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Country-specific factors influencing low-cost carrier market in Russia

Master's Thesis by the 2nd year student
Concentration — International business
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Abstract

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Master Thesis Title	Country-specific factors influencing low-cost carrier market in Russia
Faculty	Graduate School of Management, Saint-Petersburg University
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Description of the goal	The main goal of this thesis is to identify the country-specific factors influencing low-cost carrier market in Russia in order to develop managerial implication for new entrants of the market. In order to do so, this thesis investigated previous works concerning classical low-cost carrier model and checked revealed possible factors through analysis of activity of participants of the Russian market. Data was collected through several interviews with experts of the industry and secondary research. Single case study analysis suited well for the given research and helped to answer stated research questions. The results of the research can be useful in managerial implication for new entrants.
Key words	Low-cost airlines, Country-specific factors, Russia, Industry development, Business improvement, Low-fare, Airports

Аннотация

Автор	Дьяков Василий
Название магистерской диссертации	Специфические для страны факторы, влияющие на рынок бюджетных авиалиний в России
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Описание цели, задач и основных результатов	Основная цель настоящей дипломной работы – определение специфических для страны факторов, влияющих на рынок бюджетных авиалиний в России, необходимых для подготовки практических рекомендаций для компаний, желающих выйти на данный рынок. Для этого данная работа обращается к существующим работам, посвященным классической бизнес-модели бюджетных авиалиний и проверяет выявленные потенциальные факторы через анализ деятельности участников данного рынка. Данные для работы были собраны в ходе нескольких интервью с экспертами индустрии и вторичных исследований. Анализ единого кейса хорошо подходит для данного исследования и помогает ответить на все поставленные в работе вопросы исследования. Результаты исследования могут быть полезными для практического применения компаниям, желающим выйти на данный рынок.
Ключевые слова	Бюджетные авиалинии, Специфические для страны факторы, Россия, Развитие индустрии, Развитие бизнеса, Низкие тарифы, Аэропорты

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Introduction

Russian airline industry is going through hard times and it is not temporary phenomenon. In comparison with developed countries, it looks quite weak and immature. It can be reflected in high prices, weak infrastructure, small amount of flights and destinations, and many other issues. For comparison, in US there were 10 times more passengers carried last year. Only one low-cost carrier Ryanair carried almost the same amount of passengers as the whole industry in Russia. There are many reasons for that, starting with weak competition and monopolistic essence of the industry and ending with immature infrastructure.

Until the last year, there was an absence of low-carriers in Russian market, while in mature stable markets low-cost carriers occupy large share of the market of air transportation. Despite low-cost carriers are airlines that generally reduce fares with less comfort, some of them are really financial successful. For example, Ryanair, showed more than \$5 billion in revenues and \$800 million in profit last year and that is comparable or even higher than giants of the industry. In the world ranking of the largest airlines by the number of passengers carried, there are three low-cost carriers: Southwest Airlines, Ryanair, EasyJet. Another interesting point that even gigantic stable low-cost carriers are continuing to grow significantly with the rate up to 15%, while traditional airlines' average growth rates comprise around 3-4% annually. However, in Russia, this aviation business model had not taken root until the last year. In Russia there were several efforts to launch low-cost carriers. For instance, Sky Express in 2006, Avianova in 2009 or Dobrolyot in 2013. All these companies had to stop their activity due to different reasons, such as financial problems, absence of loyalty to such type of airlines among Russian customers or imposition of sanction against the background of tough political situation over the past years, as it was in the case of Dobrolyot.

However, there is an intriguing example: the only company that position itself as low-cost carrier in Russian market today, Pobeda. This company started its activity only a year ago in December 2014 but already demonstrated enormous growth and incredible success, reaching the fifth position on Russian market by the number of passengers conveyed. Pobeda became profitable just in a year of activity, exceeding all expectations. This example stands out against the background of the Russian market and deserves to be examined in details.

Today Russian economy encounters hard times that were triggered by financial crisis in Russia in 2014-2015 and tough political situation. All these led to the fact that foreign companies started abandon Russian market. Of course, these times are hard for Russian airline industry also due to decreasing buying purchase power of the population. In the current situation, huge demand for

services of low-cost carriers may be emerged. In addition, the exit of foreign players provides Russian companies with huge opportunities to occupy this niche. Moreover, recent months had enormous effect on the world airline industry. Costs of aviation fuel constitute significant part of total cost structure of a company in this business. The huge decrease of oil prices in 2014 and 2015 led to the fact that the last year the industry became profitable for the time over the long period. In other words, there is a very actual topic in the current situation, which has been changing dramatically over the last couple of years.

This paper is devoted to the examination of low-cost carrier market in Russia, reasons of its inadequacy and understanding, why such attractive business does not flourish in Russia. Research encompasses determination of the main country-specific factors affecting the market of LCC in Russia, understanding of how they influence it, and suggestion of actions for new entrants in this market.

Research gap is a research question or problem which has not been answered appropriately or at all in a given field of study. Because of insufficient level of development of Russian low cost carrier market, the amount of theoretical research on the topic is quite scarce. Low-cost carrier market is described quite well in the world. However, it is noticeable that there is a lack of research dedicated the market of low-cost carrier in Russia and factors influencing this market. Hence, there is a research gap. In this paper it focuses on the description main country-specific factors influencing low-cost carrier market in Russia.

At this point, it is possible to set three major research questions that will be investigated through this paper:

- What are the country-specific factors influencing low-cost carrier market in Russia?
- How do defined country-specific factors influence the market?
- How can new entrants benefit from defined country-specific factors in formulation of entry strategy?

By answering these three questions, we can understand the reasons of the present situation and what new entrants can undertake in order to enter and prosper in this market.

Primarily, during that research I will focus on case study research. In general, case studies are the preferred strategy when "how" or "why" questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context (Yin 2013). This type of research is very useful in the current situation, where the market

is quite immature and there is only one company operating in Russian market. Addressing the literature review, it is possible to emphasize common and crucial factors affecting this industry worldwide. These factors encompass methods in operational activity of low-cost carriers, nature of their assets, customer attitude, level and specifics of competition, macro environment and intermediates. Some of them (primarily concerning internal environment) are going to be checked through investigation and comparison activities of existing Russian LCCs and foreign LCC, while the rest (mainly the external environment) are going to be checked using interviews and opinions of experts found in public sources.

Chapter 1. Literature review

This chapter includes literature review related to the topic of the thesis. This part I started with the highlighting of low cost concept, then moved to the concept of low-cost carriers, and finally I observed the literature unveiled factors influencing the low-cost carrier market worldwide, both internal and external.

This part helps us to familiarize with the concept of low-cost model and how it looks in low-cost carrier industry. In order to answer stated research questions and identify country-specific factors in Russia, the list of potential factors could be constructed for further research. The list is based on the existing literature describing dependencies in the airline industry in other countries.

1.1 Low-cost concept

Low-cost business models share a strong coherence between the value proposition and the asset bases, organizations, and brands that support them – and this coherence delivers high operational efficiency. According to Porter, firms seeking cost leadership emphasize achieving low costs and offering products at low prices to many buyers who are price sensitive (Porter 1980).

However, there are some popular misconceptions about low-cost business model. Changing misconceptions about low-cost business models are:

- Low cost is not low margin. It can be highly profitable.
- Low cost is not low quality. It usually entails a narrower range.
- Low cost is not cheap imitation. It is true innovation.
- Low cost is not unbranded. It is frequently supported by potent brands. (Kachaner, Lindgardt, and Michael 2011)

In classical sense, low-cost business model attributes strategy focused on margin improvement with the effective usage of a company's assets. Increased revenue and reduced costs are inherent to this strategy. Effective utilization of assets means minimizing of working capital and maximization on return on assets. As a rule, low-cost competitor can pursue several strategies along various points of the value chain, and rarely focuses on just one area (Morehouse et al. 2008). Although, low-cost companies are usually perceived as innocuous, they could be a serious threat for traditional sustainable company.

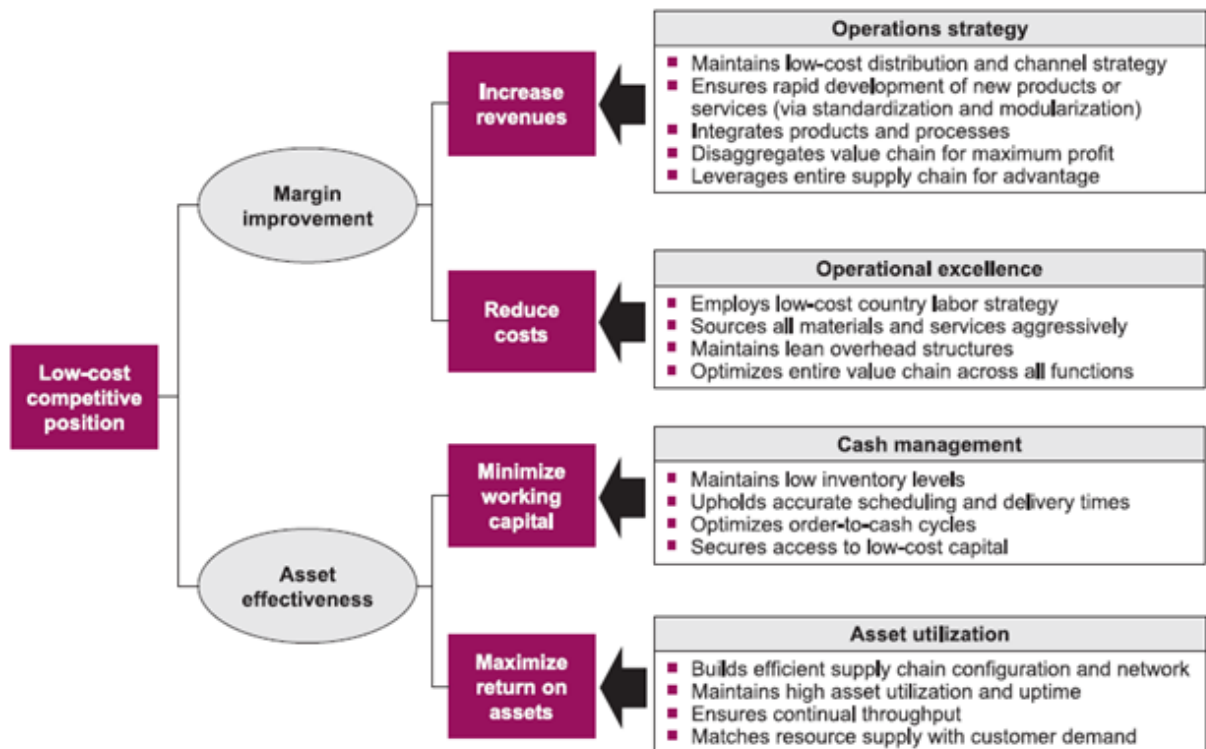


FIGURE 1. LOW-COST CONCEPT

Source: A. T. Kearney, 2008

Low-cost business models share a strong coherence between the value proposition and the asset bases, organizations, and brands that support them – and this coherence delivers high operational efficiency.

Not surprisingly low-cost innovators typically focus on price-sensitive customer segments. However, "Achieving a low overall cost position often requires a high relative market share" (Porter 1980). Low-cost innovators focus on radical rather than incremental offerings – and they design them precisely to delight the chosen customers. Product or service should be simple, focused on key basics, without any other attributes that either add complexity or cost. Pricing should be clear and reflect the basic core value of the product or service. While frills should be avoided, a well-designed menu of incremental options can be a real source of enhanced profit. Their value chain is highly effective. Low-cost models depend on a lean value chain aligned to deliver the value proposition and no more. Innovators commonly perform only core activities in-house and outsource the rest. And in many cases, they leverage up-to-date, standardized assets to facilitate scale-up and keep maintenance costs low. The cost model begins with a cost target consistent with profitably delivering on the value proposition. While it is of course important to limit overhead in low-cost models, it's also crucial to have talented people, who understand the

value proposition and organizational mission (Kachaner, Lindgardt, and Michael 2011).

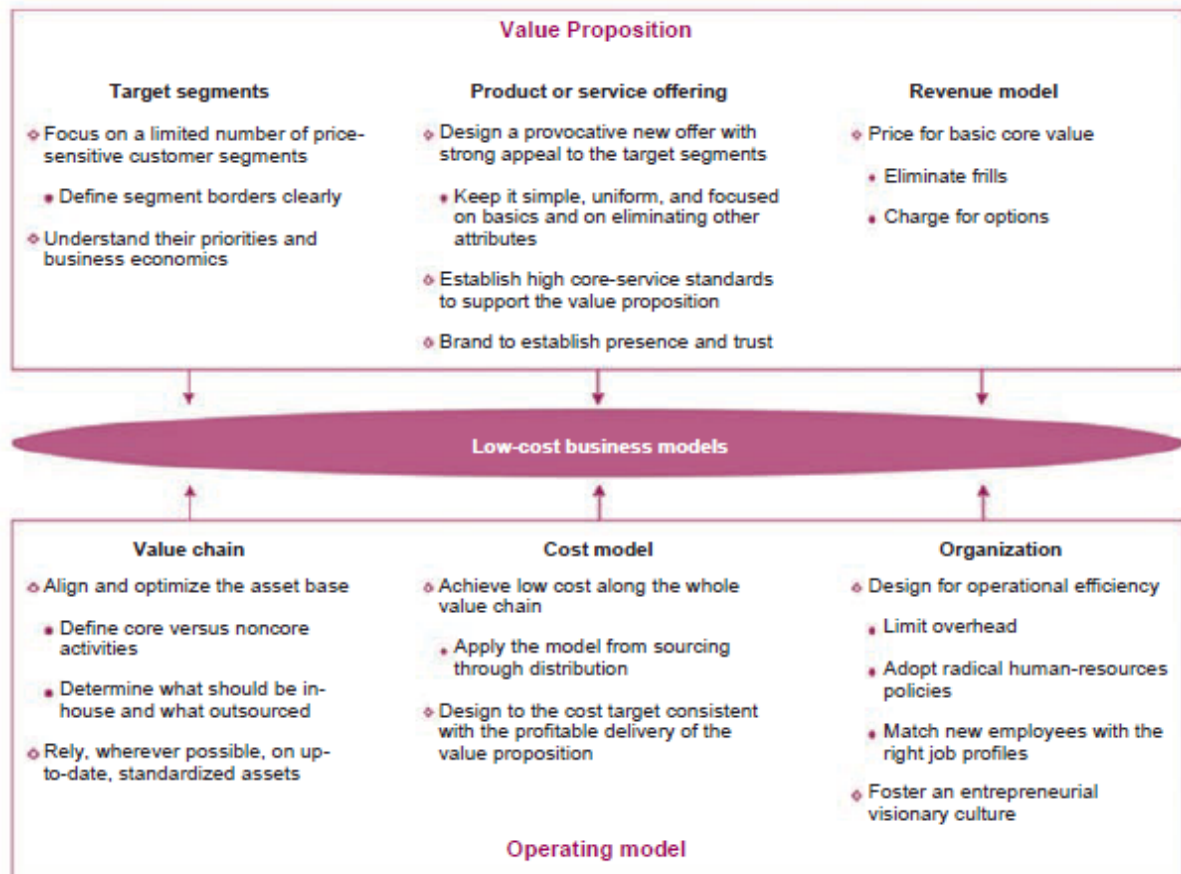


FIGURE 2. LOW-COST BUSINESS MODEL
SOURCE: BCG, 2011

Shortly speaking, low-cost model is aimed to increase efficiency of operations in order to reduce costs that allows to set the lowest prices and attract more customers. Now, let's take a look how this model takes place in the industry of air transportation.

1.2 Low-cost carrier concept

Low-cost carrier (also known as low-cost airlines, no-frills carrier, discount carrier, budget carrier or LCC) is an airline that generally offers very low fares in exchange for eliminating most of traditional passenger services. The classic model of low-cost airline focuses on the segment of price sensitive customers, who are ready to sacrifice convenience of the flight for the sake of a better price (Yee Liao and Pei Tan 2014). However, budget airlines drive the industry and attract new customers not only from airline industry. The main idea behind it was to make flights so cheap that the airline could compete not only with other airlines, but even with alternative forms of surface transportation (Buyck 2008). This was made possible by reducing service standards to a minimum, cutting costs and increasing the efficiency wherever possible (Sommer 2005).

Setting the price at the reduced level is possible due to severe economy and optimization of companies' cost structure. To make up for profit and revenue lost in lower prices for tickets, the low-cost carrier may charge for extra fee such as food and beverages on-board, priority boarding, choice of seats, and additional luggage etc. Primarily budget airlines focus on price sensitive customer segment – customers, who are ready to abandon the convenience and high quality of services for the benefit of cheaper prices.

The term was introduced within the airline industry to name airlines, whose operating cost structure is much lower than their competitors' one. Since the term is usually referred to any airline company that has low prices for tickets with limited services, without reference to their operating models, low-cost airlines should be distinguished from traditional airlines that could simply execute short flights without service, or full-service flights but with the offer at the reduced fares. Some carriers seek actively to new market and start advertising themselves as budget, low-cost or discount airlines but at the same time are maintaining and offering products, which usually are associated with traditional airlines and quite often led to increased operational complexity. These products, which can lead to increase the complexity or decrease efficiency, usually are: preferred or assigned seating, providing with food and beverages other than the basic, different classes' cabins, satellite Wi-Fi internet connection in-flight, and audio or TV and video entertainment. Low-cost carrier is more about efficient operating model than simple inefficient reducing the prices or the range of services.

