

Responding to Crisis: the Changing Structure of the Airline Industry

Rigas Doganis

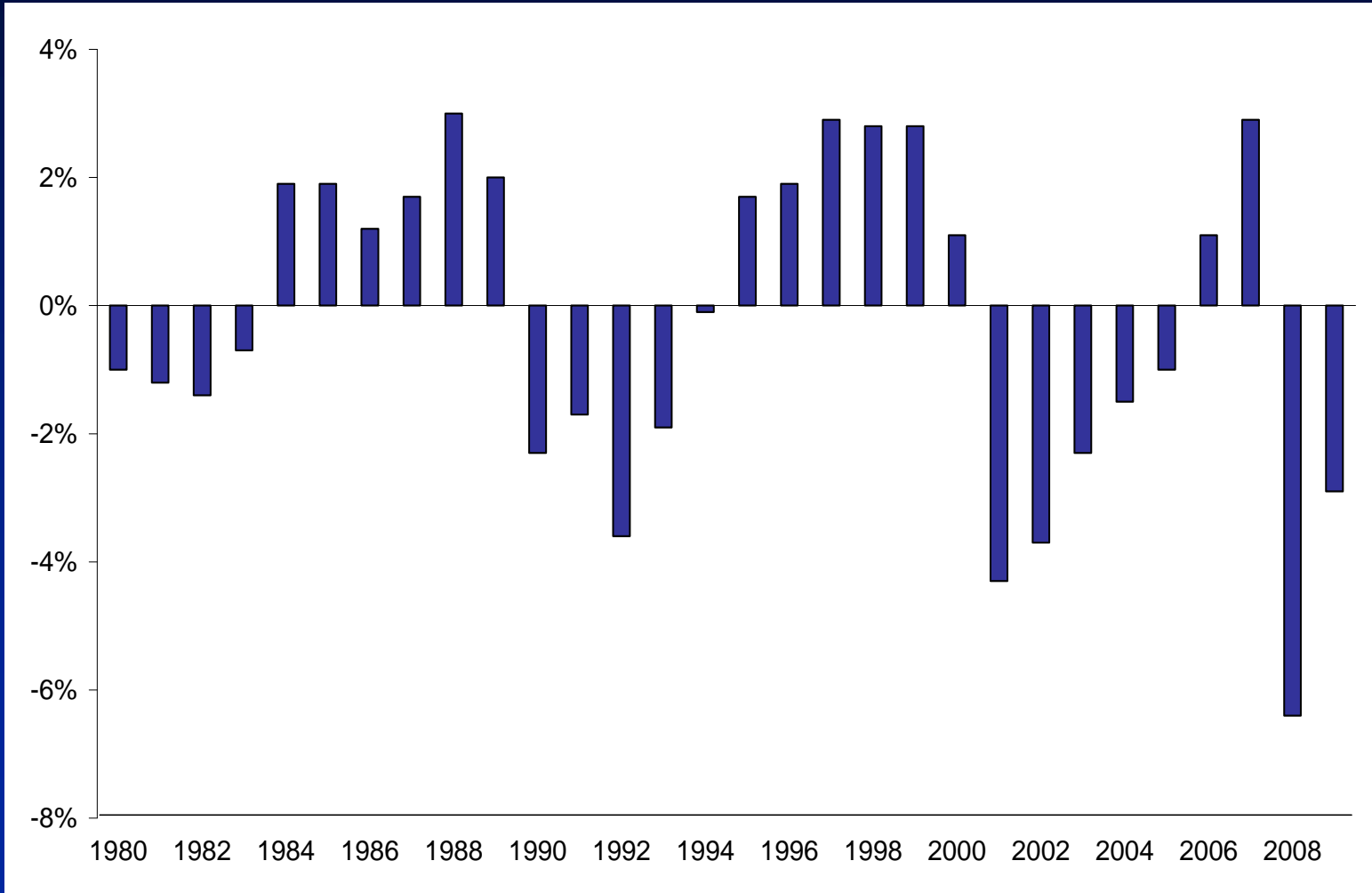
*Visiting Professor Cranfield University
Non-executive Director easyJet and Hyderabad Airport*

*The Hague
14th April 2011*



An Unstable Decade ?

Net Profit or Loss World' Airlines as % of Total Revenues



Source: Rigas Doganis – "Flying Off Course" and ICAO

The Sun Shone in 2010

Traffic grew rapidly – but growth rate declining

Change Year 2010 versus Year 2009

Airlines of:	Pax-Kms % change	Freight T-kms % change
Middle East	17.8	27.6
Latin America	13.2	29.6
Africa	12.9	23.5
Asia-Pacific	9.0	24.0
Total Industry	8.3	20.8
North America	7.4	22.9
Europe	5.0	10.8

Source: IATA



IATA Financial Forecasts for 2010 and 2011

	2010 Net profit \$ Bil.	2011 Net Profit \$ Bil.
North America	4.7	3.2
Europe	1.4	0.5
Asia – Pacific	7.6	3.7
Middle East	1.1	0.7
Latin America	1.0	0.3
Africa	0.1	0.0
GLOBAL	16.0	8.6

