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陽春服務商業模式之研究

A Study of No-frills Business Models



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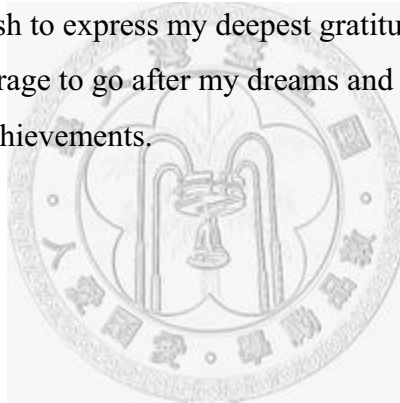
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# Abstract

In the contemporary business world, there is an interesting yet unconventional form of business that has developed in the past decade: the emergence of no-frills services. More and more businesses are trying to escape the red ocean and enter into the blue ocean using the no-frills notion in order to capture the previously untouched market. It is believed that as the society morphs into the M-shape as described by Kenichi Ohmae, many businesses had to innovate new ways of conducting business in order to survive, and the notion of no-frills is one of them.

Many different no-frills business models are examined in the thesis, some in the same industry while others are not. Seven categories of businesses are covered, all manifestation of the no-frills businesses in their own ways. Each of them is carefully examined and studied, with the common themes within each categories summarized. The categories include supermarkets (Save-a-lot and ALDI), transportations (RyanAir and Megabus), fashion and living (H&M and IKEA), electronics (ASUS), rental spaces (EasyOffice and Cubic Boxes), hospitality (Cubic, EasyHotel, and Tune Hotels), internet cafes (EasyInternetCafe), and telecommunications. Three failed no-frills business are also studied, which includes two no-frills airlines and a no-frills cinemas.

It is found that the common themes among all the businesses operate on are minimizing costs and maximizing utilization in order to pursue the price leadership strategy. Further observations are made on RyanAir and IKEA to determine the success factors and the sustainability of their successes. The question is not about how low the prices are, but rather what matters to the consumers most, and how the competitive advantages can be achieved and sustained. A generic framework has been developed in the end of this thesis from a strategic point of view to finalize on the concept of utilizing the notion of no-frills in future businesses.

**Keywords: No-frills, Services innovation, Price leadership, Yield management, M-Shape society, Razor-and-Blade strategy**

## 摘要

在社會逐漸走向 M 型化之時，越來越多的企業透過非傳統的創新商業模式，尋找並滿足先前尚未被發現的新市場族群。而當“新奢華風”被大眾廣泛積極探討的同時，光譜的另一端有著另一種商業模式正悄悄的在醞釀著：其商業模式就是“陽春服務”，英文名詞則稱之為“*No-frills Services*”。

本論文所探討的就是在不同的行業中，各家公司及企業如何利用“陽春服務”的精簡化概念來營運，並滿足消費者的需求及期望。此論文將以客觀的角度來探討七種不同商業領域中的企業及商業模式，其中包括超市(*Save-a-Lot* 及 *ALDI*)、運輸(*RyanAir* 及 *Megabus*)、流行生活(*H&M* 及 *IKEA*)、租賃空間(*EasyOffice* 及 格子鋪)、旅館(*Cubic*、*EasyHotel* 及 *Tune Hotels*)、網咖(*EasyInternetCafe*)、以及電信業。此論文也將提檢三個失敗的例子，分別有兩個是航空公司和一個電影院。

研究中之陽春服務業者的共同點是：盡可能的將成本降到最低，或將利用率增加到最大值，以追求成為該業界中的價格領袖。透過成功典範 *RyanAir* 及 *IKEA* 做深入的探討以及分析，本論文的結論則是“陽春服務”最後的成功關鍵並非取決於價格上之優勢，而是如何找出消費者真正的需求，並將其體驗與品牌成功的做一個連結。

關鍵字：陽春服務、服務創新、價格領袖、收益管理、M 型社會、刮鬍刀片策略

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# Chapter 1 – Introduction

## 1.1 Motivation of Study

For the past decade, there's an interesting yet unconventional trend of business developing in the business world: The emergence of the so-called “no-frills” services and products. In the past, the majority of the businesses have been adding features to their existing products and services, hoping to make the consumers develop the ‘bang-for-the-buck’ feeling that somehow we are paying to get something extra. However, this has been going in the reverse direction; more and more businesses are actually taking away the extra features and going ‘back-to-the-basics’. Why is this taking place and what is the indication?

No-frills is the term used to describe services or products for which the non-essential features have been removed<sup>1</sup>, mainly to save on costs which would later be reflected on the price which the consumer pays. An example is free drinks on airline journeys. Common products and services for which no-frills brands exist include airlines, supermarkets, traveling and automobiles. The obvious principle that these business models operate on is “take away the frills, and you get lower prices.” According an estimate conducted by a no-frills supermarket, Save-A-Lot, value-oriented shoppers represent 44% of the U.S. population, equating to a potential customer base of 120 million people<sup>2</sup>, which further strengthens the importance and potential of this market segment.

In this thesis, I would mainly like to focus on the no-frills services. In today's society, the private non-good producing industries account for approximately 70% of

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<sup>1</sup> Definition of No-frills from Wikipedia.org

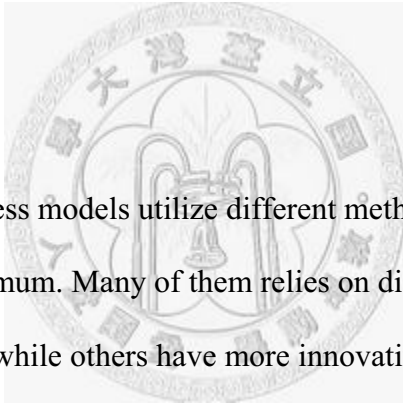
<sup>2</sup> Statistics from Save-A-Lot website



total economic activity in the United States. These non-good producing industries include retail trade, wholesale trade, and the service industries. The services industries account for 55% of economic activity in the U.S. As we can see, services industries are becoming an increasingly important part of our society as developed economies.<sup>3</sup>

This study will look particularly at several no-frills business models, which are transforming the services industry as you are reading this paper. Reasons for the developments of no-frills businesses will also be discussed briefly. Hopefully this study will provide some insights for businesses of concern on whether no-frills is applicable to their relative fields.

## 1.2 Research Objectives



Various no-frills business models utilize different methodologies of cutting the costs down to the bare minimum. Many of them relies on distributing the cost by maximizing the utilization, while others have more innovative ways to capture the consumers through disguised pricing mechanisms. I will try to look into some of these business models in this thesis.

In this study, the aim is to explore in details on the many businesses which revolve around the idea of no-frills. The thesis will attempt to answer and induce further discussions on the following subjects:

- What are the forces that drove the development of such business concepts?
- What are the types of insinuations associated with the emergence of no-frills businesses?

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<sup>3</sup> Statistics from 2006 U.S. Census Bureau

- What is services innovation? How is the no-frills model related to services innovation?
- What sort of businesses utilizes the no-frills concept?
- What are the typical characteristics in each no-frills business models?
- What are the common themes involved in these no-frills businesses?
- What makes a no-frills business successful or unsuccessful?

### **1.3 Research Methodology**

This thesis will take a qualitative approach on analyzing the recent trend of businesses. Starting in section 2.1 of the thesis, I will review the concepts of M-shape society in an effort to understand why and how the no-frills business models were developed in the first place. In section 2.2, service innovation will be covered and linkages between no-frills businesses and service innovation will be made. Section 2.3 to 2.5 covers Michael Porter's value chain, the razor-and-blade strategy, and yield management. These are the basic notions and theories in which the no-frills businesses operate upon, and will give us a better understanding of the basis of its mentality.

In chapter 3, this analysis will take a close look at the different businesses and the business models that have been developed under the no-frills notion. Chapter 4 focuses on the similarities between the various businesses. Success factors are identified in section 4.1 through examination of the failed business models. Section 4.2 explains the importance of strategy on customer loyalty, and finally the thesis is concluded with a generic strategic framework in section 4.3.

## Chapter 2 - Literature Review

### 2.1 M-shape Society

Brought up by Kenichi Ohmae, the M-Shape society is a term used to describe the social composition of the society in Japan recently. Basically it means that under the globalization trend, the rich people are using it as a stepping stone to become even richer and wealthier; on the other hand, after the redistribution of wealth, the middle class is suddenly losing their competitiveness and turning into the middle-lower class. After the redistribution, the middle class is suddenly joining either the richer or the poorer, forming a gap in the middle class. Please refer to Figure 1 for a graphical representation.

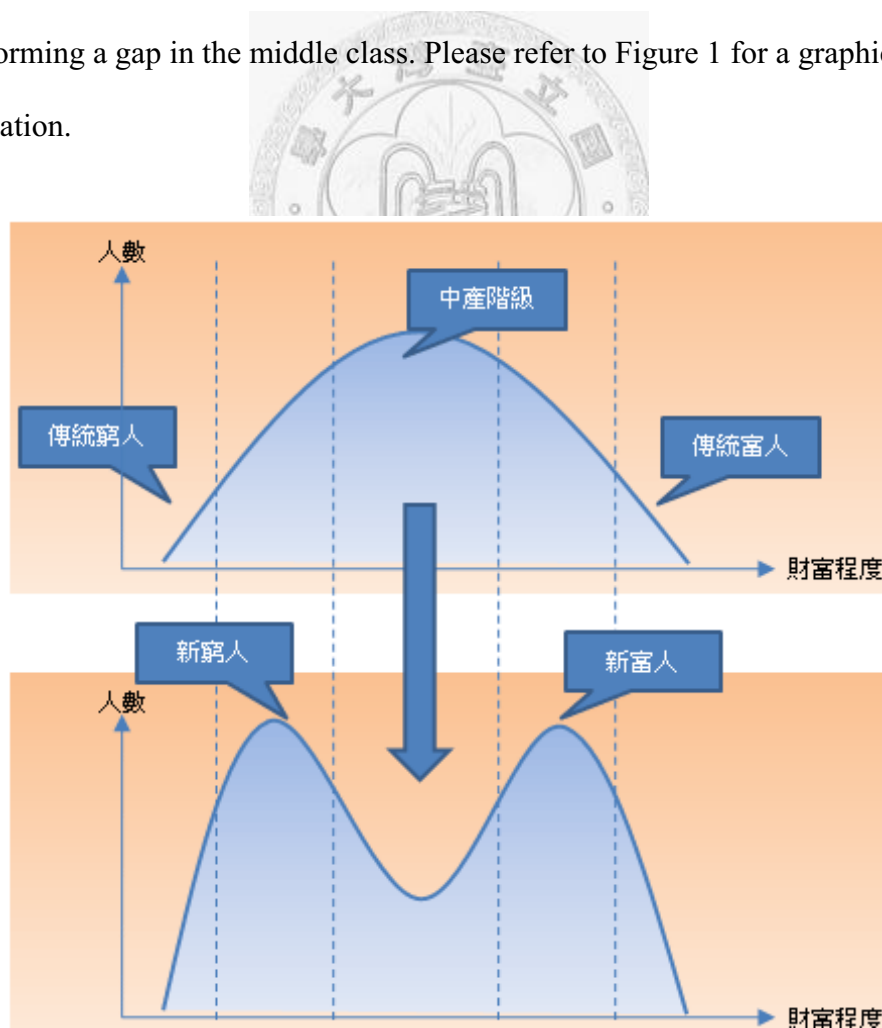


Figure 1. Transformation of Taiwanese society. Taiwan is turning from an inverted U into the M-shape according to scholars. (Source: DigitalWall.com)

Kenichi Ohmae studied the Japanese society for the past 20 years and came up with the theory. In his theory, he explained that only a small portion of the middle class is able to increase its estate and join the rich, while most of the others turn into the poorer class. This makes the distribution into a shape of an 'M' instead of the inverted 'U' which is believed to be the most stable shape for a developed society.

According to Ohmae's statistical analysis, 80% of the Japanese population has joined the middle/low income bracket in the year 2006. The way he determines whether or not one falls into this bracket is by asking three questions. If one answers yes to any of the three questions, one falls into that category: 1) Is your mortgage giving you a lot of pressure? Or you simply don't think you can afford to buy a house? 2) Do you plan to have children? Or you simply don't even want to get married due to possible financial pressures? 3) Are you worried about your children's tuition in the future?<sup>4</sup>

Under this new M-shaped society, if the enterprises and the individuals do not try to change their behaviors and with the government continuing to lead in the wrong directions, the unemployment rate and the price index will continue to rise year after year. According to statistics, M-shaped society is not only a phenomenon in Japan, but has also been taking place in the US. The same phenomenon is starting to emerge in China and Taiwan as well.

As the rich get richer and the poor get poorer, this force is definitely driving enterprises to develop new business models in order to capture the new market that has been formed. In order to capture the new social class, services must be affordable yet reasonable, and thus businesses have been formed under the no-frills mentality. Recent developments include the McFashion inclination. Taking the prefix of 'Mc' from McDonald's, it holds the meaning of fast, reasonable, and affordable fashion. The three

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<sup>4</sup> The questions are from Ohmae's book, "The M-Shape Society", 2006

companies that are most often discussed include H&M, Zara, and Ikea. In the transportation industry, we see the rise of the low-fare airlines and low-fare buses such as RyanAir and Megabus. We also see many other businesses booming by taking this opportunity as the society evolves into the M-shape.

