

# How Sustainable is Emirates' Business Model?

Dubai-based Emirates Airline, founded in 1985 with just 2 leased aircraft, is one of the fastest growing and most consistently profitable carriers in aviation history. On track to operate the world's largest A380 and B777 fleets, it has also become Boeing's and Airbus' single most important customer. Finally, if historical growth trends persist, Emirates will become one of the world's largest passenger and cargo airlines by the end of the next decade (at that time, Dubai might also boast the world largest airport). Nevertheless, there is a fair amount of skepticism with respect to the commercial viability and long-term sustainability of Emirates' business model. Some critics, essentially the CEOs of its (European) competitors, hold that Emirates' growth has simply been the result of subsidies. Others cite the political instability of the Middle East, or argue that the buildup of vast overcapacity in the Gulf region will dim the airline's prospects. In this article, we will provide a SWOT analysis of Emirates' business model that needs to be discussed in the broader context of Dubai's overall growth and development strategy into which it is firmly embedded.



By Andreas Knorr and Alexander Eisenkopf

## A Brief History of Emirates

In 1974, three years after independence, the rulers of the UAE decided to establish a joint flag carrier: Gulf Air. However, a tense relationship between the airline and the Dubai government existed ever since its inception, as the latter refused to give in to Gulf Air's demands to abandon its open-skies policy. In reaction, Gulf Air reduced frequencies and capacities to and from Dubai by more than two thirds between 1984 and 1985 without advance notice (Wilson 2005). Since foreign carriers proved unable or unwilling to fill the gap, Dubai's then ruler, Sheik Mohammed bin Rashid Al-Maktoum, convened a team of experts – headed by Maurice Flanagan and later joined by Tim Clark and the ruler's then 26-year old son, Sheik Ahmed bin Saeed Al-Maktoum – to devise an emergency plan. The group's recommendation to set up a home carrier for Dubai was quickly accepted by the ruler, but he imposed two conditions: The new airline should meet the highest quality standards and there would be no additional capital injections from the government other than the agreed USD 10 million start-up capital. On October 25th, 1985, Emirates' first flight departed to Karachi, using an A300, wet-leased

from Pakistan International Airlines. The rest is history: in 1987, Emirates began to serve its first two European destinations – London Gatwick and Frankfurt –, from 1995, it has operated an all widebody fleet, and in 2001, 2003 and 2005 Emirates placed some of the largest aircraft orders ever. As of October 2007, Emirates' route network extends to 91 destinations on all continents. In its last business year, ending March 31st, 2007, the airline transported 17.5 million passengers and 1.2 million tons of cargo on 102 aircraft. Currently, 118 aircraft are on firm order (of which 20 will be all-freighters), including 55 A380 and 43 B777.

## The Emirates Group

Emirates Airlines (including its cargo subsidiary Emirates SkyCargo) is only one division of the Emirates Group, a state-owned globally active travel and tourism conglomerate, which provides a plethora of aviation-related ancillary services. Finally, the Emirates Group owns 43.6 percent of SriLankan Airlines.

## The Dubai Government's Aviation-Related Activities

Viewed from an even higher level of aggregation, the Emirates Group, in

turn, is only one element in a comprehensive bundle of aviation-related activities, all of which come under the responsibility of Sheik Ahmed bin Saeed Al-Maktoum: (1) the Dubai World Central Consortium (activity: to build Jebel Ali Airport City including Dubai's new mega-airport); (2) Dubai's Department of Civil Aviation (activities: all aviation-related regulatory functions, operator of DXB airport, of Dubai Duty Free and Dubai Cargo Village) and (3) Dubai Aerospace Enterprise (activities: aircraft leasing, airport planning and management, consulting, maintenance and aviation-related education and training).

