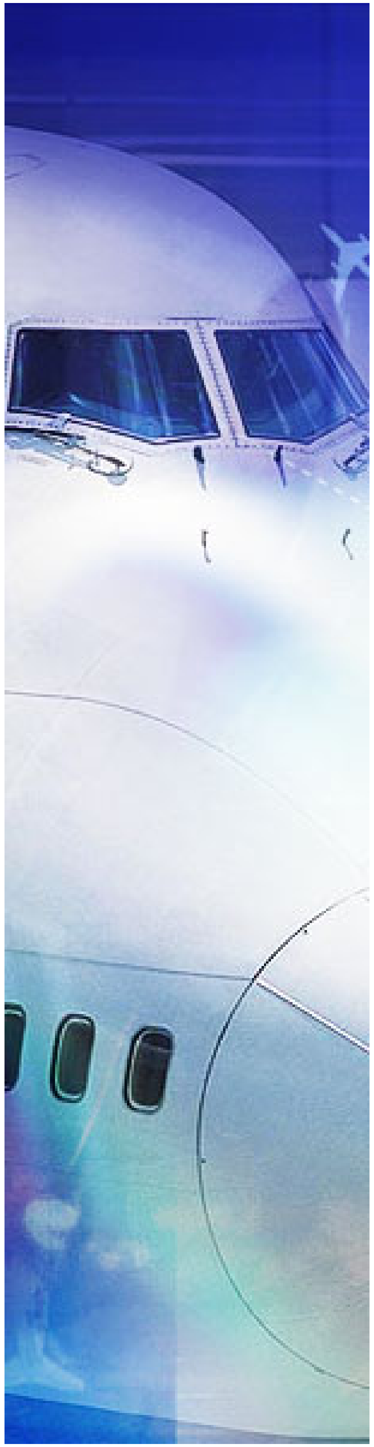

THE AIRLINE INDUSTRY: Trends, Challenges, Strategies

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The University of Sydney
Faculty of Economics and Business
Leadership and Policy Seminar Series
Sydney, Australia
23 February 2010

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

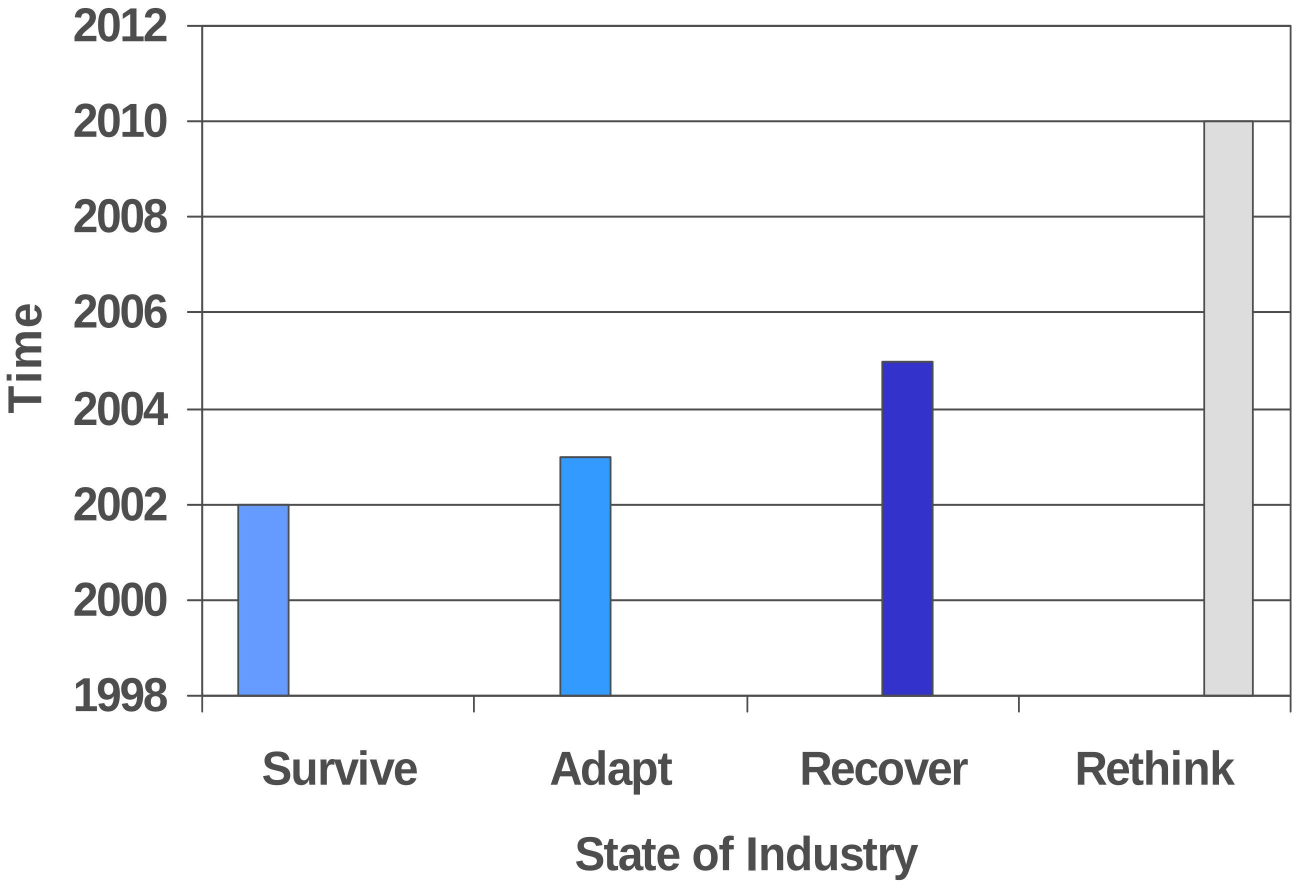
- Regulation
- Liberalization
- Deregulation
- “Re-regulation”