In other words, if the corporations do not try to innovate new ways of conducting businesses, they will become obsolete and be replaced. If one is stuck in the middle, one is destined to go under. As we can see, the ability to adapt to changes is extremely important. Companies need to develop and innovate new ways of conducting everyday activities to better serve the consumers. That leads us to the next question: what is Service Innovation?

## 2.2 Service Innovation



In a March issue of Business Week, Service Innovation is described as “The Next Big Thing.” A non-profit organization called the Service Research & Innovation (SRI) Initiative was founded by executives at IBM and Oracle which focuses on service innovations instead of product innovations. Although the term is not yet popular in academic and professional fields, its concept is not new at all. Jim Spohrer, director of service research at IBM's Almaden Research Center claims that “people don't tend to think of the related service innovations—getting light bulbs into houses and schools, setting prices for the electricity services to keep them lit. That's all service innovation,”<sup>5</sup> he argues. More recent examples, though most people wouldn't think of them under the phrase, are outsourcing and the shift toward self-service.

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<sup>5</sup> Quote from BusinessWeek article in March 2007 issue

“Consumers’ increasingly higher expectations demand business models in which services are seen as added value to products from cars to personal electronics to clothing,” says Jeneanne Rae, president of Peer Insight, a service-innovation research firm based in Alexandria, Virginia.

So it's not just technology companies that can benefit from service innovation. At the recent Service Innovation Design & Development conference in San Diego, Rae presented a chart of the revenues of top non-energy firms in the U.S., from Wal-Mart to General Electric. On average, in 2005, the 10 companies Peer Insight analyzed saw 65% of 2005 revenues from services. Moreover, those companies saw an astounding 85% of 2005 profits from services, according to Rae's proprietary research.

Different from technological innovations, service innovation involves a broader view and depth of the product that is involved. While technological innovations may mostly be associated with new products with new features, looks, capabilities, service innovation is usually referred to services, services processes, and or service firms. According to the definition defined by TEKES, a Finland research agency, service innovation is “... a new or significantly improved service concept that is taken into practice. It can be for example a new customer interaction channel, a distribution system or a technological concept or a combination of them. A service innovation always includes replicable elements that can be identified and systematically reproduced in other cases or environments. The replicable element can be the service outcome or the service process as such or a part of them. A service innovation benefits both the service producer and customers and it improves its developer’s competitive edge. ...A service innovation is a service product or service process that is based on some technology or systematic method. In services however, the innovation does not necessarily relate to the novelty of the technology itself but the innovation often lies in the non-technological

areas. Service innovations can for instance be new solutions in the customer interface, new distribution methods, and novel application of technology in the service process, new forms of operation with the supply chain or new ways to organize and manage services.”<sup>6</sup>

Most of the literatures involved on what makes services innovations successful are described in the New Service Development research field (Nijssen et al, 2006).

Innovation researchers have stressed that much service innovation is hard to capture in traditional categories like product or process innovation.

In an article titled ‘Creating New Markets through Service Innovation’ written by Berry, Shankar, Parish, Cadwallader, and Dotzel (2006), service innovation can generally be broken down into four segments, which includes flexible solutions, controllable convenience, comfortable gains, and respectful access. This can be depicted on a grid depending on the type of service (whether it is separable or inseparable from the product) and the type of benefit (whether it is core or delivery associated).

In a similar study conducted by den Hertog in 2002, he claimed that there are four dimensions in which service innovation is different from standard innovation theories. The four dimensions are as follows:

1. The Service Concept: refers to a service concept that is new to its particular market – a new service in effect, or in Edvardsson’s in his 1997 and 1998 terminology, a “new value proposition”. Many service innovations involve fairly intangible characteristics of the service, and others involve new ways of organizing solutions to problems. Examples might include new types of bank account or information service. In some service sectors, such as retail, there is much talk about

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<sup>6</sup> Definition of Services Innovation by TEKES, a Finland research agency

“formats”, such as the organization of shops in different ways (more or less specialized, more or less focused on quality or cost-saving, etc.).

2. The Client Interface: refers to innovation in the interface between the service provider and its customers. Clients are often highly involved in service production, and changes in the way in which they play their roles and are related to suppliers can be major innovations for many services. Examples might include the greater involvement of self-service for clients visiting service organisations. There is a French literature on service innovation that focuses especially on this type of innovation, identifying it as innovation in “servuction”.
3. The Service Delivery System: also often relates to the linkage between the service provider and its client, since delivery does involve an interaction across this interface. But there are also internal organisational arrangements that relate to the ways in which service workers perform their job so as to deliver the critical services. Much innovation concerns the electronic delivery of services, but we can also think of, for instance, transport and packaging innovations (e.g. pizza delivery). An emerging concept of SDP is the idea of taking a "factory" approach to Service Innovation. A "service factory" approach— is a standardized and industrialized environment for more effective service innovation, development and operations for the IP era.
4. Technological Options: these most resemble familiar process innovation in manufacturing sectors. New IT is especially important to services, since it allows for greater efficiency and effectiveness in the information-processing elements that are, as we have seen, prevalent to a great extent in services sectors. We also often see physical products accompanying services, such as customer loyalty cards and “smart” RFID cards for transactions, and a wide range of devices for



communication services.

Apparently most service innovation is a combination of these four dimensions instead of just one.

It is quite obvious that most of the service firms and processes are quite different compared to manufacturing and manufacturers in terms of their characteristics. Miles once listed a series of characteristics of services, and associated these characteristics with various types of innovation (Miles, 1993). In the following section, let's take a closer look at how some of the services features are connected to strategic innovations written by Miles.

**Table 1. Features of services associated with service production**

|   |   |
|---|---|
| Technology and Plant (Low levels of capital equipment; heavy investment in buildings)   | Reduce costs of buildings by use of teleservices, toll-free phone numbers, etc.   |
| Labour (Some services highly professional (esp. requiring interpersonal skills); others relatively unskilled, often involving casual or part-time labour. Specialist knowledge may be important, but rarely technological skills (other than Information Technology)) | Reduce reliance on expensive and scarce skills by use of expert systems and related innovations; Relocation of key operations to areas of low labour costs (using telecommunications to maintain coordination)  |
| Organisation of Labour Process (Workforce often engaged in craft-like production with limited management control of details of work.  | Use IT to monitor workforce (e.g. tachometers and mobile communications for transport staff; Aim for 'flatter' organisational structures, with data from field and front-office workers directly entering databases and thence Management Information Systems.) |
| Features of Production (Production is often non-continuous and economies of scale are limited.  | Standardise production (e.g. 'fast-food' chains), reorganise in more assembly-line-like feature with more standard components and higher division of labour.)   |
| Organisation of Industry (Some services state-run public services; Others often small-scale with high preponderance of family firms and self-employed.  | Externalisation and privatisation of public services; combination of small firms using network technologies; IT-based service management systems.)  |

(Source: Ian Mile's article "Services in the New Industrial Economy" in Futures Magazine, 1993)

**Table 2. Features of services associated with service product**

|  |  |
|--|--|
| Nature of Product (Immaterial, often information-intensive; Hard to store or transport; Process and product hard to distinguish. | Add material components (e.g. client cards, membership cards). Use telematics for ordering, reservation, and if possible - delivery. Maintain elements of familiar 'user-interfaces'.) |
| Features of Product (Often customised to consumer requirements.  | Use of Electronic Data Interchange or Internet for remote input of client details; use software to record client requirements and match to service product.                            |

(Source: Ian Mile's article "Services in the New Industrial Economy" in Futures Magazine, 1993)

**Table 3. Features of services associated with services consumption**

|   |   |
|---|---|
| Delivery of Product (Production and consumption coterminuous in time and space; often client or supplier has to move to meet the other party. | Telematics; Automated Teller Machines and equivalent information services.)   |
| Role of Consumer (Services are consumer-intensive, requiring inputs from consumer into design/production process.                             | Consumer use of standardised menus and new modes of delivering orders.)   |
| Organisation of Consumption (Often hard to separate production from consumption; Self-service in formal and informal economies commonplace.   | Increased use of self-service, utilising existing consumer (or intermediate producer) technology - e.g. telephones, PCs - and user-friendly software interfaces.) |

(Source: Ian Mile's article "Services in the New Industrial Economy" in Futures Magazine, 1993)

**Table 4. Features of services associated with services markets**

|  |   |
|--|---|
| Organisation of Markets (Some services delivered via public sector bureaucratic provision; Some costs are invisibly bundled with goods (e.g. retail sector). | Introduction of quasi-markets and/or privatisation of services; New modes of charging (pay per society), new reservation systems; more volatility in pricing using features of EPOS and related systems.) |
| Regulation (Professional regulation common in some services.   | Use of databases by regulatory institutions and service providers to supply and examine performance indicators and diagnostic evidence.)  |
| Marketing - Difficult to demonstrate products in advance   | Guarantees; demonstration packages (e.g. demo software, shareware, trial periods of use).   |

(Source: Ian Mile's article "Services in the New Industrial Economy" in Futures Magazine, 1993)

In addition, there are a number of more general tendencies involved in service innovation processes, which are:

1. The industrialization of services, involving efforts to standardize services, to yield service products of predictable characteristics and quality, with economies of scale and improved delivery times. This typically involves the introduction of high levels of division of labor, with the use of pre-packaged and automated elements (such as pre-prepared meals, word processed templates for form letters, and the like).

Standardization of the service products has become a competitive strategy for many firms.

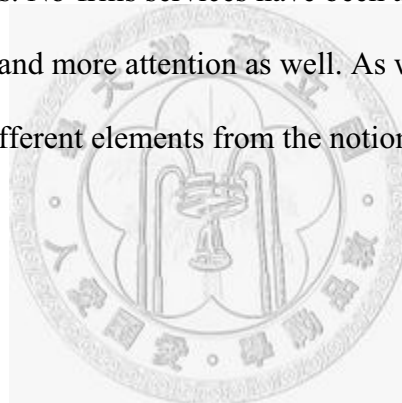
2. Organizational innovation - Survey data suggest that services place particular emphasis on organisational change. Many important innovations in services involve combinations of specific new technologies together with organization change. The role of organizational innovations in services is very apparent - developments such as supermarkets and other self-service facilities are extremely significant in the development of modern service industries. Such organizational innovations will often have a technological dimension, whether this be very basic (e.g. shopping trolleys), or relatively high-tech (EPOS - electronic point of sale - equipment or ATMs linked into networks).

3. An important trajectory of organizational change has been towards self-servicing, without necessarily following this development all the way toward the vision of the client sitting at home interacting with the service provider via a remote terminal. Instead, reorganization of the facilities of the service provider permits customer self-service in the service establishment, saving on labour costs and often increasing user satisfaction as its is possible to make decisions anonymously and at one's own

pace.

4. Beyond self-servicing, the involvement of clients as coproducers, is particularly important for knowledge-intensive business services, with the emphasis being laid upon clients' role in advancing the expertise of service suppliers, and identifying new avenues for its application. Web2.0 has brought “user innovation” to the fore in electronic services.<sup>7</sup>

As we can see, service innovation has already been a subject of study in recent years, and it is at the same time gaining more and more attention from both the academic society and the professionals. No-frills services have been around for awhile now, and are definitely gaining more and more attention as well. As we can see later on in this thesis, no-frills combines different elements from the notions mentioned above.



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<sup>7</sup> From Wikipedia.org

## 2.3 Porter's Value Chain

The value chain is a concept from business management that was first described and popularized by Michael Porter in 1985. Products and services pass through all the activities on the chain and at each activity the product gains some value. The concept is that by going through the chain of activities, the product or service obtains more added value than the summation of all the activities (Porter, 1985).

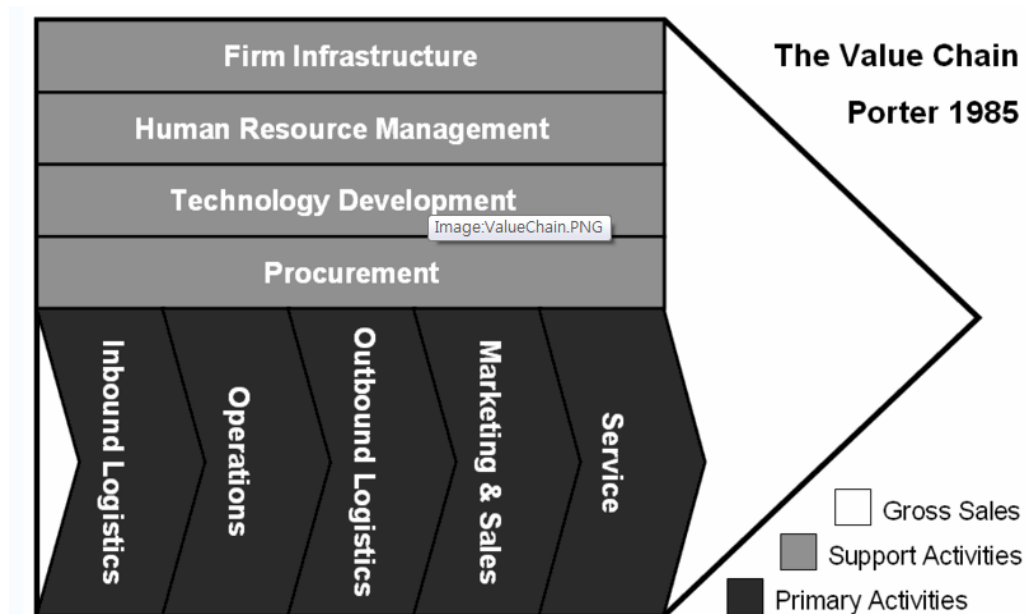


Figure 2. Porter's value chain. (Source: Wikipedia.org)

The value chain divides the activities into two groups: primary activity and support activities. Inbound logistics, operations, outbound logistics, marketing & sales, and services are considered to be primary activities, while firm administrative infrastructure management, human resources, information technology and procurement belongs to the support activities. The ultimate goal of value chain is to maximize value creation while minimizing costs, which is exactly what the no-frills business models are trying to achieve.