Source: IATA March 2011

But an Unstable Industry Faces Further Challenges

**Recovery slows/stops in some states - in Europe
esp. after Japan tsunami/nuclear disaster ?**

Rising inflation in China perhaps India

Many airlines in weak cash position

Fuel prices continually rising since early 2009

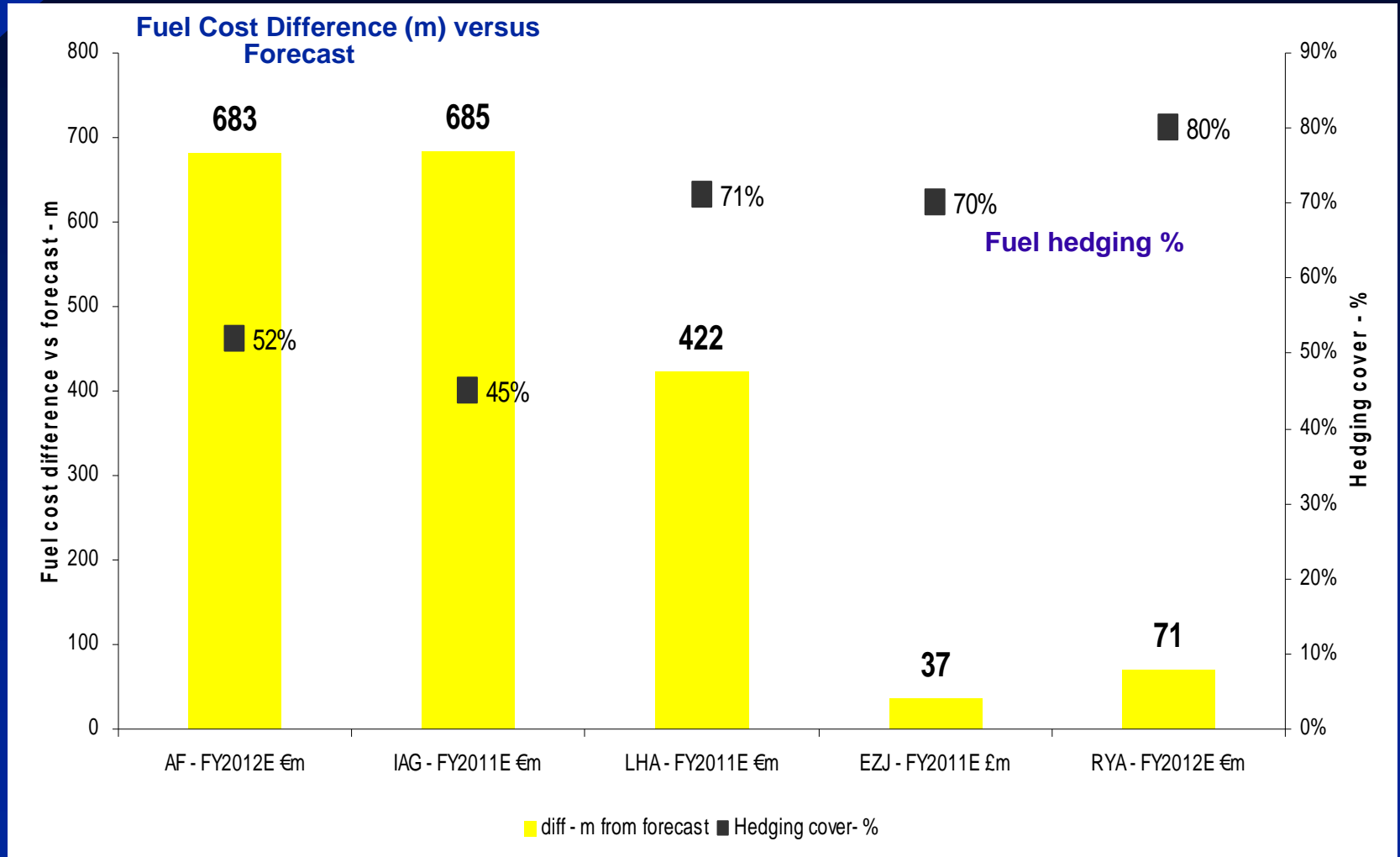


Rocketing Fuel Prices create 2008 crisis then collapse but rise sharply early 2011

<i>Annual Average price</i>	<i>Fuel Price (cents/US gal)</i>	<i>Fuel price Index 2003 (81.1)= 100</i>
Year 2004	116.1	143
Year 2005	167.7	207
Year 2006	194.8*	240
Year 2007	213.7	263
2008 June	394.6	487
December	140.6	173
Year 2009	167.4	206
Year 2010	216.8	267
2011 February	287.2	354

Compiled using "Airline Business" data. Median Spot Prices

Impact of Fuel at \$ 900/T average for FY Compared to Forecast Fuel Cost



Source: Based on "Liberum Capital" estimates (Feb.2011)

An Unstable Industry Faces Further Challenges

Recovery slows/stops in leading economies

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Fuel prices steadily rising since early 2009

