage embedded in their inter-organisation processes. As such, the management of costs needs to take a broad focus that includes processes external to the organisation, i.e. cost management should take a value chain perspective.

Value chain analysis involves the process of decomposing the processes from suppliers to final customers into strategically relevant activities as a way of managing costs. Since each strategically relevant activity involves investment in resources to be performed, it follows that each segment or link along the value chain is expected to add value. Once the distinct segments of

the value chain or the strategically relevant activities have been identified, the role of finance professionals is to contribute to the assignment of costs to these activities. Assigning costs to the strategically relevant activities facilitates process value analysis, which involves comparing these costs against the value generated by the activities. The aim of process value analysis is to ensure that each segment of the chain is not only relevant, but that it is also generating value higher than the costs it consumes.

a. The basic model of Porters Value Chain is as follows:



Porter 1985

Source: www.wikipedia.com

According to Porter (1985), the primary activities are:

- a) Inbound Logistics - involve relationships with suppliers and include all the activities required to receive, store, and disseminate inputs.
- b) Operations - are all the activities required to transform inputs into outputs (products and services).
- c) Outbound Logistics - include all the activities required to collect, store, and distribute the output.

- d) Marketing and Sales - activities inform buyers about products and services, induce buyers to purchase them, and facilitate their purchase.
- e) Service - includes all the activities required to keep the product or service working effectively for the buyer after it is sold and delivered.

Secondary activities are:

- a) Procurement - is the acquisition of inputs, or resources, for the firm.
 - b) Human Resource management - consists of all activities involved in recruiting, hiring, training, developing, compensating and (if necessary) dismissing or laying off personnel.
 - c) Technological Development - pertains to the equipment, hardware, software, procedures and technical knowledge brought to bear in the firm's transformation of inputs into outputs.
 - d) Infrastructure - serves the company's needs and ties its various parts together, it consists of functions or departments such as accounting, legal, finance, planning, public affairs, government relations, quality assurance and general management.
- b. Characteristics of Value Chain

From a strategic cost management perspective, value chain analysis has three key characteristic attributes that make this technique very useful. These attributes are (1) a clear identification of the strategy chosen by the organisation, (2) its emphasis on sources of sustainable competitive

advantage, and (3) its focus on the importance of complex linkages and interrelationships.

(1). The first attribute emphasises the need to manage costs of activities and processes in the context of the strategy selected by the organisation, i.e. making sure that activities and processes performed in the organisation are in sync with, and thus support, its strategy. In other words, there should be a strong link between the value chain activities and the organisation's strategy. This might appear obvious but the reality is that many organisations suffer from inertia and, as a result, processes, activities and systems that were deployed a long time ago continue to be performed even though some of them are irrelevant and thus should be eliminated or at the minimum significantly modified. Thus value chain analysis requires an organisation to determine activities that are denoted as strategic value chain activities. These are activities that give the organisation the potential to create value for the consumer as a way of creating and sustaining competitive advantage. The process of determining strategic value chain activities is based on the 'pull' approach, which first identifies product characteristics that are valued by the consumers. Strategic value chain activities are those activities that are critical in the ability of the organisation to produce products/services that meet the characteristics determined by customers.

Once strategic activities have been identified, the remaining activities must also be clearly identified and denoted as non-strategic. While such activities are important for the overall provision of products and services, they do not confer competitive advantage to the organisation. All non-strategic value chain activities should be streamlined, reduced or outsourced so as to make sure that the organisation's efforts are geared towards activities that have the greatest impact on its ability to achieve and sustain competitive advantage. Failure to link value chain activities to strategy results in huge wastage due to (1) the performance of activities and processes that are no longer compatible with organisational strategy and (2) emphasis placed on non-strategic value chain activities.

- (2). The second characteristic of value chain analysis is concerned with what the organisation is good at. Once strategic and non-strategic activities have been clearly understood, an organisation should then identify specific strategic value chain activities that it is good at. The idea here is that an organisation should exploit such characteristics as a way of creating value for the consumer. In order to do this, the organisation should address the question: What do we do best in order to distinguish ourselves from our competitors? The point here is that, even though most activities are necessary in the provision of products and services, not all of them are critical in distinguishing an organisation from its competitors. In order to

achieve competitive advantage, an organisation must perform activities in which it has a unique advantage. Once these activities have been identified, creating and sustaining competitive advantage involves closely managing them by making sure that they are not only performed well, but that they are also well resourced. The problem with many organisations is that strategic value chain activities are not identified. To make matters worse, when it comes to reducing costs, an across-the-board approach, i.e. cost cutting, is applied.

- (3). The third attribute of value chain analysis is the emphasis on both internal and external linkages and interrelationships. Internal linkages are typified by relationships between tasks and activities that form a process within the organisation's value chain (Chivaka; 2007)

CHAPTER III

RESEARCH METHODOLOGY

A. Location of the Research

Interested with the Low cost carrier concept, Writer tried to bring the huge phenomenon company that already implemented and succeed, which is Air Asia Company. The research is done in Jakarta with the case study in Air Asia Airlines Company. The reason why Writer choose the Air Asia Company in Jakarta, because Air Asia also has a branch in Indonesia and it would be easier for Writer to get the data and documents regarding the Air Asia, such as Annual report and financial report of the Air Asia. It would be more relevant and easier for Writer to access and clarify the hesitant toward the datas.

B. Type of Research

In this research writer will explains the object of research systematically by using descriptive analysis. Descriptive method can help writer to find the fact of the research and then analyze the collected data.

The data will be analyzed based on the current data existed that was given by the company. Then, writer will do an analysis of the low cost strategy that has been implemented by the Air Asia Airlines Company to evaluate their pricing strategy and competitive advantage by observing the cost needed for each value chain activities.