Most no-frills businesses have a 'back-to-basics' mentality. The single most important question that they are asking is: What do consumers really want? Given that the costs of raw materials are on the rise and the consumers are becoming more and more price sensitive, the no-frills businesses are reexamining their business operations and eliminating the frills. As mentioned earlier, the M-shape society is forcing a lot of the middle class into the low income bracket. This implies that these consumers are willing to sacrifice the extra and unnecessary toppings to satisfy their basic needs. These business managers know very well of the concept of value chain, thus eliminating the unnecessary activities which are incurring more costs and increasing the burdens for the consumers.

Currently more and more experts are trying to capture the values generated along the value chain, such as Dell demanding its suppliers to locate the warehouses around its assembly factory. Another example may be firms trying to bypass intermediaries by taking advantages of the information flow from upstream to downstream.

In sum, Porter's value chain is clearly a piece of the backbone behind no-frills services. Now let's look at a marketing theory and is also being utilized in most no-frills businesses.

## **2.4 Razor and Blades Strategy**

The economic theory, also known as the lay opinion, states that whatever goods and services are provided, they must be paid for by someone - i.e. you don't get something for nothing. The phrase is also known by the acronym of "there ain't no such thing as a free lunch"<sup>8</sup>. Free lunch was a commonplace term in the USA from the mid 19th

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<sup>8</sup> Phrase and definition from [phrases.org.uk](http://phrases.org.uk)

century onward. It wasn't used to describe handouts of food to the poor and hungry though, it denoted the free food that American saloon keepers used to attract drinkers.

At the time free lunches, often cold food, were provided for any customer who bought drinks. This incentive wasn't popular with the temperance lobby and was also criticized for the same reason that others in the 20th century later, that the customers who visited the saloon always ended up paying for the food in the price of the drinks they were indebted to take. As a result, some saloon keepers were punished for 'false advertising' of free lunch as customers couldn't consume of it without paying the stated money to the saloon owners first.

This notion was later adapted and evolved into many other manifestations. The basic concept involved either selling an item for an extremely low price, or simply giving it away for free in order to generate a continual market for another item, which is usually disposable. This marketing concept was pioneered by King C. Gillette, inventor of the disposable safety razor and founder of Gillette Safety Razor Company (today known as Global Gillette, a division of Proctor and Gamble). This is then known to be the Razor and Blades business model.

In the beginning, Gillette gave away his razors for free in mails. When the blades are worn out, he then charged the customers for replacements instead of sharpening the old blades, and that's what brought the huge financial success to Gillette.<sup>9</sup> The current brand value of Gillette is estimated to be worth US\$16 billion. This equates to 37% of the company's value, which is the same as DaimlerChrysler, one of the world's largest car manufacturers (Paviott, 2000).

Similar business models has been developed using the razor and blade theory, the most obvious being the printer ink cartridge market. When a consumer buys a printer,

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<sup>9</sup> From a report by Adams in 1978

he or she always pays a low price, and the manufacturers may even be selling it at a loss. However, each and every ink cartridge that is bought afterwards is charged at a price premium. In an article written in 2004<sup>10</sup>, ink is currently the most expensive liquid that is being sold in the market, even more expensive than perfume and wine. “If you were to fill up the tank of your car with Hewlett-Packard or Lexmark ink, it would cost \$100,000” said Gerald Chamales, chairman of Rhinotek Computer Products, a Carson City manufacturer of ink and toner cartridges that are compatible with name-brand printers.

The same notion can once again be seen in movie theaters. By charging high prices on concession stands, movie theaters are able to keep ticket prices lower, which allow more audience to enjoy the silver-screen experience. According to a recent marketing research from Stanford and the University of California, Santa Cruz, says that it’s better to charge more for a primary product (in this case, the movie ticket) or a secondary product (the popcorn). Putting the premium on the "frill" items, it turns out, indeed opens up the possibility for price-sensitive people to see films. That means more customers coming to theaters in general, and a nice profit from those who are willing to fork it over for the Gummy Bears.

Indeed, movie theaters rely heavily on concession sales to keep their businesses viable. Although concessions account for only about 20 percent of gross revenues, they represent some 40 percent of theaters' profits (Gil, 2008) That's because while ticket revenues must be shared with movie distributors, 100 percent of revenues generated from the concessions go straight into an exhibitor’s pockets.

Other examples include the console and games model, which again the manufacturer sells the console at a price lower than the manufacturing cost, then sells the console

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<sup>10</sup> Based on San Francisco Chronicles article “Ink Inc.” in 2004



games for an expensive price. It has been calculated that the latest console, the Playstation 3, needs the consumer to buy as many as 10 games to breakeven<sup>11</sup>, for it is selling the console at such a cut throat price in order to compete with Microsoft's Xbox.

As we will see later in this thesis, the razor and blade theory is also widely applied in many of the no-frills businesses, mainly used to obtain the price leader position in their respective fields. More will be discussed shortly.

## **2.5 Yield Management**

The last and final concept utilized in some of the no-frills business models is yield management. Yield management involves understanding, anticipating and influencing consumer behavior in order to maximize revenue or profits from a fixed, perishable resource. Examples of perishable resources include airline seats or hotel rooms, things that are capacity related. The challenge is to "sell the right resources to the right customer at the right time for the right price." (Kimes, 1989)

This is also known as price discrimination in common economic theories. By selling or serving identical products or services, each consumer will be charged a different price based on their willingness to pay. Yield management is one of the single most important revenue generators for several major industries. It is especially true for the airline industry. Robert Crandall, former Chairman and CEO of American Airlines, has called yield management "the single most important technical development in transportation management since we entered deregulation."

There are several essential conditions for yield management to be applicable:

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<sup>11</sup> Based on a report from ars technical, 2005

1. There is a fixed amount of resources available for sale.
2. The resources sold are perishable.
3. There is a time limit to selling the resources, after which they cease to be of value.
4. Different customers are willing to pay a different price for using the same amount of resources.

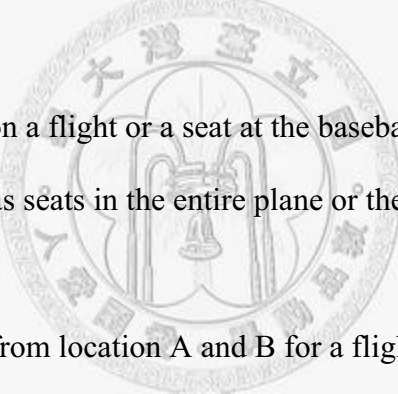
If the resources available are not fixed or not perishable, the problem is limited to logistics, such as inventory and production management. If all customers are willing to pay the identical pricing for using the same amount of resources, the challenge for the management would be limited to selling as quickly as possible, due to the costs associated with holding the inventory.

Let us take a look at yield management from an economics perspective. When the constant costs are relatively high compared to the variable costs, yield management becomes extremely important. This is because the less variable cost there is, the more the additional revenue earned will contribute to the overall profit. By focusing on maximizing the expected marginal revenue for a given operation and planning horizon, profits are in return maximized. Optimizing resources utilization by ensuring that inventory availability to the customers with the highest expected net revenue contribution and extracting the greatest level of ‘willingness to pay’ from the entire customer base is the merit behind yield management. Typical incremental gains due to revenue management activities can range from 3% to 7% according to the practitioners. In many industries this can equate to over 100% increase in profits (Becker et al, 2007).

Companies which implement yield management in their strategies review transactions for goods or services already supplied and for goods or services to be supplied in the future periodically. The firms also review information and statistics on

various events (for example holidays, or unexpected events such as natural disasters or terrorist attacks), competitive information, seasonal patterns, and other relevant factors that affect sales. The ultimate goal is to forecast the future demands using past information and known future interruptions. In an ideal case, the total demand would be in excess compared to what the firm's overall production would be in that particular period. The key is to find the perfect balance point between supply and demand, by finding the best mix of products and services in a certain period at a certain price in order to generate the maximum revenue (Chandler, 2004).

Optimization can help the firm adjust prices and to allocate capacity among market segments to maximize expected revenues. This can be done at different levels of detail:

- 
1. By goods (such as a seat on a flight or a seat at the baseball park)
  2. By group of goods (such as seats in the entire plane or the seats for the entire baseball park)
  3. By market (such as sales from location A and B for a flight going to Location C)
  4. Overall (on all the routes that an airline flies, or all the seats of a stadium during playoff season)

Yield management can be used most effectively when selling products that are perishable. Typical industries that utilizes yield management concept include (but not limited to) airlines, hotels, apparels, grocery, and electronics industries (Talluri et al, 2004) and other venues with a fixed number of seats and advertising. By advance forecasting of demand and the price, companies are able to sort the customers by their sensitivity to price, demand, and point of time in terms of purchasing the goods.

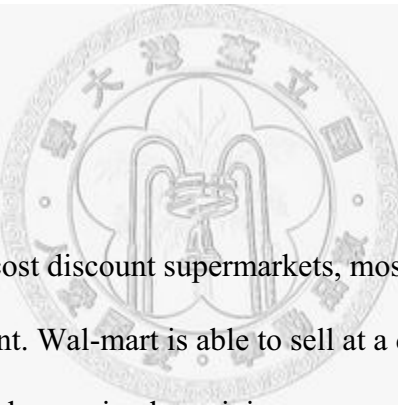
Effective yield management maximizes revenue production for the same number of units, by exploiting the forecast of high demand/low demand periods, effectively moving demand from high demand periods to low demand periods and by charging a premium for late bookings. Successfully implementing the notion will indeed make a great difference on whether or not a business will survive in the long run. As we will see in the following chapter, there are a lot of no-frills businesses which take advantages of yield management in order to thrive and maximize its profits.



## Chapter 3 - Study of Existing No-frills Business Models

In the following chapter, this thesis will examine the existing business models that revolve around the no-frills mentality and utilize the theories mentioned above. There are a total of eight categories of which I would like to cover including supermarkets, transportation, fashion and living, rental spaces, accommodation, internet cafes, and telecommunications. Each section will include a brief introduction to the characteristics of the businesses, followed by a more detailed description to the individual business models themselves. It is hoped that through this section we can better grasp of what the no-frills businesses are like and how they operate. Let us begin with the supermarkets.

### 3.1 No-frills Supermarkets



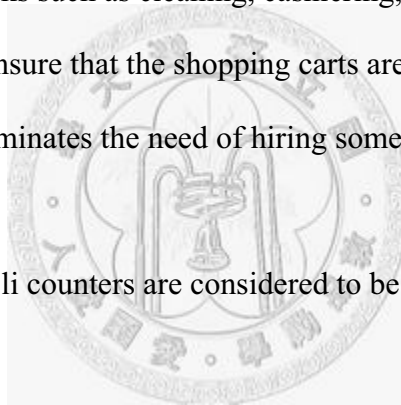
When it comes to low-cost discount supermarkets, most people would associate it with Wal-mart, the retail giant. Wal-mart is able to sell at a discount through extremely efficient distribution system, leveraging bargaining power with its size, buying from cheap sources, selling the products in bulks, and by operating its stores in the suburbs in order to cut down leasing cost for the retail space. This has proven to be extremely successful, given that Wal-mart is currently the biggest public corporation by revenue. Wal-mart has subtle differences compared to the no-frills supermarkets to be discussed, although the customer bases do overlap with one another.

Typical characteristics of no-frills supermarkets include the following:

- In order to save costs, they sell generic and private label products instead of famous brands. This eliminates the lack of bargaining power from the buyer side.
- To save space, they only stock the most commonly sold products instead of having

all available options.

- All shopping bags or boxes are charged to the consumers, forcing the consumers to reuse old bags or bring their own bags.
- The stores are usually plain and undecorated. Many stores don't even have shelves but instead put the pallets directly on the floor. As the products are sold, the entire pallet is replaced, which saves the time and the energy to restock shelves.
- Cash only transactions eliminate the waiting time for customers and also avoid the 1% charge by the credit card companies.
- They only open from 9AM to 6PM, avoiding extra staffing costs.
- Staffs perform multitasks such as cleaning, cashiering, stocking...etc.
- To save on costs and ensure that the shopping carts are not stolen, they are often coin-operated. This eliminates the need of hiring someone to collect the carts from various locations.
- Butcher, bakery and deli counters are considered to be frills, thus they are all eliminated.



After knowing more about no-frills supermarkets, let's take a closer look at Save-A-Lot and ALDI.