**Rapid expansion of LCCs – esp. Europe , Asia ,
L.America and Mid-East unstoppable**

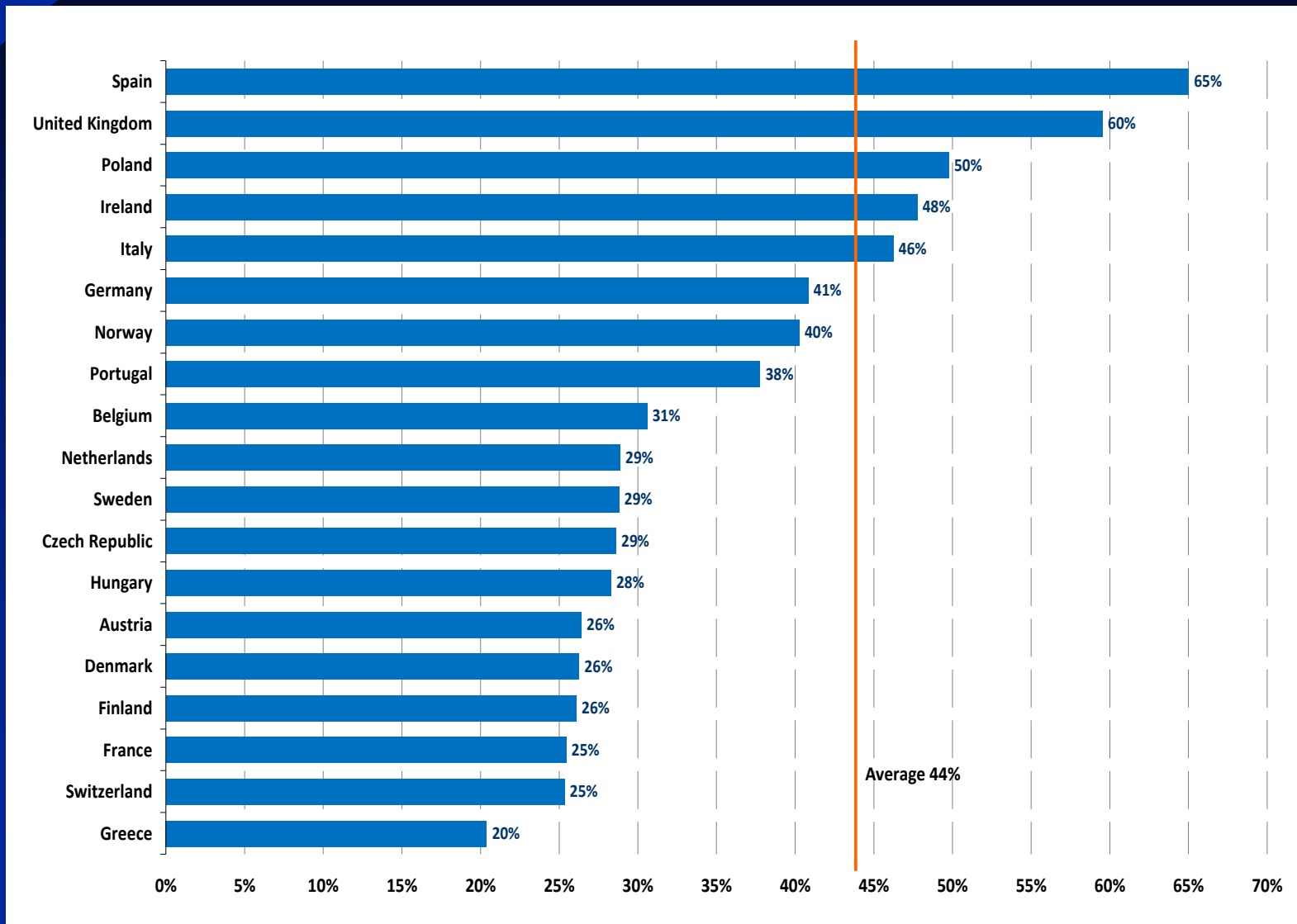


Low-cost Revolution in Asia/Pacific

2001	by 2010	2010 (contd)
<i>Operating in liberalised domestic markets</i>	<i>Many new entrants More international routes</i>	
Air Asia	Air Arabia	Paramount
Cebu Pacific ?	Air Do	SpiceJet
Freedom Air	Air India Express (A.India)	Star Flyer
Lion Air	Fly Pacificblue	Thai Air Asia
Virgin Pacific	Go Air	Tiger Air (SIA)
Virgin Blue	Indonesia Air Asia	Valuair
	Indigo	Virgin Blue Macau
	Jetstar (Qantas)	Air Jin (KAL)
	Jetstar Asia	Air Busan (Asiana)
	Jet-lite (Jet Airways)	Firefly (Malaysian)
	Nok Air	Thai Tiger (Thai Airways)
	One-Two-Go	V Australia
	flydubai	

