

Aviation Development –
Focus on Asia-Pacific

***Air Transport Services as Economic
Catalysts for Asia -Pacific:
an Introduction***

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2001-2006: A crisis too far?

*Economic downturn, Iraq War, SARS
rocketing fuel prices after 2004, credit crunch*

**Total IATA net losses 1990-93 = US\$ 15 billionbut....
(\$11 billion state aid given European carriers 1992-97)**

**Total IATA net losses 2001 to 2005 = US\$ 37.4 billion
(after \$5 + 3 billion aid to US carriers 2002-2003)**

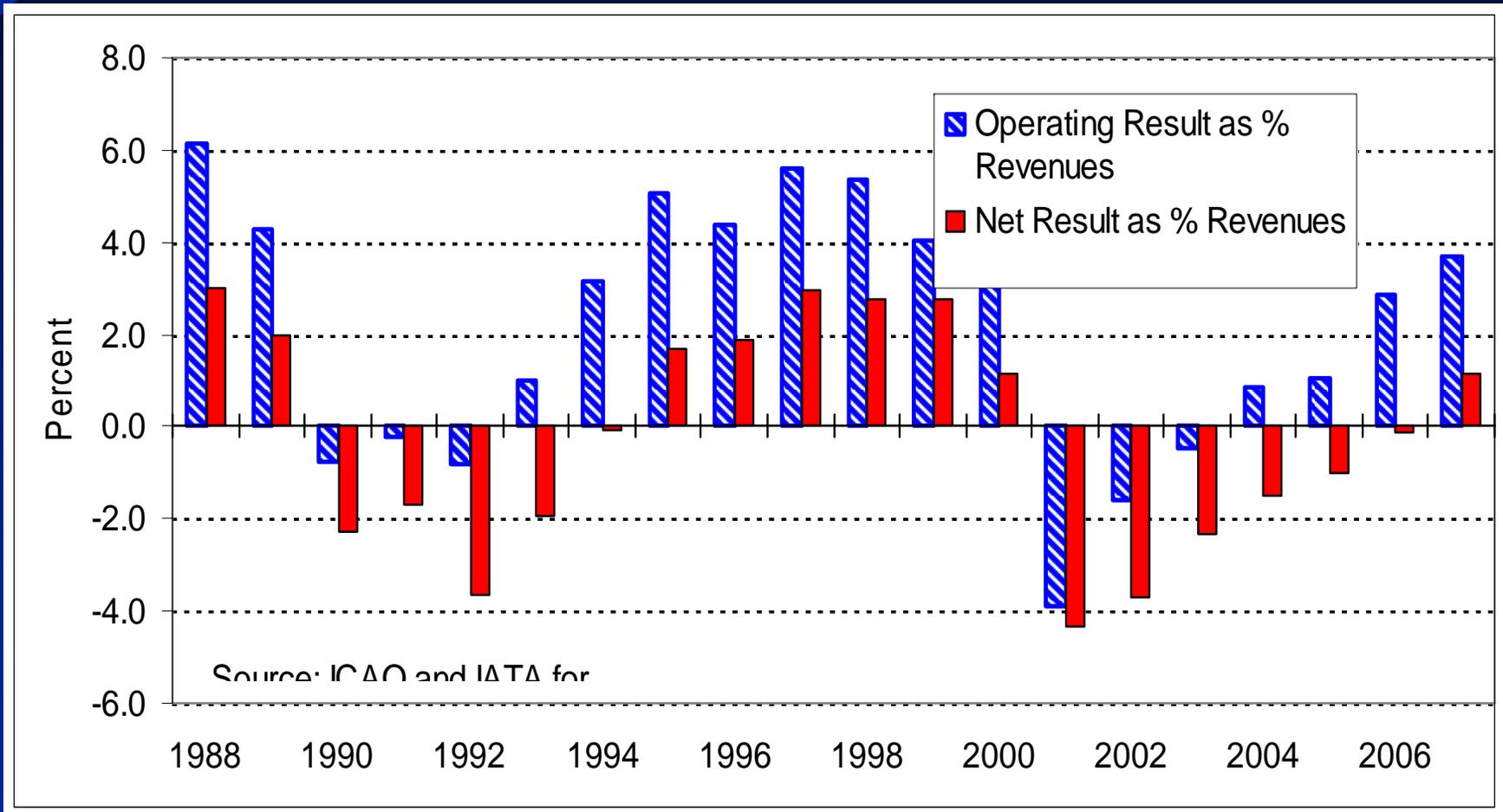
**2006 loss = \$0.5 billion (after US restructure cost 2.6 bil.)
2007 profit = + \$5.6 billion ?
2008 loss = \$6.0 bil..... if oil c. \$130/bbl**