### **3.1.1 Save-A-Lot**

Among the retail chains in the US, Save-A-Lot is the 13<sup>th</sup> largest with a little more than a thousand stores.<sup>12</sup> Save-A-Lot started as a single store in 1977, and is now based in St. Louis Missouri, with annual sales reaching approximately 4 billion USD. The

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<sup>12</sup> Statistics information based on Save-A-Lot Website

founder of Save-A-Lot is Bill Moran, who worked for a wholesaler in the 70s, and immediately identified a chance for smaller grocers to go head to head with the grocery giants. He called it a ‘limited assortment business model’, and when the first store opened in Cahokia, IL, it was an immediate success. Save-A-Lot has always been proud of its ‘Edited Assortment Strategy’.<sup>13</sup> Being a no-frills supermarket, Save-A-Lot has only limited selection on its merchandise. It carries about 90% of customer's every day food needs and about 1,250 grocery items per store and limit their store sizes to equal or under 15,000 square feet, which is less than half the size of a conventional grocery store. Private labels are the main focus and are referred to as “exclusive label brands” in the stores. Name brands are sold in special occasions under extremely low prices. They also have a special discount aisle called the ‘dollar department’ which sells general merchandises.

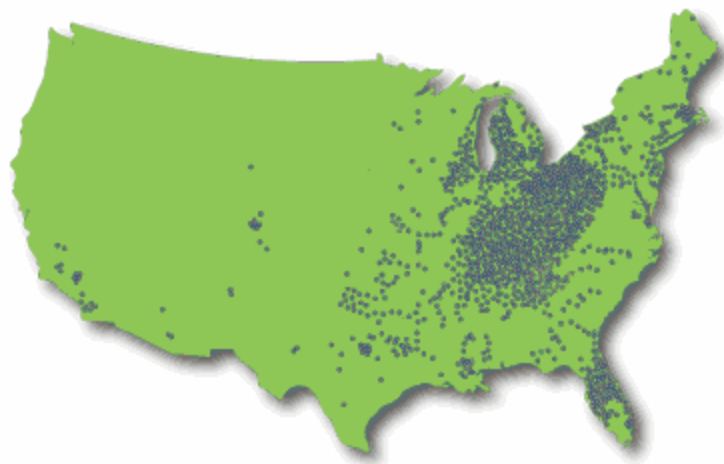
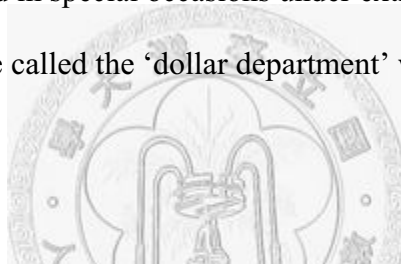


Figure 3. Save-A-Lot’s 1,150 store locations in the US

(Source: Save-A-Lot Official Website)

Merchandises are stored in their original packages on industrial-style shelving

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<sup>13</sup> Description of Edited Assortment Strategy is from Save-A-Lot Website

instead of regular grocery store types. Customers have to pay 3 cents for plastic bags, 5 cents for paper bags, and 10 cents for reusable bags. Even though this is a common practice in Taiwan, many customers in the US are quite negative toward this practice and forcing many stores to offer free bags.

Save-A-Lot has an ambitious growth goal of doubling its store counts in the long run and hiring more than ten thousand additional staffs.

### 3.1.2 Aldi

Aldi, short for "ALbrecht DIscount", is a discount supermarket chain headquartered in Germany and becoming one of the largest retail chains worldwide. It was founded by Karl Albrecht and Theo Albrecht; both have since retired. However, they are still Germany's richest men, earning an estimated €1.5 billion per year.<sup>14</sup> Aldi currently has about 2,500 stores in Northern and Eastern Germany, and 1,600 stores in Western and Southern Germany. Aldi also has its international presence in Denmark, France, the Benelux countries, the Iberian Peninsula, Poland, Ireland, UK, Austria, Australia and the U.S. According to a survey in 2002 conducted by Forsa, 95% of blue-collar workers, 88% of white-collar workers, 84% of public servants and 80% of self-employed Germans shop at Aldi.<sup>15</sup>

Aldi has many no-frills characteristics, such as charging for shopping bags, and the fact that Aldi until recently accepted only cash. Debit cards are also accepted in the U.S., the UK, Austria, Belgium, Denmark, France, the Netherlands, Switzerland, Ireland and Australia. In general, credit cards are not accepted.

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<sup>14</sup> Forbes Magazine Article "The World's Richest People" in 2007

<sup>15</sup> Statistics based on Stern Article "Hinter den Kulissen des Discounters" in 2007



Another practice at Aldi stores is requiring a coin to use a shopping trolley. This is done for efficiency reasons; the coin is returned when the shopping cart is returned to its bay so customers will return the trolley, saving Aldi's staff from having to collect trolleys from the parking lot.

Aldi stores all have a similar shop layout, making it easier for customers to find the goods they are looking for even in a store that they do not know. Many of its products are self labeled, with the number of outside brands being very limited, usually no more than two different brands for one kind of product and often only one. This increases the numbers of sales for each article and also allows Aldi stores to be smaller than supermarkets which cover the same range of products but with more diversity.

Aldi's "strictly no-frills" approach is evident for instance in that Aldi stores do not decorate aisles — or even fill shelves for that matter: pallets of the products on offer are parked alongside the aisles, and customers picking up products will gradually empty them. When all items on a pallet have been sold, it is replaced. Long lines at the checkout counter are also common, reflecting Aldi's minimal staffing levels. However, due to the efficient checkout system, a long queue does not necessarily translate into longer waiting times than in other supermarkets.



following:

- A single passenger class
- A single type of airplane/bus/transportation tool, in order to reduce training and servicing costs
- A simple pricing scheme (usually fares increase as the plane/bus fills up, which rewards early reservations)
- Unreserved seating encouraging passengers to board early and quickly
- Travels to cheaper, less congested secondary airports and bus stations. Airplanes fly early in the morning or late at night to avoid possible traffic delays and take advantage of lower landing fees
- Fast turnaround times allowing maximum utilization of transportation equipment
- Simplified routes, utilizing point-to-point transportation method instead of hub and spoke system
- Generation of additional revenue from frills, such as food and commission-based products
- Emphasis on direct ticket sales over the Internet to avoiding fees and commissions paid to travel agents and computer reservations systems
- Multitasking employees to limit personnel costs

Now let us examine RyanAir's and Megabus' operation strategies, and what makes them successful no-frills operators.

### 3.2.1 RyanAir

Ryanair was founded in 1985 by Cathal and Declan Ryan (after whom the company is named), Liam Lonergan (owner of an Irish tour operator named Club Travel), and noted Irish businessman Tony Ryan (founder of Guinness Peat Aviation and father of Cathal Ryan and Declan). It did not make money until Michael O'Leary stepped into the scene and was told to make the airline profitable. O'Leary visited the U.S. and found that the only way to fight against the industry incumbents is by shortening the turnaround times and going 'no-frills'. He copied the ideas from Southwest and made modifications to the business model.

The market entry of this independent, privately owned airline, symbolized the first real threat to the near monopoly which the state owned carrier Aer Lingus had on routes within Ireland and between Ireland and the UK. RyanAir's strategy was simple: offer a no-frills, low fare service to all. The essence of RyanAir can be captured in a simple equation:

$$\text{Lower fares} = \text{more passengers} = \text{lower costs} = \text{lower fares}^{16}$$

The formula proved to be extremely attractive to an increasingly cost conscious traveling public. No attempts were made to distinguish between different passenger groups – traveling businessmen, students, emigrants – all constituted RyanAir's target market and all shared the same non-assigned seating arrangement. This scenario was in stark contrast to the more opulent, segregated and expensive service offered by Aer Lingus. However, RyanAir was never the threat that Aer Lingus perceived it to be,. Rather than eating into Aer Lingus' existing customer base, RyanAir's arrival helped precipitate a growth in the total air travel market, especially between Ireland and the UK.

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<sup>16</sup> Equation quoted from Thomas Lawton's book, "Cleared for Take-off"

After its debut, typical passenger traffic on a route grows at an enormous rate, very often doubling or even three times as many within a few years.<sup>17</sup> RyanAir has certainly been a causal factor in the growth of traffic on major routes such as Dublin-London. In the decade prior to RyanAir's launch, passenger numbers on this route grew at a minuscule rate. This growth occurred primarily in what has been described as the visiting friends and relatives traffic. Low prices acted as the prime catalyst for growth in this market segment.

RyanAir is now based in Dublin and is currently Europe's largest low-cost carrier. RyanAir currently operates 526 routes across over 26 countries.<sup>18</sup> In terms of passenger numbers, RyanAir's exponential growth in the recent years has marked itself as a legend in the airline industry. Observe in the figure below that the number of passengers has reached more than 42 million in the year 2006.

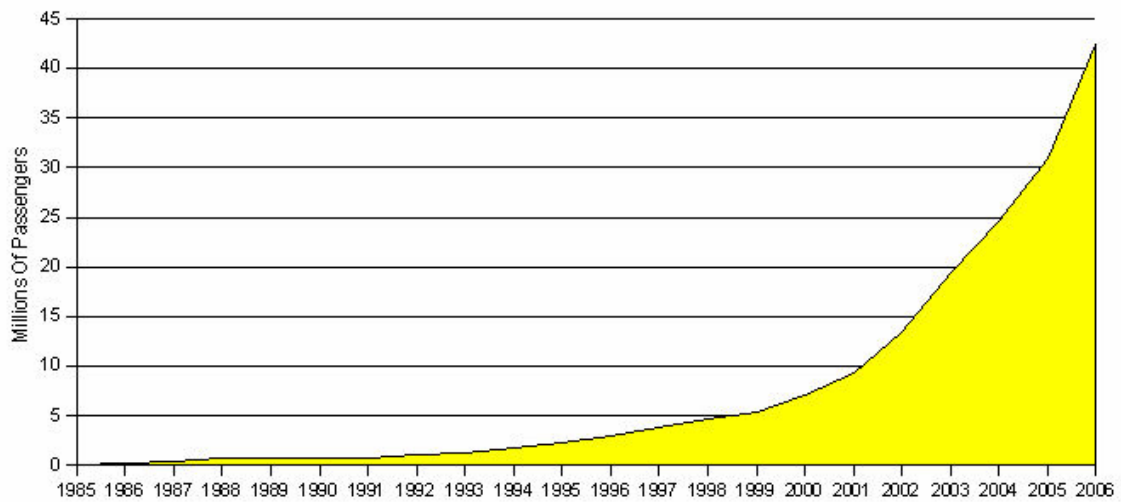


Figure 5. Number of RyanAir passengers from 1985~2006

(Source: RyanAir Official Website)

RyanAir's no-frill approach of operation is similar to that of Southwest's, except

<sup>17</sup> Statistics from a 1997 Morgan Stanley report

<sup>18</sup> RyanAir website

that it is even more extreme. Most no-frills airlines fly in and out of cities from point to point instead of having a central hub, and so does RyanAir. Instead of having one single major hub, RyanAir operates 23 baby hubs and have most flights fly from point to point. What makes RyanAir truly unique from other no-frills airlines is that it picks destinations that are relatively suburban compared to others. It has created a market of its own instead of tapping into the existing customer base like Southwest.

By locating its destinations away from major cities, this encouraged people around the area to travel by plane instead of other means of transportation. RyanAir negotiates extremely aggressive contracts with its airports, demanding very low landing and handling fees as well as financial assistance with marketing and promotional campaigns. In subsequent contract renewal negotiations, the airline plays airports off against each other, threatening to withdraw services and deploy the aircraft elsewhere if the airport does not make further concessions.

Since its ticket price is relatively low (and sometimes offered free seats), people are willing to take the opportunity and fly with RyanAir. Yet how does RyanAir generate additional profits? Simple, by charging all the 'frills' incurred before, during, and after the flight! Passengers that want to check in luggage are charged an additional fee. Since the destinations are rather remote, passengers traveling elsewhere have to rent a car or take a shuttle, book nearby hotels, which are also affiliates with RyanAir.

To further cut down costs, RyanAir operates with a single type of aircraft, the Boeing 737. Internet bookings also allowed the customers to deal with RyanAir directly instead of going through the travel agents and getting charged. In order to shorten the cleaning time and maintenance, seats do not recline and back pockets are removed (thus cutting the cleaning time and continues to generate savings and reduce repair cost). Additional profits are generated by putting advertisements throughout the cabin.