The first successful low-cost airline carrier was Pacific Southwest Airlines United States, which pioneered the concept of low-cost - its first flight took place on May 6, 1949. PSA's first experience in low-cost flight model with efficient operations was a runaway success, which later inspired many low-cost start-ups all across the United States of America, appearing in the 60s. The first airline, which executed cheap transatlantic flight with low fares was Icelandic airline Loftleiðir in 1964, often named as "the Hippie Airline". The trend was that many young Americans wished to travel to Europe after their graduation in order to get acquainted with the "old-world culture", and the main determining factor for them often was the cheapest price, rather than comfortability or even accuracy of landing or takeoff in time. Deregulation of airline industry played a great role in the development of budget airlines that allowed airlines to spend less. In 70-es it led to increased competition in the US, lower prices and better services (Meyer and Oster 1981). After the deregulation of air transportation industry in Europe, the most notable success was achieved by Ryanair, which began flights at low prices in 1990 and EasyJet airline, founded in 1995. Later in 2000 low-cost airlines appeared in Asia and Oceania - the leading companies are Malaysian AirAsia, India's Air Deccan and the Australian Virgin Blue. Low-cost model has proved popularity

around the world but for its further advancement it needed deregulation existing air transport market. In addition, low-cost carriers have created a precedent for financial threats traditional airlines with their full-service maintenance, and high levels of the cost of traditional carriers limited their ability to compete with low-cost carriers since the price is a one of the most important factor for the consumer who chooses the carrier. Not surprisingly, since 2001-2003, when the airline industry was hit by terrorism and the crisis, the majority of traditional airlines suffered losses, while many low-cost carriers declared profits. Therefore, the traditional carriers began to create their own low-cost company, for example: KLM - Buzz, British Airways - Go, Air India - Air India-Express and United - Ted. However, they soon discovered that this innovation harms its core business. By the end of 2007 there were more than 45 low-cost airlines serve more than 3,500 destinations in Europe. That indicates their economic prospects of their chosen schemes. Presently the largest low-cost airline company is Southwest Airlines, a company operating in the United States and surrounding areas.

1.3 Principles of LCC. Internal factors.

There are likely to be specific characteristics which are widespread among organizations within the same industry – and these might be significantly different from characteristics found in other industry sectors (Gordon 1991). The underlying principle behind low-cost concept, as it was stated previously, is to provide the cheapest possible ticket prices in exchange for reduced quality of services and other limitations. That way, the airline company must focus on strong cutting of costs, therefore allowing for, previously mentioned, price reduction.

The review of the principles of a budget airline is going to be investigated through following elements of low-cost concept revealed above: increased revenue (operations strategy), reduced costs (operational excellence), and asset effectiveness. Various sources unveiled several factors that conform with mentioned low-cost principles, and some additional factors.

Asset Effectiveness

One of the starting point for airline industry is the possession of aircrafts. Economy of scale is the key element, through which cost reduction and asset effectiveness could be achieved (Chan and Wright 1990). Most low-cost carriers operate their aircrafts with a single passenger class and most operate only one type of aircraft. The uniform type of aircrafts allows the company to use the same maintenance and operational equipment, and the same employees for the whole fleet of the company (Kumar, Johnson, and Lai 2009). It leads to decreased future costs. In addition, budget airlines usually operate on short-distance flights that require the narrow-body (single aisle) planes.

The usage of longer-range wide-body planes is redundant (wide-body planes require too large capital investments for low-cost airlines). The fleet usually consists of new aircrafts. Despite of more expensive purchase of new aircraft than the second side, as a rule, the new one is much cheaper to operate in the long term, because they are highly efficient in respect of fuel, maintenance, insurance or staff costs per passenger (IATA 2006).

The usage of aircraft by low-costs carrier in term of hours per day is much higher than by traditional airlines, i.e. the time spent in the air. The utilization of an aircraft should be as effective as possible (Huettinger 2013). By doing this the company reduces their average fixed costs. For example, Ryanair reduced the time of maintenance of the plane at the ground from 55 to 30 minutes and now it is a common practice for budget airlines (Thomas 2015a). It is possible since low-cost airlines are based in small remote airports, where the passenger traffic is much less than in huge international hubs passing great amount of passengers. In addition, increased time spent in air per day could be triggered with increased number of flights per day. The schedule of flights should be constructed so, that it allows to use an aircraft for maximum flights per day (Kumar, Johnson, and Lai 2009). Some budget airlines increase the utilization of its fleet from 8 to 16 hours per day (Ryanair 2015).

Primarily, budget airlines base in one airport and construct their schedule and network of smaller airports in order to ensure full utilization of an aircraft. Like the major carriers, many low-cost carriers develop more base airports in order to maximize destination coverage and defend their market. Many do not operate traditional hubs, but rather focus cities (Bamber et al. 2009).

Reduced costs

The order of huge amount of vessels simultaneously can lead to the discount from the producer of aircrafts. Later, the low-cost carrier can sell these vessels for the higher price. It brings the great savings in fixed costs (IATA 2006).

As one of the main source of costs is airport fees, some budget airlines tend to use the smaller airports or secondary airport that are quite remote from main cities. These airports are not international hubs and pass fewer passengers through their gates (Chan and Wright 1990). That, in turns, leads to the less payment for airports, airport taxes. Intriguing example here is that Ryanair use a huge approach of economy of scale. It owns the whole or a part of these airports, leading for the huge airport taxes reduction and also allowing the company to collect the revenue from other carriers operating at this airport (Ryanair 2015). These small airports usually do not have any excessive services, shops and conveniences, which give the view of a big shopping mall instead,

as we used to see in the huge international airports, but focus only on their primary function to serve flights using the minimum facilities and staff (Kumar, Johnson, and Lai 2009).

The number of employees should be as few as possible but at the same they have to be professionals and carry out multiple jobs both in-flight and on ground. Professionalism of employees keeps good customers attitude and prevents from time- and cost-consuming failures in operations (Huettinger 2013). For example, the same person at the airport can check-in the passenger, register its luggage and work as a gate agent.

It is not convenient to use secondary airports for flight connection for passenger but budget airlines do not want to operate with the connections, as it requires additional costs relate to the organization of carrying the luggage from one flight to another that incur new personnel costs. Primarily, low-costs airlines serves only point-to-point flights (Kumar, Johnson, and Lai 2009).

Distribution channels should be the cheapest, while still highly effective (IATA 2006). Today, on-line distribution is inherent in low-cost carrier business model, while the companies almost completely abandon offices and point of sales. It leads to savings of large amount of fixed costs related to rent and personnel costs. Registration for the flight is also an on-line process, while registration at the airport could be carried out only with the additional fee. Such actions suggests the company to abandon usage of offices, point of sales or even registration desk at the airport.

Aircraft often operates with minimum additional equipment, that in turn help to reduce the cost of purchase and maintenance of the plane, and at the same time to keep the aircraft's weight lower and thus to save on fuel. Low-cost carriers' seats cannot be recline or do not have back pockets in order to cut the costs of cleaning and maintenance (Huettinger 2013). Others carriers' do not have curtains or no window shades. Pilot convenience can be also reduced. Usually, no in-flight entertainments are available. The implementation of LCD monitors at the back of the seats is also excluded in order to reduce the cost of purchase. The absence of additional services and devices on the place could also be justified by the fact, that many routes served by low-cost carriers are short-haul and thereby these services are not particularly in demand (IATA 2006).

Finally, good low-cost company do not have any assets (Kumar, Johnson, and Lai 2009). All services except the fundamental one should be outsourced in order to save on it. However, some giants prefer to exploit economy of scale and keep many services in-house. For instance, Ryanair bought the whole airports in order to save on airport fees.

Increased revenue

Placement of seats in the aircraft cabin is a crucial point for designing a place for budget carriers. Low-cost carriers embed up to 189 seats in Boeing 757 compared to 128 seats incorporated by traditional airline carrier. This leads to the increased inconvenience of passenger due to limited leg room but lets the carrier to generate more revenue (Kumar, Johnson, and Lai 2009).

Severe economy on every aspect of the airline carrier's activity is not the only point of the policy of low-cost carrier. The other side of the issue is the managing the revenue flows. Low-cost carriers try to generate revenues from everything (Huettinger 2013). These typical services for airline industries such as reservation of seat or transportation of luggage, catering on board and seat selection are charged with the fee. Sometimes, the transportation of luggage can be more expensive than the ticket itself. If the passenger decides to choose the seat, the charged fee also depends on the location of the seat. For example, seats in the emergency exit rows, which have longer leg room, are more expensive than others. Offering catering service on board is one of the most popular service to generate additional revenue. Low-cost airlines receive additional revenue from a variety of different activities, providing with additional services or establishing commission-based products. Carriers may charge a fee not only for carry-on luggage but even for a pillow or blanket. In Europe, it is quite common that for every convenience and service customers have to pay an additional charge. Some companies, such as AirAsia, for example, receive their revenue by providing with accommodation as well as flights. Budget carriers charge fees even for the usage of different types of credit cards during the process of purchase of a ticket (Ryanair 2016; WizzAir 2016; EasyJet 2016; AirAsia 2016).

Budget carrier also provides flexibility and possibility to change of the ticket details only for additional price. The carrier do not offer any refund or transfer even if the flight was late or cancelled by the company's fault. If the passenger is late for the connecting flight due to the low-cost carrier, the passenger have to buy the new ticket for the next flight from his own pocket and the company will not refund these costs for the passenger (Thomas 2015a).

Yield management

Besides all these additional sources of revenue, low-cost carriers use yield management system in order to maximize revenue generated from ticket sales. High load factor is an inherent part of low-cost carrier activity (Chan and Wright 1990). Yield management is a variable pricing strategy, based on understanding, anticipating and influencing consumer behavior in order to maximize revenue or profits from a fixed, perishable resources, such as airline seats or hotel room reservations (Biermann 2007). As the resources, or items for sale, are limited, the company

implements strategy that implies the sale to the right customer at the right place for the right price. The process leads to price discrimination, where the company offers identical goods or services to different customers for the different price. It helps low-cost carrier to achieve its goal to fill the plane as much as possible and to get higher market share. However, this strategy is not inherent only in low-cost airline industry but its implementation is common for the whole airline industry. The turning point was the deregulation of the industry in US, allowing the company to set various prices.

This strategy can be applied to the airline industry, because the capacity of the aircraft is limited and the product is sold at the particular moment of time. If the plane departs, unsold seats could not generate any revenue. In other words, unsold items are unrealized or become perished. Airline companies segment their customers and use various software to monitor and predict how seats become reserved. Seats for unpopular flights can be sold for cheaper price comparing with other popular destinations in terms of RPK (Revenue passenger kilometers). Reduced price leads to the increased number of passengers and that can help to exploit maximum revenue from the flight. Statistics show that very seldom every passenger comes to the flight: some of them are late, some decide to change the date of their trip at the last moment (IATA 2006). That case is also taken into account by airline industry and to exploit maximum companies sell more tickets than there are seats in the plane. Market segmentation is also highly important issue in determining the price for the product. Some customers are ready to pay extra fee for properties of the ticket such as changing details and cancellation policy. In addition, this segmentation can be carried out by time periods. Some people, who want to save money, plan their trip in advance but some decide to buy a ticket just in a several days in advance, for instance for business trip or funeral. This case allows companies to set higher price for tickets (if the company is sure that they will sell all the seats anyway) as these category of customers is obliged to buy the ticket and they do not have no choice. If the company fails to sell all tickets for flight, it can set the very low price just before the flight in the hope to generate any revenue for unsold tickets. Otherwise, it will not earn anything. Implementation of loyalty programs is also a part of yield management (Yee Liao and Pei Tan 2014). Providing cheaper tickets for the members of loyalty program, ensuring the increased number of tickets sold. In this case, both sides win: the customer gets a discount, while the company retains the customer, persuading him to use services of this particular carrier. Yield management is based on the statistics and mathematical expectations.

Almost all LCCs have a policy of non-refundable tickets, as distinct from traditional airlines with their different refund conditions, which make them more attractive and in a degree resolve the problem of overbooking. For LCCs booking can be changed but for additional fee, but no money

is ever refunded. This gives the airline a better and more certain cash flow, which gets great savings in interest costs (IATA 2006).

Implication

Although business model practices of low-cost carriers can vary widely, all these points address to the increase of level of profitability and cost-efficiency that, in turn, is inherent in the competitive advantage of low-cost companies. Airline industry is a very tough industry with relatively low profitability level. For instance, carriers are the least profitable business in the whole value chain of providing air transportation (IATA 2015b). (There are producers of vessels, suppliers of fuel, airports, food-catering companies and etc.) Some features of each of these principles are common and universal for majority of low-cost markets, while others could be inherent in only some particular regions.

It is noticeable that some of the factors and principles from different sources overlap each other. For further research it is possible to name the list of factors that are encountered and repeated in various sources. These factors are aggregated in the list and discussed further in this paper.

1.4 External factors

In order to take a decision to enter the market, how to enter the market, and with what marketing campaign, it is necessary to assess market's potential. Market potential is determined by both external environment and internal factors. Svend Hollensen in his book "Global Marketing" provided the following framework for investigation both internal and external factors needed to be investigated for determining of market potential (Hollensen 2007).

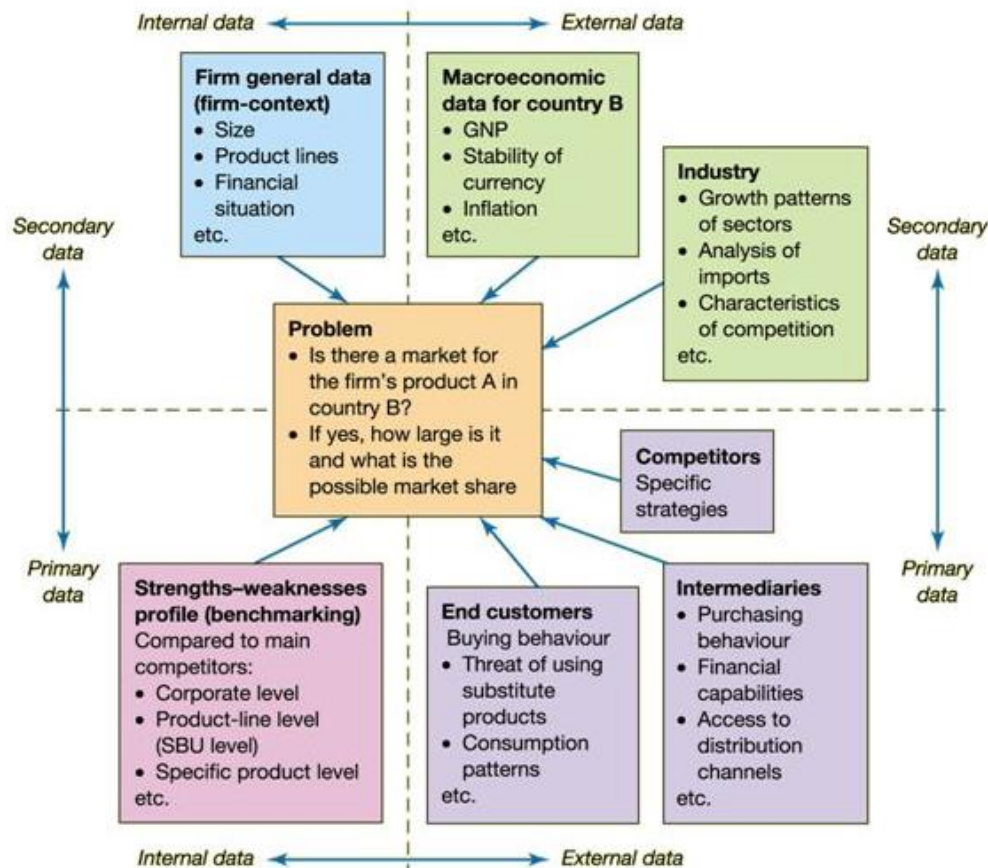


FIGURE 3. POTENTIAL FACTORS NEEDED FOR INVESTIGATION
 Source: Hollensen, 2007

Customers

Besides effective operations, it is important to understand the customer and value proposition that a company deliver. The first step helps us to understand the market, to assess the attractiveness of the market, the potential customers, whether there are any opportunities or threats related to the possible performance of company in this particular market. In other words, at this step there is an exploration of customers. This market research includes understanding the customers' segments, their needs and behavior. How big these segments are and how they have changed. How price sensitive are they or what distribution channels do they prefer. All this can give a clear picture of what the market is currently is.

Important point needed to be taken into consideration is segmentation. Every market is not homogeneous: customers could classified by their needs and preferences, age, gender, geographic location or any other characteristics, and therefore it can require different strategies for different segments. To acquire more detailed information it is necessary to do more detailed analysis and divide a market by both products and customers. For segmentation, key segmentation variables should be identified that determine how market should be divided. New narrower markets

composes the whole market and could be incorporated in segmentation matrix, which describes the whole market but emphasizes its heterogeneity and distinguishes it. After that process, it is possible to start evaluate the attractiveness of every segments.

If we are talking about budget airlines, value proposition is not so much when passengers are on the plane; rather it is when get to their destination. Most companies would want public admiration, as it would be assumed to have a positive impact on sales. However, the goal of a low-cost company then is not to be loved but to understand the true value of what they are offering and ensure that customers are willing to pay a price that ensures the long-term future of the firm (Thomas 2015a). At this point, the only true value proposition is cheap price.

