Core concepts of Strategic Airline Management

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Core Concepts of Strategic Airline Management

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Definition of Strategy

‘The direction and scope of an organisation over the long term, which Achieves advantages in a changing environment through its configuration of Resources and competencies with the aim of fulfilling stakeholder expectations’.

(Johnson, Scholes and Whittington, 2011)
The essence of strategy

Strategy is the means by which we create and take control of the future.

Source: Finkelstein, Harvey, Lawton 2007
Definition of Strategy

Includes understanding the strategic position of an organisation, strategic choices for the future and turning strategy into action

These 3 elements are all interlinked (next slide)

The airline/airport finance manager tends to see problems in financial terms
The airline/airport I.T. manager tends to see problems in I.T. terms
The airline/airport marketing manager in marketing terms, etc

The manager who aspires to manage or influence strategy needs to develop a capability to take an overview of the entire airline/airport rather than just parts of the organisation.

The Elements of Strategic Management

1. The Strategic Position
   - The Environment
     - Porters Forces
     - PESTEL
     - Internal issues (Micro)
   - Strategic Capability
     - Resources
     - Competencies and Benchmarking
     - SWOT
   - Expectations & purpose
     - Corporate Governance
     - Stakeholder power
     - Business ethics
     - Culture

2. Strategic choices
   - Competitive Strategies
     - Product/market diversity
     - Value Creation
     - International Diversity
     - Market Share/Market Growth (BCG Matrix)
   - Corporate level & International Strategy
   - Direction & Method of Development
     - Product-Market Matrix (Ansoff)
     - Mergers/Acquisition
     - Strategic Alliances

3. Strategy into Action
   - Managing Strategic Change
     - Types of Change - Adapt/Evol
     - Organisational Culture
     - Turnaround Strategy
     - Time/Scope/Readiness/Capab.
   - Organising for Success
     - Solid Functioning Hierarchy
     - Team based Structure
     - Detailed solid Master-Plan
     - Full Knowledge
   - Enabling Success
     - Managing People
     - Managing Finance
     - Strategic Capability
     - Technology Develop.
     - Ability to Integrate
   - Managing Strategic Change

Source: Johnson, Scholes and Whittington (2011)
The Operating Environment of the Airline is influenced by:

**PESTEL**
The Macro-Environment

- **Political**
  - Government stability
  - Taxation policy
  - Foreign trade regulations
  - Social welfare policy

- **Economic**
  - Business cycles
  - GDP trends
  - Interest Rates
  - Money supply
  - Inflation
  - Unemployment
  - Disposable income

- **Sociocultural**
  - Population demographics
  - Income distribution
  - Social mobility
  - Lifestyle changes
  - Attitudes to work/leisure
  - Consumerism
  - Levels of education

- **Technological**
  - New technologies create new products (iPhone 5)
  - Speed of technology transfer
  - Government spending on research
  - Rates of obsolescence

- **Environmental**
  - Environmental laws
  - Emissions trading
  - Waste disposal
  - Energy consumption

- **Legal**
  - Competition law
  - Employment law
  - Health and safety
  - Product safety

Source: Johnson, Scholes and Whittington (2011)
The Operating Environment of the Airline is also influenced by...

The Micro-Environment
(considering airline/airport industry)

- Competition
  - Network size/coverage
  - Market share
  - Competitive advantage
  - Response strategy
  - Leader/follower
  - Price elasticity
  - Mergers

- Deregulation
  - Regulated – bilaterals
  - Open sky agreements
  - Freedoms of the air
  - 7/8th freedom traffic rights (SIA)

- Operational (airline)
  - Aircraft utilisation
  - Employee productivity
  - On-time performance
  - Turnaround times
  - Schedule co-ordination
  - Fleet mix

- Marketing
  - Distribution channels
  - Relationship marketing
  - Passenger segmentation
  - Differentiating features
  - Code sharing & alliances

- Financial
  - Cash flow
  - Debt : Equity
  - Airline/airport valuation
  - Performance earnings
  - Operating margins