Phases of Industry Restructuring (resulting from Deregulation / Liberalization)

- Expansion
- Consolidation
- Concentration

Past, Present and Future Trends

The Global Airline Industry

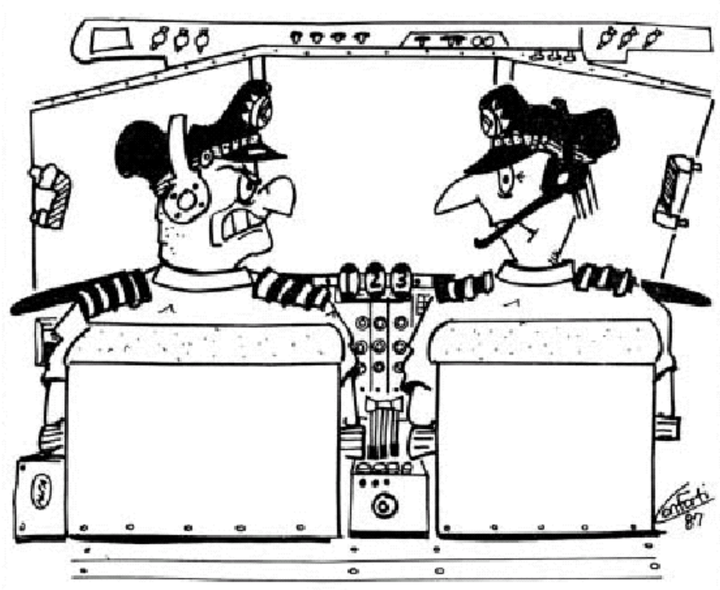


“Scenarios”