***Downturn is deeper/longer than
just another industry cycle***



A Cyclical Industry – A Marginal Industry

Profit/Loss ICAO Member Airlines



2007 is estimate

Source : ICAO/Prof.P.Morrell

Major Challenges Affecting the Airline Industry

- 1 Long downturn creating structural instability
- 2 Accelerating liberalisation of international air services
- 3 Low-cost revolution undermining short haul markets
- 4 Economic pressures to consolidate through mergers and alliances
- 5 Declining yields require new pricing strategies
- 6 Continued cost reduction a long-term necessity as fuel prices rise
- 7 Need for effective IT strategy
- 8 Growing environmental pressures

ALL THE ABOVE ARE INTER-LINKED

Airline Challenges

Structural Instability

Long financial downturn has created structural instability

- made worse by fuel increases since 2004



Rising Fuel Prices Deepen Crisis and Pessimism

<i>Annual Average price</i>	<i>Fuel Price (cents/US gal)</i>	<i>Change/ Year Ago %</i>
Year 2002	67.9	
Year 2003	81.1	+ 19
Year 2004	116.1	+ 43
Year 2005	167.7	+ 45
Year 2006	194.8*	+ 16
Year 2007	213.7	+ 10
2008 March	316.8	+ 72
June	394.6	+ 91

Rising fuel prices may destroy airline business model

	<i>Fuel as % of total operating costs</i>	<i>Brent Crude US \$ per Barrel</i>
2000	14 %	28.8
2001	13 %	24.7
2002	13 %	25.1
2003	14 %	28.8
2004	16 %	38.3
2005	22 %	54.5
2006	26 %	65.1
2007	29 %	73.0
2008 estimated	30-35 % ??? HELP !!	105.0 Jan to June

Airline failures during 2008

United States	Europe	Asia
Maxjet (Dec. 07)	Euromanx (April)	Oasis (April)
BigSky (Jan)	Silverjet (June)	
Aloha (Mar.)	XL (Sept.)	
ATA Airlines (April)	Alitalia (Sept)	
Skybus (April)		
Eos (April)		
Champion Air (May)		

Who is next ?

Annual Growth Rates (Pass-Kms) 12 Largest Markets 2007-2026

Markets	% of World Pass-Kms 2025	Annual % Growth Rate
India Domestic	2.1	+ 11.5
China Domestic	7.3	+ 8.4
Asia - PRC	1.9	+ 6.8
W. Europe - PRC	1.8	+ 6.6
W. Europe - Middle East	1.8	+ 6.5
W.Europe - South America	2.5	+ 6.2
USA - Asia	2.1	+ 5.9
World Average		
		+4.8
W.Europe - Asia	5.3	+ 4.8
W.Europe - USA	7.3	+ 4.5
Japan - USA	2.3	+ 4.2
Intra- Western Europe	8.7	+ 3.8
USA Domestic	15.1	+ 2.4
Share of World	58.2	

Source: Compiled using Airbus: Global Market Forecast

Airline Challenges

Spread of liberalisation

- Regional Agreements, e.g. Asean, Nov 2004
- Asian bilaterals opening up
 - e.g. 2005 India agrees increased flights on many bilaterals - UK/India from 21 to 80 per week,
 - e.g. June 2007 China-US double flights permitted and unlimited cargo by 2012
- EU - USA 'Open Skies' agreement from April 2008
- EU block nationality agreements eg Lebanon, Australia , Malaysia, UAE
- Neighbour states to join European Aviation Area, e.g. Morocco 2006

- **Result:**
 - **More open deregulated markets**
 - **More intense competition**
 - **New point-to-point services**

BUT: More Govt. taxes on air travel
EU Emissions trading scheme by 2011



Airline Challenges

Low Cost Revolution

- 1. Structural instability**
- 2. Accelerating liberalisation**
- 3. Low-cost revolution**