C. Area of Research

Writer will focus on the cost management strategy that is implemented by the Air Asia Company in 2009, because this year is the latest year that has passed. In this research, writer will limit the analysis on the activities in the value to portray its competitive advantage. The result on this research will be the descriptive result, where it will analyse the cost management strategy that is implemented by the Air Asia Airlines Company in value chain activities approach. The intention of this analysis is to describe the relationship of the low cost strategy, especially the cost leadership toward the Air Asia Airlines Company pricing and competitive advantage.

D. Sources and Kinds of Data

Data of this research obtained from secondary data. Secondary data is the source of research data obtained by researcher indirectly through an intermediary (Indriantoro and Supomo, 1999).

Secondary data is the data consist of:

1. Company profile
2. Work activity done by the company to analyse the value-chain activities
3. Annual report
4. Air Asia Book
5. Pricing that is existed on the Air Asia Website

E. Data Collection Method

Data collection methods used by the writer for this research are as follow:

1. Study of secondary data.

Mostly datas that is analyzed in this thesis is gotten from Air Asia Company website, that is consist of Annual Report 2007, annual report 2008, Annual Report 2009. And several datas about business process and financial side within the website.

2. Study literature

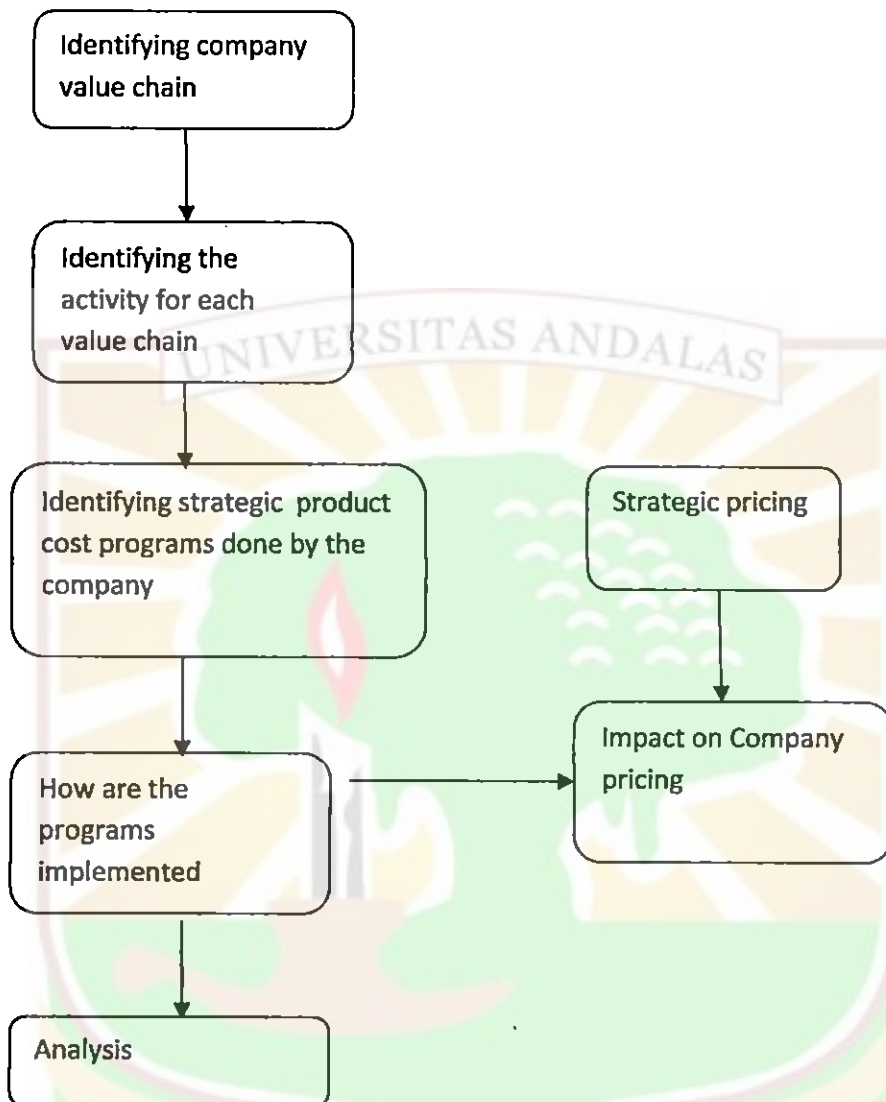
To get as many detail information as possible about Cost management strategic and value chain approach.

F. Data analysis

First, data about company activities that is gotten from the website of Air Asia company are analyzed, and the whole package of the information are clustered become the structured company value chain form, consist of primary and secondary activities. Then, these activities are elaborated become each of technical operations to portray the strategy in cost management that is gotten and stated in annual report and business operation explanation within the website. Each of activities that is defined are able to reveal the Company strategy in cost reduction and strategic cost program.

Thus, by analyzing each cost reduction per value chain activities, the technical operations are portraying the impact on the strategic pricing of Air Asia Company that leading them to have the competitive advantage.

The framework of data analysis would be:



Source: Morris and Kaplinsky, A handbook for Value Chain Research, 2000

CHAPTER IV

DISCUSSION AND ANALYSIS

A. Company Profile

1. Company Background

AirAsia was initially launched in 1996 as a full-service regional airline offering slightly cheaper fares than its main competitor, Malaysia Airlines. Before 2001, AirAsia fail to either sufficiently stimulate the market or attract enough passengers from Malaysia Airlines to establish its own niche market. The turnaround point of Air Asia is in 2001, while it was up to sale and bought by Tony Fernandes. Tony Fernandes then enrolled some of the lending low-cost airline experts to restructure AirAsia's business model. He invited Connor McCarthy, the former director of group operation of Ryanair, to join the executive team. In late 2001, AirAsia was re-launched in Malaysia as a trendy, no-frills operation with three B737 aircraft as a low-fare, low-cost domestic airline. This concept was revealed to be succeed. In only seven months (December 2002), Air Asia got the Rp 282,5 billions income and record the profit margin around Rp 48,5 billions with 1,1 millions passengers.