- 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

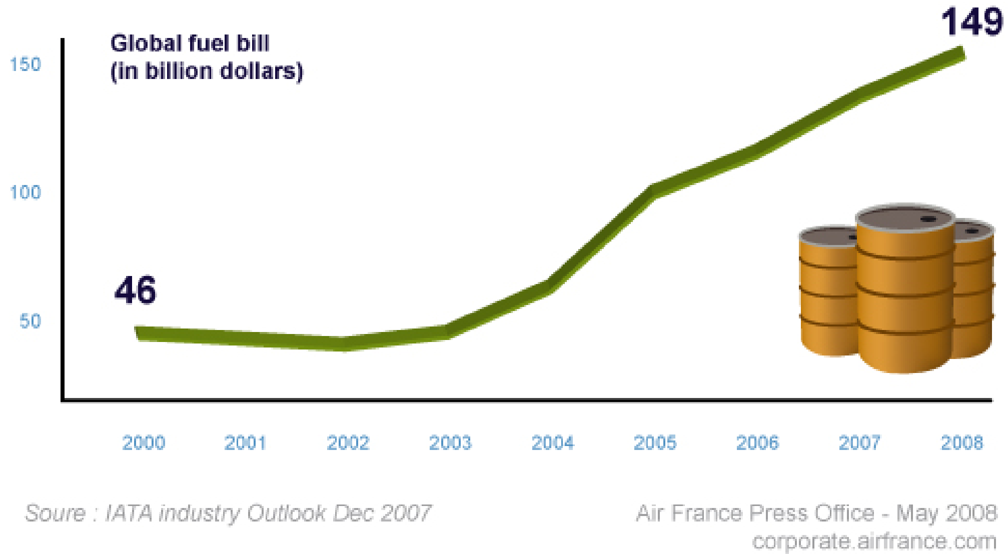
Top 5 Frustrations in Aviation

1. Fuel/oil
2. Pollution control
3. Personnel cutbacks
4. Global economic woes
5. Recurring safety lapses



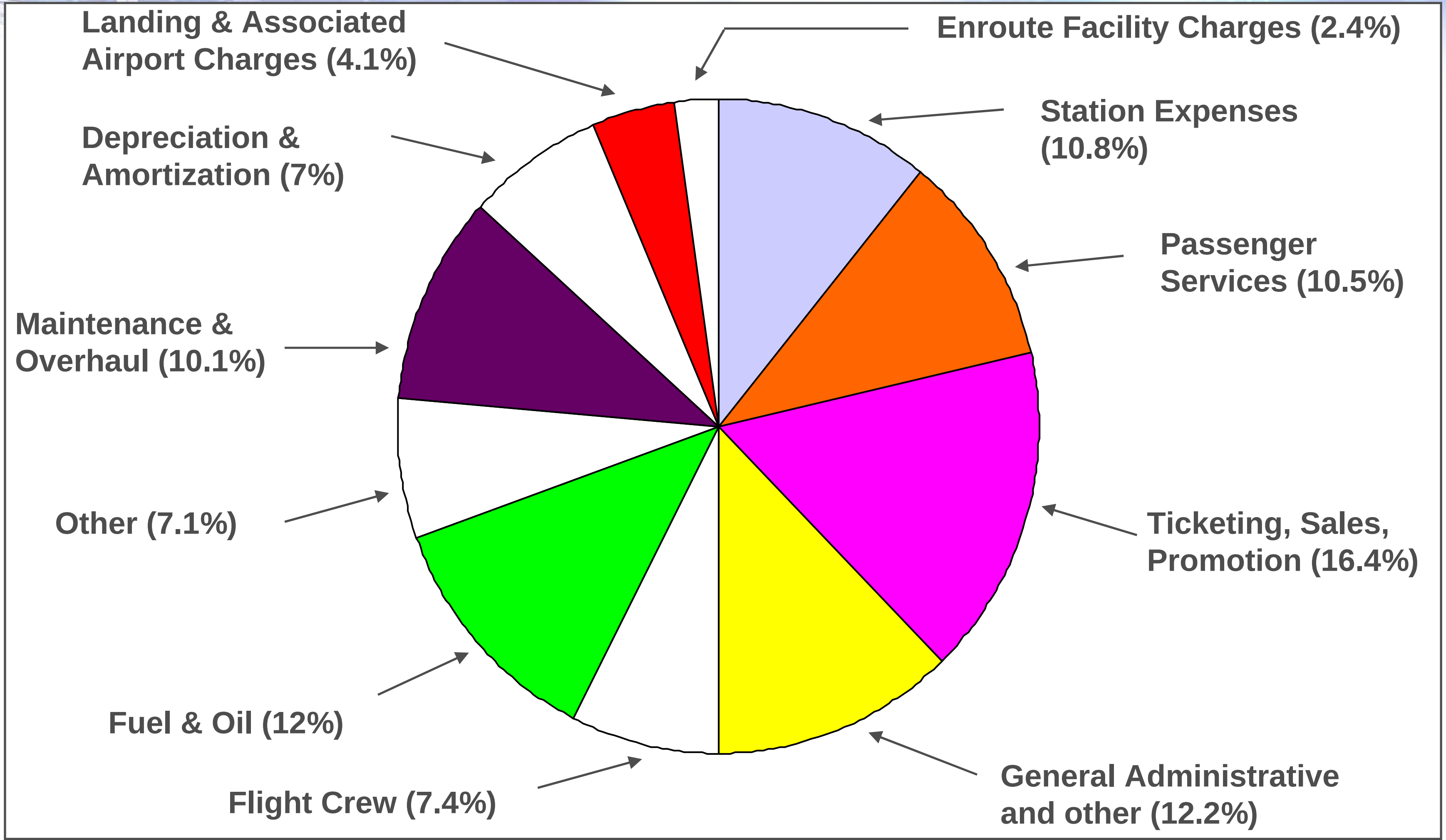
Top 3 Costs for Airlines (in any order)

