THE AIRLINE INDUSTRY: Trends, Challenges, Strategies

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Presentation Objectives

• Provide background on the global industry
• Present a regional analysis
• Discuss current and future evolvement of the industry (trends)
• Discuss challenges and strategies impacting the industry
• Discuss the new breed of airlines
• Discuss why airlines fail and how to achieve success
Background Section
3 Stages of Development Impacting the Airline Industry

• Regulation
• Liberalization
• Deregulation
• “Re-regulation”
Phases of Industry Restructuring (resulting from Deregulation / Liberalization)

- Expansion
- Consolidation
- Concentration
Past, Present and Future Trends
The Global Airline Industry

Survive  Adapt  Recover  Rethink

State of Industry

Time

“Scenarios”

• SARS
• 9/11
• War
• Financial Crisis of 2008, 2009, 2010…
• What to prepare for…
  – Globalization
  – Change in international political landscape
  – Distribution of natural resources (oil, gas, water)
  – Internal conflicts (shifts in power) and unintended consequences and unintended consequences of good intentions
  – Public and international perception
  – War
  – Terrorism
  – Continued financial issues
Top 5 Frustrations in Aviation

1. Fuel/oil
2. Pollution control
3. Personnel cutbacks
4. Global economic woes
5. Recurring safety lapses
Top 3 Costs for Airlines (in any order)

1. Fuel*
2. Labor
3. Maintenance

*40% for US airlines in 2009: 13-40% of costs in 7 years
Typical Airline Operating Expenses

- Flight Crew (7.4%)
- Enroute Facility Charges (2.4%)
- Station Expenses (10.8%)
- Passenger Services (10.5%)
- Ticketing, Sales, Promotion (16.4%)
- General Administrative and other (12.2%)
- Maintenance & Overhaul (10.1%)
- Depreciation & Amortization (7%)
- Landing & Associated Airport Charges (4.1%)
- Other (7.1%)
- Fuel & Oil (12%)

Source: The Aviation & Aerospace Almanac
ICAO Air Transport Reporting Form EF-1
Overview:
The Industry Continues to Evolve
Industry Overview: Global
(As of October 2008)

• Global economic crisis?
• Airlines to lose $5.8B in 2008 (IATA)
• High oil prices and falling demand
• Demand for travel shrinking (OAG)
• 46M seats to be cut Oct-Dec
• 500k fewer flights Oct-Dec 2008 vs. 2007

• 200+ airports to cease offering services
• 3% decline on trans-Atlantic and trans-Pacific routes
• 25 airline failures since Dec 2007
• Airlines grounding aircraft and reducing capacity
• Pax traffic to grow at 3.2% (from 3.9%) 
• Cargo traffic to grow at 1.8% (from 3.9%)
Regional Analysis
6 Regions of the World

- North America
- Europe
- Asia-Pacific
- Middle East
- Africa
- Latin America/Caribbean
Regional Regulatory Trends

- N. America – Deregulation / Privatization
- Latin America – Deregulation / Privatization
- Europe – Liberalization / Privatization
- Asia-Pacific – Deregulation / Liberalization / Privatization
- Middle East – Limited Privatization / Liberalization
- Africa – Cautious Privatization / Some Liberalization
North American Region
(Canada/USA/Mexico)

• Canada – privatization of airlines, airports, ATC; rise of low-cost carrier
• USA – rise of low-cost carrier; government control of airports; secondary airports; major airline debt; bankruptcies; mergers; stagnant domestic growth; increased international growth
• Mexico – government controlled; bankruptcy; low-cost carrier to emerge
• US domestic routes hardest hit
• “De-hubbing” or “de-peaking” starting to happen (i.e., AA at Chicago)
• Simplifying of aircraft fleet
• Automation initiatives to improve customer service and enhance productivity
• Changing distribution methods
• Modification of in-flight services
• Initiating broad range of cost savings programs
• 265k fewer flights (21M fewer seats) Oct-Dec 2008 compared to same 2007
Asia-Pacific Region

- Managed liberalization (slow to change)
- Strong growth (especially since 9/11) (i.e., China 8% PAX growth next 20 years; India growing domestically and internationally 20% per year)
- No regional organization for Asia (unique)
- “Megacarriers” and small international carriers co-exist
- No interline agreements
- Largest share of world economy
- Busiest international route in world (Hong Kong – Taipei)
- Growth of alliances
- Airport and airspace congestion, competition, need for advanced navigational equipment
- 15M seats to be cut
- Centre of growth declining
- **Airline profits shrink $900M in 2007 to $300M in 2008**
European Region (EU)

• Liberalized environment (1997) – Third Package
• Privatization of airlines
• Rise of low-cost carrier
• Growth of alliances
• Competition with other modes of transport (high speed rail)
• Theme for future is ‘leadership’ in air transport regulation
• National pride still an issue
• 45+ European airports lost all scheduled flights by end of 2007
• 83k fewer flights in EU this Q compared to 2007
• **Airline profits to fall $2.1B in 2007 to $300M in 2008**
Middle East