Based on the Air Asia Annual Report on 2009, it is informed that evolution of the Air Asia portray that AirAsia was resurrected, re-branded and re-launched as a low-cost carrier and began its new life with two planes (both ageing Boeing B737 aircraft), five destinations (Kota Bahru, Kota Kinabalu, Kuching, Labuan, Langkawi and Penang) and a staff of 250 when it is started in 2002. Just over eight years later, the AirAsia Group (including its Thai and

Indonesian affiliates) operates a fleet of 90 aircraft and flies to more than 60 destinations from hubs in Malaysia, Thailand and Indonesia.

AirAsia operates more than 3,500 flights a week, colouring the blue skies over Asia a bright red with their striking livery. The Group employs close to 7,500 staff and in its short history, has ferried more than 90 million guests.

Asia's largest low-cost carrier is now proud to be a truly ASEAN (Association of South East Asian Nations) carrier, linking communities, cultures and cities across this diverse region with its "sky bridges" that enable affordable and convenient travel, stimulate regional and local economies and help realise the ASEAN dream of integration.

Serving the underserved has helped make AirAsia popular with the masses. Its RM3.2 billion valuation on Bursa Malaysia has made it a sought-after stock with investors. Its status as a global brand makes it a shining star in the Malaysian corporate firmament. The flat management and open floor workplace make it an employer of choice for its hardworking, dedicated, talented and creative staff.

a. Company Vision, Mission, and Values

Table 4.1 Vision, Mission, and Values of Air Asia Airlines Company

Vision	To be the largest low cost airline in Asia and serving the 3 billion people who are currently underserved with poor connectivity and high fares
Mission	<ul style="list-style-type: none"> - To be the best company to work for whereby employees are treated as part of a big family - Create a globally recognized ASEAN brand

	<ul style="list-style-type: none"> - To attain the lowest cost so that everyone can fly with AirAsia - Maintain the highest quality product, embracing technology to reduce cost and enhance service level
<p>Values</p>	<ol style="list-style-type: none"> 1. Safety: Adopting a zero tolerance to unsafe practices and strive for zero accidents through proper training, work practices, risk management and adherence to safety regulations at all times. 2. Valuing Our People: Committing to our people's development and well-being and treating them with respect, dignity and fairness. 3. Customer Focused: We care and treat everyone in the same manner that we want to be treated. 4. Integrity: Practicing highest standards of ethical behaviour and demonstrate honesty in all our lines of work in order to command trust and mutual respect. 5. Excellence in Performance: Setting goals beyond the best and reinforcing high quality performance standards and achieving excellence through implementing best practices.

Source: Air Asia annual Report 2008.

b. Company Key Strategies

AirAsia's success has taken flight through the continued confidence of their guests who prefer a no-frills, hasslefree, low fare and convenient option in air travel. The key to delivering low fares is to consistently keep cost low. Attaining low cost requires high efficiency in every part of the business and maintaining simplicity. Therefore every system process must incorporate best industry practices (Air Asia Annual Report 2008).

The key strategies that are implemented in Air Asia Company portrayed on Annual Report 2009 explain in these points above:

1) Safety First

Safety is the single most important criteria in every aspect of the operations, an area that AirAsia will never compromise on. AirAsia complies with the conditions set by regulators in all the countries where the airline operates. In addition, AirAsia partners with the world's most renowned maintenance providers to ensure that its fleet is always in the best condition.

2) High Craft Utilization

AirAsia's high frequency flights have made it more convenient for guests to travel as the airline implements a quick turnaround of 25 minutes, which is the fastest in the region. This has resulted in high aircraft utilisation, lower costs and greater airline and staff productivity.

3) Low Fare, No frills

AirAsia targets guests who are prepared to do away with frills such as meals, frequent flyer miles or airport lounges in exchange for fares lower than those currently offered without comprising on quality and service. Guests have the choice of buying exclusively prepared meals, snacks and drinks from our in-flight service at an affordable price.

4) Streamline Operations

Making the process as simple as possible is the key to AirAsia's success. We are working towards a single aircraft fleet; this greatly reduces duplicating manpower requirements as well as stocking of maintenance parts. There is only one class seating, i.e. first class, and passengers are free to sit where they choose. But recently there already a new regulation that there is a seat number for the passengers of Air Asia.

5) Lean Distribution System

AirAsia offers a wide and innovative range of distribution channels to make booking and traveling easier for its guests. AirAsia's ticketless service provides a low cost alternative to issuing printed tickets.

6) Point to Point Network

The LCC model shuns the hub and spoke system and adopts the simple point to point network. All AirAsia flights are shorthaul (four hour flight or less). The underlying business is to get a person

from point A to B. Applying the point-to-point network keeps operation simple and lower costs.

B. Company Business and Operations Analysis

1. Air Asia Company LCC (Low Cost Carrier) Business Model

Every type of the company has its own business model. It is implemented as the core guidance for the company itself in running their business and operations for getting the competitive advantage. It is also happened to the Air Asia, by taking the Low Cost Carrier business model as the fundamental, Air Asia already imply their business model that is leading them to the success. The business model are defined on the table below.