1. Fuel*
2. Labor
3. Maintenance



*40% for US airlines in 2009: 13-40% of costs in 7 years

Typical Airline Operating Expenses



Source: The Aviation & Aerospace Almanac
ICAO Air Transport Reporting Form EF-1

Overview:

The Industry Continues to Evolve

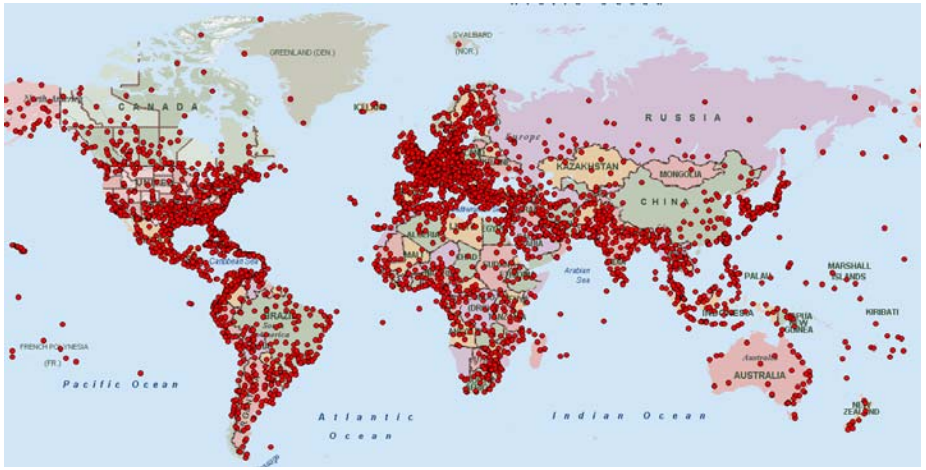
Industry Overview: Global
(As of October 2008)