## Emirates' Business Model

Emirates Airline (or rather the Emirates Group as a whole) is a crucial element of Dubai's growth and development strategy. Currently based on the Dubai Strategic Plan 2015 (Dubai Government 2006), its objective is to prepare the emirate for the post-oil era by firmly establishing it as a leading tourist destination (including trade fairs and conferences), as a center for financial, IT and professional services, as a location for corporate headquarters and light manufacturing, and, last but not least, as a regional transportation,

logistics and distribution hub (“regional” refers to the area between Singapore, Europe, Southern Africa). Obviously, Dubai’s (and, as a result, Emirates’) spectacular growth in recent years – on average, GDP increased by 13.4 percent per year since 2000, and its population is set to grow from today’s 1.45 million to around 5.4 million by 2015 (1968: 6,000!) –, has been helped by two complementary factors: sound politics and its very favorable geographical location. The former include its uniquely liberal (by regional standards), cosmopolitan environment, political stability, free-trade agreements with most of the booming Asian economies, world-class infrastructure, efficient public services, and very low to non-existent corporate and income taxes. The latter point reflects the fact no major agglomeration on the globe is further than 8,000 nautical miles away from DXB. As a result, any two major cities on earth can be connected via Dubai with only one stop.

It is against this backdrop that Emirates’ business model must be analyzed. First and foremost, the airline – plus the next to 140 carriers which serve DXB – provides excellent air links worldwide, not only for the benefit of Dubai’s thriving tourist industry, but also of its rapidly expanding local business community (including the thousands of foreign companies that have set up their regional presence there). To be more specific, Emirates’ business model is built on the following features:

- A well-balanced mix of O&D- and transfer traffic in its passenger business (currently 50:50, although the introduction of the A380 fleet is likely to increase the transfer passenger share to 60 percent);
- a very strong focus on cargo traffic, which generates 20 percent of Emirates’ revenues – one of the highest percentages in the airline industry (to the authors’ knowledge, only LAN Chile tops Emirates in this segment, achieving a 40 percent turnover share);
- strong presence in those secondary markets that are underserved by Emirates’ competitors such as BA, LH, and AF which focus on their own hubs

(London, Frankfurt, Munich, Paris) for long-distance flights. Typical destinations in this category include Newcastle, Manchester, Birmingham, Glasgow, Düsseldorf, and Hamburg in its European network as well as Kochin, Kolkata, Thiruvananthapuram, and Ahmedabad in India, to name just a few. Emirates’ competitive advantage in these markets is enhanced by the fact that it, unlike the competition, does not have to deploy a fleet of rather small and, hence, inefficient short-haul and even regional aircrafts for feeder flights to its hub, but can offer long-haul service standards instead (moreover, given its much longer average stage length, Emirates is not subject to competition from low-cost carriers either);



- strong presence in markets that have been largely unconnected to the global air transport network, and especially to the Middle East, to India, Southeast Asia and/or Africa, for lack of a (potent) local flag carrier. This holds not only true for the vast majority of Emirates’ 15 destinations in North and Sub-Sahara Africa (Emirates’ CEO Tim Clark recently observed in an interview with the online edition of German weekly magazine SPIEGEL, that “Africa is a ripe fruit which only needs to be picked”). It also includes cities like Moscow, Brisbane, Perth, São Paulo, New York, and Houston;
- high frequencies: The mid-term objective is to serve most destinations at least twice daily. Currently Emirates’ operates three waves at DXB, a fourth is being gradually phased in;
- high-quality service in all classes onboard and on the ground including up to 600 entertainment channels in all classes and limousine service (pick-up and drop-off) for first and business class passengers;

→ high labor productivity: According to a recent study by UBS, a Swiss bank, Emirates’ unit costs are around 40 percent lower than KLM’s (Horth/Alwyn 2005), a cost advantage that is likely to even increase after the introduction of its A380 fleet; and

→ no alliance membership: In the words of Tim Clark: “If we take the long-term view, then alliances offer a sure-fire way of achieving mediocrity and reduced profitability” (as quoted by Horth/Alwyn (2005)). However, select codesharing agreements are in place.

### SWOT Analysis Strengths

Many of Emirates strengths come from the right decisions taken at its foundation, and from its unique organizational structure. Not only does the carrier benefit from having been created from scratch only 22 years ago, resulting in flat hierarchies and essentially no legacy costs, but, more importantly, the central role of aviation in Dubai’s development strategy also guarantees Emirates a very favorable political environment. First and foremost, the overall responsibility of Sheik Ahmed Bin Saeed Al-Maktoum for all aviation-related activities in Dubai and the lack of a “NIMBY-culture” with respect to airport expansion or new airport projects ensure that the airline will not in decades face infrastructure bottlenecks (which increasingly stifle the growth prospects of its principal European competitors).