Etc..etc ... ANA and JAL now planning LCC subsidiaries

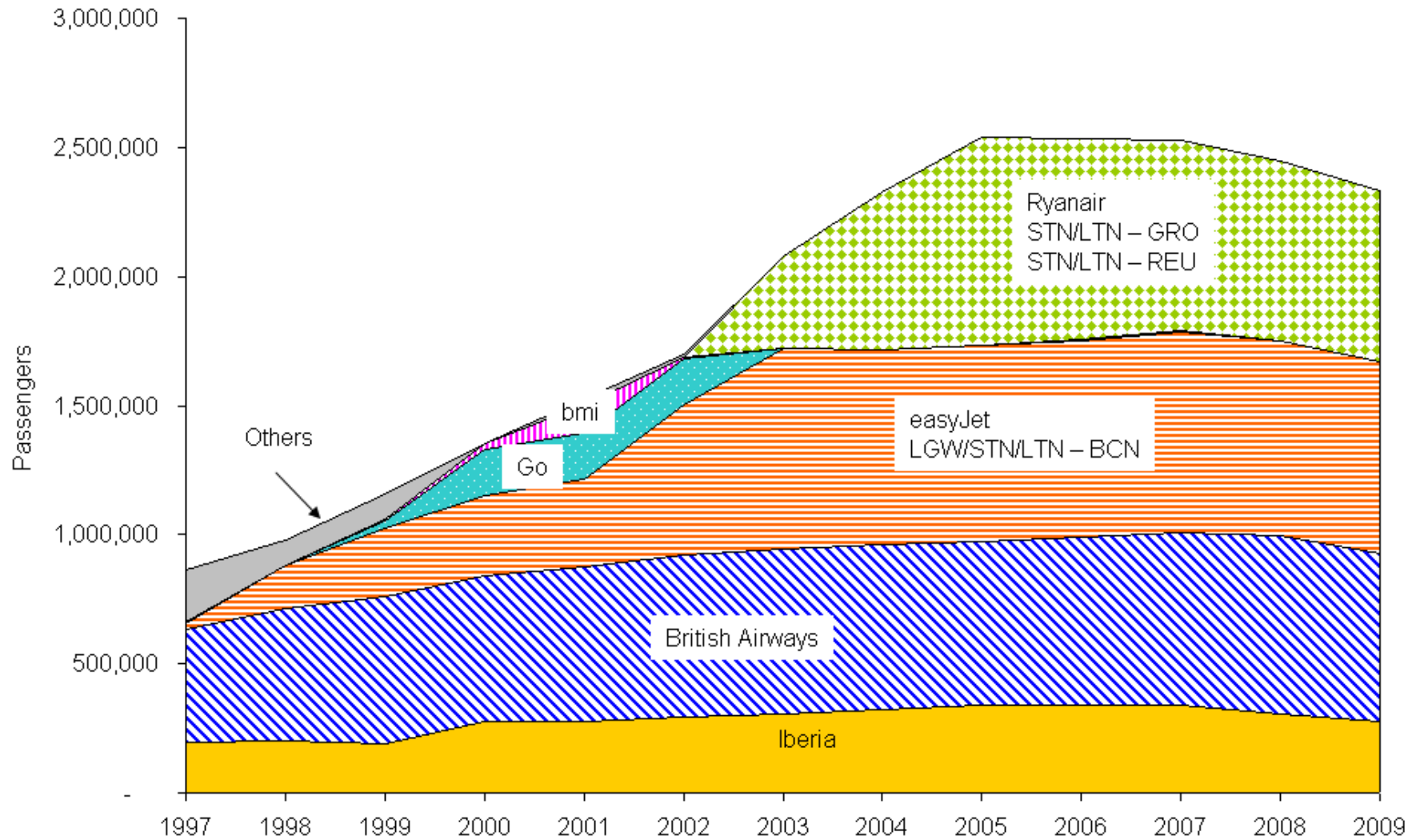
Share of “Low-cost” seats on domestic and intra European routes in each country –Sept.2010



LCC Average share in 2003 was 17%

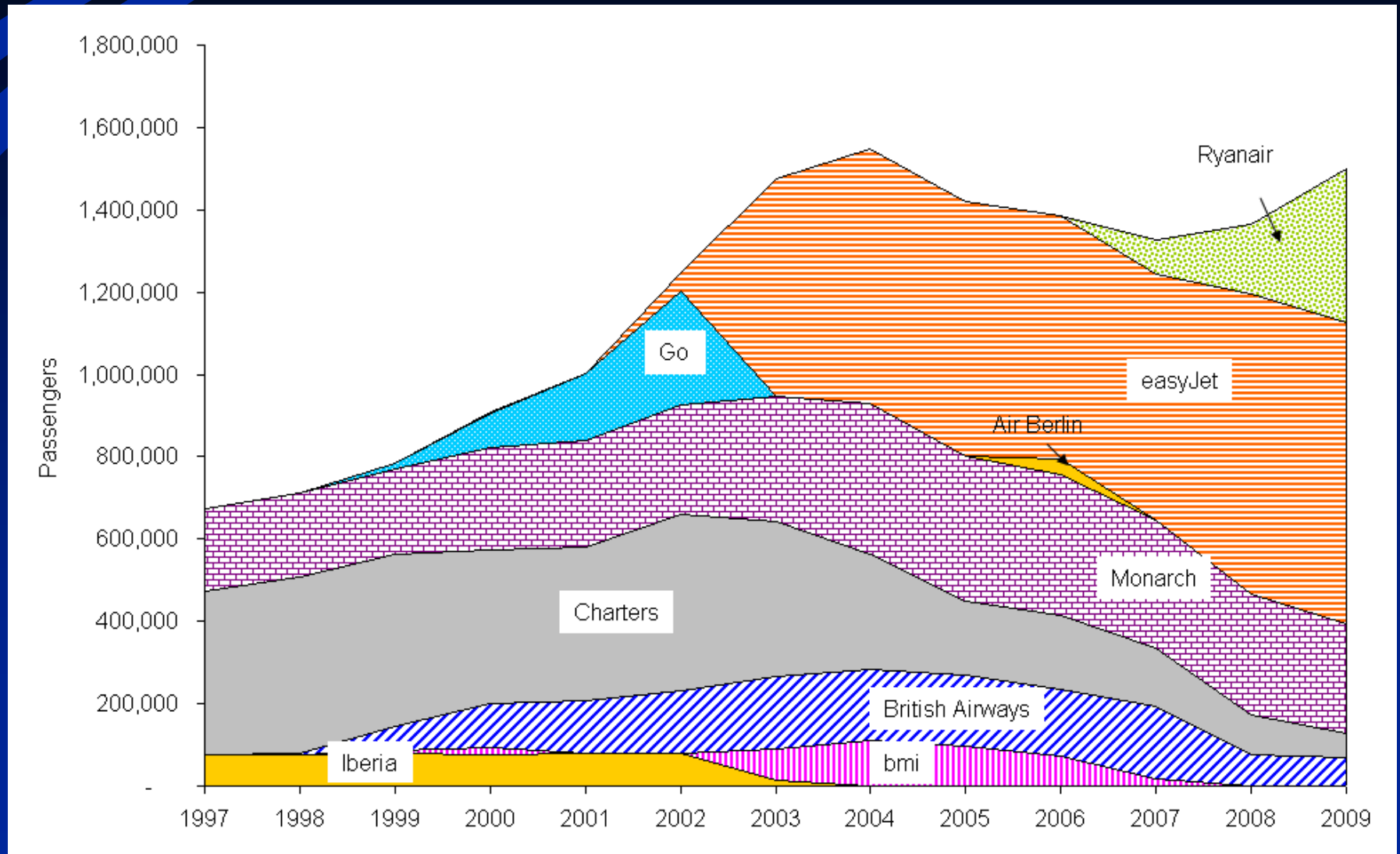
Source: compiled by author using OAG data,