- 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

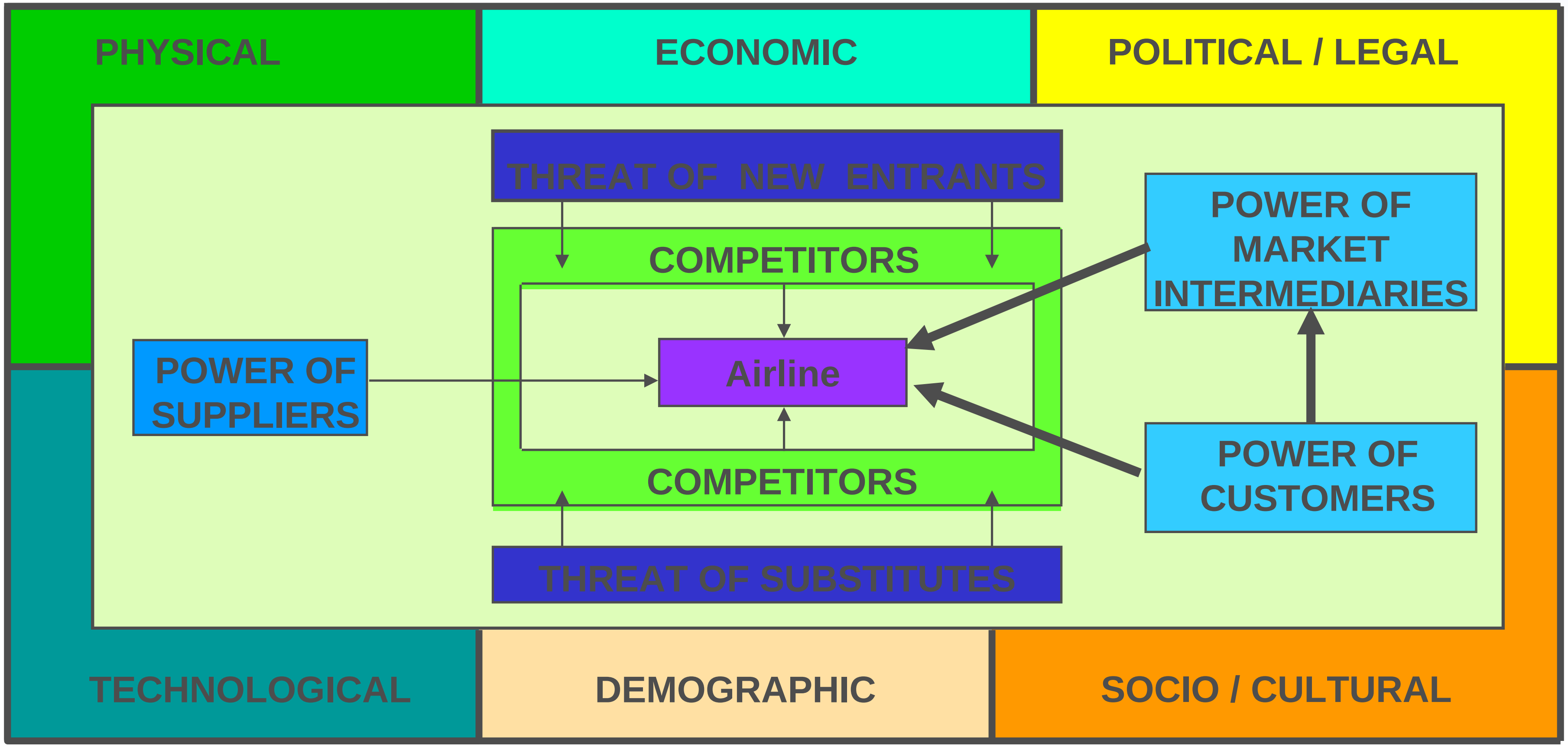
Latin American Challenges

- 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:

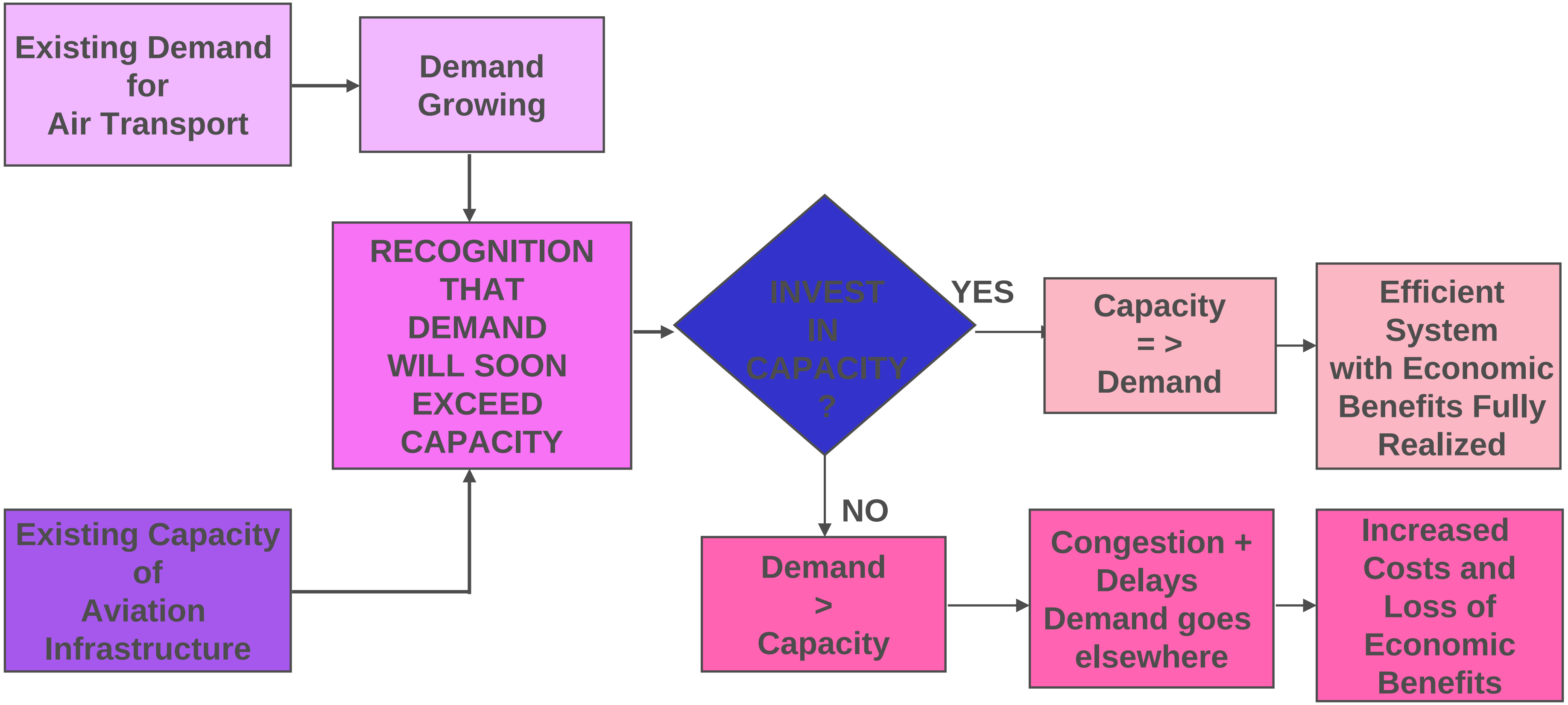
Challenges & Strategies

Major Players and Forces Comprising An Airline's Environment



Infrastructure Issues

The Case for Investing in Aviation Infrastructure



Source: The Economic Benefits of Air Transport - 1994 Data - Air Transport Action Group

