Key strategic issues affecting the airline industry

Dr. George Williams

Reader in Airline Economics

Scheduled and charter airlines: current issues and future developments

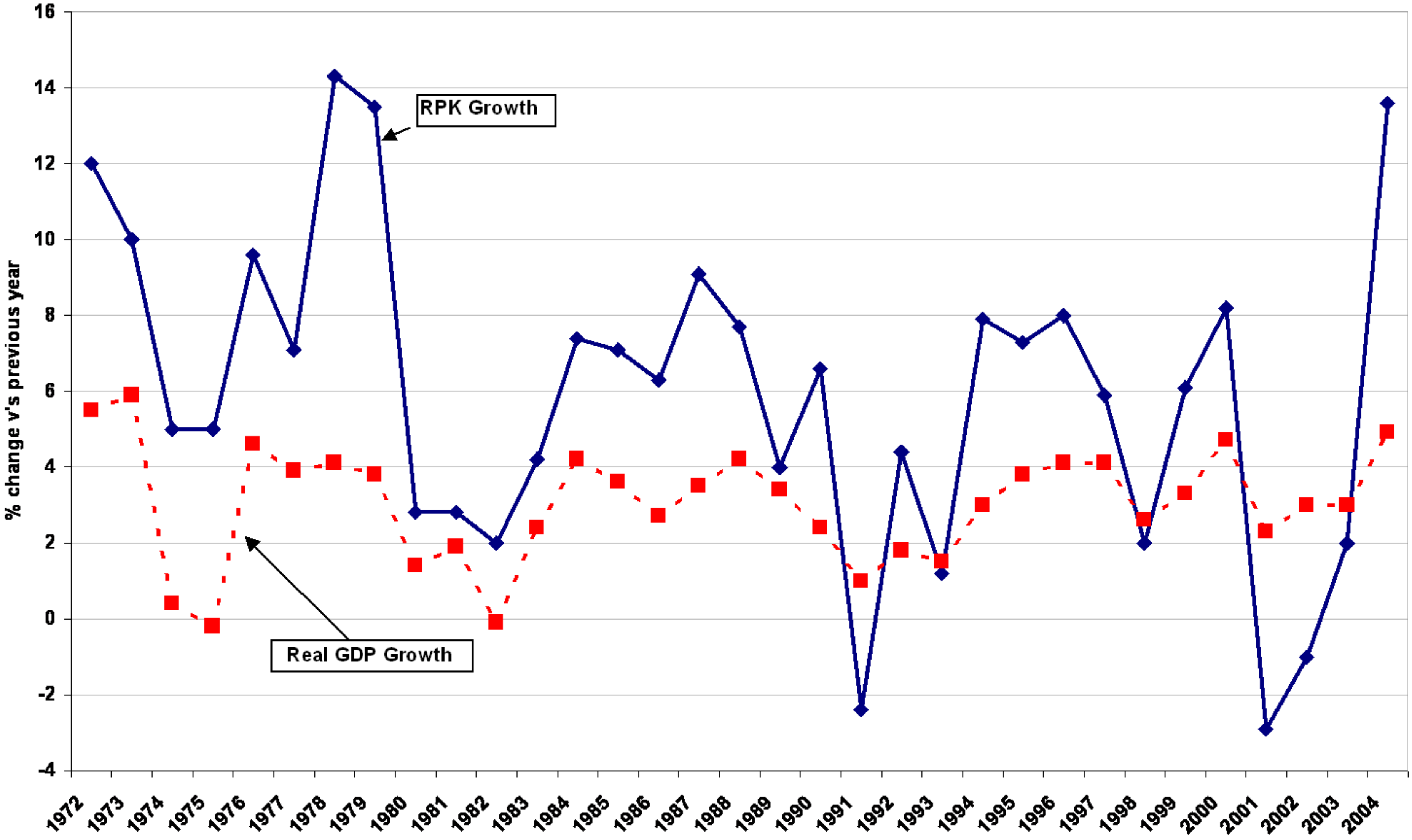
- Key characteristics of airline markets
- Market penetration of low cost scheduled airlines
- Recent developments in the charter sector
- Future prospects

Key characteristics of airline markets

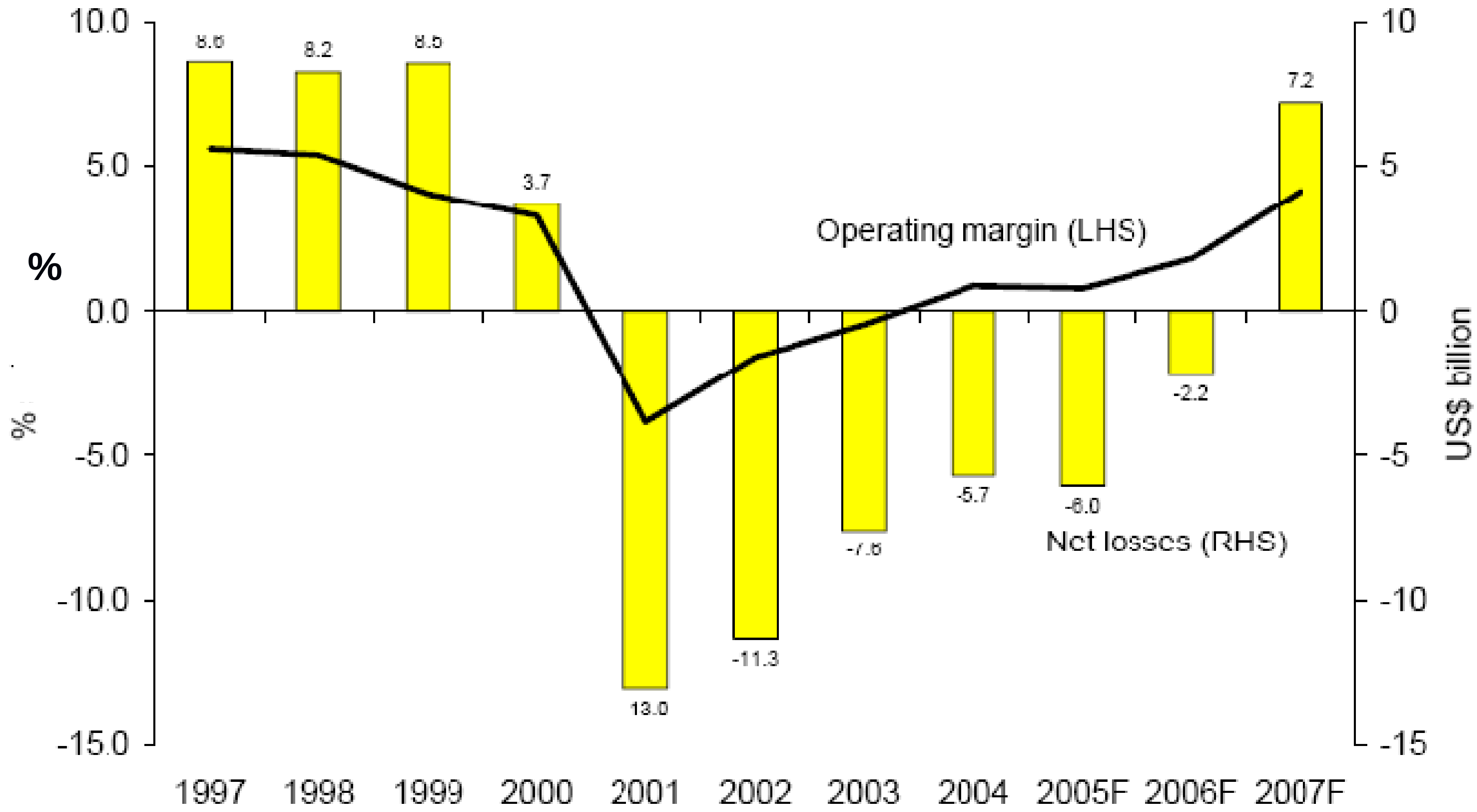
- Unique economic regulatory framework
- Strongly influenced by economic cycles and safety related issues
- Poor profitability of most airlines
- Rapid growth of low cost airlines
- Falling yields
- Increasing consumer awareness
- Link with national identity still a feature