Second, Emirates profits from the very low charges at its home airport. While landing fees are by and large identical to those at major European airports, no airline flying into DXB has to pay any additional charges (such as noise charges, ATC charges, security charges etc.). This is because the airport infrastructure and all related services are provided by Dubai’s government and fully financed from the state budget. It is a hotly debated issue whether this particular fee regime is a form of indirect subsidy to Emirates. Judged against the EU’s state aid rules, this would clearly not be the case since Dubai operates an open-skies policy and all airlines are subject to the same non-discriminatory treatment. From an

economic perspective, the lower overall level of charges at DXB might result from a variety of reasons: cost savings due to higher factor productivity, the non-existence of a double markup (as a result of the central management of Dubai's aviation interests by Sheik Ahmed bin Saeed Al-Maktoum), monopoly rents enjoyed by other hub airports at the disadvantage of their airline clientele, and lower marginal damage costs of noise pollution in Dubai (because of different ecological preferences).

Third, Emirates – like all other companies doing business in Dubai or, for that matter, in most Gulf states – benefits from Dubai's low tax regime, which only subjects subsidiaries of foreign banks and energy companies to corporate tax. Obviously, this is an advantage as long as the company remains profitable. As ordinary citizens including expats do not pay income tax either, and enjoy generous government-financed social benefits, too, Emirates is a very attractive employer paying above average net wages although gross wages are lower than in Western countries.

Fourth, Dubai's immigration laws are quite generous by international standards. This does not only hold for foreign experts who may be easily recruited by local firms. It also applies to transit passengers who do not have to clear immigration at DBX when changing planes. While this might appear to be a negligible fact at first sight, it greatly improves Emirates' competitive position on quite a few routes. A good example would be trips from

Brazil to Japan (1.2 million Brazilians are of Japanese descent). On this route, three almost equidistant itineraries – via the USA, Europe and DXB are available, one of which – via the USA – requires a transit visa. Another example would be the UK's restrictive and complicated transit regulations for residents of some Asian countries en route to the USA even if they do not leave the airport while in transit.

Fifth, another of Emirates' strong point is its award-winning service in all classes, which is matched or exceeded only by very few other carriers such as Singapore Airlines. Sixth, clever marketing – for example, Emirates, not Lufthansa – was named official carrier of the 2006 FIFA World Cup hosted by Germany – has created a very strong brand awareness worldwide. Finally, since the UAE's currency is firmly pegged to the US dollar, Emirates has benefited, at least in recent years, from an additional devaluation-related cost advantage, especially vis-à-vis its Eurozone-based rivals.

### **Weaknesses**

It is almost impossible for outsiders to discern any relevant weakness. However, although notoriously unreliable as a source, some posters on travel-related internet blogs are complaining about (allegedly) slipping service standards in general and lack of consistency in service quality in particular. Indeed, Emirates was less successful recently in winning Skytraxx and other awards for outstanding service quality.

### **Opportunities**

Clearly the most important contribu-

ting factor to Emirates' success, and a huge opportunity for future growth, is Dubai's very favorable location. Some 3.5 billion people live within eight flight hours. Moreover, Dubai is placed right at the crossroads of some major passenger and cargo flows, e.g. Asia (China/India)-Africa, Europe-Southeast Asia, Europe-Australia/New Zealand, India-North America, the economic importance of which is set to grow in parallel with the rise of the near-by emerging economies. In addition, DXB has become a major – and frequently time-saving – connecting point for passengers (and cargo) traveling from secondary cities, especially in Western Europe, en route to Australasia and even Africa. In fact, for passengers flying from, say, Hamburg to Sydney, Emirates offers a one-stop connection instead of at least two stops on almost all Oneworld, Skyteam or Star Alliance routings. And for flights to Asia, Emirates offers the same one-stop service as its European rivals, but to a larger number of destinations).