Table 4.2 : Low Cost Carrier Business Model

<p>Simple Product</p>	<ul style="list-style-type: none"> a. Catering on demand for extra payment b. Planes with narrow seating and only a single class c. No seat assignment d. No frequent flyer programmes
<p>Positioning</p>	<ul style="list-style-type: none"> a. Non-business passengers, especially leisure traffic and price-conscious business passengers b. Short-haul point to point traffic with high frequencies c. Aggressive marketing d. Secondary airports e. Competition with all transport carriers

Low Operating Costs	<ul style="list-style-type: none"> a. Low wages b. Low airport fees c. Low costs for maintenance, cockpit training and standby crews due to homogeneous fleet d. High resource productivity e. Short ground waits due to simple boarding processes f. No air freight, no hub services, short cleaning times, and high percentage of online sales
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Source : Air Asia Annual Report 2009

2. Air Asia Company SWOT Analysis

Table 4.3 : SWOT Analysis of Air Asia

Strengths	Weaknesses
a. Low cost operations	a. Service resource is limited by lower costs
b. Fewer management level, effective, focused and aggressive management	b. Limited human resources could not handle irregular situation
c. Simple proven business model that consistently delivers that lowest fares	c. Government interference and regulation on airport deals and passenger compensation
d. Penetrate and stimulate to potential markets	d. Non-central location of secondary airports
e. Multi-skilled staffs means	e. Brand is vital for market position and

<p>efficient and incentive Workforce</p> <p>f. Single type fleet minimize maintenance fee and easy for pilot dispatch</p>	<p>developing it is always a challenge</p> <p>f. Heavy reliance on outsourcing</p> <p>g. New entrants to provide the price-sensitive services</p>
Opportunities	Threats
<p>a. Long haul flight is an trial to get undeveloped market share</p> <p>b. Differentiation from traditional LCC model by adding customer services or operation as full service airline with low fare</p> <p>c. Ongoing industry consolidation has opened up prospects for new routes and airport deals</p> <p>d. High fuel prices will squeeze out unprofitable competitors</p>	<p>e. Full service airlines start cut costs to compete</p> <p>f. Entrance of other LCCs</p> <p>g. High fuel price decreases yield</p> <p>h. Accident, terrorist attack, and disaster and affect customer confidence</p> <p>i. Aviation regulation and government policy</p> <p>j. Increase in operation cost in producing value-added services</p> <p>k. System disruption due to heavily reliance on online sales</p>

Source: Cary, 2009

3. Company value chain Analysis

In order to analyze the specific activities within the company that can create the competitive advantage for the Air Asia Company, a value chain analysis conducted for the airlines industry to initiate the model for Air Asia as

achain in value creating activities. The intention of these activities are creating the value that exceed the company cost of providing product or service to generate the competitive advantage. The value chain of Air Asia Airlines are portrayed as the table below.

a. Primary Activities

Table 4.4 : Primary activities description of value chain of Air Asia

	Activities	Description
Inbound Logistic	Landing slots acquisition	Landing slots were scarce resources and also possessed critical value in airlines industry (OECD, 1997). Air Asia needs to really determine the sufficient landing slot for arranging the flight schedule.
	Aircraft leasing or purchasing	The cost of leasing or purchasing the air craft are the main cost occurred for its business. By concentrating in SEA market, Air Asia are convinced to keep the profit for the businees.
	Aircraft parts and fuels purchasing	Air craft fuels and parts commonly taking around 30-40% of the total cost.
Operational	Transporting passengers	Transporting passengers is the core activities in operational.
	Air craft ground maintenance	Air Asia keeping effort to stressing down the cost in this part of activities.

	Flight scheduling	Air Asia doing tight control in flight scheduling for frequently punctual schedule and saving brand.
Outbound Logistic	AA only provides transportation services, no significant outbound logistics can be identified	
Marketing and Sales	Advertising and promotion	Advertising and promotion are the important parts of Air Asia business activities. Intensive advertising and promotion has brought more than five million customers to use AA services (Corporate website, 2005).
	Computer reservation system	Air Asia invest alot for the computerization in reservation activity. It is a part of the major strategy of Air Asia to stressing down the cost by pursuing the online sales.
Service	Call Centre System	A system for managing the costumes enquiries and problem.

Source: Air Asia Annual Report 2009

b. Secondary Activities

Table 4.5 : Secondary activities description of value chain of Air Asia

Activities	Description
Firm Infrastructure	Designing the strategic decision for Air Asia
HR Management	Concerning about the human resource (employee) by accomplishing them with credible training and education to leverage their skill and capabilities (High skill and potential)
Technology	Developing the technology system in maintaining and operation of the air craft to enable the low cost flight
Procurement	Selecting the best and high quality product from suppliers without driving high cost.

Source: Air Asia Annual Report 2009

4. Cost Break down

Cost Breakdown of Air Asia Operation 2009 are portrayed with the table below:

Table 4.6 : Cost Breakdown Air Asia 2009

Cost//ASK* (US Cents)	Q1	Q2	Q3	Q4	FY2009
Staff Costs	0.34	0.38	0.36	0.38	0.35
Fuel and Oil	1.04	1.30	1.37	1.39	1.21
User Charges and	0.26	0.25	0.29	0.33	0.26

Station Expenses					
Maintenance and Overhaul	0.17	0.11	0.15	0.13	0.16
Aircraft related cost	0.15	0.13	0.15	0.09	0.14
Depreciation and Amortisation	0.41	0.41	0.43	0.44	0.42
Others	0.24	0.25	0.30	0.37	0.29
Sales and marketing	0.11	0.11	0.17	0.14	0.14
Total Cost/ASK*	2.71	2.93	3.21	3.27	2.95
Finance Expense	0.51	0.51	0.46	0.46	0.47
Cost/ASK inclusive Finance Cost	3.22	3.44	3.67	3.73	3.42

Source: Air Asia Financial analyst 2009 (www.airasia.com)

*ASK : Available seat kilometers, which is the total number of seats available on scheduled flights multiplied by number of kilometers these seat were flown.

* Cost/ASK : Total operating expenses (excluding finance costs and taxation) divided by ASK. In the airline industry, this is comparable to "unit cost".