Cranfield UNIVERSITY

Air Traffic v's real GDP Growth Rates



IATA Airlines’ Operating Margins



Source: IATA

Net profits / losses of the world’s airlines

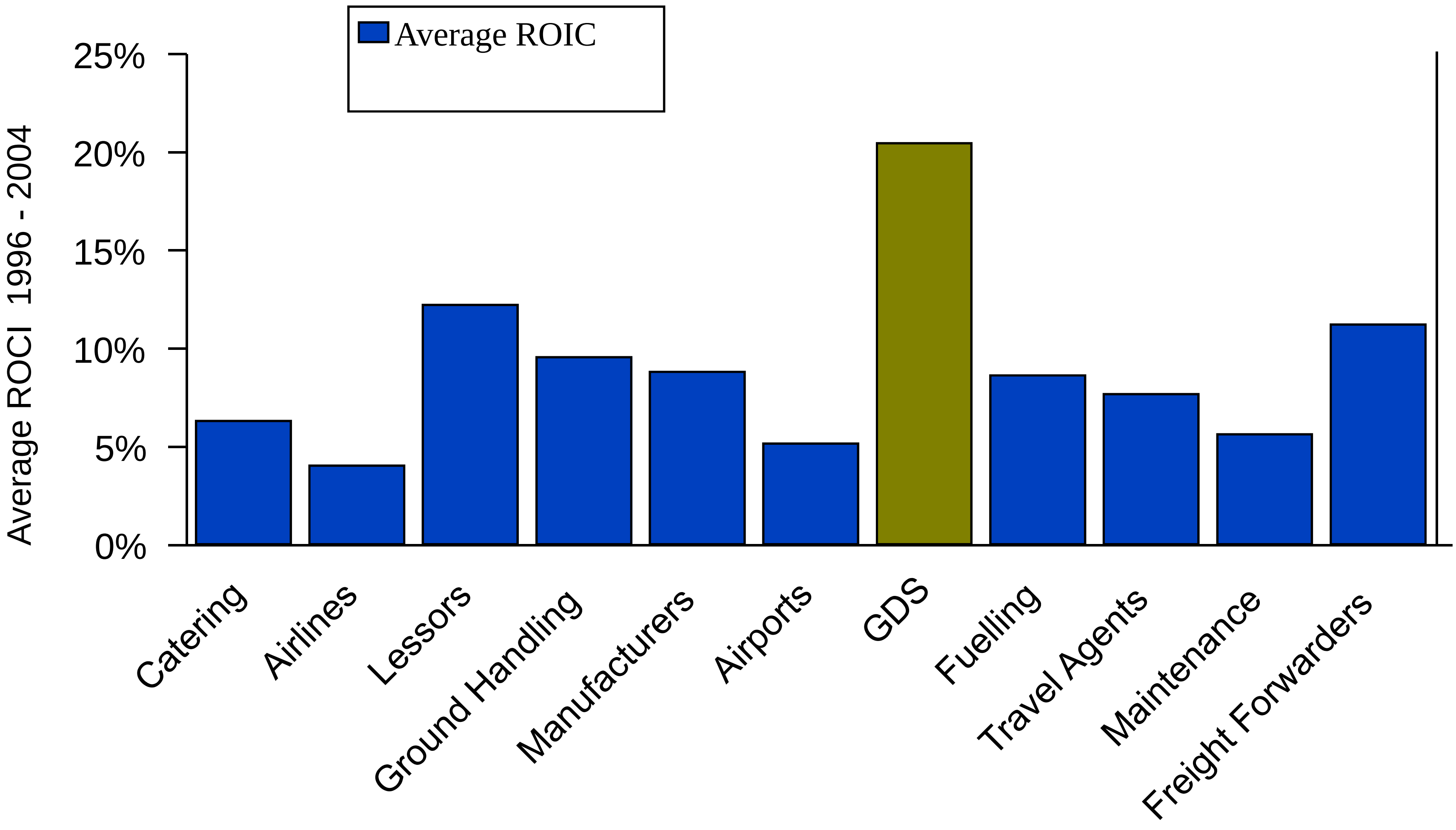
- **Net profit of US$8,500 million in 1999**
- **Net profit of US$3,700 million in 2000**
- **Net loss of US$13,000 million in 2001**
- **Net loss of US$11,300 million in 2002**
- **Net loss of US$7,600 million in 2003**
- **Net loss of US$5,600 million in 2004**
- **Net loss of US$4,100 million in 2005**
- **Net loss of US$500 million in 2006**

- **Accumulated net loss of $29,900mn (1999-2006)**

Sir Richard Branson is said to have admitted when asked how to become a millionaire:

"*Start as a billionaire and buy an airline.*"

Industry Performance Comparisons



Source: Value Chain Profitability (June 2006), IATA

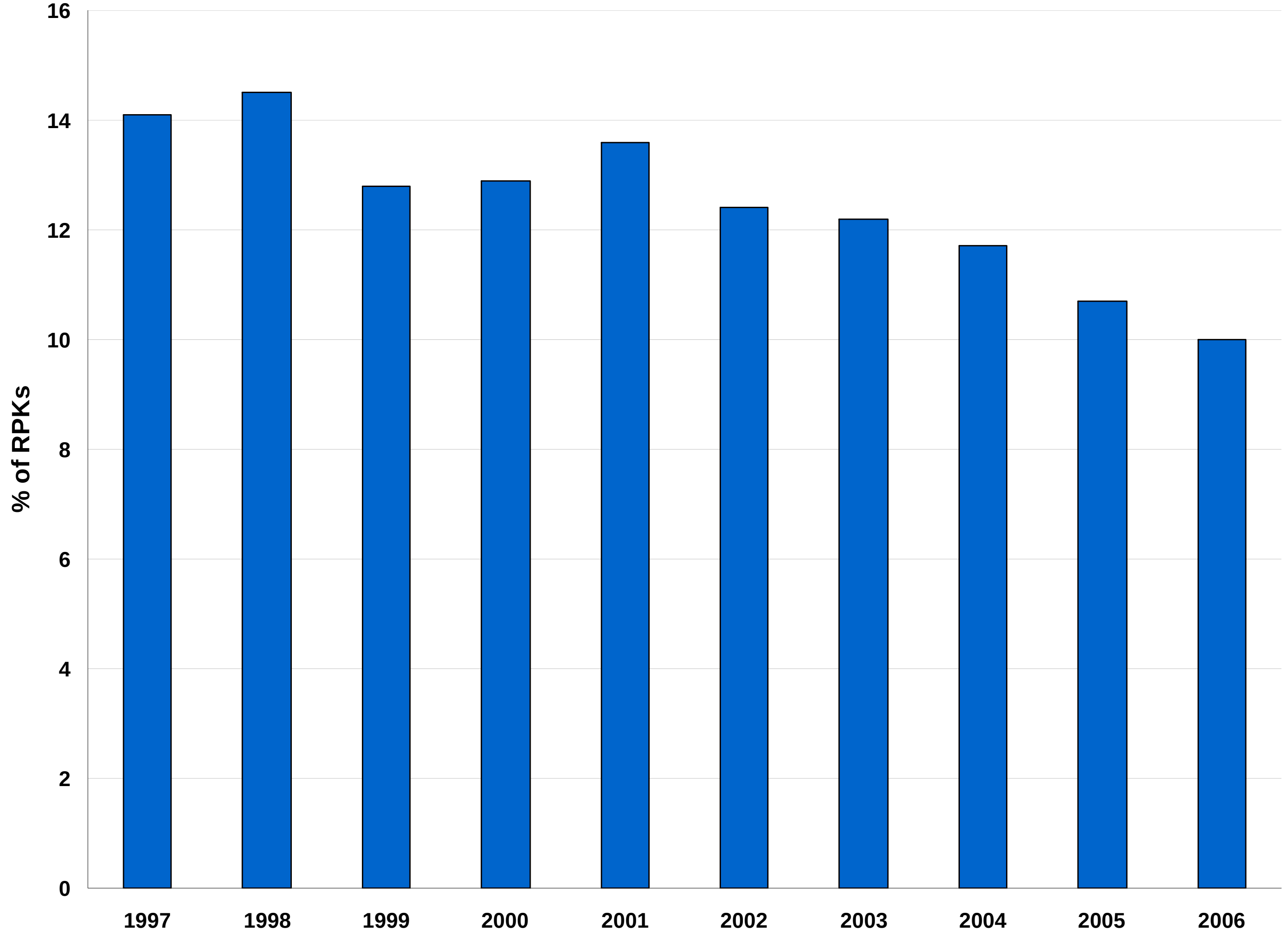
Source: Airline Business, Dec 2005

The Airline Sector in 2006

- **Passengers**
  - **71.1% of scheduled world Revenue Tonne-Kilometres**
- **Freight, Mail & Express Cargo**
  - **28.9% of scheduled world Revenue Tonne-Kilometres**

(Source: ICAO)

Non-scheduled share of passenger traffic



Forecasting demand

- **Traditional analysis identified *Economic Growth* (measured in terms of GDP per capita) or *Volume of International Trade* as the key driver of air transport demand**