Low-cost stimulate markets : Lon-Barcelona



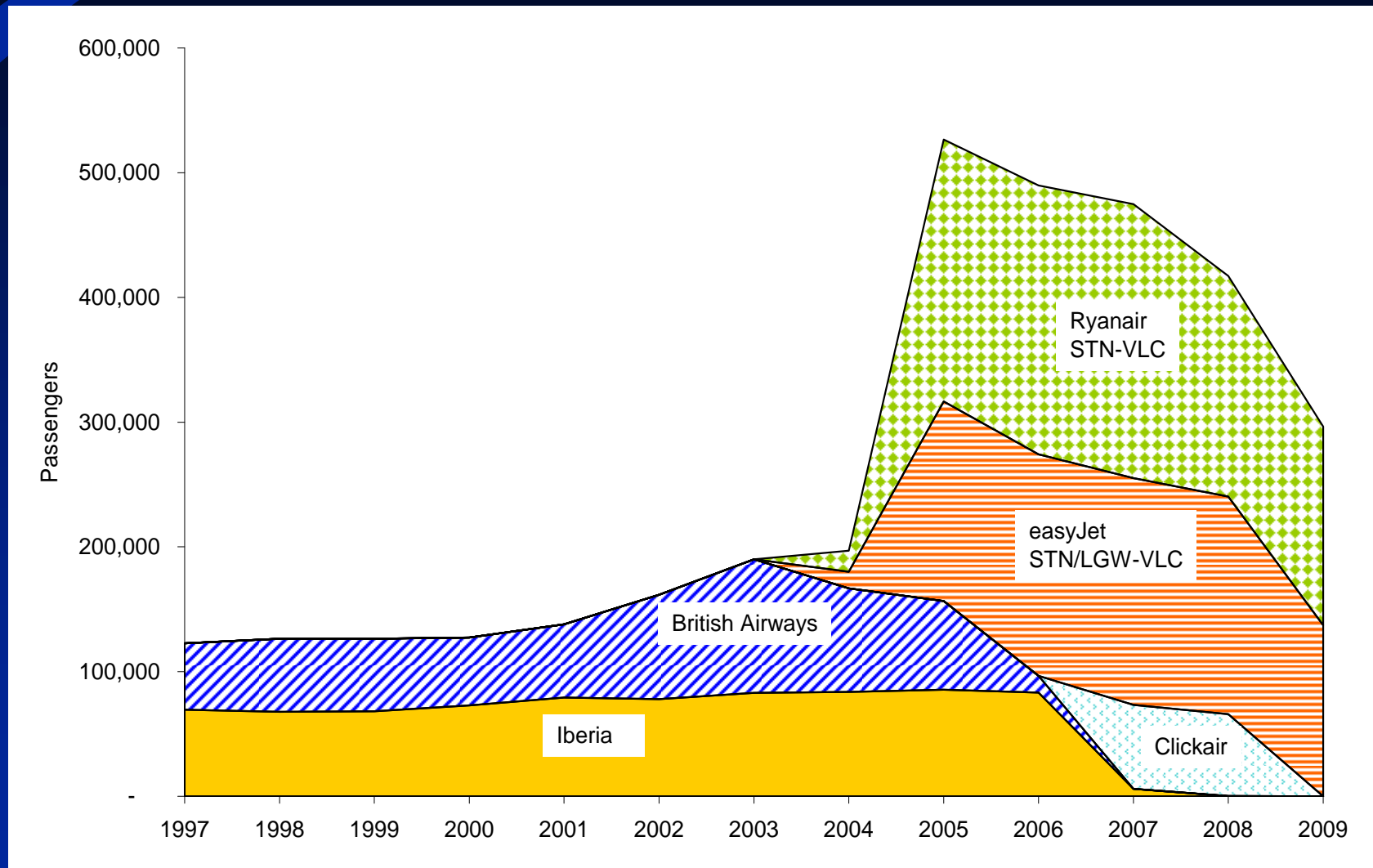
Source: Compiled using UK CAA data.

Low-cost squeeze out charters: Lon-Alicante



Source: Compiled from UK CAA data.