Here also the data taken from several resources about the Cost per ASK comparison between Air Asia and others. The data about the others airlines are taken in 2005, but actually the comparison is almost still the same. This data portrayed only intended for comparing the operating cost of Air Asia and

others low cost airlines to give the description about the operating cost in Air Asia.

Table 4.7 : Cost per ASK Comparison between Air Asia and others airlines

Operating Expense	Cost/ ASK (US\$) Air Asia	Cost/ ASK (US\$) Others*	Description
Staff Cost	0,35	1,16	Superior Productivity
Fuel and Oil	1,21	1,03	
Maintenance and overhaul	0,16	0,38	Low-cost short haul reduce cost for maintenance
Costs of Aircraft	0,14	0,50	Emphasis on economies of scale
Depreciation and amortization	0,42	0,18	
Total	2.28	3,25	29% lower than others

*Others: Gol, JetBlue, Southwest, Virgin Blue, EasyJet

Source: Air Asia Financial Analyst 2009

Based on the data above, we can see that mostly Air Asia is stressing the cost down in terms of Staff, maintenance and cost of aircraft. The total that is resulted from the effective operation are 29 % lower operational cost that

others airlines. For more detail operation based value chain analysis will be explain on the strategic cost program analysis.

5. Strategic Cost Program Analysis

a. Primary Activities

Air Asia has developed a considerable value chain in its approach to the strategy. The value for these activities really added a significant amount in its pursuit to provide low price air transportation services (Aruan, 2005). Considering the low cost carrier business strategy that Air Asia Implement, we can notice the several efforts that they take by analyzing each part of the activities portrayed in value chain.

1) Inbound Logistic

Landing slots or Airport slots are rights allocated to an entity by an airport or government agency granting the slot owner the right to schedule a landing or departure during a specific time period (wikipedia). This point will not elaborate in this writing.

a) Streamline Operation and Fleet Renewal

Air Asia are purchasing only one type of airplane to simplify the process. AirAsia is currently the largest single customer of the Airbus A320. The company has placed an order of 175 units of the same plane to service its routes and at least 50 of these A320 will be operational by 2013. The first unit of the plane arrived on 8 December 2005. It is being one of the key strategy of Low Cost Carrier concept to reducing cost which is called with streamline

operation. In the process of simplifying, the cost reduction process gained:

- (1) Single type of aircraft. Pilots, flight attendants, mechanics and operations personnel are specialized in a single type of aircraft, which means, among others, that there is no need for costly re-training of staff, for maintaining a stock with parts for different types of aircraft, for knowledge and skills in order to operate and maintain different types of aircraft with their own characteristics, or for new work requirements.
- (2) Single class seating. There is only one class seating, i.e first class, and passengers are free to sit where they choose. If they want to have the privilege to choose their seats, they can by purchasing Xpress boarding.
- (3) Standard Operating Procedures. SOPs are important to ensure same level of competence among all the staff. This way is able to ensure the homogeneity of service throughout the company (Air Asia Website).

AirAsia began a gradual conversion of its fleet from the Boeing 737-300 to the Airbus A320-200, with the first order made for 40 Airbus A320 aircraft and 40 more on option in a Memorandum of Understanding made in 17 December 2004. When the contract was signed on 25 March 2005, the order was increased to 60 firm orders with 40 on option. The first six Airbus A320s were

delivered on 9 December 2005, with the remaining 54 aircraft from the 2005 order to be delivered by June 2009.

On 19 July 2006, the airline exercised the options of 40 Airbus A320-200s to increase its total firm orders to 100 aircraft, with another 30 on option. It made a third order of 50 firm A320-200s and increased the options to 50 on 8 January 2007, with delivery expected to be completed by December 2013. The Airbus A320-200 was expected to completely replace the Boeing 737-300 fleet at the Kuala Lumpur base by July 2007. The airline made its latest order of 25 firm orders on 25 November 2007, bringing its total orders of Airbus aircraft to 175 with 50 on option.

In August 2009, AirAsia had signed an amendment agreement with Airbus to defer the delivery dates for 8 of its A320s aircraft by four years to 2014 due to "infrastructural constraints" at the existing low-cost carrier terminal (LCCT) in Sepang as it cannot accommodate its fleet expansion. The rationale to scale down on the delivery of aircraft in 2010 and possibly 2011 is to enable AirAsia to optimize its fleet and avoid the costs associated with leaving idle or under-utilized aircraft due to infrastructural limitations, avoiding having to incur depreciation, interest expense and other costs without earning revenue. The infrastructural constraints will continue at the current airport until the new low-cost carrier terminal is constructed. Earlier In February 2009 the Malaysia's government vetoed an ambitious plan by AirAsia to

build a 460-million-dollar airport nearby as KLIA East @ Labu (www.wikipedia.com accessed August 11, 2010).

Indeed, The big potential savings for Air Asia would not be in labour costs but in obtaining aircraft best suited for the Asia-Pacific region and in sharing spare parts .

b) Hedging and Fuel Surcharged Discontinued.

Based on table 4.6, we can see that Air Asia cost for fuel and oil are about 1,21 USD/ASK. Although it is taking the most portion of cost that is issued by the Airlines business, but Air Asia still have a way to reducing the actual cost. Air Craft Fuel and parts are reduced by Air Asia by implementing hedging system. It has hedged 100% of its fuel requirements for the next three years, achieves an aircraft turnaround time of 25 minutes, has a crew productivity level that is triple that of Malaysia Airlines and achieves an average aircraft utilisation rate of 13 hours a day. On 12 November 2008, AirAsia abolished fuel surcharges. In doing so, it claimed to be the 'first airline in the world to abolish fuel surcharges'. By May 2008, the airline had flown 55 million cumulative passengers. In 2010, it has the world's lowest costs for an airline, at under 2 cents per seat per kilometre (www.wikipedia.com accessed August 11, 2010).