Despite the widespread opinion, that low-cost carriers are perceived as airlines with no comfort and poor quality, there are more positive than negative attitude to LCCs. There are a lot of place to improve in customer service for low-cost carriers, however, in average, customers' expectations are fully satisfied (Yee Liau and Pei Tan 2014). The average flight does not exceed couple of hours. Customers deliberately choose this type of service and they are satisfied with them. Interesting point here that ticket promotion can even increase a positive attitude to a company among customers significantly (Chan and Wright 1990). An apparently negative point relates to customer service is flight cancellation. Flight cancellation leads to negative responses in a half of cases entailing that customers abandon the airline's service. Because flight delays or cancellations create loss for both parties, customer support play a crucial role. With enhancement of the database management system, the customer support staff can offer alternative flight to fulfil the customer's needs. This can be done by cooperating with other airlines on sharing their databases (Yee Liau and Pei Tan 2014). Another research (Saha and Theingi 2009) showed that passengers indicated overall satisfaction with the four dimensions of service quality examined in the study (tangibles, schedule, ground staff, and flight staff). The correlation between schedule and satisfaction was very strong, which implies that improvement in flight schedules is an important issue that requires attention more than any other issues of providing quality.

However, there are some successful examples, where airlines applied both principles of low-cost and traditional model. Their focus is biased from price sensitive segment and could include not only low and middle class bur also premium segment. WestJet or Singapore airlines are the most spectacular examples. Singapore Airlines (SIA) has been able to attract premium customers whilst stringently controlling its costs (Thomas 2015b). It has defined its offer by consistently innovating and offering new services to its customers. The company has added to its value proposition in areas such as on-flight entertainment. For certain flights, this includes possibility to rent a tablet that been pre-loaded with early release films and television shows. It also offers live satellite TV

having established a partnership with Bell. This is also a way of setting itself apart from other airlines.

Attractive LCC's image could be an effective weapon, which influences the customer decision-making process (Fernando, Saad, and Haron 2012). The LCC service could be unique if management employ and manage the young generation as workforce, especially as frontline staff who provide services to customers. Nurturing youngsters in a LCC organization with training and development will bring an innovative spirit, creativity and new service development, toward the overall success of the organization.

Having analyzed academic sources, it can be stated that value proposition should be focused on main customer's needs, such as punctuality and fares for air transportation. However, more benefit could be exploited through better investigation of customers' preferences. In this respect it is useful to address to marketing mix. The term "marketing-mix," was first coined by Neil Borden, the president of the American Marketing Association (Borden 1964). It is still used today to make important decisions that lead to the execution of a marketing plan. It helps to identify how exactly a product should be delivered to customers. Under marketing mix means often popular framework of 4P's or 7P's. Product, Price, Promotion, Place and three additional points – Physical evidence, People and Process.

Macro-external environment

Here it is useful to understand not only the market, but also a macro-external environment. What are political or macroeconomic situations at the moment and how can it affect the market? The literature on marketing and management gives a very useful model for the firm's marketing environment, which defines categories of dividing marketing factors: Political, Economic, Social, Technological, Environmental and Legal, so-called PESTEL Analysis. What are the risks related to this areas? Sometimes, as it is in our case of airline industry in Russia, these factors are ones of the most significant ones. For instance, monopolistic essence of the market, government protection, changes in population's wealth or embargos against the whole industry heavily affected the situation recent years in many industries. Without evaluating these risks, it was impossible to predict the direction of the development of industries. Thereby, it is highly important to reveal key drivers of change and assess their impact on the market. However, it can be very time consuming to analyze all possible influential aspects. It is very important to distinguish those that create more value for customers and evaluate them.

Shaw (Shaw 2011) explores each component of the PESTEL model in airline context, which is presented in the Figure 4 below:

TABLE 1. FACTORS OF MACRO-EXTERNAL ENVIRONMENT

Source: Shaw, 2011

<u>Political</u>	<u>Economic</u>	<u>Social</u>	<u>Technological</u>	<u>Environmental</u>	<u>Legal</u>
Political instability	Economic growth and trade cycle	The aging population	Internet	Global warming	Regulations
Deregulation and “open skies”		Changing in customer preferences	Transport investments	Tourism	
Privatization				Weather conditions	
State aid					

Many authors (Meyer and Oster 1981; Graham, Kaplan, and Sibley 1983; Graham and Kaplan 1982; Huettinger 2013) mentioned the important role of favorable legal and political environment in a country in the development of the industry. For example, deregulation of the industry in US and Europe led to the rapid prosperity of the industry. Restraining regulations could be an obstacle for many aspects of airline activity, such as fleet utilization, entry barriers or choice of destinations (Graham, Kaplan, and Sibley 1983).

So-called “open-skies” policy determines the level of openness of the market, liberalizing aviation services between two contracting states. A bilateral air transport agreement is needed to implement international flights. These agreement allows the airlines of both states to launch commercial flights between these countries. “Freedom of the air” could bring the greatest potential to an airline company (Huettinger 2013).

Huettinger mentioned that political situation and government participation in an airline’s activity have substantial effect on airlines (Huettinger 2013). Among state influence factors he primarily focuses on level of privatization and level of state influence on decision-making process. In this research, it is revealed that the level of privatization affect the optimization of processes, level of bureaucracy, number of employees and other labor-related factors, and the process of development of strategy. The participation of state in activity of a company could adjust the strategy of a company, following the state interests instead of company’s ones. A huge support from the state can be gained through its participation in a company. In addition, in many countries, the business activities of airlines are determined by their history of being national icons operating in a heavily regulated and restricted market (Prideaux and Kim 2006).

Intermediaries

Airlines inseparably interact with airports. Airport fees for landing, passenger embarkation and other related services could reach significant amount of costs and if the airline succeeded in reduction of them, it has a good background of the cost leadership (Thomas 2015a). Most of the LCC support the policy of the underutilized airports. In the expansion policy of Ryanair, the existence of the underutilized airport is the most fundamental requirement, even if it is a long way from the city. The same policy holds Southwest Airlines, looking for the unused airport, even if these are old, dilapidated and unfashionable.

A strong and value-driven management strategies, as well as long-term relationships with their stakeholders is an important issue for secondary airports (Aulman 2015). As a rule, these airports are ready to negotiate the price with airlines. Low fares services gave many secondary airports the international recognition which most of them previously lacked. Secondary, regional, airports increasingly provide a competitive alternative to the congested, expensive hub airports. In addition, LCC can increase passenger traffic significantly that lead to increase of other sources of revenue for airports.

Finally, effectiveness of operations in airport is highly important for successful activity of budget airline (Paramonovs and Ijevleva 2015). Budget airlines has to carry out its stop in an airport in short time, therefore this factors is a very important one.

Competition

The next step shows the level of competition or how the market belongs to the existing players. Evaluating the competitive environment includes understanding main players on the market, how they differ and what their behavior is and how it has been changing, evaluating entry barriers to this particular market and some qualitative factors such as networking or suppliers' power. This step can help to reevaluate the segments explored in the first step with consideration of competition and the attractiveness of the segments could be shifted. The useful instrument to conduct this analysis is Porter's Five Forces of Competition framework. The five forces are: Industry competition, Suppliers, Buyers, Potential entrants and Substitutes. This framework refers to not only rivalry among existing firms in the market but takes into account other important issues. Investigation of threat of entries includes capital requirements, access to distribution channels, government and legal barriers, relationship with suppliers and economies of scale. Knowing this, a company can understand, how difficult is to enter this market. It is crucial issue that we have to study in this paper.

The major point here is evaluation of existing substitutes, such as trains or busses. It is necessary to assess how likely customers will switch to substitute services if they are not satisfied with the current state of the market. In addition, substitutes could be a partner and provide additional spokes for LCCs (Givoni and Banister 2006).

One more feature of air transportation industry is Air Alliance, a partnership association of airlines, which allows to achieve a higher level of international cooperation in commercial air transport. Airlines within the alliance retain their legal independence, but at the same time unify elements such as booking system, bonus program for passengers, introduce codeshare flights and coordinate schedules flights. The reason for the emergence of airline alliances is the regulation of air transport at the national level and intensification of competition. Since commercial air service between Europe and the United States are regulated and could be carried out only by the airlines of member countries of the contract. For example, air travel between the United States and France may only American and French airlines. German airline may not be present in this market, but through membership in the alliance, the German flag carrier Lufthansa, for example, can offer such flight through code-sharing with American airline. In addition, participation in an alliance increases number of passenger and therefore revenue flows.

Other factors

Despite of the fact that Porter's five forces of competition is very prominent and useful framework to get brief and quiet full understanding of rivalry, it has been the subject of constant criticism. This is a universe model that describes the industry structure and its main elements, but it does not take into consideration some secondary issues, that could be highly important for a particular industry.

Another important issue that could affect an industry and competition within it is an existence of complementary goods. Complementors – These are other players who provide a product or service that can be linked to your own to make both offerings more attractive to your customers (Brandenburger and Nalebuff 2011). In this way, complementary goods can generate new demand and therefore new opportunities can be exploit. Two American economists, Adam Brandenburger and Barry Nalebuff, even developed new model called Value Net, where they replace substitutes with complementors in Porter's five Forces. In our research consideration of complementary goods will help to better understand the demand for passenger transportation but also find out new sources of revenue that low-cost carriers should use.

The second important flaws of Porter's Five Forces analysis is that it is a static framework, which do not take into consideration the behavior of competitors and their interactions. It is not true that

independent action of one player do not affect activity of others. Especially, it can be noticed explicitly in industry with the low level of competition, where an action of one firm could launch a trend for the whole industry. To take into account such risks, the huge contribution was made with Game Theory. Game theory helps to structure strategic decisions, identifying the main actors, understanding their behavior and their payoffs in every possible outcome. Knowing this information, a company can action in the best way and choose the best strategic option, reducing uncertainty comes from competitors' behavior. As a result of game theory, a company can reach one of many decisions, such as cooperation, deterrence, commitment, signaling (communication to competitors in order to influence their decisions) or even changing the structure of the game (for instance, technological change or creation of a huge alliance within the industry).

However, prediction of competitors' behavior is not that easy. There are three main purpose and sometimes it is impossible to predict some of them. They are:

- Forecast of competitors' future strategies and decisions
- Prediction of competitors' likely actions to a firm's strategic initiatives
- Determination of how competitors' behavior can be influenced to make it more favorable (Grant 2015).

In order to answer these three points, it is necessary to take into account competitors' current situation, competitors' objectives', competitors' assumptions about the industry and competitors' resources and capabilities. Understanding how competitors are competing at present, why they are behave in a particular way, what are their goals and what resources and capabilities of a company are will lead to apprehension of their behavior. Assumption about the industry means competitors' perception of itself and the outside the industry. All this can answer the question: "What competitive initiatives is the firm likely to take?"(Porter 1980).

Market entry issues

If a company decide to enter low-cost market, some important issues appear:

- Should a new low-cost business model be operated within the core business?
- Should it share the same brand as the parent?
- Should it try to maximize synergies with the parent or favor autonomy?
- Should the low-cost business grow organically or through acquisition?

There are no one-size-fits-all answers to these questions, but experience suggests some general rules (Kachaner, Lindgardt, and Michael 2011):

- Low-cost offerings cannot flourish within a traditional “high cost” environment.
- Brands can stretch only so far. Thus, a secondary brand is often advisable.
- The first priority for a low-cost model is that it must win on its own merits. Synergies should be a secondary concern.

Most traditional airlines that launched low-cost offerings chose to maximize synergies, leading to disappointing results because of the mismatch between their low-cost value proposition and a hybrid operating model that combined some low-cost elements with largely major-carrier economics (Kachaner, Lindgardt, and Michael 2011)

1.5 Implications from the literature review

The main aim of the paper is to define key country-specific factors influencing the market of low-cost carrier market in Russia and to assess their influence on the market. In addition, these results will help to elaborate recommendation for companies, who potentially can be interested in entering low-cost airline market in Russia. In other words, the major task here is to understand what factors affect the market of low-cost carriers in Russia the most that should be taken into consideration if an airline desires to participate in this market, what their influences are, and how the market can evolve and new companies can emerge.

In this way, having conducted literature review, it is possible to determine key factors that can have possible influence on low-cost carrier market in Russia. According to their nature, these factors should be divided into two categories: external and internal factors. Internal factors are inherent part of operational model of LCC’s business. External factors includes customer attitude, competition and macro environment. Some factors from different source overlap each other. Having aggregated the information found during the literature review, it is possible to define following potential factors that are going to be used in the research.

Internal factors:

- Fleet characteristics
 - Fleet size
 - Homogeneity of fleet
 - Type
 - Age
 - Number of seats
 - Country of registration
- Aircraft utilization

- Turnaround time
- Utilization time
- Punctuality
- Operations
 - Crew's operations
 - In-land operations
 - Distribution
- Yield management
- Materials, Fuel and Maintenance
- Airport related factors
 - Airport fees
 - Quality of airport services
- Additional services
- Quality of services
- Relationships

External factors:

- Political environment
- Legal environment
- Macroeconomics
- Industry growth
- Competition
- Airport infrastructure
- Customer attitude

Further investigation and analysis of Russian market will be conducted with consideration these factors in order to assess which of them are unusual for the world budget airline market and inherent in Russian reality, and have the most impact on the market in Russia.

Chapter 2. Methods

2.1 The strategy, methods and instruments

One of appropriate strategies for exploring low-cost airline phenomenon in Russia is case study research. Due to the lack of appropriate cases in Russian history and relatively big difference between Russian market and the majority of developed and emerging markets in the world, case study research helps us to construct theory basing on the few sources. Even emerging and developing markets differs from Russian market heavily due to distinctive features of the market, such as high corruption, monopolistic essence of the market or customers preferences and habits.

As the goal of the research is to identify the country-specific factors influencing low-cost carrier market in Russia and to develop managerial implication for new entrants of the market, the unit of analysis is *the whole market of budget airlines in Russia*. Single case study is going to be conducted. There are several participants in the market including incumbents, new entrants, airports, end customers and in some extend even substitutes (railroad, buses, cars). In this research the impact of country-specific factors on all participants of the market will be investigated. However, the main focus is on potential new entrants of the markets. The results of the research will help them to understand better which factors are going to be taken into account in formulation entry strategy.

This research of low-cost carriers market in Russia are based on primary data and secondary data. Secondary data is collected from open sources such as academic articles, interview in public sources, reports of institutions and companies, researches of analytical and statistical agencies. Primary data involves preliminary and semi-structured interviews. Preliminary interview gives us the first understanding of the market, Russian reality in respect to the market and adjusts the direction of the research. Semi-structured interviews are interviews with the representatives of the industries or experts, who work in it. It will help us to understand special features of the industry, companies' strategies and gives the deeper understanding of country-specific factors influencing the market, and how to behave according to these factors. However, the main focus is on the secondary data. The majority of information relate to the cases that is explored in the research, is collected from the open sources such as companies' financial reports, official statistics, reports of institutions operates with the industry (RosAviation, IATA), interviews of the experts published in the open sources. Finally, literature review is an essential part of any academic research. Although, there is a lack of appropriate academic literature, it will help us to get acquainted with papers that were written before, that, in turn, helps to identify the existing knowledge base and factors needed to check in this research.

2.2 Case study research

One of appropriate methods for exploring low-cost airline phenomenon in both developed countries and other emerging markets, especially Russia is case study research. The case study is one of the several ways of doing science research. Other ways of conducting research are: surveys, experiments, histories and the analysis of existing archival studies (economic studies, student records). Each of these strategies has its own advantages and disadvantages; some of them are appropriate in one situation, but could be not so useful in others. The strategy is depending upon three conditions:

- the type of research question,
- the control an investigator has over actual behavioral events, and
- the focus on contemporary as opposed to historical phenomena.

In general, case studies are the preferred strategy when "how" or "why" questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context (Yin 2013). However, cases could be of the two types: "exploratory" and "descriptive" case studies. Since "descriptive" type simply describes the problem or practices, investigator in research should focus more on "exploratory" type and does a great care in designing and doing case study research in order to resist the criticism of this method.

"As a research endeavor, the case study contributes uniquely to our knowledge of individual, organizational, social, and political phenomena. Not surprisingly, the case study has been a common research strategy in psychology, sociology, political science, business, social work, and planning" (Yin 2013).

Hence, the important question is why and when we should use case study research and when is better to use other strategies. There is a popular misconception that the different research strategies should be implemented directly to the particular phase. This misconception includes that case studies are appropriate for the exploratory phase of an investigation, that surveys and histories are appropriate for the descriptive phase, and that experiments are the best way of doing explanatory or causal inquiries (Platt 1992). However, some literature refers to the fact that case studies can be used for all these three processes – exploratory, description and explanatory.

In respect to three conditions mentioned earlier: (a) the type of research question, (b) the degree of control an investigator has over actual behavioral events and (c) the focus on contemporary as

opposed to historical events, it is possible to understand where it is appropriate to use a particular strategy (Figure 1.1).

TABLE 2. RELEVANT SITUATIONS FOR DIFFERENT RESEARCH STUDIES.
SOURCE: COSMOS CORPORATION.

Strategy	Form of research questions	Requires control over behavioral events?	Focuses on contemporary events?
Experiment	How, Why	Yes	Yes
Survey	Who, What, Where, How many, How much	No	Yes
Archival analysis	Who, What, Where, How many, How much	No	Yes/No
History	How, Why	No	No
Case study	How, Why	No	Yes

The case study is appropriate in the situations with examining contemporary events, but when behavioral events cannot be controlled. The case study includes many the same techniques and methods as a history, for example, but it also includes other sources of evidence that are not usually use in the history (Systematic interviewing and direct observation). Again, despite of the similarity of case studies and history, the case study includes unique advantage: It deals with a wide range of evidence (documents, interviews and observations) beyond what might be found in the historical study and could be more useful. In addition, sometimes, informal manipulation can occur.