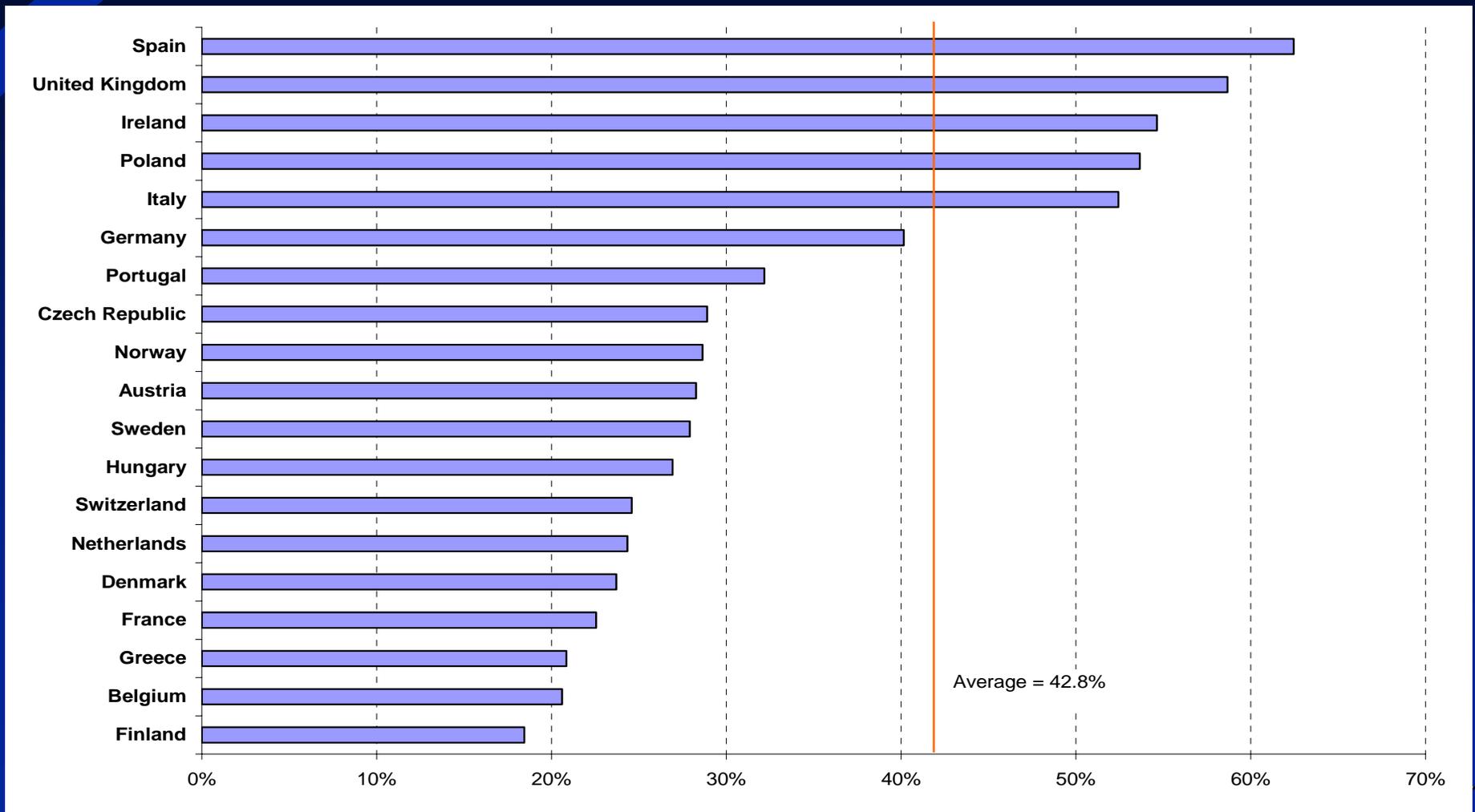
Launched in US after 1978, Europe from 1995 , Asia from 2000

- **Has undermined short-haul scheduled and charter markets in US, Europe and Australia**
- **Now spreading in South America, Middle East, Africa**

Low-cost carriers in Asia/Pacific

2001	by 2007	2007 (contd)
<i>Operating in liberalised domestic markets</i>	<i>Many new entrants More international routes</i>	
Air Asia	Air Deccan	Paramount
Cebu Pacific ?	Air Do	SpiceJet
Freedom Air	Air India Express	Star Flyer
Lion Air	Fly Pacificblue	Thai Air Asia
Virgin Pacific	Go Air	Tiger Air
	Indonesia Air Asia	Valuair
	Indigo	Virgin Blue Macau
	Jetstar	and in China
	Jetstar Asia	United Eagle
	Kingfisher	Spring
	Nok Air	Okay
	One-Two-Go	East Star etc.....

