

Nature of Airline Demand

Air Transport Management Seminar
Universidade Lusofona
Lisbon
7th - 11th January 2008

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The Airline Industry

- Big and Wide and Tall
- Characteristics
- Changes in Demand
- Key Issues

Big and Wide and Tall

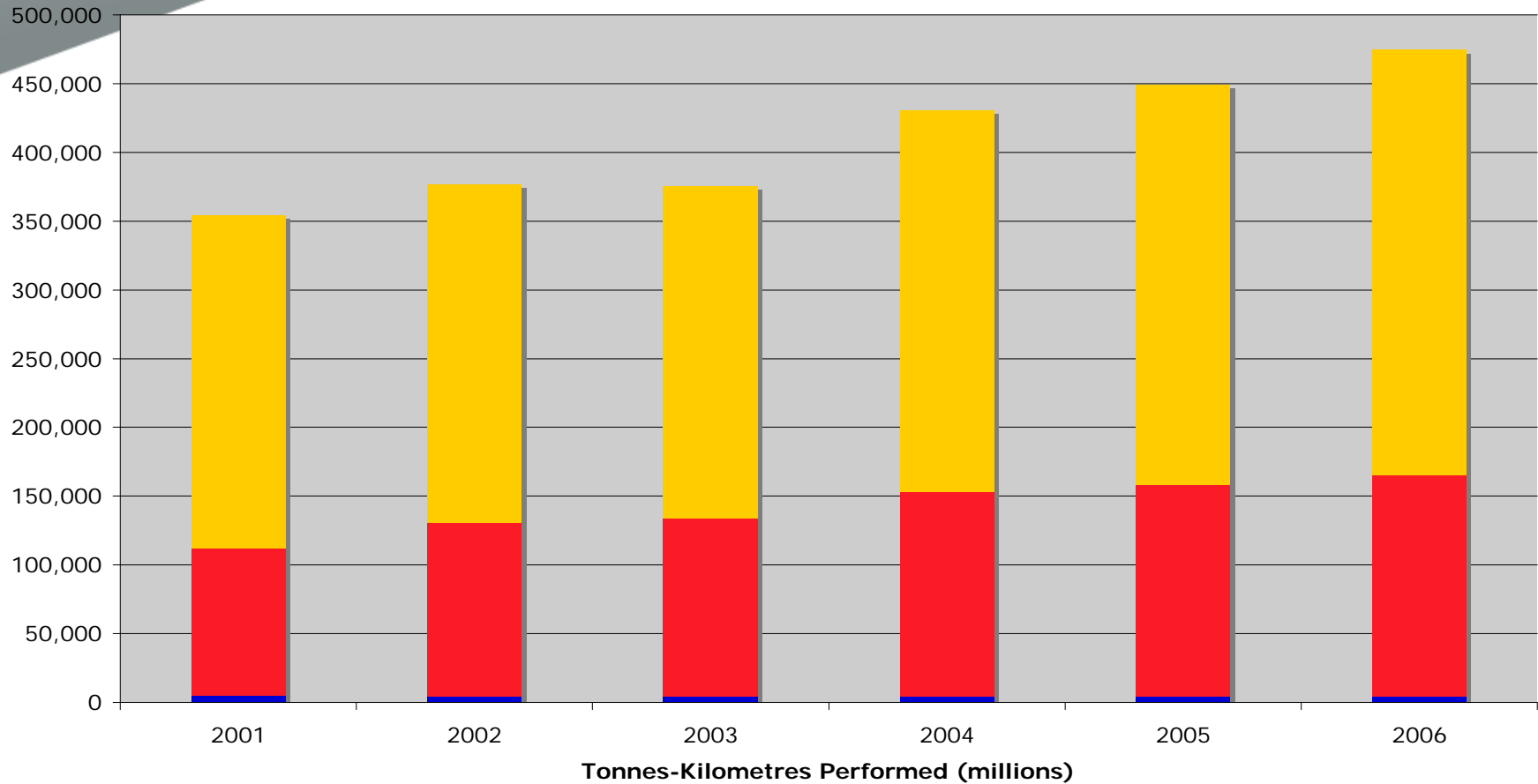
2,100 million passengers (4.1% increase)