- **Market liberalisation and the resulting advent of low cost scheduled airlines has made demand much more difficult to forecast. The supply of seats in short haul markets is often now a more significant driver of demand.**

Market Penetration of Low Cost Carriers

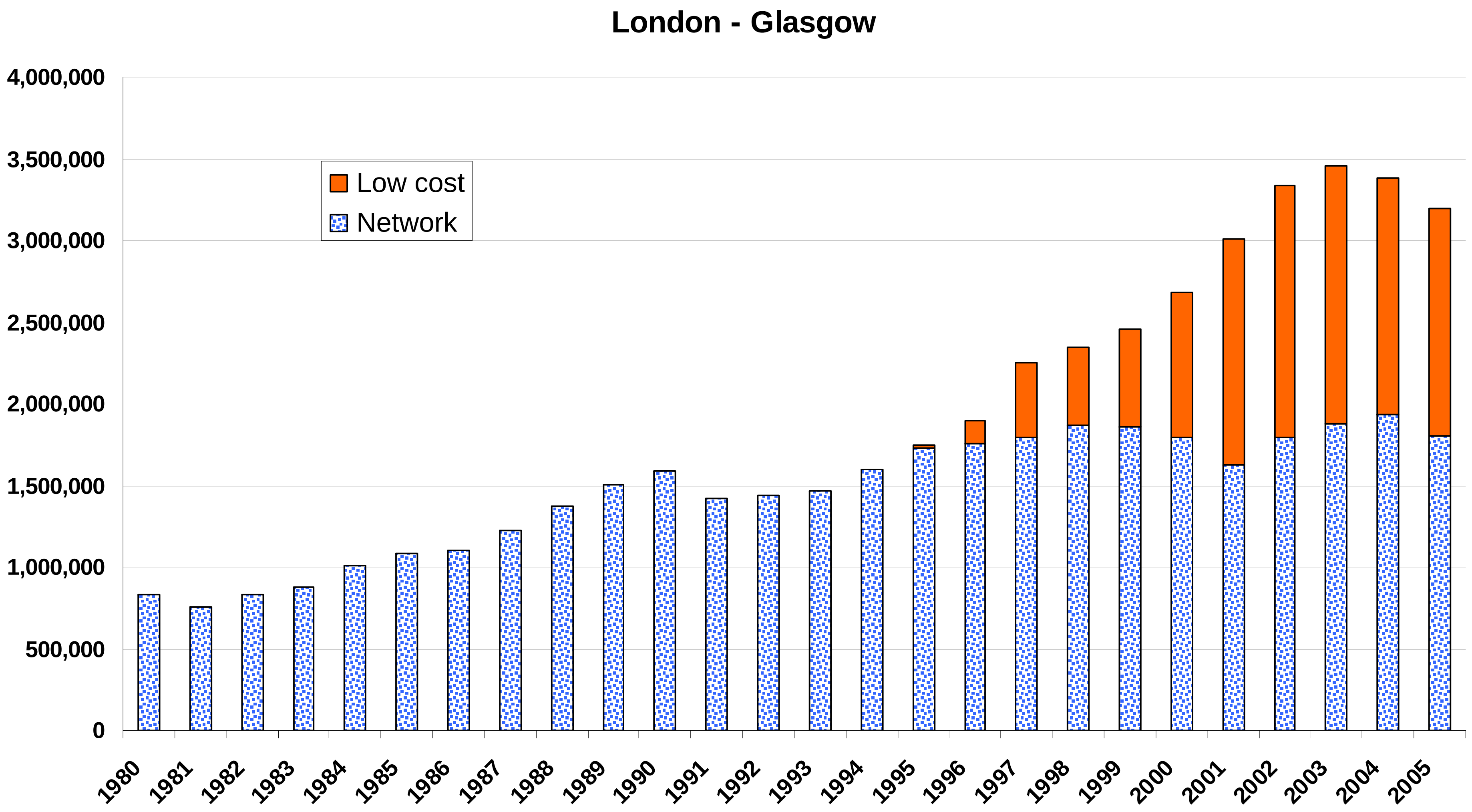
- Some 30% of passengers travelling on intra-European routes in 2006 used low cost scheduled airlines
- Seat capacity of European low cost carriers rose by over 25% in 2006
- More than 40 airports in Europe rely on low cost airlines for more than 95% of flights operated

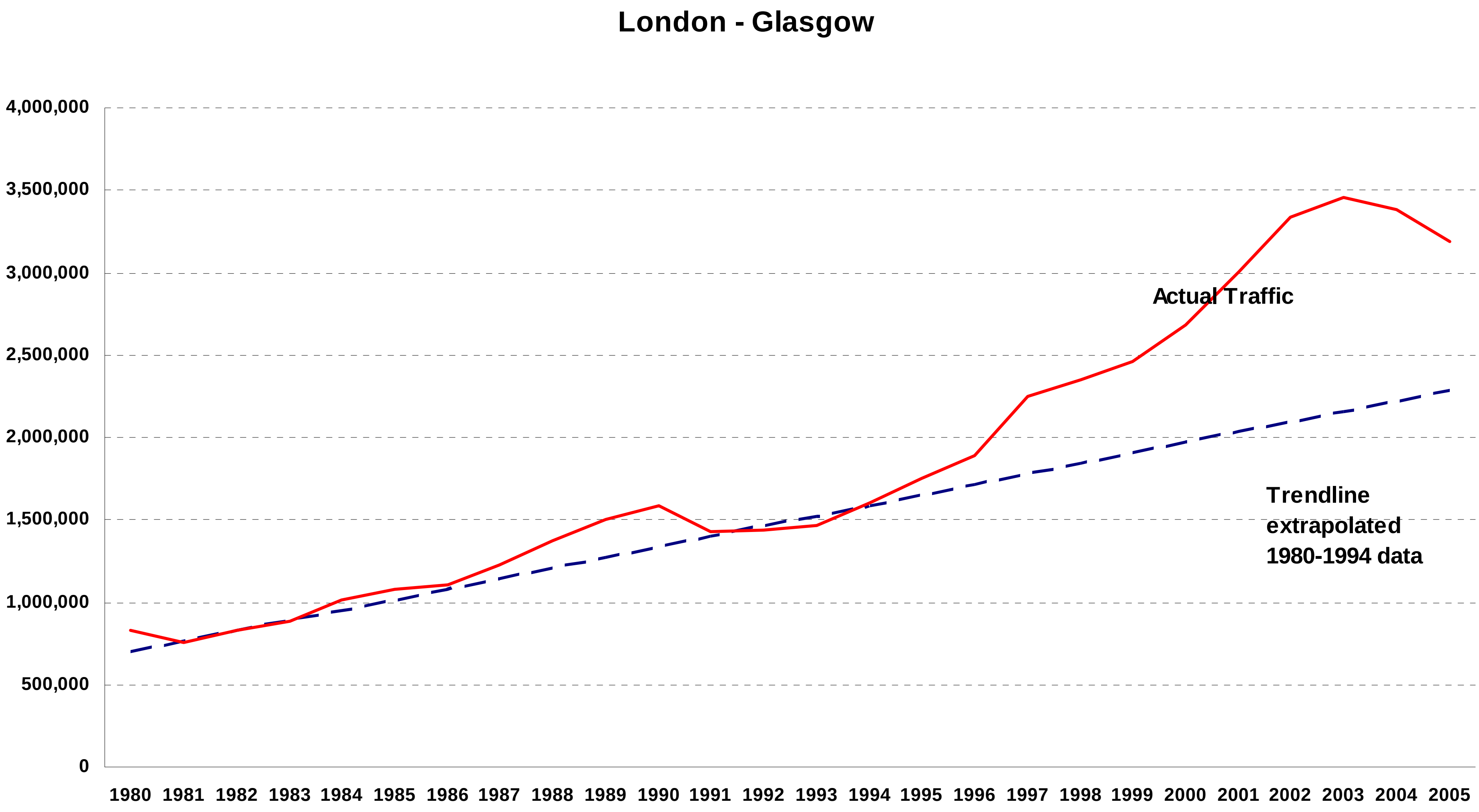
UK Domestic Trunk Routes

- Low cost scheduled carriers have had a major impact on UK domestic air routes, with 50% of passengers now travelling within the UK on such services (up from 22% in February 2001 and 37% in February 2003).

- London – Glasgow is one of the UK's busiest domestic city pairs, with services provided from four of the capital's airports.

- Of the 3.2 million journeys undertaken in 2005, some 46% were on flights operated by low cost airlines.