Share of "Low-cost" seats on domestic and intra European routes in each country –Sept.2008



LCC Average share in 2003 was 17%

Source: compiled using OAG data,

Airline Challenges

Consolidation

1. Structural instability
2. Accelerating liberalisation
3. Low-cost revolution undermining short-haul markets
4. **Economic Pressure to Consolidate**
 - **Benefits of larger network/wider market spread**
 - **Need to reduce costs and over-capacity**
 - **Need to reduce number of players especially long-haul**
 - **Relaxing 'nationality' will facilitate cross-border mergers**
 - **Airlines must plan or renew alliance/merger strategy**

* e.g. Air France/KLM (2004), Lufthansa/Swissair (2005), Air China/Cathay link-up (2007), Delta-Northwest (2008 ?)
BA-Iberia (2009 ?)



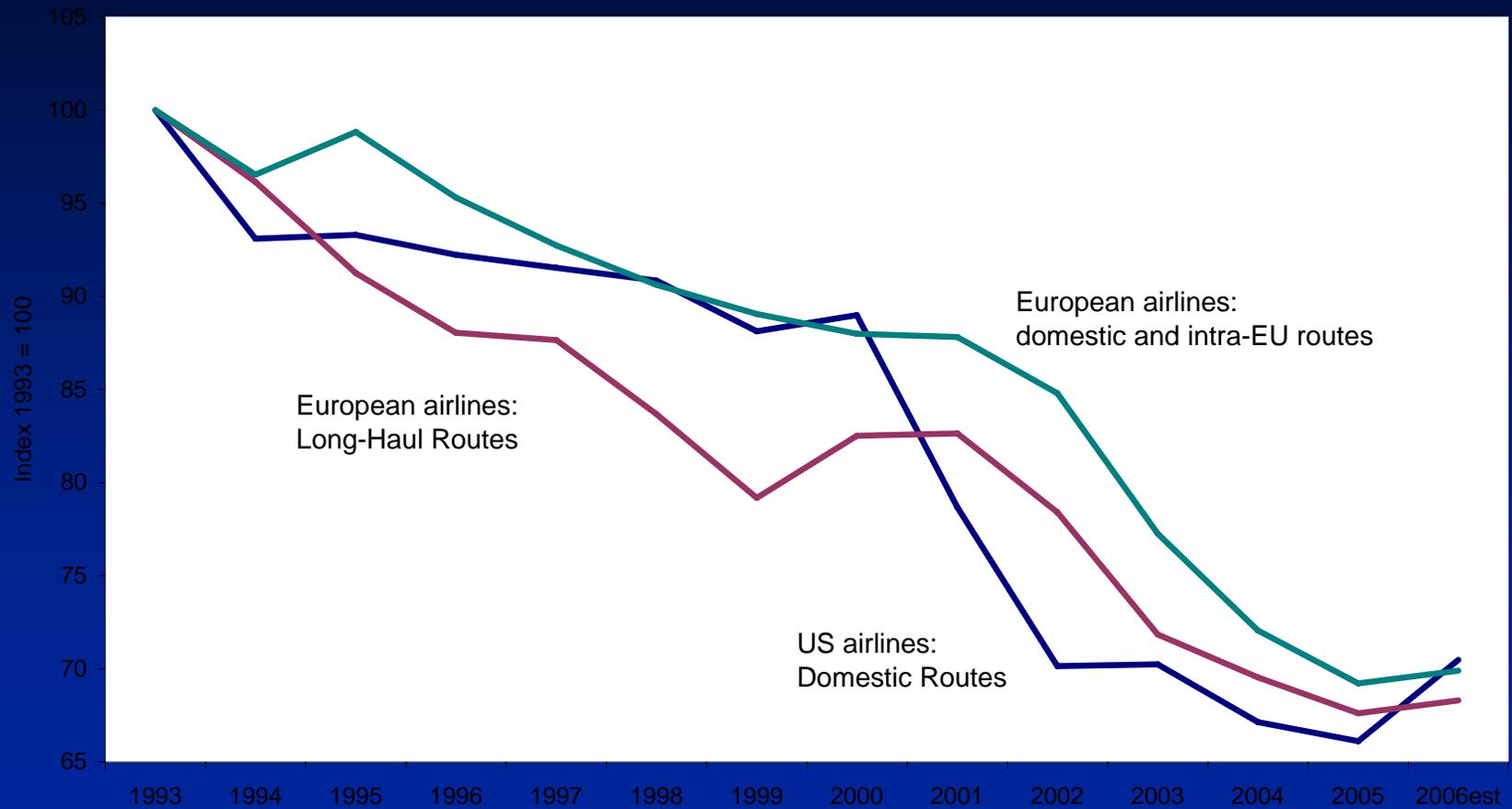
Airline Challenges

Declining Yields

1. Structural instability
2. Accelerating liberalisation
3. Low-cost revolution undermining short-haul markets
4. Economic Pressure to Consolidate
- 5. Declining yields require new pricing strategies**
 - **Over-capacity in long-haul markets**
 - **Impact of low-cost airlines on short-haul/domestic**
 - **Impact of internet**