Table 5. List of cost cutting activities by RyanAir

|                                  |   |
|----------------------------------|---|
| Secondary airports               | Lower charges and less congestion means airline can increase punctuality rates and gate turnaround times  |
| Standardized fleet               | Lower training costs and cheaper parts and equipment supplies and maintenance costs   |
| Point-to-point services          | Direct, non-stop routes; through- service with no waiting on baggage or passenger transfers   |
| Maximize aircraft utilization    | Fewer aircraft used to generate higher revenue; lead to higher passenger capacity and greater staff productivity  |
| Cheaper product design           | No assigned or multi-class seating; no free food or drinks  |
| No frequent flyer program        | Costs money to manage and to implement  |
| Non-participation in alliances   | Code sharing and baggage transfer services lowers punctuality and aircraft utilization rates and raises handling costs  |
| Minimize personnel costs         | Increase staff to passenger ratio; employee compensation linked to productivity based pay incentives  |
| Customer service costs           | Outsource capital intensive activities, e.g. passenger and aircraft handling; increase direct sales through Internet site and/or telephone reservation system |
| Lower travel agent fees          | Reduce associated travel agent commission, with the objective of moving eventually to total direct sales  |
| Minimize aircraft capital outlay | Purchase outright used or new aircraft of a single type   |

(Source: Thomas Lawton's book "Cleared for Take-off")

Table 6. Net margin comparison between RyanAir and competitors.

| Airline         | Revenue/passenger | Cost/passenger | Net Margin |
|-----------------|-------------------|----------------|------------|
| RyanAir         | 53                | 43             | 18%        |
| Aer Lingus      | 129               | 122            | 6%         |
| Southwest       | 73                | 69             | 6%         |
| EasyJet         | 72                | 68             | 6%         |
| Air Berlin      | 80                | 77             | 4%         |
| Lufthansa       | 371               | 356            | 4%         |
| British Airways | 377               | 364            | 3%         |
| Sky Europe      | 62                | 84             | -35%       |

(Source: RyanAir Official Website)

Although RyanAir is frequently voted the least favorite airline among consumers,<sup>19</sup> the numbers tell a different story. RyanAir's net profits have risen from €48 million euros in 1998 to an estimated €239 million euros in 2003. Revenues reached 4 Billion USD in 2007, with half year profits for the period ended October 31, 2007 included ancillary revenue of €252 million euros. The activities associated include car rental, hotels, travel insurance, on board sales and excess baggage handling fees. The ancillary revenue accounts for over 16% of total revenue. It is also the airline in Europe with the fewest lost baggage.

Announced in April 2007, RyanAir plan to launch a new long haul airline around 2009. This new service will compete head to head with Virgin Atlantic, and the will fly cross the Atlantic to the U.S. Airports in the US will be smaller airports outside of

<sup>19</sup> BBC News Article "RyanAir 'is least liked airline'" in 2006



major cities. The current name of the new airline is going to be RyanAtlantic, which is said to offer first class service with the cost of economic class for the customers.

### **3.2.2 Megabus**

Bus travel was already considered to be a no-frills travel option to get around; until Megabus took it a step further to capture the ‘market of the poor’ by removing even more frills. Megabus is owned by the Scottish bus company called Stagecoach, which was founded by Brian Souter and his sister, Ann Gloag, in Perth, Scotland in 1980. What’s special about Megabus is that fares typically start from as low as \$1 USD, and an additional booking fee of 50 cents. Yield management is used in the Megabus business model. Consumers who book their tickets way in advance will get a major discount, whereas people booking late will be charged a premium price. Another practice is locating the destinations outside of populated areas, which avoids congested traffic areas and allows Megabus to be punctual and save on bus station charges, for most rural stations charge far less than popular bus stations.

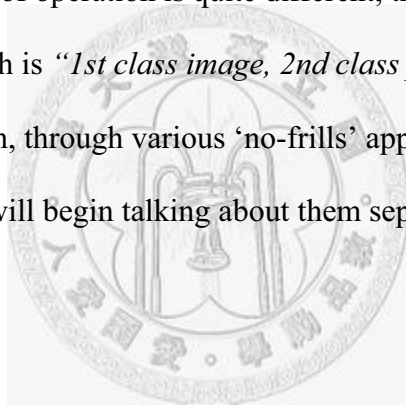
Tickets are sold through the internet website only. Customers will be given a reservation number and shown to the driver, and customers can not pay for a ticket on the bus, so that the driver can concentrate on driving instead of other tasks. Initially, most of the routes used buses designed for short local public transport journeys that had no toilet or luggage space, and each passenger was allowed only one bag. Toilets have been added to the fleet, enabling Megabus to eliminate toilet stops on longer journeys.

Megabus started its services in the US on March 22<sup>nd</sup> of 2006, with the hub located in Chicago. In 2007, Megabus started operating in the San Francisco bay area, and in 2008 it has began service in NYC. Aside from the bus services, the Megabus concept

was also extended to certain rail services, with the introduction of Megatrain between London Waterloo and Southampton Central, and London and Portsmouth and Southsea/Portsmouth Harbour, using a dedicated carriage on selected South West Trains services.

### **3.3 No-frills Fashion and Living**

In the fashion and living industry, the no-frills business approach is also taking away the profits by storm. The two companies I would like to focus on are H&M and IKEA. Although the modes of operation is quite different, the motto behind the two businesses are similar, which is “*1st class image, 2nd class products, 3rd class prices*”. How is this achieved? Again, through various ‘no-frills’ approaches. Since the two are quite different by nature, I will begin talking about them separately.



#### **3.3.1 H&M**

H&M, which stands for Hennes & Mauritz, is a Swedish clothing company that is famous for its affordable pricing yet fashionable design. The company was founded in 1947 by Erling Persson, which started the store originally selling only women’s clothings. In 1968, Persson acquired a hunting store and started selling the remaining inventory for men. Persson’s son became the CEO in 1990, and close to 100% of H&M’s clothes are made in China.

Taking the prefix ‘Mc’ from McDonald’s, H&M is generating strong profit flows by creating the so-called ‘McFashion’. It is a term used to describe a new type of fashion that stands for fast, affordable and chic fashion. It is mentioned earlier that in

the M-shape society, there are two opposite types of consumers, the rich and the poor. For the rich, they spend even more on their luxuries, but the poor on the other hand, have always tried to find good and fashionable products with affordable pricing. H&M does exactly that by providing the necessary products.

Instead of hiring its own designers as full-time employees, H&M hires them based on contracts and through franchising with design studios. In order to bring up the brand image and perceived value, H&M hires famous models and created limited edition clothing. By efficiently cutting the costs down, H&M offered in 2004 a piece of clothing designed by a famous designer who used to work with Chanel. Instead of paying four to five thousand USD for a piece of clothing, H&M sells the product for \$18 USD. The turnaround time is also extremely short for H&M to launch a new design. The overall strategy is to launch as many designs as possible, but always keep inventory low, which is similar to Zara's strategy.

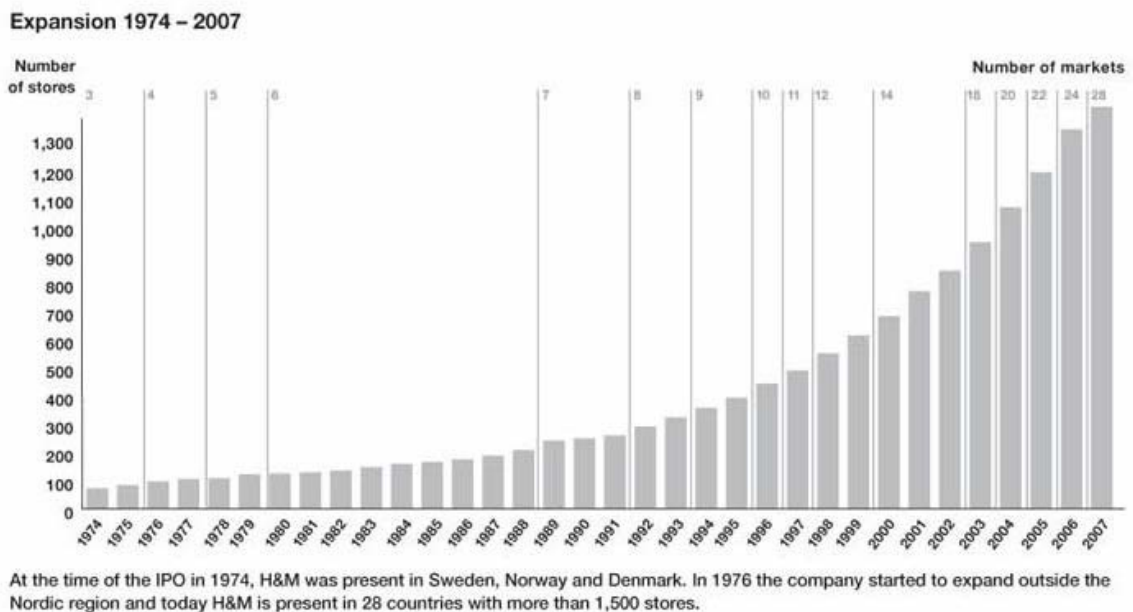


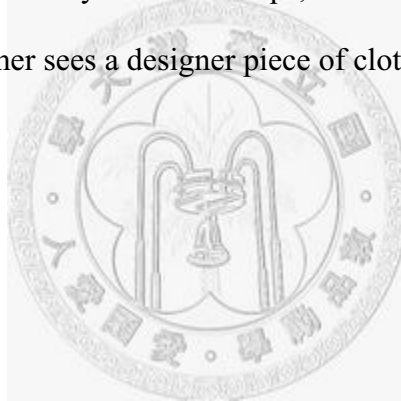
Figure 6. The number of H&M stores over the years

(Source: H&M 2006 Annual Report)

In order to cut down the unnecessary costs, fewer store clerks are there help the

consumers ‘pick’ their clothing. Thus the shopping experience can be quite different compared to other fashion giants. Also, there are frequent stock-outs for popular items, and they are never re-stocked. In other words, the consumer better buy at that instant because the next time he or she comes back, the item may be sold out forever. This is done to keep the inventory low. Another frill taken away may be the sacrifice of materials used. Instead of using high quality clothes and high quality workshops, H&M cooperate with many Chinese workshops and uses secondary materials that may not be as durable and comfortable compared to the materials used by the fashion giants.

Other no-frills fashion businesses include Zara and Primark. Primark is a UK based discount retailer of fashion industry with 123 shops, and also doing quite remarkably in the UK. Whenever a consumer sees a designer piece of clothing, the mentality is “I can get that cheaper”.<sup>20</sup>



### 3.3.2 IKEA

IKEA is a private home furnishings retailer that sells furniture, accessories, bathrooms and kitchens at retail stores around the world. IKEA was founded in 1943 by Ingvar Kamprad in Sweden and it is owned by a Dutch-registered foundation controlled by the Kamprad family. IKEA is an acronym comprising the initials of the founder's name (Ingvar Kamprad), the farm where he grew up (Elmtaryd), and his home county (Agunnaryd, in Småland, South Sweden). IKEA originally sold pens, accessories such as jewelry, watches, wallets, picture frames, and anything that Kamprad can sell at a discount. It wasn't until 1948 that it began selling furnitures, and only started to design the furnitures in 1955. The company motto is: "to create a better everyday life for the

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<sup>20</sup> BBC News Article “Primark – The King of No-frills fashion” in 2005

many people."

With over 278 stores around the globe, IKEA currently operates in more than 36 countries.<sup>21</sup> Most importantly, IKEA is definitely one of the most successful representations of the no-frills services industry. The products sold at IKEA all requires self-assembly, this is quite revolutionary at the time of introduction. However, by having the products ready-for-assembly allows IKEA to save significant store spaces and eliminates the need for delivery. Since the products are packaged in flat boxes, most consumers can simply take them home using their own transportation. Although IKEA does offer delivery for larger items, delivery is considered a frill thus depending on the size of the merchandise and the distance of the delivery, consumers will have to pay extra if the two exceeds the limits. Self assembly allows IKEA to minimize the number of labor involved in the production line. Most products are outsourced to China for cheaper manufacturing.

Inside the store, there is minimal staffing to help the consumers. Instead, the products are pre-arranged and placed into the settings so the consumers can get a feel of what the products are like in a real room. This eliminates the need for the store clerk's explanations. In addition, plastic bags are charged for at the checkout counter, which is once again considered to be a frill. Once a purchase is complete, the consumer has to go into the warehouse themselves to pick up the items that they have bought. To further save costs on its operations, newer IKEA stores are built with skylights, which saves electricity costs and is believed to be able to boost employee morale and provide a happy shopping experience. Most of the IKEA stores are located outside of city centers to avoid traffic congestions and to save on rents.

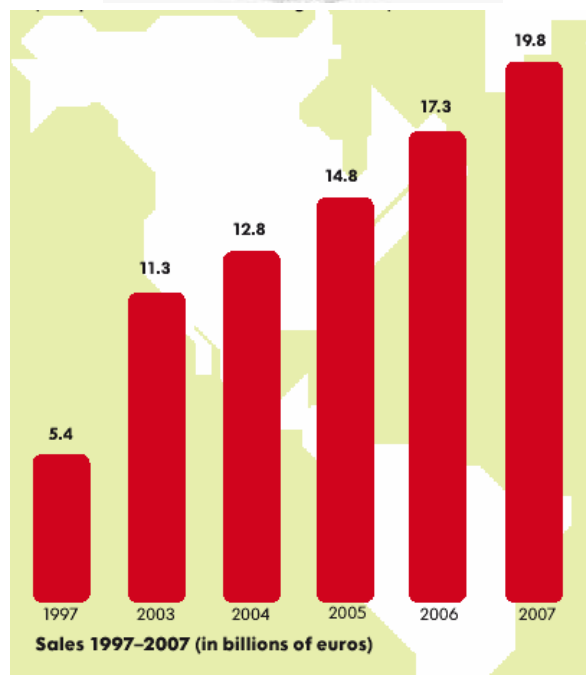
Newest ventures from IKEA include the online catalogue and the IKEA business.