753 million international passengers (6.7% increase)

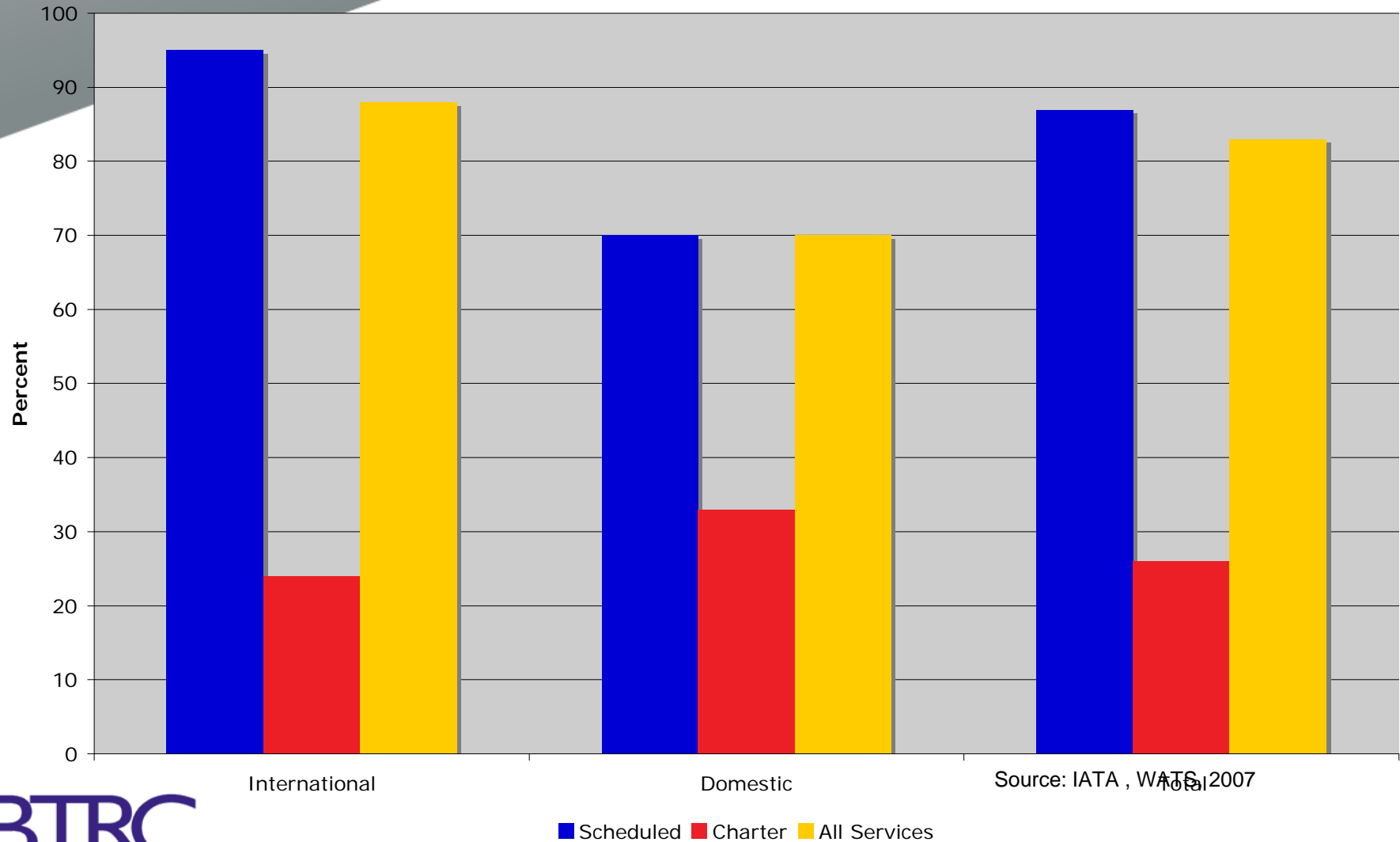
ICAO preliminary figures

IATA Members Operations