It is possible to identify situations in which all these research strategies might be appropriate, and other situations in which two different strategies could be equally attractive. It is also possible to use two or more strategies in any studies (for instance, a survey can be used within a case study or vice versa. In respect to this, different strategies are not mutually exclusive. However, according to the figure 1.1, it is possible to identify situations when specific strategy will be the most appropriate with distinct advantages. For example, the case study is useful when “how” and “why” questions are asked in respect to contemporary events over which the investigator does not have control or has little control.

Probably one of the greatest concern is the lack of rigor in case study research. There were many examples when an investigator was sloppy or allowed ambiguous evidence or biased views to affect the findings, the conclusions and the direction of the research. Sometimes, people are

confused with the type of purpose of the case study. For instance, in teaching, case can emphasize or deliberately change and exaggerate a particular point in the more needed way.

Another important concern says that case studies provides too little base for scientific generalization. In other words: "Is it really possible to generalize and induce from a single case?". However, other strategy, experiment, also does not represent a sample. Nonetheless, the goal is to do a "generalizing" and not a "particularizing" analysis (Lipset, Trow, and Coleman 1956).

The last popular complaint about case studies is that the result is presented in massive document, which is hard to read and it takes a lot of time. In addition, a good case study is very difficult to do.

To summarize and determine what case study research is, let us address to one popular definition. "The essence of a case study, the central tendency among all types of case study, is that it tries to illuminate a decision or set of decisions: why they were taken. how they were implemented, and with what result" (Schramm 1971).

Yin in his book about case studies mentioned that the crucial features of case study are that case study:

- investigates a contemporary phenomenon within its real-life context, especially when
- the boundaries between phenomenon and context are not clearly evident;
- copes with the technically distinctive situation in which there will be many more variables of interest than data points, and as one result;
- relies on multiple sources of evidence, with data needing to converge in a triangulating fashion, and as another result;
- benefits from the prior development of theoretical propositions to guide data collection and analysis (Yin 2013).

Another point that it is necessary to understand is how the process of inducting the theory using case studies is organized. The process from determining the research questions to closure of the research. Several steps of the process, such as problem definition and building validation, in general are the same as in hypothesis-testing research. Others steps, for example within-case analysis and replication logic, are very specific and unique to the inductive case-focused process. This type of approach for research especially good suits for new topic areas. "The resultant theory is often novel, testable, and empirically valid. Finally, framebreaking insights, the tests of good theory (e.g., parsimony, logical coherence), and convincing grounding in the evidence are the key criteria for evaluating this type of research (Eisenhardt 1989)".

According to Eisenhardt there are several steps of the process of building theory from case study:

- Definition of research question
- Selecting cases
- Multiple data collection methods
- Entering the field - Flexible and opportunistic data collection, allows investigators to make helpful adjustments
- Analyzing the data
- Shaping hypothesis
- Enfolding literature
- Reaching closure

However, the confusion about the distinction of qualitative data, inductive logic and overall case study research appears. Involvement of inductive logic in the development theory is especially the issue with the lack of clarity. Development of theory is a central activity in organizational research. Traditionally, authors have developed theory by combining observations from previous literature, common sense, and experience. However, the tie to actual data has often been tenuous (Perrow 1986).

The process is alive with tension between divergence into new ways of understanding the data and convergence onto a single theoretical framework. For example, the process involves the use of multiple investigators and multiple data collection methods as well as a variety of cross-case searching tactics. Each of these tactics involves viewing evidence from diverse perspectives. One strength of theory building from cases is its likelihood of generating novel theory. Although a myth surrounding theory building from case studies is that the process is limited by investigators' preconceptions, in fact, just the opposite is true. This constant juxtaposition of conflicting realities tends to "unfreeze" thinking, and so the process has the potential to generate theory with less researcher bias than theory built from incremental studies or armchair, axiomatic deduction (Huberman and Miles 2002).

A second strength is that the emergent theory is likely to be testable with constructs that can be readily measured and hypotheses that can be proven false. A third strength is that the resultant theory is likely to be empirically valid. The likelihood of valid theory is high because the theory-building process is so intimately tied with evidence that it is very likely that the resultant theory will be consistent with empirical observation (Huberman and Miles 2002).

However, some characteristics that lead to strengths in theory building from case studies also lead to weaknesses. For example, the intensive use of empirical evidence can yield theory which is overly complex. Another weakness is that building theory from cases may result in narrow and idiosyncratic theory. The risks are that the theory describes a very idiosyncratic phenomenon or that the theorist is unable to raise the level of generality of the theory (Eisenhardt 1989)".

Besides the relevance of these issues, the important aspect of case study research around which there have been many debates is representation. The way of how case studies are written, reported and presented to the audience. "Representation is a key component of any scientific output, as it shapes what readers will accept as reality" (Stern 1998).

2.3 Research design

Research design guides the investigator in the process of collecting, analyzing, and interpreting observation. It is a logical model of proof that allows the researcher to draw inferences concerning causal relations among the variables under investigation (Nachmias and Nachmias 1976). Another way of thinking about a research design is as a "blueprint" of research, dealing with at least four problems: what questions to study, what data are relevant, what data to collect, and how to analyze the results (Philliber, Schwab, and Samsloss 1980).

Research strategy: Single-case study

In the research the only case is going to be to be investigated. In order to answer the stated questions the whole market with all its participants should be investigated simultaneously from the different points of view. This gives us the wider and clearer picture of the current situation in the market encompassing all the participants. On the other hand, Russian market is quite outstanding and cannot be compared with other market in the world due to its specific features. In addition, the market is quite new for Russia and does not have enough cases of low-cost airlines in history. All 4 companies presented in Russia had so many differences in their activity that they should be observed together with other participants and features of the market in order to get understanding of factors influencing the market.

Overall, the single-case study design is eminently justifiable under certain conditions – when the case represents (a) a critical test of existing theory, (b) a rare or unique circumstances, or (c) a representative or typical case or when the case serves a (d) revelatory or (e) longitudinal purpose (Yin 2013).

Research questions:

- What are country-specific factors influencing low-cost carrier market in Russia?
- How do defined country-specific factors influence the market?
- How can new entrants benefit from defined country-specific factors in formulation of entry strategy?

Study proposition: Defined country-specific factors are directly influencing the market of budget airlines in Russia.

Unit of analysis: Low-cost carrier market in Russia. Participants of the market.

Criteria: Costs triggered by a factor, Effect on revenue triggered by a factor, Number of passengers

The research consists of two parts. The first part is devoted to the identifying of the country-specific factors affecting the industry using secondary data. The second part includes interview results that reveal how exactly these defined factors affect the industry and what recommendations could be suggested. The results from the first part and the second part is going to be compared and used in answering the stated questions.

- **The first part** is exploration the effect of internal and external factors affecting the market using secondary data. Investigation of external factors includes exploration of macro-external environment and all participants of the market. Internal environment is going to be investigated on the base of studying the activity of Russian LCC and through comparison of it with Ryanair's activity. This entails understanding of which factors from list mentioned above affect low-cost carrier market in Russia and are country-specific. Secondary data using in this part of the research consists of company's reports, industry reports by institution and statistical or consulting agencies, interviews of experts of the industry published in public sources. This analysis helps us to determine which factors play the greatest role in activity of budget airlines in Russia and which of them are country-specific, i.e. are inherent in Russian market.
- **The second part** of the research includes primary interviews with experts of the industry. The semi-structured interviews are based on the questionnaire dedicated to the potential factors identified through literature review and with the consideration of information collected in the first part of the research. The interview reveals to what extend these factors influence the industry and helps to understand how potential new entrants should behave. In other words, information collected through interview helps to answer stated questions more concretely and precisely.

However, we have to take into consideration the credibility of research findings. In order to reduce the possibility of getting the wrong answer, it is important to pay attention to attributes of research design: validity and generalizability. Validity is concerned with whether the findings are really about what they appear to be about. Is the relationship between two variables a causal relationship? In addition, there is a concern about the extent to which the research results are generalizable: that is, whether the findings may be equally applicable to other research settings or not.

Chapter 3. Empirical research

3.1 World Market overview

The world market for air travel continues progressive development, in spite of the complications of the macroeconomic situation in some regions. For the global aviation industry in general, 2015 became quite successful. However, the growth is accounted for by passenger transportation, while the volume of air freight did not grow. According to IATA, passenger traffic grew by 6.5% in the world. The largest contribution to global market growth came from Asia-Pacific and Middle East regions, where passenger traffic rose with a rate of up to 15% (IATA 2015a). One-third of total growth in passenger transportation accounted for Asia Pacific region. However, the pace of growth has been slightly slowed down.

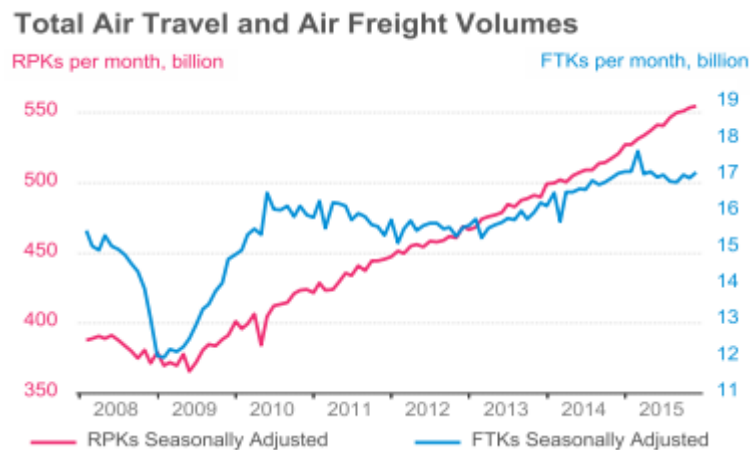


FIGURE 4. TOTAL AIR TRAVEL AND AIR FREIGHT VOLUME
Source: IATA, 2015

Primarily, this growth was triggered by passenger budget transportation. The growth of RPK of traditional airlines worldwide is quite modest except some emerging markets, while the growth in low-cost market segment reaches up to 15% even in such developed and mature market as US. For the last 10 years the share of budget airlines in European market doubled (Israel 2015). It stemmed from easing of major drivers of premium travel demand, such as slowing growth or recession in a number of large markets such as China and Brazil or tough conditions in some key industry sectors (IATA 2015c).

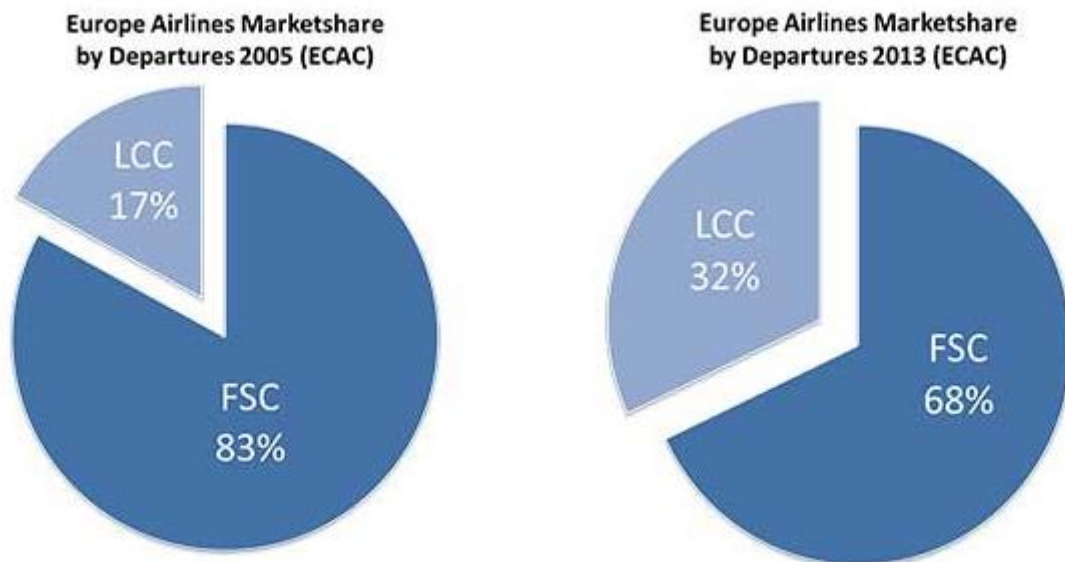


FIGURE 5 EUROPE AIRLINE MARKETSHARE
Source: Airline Profiler, 2015

Net posttax profit of the industry for 2014 was \$16.4 billion, a 2.2% margin on revenues. This was the fifth successive year of profitability, and it builds on the \$10.6 billion profit and 1.5% profit margin in 2013. The air transport industry's profitability in 2014 is owed primarily to improving global economic conditions, which underpinned robust growth in passenger demand. Lower fuel costs also helped, but because of hedging some airlines have yet to experience the benefits of the decline in fuel prices (IATA 2015b).

Annual traffic growth and profit margin

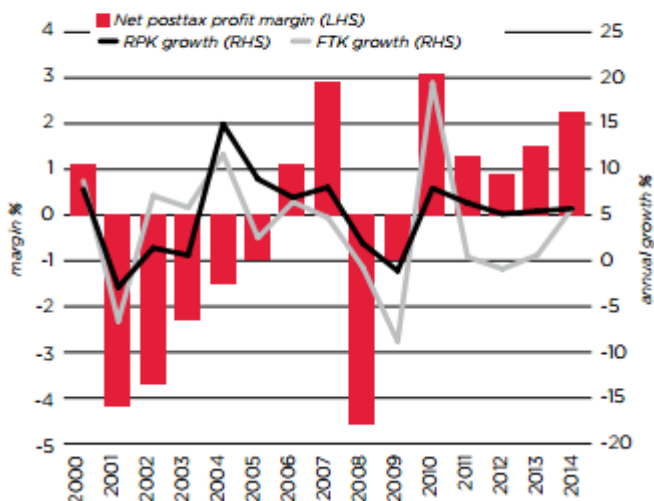


FIGURE 6. ANNUAL TRAFFIC GROWTH AND PROFIT MARGIN
Source: IATA, 2015

Jet fuel prices have decreased significantly over the past year. Jet fuel prices are highly correlated with crude oil prices. The second half of 2014 and 2015 was challenging time for oil industry. Yet even in 2013 crude oil price for Brent fluctuated around 110\$ for a barrel but the following 1,5 years completely changed industry situation. By the end of 2015 crude oil prices declined significantly and reached its lowest level of 27,72\$ for a barrel of Brent in January 2016. Followed by crude oil prices, jet fuel prices declined dramatically. Average price of jet fuel in 2013 was 124,5 a barrel but the latest prices in March did not exceed the level of 45\$ for a barrel.

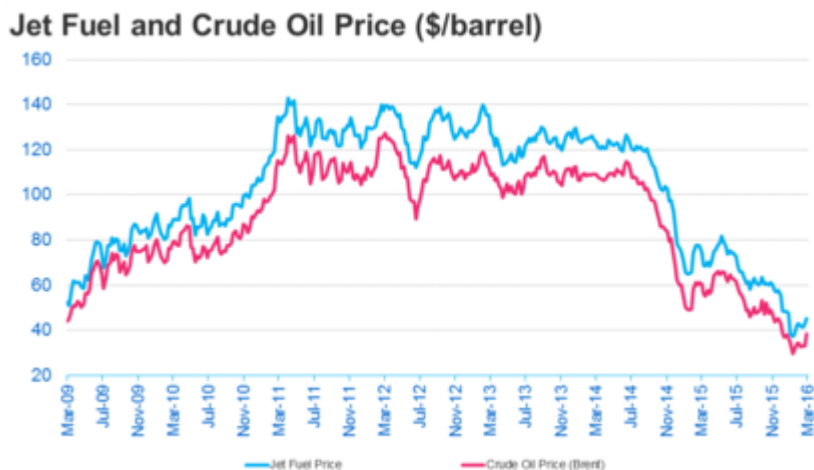


FIGURE 7. JET FUEL AND CRUDE OIL PRICE (\$/BARREL)
Source: Oanda, 2016

Crude oil is commodity and its prices is formed under the pressure of market forces of supply and demand. The peculiarity of the demand for oil is that in the short term demand for crude oil is not elastic: the rise in prices has little effect on demand, because oil is a major energy and can not be replaced by some other resources in those areas where it is used most wide (the fuel for most forms of transport, petrochemicals). Therefore, even a slight drop in oil supply leads to a sharp rise in prices (Cooper 2003). The overall supply of oil has increased. There are some reasons for it.

Kingdom of Saudi Arabia for the second year is in a real "oil war" against the United States - or rather, against the American oil companies involved in the development of shale deposits (Conca 2014). It shale revolution, by which production in the US has increased since 2008 by 90 percent, led to the fact that markets are reduced to Arab oil. In shale oil, there is one significant difference from the Arab - it is expensive. Many fields can be at breakeven price of \$ 60-80 per barrel, while Saudi Arabia is enough and 20, or even 10 dollars per barrel. The idea of the kingdom to pump oil market, lower prices and bankrupt shale producers.

European and American sanctions was taken off against Iran, the country has sharply increased supply on the world market. There is no doubt that it will not wait or restrict exports to raise prices

- Iran needed inflow of foreign currency immediately, the country had for too long lived under sanctions (Walayat 2016).

Despite of the disadvantage position of Russia in the background of lower crude oil prices, Russian companies did not reduced their level of extraction of oil (Rosstat 2016). The official position of Russian oil companies is to produce as much as possible - and at least compensate for this fall in prices (Leiva 2016). No one wants to voluntarily withdraw from the market because he feared that he was immediately replaced by competitors.