London - Glasgow
Low cost
Network
4,000,000
3,500,000
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005

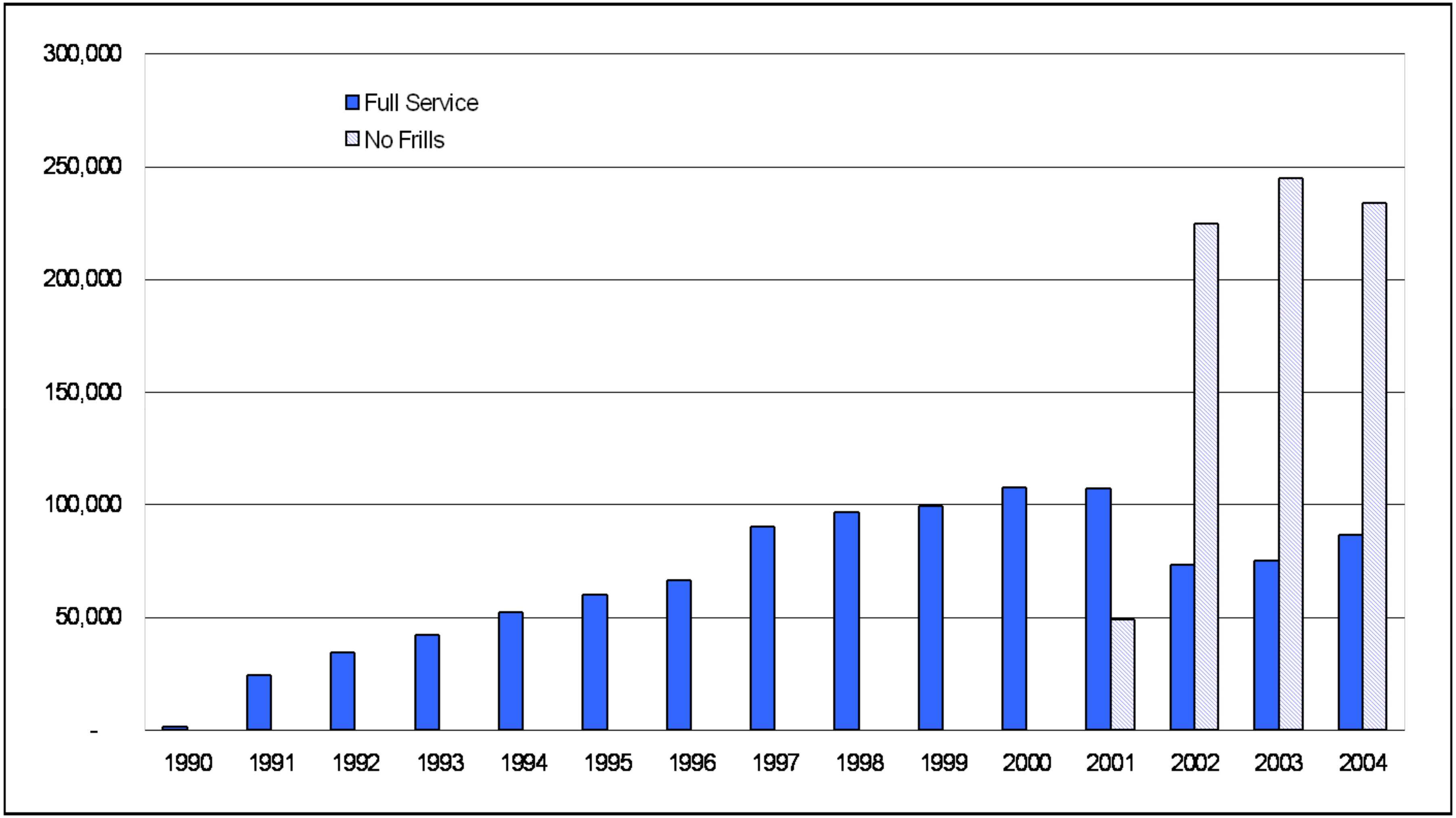


London - Glasgow
4,000,000
3,500,000
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005
Actual Traffic
Trendline extrapolated 1980-1994 data

No frills traffic at UK Regional Airports

- Since 1999 UK regional airports have attracted the attentions of low cost operators
- Go, for example, began operations between Bristol and Edinburgh in September 2001, producing an even more dramatic increase in traffic volumes than that experienced on London-Glasgow
- Passenger journeys have trebled from 107,000 in 2000 to 330,000 in 2005

Bristol – Edinburgh traffic 1996-2004



Market Penetration of No-frills Carriers

- No-frills carriers account for 54% of traffic to EU destinations from the UK
- Within the EU 26% of passengers travelled on low cost carriers in 2006

Prospects for scheduled carriers

- **Network carriers are competing on price and distribution – elimination of Saturday night stay requirement and booking via the Internet**

- **With over 30 low cost carriers now operating in Europe further consolidation is inevitable – there will only be three or four large airlines in the longer term, plus a small number of niche operators**

- **Independent low cost quality airlines are not viable in Europe (eg. Duo, JetMagic)**

Developments in the European Charter Market

1960s	**Hotel Based Inclusive Tours**
	Affinity Group Charters
1970s	**Advanced Booking Charters**
	***Bucket* Shops**
1980s	**Direct Sell Tour Operators**
	Self Catering Inclusive Tours
	Seat Only
	Horizontal & Vertical Integration
1990s	**Long Haul Inclusive Tours**
	Wider Choice of Destinations
	International Tour Operator Integration
	Competition from *No-frills* scheduled airlines
2000s	**Dynamic Packaging**

Europe's Inclusive Tour Market in 2005

	TUI	Thomas Cook	MyTravel	First Choice	Kuoni
Airlines	Thomsonfly Hapagfly Britannia Nordic Corsairfly Arkefly	Thomas Cook SunExpress	MyTravel MyTravel A/S	First Choice	Edelweiss Novair
Tour Operators	TUI Thomson	Thomas Cook Neckermann Kreutzer Ter. Air Marin	Airtours Going Places Travel World	First Choice	Kuoni
Travel Agents	Thomson Hapag-Lloyd Nouvelles Frontieres	Thomas Cook	Going Places	First Choice	Kuoni Helvetica

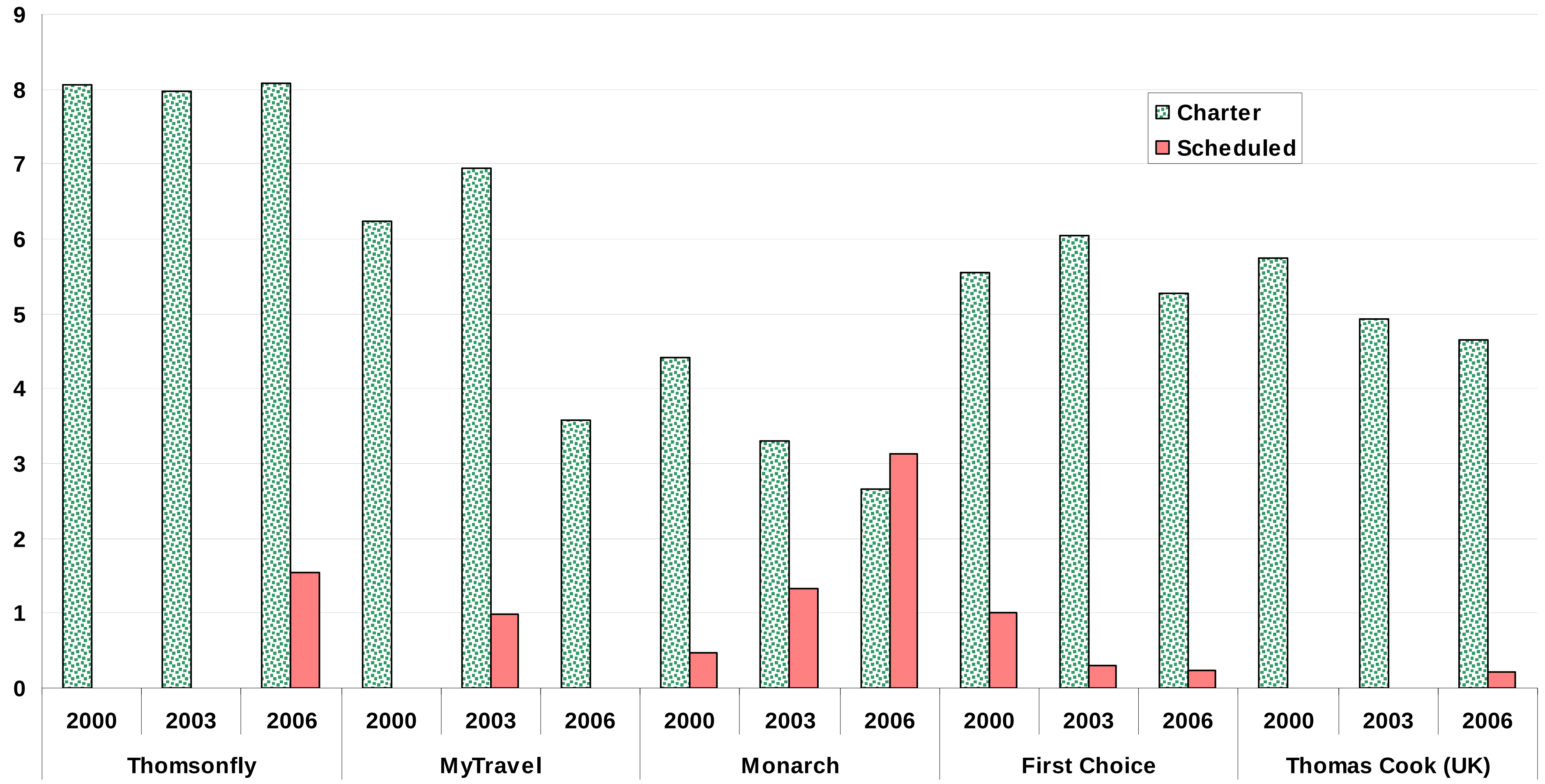
Europe's Charter Airline Groups in 2007/2008