2) Operational

a) Transporting Passengers

In the process of transporting passengers as the core business, the aircraft maintenance and scheduling flight are the main supporting activities in operational through value chain analysis. Seeing the process of transporting passengers, the streamline operation is one of the strategy that is implemented by Air Asia. Others strategy that also implemented are portrayed in operational part, such as:

(1) High aircraft utilization

Aircraft is kept flying as much as possible, the first flight starts as early in the morning commercially possible and the final flight typically ends at midnight. A fast turnaround is critical to ensure time spent of the ground is minimal – an airline makes money when the aircraft is flying, not when the aircraft is parked. AirAsia's turnaround time is 25 minutes; compare that against 1 hour for a Full Service Carriers. On average, AirAsia's utilization per aircraft is 12 block hours per day, a Full Service Carriers might do about 8 block hours per day (Air Asia Website).

(2) Safety

AirAsia complies with the highest international standards and procedures.

(3) Point to Point Network

Air Asia as one of the Air Flight business that adapt the Low Cost Carrier concept also shuns the hub-and-spoke system and embraces the simple point-to-point network. Almost all AirAsia flights are short-haul (3 hour flight or less). No arrangements have been made with other airline companies on connecting flights, on possibilities of flight transfers, nor on having the luggage labeled and passed through from one flight to another.

(4) No Frills

The underlying business for Air Asia as a part of Low Cost Carrier is to get a person from point A to point B. Everything else is considered to be luxury item or “frill”, of which can be acquired for a small fee. Among many of the frills that AirAsia has do away are:

(a) No free food & beverages. Air Asia does not provide free food and beverages on flight as the additional service.

Passengers are most welcome to purchase food & drinks at an affordable price from the cabin crew.

(b) Ticketless airlines. Less hassle for the customer, who doesn't have to worry about collecting tickets before traveling, and cost-effective for the airlines (paper, printing, distributing).

(c) No refund. Airlines waste a lot of money when passengers do not show up for a flight due to refunds and rescheduling. Whether a passenger shows up or not, the cost of flight to the airline is the same. LCC are unforgiving to no show passengers and do not offer refunds for missed flights.

(d) No loyalty programme. Air Asia has its own way to keep their brand and they are confident in pursuing the low fares will attract their own customers to fly with them.

3) Marketing and Sales

By pursuing tagline “ Everyone can Fly”, Air Asia success factor indeed created by the Courage that is accomplished by the ability to read the market need. The low cost carrier concept and market segmentation already brought Air Asia to be the Number One Low Cost Flight awarded by SkyTrax in 2009 and achieve RM 447 million operating profit. Air Asia implement such unique way to do sales and marketing. Selling the low ticket price is not only marketing tactic that is done by Air Asia, it is more to business strategy that they implement. As what people said, Air Asia made the orange juice from orange, where the orange is found. Air Asia concentrate in Asia Market and several Countries which has the busy point, such as Australia, China, India, etc.

Actually in the Air flight Business, not the whole of seat in every air craft which is ready to take off is full with passengers. Accomplished with the experience, Air Asia know which are the busy routes. They

offer to the customers the potential empty seat with the low price.

They advertise and sell it by having objective such as:

- a) Selling the empty seat (although it is not offered, it is still empty)
- b) Selling seat since weeks ago, so they will have a chance to make the air craft full which is able to be done previously.
- c) It would be feasible for customers who still hesitate to fly and have a trip to try the flight service
- d) Strengthening their positioning as the Low Cost Carrier
- e) Creating mouth to mouth marketing through advertisement and loyal customers.
- f) Would be able to make them easy to remembered.

In the selling process, Air Asia also reducing cost by reducing the printed ticket and sales counter amount. Mostly the sales counters are placed in the airport and hotels. This strategy called by lean distribution system. Low Cost Carrier will keep their distribution channel as simple as possible and will cover the whole spectrum of the clientele profile. For example, AirAsia can cater to the most sophisticated European traveler via internet and credit card sales. And at the same time, AirAsia has an established system to sell our tickets to the most remote and technology deprived locations, such as in Myanmar (Air Asia Website).

- a) Internet Sales. The bulk of sales ($\pm 65\%$) are done via the airline's website, whereby the fares are paid using a credit card. This is the most cost effective distribution channel.

b) Sales office. AirAsia only has a few sales offices. They only establish a call centre if they are confident the sales derived from the centre will be worth it. Furthermore, they are not fixated with having their sales office in the posh side of town.

c) Travel agents. LCC avoids reliance for sales via travel agent as much as possible. This means that the airlines do not pay any commission to a travel agent, which would otherwise have been reflected in the fares. Also, as they do not use travel agents, they do not use, nor participate in the world wide reservation systems and thus save costs, which again are reflected in their pricing.

4) Service

Air Asia provide the service for the customers by having the call centre that can be done via telephonically. This is one of the cost effective and simple method for servicing customers.

b. Secondary Activities

1) Technology

AirAsia has currently adopted information technologies strategically to integrate the operations and coordinate all the business and management functions. The followings are few system implementations that AirAsia has done in its marketing and sales activities as well as operation activity in the value chain.

a) Yield Management System (YMS)

Anticipates and reacts to the behavior of customers to maximize the revenue - taking into account the operating cost and aids

AirAsia to optimize prices and allocate capacity to maximize the expected revenues by 2 levels:

- (1) Seat – Seats are available at various prices in different points of time. A reservation done at a later date will be charged more than the one done earlier for the same seat
- (2) Route – By adjusting prices for routes / destinations that have a higher demand when compared to others.