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

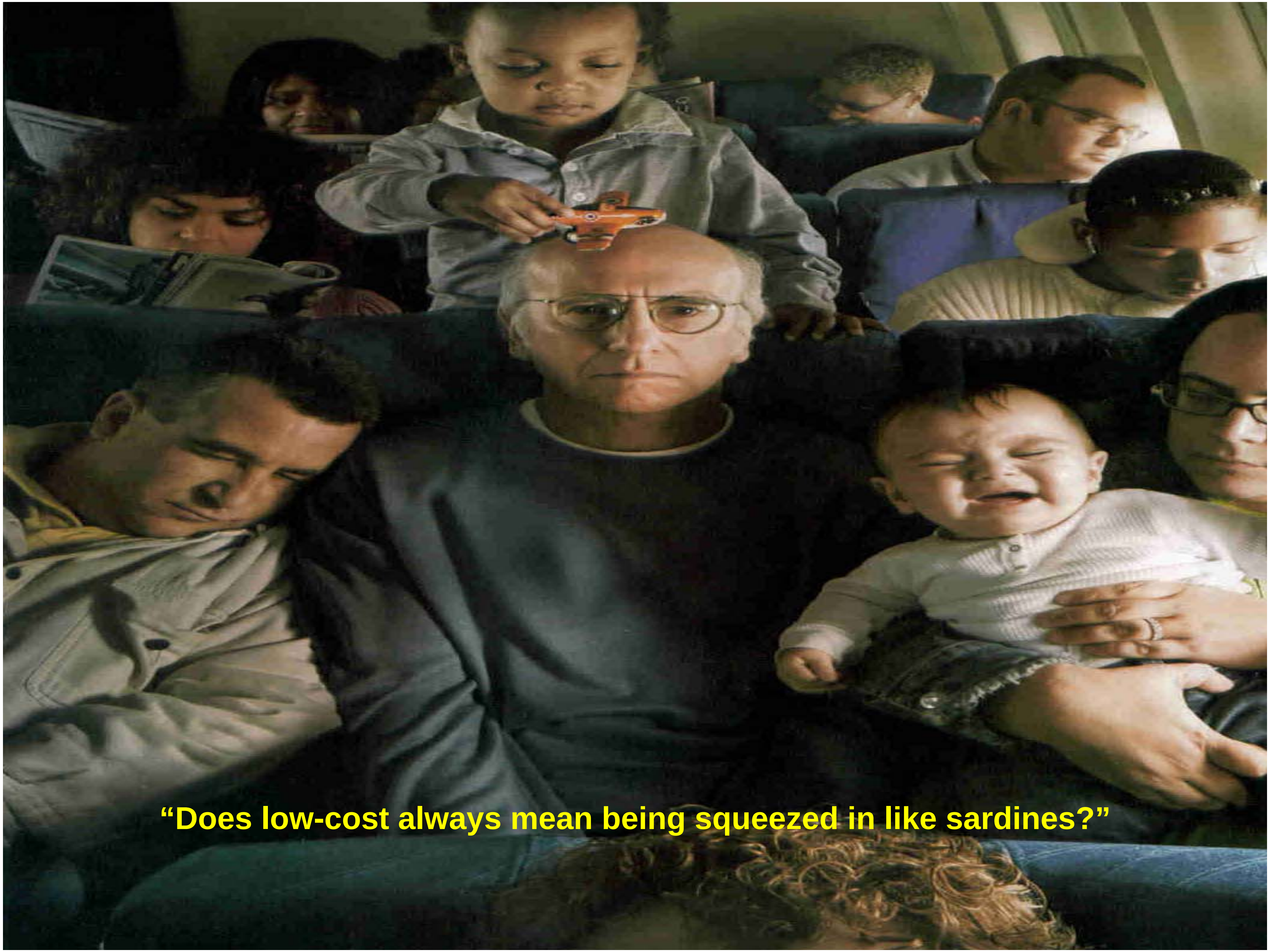
Global Aviation Strategies 21st Century

- 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

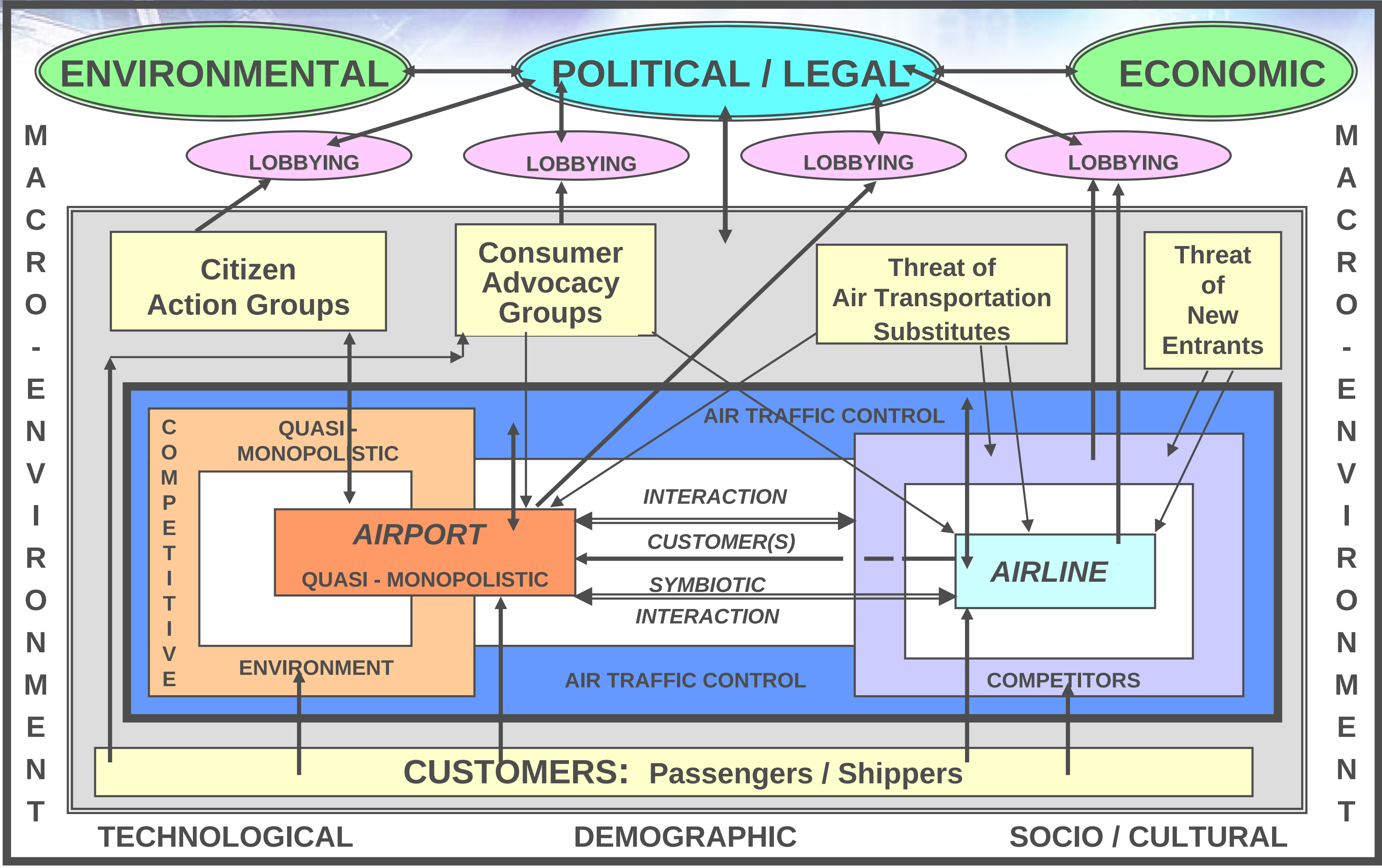
- Megacarrier Alliances
- “LCC” Alliances (P-P now overlapping)
- Network Specialist Alliances?
- Product Specialist Alliances?
- Price Specialist Alliances?
- Interactive Marketing Agreements