TUI	**Thomas Cook**	***Air Berlin***
Arkefly	**MyTravel**	**Air Berlin**
Corsairfly	**MyTravel A/S**	**Belair**
First Choice	**Thomas Cook (Belgium)**	**Condor**
Jetairfly	**Thomas Cook (UK)**	**LTU**
Thomsonfly		
TUIfly		
TUIfly Nordic		

Characteristics of the Charter Market

There are four types of airline company that operate charters:

- **vertically integrated charter carriers**
- **independent charter carriers (some destination based)**
- **charter airline subsidiaries of scheduled flag carriers**
- **scheduled airlines**

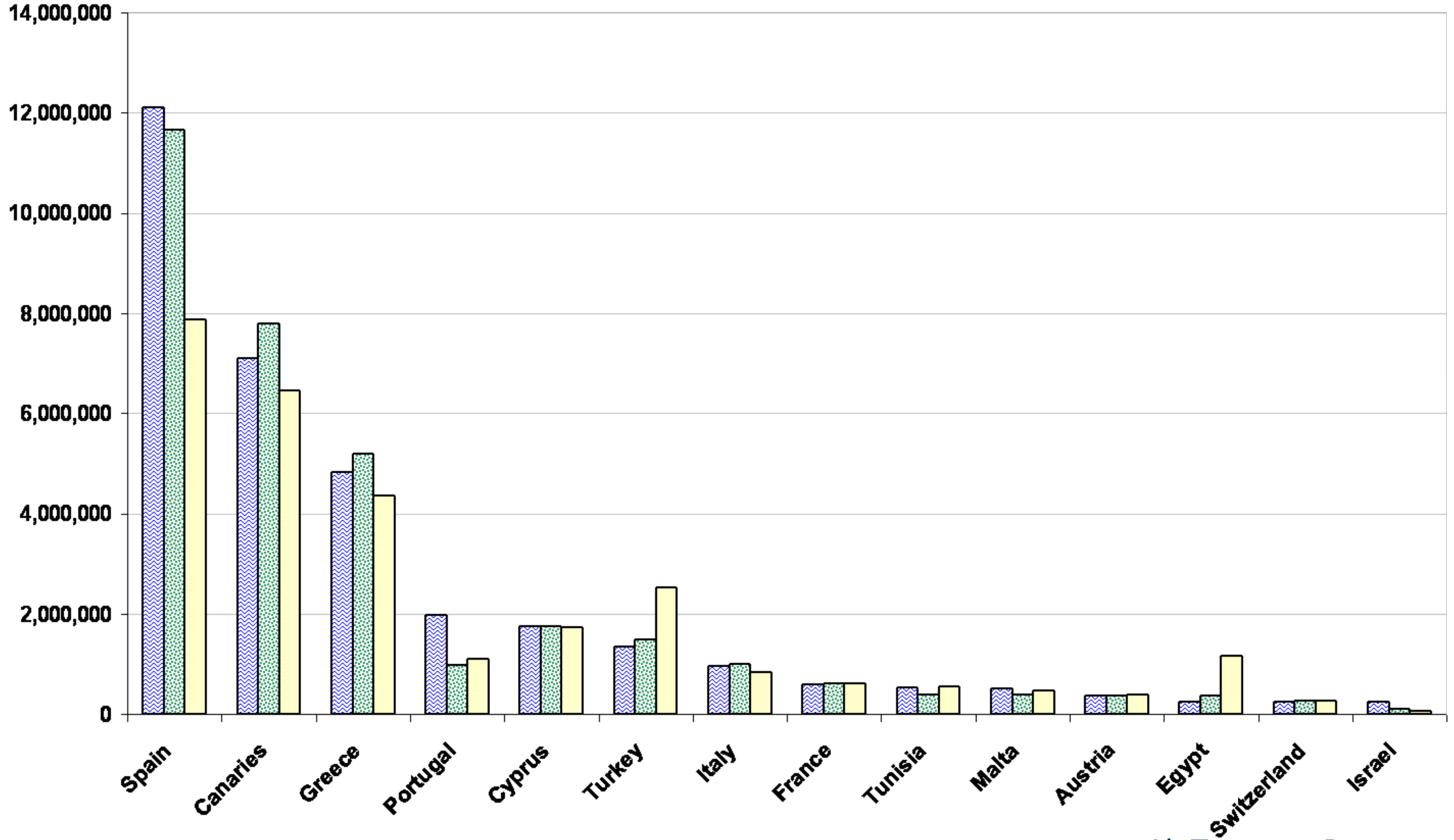

9
8
7
6
5
4
3
2
1
0
Charter
Scheduled
2000
2003
2006
Thomsonfly
MyTravel
Monarch
First Choice
Thomas Cook (UK)

Market Trends

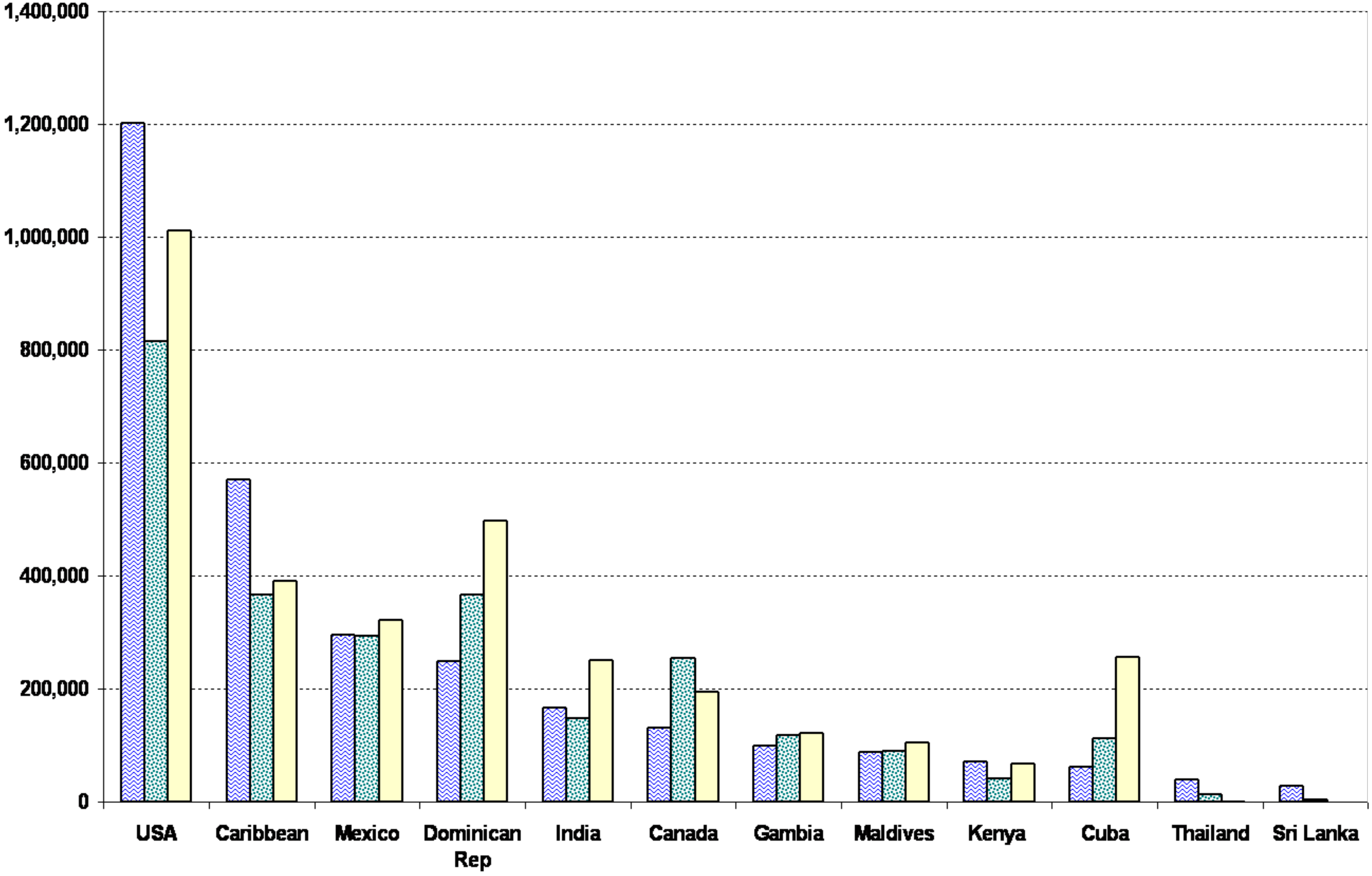
- Short Haul Charter Markets
- Long Haul Charter Markets
- Specialist Charter Markets