LCCs push out Legacies: London- Valencia



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**Rapid expansion of LCCs – esp. Europe , Asia ,
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Increasing govt. travel and emissions taxes (ETS Europe)



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**Rapid expansion of LCCs – esp. Europe , Asia ,
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Increasing govt. travel and emissions taxes

Continuing trend to overcapacity



Airline Responses to Crisis

- 1 Dash for Cash**
- 2 Cut costs**
- 3 Push up revenues + yields**



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- 4 Run for cover – Sell out or merge**
 - Focus on global alliances**
 - Concentrate or Consolidate**

Run for cover –selling out

BMed sold to **BMI** (Oct 07)

GB Airways sold to **easyJet** (Jan 08)

Alitalia sold (Dec 08)

Spanair – **SAS** sells 80% (Jan 09)

SN Brussels sold to **LH** (2009)

Bmi sold **LH** (July 09)

Austrian sold **LH** (Sept 09)

Olympic sold (Oct 09)

Ukraine International sold **Austrian** (Feb.2011)

But most of these still face serious problems



Run for cover – merge

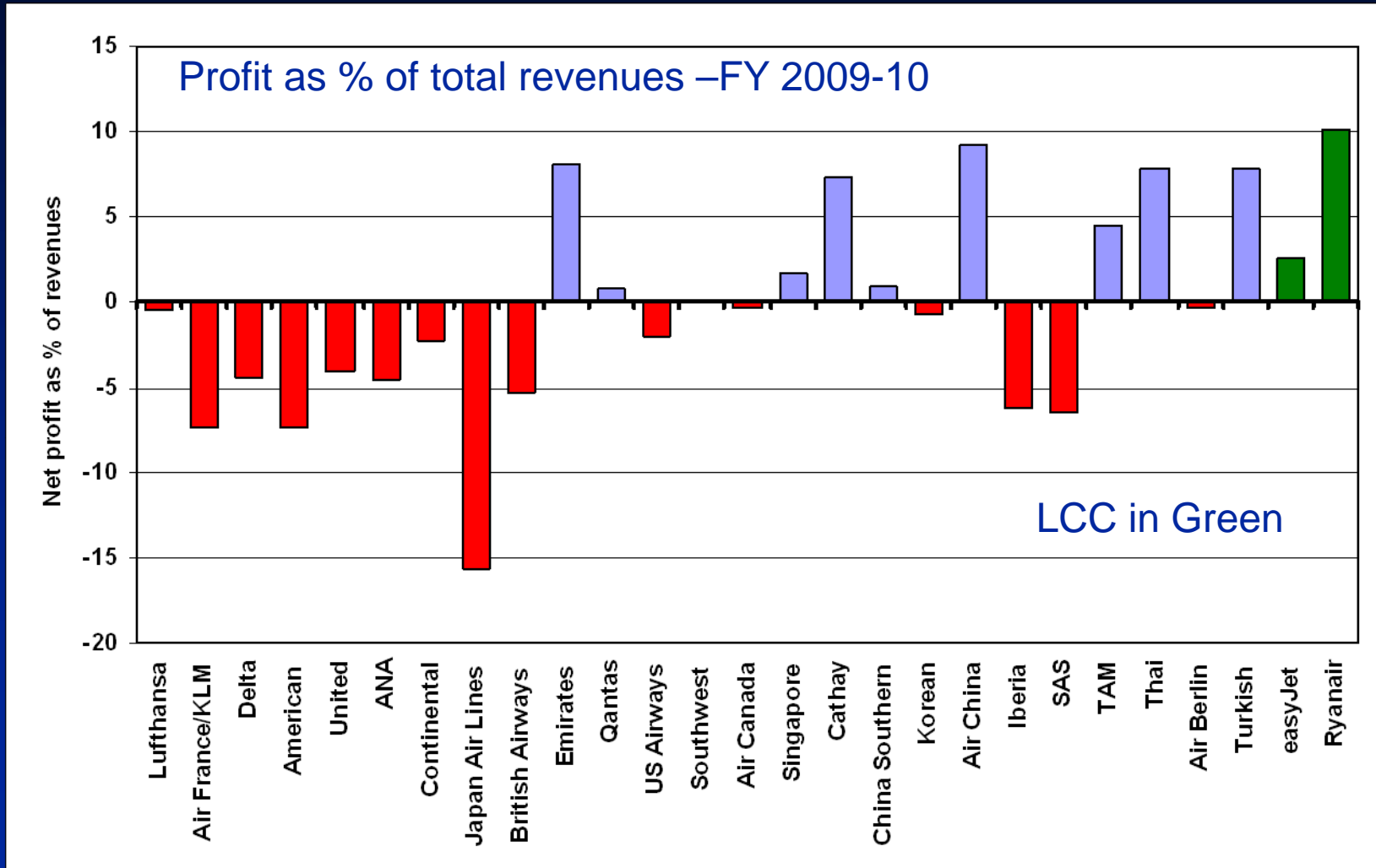
Cross-Border	Domestic
Air France – KLM (2004)	Jet - Sahara (2007)
Air China – Cathay linkup (2007)	Kingfisher –Air Deccan (2007)
Avianca – TACA (Central Am.)(2010)	Air India – Indian Airlines(2007)
Lan Chile – TAM (Brazil) (2010)	Alitalia –Air One (2008)
British Airways – Iberia (2011)	Delta – Northwest (2008)
	Meridiana – Eurofly (2010)
	Continental – United (2010)
	Southwest – AirTran (2010)

And many more.....

Consolidation changing industry dynamics ?