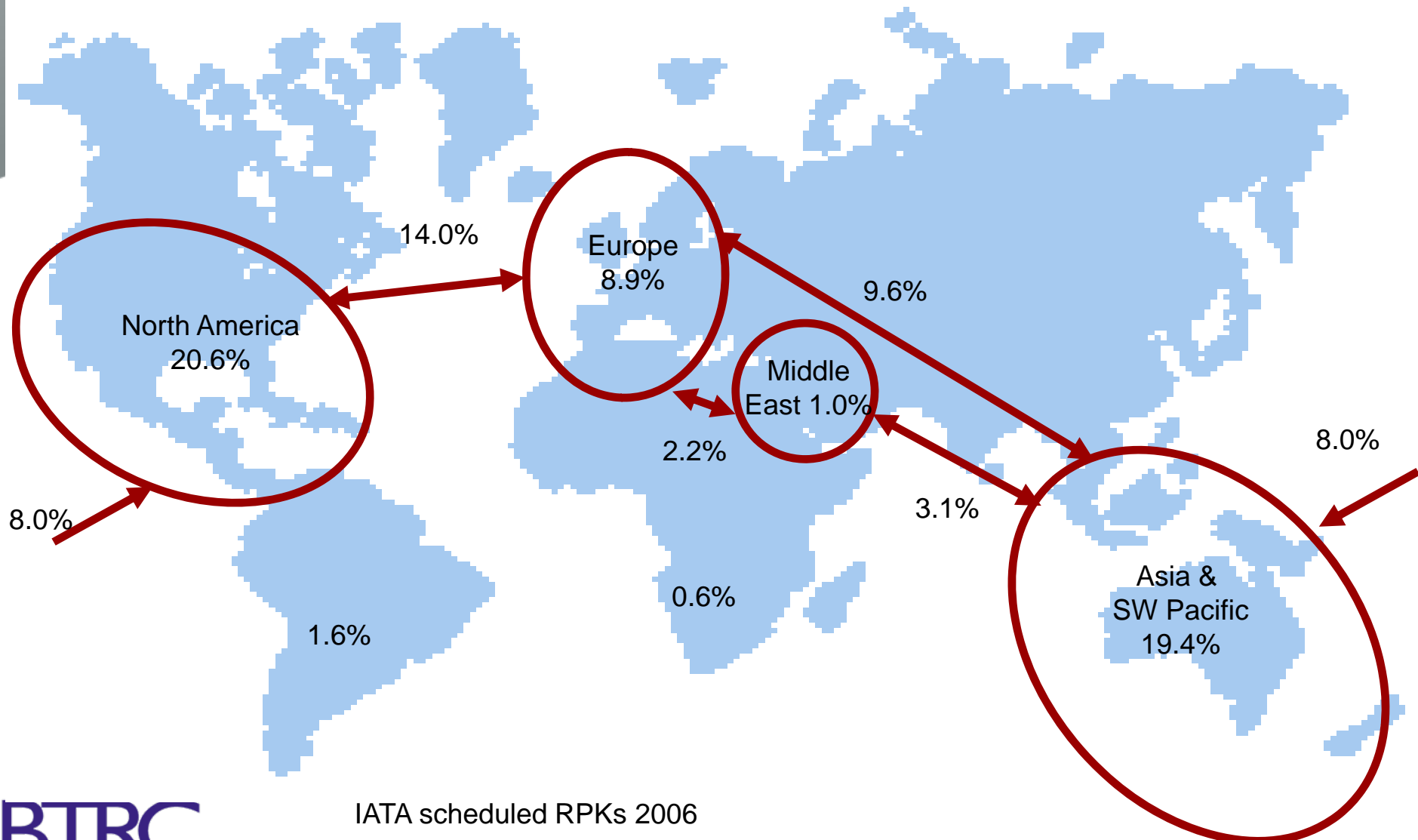
IATA members Air Transport Operations



IATA Share of World RPKs, 2006



Major Passenger Traffic Flows (RPKs)