Cranfield UNIVERSITY

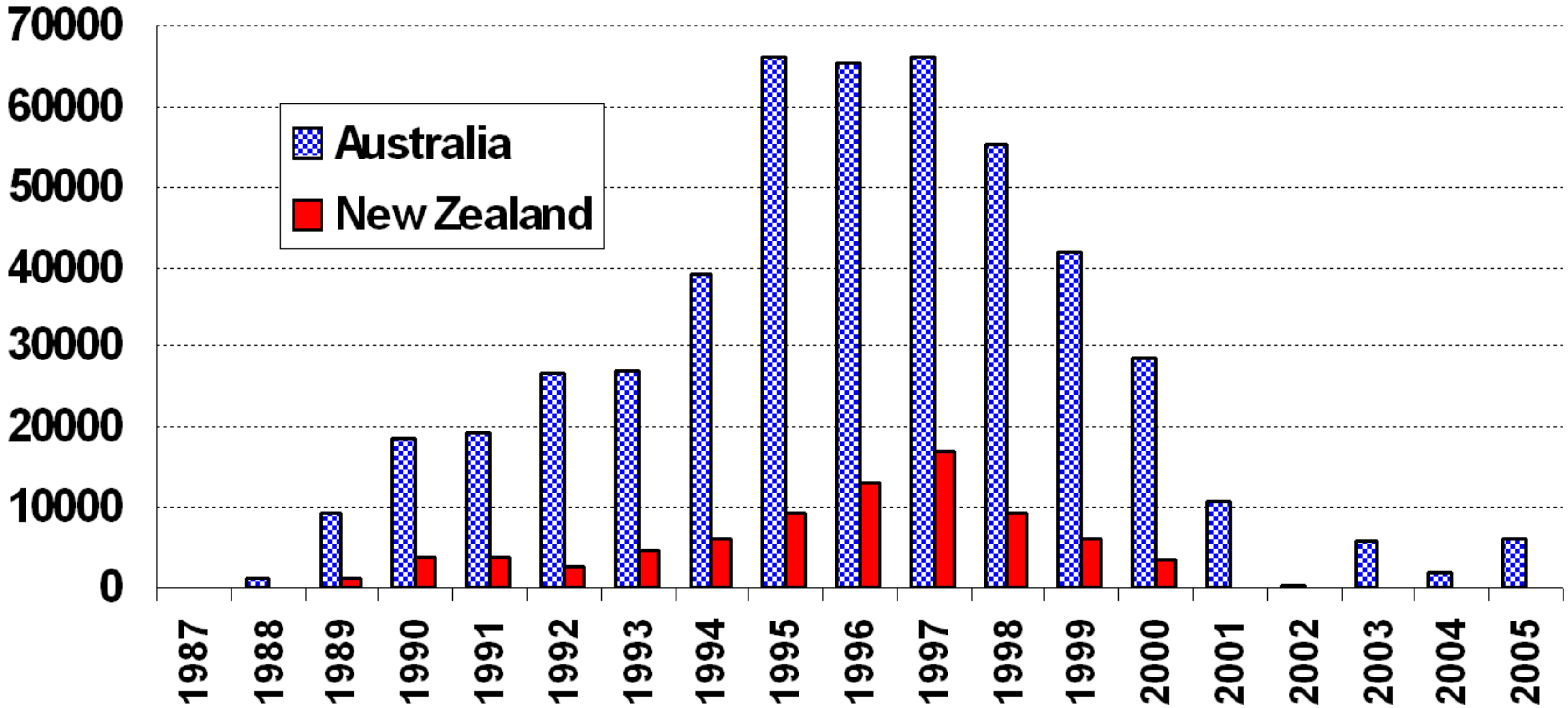
Short Haul Charter (2000, 2003, 2005)