But does Large Size Ensure High Profitability

Airlines ranked by total revenues with largest on left



Consolidation Creates Problems

Revenue benefits from larger scale are clear but cost economies more limited

Mergers costly to implement

Harmonising wage levels/conditions may be difficult

Pilot seniority issues

Some existing hubs may need to be downsized

Cross-border mergers create traffic rights problems because of nationality rule –

- so airlines kept separate and benefits reduced

Alliances have been easier option



Profile Major Global Alliances in 2010

Share of 2009 Global Scheduled Pass-Kms

Alliance Members (June 2010)	Share of Total Pass-Kms % 2009	Share of International Pass-kms (%)
Star Alliance -23 members Air Canada, Air China, Austrian, ANA, ANZ, Asiana, BMI, Brussels, Continental, Egyptair, Lufthansa, LOT, SAA, SAS, SIA, Shanghai, Spanair, Swiss, TAP, Thai, Turkish, United, US Air,	30.8	29.8
Oneworld - 12 American, BA, Cathay, Dragonair, Finnair, Iberia, JAL, LAN, Malev, Mexicana, Qantas, R Jordanian	19.5	20.2
Sky Team -11 Aeroflot, Aeromexico, Alitalia, Air Franc-KLM, China Southern, Czech, Delta, Korean, Northwest	19.3	17.7
TOTAL 3 ALLIANCES	69.6	67.7

Source: Compiled using IATA World Air Transport Statistics

PHASES IN CEMENTING AN AIRLINE ALLIANCE

PHASE ONE REVENUE GENERATION

Code Shares
Joint FFP
Network Co-ordination
Joint Sales
Shared Lounges, etc.
Alliance Logo
but
Separate Airline Brands

ENTRY AND EXIT
RELATIVELY EASY

Source: Rigas Doganis- "The Airline Business"

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PHASE TWO COST REDUCTION

Common Ground Handling
Joint Maintenance
Joint Sales in Third Countries
Joint Call Centres
Common IT Platform
Joint Purchasing
Fleet Harmonisation
but
Still Separate Airline Brands

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PHASE THREE JOINT VENTURE ORIENTED

Route Specific Joint Venture
Joint Product Development
Sharing of Aircraft & Crews
Single Operating Company
- passengers
- cargo
Single Alliance Brand

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EXIT BECOMES
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OR IMPOSSIBLE

PHASES IN CEMENTING AN AIRLINE ALLIANCE or Cross-Border Merger ?

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PHASE THREE JOINT VENTURE ORIENTED

Route Specific Joint Venture
Joint Product Development
Sharing of Aircraft & Crews
Single Operating Company

- passengers

- cargo

Single Merged Brand

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- 5 Restructure networks**



Network restructuring

- 1. Reduce long-haul network refocus on short-haul**
eg Austrian , Gulf Air, USAir, JAL, Kingfisher
- 2. Cut some/many short-haul routes**
eg BA, Bmi, SAS , US Legacy majors , JAL , Czech
- 3. Separate short and long-haul operations**
eg. Iberia – but now outsourcing to Vueling

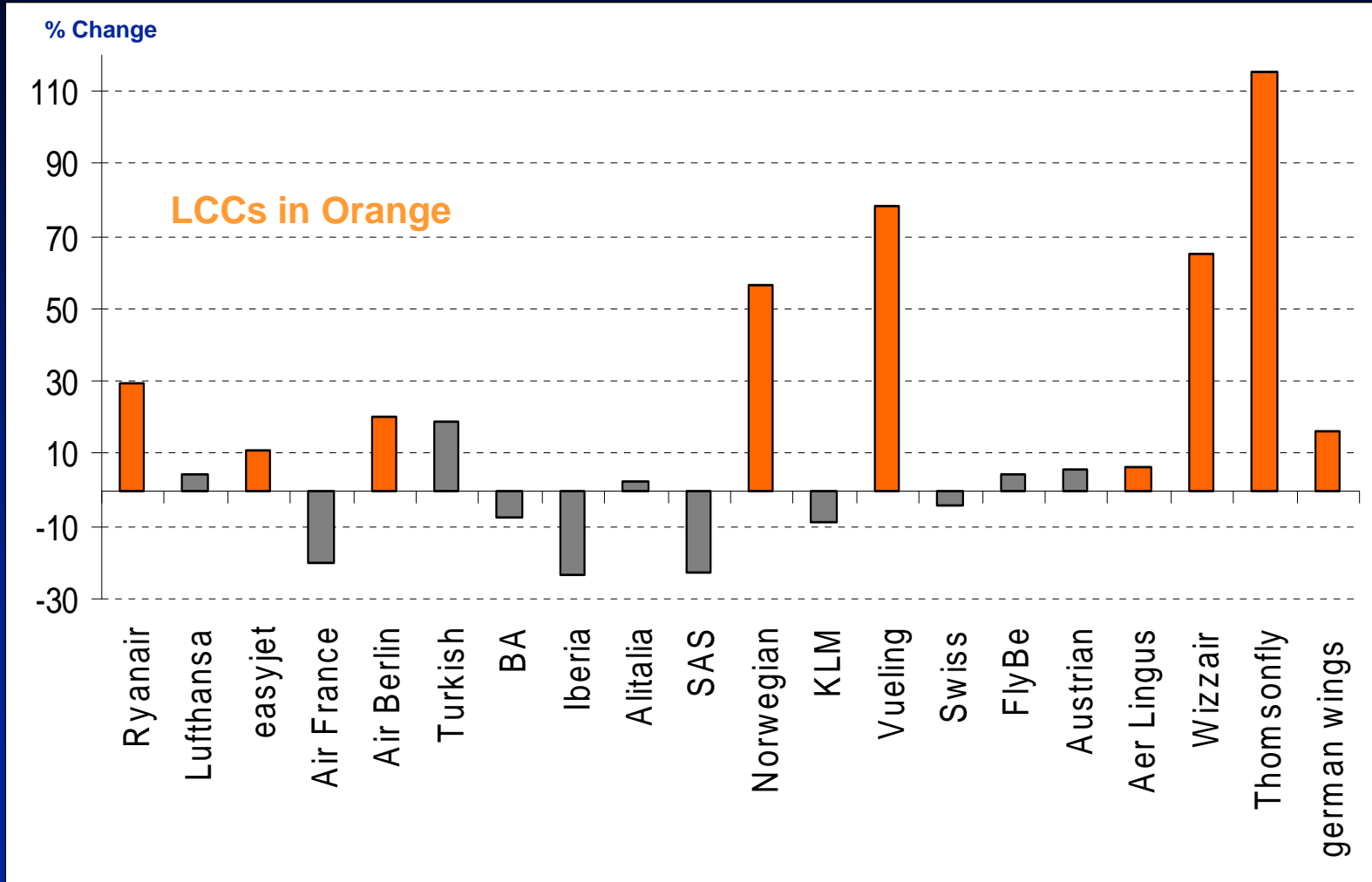
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- 6 Try to grow out of crisis**
 - organic - eg Turkish Airlines, Gulf carriers, LCCs
 - structural - eg Lufthansa