IATA scheduled RPKs 2006

Passenger traffic growth forecast

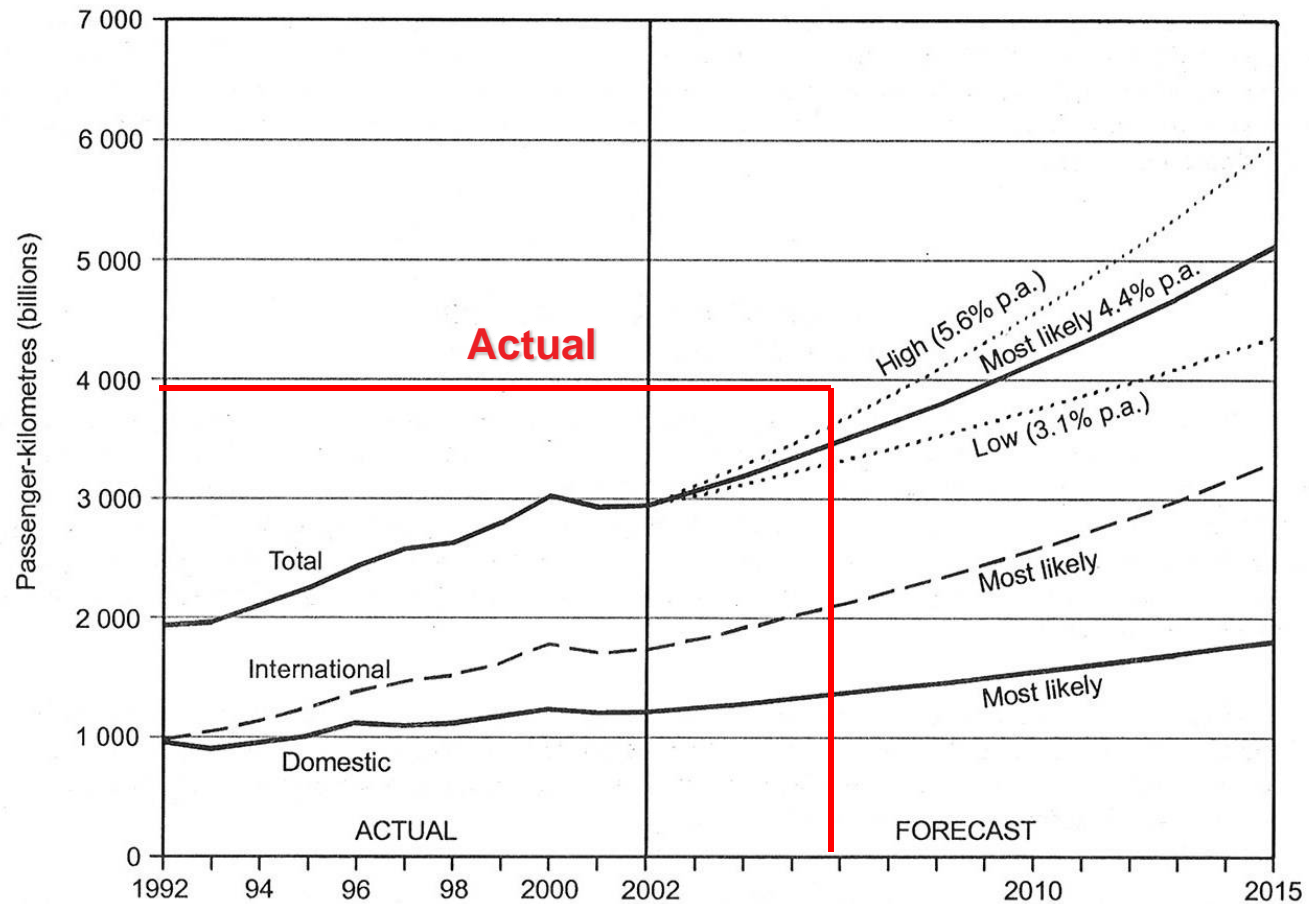
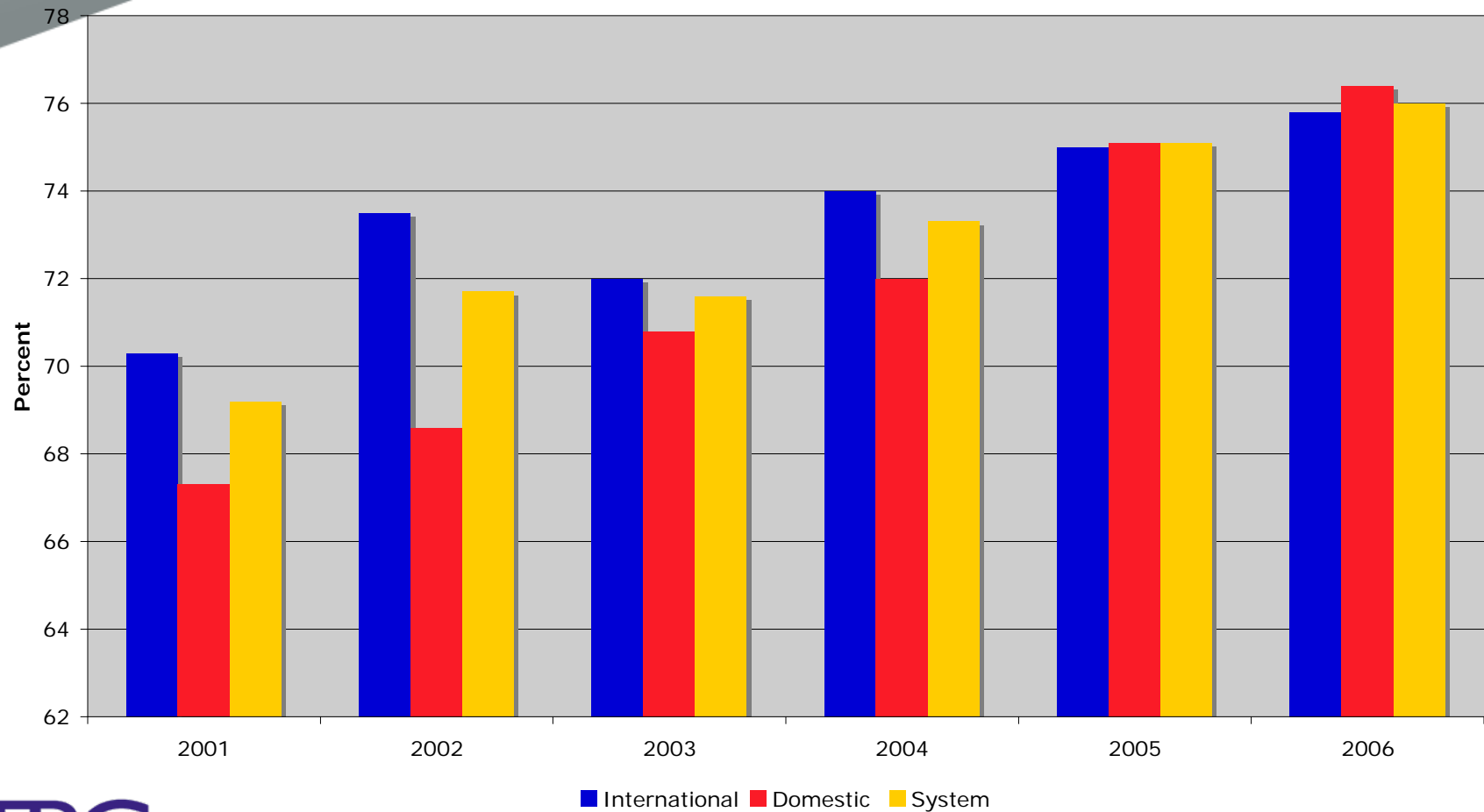