- Brand
  - Image/reputation
  - Advertising
  - Sponsorship

Source: O’Connell, PhD 2007
The Operating Environment of the Airline is influenced by:

- **Political**
  - Government stability
  - Taxation policy
  - Foreign trade regulations
  - Social welfare policies

- **Legal**
  - Competition law
  - Data Protection Act
  - Employment law
  - Health & safety

- **Economic Factors**
  - Business cycles
  - GDP growth/decline
  - Interest rates
  - Money supply
  - Inflation
  - Unemployment
  - Income levels
  - Oil supply

- **Sociocultural**
  - Terrorism and extremism
  - Population demographics
  - Income distribution
  - Social mobility
  - Lifestyle changes
  - Attitude to work/leisure
  - Consumerism
  - Levels of education

- **Technological**
  - Research & Development
  - Internet & eCommerce
  - A380 vs 747
  - Obsolescence
  - Cost to acquire technology

- **Environmental**
  - Emissions
  - Carbon Trading
  - Energy Consumption

- **Competition**
  - Network/geographical coverage
  - Growth/decline of market share
  - Demand versus capacity
  - Code sharing & Alliances
  - Competitive strategy
  - Fare

- **Deregulation**
  - Liberalised markets
  - Open skies
  - Current bi-laterals
  - 8 Freedoms of the Air

- **Operational**
  - Aircraft utilisation
  - Employee productivity
  - On-time performance
  - Schedule
  - Fleet mix
  - Contingency plans

- **Marketing**
  - Passenger Segmentation
  - Distribution channels
  - Differentiating features
  - Sustaining customer loyalty
  - Connecting with passengers
  - Business/leisure product mix
  - Effective Advertising
  - Brand

- **Financial**
  - Operating Margins
  - Performance earnings
  - Cash flow
  - Debt
  - Equity investment
  - Airline valuation
  - Merger/acquisition

Source: O’Connell PhD, 2007
In 2014, airlines took delivery of around 1,400 new aircraft, representing an investment by the of over $150 billion.

The global airline industry posted net post-tax profits of $16.4 billion in 2014, which is a margin of just 2.2%. Apple (one company) made of net profit of  $18 billion in the 1\textsuperscript{st} Quarter of 2015.
The airline industry needs to attract $5 trillion of capital Boeing/Airbus estimate will be necessary to buy sufficient aircraft over the next 20 years.

The ROIC needs to be higher than its costs of Capital always.
The challenge of strategic management

- The management of complexity and ambiguity.
- The ability to analyse and conceptualise big picture issues.
- The reconciliation of the influences of a changing environment, stakeholder expectations, and resource capabilities.
- To identify or create organisational opportunities.
- To effectively manage change.
Benefits of a strategic approach to management

• Guides entire firm re ‘what it is we are trying to do and achieve’.

• Increases management’s threshold to change.

• Provides basis for resource allocation decisions.

• Unites various strategy-related decisions of managers at all levels in organisation.

• Creates proactive rather than reactive atmosphere.

• Enhances long range performance.
Porter’s Bases of Competitive Strategy

Gaining competitive advantage

✓ Cost Leadership
✓ Differentiation
✓ Hybrid (Difficult to get right)
✓ Focus Strategies

If company doesn’t meet any of these Criteria’s:-

Stuck in the Middle

Source: Michael Porter, Harvard University
Cost Leadership

1. A no Frills strategy, combining low prices and low perceived added value
e.g. Ryanair, Air Asia, Spirit

2. A low Price strategy, providing lower price than competitors at similar
added value of product or service to competitors
e.g. easyJet, Southwest, Jetblue, Flydubai ... (Low cost carrier with add-ons)
Cost Leadership

• The companies that attempt to become the lowest-cost producers in an industry can be referred to as those following a cost leadership strategy.

• The firm sells its products either at average industry prices to **earn a profit** higher than that of rivals, or below the average industry price to **gain market share**.