Results increased revenue (3-4%) by taking advantage of the forecast of the high / low demand patterns, lower prices as YMS has aided AirAsia to increase the revenue by offering higher discounts, more frequently during off-peak times while raising prices only marginally for peak times.

b) Computer Reservation System (CRS)

- (1) An integrated web-enabled reservation and inventory system suite powered by Navitaire's Open Skies technology that includes Internet, call center, and airport departure control functionality.
- (2) Satisfy the unique needs of AirAsia implementing a low-cost business model to transform the business process to efficiently streamline operations.
- (3) Helps AirAsia to grow at a dramatic pace in the past few years as stated below:

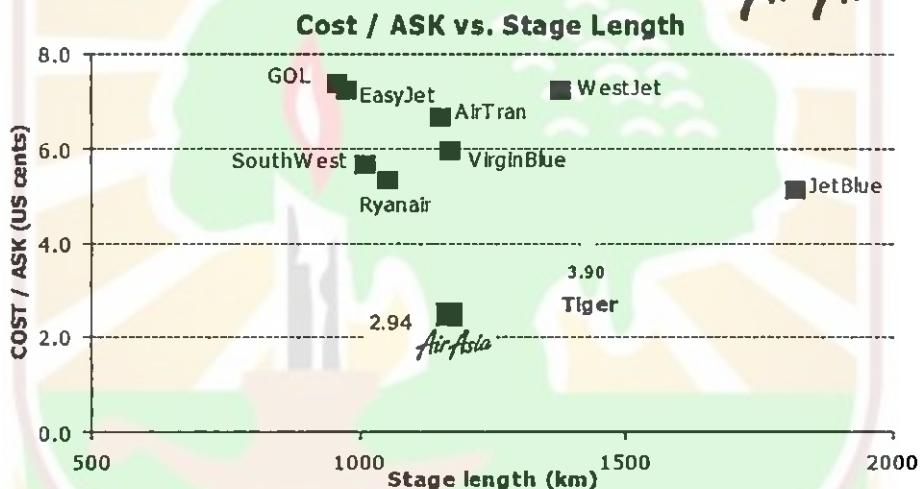
"Navitaire's Open Skies technology has truly enabled AirAsia's growth from 2 million passengers to 7.7 million passengers in less

than two years. Open Skies scaled easily to accommodate our growth." - Tony Fernandes, (Cary,2009)

6. Competitive Advantage Analysis

In the end of this chapter, writer would like to pursue one of the proven graphic that is portrayed position of Air Asia in the region and the rest of the world as the Low Cost Carrier:

Lowest Cost Airline in the World



→ Lowest cost LCC in the region and the rest of the world

Source: www.airasia.com

* **ASK:** Available seat kilometers, which is the total number of seats available on scheduled flights multiplied by the number of kilometers these seats were flown.

Cost per ASK: Total operating expenses (excluding finance costs and taxation) divided by ASK. In the airline industry, this is comparable to 'unit cost'.

Based on the graphic above, we can see the position of Air Asia comparing with the similar business airflight companies are taken the lowest cost around the world. Air Asia is taking 2.94 cost/ASK (US cents) which mean that Air Asia has the total Expense (excluding finance cost and taxation) around that amount and it is the lowest one around the world nowadays. Based on the data taken above, the competitive advantage that is portrayed by Air Asia really define their capabilities in reducing cost with several points below:

1. Quick turnaround time

The longer aircraft on the ground means that the less productive it will be. By shortening the turnaround time, AA was able to gain more profits. It was gained by removing frills service and removing chair booking and extensive crew drilling on performing quick turnaround. (Shari, 2003)

2. Low-cost short haul

Management also conferred with mechanics on how to coddle spare parts so they can last longer. For example: to extend the landing gear usage time, mechanics advise pilots to take a shallow approach on landing (Shari, 2003). By doing such things, AA was able to lower the cost on short haul. It was because less part would need to be replaced.

3. High rate aircraft utilization

Due to above practices, AA then will able to utilize its aircrafts at higher rate. Higher rate of utilization signify that higher profit will be gained by the firm and also lower the cost as the distributed fixed cost get smaller.

Seeing also on the competitive advantage that is portrayed by Porter comparing with the facts revealed in Air Asia business strategy, Air Asia are using the Low Cost strategy to keep its business sustainable. It implements several detail strategy in implementing, such as cost leadership that can be attained by Economic of scale in production, experience curve effects, tight cost control and cost minimization in such areas as research and development (R&D), service, sales force, or advertising. (Shank and Govindarajan; 1992).

Low cost concept that is implemented by the Air Asia in pursuing several strategy in each of value chain activity already brought them to the Biggest Low Cost Airlines in the world. The pricing strategy are defined implicitly by implementing those strategies as the key factors. Because pricing is not only defined by the tactical marketing, but indeed it is more to business strategy which is considering detail strategy in each of value chain activities by implementing low cost management strategy that is portrayed above.

7. Analysis

Competitive advantage that is having by Air Asia as the Low cost Carrier Company already amazed the LCC business with its growth and positioning. Step by step it has been ahead to achieve the profit margin and catch the ASEAN loyal market. This competitive advantage are gaining by placing Air Asia as the low cost carrier that is intended for the undeserved market with the low price. By pursuing the tagline, "Everyone can Fly", it already reflect the mission that is brought by Air Asia in their business. The Low price in Air Asia is gaining by pressing down the cost without leaving the quality of value added

cost and the ability to read the market need and forecasting the trends and situation of ticket purchasing.

The low price are gaining by reducing cost in several central points to achieve the affordable price for their target market. Such as the high air craft utilization, quick turnaround flight, and ommitting the frill service. In the value chain analisys part, we can see how smart they are in managing strategy of cost reduction in each activity. The ability to see and forecast the busy time is creating an idea for the Air Asia by selling the empty seat and sell it with the low price also one of the strategy. It is also accomplished with the marketing business strategy by selling the price lower in the long range of time before flight schedule and step by step increase it nearly the flight schedule.