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<sup>21</sup> IKEA website

IKEA business is a new concept which a team of IKEA experts can help out small and medium size businesses get organized and decorated using IKEA products. There is also an online community where the different businesses can share their experiences and suggestions with others, not only on furnishings, but also on general business concepts. Behind the whole activity, it is really a marketing campaign used by IKEA to let the businesses promote its products through word of mouth. The online catalogue is a mean of informing what the existing and new products are like to the consumers. Many items are not available through the internet, but only sold through physical stores to eliminate the frill of shipping and handling.

In terms of sales in the year 2007, IKEA generated a impressive 19.8 billion euros, which is a 14% increase from the previous year. The top five countries contributing to the sales are Germany (16%), USA(10%), UK(9%), France(9%), and Sweden(7%).<sup>22</sup> It is considered an extremely successful venture in the no-frills market, considering that it is not a publicly listed company.



<sup>22</sup> Statistics from IKEA website

Figure 7. IKEA sales over the past ten years (Source: IKEA Official Website)

### 3.4 No-frills Rental Spaces

Expanding on the no-frills mentality from the consumer's perspective, another market has emerged to serve the small startups and entrepreneurs: rental spaces. Many start-up entrepreneurs realize that office space rentals can drain on their precious capital. Yet their customers may look for a professional looking office to gain trust and build the needed consumer relationships. This spawns the need for a shared office. Shared office space refers to fully equipped and furnished offices ready for quick setup for a branch office or entrepreneur who doesn't want to work from home or sign a long term contract. Shared office spaces can provide professional facilities at a lower cost than traditional office rents and even offer the possibility for outside input and referrals from others that utilize the same arrangement. Another type of shared office space involves an individual or business potentially renting a single desk space or possibly a group of offices within another company's larger space.

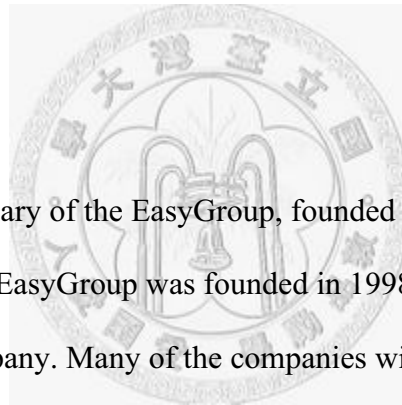
A similar type of shared office situation might be used for telecommuters when they come in to the office to work. The desk, phone and equipment are theirs only for the work period and typically used by others at other times. This shared office space situation is good for complementary types of businesses; for example, a health professional sharing space with another medical professional with a different specialty. In this type of arrangement, the lessee is less likely to benefit from secretarial or other services. The advantage to the company providing the shared office space is that it is a quick, inexpensive way to recoup expenses for excess space.

Either of these types of shared office space offers advantages including reduced

need for support staff, all-inclusive monthly costs and quick occupancy. The arrangement is especially attractive to small business owners and start-up companies. These arrangements also require no great outlay of capital for equipment and furniture. When choosing a shared office space, consider the same types of issues you would if you were leasing a traditional office space: site, other tenants and the contract.

We know there are single entrepreneurs and small businesses out there that are currently not served by the traditional serviced office market - the monthly costs can be just too high or the terms too inflexible. Thus the so-called no-frills rental spaces emerged on the market such as EasyOffice and Cubic Boxes Rental.

#### **3.4.1 EasyOffice**



EasyOffice is a subsidiary of the EasyGroup, founded by Stelios and most famous for his airline EasyJet. The EasyGroup was founded in 1998 by Stelios Haji-Ioannou, and is a privately held company. Many of the companies within the group follow the "easy" format of taking away the frills in something to make it cheaper overall, plus using the yield management system of supply and demand. EasyOffice is basically a shared office space for rent.

Typical shared office space arrangements include business equipment, such as copiers, fax machines, office furniture, receptionist and mail services. Some offer conference room accessibility, delivery or publishing services and other amenities. The leases on these types of offices are generally six to 12 months, with some offering three-month options. EasyOffice however, takes out the frills and shortens the lease time. The minimal lease time that one can get with EasyOffice is as short as 7 days. In addition, it only provides the space and the basic furniture, with all other services



available at an additional charge, such as phone lines, copiers, cleaning and secretaries, etc.

EasyOffice offers flexible and affordable office space to rent by the room, short or long term, allowing customers to match the space one rent with the demands of one's business. Yield management is once again used by EasyOffice, thus the earlier one manages to reserve and book the space, and the less one needs to pay. The next example to be discussed is also aimed at a similar market.

### **3.4.2 Cubic Boxes Rental**

The origin of cubic boxes rental started in either Hong Kong or in Japan. For entrepreneurs that wants to sell products but can not afford to open their own shop, cubic boxes rental may be the solution to the problem. Now having one's own shop is no longer a dream, but a miniature realization of it.

In a typical rental store, there will be around 100 square spaces available for rental. Each space is around 33cm by 33cm by 33cm, thus the name 'cube' is given. Anyone can walk into a store and rent a cube and start displaying one's own products or creations. The rent is variable depending on the placement of the cube; cubes that are near eye level or near the entrance are more expensive than others. Each store varies on the contract and obligations, some requesting the contract be signed up to one year, while others are on a monthly basis. The rent varies from 500NTD to 1500NTD, based on the location of the store and the placement of your cube within the store. If the cube is in a obvious spot among all others, that will cost the renter extra fees. In addition, online inventory status can be checked and updated by the store operator, but the renter needs to pay an extra fee for accessing the inventory status. There is also a commission

involved whenever an item is sold. The charge is usually 3% ~ 8%, depending on the contract one has with the store operator. The creation of this form of vending dramatically reduces the overhead cost for small businesses. It also minimizes the anxiety of some of the online shoppers, for now they are actually able to walk into a store and look at the physical products.

This is another no-frills approach from the store owner's side. The concept itself is not original, since most retail stores are already utilizing similar notions. For example, if a product is to be displayed on 7-Eleven shelves, the manufacturer needs to pay certain fee and guarantee a typical amount of sales. This is the same for the cubic boxes rental, except this time the store owners are dealing with multiple individuals selling some truly unique items. The entry barrier for those who wants to operate a store is completely removed, and the frills of hiring employees are removed. People that rents the cubes typically sells self-made items, 2<sup>nd</sup> hand items, or simply uses the boxes as a display to boost the marketing of their websites.

Cubic Boxes stores are extremely common and can be seen in major cities around Taiwan, Japan, Hong Kong, and even has began to emerge in China. The idea is taking the retail market by storm and the demand still deem unsaturated in the short being.

### **3.5 No-frills Accommodations**

The so-called no-frills hotels have been appearing throughout the world, especially in Europe where both rent and services are expensive.

Characteristics of no-frills hotels are:

- Small studios with bathroom and desks somewhat incorporated into the room

- Booking via the internet only
- No cleaning, and no extra towels
- No meals
- No transfers or shuttle buses from and to the airport
- Practice of yield management (the earlier one books, the cheaper the fare)
- No luxuries!

There are several different hotels that exist in the market right now, which includes Qbic and EasyHotel in Europe, and Tune Hotel in Malaysia. These are all evolved forms of budget hotels like Homestead and Motel 6, and they all went a notch up in terms to taking the frills away.

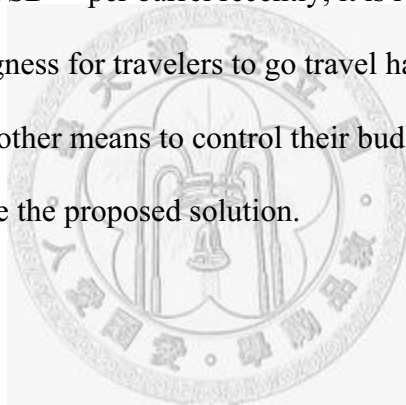
Among the three mentioned, Qbic has been trying to target its market to the young adults who are frugal yet enjoys the feeling of being a fashionable icon, thus developing the tagline “Cheap, chic, and no-frills” as their main marketing campaign slogan. The rooms are typically futuristic and in a shape of a ‘cube’. The lightings in the room can be changed to different colors depending on the consumers. Everything is self-service, including check-in, check-out, and there’s even a corner with many different vending machines selling food and beverages. At Qbic, only one representative will be around the lobby to answer any concerns a customer may have.

EasyHotel shares pretty much the same characteristics as most no-frills hotels do. Rooms can only be booked online, and the earlier one books, the cheaper the fare. The time of the season also affects the daily rates. Most hotels rooms do not have windows, and it will cost a customer extra if he/she demands one.

Tune Hotel is yet another no-frills accommodation, which is based in Malaysia. Typical rooms are small without windows, and are decorated with vibrant colors to

soften the atmosphere a bit. There are no chairs in the room, customers are expected to sit on the bed itself with a fold-down board serving as a desk. Air conditioning is not included in the bill, but customers can ask for a charge card which can be put into the card reader in the rooms and charged upon checking-out.

These no-frills hotels accounts for a small percentage of the travel and leisure market compared to the other chains. They are still in their infancy, but it is believed that it will become the mainstream form of hospitality, especially in developing countries with growing domestic traveling such as China and India. In addition, the popularity will most likely increase as well in developed countries such as the U.S. As oil prices increase to \$130 USD<sup>23</sup> per barrel recently, it is reported that travel expenditures and the willingness for travelers to go travel has been dramatically reduced. Consumers will surely find other means to control their budgets, and no-frills accommodation may well be the proposed solution.



### **3.6 No-frills Internet Café**

EasyInternetCafe is yet another business venture operated by Stelios' wide array of no-frills businesses under the easy group. It is Europe's largest chain of Internet cafés. EasyInternetCafe provides the basic services that one could expect, internet surfing only. There are only a few workstations that had Microsoft Office installed; for the most part, computers are there for surfing purposes only. There are no store clerks or technicians available in every store; one staff is likely to be managing multiple stores. Customers do not interact with store clerks, but instead buys useable times from vending machines. The stores are not decorated, with rows of computers packed together to save spaces.

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<sup>23</sup> United Press International (UPI) article "Oil prices back near \$130 per barrel" May 2008

The pricing is dynamic; as more seats are filled up, the charge per minute also increase. However, it is still relatively cheaper than the oppositions even during peak hours.

EasyInternetCafe faces certain challenges with the lack of clerks. Customers frequently complain that the keyboards are unhygienic due to insufficient cleaning, which has led to diminishing sales. In addition, it lost a major lawsuit in court to the music industry in London, as it was burning unlicensed music CDs for customers for free (customers only had to pay for the cost of CD itself.)

### **3.7 No-frills Telecommunications**

No-frills telecommunications operators have emerged in the industry for awhile now. The more famous and well-known ones include Heyah in Poland, Halebop in Sweden, EasyMobile in Germany, Netherlands, and UK, and Simyo in Germany. The no-frill operators are involved in the following activities:

- They mainly sell SIM cards online or through call centers, but they seldom sell handsets.
- They target prepaid service users and focus on voice services and SMS.
- They offer end users low price and simple pricing schemes.

The rise of the no-frills operator can be attributed to many factors. In the early 1990s, the telecommunication authorities in Europe and North America have deregulated the access restriction of the telecom market. The regulatory parties have also been encouraging competition among operators and urging them to open telecom networks with different service providers. This is for the purpose of inter-network

roaming and number portability, which extends connectivity service to subscribers to use their mobile phone numbers even when they switch to another service provider. The new strategy of the telecommunication authorities regarding the deregulation of the telecom market lowered the access control of mobile service market and created an opportunity for the rise of the MVNO (Mobile Virtual Network Operator).

The increased market penetration has resulted in the polarization between two market segments (which coincides with the M-shape), that is between those who see the mobile phone as a commodity and between those who see it as a technology where offering mobile service is still a lifestyle activity.

Under the current cost structure of many traditional operators in Europe and America, profit margin of mobile service tariff is sufficient to offset the cost of bundling handset sales. If users do not want handsets as gifts, operators have the option to drop the service price to the level that the profitability is not affected. A survey on mobile users in North America found that if the Minutes of Usage (MOU) falls below 430 minutes, the price elasticity index exceeds 1 at which point the price slash helps in increasing the ARPU (Average Revenue Per User). According to the figures released, Europe has the MOU stabilized at 120 minutes on an average and thus has great potential to claim a price surge (Yong, 2007). All these factors encourage operators to compete more aggressively on price.

No-frills business models, initially launched by the MVNO, are designed for price-sensitive mobile users. When Telmore launched an MVNO business in October 2000, the mobile market in Denmark had already reached the point of saturation, with five operators slicing the market and thus the market penetration reaching 70%. But after 18 months in business, Telmore reported ample profits (positive EBIDTA) and seized 10 percent of the mobile market by June 2004. More importantly, within 10

months, the price of a prepaid services in Denmark dropped by 50 percent.

The market varies depending on the geographical structure and culture. Therefore the MVNO faces many difficulties in their efforts to expand the no-frills business model to broader geographies. EasyMobile, which piggybacked on T-Mobile's network, was soft-launched by the TDC in the UK in March 2005 with a SIM-only proposal. It offered cheap flat-rate calls and texts with online top-up. Understanding the significance of marketing the handsets to UK consumers, EasyMobile, one year later, began offering its services and selling EasyMobile handsets for the first time through The Link retail shops. EasyMobile, however, did not succeed in UK as expected and had to close all its operations in November 2006.