• A low cost producer finds and exploits all sources of cost advantage.

  o Ryanair, Spirit, Air Asia, JetStar, Cebu

  o IKEA

  o LIDL

  o ASDA

  o ARGOS

  o Wal-Mart
World Airline revenues and expenses
1991 - 2015

Source: ICAO and IATA
The strategic business model of Ryanair

A cost leader in the Airline Industry

Ryanair made a pre-tax profit per aircraft of around €1.9m in 2014
The competitive advantage of the low cost carrier – 2014 data

Ryanair’s cost advantage

- Lower compensation costs
- Higher crew productivity & commonality
- Reduced cabin crew

- Reduced aircraft prices by highly leveraged Negotiation
  - New generation aircraft and commonality
  - High aircraft utilisation
  - Fuel hedging, winglets

- Direct sales only
  - Marginal GDS Fees (just beginning to implement these)
  - No commission on ticket sales

- Use of secondary airports
  - Low ground handling charges
  - Allows for quick aircraft turnarounds

- Seat Density
  - 20% more seats/aircraft

Average unit cost of British Airways, Air France and Lufthansa

10.8c ($/ASK)

Distribution & Overheads

Aircraft & Fuel

Labour

Ryanair’s unit cost

4.6c ($/ASK)

Note: Stage lengths are adjusted
Core labour differences between LCCs and flag carriers
Cost and Productivity Issues

Employees per Aircraft - 2015

Sets of Pilots per Aircraft - 2011

Personnel cost per ASM (US Cents) – 2015 data

Number of Passengers per Employee - 2015
LCCs fly around 11 hours per day with short-haul aircraft compared to 9 hours for flag carriers.

- easyJet has a 25-30% higher aircraft utilisation than BA.
- As a consequence, European LCC generates 35-50% more seats per day from one aircraft.

Source: UK CAA, 2014; Wizz Air, FlightGlobal
Ryanair’s non-fuel costs as being 50% lower than most of its rivals.
Principle reason for travelling on a low cost carrier
Surveys conducted with Ryanair, Air Asia and Air Deccan

Penetration of LCCs in Europe
European market share

Source: Company filings, Deutsche Bank Airline Research, HSBC Research
New Routes opened between 31 August and 04 September 2016
Porter’s Bases of Competitive Strategy

Gaining competitive advantage

- Cost Leadership
- Differentiation
- Hybrid (Rarely successful)
- Focus Strategies

If company doesn’t meet any of these Criteria’s:-

Stuck in the Middle

Michael Porter
Differentiation Strategy

Differentiation Strategy seeks to provide products or services that offer benefits different from those of competitors and are widely valued by customers. It also implies offering better products or services than competitors. Differentiation also reduces the price sensitivity of consumers.

- JetBlue’s LiveTV: This is the second/third most important reason why passengers travel with Jetblue.
- JetBlue’s aircraft ongoing upholstering program.
- BA’s Flat Bed.
- Virgin Atlantic and Emirates Limousine Service.
- Qatar Airways Business Lounge at Doha.
- Automatic check-in by Mobile Phone offered at some Japanese airports.
The economics of differentiating a business class product

BA invested £600 million into the design and development of flatbeds for their premier classes in 2000. This differentiation strategy increased the average cost from AC₀ to AC₁

As a result of the product differentiation, more business passengers became attracted, thus pushing out the demand curve from D₀ to D₁. In 2005 BA’s premium passengers increased by 8% - Triggering the carrier to add more business seats. In ’06 invested £100m

Singapore Airlines invested $370 million in its flatbeds and it increased business fares by 15-20% (P₀ to P₁) as a result of its differentiation strategy attracting more pax (Pilling, 2007).
Differentiation Value Innovation

Source: Boeing
Differentiation Strategy – Example: the Business class Flat Bed

**Recliner Seats:** These seats do not offer the significant recline of the Lie-flat and Flat Bed Seats, but still offer excellent space and comfort.

**Lie-Flat Seats:** While airlines often market these seats as having 180 degrees of recline, in their fully reclined position they are slightly angled and do not lay completely horizontal. Passengers often find these seats to be extremely comfortable for relaxing and working, but not conducive to sleep when in the fully reclined position because of the awkward angle.