- Fairly stagnant in terms of growth
- Rich and poor
- High cost airlines feeling pinch of 9/11
- Implementing low-cost strategies
- Safety and security?
- **Airline profits to fall from $300M in 2007 to $200M in 2008**
African Region

- Low standards (safety, environment)
- Airlines do not contribute to regional economy
- Slow growth but growing (i.e., N. Africa regional growth 4-6% per year 2000-2010)
- Propensity to fly variable limited but will increase over next 15 years
- Increased stability in the region
- Old aircraft fleet (i.e., B727)(Stage I and II)(average age is 18 years)
- Will need 1,000 new aircraft next 15 years to replace old technology
- Since 1992: airline integration; restructuring; commercialization – positive
- ‘Flag carrier’ to self-reliance, privatization, less governmental control
- Need for new management to cope with global trends
- Need autonomy in civil aviation authorities
- Need infrastructure
- Need personnel training
- Airlines to work together as partners
- Rise of LCC start-ups
- **Airline losses of $700M in 2008**
Latin America & Caribbean

- Moving toward liberalization
- Increased PAX growth and competition
- Increased alliances
- Developing corporate strategy and a competitive strategy to cope with competition
- Need for training
- Need for R&D
- Brand culture important
- Focus on safety
- **Airlines losses of $300M in 2008**
Latin American Challenges

- Think as a “business” and not an airline
- Cost savings
- Focus governments on economic benefits the industry brings
- Airport privatization issues (failed?)
- User charges and accounting for money
- Taxes and use of proceeds
- Safety performance
  - Industry 1:1.5M; LA 1:550,000 (2006)
  - 5% of traffic and 14% of incidents
- Environmental performance
  - Invest in new technology
  - Efficient use of infrastructure
  - Operate aircraft effectively
  - Discuss emissions trading
- Infrastructure (airports)
- Liberalization issues
- Improve communication internally and externally
- Will there be a SAFTA? Impact?
The Industry:
Challenges & Strategies
Major Players and Forces Comprising An Airline’s Environment

- COMPETITORS
- POWER OF SUPPLIERS
- THREAT OF NEW ENTRANTS
- COMPETITORS
- THREAT OF SUBSTITUTES
- AIRLINE
- POWER OF CUSTOMERS
- POWER OF MARKET INTERMEDIARIES

- PHYSICAL
- ECONOMIC
- POLITICAL / LEGAL
- TECHNOLOGICAL
- DEMOGRAPHIC
- SOCIO / CULTURAL

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The Case for Investing in Aviation Infrastructure

- **Demand Growing**
- **RECOGNITION**
  - **Demand WILL SOON EXCEED Capacity**
- **INVEST IN CAPACITY?**
  - **YES**
    - **Capacity = > Demand**
      - **Efficient System with Economic Benefits Fully Realized**
  - **NO**
    - **Demand > Capacity**
      - **Congestion + Delays Demand goes elsewhere**
      - **Increased Costs and Loss of Economic Benefits**

Critical Financial Issues & Challenges

- Cost Controls
- Access to Capital Markets
- Insurance
- Foreign Currency Exposure
- Fleet Replacement and Price of New Aircraft
- Industry Losses and Inconsistent Profitability
- Cost of Funds and Low Yield on Surplus Funds

- Productivity and Labor Reform
- World Economy
- Irrational Pricing and Predatory Action by Major Carriers
- Over-Capacity
- Cash Flow and Ability to Self-Finance
- Debt/Equity Ratios
- Taxation
- Ownership Issues
Global Aviation Challenges 21st Century

• New operating environment
• Bankruptcy and shut downs
• “Generic” vs. “Airline” business plan
• “Flexible” strategic plan (key)
• Treat as a “business”
• Regulation vs. Liberalization vs. Deregulation
• Rising costs (fuel, labor, maintenance, security)
• New generation airlines vs. legacies (tiers)
• Restructuring and alliances
• Excessive capacity
• Competition (transport and technology)
• Customer (target, loyalty)
• Organizational design
• Internal challenges
• Strategy
• Duplication
• Functional and departmental barriers
• Staff relations and new types of employees (Generation Y)
• Legacy system dependencies
• Lack of compromise
• Air carrier ownership and control
• Sustainability of air carriers and safeguards
• Physical and environmental constraints
• Air transport and the global trade mechanism
• Consumer protection and passenger rights
• Impact of technology (aircraft, e-commerce, CRSs and GDSs, Internet) on liberalization process
• Future approaches to regulatory reform
Global Aviation Strategies 21st Century

- Understand reality of change and become “flexible”
- Revitalize strategy
- LCC, LC/HV, “Virtual” carriers
- Customer focus (ask what they want)
- Eliminate duplication
- Organizational accountability
- Staff relations into strength
- Updating of airline systems
- Build partnerships (alliances, interactive marketing)
- Act decisively
- Diversify the business (core and non-core)
• Airlines “inventing” new ways to reduce future costs and spending of capital
• Increased efficiency
• Dependent upon aviation (links local, national and international economies)
• Airlines must take control of business issues and work in partnership (first time in history)
The New Breed of Airlines: Is Low-Cost the Answer?
“Does low-cost always mean being squeezed in like sardines?”
Discombobulated Syndrome: What the heck does low-cost mean?