In January, 2008 the EasyGroup launched a partnership with the Mobile VoIP provider Rebtel. With this service, users can make international calls for the cost of a local call from their regular mobile phone and carrier without additional software downloads, connecting to the Internet, or access to the computer. The service leverages VoIP technology to route the international leg of the call over the Internet passing the savings on to the user.

### **3.8 Failed No-frills Businesses**

After seeing all the successful business ventures that revolved around the no-frills business model, it may seem like no-frills is the answer to the future. However, is that really true? In the following section of this paper, no-frills businesses that did not survive the test of time will be examined. Perhaps this section is even more important than the previous, for it provides clues on the following question: Under what circumstances will no-frills NOT work? The businesses to be discussed include Skybus,

Oasis, and EasyCinema. How did these businesses operate similarly and differently from their counterparts? What made them unsuccessful?

### 3.8.1 Skybus Airlines and Oasis Airlines

Perhaps the most famous business model among the no-frills businesses is the low-cost airlines. Yet the two failed businesses I would like to discuss, Skybus of the U.S. and Oasis Airlines of Hong Kong, are both considered to be no-frills, low cost airlines.

Skybus is a private company that is based in Columbus Ohio. It was founded by John Weikle and Ken Gile, who is the former director of Southwest Airlines. It operated as an ultra-low-cost carrier modeled after Ryanair. Its first flight out of Columbus Ohio was on May 7th of 2007. Less than a year later, Skybus announced on April 4, 2008, that it would cease operations as of April 5.<sup>24</sup>

Different from the rest of the no-frills airlines, Skybus operated strictly on a hub-and-spokes model instead of point to point. The business model was heavily reliant on flying routes where other airlines did not have direct flights, as Ryanair did in Europe, thus keeping competition to a minimum, and utilizes secondary airports, rather than heavily-trafficked ones. It also had advertising on both the inside and the outside of the airplane. In addition, merchandises are sold as an in-flight service. Ticket pricing utilizes yield management; the price increases as the number of seats are sold. Overweight baggage and baggage which needed check-in are charged and extra fee, with the first two bags under fifty pounds being \$10 each online or \$12 each at the counter, with each additional bag after two incurring a charge of \$50 per bag. Reserved

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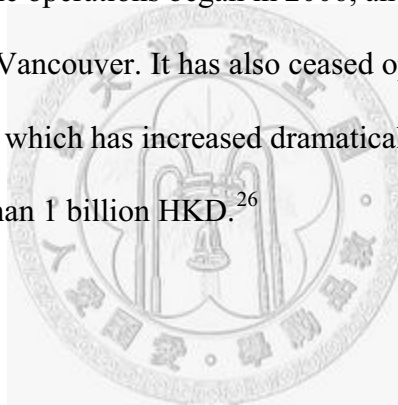
<sup>24</sup> MSNBC News article “Low-cost carrier Skybus calls it quits” April 2008



seating required an extra \$10; else all seats are on a first come, first served basis. Food and beverages are not allowed, unless you purchase them from the flight attendant. Employees were paid lower than industry average, but compensated with stock options and commissions.<sup>25</sup>

Skybus soon announced bankruptcy within a year. A statement on its website regarding the shutdown said that "Skybus struggled to overcome the combination of rising jet fuel costs and a slowing economic environment. These two issues proved to be insurmountable for a new carrier."

Oasis Airline, which is based in Hong Kong, operated as a low-cost airline which flies only long haul trips. The operations began in 2006, and the main routes are from Hong Kong to London and Vancouver. It has also ceased operation on April 9th of 2008, due to the surging oil prices which has increased dramatically and left the company in financial troubles of more than 1 billion HKD.<sup>26</sup>



### **3.8.2 EasyCinema**

EasyCinema was one of Stelio's business ideas among the Easy Group, and this time, he tried to automate the entire operation and management of a cinema. Customer book and pay for the tickets solely online. Entry at the cinema is completely automated through the use of bar-code scanners, eliminating the need for expensive box offices and entry management facilities. The principle for EasyCinema is the same as all its other businesses: low cost, high volume.

Most cinemas fill only 10% of their seats at off-peak hours but Stelios believes that he can get over 50% capacities with his cheap tickets and by tying in customers to

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<sup>25</sup> Details of operation from Skybus Website

<sup>26</sup> Reuters article, "HK budget airline Oasis to stop flying" April 2008

screenings booked in advance. Tickets bought two weeks in advance will be sold for 20p, with the price rising to £5 immediately before the screening. There are no box office, popcorns, soft drinks, thus eliminating the need for a concession stand.

The web system provided advanced revenue and yield management functionality that allowed EasyCinema to dynamically price the tickets, based on demand for particular shows. This maximized yield while reducing the average price of a cinema ticket significantly.

By early 2006 however, EasyCinema was closed due to poor sales and debt, and since then turned into an online DVD rental company, a business model copied from Netflix.



## Chapter 4 – Discussion

After looking at all the different business models, I would like to discuss and attempt to answer some of the questions that were brought up in the research objectives. Several questions has already been touched upon in the main body of this thesis, thus I will not specifically answer them again in this section. Furthermore, I would like to draw a more generic conclusion to the discussion of no-frills businesses from a strategic perspective.

### 4.1 Emergence of No-frills Businesses and Related Success Factors

There are many forces driving the formation of the no-frills businesses, one of them being the M-shape society mentioned earlier. As the society divides, many of the existing businesses are forced to move away from the middle market. Many of the new businesses have also decided to focus on the lower-end. One of the ways to satisfy this market segment is by price leadership. It is not a simple task, however, to achieve price leadership in an already competitive market. No-frills businesses models have hence been developed to drive operational costs down and satisfy the consumer's needs.

There is another major 'tool' that must not be overlooked which allows the development of no-frills businesses: the Internet. One of the single most important notions behind the development of no-frills business is information symmetry. In the old days where the internet is not yet popular, information has always been conceded and non-transparent to most of the consumers. Many businesses use information asymmetry to their advantage in profit maximization. Price discriminations were popular in the different industries. Without sufficient knowledge, consumers were forced to buy what the manufacturers and service providers sell them. The market was

in favor of the supply side rather than the demand side. However, as information becomes available and easily accessible to the public, consumers become smarter at what they are buying. People are now able to compare prices and truly understand what is included in the product or service package they are buying.

Better yet, with oil prices surging and inflation taking place, consumers are forced to become smart shoppers. They seek for what they truly need and pay what they think is reasonable. And that is precisely why the no-frills businesses have spawned in almost every imaginable industry today.

According to the studies done by Miles (1993), new ways to conducting businesses in service production, service product, service consumption, and/or service market can all be considered as forms of services innovation. As we can see from the previous chapter, each and every company mentioned has some distinctive ways of conducting business through the notion of no-frills. No-frills is only one of the manifestation of service innovation, and it is up to the individual businesses to innovate and achieve the no-frills standards.

Two major similarities can be observed among the businesses. Notice that most of these so-called no-frills businesses operate primarily on reducing costs and increasing utilization. Reducing costs has been achieved through various ways. A lot of the businesses eliminated the need of a middleman through the usage of the Internet. With the Internet, the no-frills companies in the transportation and hospitality industries can interact with the customers directly without having to go through the travel agent. In addition, more costs can be reduced from staffing, for companies no longer need to hire as many customer representatives. These are all examples of automating the existing services and encouraging self service instead of having the customers served by employees. Other ways to cut costs includes collaborating with 3<sup>rd</sup> parties, and most

obviously, the elimination of frills. Increase in utilization is mainly practiced in industries where the goods and services are perishable, such as the transportation, accommodation, and the internet cafes. Through one form or another, yield management is usually practiced to achieve maximum utilization.

There are three important factors that can be drawn from the above discussions. These factors can serve as guidelines that business owners must clearly understand before implementing the no-frills model, because apparently the no-frills business model does not guarantee success. Of course, there are a lot more research that one needs to conduct before starting his/her own businesses, these are simply serving only as guidelines. Business owners must clearly understand each of the following factors with details before proceeding further:

- 1) Define your target market
- 2) Define target customer's true needs and wants
- 3) Understand the cost structure of your business in detail.

Before starting any business, one must define its target market. As we can see from the previous examples, failure to do so will only cause your business to tumble early on. Even though the reality is more complex than my assumptions, let us take a deeper look at the case of EasyCinema. Even though the cheap pricing can seem as an incentive for movie goers, yet there seems to be lacking a clear target market. Who exactly is the target audience? Is it the people that visit other cinemas on a regular basis or people that don't usually go to movie theaters? If it is the first group, pricing certainly isn't a main concern for that they have already been paying visits regularly to the theaters. Thus we can assume it must be the people that don't visit cinemas on regular basis. However, is price the sole reason for why these people don't pay visits? Perhaps they simply prefer the convenience of DVDs and the comfort of sitting on the couch at home. It is in doubt

that pricing alone will be able to attract these customers to visit the theaters. This leads us into the second question.

Fulfilling what a customer truly wants may sound simple but in reality it can be a real headache for businesses. Thorough studies must be conducted before making assumptions, and even after that there may still be chances of inaccuracy. Let us return to the case of EasyCinema, and assume that we are targeting the majority audience that visits movie theaters on a regular basis, and we are simply starting a price war using the no-frills tactics. Take a minute off and ask yourself the following questions. What movie did you watch and what made you remember the occasion? What was the most enjoyable moment? What was different from watching the movie on a DVD? No matter what your answer is, it is probably somewhat related to ‘the atmosphere’. The atmosphere is constituted by a million details, such as who you were with at the time, the plot of the movie, the sound and special effects of the movie, the popcorn, the soda, the experience of lining up and the anticipation associated with it, ...etc. Thus by removing the frills and making the ticket price lower is unlikely to generate more sales. This is especially true for movie theaters, given that the concession sales are a major constituent to the total profits being made. Thus removing it would be a sin!

Detailed analysis must be performed on defining the cost structure of operating a business. Many of the no-frills businesses operate as no-frills to increase their utilization towards 100%, as can be seen in the no-frills transportation sector for instance.

Increasing utilization by selling unused capacity at discounted price means more money can be received to cover the fixed cost. Fixed cost can be the pilot’s salary, landing fees, and maintenance. RyanAir is able to do so by using the same type of airplanes. This keeps the maintenance costs low and most importantly, pilots can be utilized more efficiently for they only need to fly a single type of aircraft. Furthermore, RyanAir has

an average load factor of 72.5% which is considerably higher than the estimated European average load factor of 64% <sup>27</sup> and is driving yields down. Load factor measures the percentage of an airline's output that has been sold (Holloway, 1997). This is distinct from yield management, which focuses on the average revenue generated per unit of output sold. Managing load factor alone is not enough, the issue is rather one of relating the average load factor to the break-even load factor. Selling seats on flights must be combined with overall cost reductions if an airline is to be profitable. Please look at the table below.

Table 7. RyanAir passenger load factors and break-even load factors comparison  
(PLF Stands for Passenger Load Factor, BELF stands for Break Even Load Factor)

|             | 1995 | 1996 | 1997 | 1998  | 1999 | 2000 | 2001  |
|-------------|------|------|------|-------|------|------|-------|
| PLF         | 76%  | 73%  | 72%  | 70.5% | 71%  | 71%  | 72.5% |
| BELF        | 72%  | 68%  | 64%  | 59%   | 57%  | 56%  | 54%   |
| Differences | 4%   | 5%   | 8%   | 11.5% | 14%  | 15%  | 18.5% |

(Source: Thomas Lawton's "Cleared for Take-Off", 2002)

The table shows that the difference between average load factor and breakeven load factor has been consistently positive throughout the years. In addition, the gap between these two sets of numbers has increased annually, allowing the airline further latitude in price-cutting and ensuring continued increases in absolute profit figures. Thus, even if RyanAir experience declining yields periodically, it also secures falling costs, suppresses its breakeven load factor, and therefore consistently turns a profit.

One of the main reasons why Skybus and Oasis ceased operation is failing the find

<sup>27</sup> Statistics from Thomas Lawton's book, "Cleared for take-off"

the balance between the surging fuel prices and what to charge their passengers. The oil price has reached so high that even if they reach high capacity, they will still be operating at a loss. Without the other mechanisms besides the core services, such as what RyanAir has, Skybus and Oasis could not have survived. Continuous reduction on costs is a necessity to keep the breakeven load factor even lower, otherwise one must be able to generate additional revenues from alternative sources. For RyanAir, the core service is simply used to attract customers, while the supplementary services are the ones used to charge the customers and generate additional profits, just like what the razor and blade strategy teaches us.

#### **4.2 Critical Perspectives of Low-cost Strategy**

It is apparent that most of these no-frills businesses are in pursuit of being the low price leader in its respective industries. According to Lynch (1997), in order to be a low price leader, a business must cut costs off of every element of the value chain (Porter, 1985). However, low cost alone does not provide competitive advantage. Competitive advantage can only be achieved in terms of a product or service that is seen by the consumer to have an advantage over its competitions. Low cost strategies can have many different manifestations (Johnson et al, 1997):

- The ‘cheap and cheerful’ strategy, dependent on low cost and low value added
- Reduced price strategy but with an emphasis on quality
- Competitive prices with a better quality and more reliable product or service than rivals.