**Flat Bed Seats:** When fully reclined, these seats are completely horizontal, creating a bed that is fully flat. These seats always receive high accolades for being comfortable both as seats and beds.
Cabin Seating Comfort
Total Comfort Analysis

Quality Grading System

Seat Pitch 18%
Seat Width 16%
Sleep Position & Comfort 14%
Seat Recline 13%
Lumbar Support 12%
Headrest Comfort 10%
Switch Controls 4%
Footrest Support 5%
Leg-rest Support 8%

2016 Skytrax Awards

World's Best Business Class:
1. Qatar Airways
2. Singapore Airlines
3. Etihad Airways
4. Emirates
5. Cathay Pacific
6. ANA All Nippon Airways
7. EVA Air
8. Turkish Airlines
9. Air France
10. Lufthansa

Source: Inflight Research Services
Benchmarks the Business class Seat against the competition (Boeing 777-200)

Dimensions of Perceived Use Value

**Most Important**
- Seat Pitch (18%)
- Seat Width (16%)
- Sleep Position & Comfort (14%)
- Seat Recline (13%)
- Lumbar Support (12%)
- Headrest Comfort (10%)
- Legrest Support (8%)

**Least Important**

Source: Adapted from Bowman - ‘Formulating Strategy’
<table>
<thead>
<tr>
<th>Weighting</th>
<th>BRITISH AIRWAYS</th>
<th>AIR FRANCE</th>
<th>KOREAN AIR</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rating</td>
<td>Rating * Wt</td>
<td>Rating</td>
</tr>
<tr>
<td>Seat Pitch</td>
<td>18</td>
<td>2</td>
<td>36</td>
</tr>
<tr>
<td>Seat Width</td>
<td>16</td>
<td>1</td>
<td>16</td>
</tr>
<tr>
<td>Seat Recline</td>
<td>13</td>
<td>3</td>
<td>39</td>
</tr>
<tr>
<td>Sleep Position &amp; Comfort</td>
<td>14</td>
<td>3</td>
<td>42</td>
</tr>
<tr>
<td>Lumbar Support</td>
<td>12</td>
<td>3</td>
<td>36</td>
</tr>
<tr>
<td>Headrest Comfort</td>
<td>10</td>
<td>3</td>
<td>30</td>
</tr>
<tr>
<td>Legrest Support</td>
<td>8</td>
<td>3</td>
<td>24</td>
</tr>
<tr>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>223</td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Bowman - ‘Formulating Strategy’
What makes Singapore Airlines a differentiator in the Market?
First/Business Class Revenues as a % of Total Passenger Revenues
2015 data

- **Singapore Airlines**: 40%
- **All Nippon Airways**: 35%
- **Cathay Pacific**: 33%
- **Japan Air Lines**: 33%
- **Korean Air**: 22%
- **Qantas**: 22%
- **Air China**: 20%
- **China Airlines**: 20%
- **EVA Air**: 20%
- **China Eastern**: 15%
- **China Southern**: 10%
- **Virgin Australia**: 8%

Source: Company accounts
Singapore’s strategy going forward

Singapore places huge influence on 3 core areas
Focus on 3 pillars

1) Service Excellence
   • Highest quality of service from cabin crew (all Asian)
   • Enhancing customer service

2) Product Leadership (see slide above)
   • Superior business and first class product (constantly innovating)
   • Focusing on next generation first and business class seats

3) Network connectivity
   • Frequencies, right schedule, on-time, seamless transfers, airport, waves
   • Leveraging and deepening partnerships
Porter’s Bases of Competitive Strategy

Gaining competitive advantage

- Cost Leadership
- Differentiation
- **Hybrid** (Rarely successful)
- Focus Strategies

If company doesn’t meet any of these Criteria’s:-

**Stuck in the Middle**

Michael Porter
Hybrid Strategies

The hybrid strategy seeks simultaneously to achieve differentiation and a price lower than that of competitors.