Organic Growth ? Seats on Intra-European Flights

July 2010 compared July 2008



NB: Airlines ranked by size of seat offer with largest on right and smallest on left

Source: Compiled using data from rdcaviation "Capacity Report"

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Market Dynamics will Re-shape Airline Industry

Largest network airlines will

- (a) Focus on long-haul routes at their mega-hubs***
- (b) Reduce many short haul services***
- (c) Increasingly use partners or franchisees to feed hubs***
- (d) Looking to strengthen working of global alliances***
- (e) May code share with and feed from LCCs ?***

Air France 3 year Growth Plan - announced 18 Nov. 2010

Long-haul to/from emerging markets :	+ 7.5% p.a.
Long-haul to/from developed markets :	+ 5.0%
Short/medium-haul feeder routes :	+ 3.0%
Short/medium-haul point to point :	- 2.0%
easyJet domestic and intra-European :	+ 7.5%
Ryanair :	+ 8.8%

Scheduled Flights French Regions to London airports – March 2011

Airport	easyJet	Ryanair	BA	BE/AF
Bergerac		Yes		
Beziers		Yes		
Biaritz		Yes		
Bordeaux	Yes		Yes	
Brest		Yes		
Carcassone		Yes		
Grenoble	Yes	Yes		
La Rochelle		Yes		
Limoges		Yes		
Lyons	Yes	Yes	Yes	
Marseilles	Yes	Yes	Yes	
Montpellier	Yes			
Nantes				Yes
Nimes		Yes		
Nice	Yes		Yes	
Pau		Yes		
Rodez		Yes		
Toulouse	Yes		Yes	
Tours		Yes		
	7	14	5	1

NB. Additional
Summer routes
by easyJet and
Ryanair

Growing Links between LCCs and Network Majors

- Germanwings owned by Lufthansa
- Vueling and Iberia
- Air Berlin joins Oneworld Alliance (2011)
- VAustralia feeds Etihad (2011)
- Delta-GOL code share (2011)
- WestJet interline with Delta and BA ; code share with American (2011)
- jetBlue codeshares Lufthansa (2010), interlines with American , Etihad etc



Market Dynamics will Re-shape Europe's Airline Industry

Mid-Smaller network airlines will

- (a) reduce long-haul network and will focus on regional niche markets where they have some competitive advantage***
- (b) look for alliances/mergers with the big boys***
- (c) struggle against LCC competition***

Are they an endangered species ?

e.g. SAS, Czech, Olympic, Gulf Air , Air Lanka ?



Market Dynamics will Re-shape Europe's Airline Industry

Smaller regional airlines will only survive if :

- (a) focus on defensible thin niche markets***
- (b) have adequate time sensitive business traffic so high yields can compensate for high costs***
- (c) feed or link up with network carriers***

eg Flybe , Meridiana

Market Dynamics will Re-shape Europe's Airline Industry

LCCs will increasingly dominate short haul services in Europe at expense of legacy and charter carriers

Only the larger 3-4 will survive

Increasing consolidation

More product/service diversification – some long-haul

May feed/code share with long-haul network airlines

European Charter airlines will focus on long-haul holiday routes

Substantially reduce intra-European services leaving many short-haul holiday markets to LCCs



Future Structure of Worlds Airline Industry

Largest network airlines increasingly focused on long-haul at mega-hubs and on strengthening alliances/mergers

Mid-Smaller network airlines will reduce long-haul network, focus on regional niche markets, link or merge with majors

Smaller regional airlines will focus on defensible thin niche markets and link up with bigger partners

LCCs will increasingly dominate short haul but also feed “legacies”

Period of further consolidation and structural instability



Impact of Airline Industry Re-structuring on Airports

1. Uncertainty in forecasting
2. Changing route patterns and operators
3. Need to attract “low-cost” growth
4. Must negotiate with Alliances/merged airlines
5. Pressure to cut costs and charges
6. May need to facilitate LCC – Network feeding
7. Traditional West European hubs poorly located as focus of traffic growth moves east



“Alliances are a tool for extending or reinforcing competitive advantage, but rarely a sustainable means for creating it.”

Source: Michael Porter
“The Competitive Advantage of Nations”, 1990



New Enlarged Edition : 2010

“Flying Off Course: Airline Economics and Marketing”

Rigas Doganis

Revised and Enlarged Fourth Edition includes chapters on :

Low-cost airline economics

Charter airlines

Cargo trends and economics

New “a la carte” pricing

.....etc etc

Publisher: www.routledge.com, and also from
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