At the same time the problem comes from the supply side. The growth of China's economy is slowing down, which means that oil consumption in the country is not as big as expected a few years ago (ITA 2016). The point, however, not only in China: the world consumption of oil is not too grows - the GDP of many major economies did not increase from year to year, and now Europe and the United States are actively developing alternative energy and stimulate citizens commute to work by bike rather than by car – shortly saying, do everything that consumes less oil. Under such conditions, the global demand for oil is growing at one percent a year - offer the same increases much faster.

Despite the fact that the traditional air transportation market has been growing with very modest pace, budget airlines showed a significant growth both in revenues and number of passengers, making budget airline industry more and more popular. CAGR of supply of seats in European market for budget airlines comprised 21,8% for the period from 2000 to 2011, while traditional carriers did not show any growth for the corresponding period. Notable fact here is that the share of seats offered by budget airline in the total amount of seats offered in the European market has been growing from 6% to 38% for the same period of time (IATA 2015b). These numbers are really impressing, especially if we are looking at the results of traditional carriers and their humble results against the background of the absence of profitability.

Huge players at the market of low-cost air transportation demonstrated also quite steady growth. For the last 8 years EasyJet, one of the largest budget carrier based in England, showed stable growth both in the number of passengers and revenue. Its CAGR of revenue from 2007 to 2014 constituted 11% and CAGR of the number of passengers was 8% (Easyjet 2014). These numbers are especially impressive if we look at the size of the company. EasyJet possesses around 230 vessels and it ordered and is waiting for additional 170 planes.

But the leader of budget carriers in Europe is Ryanair. Its financial results are even more. Ryanair experienced revenue growth with CAGR of 14% for the period from 2010 to 2014, while its passenger traffic rose with CAGR of 5% (Ryanair 2015). The most incredible point here that the

company encompasses 300 planes and is waiting for 400 in the future. Ryanair conveyed 82 million of passengers in 2014 that is more than the whole airline industry in Russia in the same year. Its revenue reached the level of 5 billion EUR in 2014.

The largest discount airline in the world is Southwest Airlines. It is a mature and very sustainable company operating in the US market and its surrounding areas since 1971. The company has more than 600 vessels in its fleet and ordered additional 300 planes. The revenue of the company has been increasing with CAGR of 10% from 2005 and comprised more than 18 billion dollars in 2014 (Southwest airlines 2014). However, the number of passengers has been growing with CAGR of 3% for the same period of time and constituted 110 million people, much more than the whole industry in Russia.

The previous example demonstrates activity of stable and sustainable companies. There are also small companies established on the market relatively recently. For example, Vueling, Spanish budget carrier founded in 2004, started its business with relatively small fleet of about 20 vessels but the wise management leads to fact that the company has been gaining their facilities and turnover very rapidly. For the whole history of the company, Vueling gained its revenue with CAGR of 20% and its passenger traffic with CAGR of 18%. Today Vueling has more than 100 plane in their facilities and conveyed more than 20 million of passengers (Vueling 2014).

The world market overview showed that the current situation in air transportation is favorable for the development of low-cost segment. Impressive numbers of growth of companies represented in this segment advocate it. The business model of low-cost carriers could be profitable and prospective. In this way, it is needed to investigate closer Russian market in order to understand the reasons of its inadequacy and factors affecting it.

3.2 Russian market overview

Macroeconomics

Economic situation in Russia was not favorable last years. Economic crisis emerged in 2014 significantly slows the development almost all fields of economy of Russia. In addition, low oil prices exacerbated the situation (Moody's 2016).

In 2013, economic growth in Russia fell under the influence of structural problems and a decrease in investment activity. GDP growth was 1.3%, inflation - 6.5%, industry growth - 0.8%. Capital outflow from Russia amounted to \$ 61 billion for the year 2013. In 2014, economic stagnation continued. In 2014, economic sanctions were imposed toward Russia that led to the huge economic changes. Economic growth in Russia amounted to 0.6%, the inflation rate was 11.4%, and

industrial production grew 1.7%. The outflow of capital from Russia in 2014 amounted to a record \$ 151.5 billion. In December 2014, there was an enormous fall of the ruble against the US dollar and euro. In Russia a currency crisis caused by the imposition of economic sanctions and falling oil prices began. It contributed to a further decline in the economy. In 2015, Russia's economy encountered the same problems: falling oil prices and the preservation of economic sanctions. During 2015 decline in GDP was 3.7% (Rosstat 2016). The devaluation of Russia's currency and stock market slump led to the fact that the market capitalization of Russian companies has returned to the level of 2005. According to the Bank for International Settlements (BIS 2016), the real effective ruble exchange rate in September 2015 decreased compared to December 2013, 30.4%.

The weakening of the ruble has become a major factor in the increase of inflation and, as a result, contributed to the decline in real disposable income and long-term cooling of consumer demand. At the end of 2015, inflation in Russia rose to 12.91%. According to Rosstat data (Rosstat 2015), as of October 2015, the average monthly real wages of workers' organizations in Russia decreased year on year by 10.9%. This was most significant falling of real incomes of the population in the period since 1999. 2016 began with weakening and extreme instability of the ruble against the backdrop of falling oil prices.

The current situation does not look favorable for the development of low-cost carrier market due to ruble exchange rate, stagnation of economy and decline in disposable income of potential customers. The costs are increasing, while revenue per passenger is decreasing.

Industry trends

For the Russian civil aviation in 2014 and 2015 became difficult. The industry observed significant decline in passenger turnover against the background of slowing macroeconomic fundamentals. Despite the negative trends, the Russian market was still growing in 2014 at a faster pace compared with other regions. However, 2015 with its severe macroeconomic situating change the direction of the trend and the industry suffered the drop in industry turnover (Aeroflot 2015).

This drop was triggered by both domestic companies and foreign players. Foreign companies exit Russian market in prevailing amount primarily due to decreasing purchasing power of Russian Rubble, reduced income of customers at this market and tough political situation. Even huge giants such as DeltaAirLines or Lufthansa and its subsidiary GermanWings (Papernaya 2015) reduced their activity in Russia to a minimum level or just abandoned this market. In the current situation, the tickets are expensive enough to ensure the previous level of profitability on international routes for foreign companies. In respect to domestic companies, it can be seen at the figure 1 that the overall turnover strongly reduced by the decline in international flights. Only just

among Russian companies, there was a drop in international transportation by around 20% (RosAviation 2016a).



FIGURE 8. PASSENGER TURNOVER OF RUSSIAN COMPANIES 2011-2015.
SOURCE: ROSAVIATION, 2016

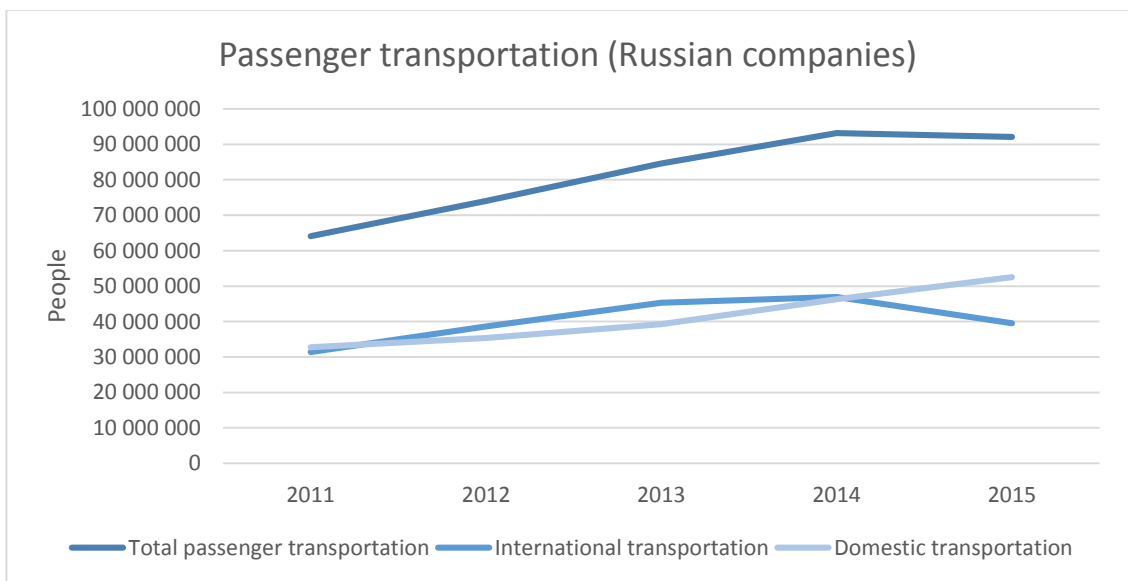


FIGURE 9. PASSENGER TRANSPORTATION 2011-2015.
SOURCE: ROSAVIATION, 2016

Weakening competition triggered by the exit of international companies and bankruptcy of some domestic players allowed the existing companies to increase their prices (Aeroflot 2015). It also adversely affected the number of passenger conveyed. Increase in price could also be explained by the monopolistic characteristic of the Russian market.

Competition

Russian airline industry is not fragmented and has more monopolistic essence. The main player at Russian market is Aeroflot, state-owned company, the national airline of Russia. Together with its subsidiaries Rossiya, DonAvia, Avrora, Orenair, Pobeda and other small airlines, form the largest aviation holdings in Russia - "Aeroflot" group. The Aeroflot group holds around 55% of the whole Russian market (RosAviation 2016b).

A year ago, it was possible to observe other large player at the market – TransAero. Transaero, the second largest airline in the country and the company, whose appearance in 90s actually marked the beginning of real competition in the Russian passenger aircraft industry. In 2014 TransAero holds 33% of Russian market in terms of PSK (RosAviation 2016b). However, on October 26 2015 Transaero was declared bankrupt with the debt amounting to 250 bln. Russian rubbles. Aeroflot and its subsidiary Russia gained access to 56 routes Transaero on a number of major areas. In 2014 Aeroflot had market share of around 25%. In 2015 the company gained its share and it comprised around 28%. In January 2016 Aeroflot reached 36% of the whole market. Since Aeroflot got all the key areas, the level of monopolization of the Russian market of international traffic increases dramatically. In particular, the full monopoly on the Russian side are routes from Moscow to London, Paris, Berlin, Vienna, Rome, Milan, Venice, Prague, Heraklion, Tel Aviv, Istanbul, Antalya, New York, Los Angeles, Miami, Bangkok , Phuket, Beijing, Hong Kong, Karaganda (Transaero 2015). As for the remaining 64% of the liberated areas of "Transaero", they have no claim, and it is unlikely to be eligible in the next few years, because they are direct flights from Russian regional centers, where demand for international transportation greatly reduced. Thus, it is possible to name Russia as the market resembled to monopoly.

TABLE 3. TOP RUSSIAN COMPANIES. 2014-2015
SOURCE: ROSAVIATION, 2016

	Passenger transportation, people		Passenger turnover, thsd pass km	
	2014	2015	2014	2015
Aeroflot	23 610 036	26 111 728	67 121 707	74 115 874
Transaero	13 198 591	11 218 909	47 066 421	35 584 398
Siberia	7 938 199	8 208 508	15 582 789	15 701 045
UtAir	8 564 340	5 540 382	20 198 948	9 994 954
Ural Airlines	5 160 588	5 445 134	13 327 154	13 124 658
Russia	5 191 783	4 751 568	10 147 404	8 694 979
Pobeda	39 565	3 089 676	50 325	4 668 439
OrenAir	3 034 659	2 840 284	8 471 008	6 348 659
Top 8 companies	66 737 761	67 206 189	181 965 757	168 233 007
% of 8 in the total	72%	73%	75%	74%
Total Russian airlines	93 180 376	92 071 065	241 429 335	226 843 354

TABLE 4. TOP RUSSIAN COMPANIES JANUARY 2015, JANUARY 2016
SOURCE: ROSAVIATION, 2016

	Passenger transportation, people		Passenger turnover, thsd pass km	
	Jan 2015	Jan 2016	Jan 2015	Jan 2016
Aeroflot	1 810 922	2 005 421	5 330 132,60	5 831 875,00
Siberia	538 216	690 195	1 082 195,00	1 311 703,00
UtAir	395 818	376 876	903 766,44	599 628,21
Ural Airlines	325 858	350 403	797 590,79	793 737,58
Pobeda	79 000	330 956	117 438,08	490 701,07
Russia	379 310	275 411	741 875,72	484 063,79
OrenAir	199 596	192 617	370 488,49	590 781,88
Globus	178 998	189 687	449 403,00	478 038,00
Top 8 companies	3 907 718	4 411 566	9 792 890	10 580 529
% of 8 in the total	66%	80%	62%	77%
Total Russian airlines	5 900 119	5 540 107	15 784 228,76	13 692 793,73

However, experts within industry mentions that typically 50-80% of the first passengers on the route of a low-cost airline company - new travelers. Thus main competitors for LCCs are buses, train and cars. People, who used these types of transport before, now can use planes and reach the destination faster but for cheaper price (Aeroflot 2015). However, current economic situation are more favorable for substitutes.

Destinations

According to information from Transport Clearing Company, main destinations in Russia are between Moscow and other main cities of Russia (Transport Clearing Company 2015). Two the most popular routes are from Moscow to Saint Petersburg and back. In this way, there is only one huge hub in Russia – Moscow. The prevailing majority of flights between regions are routed through Moscow. Other small hubs are Saint Petersburg and Ekaterinburg but they are much less than three Moscow airports. Here is the table with the largest airports in terms of passenger traffic. In the table airports with more than 1 mln passengers annually are presented.

**TABLE 5. PASSENGER TRAFFIC SOURCE
SOURCE: ROSAVIATION, 2015**

Name	Passangers		
	2014	2015	%
Moscow (Sheremetyevo)	31 259 662	31 279 508	100,1
Moscow (Domodedovo)	33 039 531	30 504 515	92,3
Moscow (Vnukovo)	12 733 118	15 815 129	124,2
Saint Petersburg (Pulkovo)	14 264 732	13 501 454	94,7
Simferopol (International)	2 685 269	5 017 758	186,9
Ekaterinburg (Koltsovo)	4 473 239	4 170 737	93,2
Sochi	3 065 644	4 076 509	133,0
Novosibirsk (Tolmachovo)	3 829 667	3 600 291	94,0
Krasnodar (Pashkovskiy)	3 420 385	3 121 630	91,3
Ufa	2 356 467	2 291 502	97,2
Samara (Kurumoch)	2 359 133	2 193 744	93,0
Rostov-na-donu	2 340 295	2 061 016	88,1
Mineralnie vody	1 921 453	1 957 121	101,9
Kazan	1 942 408	1 794 735	92,4
Krasnoyars (Emelianovo)	2 045 249	1 788 754	87,5
Habarovsk (New)	1 924 253	1 716 333	89,2
Vladivostok (Knevichi)	1 772 370	1 678 628	94,7
Irkutsk	1 661 261	1 635 478	98,5
Kaliningrad (Hrabovo)	1 460 060	1 533 057	105,0
Surgut	1 353 287	1 416 846	104,7
Tumen (Roschino)	1 369 094	1 399 264	102,2
Perm (Bolshoe Savino)	1 315 144	1 284 970	97,7
Chelyabinsk (Balandino)	1 394 142	1 229 435	88,2
Anapa (Vityazevo)	1 005 383	1 178 984	117,3
Nizhniy Novgorod (Strigino)	1 126 755	946 334	84,0
Volgograd (Gumrak)	757 748	901 522	119,0
Omsk (Centralniy)	1 037 808	881 186	84,9

Airports

The second largest cost item in a structure of costs of airline is airport services (Aeroflot 2015). The cost of airport services, the transparency of its formation and inadequate quality of the ground infrastructure are still sharp subjects in relationships airlines and airports (Belousov 2014). Parties are in any case tied to each other. One of the most important reason for high taxes is the absence of competition among airport.

Classic model of budget airlines implies that an airline chooses less comfortable airport but cheaper. However, Russian market does not have secondary airports and airlines do not have choices. Number of experts in interviews published in media named weak infrastructure as one of the main problem for successful activity of LCC. Lack of competition, lack of investments and small passenger turnover leads to slow pace of development of regional airports (Belousov 2014;

Mokrousova 2012). As a result, airport cannot serve aircraft in time comparable with the best airports and therefore it has negative effect on activity of LCC. In addition, CEO of Avainova, Teterin Konstantin, stated that airports historically prefer to serve classic airlines. As a result, LCC could get uncomfortable, day or night slots, which means that their flights will have fewer passengers, because the main traffic is in the morning or evening (Mokrousova 2012).

Costs of services in different scale and geography should not be the same. They have fixed costs - the runway should always be in a good quality, the terminal should be maintained, regardless of the number of passengers. Tariffs should at least provide a refund that are different for all airports. The smaller airport by number of operations or passenger traffic, the more the size of rates and tariffs is critical for it in terms of preserving financial stability. The difference in the cost varies depending on the particular equipment of the airport and the amount of consumption of services. For example, in the upgraded or new airports (Sochi) air terminal use can be more expensive than in the old (Krasnodar) (Belousov 2014). In addition, some airports provide with additional services such as leading of aircraft, while others do not use it.

The Federal Tariff Service sets limits fees for takeoffs and landings, aviation security, terminal use, passenger service and excessive parking – five main costs at airports. Management of several Russian airlines, such as S7 and Ural airlines stated that the lack of state control of price determination lead to the lack of transparency of the price (TASS 2016). Tariffs are unregulated and could be set arbitrarily, without reference to the cost, always significantly exceeding costs of airports, often in several times. Price are calculated using the desired total revenue for the company (Belousov 2014). Due to the fact that supply is usually monopolistic, airports could set higher price. However, some experts of the industry (Oleg Panteleev, Industry agency AviaPort; Irina Frolova, Transaero) mentioned that regulation of these taxes could lead to the reduction of investments in the development of infrastructure (Mamonova 2014; Belousov 2014). At this point, the ability to negotiate could be an advantage of the company.