The success of the Hybrid strategy depends on the ability to deliver enhanced benefits to customers together with low prices whilst achieving sufficient margins for re-investment to maintain and develop the bases of differentiation (e.g. Aer Lingus).
# Hybrid Positioning of Aer Lingus

<table>
<thead>
<tr>
<th></th>
<th>LCC Ultra-Low Cost Carriers</th>
<th>Aer Lingus</th>
<th>Full Service Flag Carriers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Key Target Audience</strong></td>
<td>Price-sensitive leisure</td>
<td>Combination of leisure and business</td>
<td>Business and premium leisure</td>
</tr>
<tr>
<td><strong>Product offering</strong></td>
<td>Basic seat</td>
<td>Quality core product plus benefit-driven à la carte paid options</td>
<td>Multiple product attributes fully-bundled</td>
</tr>
<tr>
<td></td>
<td>Very limited paid add-ons</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Airport selection</strong></td>
<td>Secondary</td>
<td>Central</td>
<td>Primary</td>
</tr>
<tr>
<td><strong>Customer engagement</strong></td>
<td>None</td>
<td>Natural positive engagement</td>
<td>Structured approach to customer engagement (one-to-one)</td>
</tr>
<tr>
<td>and relationship</td>
<td></td>
<td>Standalone FFP with selected reciprocity</td>
<td>Alliance-based FFP’s</td>
</tr>
<tr>
<td>management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Customer Expectations</strong></td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td><strong>Distribution Channel</strong></td>
<td>Internet only</td>
<td>Internet as priority but multi-channel where appropriate</td>
<td>Multi-channel by default</td>
</tr>
<tr>
<td><strong>Network Connectivity</strong></td>
<td>None</td>
<td>Appropriate connectivity offering at selected hubs</td>
<td>Complex connectivity across several hubs</td>
</tr>
<tr>
<td><strong>Brand Image</strong></td>
<td>Downmarket</td>
<td>Professional but affordable</td>
<td>Polished, upmarket</td>
</tr>
</tbody>
</table>
Short haul is Low Cost

European Route structure 2002

European Route structure 2016

Source: SRS Analyser
Aer Lingus Connectivity from UK regional airports to Dublin
2009 and 2016 data
Long Haul is Full Service

US route structure 2002

US route structure 2016

• Aer Lingus carried 1.06 million passengers from the US to/from Ireland in 2015 worth $636 million
• 306,830 transferred at Dublin to other points in Europe worth $237 million

Of those 306,830 passengers who transferred on Aer Lingus
• 116,000 transferred at Dublin for other points in the UK worth $93 million
• 38,000 transferred at Dublin for other points in France worth $28.5 million
• 28,000 transferred at Dublin for other points in Germany worth $20 million
• 22,000 transferred at Dublin for Amsterdam worth $15.5 million

• Dublin airport advantages: US Pre-clearance Immigration and new Terminal

Source: SRS Analyser
Porter’s Bases of Competitive Strategy

Gaining competitive advantage

☑ Cost Leadership
☑ Differentiation
☑ Hybrid (Rarely successful)
☑ Focus Strategies

If company doesn’t meet any of these Criteria’s:-

Stuck in the Middle

Michael Porter
Focus Strategies

A focused strategy seeks to provide high perceived product/service benefits justifying a substantial price premium, usually to a select market segment niche e.g. Fedex; TAP (long-haul to Brazil and Africa); Iberia (Long-haul to S. America); Finnair (Europe to Asia)
In Summer 2005, TAP had 39 weekly flights to 6 cities in Brazil.