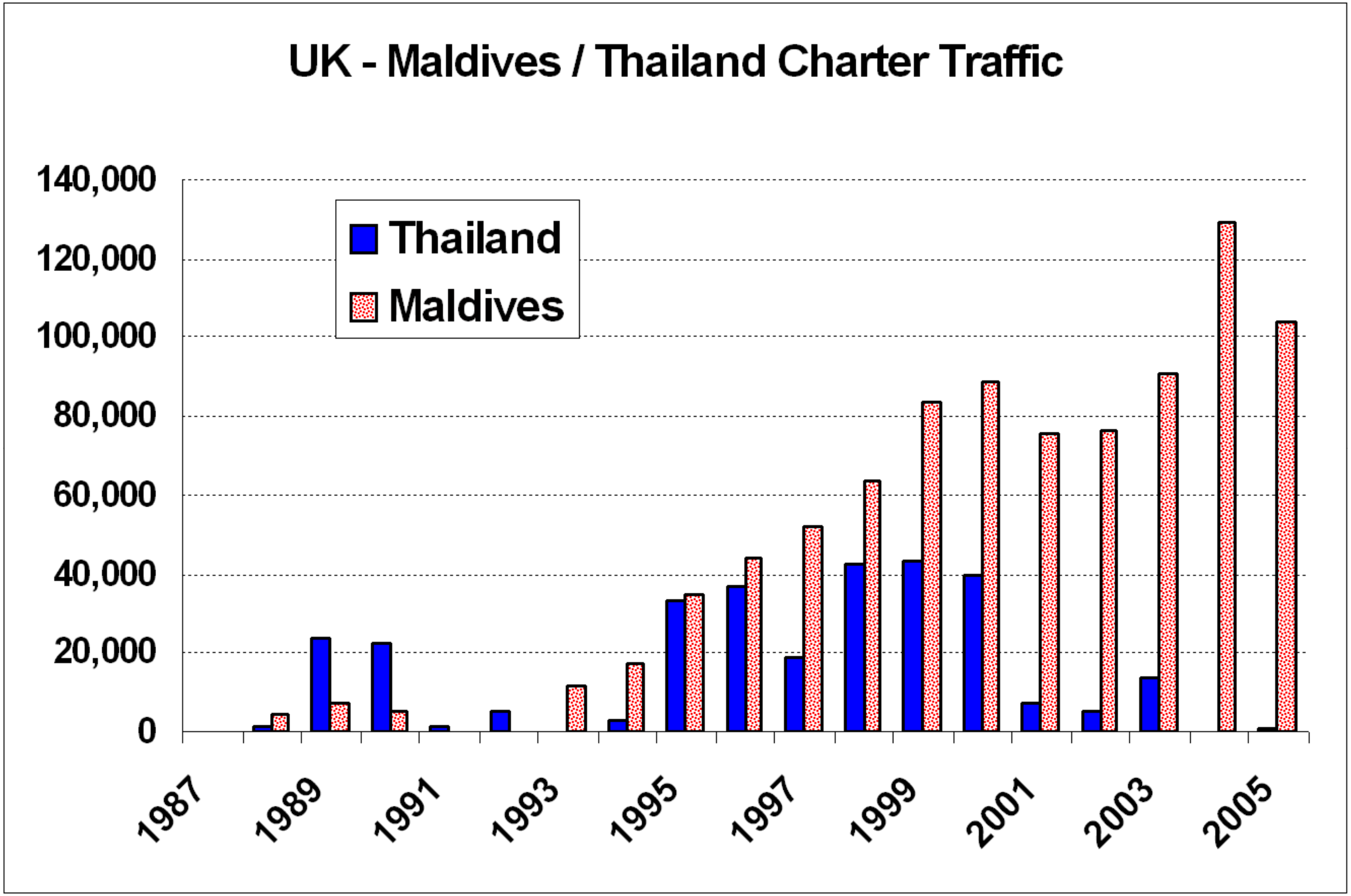


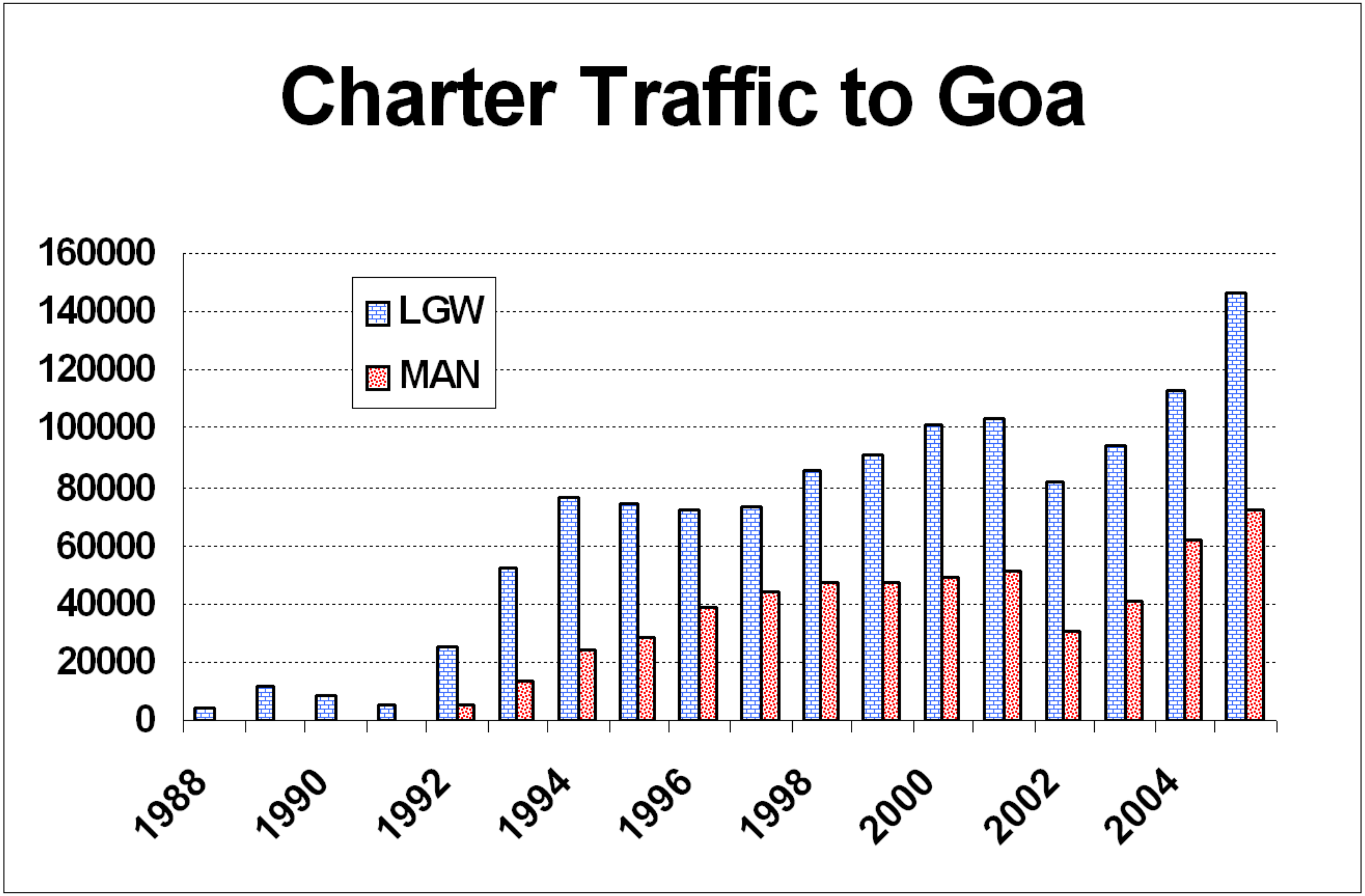
Long Haul Charter Demand (2000, 2003, 2005)



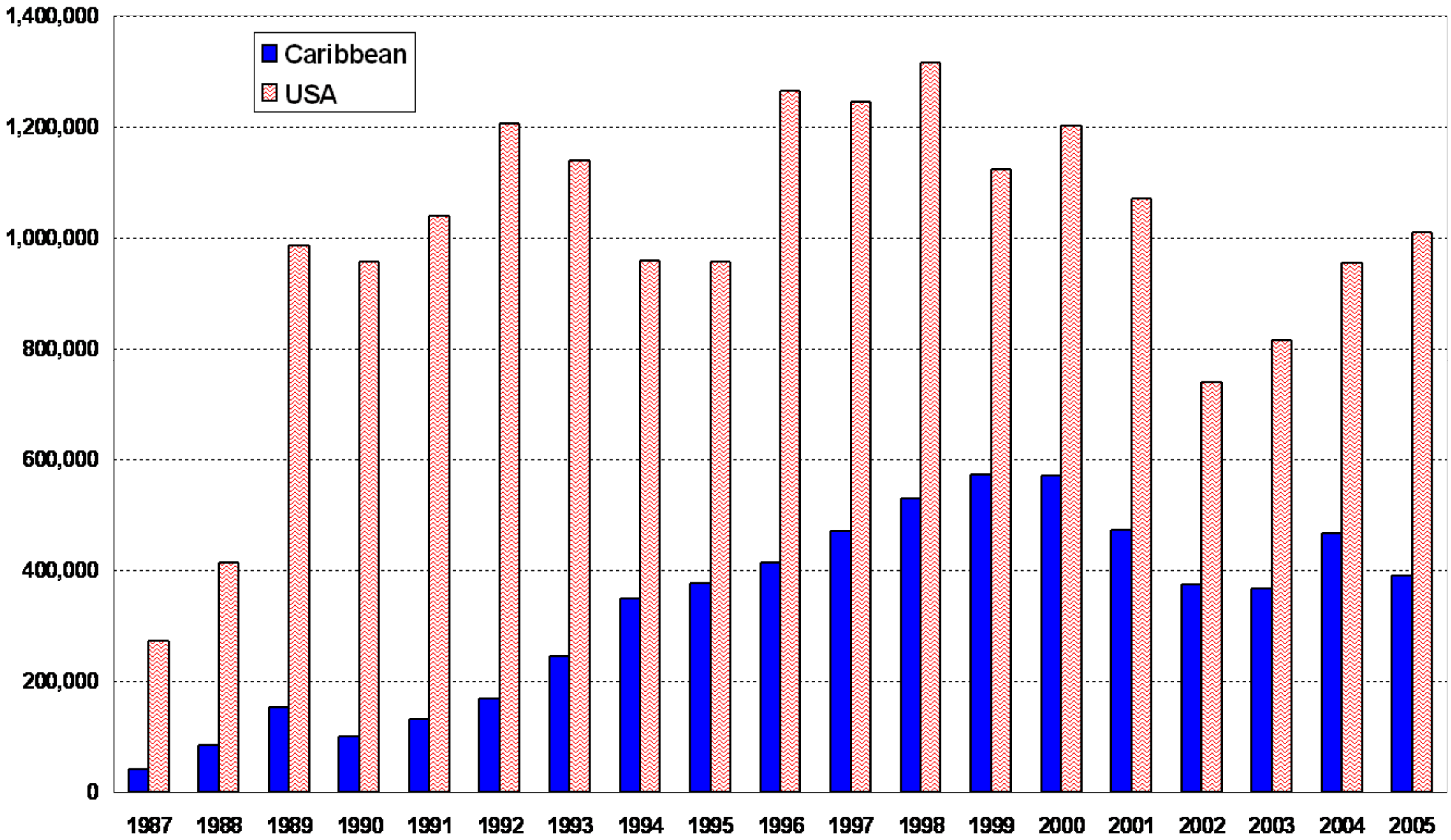
UK - Australia / New Zealand Charter Traffic