What is more, not only has the UAE's government has been very successful in negotiating free-trade agreements with all major economies from the USA to the emerging markets of Asia (though not with a reluctant EU), which are very likely to further increase demand for air travel to and from the UAE. What is more, the entire Arabian peninsula has been one of the fastest growing regions worldwide. Since many neighboring countries, including the most populous one, Saudi Arabia, have embarked on a progressive liberalization of their air transport markets, new opportunities for growth exist for Emirates also in its home region.

Finally, Emirates' decision to operate a huge fleet of A380 aircraft will enable the airline to continue to grow at all slot-constrained airports it serves, too – including all of its European competitors' main hubs.

### **Threats**

From the point of view of most foreign, in particular North American, observers, the (alleged) political instability of the Middle East, poses by far the biggest threat to Emirates' growth. However, this perception is clearly not based on hard facts with respect to





the Gulf states, and recent history tells a different story as well. Although also affected by severe regional political crises even early in its start-up period – Iraq’s invasion of Kuwait and the latter’s liberation soon after cross one’s mind –, but also by more recent events like the wars in Afghanistan and Iraq, as well as the outbreak of SARS, Emirates has so far proven its robustness.

A much more likely threat is the increasing lobbying by some of its competitors in core markets such as Australia, France and Germany, as well as in largely untapped ones like Canada, for legal protection against Emirates’ expansion on their “home turf”. For instance, Lufthansa is vigorously campaigning against Emirates’ plans to serve Berlin and Stuttgart even though the operators of these two airports have long attempted to attract more intercontinental services which Lufthansa has been unwilling to provide, or, in the case of Berlin, has been unable to provide profitably.

Nevertheless, it is the very aggressive growth plans of some other Gulf-based carriers, most notably of Qatar Airways and Abu Dhabi-based Etihad Airways, that might pose the most serious future threat to Emirates. Qatar Airways currently operates a fleet of

57 aircraft with another 113 on firm order, and Etihad’s fleet comprises 25 widebodies (plus 21 aircraft on order). While Qatar Airways’ catch-up strategy with Emirates seems to rely largely on undercutting its competitor while offering similar product quality, Etihad’s expansion might prevent Emirates from obtaining much needed traffic rights to countries that do not pursue an open-skies policy (note that both Emirates and Etihad are UAE-based carriers). What is more, both the Qatari and Abu Dhabi’s governments (i.e. ruling families) have devoted huge budgets to the expansion of their local airport facilities. By 2008, Doha’s airport will be able to handle 50 million passengers (compared to today’s 6 million), while Abu Dhabi’s airport will be upgraded to 40 million pax (9 million today) – in addition to a substantial expansion of cargo facilities. It remains to be seen whether this unprecedented buildup of capacity by two (still) unprofitable regional competitors (and their government owners) will have a negative impact on Emirates in the long-run.

### Conclusion

Emirates’ success is clearly not built on sand. In fact, it is based on a hard-to-emulate mix of an excellent geographic location and outstanding management, embedded in an ambitious,

visionary development master plan. Nor is it unique. In many respects, strong similarities exist between Emirates’ approach and Singapore Airlines’ rise from a small regional player to a global powerhouse in the airline industry only a few decades ago. It therefore seems reasonably safe to conclude that Emirates is writing another of the very few success stories in the history of civil aviation.

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### Footnote

<sup>1</sup> It is noteworthy that the term “state-owned” has a different meaning the context of Gulf societies compared to the West because many assets are owned by the ruling families. This, in turn, means that “state-owned” companies there are more similar to Western-style family businesses than to Western-style state corporations. Moreover, and again in clear contrast to Western practices, most of Dubai’s “state-owned” enterprises must operate in open, competitive markets on commercial terms. Their profits and dividend payments – instead of taxes – are also the main source of income in Dubai’s state budget.

<sup>2</sup> In 2006, with 6.5m guests, Dubai’s hotels (occupancy rate of 86%) accommodated more visitors than Australia.

### Pictures

All photos used in this article are courtesy by Emirates Airlines.