- Low-Cost Carrier/No Frills (LCC/NF)
- Low-Cost Carrier (LCC)
- Low-Fare/High Value Carrier (LFHV)
- Less Frills Carrier
- Value Carrier
- Budget Carrier
- New Generation Carrier
New Airline/Airport System

- Legacy Carrier Network
  - Small number of global alliances

- Point-to-Point Network
  - Mini alliances
  - Interactive marketing agreements / cross-selling
  - Mergers / acquisitions
  - Establishment of global network

- Regional/Feeder Network
  - Independent with loose partnerships
New Breed of Air Carriers

- Megacarrier – legacy airlines
- “LCC” (multiple versions)
- Regional/Commuter
- Network Specialist - PrivatAir
- Product Specialist – Eos, MAXjet, Silverjet, L’Avion (now British Airways)
- Price Specialist – Oasis, Zoom, Jetstar
New Breed of Airline Alliances

• Megacarrier Alliances
• “LCC” Alliances (P-P now overlapping)
• Network Specialist Alliances?
• Product Specialist Alliances?
• Price Specialist Alliances?
• Interactive Marketing Agreements
Failing & Achieving Success
Failures in Airline Business Planning

- Undercapitalization
- Overexpansion
- Lack of flexibility
- “Wrong” leadership
- “Wrong” money
- Unable to obtain sustainable, competitive advantage
- Failure to demonstrate revenue growth and profitability
- Lesson?
Air Transport Infrastructure: A Conceptual Framework for Decision-Making

CUSTOMERS: Passengers / Shippers

Threat of Air Transportation Substitutes

Threat of New Entrants

ENVIRONMENTAL

POLITICAL / LEGAL

ECONOMIC

MACRO - ENVIRONMENT

MACRO - ENVIRONMENT

COMPETITIVE

QUI - MONOPOLISTIC

AIRPORT

AIRLINE

INTERACTION

COMPETITIVE

QUI - MONOPOLISTIC

ENVIRONMENT

AIR TRAFFIC CONTROL

CUSTOMERS: Passengers / Shippers

TECHNOLOGICAL

DEMOGRAPHIC

SOCIO / CULTURAL

Citizen Action Groups

Consumer Advocacy Groups

Threat of New Entrants

LOBBYING

LOBBYING

LOBBYING

LOBBYING

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Five Forces Affecting Industry Profitability

- Threat of New Entrants
- Bargaining Power of Suppliers
- Rivalry Among Existing Competitors
- Bargaining Power of Buyers
- Threat of Substitutes

Source: Competitive Strategy by Michael E. Porter
Five Forces Affecting Airline Industry Profitability

THREAT OF NEW ENTRANTS
- DEREGULATED / LIBERALIZED ENVIRONMENT
- FREEDOM OF ENTRY / EXIT
- AVAILABILITY OF AIRCRAFT, ETC.

BARGAINING POWER OF SUPPLIERS
- SUPPLIER CONCENTRATION
- ACCESS TO CAPITAL ETC.

RIVALRY AMONG EXISTING AIRLINES
COMPETING FOR GROWTH, MARKET SHARE, ETC.

THREAT OF SUBSTITUTES
- TELECOMMUNICATIONS
- VIDEO CONFERENCING
- HIGH-SPEED RAILROADS ETC.

BARGAINING POWER OF BUYERS
- BARGAINING LEVERAGE
- BUYER INFORMATION
- SUBSTITUTE PRODUCTS
- PRICE SENSITIVITY ETC.

Adapted from: Competitive Strategy by Michael E. Porter
Achieving Success

- Solid “airline” business plan
- Flexibility
- Diversity
- Leadership
- Steady and moderate growth strategies
- Effective cost cutting strategies
- Fleet commonality
- Reasonable capital requirements
- Long-term vision
• Ensure that available tonne-km remain congruent with demand (route / network realignment / optimization)

• Shift capacity to take advantage of routes and markets where depressed currency will significantly increase value-for-money opportunities for leisure travel

• Improve balance sheets and credit ratings (prudent capital planning)
• Develop strategies to counter continuing pressure on yields (e.g., pricing service to cover costs, avoid price wars)

• Carefully evaluate new partnerships and alliances

• Respond to consumer needs

• Create an environment that enhances labor/management relationships and cooperation

• Engage in effective lobbying efforts to influence critical government policies, laws, regulations and taxes

• Reduce cost structures, eliminate inefficiencies and increase productivity to the greatest extent possible (e.g., technological applications)
Questions & Answers

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