In determining the best routes for potential low-cost airline it is important to take into consideration tariffs of airports. Calculations for the price of airport services provided in this paper take into account 4 major costs: fees for takeoffs and landings, aviation security, terminal use and passenger service. Two first cost items are fixed costs and depend on the maximum takeoff weight, while the last two cost items are variable and depend on passenger traffic. The information about tariffs (table 4) for these services are gathered by AviaPort, a Russian information-analytical agency specializing in the collection, processing and dissemination of business details about the aviation industry. Information was updated in the beginning of 2016 (Aviaport 2016). The list contains cities with a passenger traffic more than 1 mln people in last year, as fixed costs (fees for takeoffs

and landings, aviation security) for low-cost airlines are acceptable. In addition, this calculations do not take into consideration additional secondary services provided by airports. In this way, the price could be understated. This calculation are done only for the purpose of ranging airport according their prices.

The price will be calculated for typical aircraft of low-cost carrier, Boeing 737-800 with the average maximum takeoff weight of 75 tons and 189 seats onboard. The passenger load factors is 75%. To get the price, fees for takeoffs/landings and aviation security are multiplied by the weight of average vessel and summed up with the product of the average number of passengers conveyed and fees for terminal use and passenger services for 1 passenger.

TABLE 6. TOTAL COSTS FOR AVERAGE VESSEL

Source: by author on the base of Aviaport data, 2016

Airport	Take-off/landing		Aviation security		terminal use	passenger services	Total costs
	rub per tonn	Maximum Takeoff Weight — MTOW	rub per tonn	Maximum Takeoff Weight — MTOW	rub per passenger	rub per passenger	
Noviy Urengoy		1177	610		50	242	175 366
Surgut		666	438		73	251	128 734
Tumen (Roschino)		661	405		50	184	113 069
Ekaterinburg (Uktus)		495	390		90	230	111 735
Omsk (Centralniy)		545	484		66	165	109 919
Samara (Kurumoch)		376	300		90	290	104 565
Sochi		374	270		82	291	101 144
Vladikavkaz (Beslan)		434	477		51	149	96 682
Chelyabinsk (Balandino)		497	222		72	209	93 737
Novosibirsk (Tolmachovo)		310	256		111	249	93 423
Saint Petersburg (Pulkovo)		332	303		79	243	93 345
Vladivostok		450	205		139	148	89 814
Irkutsk		470	342		39	141	86 387
Habarovsk (New)		346	227		115	184	85 370
Krasnoyarsk (Emelianovo)		388	235		56	214	84 896
Ekaterinburg (Koltsovo)		424	248		50	191	84 607
Simferopol		398	280		118	105	82 460
Mineralnie vody		352	261		77	177	82 001
Rostov-na-donu		344	326		51	123	74 934
Kazan		385	208		47	159	73 545
Yaroslavl (Tunoshka)		351	151		112	130	71 964
Anapa (Vityazovo)		370	232		55	130	71 308
Krasnodar (Pashkovskaya)		390	190		40	145	69 751
Volgograd (Gumrak)		428	236		40	86	67 703
Kaliningrad (Hrabovo)		343	269		48	89	65 277
Ufa		361	244		34	100	64 370
Krasnoyarsk (Cheremshanka)		351	168		48	119	62 597
Perm (Bolshoe Savino)		376	194		31	96	60 757
Nizhniy Novgorod (Strigino)		359	145		43	107	59 030
Novosibirsk (Severniy)		214	133		85	141	58 068
Moscow (Domodedovo)		200	151		46	160	55 455
Moscow (Vnukovo)		178	159		49	127	50 247
Moscow (Sheremetyevo)		178	55		113	77	44 386

Having calculated costs for airport services for average vessel using by low-cost carriers, conventional unit cost, it is possible to range airports according to their price. The huge difference in prices can be noticed. Moscow airports are the cheapest ones, while Saint Petersburg, the second largest city, has a very expensive airport. That is one of the major explanation, why there is almost no low-cost carriers in Saint Petersburg despite of the huge potential market.

Customers

In order to attract passengers who are sensitive to the cost of transportation, creation a new airline, budget carrier, could be a good option. Low cost carriers in most cases generate new passenger traffic and stimulate the growth of total traffic. Typically 50-80% of the first passengers on the route low-cost airline company - new travelers (Aeroflot 2015). According to interview with CEO of Pobeda, Andrei Kalmykov, main competitors of LCCs in Russia are substitutes, ground transport modes, such as buses, trains, cars. "A huge number of passengers, who used buses before, now prefers flights lasting up to two hours. Passengers who previously traveled to the capital by bus, now travel on the plane, because it costs about the same money, but the speed is much faster. Because the plane encompassed 189 seats can offer the lowest fare and the lowest fare generates additional passengers, which would never have flew. Student can visit relatives, go somewhere on weekends and so on. Therefore, our main competitors are not Russian airlines but ground transportation." (Medvedev 2016c)

The main customers of LCCs are not only price sensitive customers. All categories of population use this type of travel. Even share of business customers are significantly growing. People who fly on business trip prefer to save money and to spend it with a worthy purpose (Medvedev 2016c). The other reason that true LCC operates with very high punctuality. For business passengers is important to get there on time and with the guarantee to get where they need. They fly mainly on one or two days - they have a minimal amount of luggage. They can get on board conditions that they are used to receive in the classic airlines: they can book priority boarding at the airport, booking places that are at the emergency exits, in which the increased distance for legs and to fly with comfort. Today, LCC is not something shameful, or an indication that a person has no money. CEO of Pobeda mentioned that up to 30% of their passengers are from business segment.

Ticket promotion

Low-cost carriers use tickets promotions that lead to attraction of new customers. Pobeda offer tickets for 999 rubbles, Avianova offered tickets for only 250 rubbles, Ryanair seldom sold tickets just for 1 Pound. This is a very effective technic. These ticket promotions are so effective that helped Pobeda, Avianova and Sky Express get into top 10 companies out of 150 by RPK in only one year (Rosaviation 2008, 2009, 2015). Moreover, it was achieved with relatively small fleets. However, it does not mean that passenger can buy tickets for such a low price. With the filling of a plane, the ticket price is increasing. Low-cost carriers use yield management system in order to maximize revenue generated from ticket sales. Yield management is a variable pricing strategy, based on understanding, anticipating and influencing consumer behavior in order to maximize revenue or profits from a fixed, perishable resource. Therefore it is possible to get really cheap

tickets only in advance. When the number of tickets left are small, their price is comparable to traditional airline. However, this technic is so powerful that allows to fill planes with maximum load factor.

Political environment

Political environment highly affect airline industry, where passengers are favored over the airlines. According to words of CEO of Pobeda, “safety is paramount” (Medvedev 2016b). In addition, Russian government has a strong influence on the market because it owns Aeroflot group. In other words, more than 50% of market belongs to state-owned company. It leads to the fact that state-owned company can behave in its own interests. In addition, tough political situation in Russia and its relationship with some countries could also affect activity of Russian airline companies. For example, sanctions against Dobrolyot forced the company to be closed (Reguly 2014).

Legal environment

Legal environment determine the boundaries of the industry, therefore, in any ways, companies have to take into account. There are still some restrictions, which are unusual for worldwide industry; Russia is a “unique” country to some extent. However, due to the efforts of Aeroflot group, the situation has been improved and some important laws were enacted. Connection with authorities and the status of state-owned company helped in it.

Only two years ago, it became possible to sell non-refundable tickets (Federal law №79, 20.04.2014). The law allowing it was enacted due to the efforts of Aeroflot but it spreads to all players in the industry. This is crucial point for LCC’s activity as it helps in cost saving significantly. CEO of Avianova mentioned that to refund ticket with the price of 1000 Rub, it was necessary to involve staff in the amount of 3-4 thsd. Rub. It is unacceptable for flourishing low-cost business.

Concerning catering, today all plane have to unload and carefully inspect all food and drinks on board in any airport (Federal law №60, 19.03.1997). It requires additional costs and time needed for these procedures, thereby it could significantly burden LCC’s activity. It is quite unusual for European markets.

Russian legislation allows passengers to convey luggage with the weight of 10 kg for free. In addition, there is a list of items that is possible to bring on board for free, such as portfolio, ladies' bag, suit in holdall, cot, baby food, umbrella, camera, computer, and so on (Federal law №60, 19.03.1997). In this respect minimum requirements for luggage transportation are more favorable

for customers in Russia, you do not find such conditions abroad, for every item on board LCCs are in right to charge fee.

Another restraining factor is necessity of usage of paper tickets (Federal law №60, 19.03.1997). Advanced airlines abolished physical tickets and use only bar code on passenger phones. It save time and money needed for registration of passengers, printing tickets or buying machines for it. All this leads to increased time of passenger service in airport that, again, is very important for LCC's activity.

According to air code of Russia, the minimum amount of vessels that company has to have in its fleet today is 8 (Federal law №60, 19.03.1997). It requires significant amount of investments, if a new player wants to enter the market. In addition, all planes operate in domestic market should be registered in Russia. If an aircraft was assembled outside Russia, it requires owner of the plane to pay VAT and custom taxes. In this way, legal environment becomes a serious barrier both for entrants and for existing companies.

3.3 Internal factors

The comparison of Russian budget airline and Ryanair in the context of internal factors is presented in Appendix 1. The detailed analysis is described further.

Pobeda

Another very remarkable point related to Russian market is the launch of Pobeda – the forth Russian low-cost airline and *the only one existing* nowadays. The airline was established after sanctions of the European Union against the airline Dobrolet for the flights to Simferopol have been introduced on July 30, 2014 and whereby the airline was forced to terminate all its flights. Airline Pobeda was founded in September 2014 as part of "Aeroflot" Group. 100% of Pobeda belongs to Aeroflot group. The company develops on the basis of the classical business model of budget airline with global best practices accumulated in the industry. Pobeda is based at Moscow's Vnukovo airport. December 1, 2014 Pobeda has carried out its first flight on the route Moscow – Volgograd. The situation is outstanding because the company showed extremely great success in its first year of activity (Aeroflot 2015).

The decision to establish the budget airline was adopted by the Board of Directors of Aeroflot group in 2013 in order to consolidate its leading position in the emerging segment of low-cost transportation. Activities of the airline aims to increase the mobility of the population and mutual access to Russian regions (Aeroflot 2015).

On November 11, 2014 Pobeda launched on sale tickets for the first flights and for the first 12 hours sold more than 7 thousand tickets, and 20 thousand for a week of work. In January 2016, after only 1 year of activity, Pobeda became the 5th largest Russian company in terms of conveyed passengers. In 2015 Pobeda made a profit of 37 million rubles, according to Russian GAAP after just 1 year of activity. All these results were achieved with a fleet of only 12 aircrafts (Aeroflot 2015).

Dobrolyot

Dobrolyot was Russia's budget airline, a 100% subsidiary of Aeroflot, based in Moscow Sheremetyevo airport. The company was founded on October 4, 2013 and began commercial operations in June 2014. On July 30, 2014 the sanctions of the European Union for the flights to Simferopol was introduced against the company. After that the airline was forced to terminate all its flights (Dobrolyot 2016). In July 2015 it became known about the liquidation of the company. Majority of assets became the part of Pobeda (Aeroflot 2015).

In short, Dobrolyot was a predecessor of Pobeda. It had the same CEO, the same team and strategy, all vessels of Dobrolyot would be used by Pobeda later. The only official reason why Dobrolyot had to be closed lies in sanctions against the company. The company carried out flights to Simpheropol' against the background of tough political situation. On August 3, 2014 Dobrolyot officially announced that due to EU sanctions "under unprecedented pressure from European suppliers" the company "forced to terminate flights and ticket sales." The press release explained that a number of European counterparties had canceled the lease agreement on the aircraft, maintenance and insurance of aircraft, as well as the provision of aeronautical information. The new LCC Pobeda do not have flights to Simpheropol'.

Sky Express

Sky Express is previously existed Russian airline, the first low-budget airline in the country, founded in 2006 and based in Moscow airport Vnukovo. According to the number of passengers carried in 2009, it took 13th place in the country (1.02 million passengers). The business model of Sky Express has not been copied from European low-cost airlines but developed independently. Due to the lack of readiness of the Russian market to the traditional models of aggressive low-cost airline, Sky Express combines the features of both low-cost airlines and traditional airlines. The company ceased operations in the autumn of 2011, the air carrier certificate has been revoked by Rosaviation on October 31, 2011. By the end of 2012, the Arbitration Court of Krasnodar region recognized airline insolvent (bankrupt).

Avianova

Avianova was Russian budget airline, which operates in 2009-2011. The company became the second LCC in Russia, rapidly increased its route network. Nevertheless, two years later the airline ceased operations due to a chronic loss-making, and in part because of the conflict of shareholders (Gazeta.ru 2012). January 12, 2012 operator certificate of Avianova was canceled.

Business model of Avianova includes both features of LCC and elements of traditional airline. However, the company did not show any profit for the whole period of activity. The company did not do its best to reduce its costs, while fares were really low. Finally, after first huge losses and debts, investors of the company could not come to the single conclusion that led to the termination of financing from some parties and to the larger losses.

Fleet characteristics

Successful business model of low-cost carrier involves appropriate fleet as it directly affect cost structure of a company.

TABLE 7. FLEET CHARACTERISTICS

Source: Source: Database Planespotters.net

	Pobeda	Dobrolyet	SkyExpress	Avianova	Ryanair
Fleet size	12	2	10	6	345
Homogeneity of fleet	one type	one type	3 types Boeing 737-300/ Boeing 737-500 /	one type	one type
Type	Boeing 737-800	Boeing 737-800	Airbus A-319	Airbus A320-232	Boeing 737-800
Age	1,5	1	19	10	6,5
Number of seats	189	189	132-148	170	189
Country of registration	Bermudas	Bermudas	Russia	Ireland	Ireland

Pobeda's fleet includes aircrafts of one type – Boeing 737 with 189 seats. As of April 2016 the average age of aircraft airline was 1.8 years. All of them are used through operational leasing. The company perfectly exploit economy of scale. New fleet allows to save from technical maintenance, fuel consumption and insurance payments (Medvedev 2016b). The average age of Sky Express was 18-19 years that led to increased costs relate to technical maintenance, oil consumption, number of breakdowns and time spent in airports. Some experts (Chernyak, Avrora; Tetetin, Avianova; Koltovich, Aeroflot) of the industry mentioned that this was a crucial point that led company to the bankruptcy (Mokrousova 2012)(Mokrousova 2012). Avianova also had increased costs and time for maintenance, fuel consumption and insurance payments due to old fleet. This was also one of the reason for constant delays of both companies that also had a huge impact on companies' performance.

Recommendations in Russian context could be similar to classic low-cost carrier model. As the majority of directions relevant for low-cost activity in Russia does not exceed 2 thsd. km., utilization of new middle-haul narrow-body planes with maximum amount of seats is the perfect option. Longer-range or wide-body planes are redundant for the market as it requires too capital-intensive investments and too large passenger turnover to recoup the costs. Single type of aircrafts allows to save on salaries for pilots and maintenance. In addition, the more seats are in aircraft, the more revenue it can generate from one flight. The fleet should be as new as possible.

All planes of Pobeda are not registered in Russia but in Bermuda as well as all planes of Aeroflot. It helps Pobeda not to pay taxes, as it is necessary to pay them for import of planes in Russia. There are only two countries – Bermuda and Ireland – that have signed an agreement allowing free movement to Russia. However, these agreements implies only international flights but the Russian government may provide with exceptions to this rule, as it often does; an aircraft with foreign registration can also be used for domestic flights. As it was mentioned, all vessel by Aeroflot group are registered in Bermuda but are used within Russia, while some other Russian companies did not get permission for it (Roche & Duffay 2016). This shows how huge impact of government on airline industry is and its possibility to change the rules. One implication can be made that relationships and connections play significant role in Russian market. Avianova registered its fleet in Russia and paid significant amount of import taxes that comprised up to 41of total price of aircraft (Dagaeva 2011b).

Fleet utilization

As airline has relatively huge amount of fixed costs (for instance, lease payments), it is necessary to utilize fleet to the full extend. It should bring money at any moment.

TABLE 8. FLEET UTILIZATION

Source: Interviews with experts and representatives of companies; websites of companies.

	Pobeda	Dobrolyet	SkyExpress	Avianova	Ryanair
Utilization time	12-16 hours	12-14 hours	8 hours	12 hours	12-16 hours
Turnaround time	25-35 minutes	30-40 minutes	1 hour	1 hour	25-30 minutes
Punktuality	0,81%	1,65%	17%	12%	2%

All Russian budget airlines tried to utilize their fleet at full capacity. However, only Pobeda and Dobrolyot achieved results that are close to the best practices worldwide. Pobeda could reach turnaround time in some airports of 30 minutes and time of utilization of aircraft up to 16 hours per day. These result are one of the best in the world (Medvedev 2016b). This results has been achieved through close collaboration with airports and thorough training of employees. To improve airport service and reduce the spent in airport by aircraft, Pobeda started to interact with

airport very intensively. The main goal was to introduce and implement new standard of airport services. CEO of Pobeda mentioned that Pobeda had been involved in elaboration of optimization strategy for some main region airports. A huge number of operations should be performed simultaneously and it should become technologically coordinated work. Pobeda even arranged business trip for representatives of airports to the best European low-cost airports with the aim to show them, how it is possible to improve quality of airport services. In addition, all operations are strictly described and personnel know what exactly and in which order they have to do. Some of services such as cleaning services were eliminated and now are carried out by crew of a plane. Strict adherence of the rules is also highly important. If passenger is late for 1 minute, it means that flight is not going to wait him (Medvedev 2016a).