In Summer 2016, TAP had 67 weekly flights to 10 cities in Brazil.
Europe – South America (September 2016 data)
Leading airlines by weekly non-stop flights

Number of Flights per Week

Source: OAG
Passenger dynamics of TAP’s traffic to/from Europe - Brazil
2007 – 2015 (traffic is both ways)

- In 2015, the revenues that TAP generated from its Brazil operations amounted to over $574m

Source: Sabre
Focused differentiation Market share of TAP from Europe to Brazil 2000 - 2014

- Around 22 million people travel yearly between Europe and Brazil each year
- TAP has around 30% of this market

Source: OAG Data
• It carried 11.4 million passengers in 2015, same as the year before
• It generated $2.86 billion in revenues in 2015
• The airline also made progress in reducing its net debt, by cutting it from €1.2 billion in 2008 down to €780 million by 2013.
• Around 70% of TAP’s revenues are generated outside of Portugal
• Spain is its most important market with around 850,000 passengers per annum
• Brazil and Africa are its most important International markets
• It operates 61 aircraft including 18 long range aircraft (14 A330s and 4 A340s)
• It has 12 A350s on order but no narrow bodies
• Europe accounts for 6.3 million passengers (out of 11.4m) with 49 destinations to EU
• It purchased PGA-Portugalia Airlines in 2006 for €140m – operates 16 RJ jets
• TAP has code shares with almost 27 carriers mostly from STAR
• The EU IMF attached conditions to Portugal’s €78 billion bailout including the privatisation of national assets including TAP (top of list).
• Azul – Brazil’s 3rd largest airline purchased a 61% stake in TAP in the Summer of 2015 for $391 million.
SN carried 244,000 passengers from Brussels to Africa in 2015 generating $181.5 million (Sabre, 2016)
The Holiday Market – a Focus market

Two scenarios ongoing in the European Charter Market

1. Charters based out of a specific country like the UK such as Monarch
2. Charters based out of specific regions like that covering all of Europe such as Thomson and Thomas Cook
Monarch Airlines
Change in Strategy

- Monarch has 25 A321s; 8 A320s; 1 737-700 in service – all are narrowbody aircraft (Sept 2015 data)
- Has 30 737-800s on order. No long haul aircraft
Changes in UK **short-haul** charter demand

*Spain includes the Canary Islands*

Focus Strategies - Charters
Focus Strategies - Charters
Thomas Cook Group Snapshot – 2014 data

Total Revenues: £4.1 billion

- Continental Europe: £2.9 billion
- UK: £1.3 billion

- Germany: £9.5 billion
- Northern Europe: £1.2 billion

- 23.1m Passengers
- 89 aircraft (11th largest airline in Europe by fleet size)

Retail outlets: 3,084 employees: c27,000

Includes Widebodies
Changes in UK long-haul charter demand

Airline Positioning for Success

Where would Thai Airways be positioned?
Conclusions

The Strategic Position, Strategic Choices and Strategy into Action are the most important elements of Strategic Management.

Strategic positioning of Airlines depends on the Macro and Micro environment.

The strategic cycle is concentric on Leadership.

An airline can gain competitive advantage through:

i) Cost leadership
ii) Differentiation
iii) Hybrid strategy
iv) Focus Strategy
Thank you all very much
The Risks facing the Airline Industry

Financial Risks
- Fuel prices
- Currency fluctuation
- Financial market risk
- Interest rate fluctuation
- Asset valuation
- Taxation
- Credit default
- Recession
- Fare wars
- Alliance troubles
- Market share battles
- Customer demand fall off
- Non-traditional competitors
- Passenger defection

External
- Union disagreements - Strikes
- Ineffective planning
- Capital expenditure overrun
- Consolidation/mergers
- Credit rating
- Aircraft acquisition
- Revenue Mgt
- Liquidity/Cash
- Consolation/mergers
- Scheduling risks
- Maintenance/reliability
- Accounting systems
- IT obsolescence
- Key planning
- E-commerce
- Network constraints
- Government regulations
- Supply chain logistics
- 3rd party problems
- 3rd party problems

Hazard Risks
- Hull loss
- Cargo losses
- Political risks
- Airline inquiry
- Terrorism
- Deductibles
- Deductibles
- Workers Comp
- Legal risks
- Weather
- Cargo losses

Operational Risk

Operational Risk
- Maintenance/reliability
- Accounting systems
- IT obsolescence
- Key planning
- E-commerce
- Network constraints
- Government regulations
- Supply chain logistics
- 3rd party problems
- 3rd party problems

Source: O’Connell