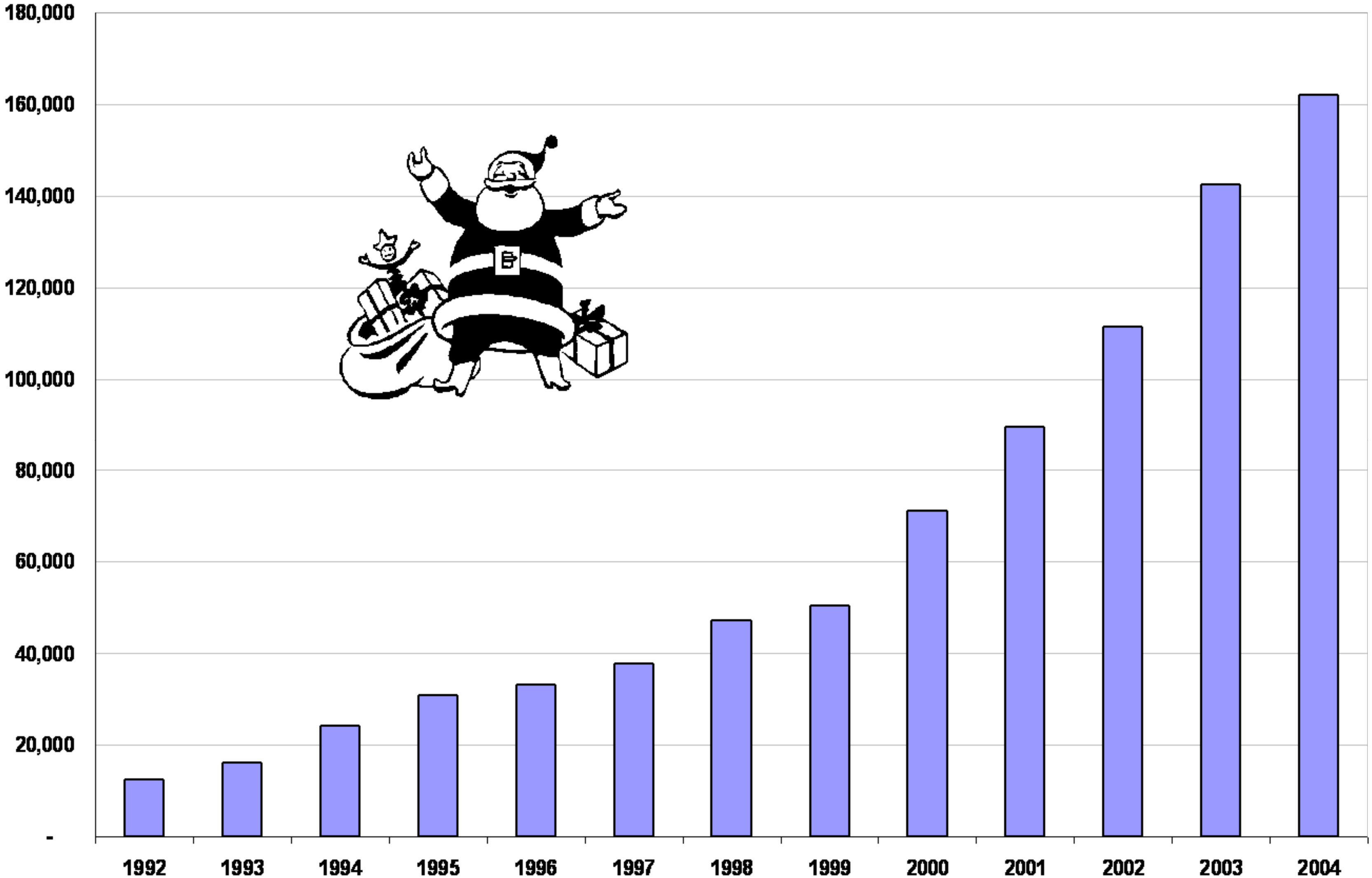

UK - Maldives / Thailand Charter Traffic
Thailand
Maldives
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005


Charter Traffic to Goa
160000
140000
120000
100000
80000
60000
40000
20000
0
LGW
MAN
1988
1990
1992
1994
1996
1998
2000
2002
2004

UK - Caribbean Charter Traffic



Come and see me in Lapland!



Future developments

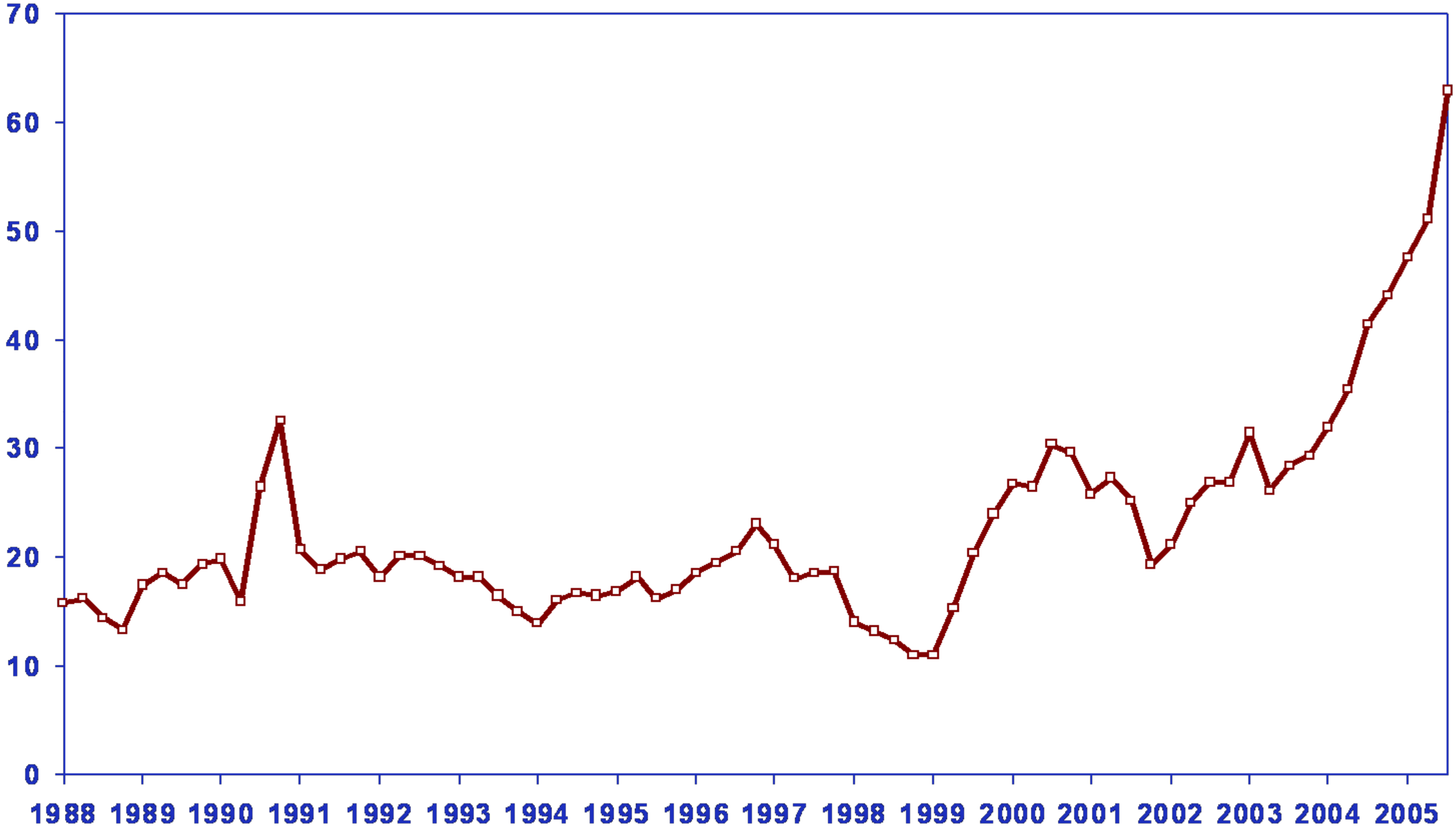
- Poor financial results likely to continue
- Continuing rapid growth of the low cost sector
- Airline consolidation
- Increasing environmental constraints
- Increasing use of e-commerce

Constraining Factors

- **High Oil Price**
- **Environmental Controls**
- **Infrastructure Limitations**
- **Global Warming Concerns**

Oil Prices Rising Sharply

Brent crude spot, $ per barrel



Continuing Evolution

***More differentiation*:**

- **Lower cost business class only airlines**
- **Greater emphasis on customers' convenience**
- **Low cost with frills**
- **Longer haul low cost services?**