Avianova and Sky Express also tried to minimize time spent in airport. However, weak development of infrastructure and lack of thorough study of all processes in airport and lack of involvement and collaboration with airports did not allow to reduce the time. In some cases, good relationships between airline and airport could lead to better results. For instance, the priority of a company can be increased (Dagaeva 2011a).

Punctuality rates of Pobeda and Dobrolyot are also highly positive. This rate shows the share of flights that were delayed for more than 2 hours. There are two main reasons for weak punctuality rate. Beside ineffective operations in airport, poor weather conditions can also affect punctuality. Russian climate is relatively unpredictable, so it is not unusual that weather can lead to delays. Weak infrastructure of airports does not allow to land the plane in bad weather conditions. Punctuality leads not only to missed revenue but also to catastrophic losses for providing accommodation for passengers. Such high level of delays in Sky Express (up to 29% in some months) was also triggered by lack of vessels: 2 new aircraft were delivered one month later than they should be (Dagaeva 2011a).

This information confirmed the fact of weak development of airports. Some of them are not ready to serve aircraft for 30 minutes. The implications derived from this information tell that close collaboration with airports could significantly help in utilization of aircraft as in Pobeda case.

Operations

TABLE 9. OPERATIONS

Source: Interviews with experts and representatives of companies; websites of companies.

	Pobeda	Dobrolyot	Sky Express	Avianova	Ryanair
Fuel consumption	Effective + Discounts due to large amounts bought together with Aeroflot	Effective + Discounts due to large amounts bought together with Aeroflot	Less effective/No discount More spending on maintenance/frequent breakdowns	Less effective/No discount More spending on maintenance/frequent breakdowns	Effective + Economy of scale
Maintenance & Insurance	New fleet allows to spend less	New fleet allows to spend less	Multifunctionality	Multifunctionality	New fleet allows to spend less
Personnel Distribution channels	Multifunctionality	Multifunctionality	Multifunctionality	Multifunctionality	Multifunctionality
Cheapest ticket	Primarily On-line	Primarily On-line	Primarily On-line	On-line. Offices	Primarily On-line
Yield	999 Rub	999 Rub	500 Rub	250 Rub	1 £
Management	Yes	Yes	Yes	Yes	Yes

As it was told above, new fleet allows to save from technical maintenance, fuel consumption and insurance payments. New fleets lead to the reduced number of breakdowns that, in turn, reduce the time spent on ground and less costs. In addition, new aircrafts produced by Boeing and Airbus consume less fuel (Medvedev 2016b). The average age of Sky Express was 18-19 years that led to increased costs relate to technical maintenance, oil consumption, number of breakdowns and time spent in airports. The same story with Avianova (Mokrousova 2012).

Pobeda has only 100 employees, who do not fly. All the rest are members of crew. That is why it has no employee in airports. The number of members in crew in the least possible according to Russian legislation. This helps significantly to reduce costs. The crucial principle here is multifunctionality. The same person serve passengers both in air and on ground. She is responsible with customer registration, their loading, customer service in flight and even vessel cleaning. Moreover, all function of the staff are described in details. All the rest should be outsourced. A huge number of operations performed simultaneously in order to reduce time spent in airports (Medvedev 2016a). Sky Express and Avianova tried to follow the same strategy.

The essential aspect of low-cost carrier is to abandon traditional distribution channels. All Russian budget airlines understood it and focused primarily on on-line distribution. If a passenger wants to buy ticket at the airport, he has to pay more for it. This mark-up covers all additional costs tied to this sale. The transaction costs more, therefore passenger should pay more (Medvedev 2016b).

In addition, all companies implemented yield management system that helped to increase revenue flow through price discrimination. First tickets are extremely cheap in advance but the more plane

is filled, the more expensive they are. The last tickets for a flight is usually comparable with prices of traditional airlines (Medvedev 2016b)

Another point that helped Pobeda to be more successful than its predecessors is economy of scale in fuel procurements. Pobeda is a part of Aeroflot group and therefore have an access to the cheaper fuel (Labykin 2013). This is a positive point emphasizing advantage of synergy effect of collaboration traditional airline and low-cost carrier.

To sum up, all these points are inherent in classic low-cost carrier model activity and should be taken into account in any market. To increase probability of success, a company should elaborate strict plan concerning these points. Avianova and Sky Express did not emphasize it and therefore incurred significant losses. In addition, possibility of achieving economy of scales could be an advantage.

Destinations and Airport related issues

TABLE 10. DESTINATIONS AND AIRPORT FEES

Source: websites of companies, Wikipedia

	Pobeda	Dobrolyot	SkyExpress	Avianova	Ryanair
Destinations	Majority flights are from Moscow. Developed network of regional flights	All flights are from Moscow	All flights are from Moscow	Majority flights are from Moscow. Developed network of regional flights	Developed network
Airport fees	Use all airports / Lower fees due to connections	Use the cheapest airports / Lower fees due to connections	Use all airports	Use all airports	Use the cheapest airports / Ryanair owns some airports

There are two factors that affect the choice of destinations of an airline. The first is a passenger traffic. Airline has to provide each flight with the maximum number of passenger in order to achieve satisfactory load factor and possibility to use aircraft as much hours per day as possible. The second is payment for airport services. As we discussed it earlier, there is a problem with the development of infrastructure in Russia that includes lack of competition, inadequate service in some airports and lack of transparency of airport fees. In addition, airports historically prefer to serve classic airlines. As a result, LCC could get uncomfortable, day or night slots, which means that their flights will have fewer passengers, because the main traffic is in the morning or evening (Mokrousova 2012).

Pobeda focuses on most popular destinations and tries to use the cheapest airports, where it is possible. Pobeda started its activity with only 11 directions from Moscow to regions of Russia: Industrial - centers of Russia - Ekaterinburg, Perm, Chelyabinsk, Tumen, Surgut; South of Russia:

Vladikavkaz, Sochi, Mineralnie Vody; Cities of central Russia: Volgograd, Belgorod, Samara. These are the most popular destinations in Russia. Today Pobeda's flight network has been expanded to 34 directions from Moscow with both domestic (Anapa, Astrakhan, Gelendzhik, Kirov, Krasnodar, Makhachkala, Nazran, Nizhnevartovsk, Novosibirsk, Saint Petersburg and Cheboksary) and international flights (Vienna, Bratislava, Cologne, Milano, Minningem, Larnaka and Pafos). Also there are some connections between south resort cities (Anapa, Sochi) and largest cities of Russia, allowing to exploit tourists flow. Recently, Pobeda launched some flights between main cities of Russia except Moscow (Saint Petersburg, Ekaterinburg, and Krasnodar). In respect to foreign destinations, Pobeda choose the cheapest airports. Choosing the cheapest airports, Pobeda also provide customers with Fly&Bus offer, allowing them to get more European cities. For example, using a flight from Moscow to Minnengem, customers can reach Munich and Zurich as well. Pobeda sell a bundle for a flight ticket and bus provided by the company from cheap airport in Minnengem to the center of Munich or Zurich. This trick helps the company to widen its destination network. As Pobeda is a part of Aeroflot Group, the company has some synergies from it. First of all, Aeroflot has a good connections with some airports and therefore it can an access for cheaper tariffs for airport services and access to the better time slots (Medvedev 2016b). Airport fees are the second largest cost driver, thus this advantage is a key point.

As well as other LCCs in Russia, Sky Express used all main airport that sometimes were quite expensive but primarily due to the absence of competition between airports in regions. However, all its flights were only from Moscow with the focus on the most profitable destination. All flights were effectively optimized. The most important factor in the growth of production indicators in 2009 was access to the international charter market, primarily in Turkey (Istanbul), Greece (Heraklion), Cyprus, Spain (Ibiza), Egypt (about 30 lines). According to the Transport Clearing House, in 2009 the number of airline passengers on international flights increased by 7.5 times - from 18.9 to 205.3 thousand people (Transport Clearing Company 2016).

Avianova also had developed network of its flights, while majority of them were form Moscow. However, Avianova's network included also not very attractive flights. For example, it used expensive Pulkovo airport in Saint Petersburg as a hub with empty flights to unattractive destinations (Labykin 2013).

Political aspect is also important issue. Due to flights to Simpheropol' and against the background of current political situation in the Crimea, the sanctions were imposed on Dobrolyot. The press release explained that a number of European counterparties had canceled the lease agreement on the aircraft, maintenance and insurance of aircraft, as well as the provision of aeronautical information. After that the airline was forced to terminate all its flights. Pobeda now does not flight

to Simpheropol' (Skifsky 2014). Political tension also leads to the difficulties with receiving permission for flights in some European countries for Pobeda (BFM 2015).

To sum up, destinations should be chosen with consideration of passenger traffic, airport services and airport fees. As Russian airport infrastructure is not developed properly, there is an absence of competition and therefore lack of service quality and transparency of fees. Good connections and relationship could be a great advantage at this point. In addition, the direct participation of LCC in the development of an airport could be extremely useful. Political situation also affects the scope of activity of Russian companies. It has influence on restrictions of foreign flight, sources of foreign capital and cooperation with foreign counterparties and intermediaries.

Additional services

TABLE 11. ADDITIONAL SERVICES

Source: websites of companies, Wikipedia, Interview with representatives of companies.

	Pobeda	Dobrolyot	SkyExpress	Avianova	Ryanair
Luggage	10 kg free / no hand luggage allowed	10 kg free / no hand luggage allowed	15 kg / hand luggage allowed	15 kg / hand luggage allowed	Hand luggage allowed
Seat selection	Paid	Paid	Paid	Paid	Paid
Priority boarding	Paid	Paid	-	-	Paid
Non-refundable tickets	Yes	Yes	No	No	Yes
Different types of payments	Paid	Paid	Free	Paid	Paid
Catering	No catering	No catering	No catering	Catering	Catering
Entertainments	No	No	No	No	Paid
Share of revenue	40%	-	10%	12%	25%

Pobeda provides all range of services common for LCCs and charge fee for them. 40% of its revenue comes from providing customers with additional service, such as luggage transportation, seat selection, priority boarding. The only distinct difference that Pobeda do not provide catering on board. It is triggered by Russian legal environment that obliges all planes to unload and carefully inspect all food and drinks on board, when it is in airport. These procedures are time consuming and do not allow vessel to depart in 30 minutes after arrival that is paramount for LCC's activity (Medvedev 2016b). Nevertheless, Pobeda has quite unusual policy for luggage transportation. Due to Russian legislation, it is possible to convey 10 kg for free and bring on board some items from the list approved by Federal aviation rules. It is not common for LCCs worldwide, where you have to pay almost for everything and therefore make LCCs in Russia much more convenient for customers. However, sometimes it leads to absurd situation, when you can to bring laptop onboard but cannot take a bag for laptop for free. Representatives of Pobeda say that any hand luggage brought on board make people wait in the aisle, while other passengers load their luggage on shelves. It extends the time spent for boarding and therefore the whole time spent in

airport that is crucial for effective scheduled activity of LCCs. Charging a fee, persuade people not to take belongings with them or to convey them as luggage (Medvedev 2016a).

The majority of principles of LCCs were implemented in the business of model of Sky Express. However, it encompasses some elements that are not inherent for budget airlines. In addition, Sky Express allowed their passengers to travel with 15 kg of luggage and carry hand luggage onboard for free that completely washed away revenue for luggage transportation. This was due to existed regulations that obliged all airlines to transport 15 kg of luggage for free. The company also did not charge any fee for different types of payment and therefore did not cover costs relate to processing it. Only 10% of revenue came from additional services (SkyExpress 2010). In addition, it was not allowed to sell non-refundable tickets until 2014, when this law was passed. This led to significant costs.

Avianova also provide additional services that can bring revenue. The share of revenue from additional services comprised only 12% according to CEO of Avianova, Andrew Payne (Attikova 2014). Avianova allows passengers to carry hang luggage on board and 15 kg as luggage. These rules completely diminished potential revenue from luggage transportation. As well as Sky Express, Avianova was not able to sell non-refundable tickets that also led to some costs. In addition, Avianova provided their passengers with food and drinks on-board that slow the time spent in airport. As it was mentioned before, regulation in Russia obliges every aircraft to unload all food and beverages in airport for inspection. These procedures are very time consuming.

Charging fee for any additional service could help to succeed in Russian market and generate significant amount of revenue. However, Russian legal system has strong influence on activity of LCC that should be taken into account, when a company elaborate its strategy.

Relationships

Relationship and corruption have an influence on Russian business to some extent. In respect to airline industry, good relationship with government could help to implement new favorable laws or mitigation of come requirements. As it was described above, Aeroflot facilitated to promotion of deregulation of some aspects of the industry. In addition, it receives some privileges towards utilization of fleets registered abroad. Good relationship with airports lead to discount for airport services. Finally, it could help to receive attractive international destinations. International destinations are limited and a company can receive through a contest. To sum up, relationships and connection plays significant role in Russian airline industry.

Implication of secondary research

Having conducted market research and analyzed the activity of Russian budget airlines, it is possible to summarize results and highlight some features of the market that have the most influence.

- **Macroeconomic situation** is not favorable for low-cost airline.
- **Monopolistic essence** of the market make it difficult to compete; However, the majority of new clients come from substitutes;
- **Airports and infrastructure** are immature; It does not allow to utilize aircraft at maximum capacity. Close collaboration with airports could help in increase of effectiveness of airport services;
- **Legal environment** is “unique” and very restrictive;
- **Government support** is a great advantage that can help to overcome legal, financial and airport related issues;
- **Political situation** could affect international routes.

In addition to mentioned issues, SkyExpress and Avianova had ineffective management and poorly elaborated strategy. Strategy elaboration is crucial and should cover all internal factors with the aim of cost optimization and improvement of asset optimization but it should be adjusted according to country-specific factors.

Based on observation of activity of companies in Russian market, the possible actions could be:

1. New one-type fleet with maximum amount of seats;
2. Multifunctionality of staff and optimized operations;
3. Abandonment of physical assets; Focus on online distribution;
4. High level of outsource
5. Payable additional services
6. Focus on the most profitable destinations and cheaper airports

3.4 Expert interviews

The primary data is the data, collected by the researcher himself. When it is not enough of secondary information to solve the problem or answer the research question, the researcher needs to gather data by using special techniques (Easterby-Smith, Thorpe, and Jackson 2012). The advantage of primary data is that it is tailored for particular research and therefore more reliable. The disadvantage is that primary data collection can be very costly and time-consuming.

In this research, I elaborated non-standardized set of questions with some level of flexibility (see Appendix 2). It follows that there is no one “objective” view to be discovered which the process of interviewing may bias (Easterby-Smith, Thorpe, and Jackson 2012).

The set of question used during the interview was based on the factors revealed during the literature review and with consideration of findings from the first part of this research. Through interviews I intended to find more detailed description of the factors’ impact on low-cost carrier market in Russia. During interviews external factors were primarily considered.

Interviews were conducted with 4 experts of the industry. The experts are:

- Director of the Department of Public Policy in the field of Civil Aviation. Ministry of transportation of Russian Federation;
- Manager of Russian low-cost carrier;
- Representative of low-cost airlines. Domodedovo airport;
- Consultant worked on cost optimization in large airline company. McKinsey & Company.

All interview lasted from 15 to 20 minutes and includes answers on all questions from Appendix 2 and some specifying questions that helped to acquire more detailed understanding of the issue.

Economic situation

Economic situation was named by all interviewees as a restraining factor. Although economic downturn is not considered as unfavorable condition for low-cost carriers (sometimes it even helps to improve LCC’s position through gaining its market share), in Russia it became significant obstacle.

“All lease payments are in foreign currency. Tickets for 1000 rubles cannot cover this payments”

“Being as a part of existing company, low-cost carrier can get significant synergy effect and achieve economy of scale”

Financial crisis in Russia in 2014-2015 led to the devaluation of Russian Rubble. This led to additional difficulties with covering lease and other payments made in foreign currency. In

addition, purchasing power of population has dropped. This reduced passenger traffic to the directions to Europe.

“People travel abroad less, especially in Europe”

“New low-cost company will emerge only if the economy recover”

Competition

Competition also affects the market. Especially, international routes. In order to fly abroad, airline should get commercial rights for implementation this flight. These rights are limited resource. There is a contest for getting these rights and Aeroflot group has an advantage here due to government aid. In the current situation of economic crisis in Russia, this international flights are the most profitable. In that way, the access to the most profitable routes is quite restricted.

“Commercial flights are limited resources. It could be hard to get them.”

“Pobeda focuses on international routes and western part of Russia. Maybe new entrants should focus on eastern part, Urals.”

In domestic market, the main competitors are traditional airlines and substitutes (trains, buses, cars). In current situation of economic downturn, a low-cost carrier can attract new customers from both these segments. If a company choose new destination, it should be sure that load factor will be high. It obliges airlines to fly only to very popular directions.

“If the price for the train ticket is lower, people prefer ground transport mode.”

Airports and infrastructure

All experts mentioned that many regional airports are not ready to serve aircrafts in 30 minutes. The reality that the lack of efficiency and optimization in airports leads to prolonged time spent in airports, up to 1 hour. Even Pobeda spend in some airports more time than it is stated officially. However, as it was mentioned above, Pobeda closely interacts with airports at improvement of efficiency. It entirely involved in process of optimization and even arranged business trips for representatives of airports in order to get acquainted with best practices. These action could be very useful managerial implication in this situation that both helps airline and improve infrastructure.