Porter also argues that the low cost firms usually sell a standard or no-frills product or



service and that such a firm will generally be an above average performer in its industry, provided it can command prices on or about the industry average (1985).

Let us look back at the success of IKEA. It can be a hassle for customers to shop at IKEA. The design of the store layout forces consumers to walk through every single display area. Customers usually have to spend a lot of time there, even if one is only purchasing a single item. There is almost no customer service, and once you go through the hassle of locating and putting the items into your shopping cart, you wait in the long line for check out. What's worse, once you get home, you have to assemble it yourself. It is an inconvenient and time-consuming in-store experience. However, consumers continue to go back at shop at IKEA.

Daniel Kahneman, a Nobel prize-winning psychologist pointed out that people could only remember two things during an experience process: how we feel at the peak (whether it is good or bad) and at the end (1999). These peak-end feelings will conclude our entire experience and be stored in our brains at subconscious level, directing our next shopping decision; whereas the proportion and duration of pleasure or pain throughout the whole experience process do almost nothing to our memories. Although there are some disappointments, it's the peak-end experience that takes charge and drives one to go back again. According to surveys, for most consumers, the peak-end experience is consisted of the value of the products for the money one pays, the free-to-trial shopping experience and the effective display that demonstrates practical and efficient use of the products (Lee, 2006). The peak-end memories would override the unpleasant feelings and evolve into a positive experience that drives consumers back. To build customer loyalty, companies have to deliver their most unique brand values and meet (or exceed) the most critical needs and expectations of the target customers through peak and end experiences.

Even though not every single aspect of the in-store experience is great and some aspects even induce pain in customers; it remains effective in generating positive memories and delivering the brand values of IKEA—the natural outcome of a branded experience. A branded experience is not necessarily a great experience at all touch-points. On the contrary, a branded experience requires you to allocate your limited resources to create significant pleasure peaks (those that perform way above the average, such as product and price) and limit "pain" to an acceptable level. IKEA's primary target is the general masses, and its strategy is to select some, but definitely not all, of the critical needs of this target group and focus its resources on performing superbly well on fulfilling the select critical needs.

To better understand the consumers, let us take a look at the importance-performance quadrant for IKEA. Figure 8 below illustrates IKEA's importance-performance quadrant. This chart shows the attributes or drivers located on the dimension of importance (to the customer) and performance or satisfaction of the IKEA in-store experience. A generic conclusion can be drawn to reduce or minimize the spending on those attributes with low importance to the customers; maintain the investment on those of high importance and high performance; and focus all resources on enhancing those with high importance and low performance.

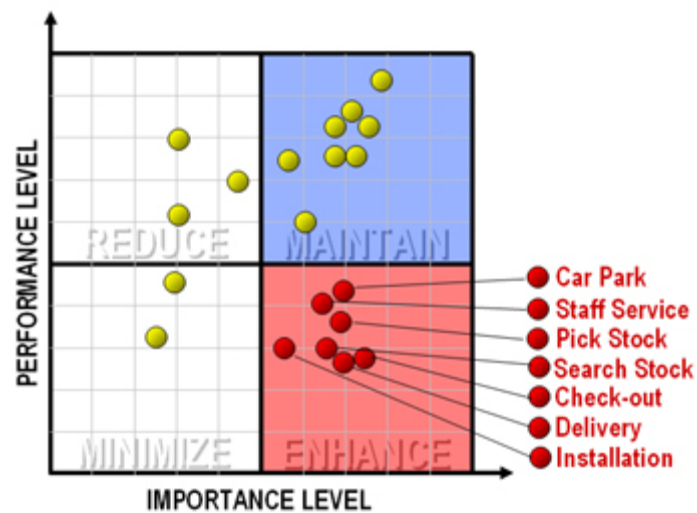


Figure 8. Importance-performance quadrant of IKEA in-store experience

(Source: Sampson Lee’s article “IKEA: A Branded Experience Is More Important Than Customer-Centricity”, 2007)

If IKEA was to follow the voice of the consumer as specified, the company has to enhance the bulleted attributes in red, namely the car park, staff service, choosing stock, searching stock, check-out, delivery and installation because they are important to the consumers but performed badly. However, if IKEA was to proceed and focused on those attributes, IKEA will never be the great brand it is today. Simply put, there will be no pleasure peaks during the whole in-store experience because the company's resources would be spread too thin among the various attributes without any focus.

Strategy is about making choices. Designing an effective strategy means allocating your resources at the right places. Even if a company has enormous funding, customer needs can never be fulfilled on all aspects. To deliver a differentiated, branded experience, one needs to select the right ones and stay focused. Factor in the brand elements while listening to the voices of the customers. Factors that are important to the customers may not be important to the brand. That means one needs to focus limited resources on those processes that are important both to the customers and to the brand,

as long as other processes don't fall below the acceptable level. The blue stars in Figure 9 represent IKEA's processes of product quality, price, display setting, product trial and the canteen. These are the only points that consumers will recall, and thus are the ones of importance!

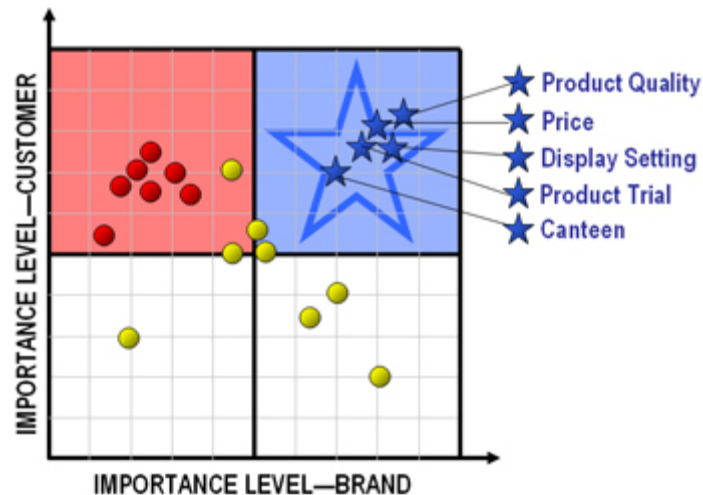


Figure 9. Importance level to brand and customer of IKEA in-store experience  
 (Source: Sampson Lee's article "IKEA: A Branded Experience Is More Important Than Customer-Centricity", 2007)

An experience is not effective unless it is both remembered and branded. All efforts will be wasted if the consumers do not remember them. On the other hand, if the consumers recall the positive experience, but doesn't connect it to your brand, it is wasted as well. An unbranded experience will have no impact on building brand loyalty. It is not a difficult task to cut costs for a firm.

Thus for no-frills businesses to thrive in the long run and expand, the question is not about how low the prices are, but rather how the competitive advantages can be achieved and sustained through price leadership.

### 4.3 A Generic Strategic Framework for No-frills Businesses

If a no-frills business is to establish itself as the price leader within its industry, it must first construct a viable strategic framework. There are three components, the first of which is 'positioning'. Strategy is the mediating force between the organization and its business environment, between the internal and the external context. Strategy encourages us to look at how firms find their market positions and protect them in order to meet, avoid, or subvert competition (Mintzberg, 1998). Needs-based positioning (Porter, 1996) – targeting the needs of price sensitive customers for instance – comes closest to conceptualizing the no-frills businesses source of strategic positioning. A focused competitor, such as IKEA in retail, RyanAir in airline travel, thrives on groups of customers who are overpriced by more broadly targeted competitors. Strategic positioning is usually described in terms of its customers. A successful positioning strategy necessitates hard choices in terms of customer focus. RyanAir has staked out a unique and valuable strategic position based on a tailored set of activities. On the routes served by RyanAir, a full service airline would never be as convenient or as low cost. This model is not easily transferable, as the culture and organizational capabilities are not able to be duplicated by competitors.

Once that position is established, competitive advantage is secured by leveraging capabilities that cannot readily be emulated by rivals. Quality, efficiency, innovation and customer responsiveness can all be building blocks to competitive advantage (Lawton, 2002). Distinctive capabilities are generated from organizational resources. Resources may be tangible, as in the case of human and technological assets, or they may be intangible, as in the case of reputation, market information, and knowledge. The most important company resources in strategy development are architecture, reputation,

and innovation (Kay, 1993). These contribute to the distinctive development of a company's strategy and differentiate a company's resources from its competitors. Architecture is seen in terms of a distinctive structure of relationships either within the company or between it and its suppliers and customers. This is something that is not so readily copied and forms the bedrock of a company's unique organizational capabilities. Reputation allows an organization to communicate favorable information about itself to its customers. Reputations are difficult to create and are not easily copied. Ultimately, the primary physical source of advantage for no-frills businesses is the business culture and practices. Also, for service sector companies, key capabilities are derived from human resource management and customer services. Long term competitive advantage is fabricated upon the relationship that exists between the company, its employees, and its customers, as well as the reputation that is built on the basis of reliability and consistency in the quality of service.

The final stage in developing a strategic framework for no-frills businesses is to pursue a route that will revolutionize the terms of competition within the industry. Companies that were discussed earlier have taken the route which Hamel (1996) described, 're-conceiving a product or service', through radically improving the value equation. This refers to improving an industry's ratio of price to performance or put simply, offering better value for money. Through this revolution, a company can force a re-conception of a given product or service. This is what many of these no-frills companies have done, becoming the so-called 'value-revolutionaries' (Hamel, 1996) in the process, wherein a company refuses to take its industry's conditions and norms as given, preferring instead to pursue market innovation. The end result is the emergence of all these different no-frills businesses mentioned in the previous chapter.

#### 4.4 Conclusions

As the M-Shape society develops into maturity, more enterprises will begin to focus on the social class instead of the riches. Even though the rich has strong buying power, the market is still limited and relatively smaller than the social market. As the society divides, companies need to focus even more at the bottom of the pyramid, because this is probably where the most profits can be generated. However, note that the no-frills businesses are not aiming only at the bottom of the food chain. Instead, the businesses are aiming at the newly developed group of consumers, the middle class who has shifted to the lower end of the spectrum.

As the consumers become smarter at shopping and price sensitive, companies need to define what the consumers really want and need. During the process of dissection, frills can be eliminated to the bare; by eliminating the non-value adding activities on the value chain (Porter, 1985), more savings and values can be passed back to the consumers. And this, is the no-frills mentality of developing new business models.

For product developments, speed and partnerships are also the keys to meeting consumer demand in the fast changing society today. IKEA and H&M are both prime examples which utilizes powerful and efficient strategic alliances and partnerships to help shorten the response time, lower the inventory, the eliminate unnecessary costs in order to reflect reasonable pricing.

According to a market research conducted by McKinsey, there is still a huge social market being neglected in various countries around the world. It is estimated that in China, there are around 35 million families from the social class who has competent buying power, yet is being neglected due to geographical and logistics reasons.

Max New York Life, an insurance company, entered India and started selling an insurance policy of \$2 USD a year that can pay up to \$208 USD. The policy aimed at villages with population of 5,000 or less. In Africa, Freeplay Energy Group designed a radio that can be powered by rotating a knob, thus consumers do not have to pay for expensive batteries. In Bangladesh, Grameen bank started a financial service that allowed people to receive loans for up to \$15 USD, and the effort itself made the founder, Muhammad Yunus, receive the Nobel Peace Prize in 2006. These examples show that as the existing markets which we are familiar with becomes saturated, businesses has to penetrate into untapped markets. No-frills services has already manifested in China, with the most recent example being the cubic rentals in Shanghai and the launch of Spring Airlines. Spring Airlines estimates that the market potential for domestic traveling will be extremely profitable. Spring Airlines is a subsidiary of Springs International, which operates the biggest travel agency in China.

Satisfying the consumer continues to a much bigger scale of complexity when it comes to a different nation. Culture plays a major role on consumer expectations and how they behave given the same circumstances. Therefore success of a no-frills business in one country does not guarantee the same success in a different country.

No-frills is certainly one of the many approaches that can reach this new social class. However, we should once again keep in mind that the no-frills businesses are not targeting solely on this market, but rather utilize this mentality to reinforce the concept of developing products or services that people truly needs at the lowest price possible.

Consider the development of ULPC. Although it was originally developed to be sold in 3rd world countries, it has proven to have a market in the most advanced countries, which includes the U.S. and the European nations. This further strengthens the potential of using the no-frills approach to operate businesses in the M-Shape



society. More and more consumers are no longer looking for something that has all the frills. Instead, they are shopping smart and looking for products that meets their requirements and is not willing to pay for anything else.

As inflation takes place and the society morphs into the M-shape, more and more population falls into the category called the social class. In addition, consumers in general are becoming more tech-savvy and informational, making them smarter at shopping. It is up to the enterprises and the brilliant minds of the entrepreneurs to develop new, attractive, and profitable business models to satisfy what people need. The market is no-longer a 'push-system' but instead it has transformed into a 'pull-system'. Only the ones who sell what the people truly want and need will succeed.

In our bifurcated global market, businesses need a clear strategy for aiming high or low, while staying away from the treacherous middle, where so many have recently stumbled. If one's offering isn't exciting enough to inspire trading up, but not enough of a bargain to satisfy the frugal treasure hunters, one will have no emotional connection with the target audience. And, like General Motors or Sears in recent years, typical tried-and-true marketing strategies will go into a severe stall.

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