These integrated business strategy really adapt the Low Cost Carrier business concept, but Air Asia by their own way already grab the market attention and knowing well in what market they will shine as business entities. The detail action counted and considered carefully without leaving the central point such as safety and punctuality. Both of them are the main priorities for the transportation business, they are not forget this foundation. But we do hope that Air Asia is persistent in delivering these elements and able to maintain their business positioning and service to the market forward. So, the brand loyalty and customer satisfaction are still become number one that accomplish the success gained by Air Asia. We are really optimist the competitive advantage that is had by Air Asia is really easy to imititate, but the persistent action and customer loyalty is what matter.

CHAPTER V

CONCLUSION

A. Conclusion

Based on the previous chapter discussion, writer would like to pursue several conclusions regarding Air Asia Company Cost Management Strategic by using value chain approach to define its price. They are:

1. Air Asia as the phenomenon company are really concern about the competitive advantage that they can pursue for the customers. The ability of Air Asia to read the market needs already bring them in to big succeed by initiating the Low Cost carrier as the business foundation.
2. Cost reduction in several business activities that is portrayed by value chain, such as high rate aircraft utilization, lean system, and cutting frill cost are the main things that implemented by Air Asia to cut the cost and define the pricing method that is acceptable for market needs.
3. Pricing methods are defined in detail by having the competitive ticket price comparing to the full-service airlines and bus. They afford it by really knowing the busy rutes and sell the potential empty seat with the low price. They also have the tier system in offering the price (the range of time in selling the low price) and increase it based on the range time nearer to the flight schedule.
4. Safety is the main priority of the Air Asia Company in operating their low cost carrier.

B. Research Limitation

Limitations of this research is this research are mainly arranged from the secondary data, such as the website informations and annual report, it might be creating the unassurance valid information because the secondary data is risky to be manipulated.

C. Suggestion

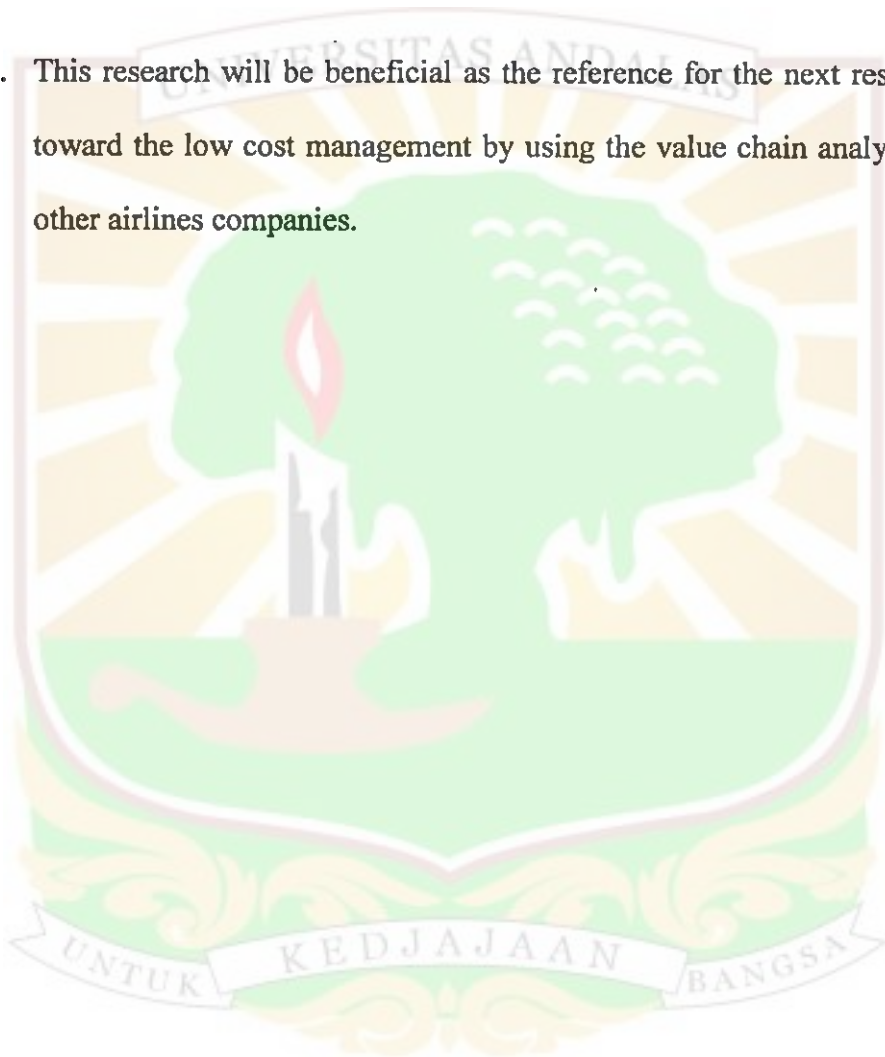
The result of this research has an implication toward the low cost management for the airlines, especially the airlines that is using the low cost carrier concept. This research already shown the result on how we press the cost for being effective in such activities and looking for the value added activities to be forced. What Air Asia did in managing the cost for operations already been an inspiration without leaving the most important thing in Airlines business such as safety. But surely, the quality and service should be the next priority that should be thought by Air Asia also. Then, hopefully this research will be beneficial as the reference for the next research toward the low cost management by using the value chain analysis in others air lines company.

D. Implication

The result of this research has already resulted some implications such as:

1. The data taken from the research is limited in only two years period, and only focus in 2009. It would be better if the next research are portraying at least 3 years period to really see the persistency of the result aimed analysis.

2. This research also limited in terms of data provided regarding the others airlines cost data. It would be better if the next research, the research is accomplished with the updated and complete data from others low cost airlines to see the comparison among airlines to reveal the facts that Air Asia are taking the lowest cost perfectly.
3. This research will be beneficial as the reference for the next research toward the low cost management by using the value chain analysis in other airlines companies.



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