“Lack of efficiency does not allow to serve an aircraft fast”

“Yes. Collaboration with airports could be very useful action”

In addition, the lack of competition between airports leads to increased tariffs and difficulties to get the best slots in airports. Experts mentioned that huge investments in infrastructure development are not expected due to economic downturn.

“Secondary airports cannot even land Boeing”

“No investments in development of infrastructure are expected in the nearest future”

“High tariffs significantly subside the attractiveness of some destinations. For example, Saint Petersburg’s Pulkovo”

End Customers

The majority of new passengers comes from substitutes such as trains, buses or cars. Budget airlines allow this segment to travel faster but for the same price. However, population in regions does not know all the advantages of budget airlines, considering it as a mean of transport with very poor service. Some people also consider budget airlines with delays and destinations but it is not truth.

“Many people in regions do not know what budget airline is. They think it is an airline with poor service and constant delays or cancellations. Otherwise is true”

“The mentality of Russian people that they do not trust Russian low-cost airlines”

People in Moscow and in Saint Petersburg buy tickets online but the rest of the country prefer to buy tickets in ticket offices. Therefore they do not know what actually low cost carriers provide. Budget airlines simply do not possess ticket offices.

“Online purchases are common in Moscow and Saint Petersburg but people in other cities buy tickets in ticket office.”

“Many people in Russia are very conservative”

“Some of them even do not know that Pobeda exists”

Legal environment

Legal environment was named as one of the main obstacle by all experts. Regulations determine boundaries or rules of the industry. Under the pretext of security, Russian legal system has so many conditions that restrict the development of low-cost carrier market. These restrictions imply additional costs that are crucial point in this issue.

“Luggage for free is impossible for budget airline.”

“So many rules that do not allow industry to flourish”

“At least 8 vessels for a start. No investor is ready to provide such a big amount of money. A budget airline should appear only as part of existing company or instead of it”

“Security is paramount – that’s why there are so many restrictions”

These restrictions both operational costs and investments needed to be made in order to run this business. If we are talking about operational costs, legal environment obliges companies to transport 10 kg of baggage for free or inspect all food and drinks on board in every airport. It slows airport services or does not allow to generate additional revenue. In addition, the minimum amount of planes that company has to have is 8. It is very big obstacle for new entrants, as it requires enormous amount of investments. Moreover, airline could not get any destinations without having of fleet, so these investments should be made in the condition of uncertainty. Too risky for investors. These investments is also increased with the necessity of registration foreign planes in Russia that requires payments of VAT and custom taxes. Without this registration, no aircraft can operate in domestic market.

Government support

Nevertheless, all these obstacles could be omitted by companies with enough level of government support. According to opinions of all expert, the success of Pobeda was partly triggered by Aeroflot and government support. Many of these restrictions were avoided with the help of government. For example, Pobeda started sell tickets in advance, when the company did not have permission for it. In addition, all vessel by Pobeda is registered in Bermuda. However, they operate in domestic market in Russia. Experts mentioned that it is more “political project”, initiative of president of Russia and therefore it received huge advantages.

“Pobeda is a presidential project”

“There are no obstacles for Pobeda”

“Pobeda started selling their tickets before the company appeared. It did not have the right for it.”

Of course, success of Pobeda is determined partly by many other factors, starting from wise management and access to economy of scale. However, all experts mentioned that government support played very significant role in Pobeda’s success. Being as a part of Aeroflot, Pobeda has access to many advantages. As we can see it through many examples in this paper, government support helped Pobeda to avoid many legal restrictions, to get attractive international flights or

achieve better communication with airports. Again, experts mentioned that it is more “political project”, initiative of president of Russia and therefore it received huge advantages.

Implications of primary research

Primary interview explained the effect of mentioned factors clearer. Findings show new results as well as support results from the first part of research:

- Today the **economic situation** for budget airlines is **quite unattractive**. The emergence of new low-cost carrier can be expected only when the economy recover;
- **Highly limitative legal environment;**
- Due to high entry barriers, new budget airlines preferably **should be established as a part of existing company** under the new brand or **on a base of existing company;**
- **Poor awareness** of advantages of budget airlines among population. The company should emphasize on it;
- **Close collaboration with airports** and their **participation in process optimization** could significantly improve airport services;
- **Government support** provide with enormous advantage.

3.5 Discussion

This paper is devoted to the examination of low-cost carrier market in Russia and reasons of its inadequacy. Research encompasses determination of the main factors affecting the market of LCC in Russia, understanding of how they influence it and suggestion of actions for new entrants in this market.

The research started with **literature review**, which gives is the understanding of the classic low-cost carrier model and major factors that potentially can affect the market in Russia. Then, these factors checked with two researches.

The first part of the research is exploration the effect of internal and external factors affecting the market using secondary data. Investigation of external factors includes exploration of macro-external environment and all participants of the market. Internal environment is going to be investigated on the base of studying the activity of Russian LCC and through comparison of it with Ryanair’s activity.

The second part of the research includes primary interviews with experts of the industry. The semi-structured interviews are based on the. The interview reveals to what extend these factors influence the industry and helps to understand how potential new entrants should behave.

If the first part gives us full picture of the current situation in the market and how activities on Russian market differ from classic low-cost carrier model, the second part helped us to ascertain and adjust, which factors has the major impact, and support results from the first part. There was no huge differences or contradictions in results between secondary and primary research. However, interviews highlighted the most important aspects of the market from experts' point of view and pinpointed the weakest points where recommendations could be applied.

Aggregated the information from both parts, it is possible to answer the stated questions.

What are country-specific factors influencing low-cost carrier market in Russia?

During the study, following country-specific factors affecting the market of budget airlines were revealed:

- Highly limitative legal environment
- Adverse economic situation
- Government support or close relationships with government and airports
- Immaturity of infrastructure and weak airport services
- Poorly informed population about advantages of LCC
- Managerial issues

How do defined country-specific factors influence the market?

Highly limitative legal environment

During both secondary and primary research, experts mentioned that this factor is the most influencing. Legal environment determine the boundaries of the industry, therefore, in any ways, companies have to take into account. There are still some restrictions, which are unusual for worldwide industry; Russia is a “unique” country to some extent. These legal restrictions significantly hinder the development of the market of budget airlines including additional investments, higher operational costs and lost revenue.

Adverse economic situation

Both secondary data and information collected from interviews unveiled adverse effect of current economic situation. For the Russian civil aviation in 2014 and 2015 became difficult. The industry observed significant decline in passenger turnover against the background of slowing macroeconomic fundamentals. Although economic downturn is not considered as unfavorable condition for low-cost carriers (sometimes it even helps to improve LCC's position), in Russia it became significant obstacle. All lease payments are in foreign currency. Financial crisis in Russia

in 2014-2015 led to the devaluation of Russian Rubble. This led to additional difficulties with covering lease and other payments made in foreign currency. In addition, purchasing power of population has dropped. This reduced passenger traffic to some profitable directions to Europe or other countries. Foreign companies exit Russian market in prevailing amount primarily due to decreasing purchasing power of Russian Rubble, reduced income of customers at this market and tough political situation.

Government support or close relationships with government and airports

This factor was also supported by experts of the industry during primary interviews. Relationship with government or airports are crucial factor in Russia as it can help the company to save costs in some cases or get different advantages. Government support helps to avoid some legal, financial and airport related restrictions. Aeroflot group could even accelerate the adoption of several laws that made the life of LCC easier. Good connections with airport could provide low-cost carrier with significant advantage both in services and airports fees. Government support also helps in issues of competition for commercial rights for international flights.

Immaturity of infrastructure and weak airport services

All experts in interview supported the results found during the secondary research concerning immaturity of infrastructure. Today's infrastructure of airport significantly affect budget airline industry. It is still significant restriction for the development of the industry. Some airports provides slow and inefficient services for aircrafts that is unacceptable for budget airlines. High airport fares and absence of secondary airports also slow the development of industry.

Poorly informed population about advantages of LCC

It was not obvious during secondary research, but experts in interviews mentioned this problem - public awareness of advantages of budget airlines. Population do not know that in some cases budget airline can provide more than traditional airline – punctuality of flights and cheap tickets. People that are not from Moscow or Saint Petersburg suppose that budget airlines do not follow the schedule and the probability of delays or cancellations are high. However, the opposite is true.

Quality of providing services is important but not as much as other factors that affect profitability directly. Customer service can influence customer satisfaction. Nevertheless, customers are ready to spend one or two hours with less comfort but save decent amount of money and spend them for other purposes. They are not well informed about advantages of it. However, delays and cancellations play great role in customer's attitude. The failure of Avianova and SkyExpress led

to the fact that population consider budget airlines as companies that are not punctual. In average, customers are not ready to use services of LCC after experienced cancellation of flights. Thereby this factor is very important.

Managerial issues

Managerial issues primarily address to internal factors. Internal factors are not country-specific factors but needed to be considered anyways. Avianova and Sky Express failed partly due to lack of effective management and well-detailed strategy. These factors directly influence the activity of low-cost carrier. Strategy elaboration is crucial and should cover all internal factors with the aim of cost optimization and improvement of asset optimization but it should be adjusted according to country-specific factors.

How can new entrants benefit from defined country-specific factors in formulation of entry strategy?

There are three changeable and three non-changeable factors from the defined list of country-specific factors. The assumption for the third questions is that highly limitative legal environment, adverse economic situation and government support cannot be changed by new entrants without huge support. As new entrants imply any company that potentially wants to enter the market, it is necessary to take into account this assumption. In this way, we have to focus on changeable factors and adaptation to non-changeable factors. The defined country-specific factors mentioned above determine new rules of how LCCs have to behave in market. In order to succeed in market, low-cost carrier should try to adapt their business model to these factors but also minimize negative effect from them and exploit maximum benefit from them.

As immaturity of infrastructure and weak airport services were named as one of the restraining factor during both secondary and primary research, actions for improvement of the situation should be implemented. Close collaboration with airport was mentioned as an effective way of decreasing the time spent in airports. It will help to improve airport service that, in turn, will lead to increased effectiveness of fleet utilization. Optimization of processes is a crucial point. Achieving high optimization of processes entails assets effectiveness that can help to succeed in the market.

Today, economic situation is not so favorable for low-cost carrier activity. However, it is a great opportunity to gain market share in short terms. Experts stated in conducted interviews that new company should be established as a part of existing company but under a new brand in order to differentiate itself or on the base of existing company instead of it. Economy of scale and synergy effect could be achieved and help in margin improvements and asset effectiveness.

Experts of industry declared that population is not informed well about the advantages of low-cost carriers. Biased perception of its services leads to inadequate load factor. Emphasis on improvement of public awareness of advantages of LCC is a must.

Finally, strategy elaboration is crucial and should cover all internal factors with the aim of cost optimization and improvement of asset optimization but it should be adjusted according to country-specific factors.

3.6 Managerial implication

This research demonstrates factors that restrict low-cost carrier market in Russia. These factors determine the boundaries of the industry and behavior of key and potential players in the industry. Information revealed in this research could significantly help in understanding the current situation of the market and in strategy elaboration.

The main goal of LCC is to set lower fares through low costs. Internal factors definitely should be taken into account as they directly affect profitability of airline. Mainly the strategy should follow classic low-cost strategy but with country-specific adjustments. To succeed in market, low-cost carrier should try to adapt their business model to these factors but also minimize negative effect from them and exploit maximum benefit from them.

In addition to mentioned results, entry strategy should focus on maximum asset effectiveness and cost optimization. It includes mainly pieces of classic low-cost carriers. Based on information gained through secondary data and primary research, it is possible to determine the list of recommendations or principles that should be followed in Russian market:

- New one-type fleet with maximum amount of seats;
- Multifunctionality of staff and optimized operations;
- Abandonment of physical assets; Focus on online distribution;
- High level of outsource
- Payable additional services
- Focus on the most profitable destinations and cheaper airports

3.7 Suggestions for further research

As it was revealed during the research low-cost market in Russia is very dynamic and has high potential for growth. However, the restraining factors has an enormous influence on the market. More detailed investigation of them could be very useful and relevant for investigation and understanding key obstacles of development of the market. Under these circumstances, I consider future researches in the following directions:

- Development of airports in Russia.
- Optimization of airport services;
- Influence of LCC's activity on the market players, monopolistic essence in Russia;
- Customers' attitude to LCC.

Conclusion

This paper focuses on the investigation of country-specific factors influencing low-cost carrier market in Russia. The research includes literature review concerning the given topic, market research using secondary research and investigation of opinions of industry experts. Main peculiarities and factors of the market were described. Recommendations for new entrants were elaborated.

The current situation is not very favorable for the development of low-cost carrier market in Russia. Current economic situation coupled with restrictive legal environment and immaturity of infrastructure significantly prevents the growth in the industry. Revealed factors make it quite difficult to be profitable low-cost company and still set low prices for attracting customers. Legal environment needs some transformation and deregulation for future prosperity of the industry. Infrastructure requires huge investments. In addition, population is not ready for emergence of budget airlines to some extent. Conservatism, adherence of traditions or simple inadequate spreading of information lead to the fact that population chooses another type of transportation.

However, the industry is developing and the emergence of Pobeda made first steps for improving the situation. In particular, Pobeda facilitated in adoption of some laws mitigating the boundaries for low-cost carrier activities. In addition, other airline companies can also improve the situation with the focus of their actions on improvement airport services through close collaboration or changing the image of budget airlines.

Besides, new entrants should be very careful in strategy elaboration. Maximization of profitability and asset effectiveness are two major principles of classic low-cost model that should be taken into consideration in every aspect of activity. However, former Russian airlines (Avianova and SkyExpress) did not adhere them.

Appendix 1

	Pobeda	Dobrolyet	SkyExpress	Avianova	Ryanair
Fleet size	12	2	10	6	345
Homogeneity of fleet	one type	one type	3 types	one type	one type
Type	Boeing 737-800	Boeing 737-800	Boeing 737-300/ Boeing 737-500 / Airbus A-319	Airbus A320-232	Boeing 737-800
Age	1,5	1	19	10	6,5
Number of seats	189	189	132-148	170	189
Country of registration	Bermudas	Bermudas	Russia	Ireland	Ireland
Utilization time	12-16 hours	12-14 hours	8 hours	12 hours	12-16 hours
Turnaround time	25-35 minutes	30-40 minutes	1 hour	1 hour	25-30 minutes
Punctuality	0,81%	1,65%	17%	12%	2%
Fuel consumption	Effective + Discounts due to large amounts bought together with Aeroflot	Effective + Discounts due to large amounts bought together with Aeroflot	Less effective/No discount	Less effective/No discount	Effective + Economy of scale
Maintenance & Insurance	New fleet allows to spend less	New fleet allows to spend less	More spending on maintenance/frequent breakdowns	More spending on maintenance/frequent breakdowns	New fleet allows to spend less
Personnel	Multifunctionality	Multifunctionality	Multifunctionality	Multifunctionality	Multifunctionality
Distribution channels	Primarily On-line	Primarily On-line	Primarily On-line	On-line. Offices	Primarily On-line
Cheapest ticket	999 Rub	999 Rub	500 Rub	250 Rub	1 £
Yield Management	Yes	Yes	Yes	Yes	Yes
Destinations	Majority flights are from Moscow. Developed network of regional flights	All flights are from Moscow	All flights are from Moscow	Majority flights are from Moscow. Developed network of regional flights	Developed network
Airport fees	Use all airports / Lower fees due to connections	Use the cheapest airports / Lower fees due to connections	Use all airports	Use all airports	Use the cheapest airports / Ryanair owns some airports
Luggage	10 kg free / no hand luggage allowed	10 kg free / no hand luggage allowed	15 kg / hand luggage allowed	15 kg / hand luggage allowed	Hand luggage allowed
Seat selection	Paid	Paid	Paid	Paid	Paid
Priority boarding	Paid	Paid	-	-	Paid
Non-refundable tickets	Yes	Yes	No	No	Yes
Different types of payments	Paid	Paid	Free	Paid	Paid
Catering	No catering	No catering	No catering	Catering	Catering
Entertainments	No	No	No	No	Paid
Share of revenue	40%	-	10%	12%	25%

Appendix 2

Question for interview

1. A key element of successful performance of LCC is the presence of a consistently high passenger traffic. In accordance with this statement whether you think that there is a demand for low cost air travel in Russia?

Your answer:

Is there a negative attitude towards budget airlines from the population in Russia? Is the population informed enough about the advantages of low cost airlines?

Your answer:

2. Implementation of low fares policy is possible due to a substantial reduction in costs. Airport fees are a significant item of expenses in the activity of airlines, while appropriate infrastructure and effective services at airports allow the use of an aircraft as efficiently as possible. Do regional airports provide fast and efficient service of aircraft that is so necessary for the success of the low-cost airlines?

Your answer:

The lack of competition among airports and a modest passenger traffic lead to inflated rates in some airports. Is it a significant obstacle for the development of low-cost airlines?

Your answer:

Does the good relationship with the management of airports have a significant impact on these factors?

Your answer:

3. Do you agree that prices for aviation fuel in Russia is quite high and it substantially prevents the emergence of new low-cost airlines?

Your answer:

4. The legal environment defines the rules that must be followed by airlines that leads to additional costs. Do you agree that the current legal environment greatly restrict the development of low-cost carrier market in Russia?

Your answer:

Can airlines influence the changes of the Air Code?

Your answer:

5. Does the current political situation have an impact on the international flights (for example, the difficulty of obtaining permits to carry out international flights)?

Your answer:

6. How would you assess the probability of the emergence of another budget airline in the Russian market? Why?

Your answer:

7. What is the key factor hindering the development of low-cost airlines market in Russia?

Your answer:

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