Are Airlines Losing Price Control?
Are new pricing strategies needed

Average Fares in Real Values in Deregulated Markets



Source: Mark Smyth "Low-cost is necessary; Will it be sufficient" IATA Nov. 2006

Yields European Network Airlines 1999 to 2006

<i>Traffic Region</i>	Real Yields in US cents/RPK		
	<i>1999</i>	<i>2006</i>	<i>% change</i>
Domestic	17.72	14.74	- 16
Europe – Middle East	10.89	7.78	- 29
Intra-European	16.00	11.65	- 27
North Atlantic	6.68	6.05	- 9
Europe – Far East/Australia	6.27	5.77	- 8

Real = adjusted for exchange rate and inflation

NB. North-Atlantic 2005 was 5.53

Source: compiled from AEA data

Airline Challenges

Continued Cost Reduction

- 1. Structural instability**
- 2. Continued liberalisation**
- 3. Low-cost revolution undermining short haul markets**
- 4. Declining yields require new pricing strategies**
- 5. Economic Pressure to Consolidate**
- 6. Continued cost reduction critical as fuel prices rise**
 - Labour is the key (15-30% of total costs in Europe – 12-25% Asia)
 - Cut distribution costs (up to 15% total costs)
 - Rationalise network/fleet
 - Out-sourcing



Airline Challenges

Information Technology Critical

1. Structural instability
2. Continued liberalisation
3. Low-cost revolution undermining short-haul markets
4. Declining yields require new pricing strategies
5. Economic pressure to consolidate
6. Continued cost reduction a long-term necessity
- 7. Information Technology (IT) increasingly critical tool**

Airline Challenges

Environmental Pressures

- 1. Structural instability**
- 2. Continued liberalisation**
- 3. Low-cost revolution undermining short-haul markets**
- 4. Declining yields require new pricing strategies**
- 5. Economic pressure to consolidate**
- 6. Continued cost reduction is long-term necessity**
- 7. IT increasingly critical**
- 8. Growing environmental pressures**

eg. European Emissions Trading scheme 2012 will add \$3.5 bil. costs



Airline Challenges

Capacity Constraints

1. **Structural instability**
2. **Continued liberalisation**
3. **Low-cost revolution undermining short-haul markets**
4. **Declining yields require new pricing strategies**
5. **Economic pressure to consolidate**
6. **Continued cost reduction long-term necessity**
7. **Developing effective IT strategy**
8. **Growing environmental pressures**
9. **Airport and ANS capacity shortage worsening**

eg European Single Sky still not implemented



Network Airlines will be Challenged by

- **Spread of deregulation** → over-capacity and more competition
- **Alliances** → aggravate over-capacity and weaken smaller carriers
- **Low-cost carriers** → undermine conventional short-haul
- **Internet selling** → shifts market power to consumers, and pushes fares down
- **Continued high fuel prices**
- **Losses or only marginal profits** for many carriers

***Continued structural instability inevitable
Survival strategies must be re-thought***

Strategies for low-cost carriers

- ✓ Grow rapidly .. + 15% p.a. in Europe, faster in India, China, S.E.Asia
- ✓ Many new-entrant LCCs but most will not survive
- ✓ Consolidation into 2-4 majors in each region (e.g. Air Berlin + DBA + LTU +or Germanwings+Eurowings+TUIfly ?? -)
- ✓ Become dominant on most short-haul routes
- ✓ Attack smaller national/regional carriers, e.g. Malaysian, Thai Airways, Alitalia,
- ✓ Some product differentiation?
- ✓ New, longer-haul LCCs may emerge (e.g Air Asia, Jetstar, or Ryanair)



Future of Network Carriers

1. **Lower fuel prices** – if any – will only be short-term palliative
2. **Deep cost-cutting essential** – but not enough to ensure long-term viability
3. A key to survival in age of growing low-cost dominance in short-haul markets and imminent over-capacity in long-haul is:
 - **radical network restructuring**
 - **capacity reduction/rationalisation**
 - **product improvement/differentiation**

For these and other current issues see new 2006 revised edition of

The Airline Business

For a more a more in-depth economic study of the industry see

Flying Off Course: the Economics of International Airlines

both by

Rigas Doganis

Publisher: Routledge.com, and also available through
www.amazon.com or www.amazon.co.uk



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