Failing & Achieving Success

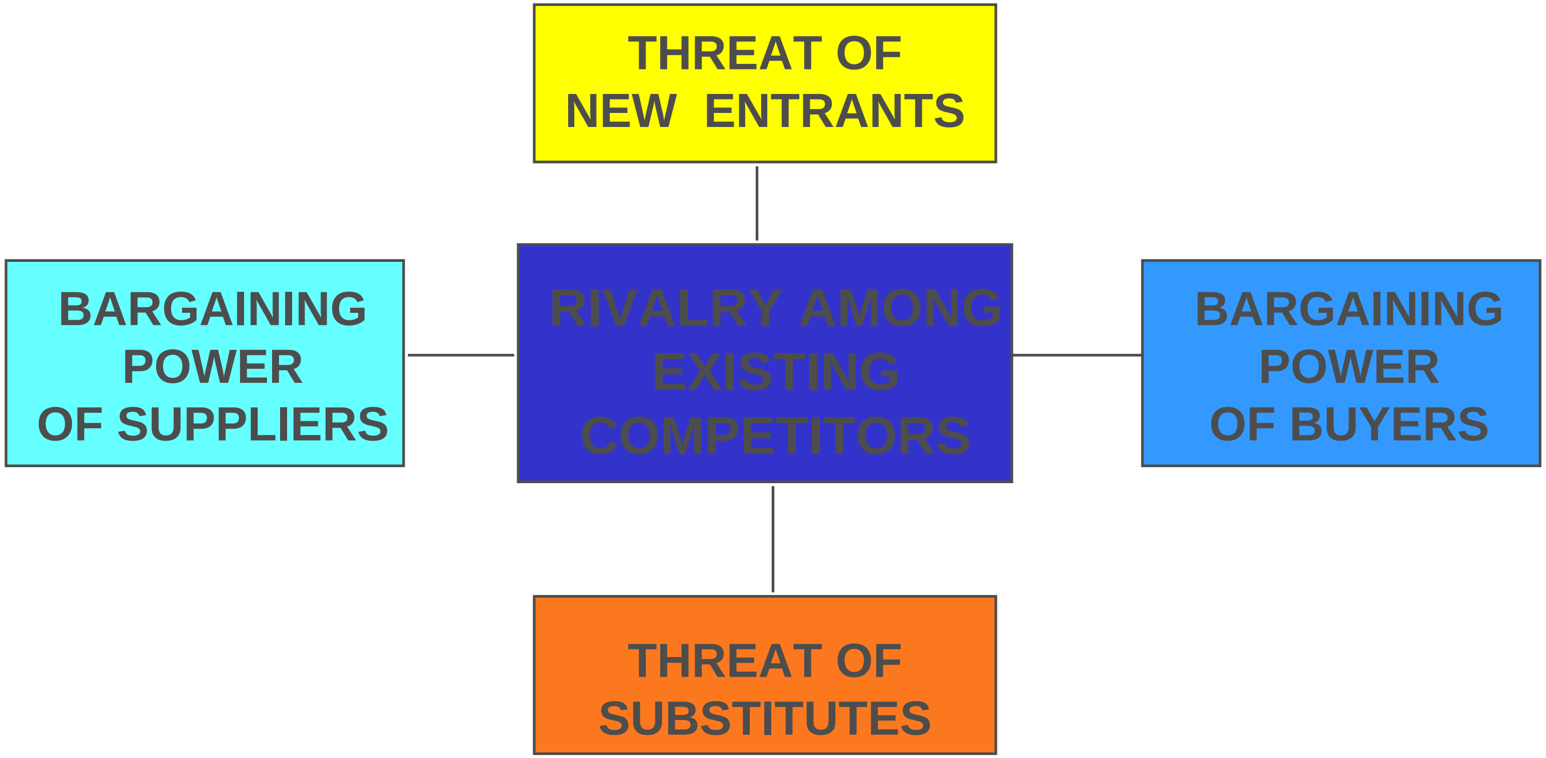
Failures in Airline Business Planning

- **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



Five Forces Affecting Industry Profitability



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.

BARGAINING POWER OF BUYERS

- *BARGAINING LEVERAGE*
- *BUYER INFORMATION*
- *SUBSTITUTE PRODUCTS*
- *PRICE SENSITIVITY*

ETC.

THREAT OF SUBSTITUTES

- *TELECOMMUNICATIONS*
- *VIDEO CONFERENCING*
- *HIGH-SPEED RAILROADS*

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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