Figure 5-1. Trends in scheduled passenger traffic — World (1992–2015)
(ICAO Contracting States)

IATA Members' Passenger Load Factors

IATA Member Passenger Load Factors

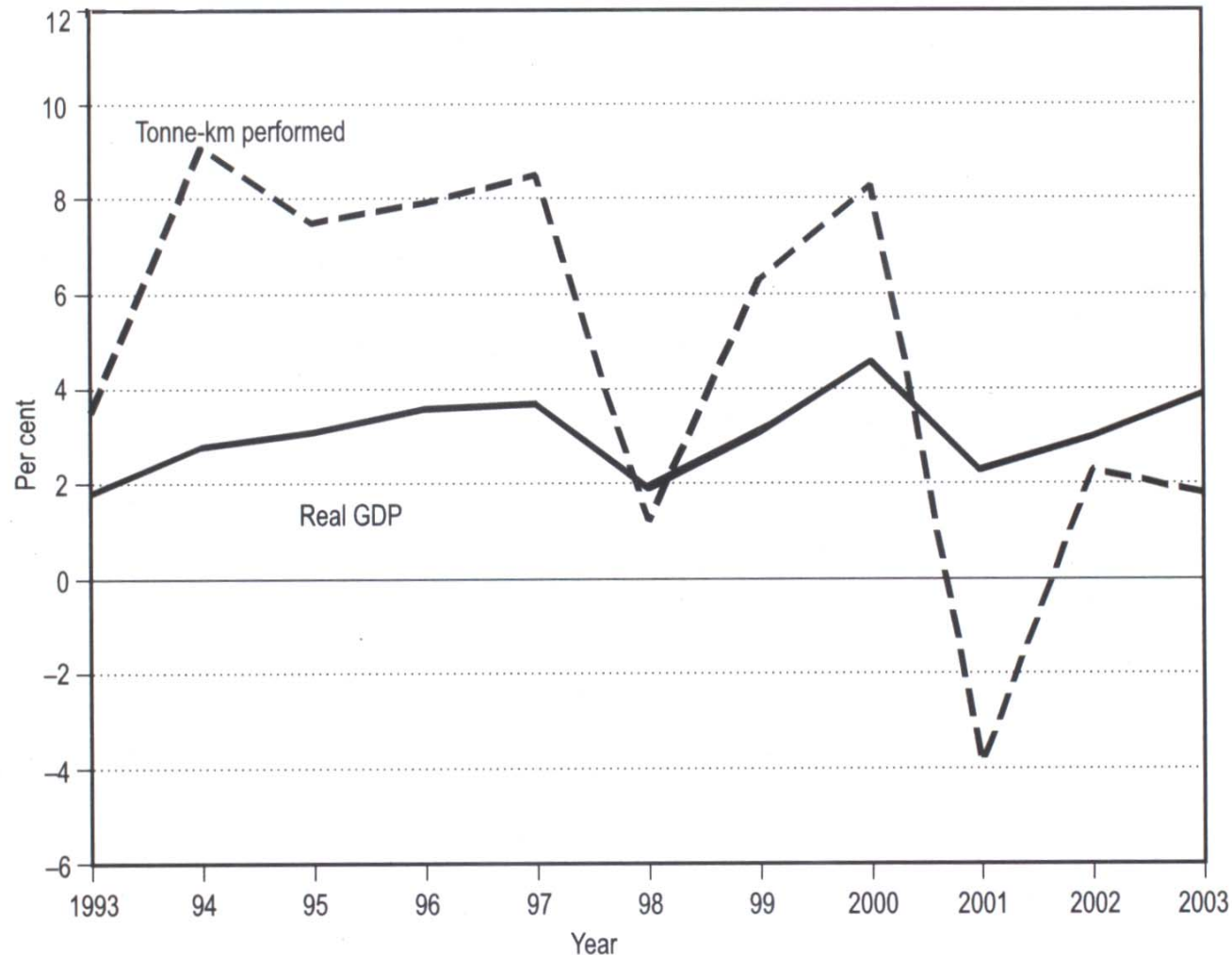


Airline Industry Characteristics

Airline industry characteristics

- Strongly influenced by economic cycles
- Seats cannot be stored
- High operating gearing
- Many markets highly seasonal
- Long aircraft ordering lead times
- Poor financial performance

World GDP & scheduled traffic growth



Source: IMF, ICAO Air Transport Reporting Form A.

Aircraft Manufacturer Forecasts (Passenger-kms)

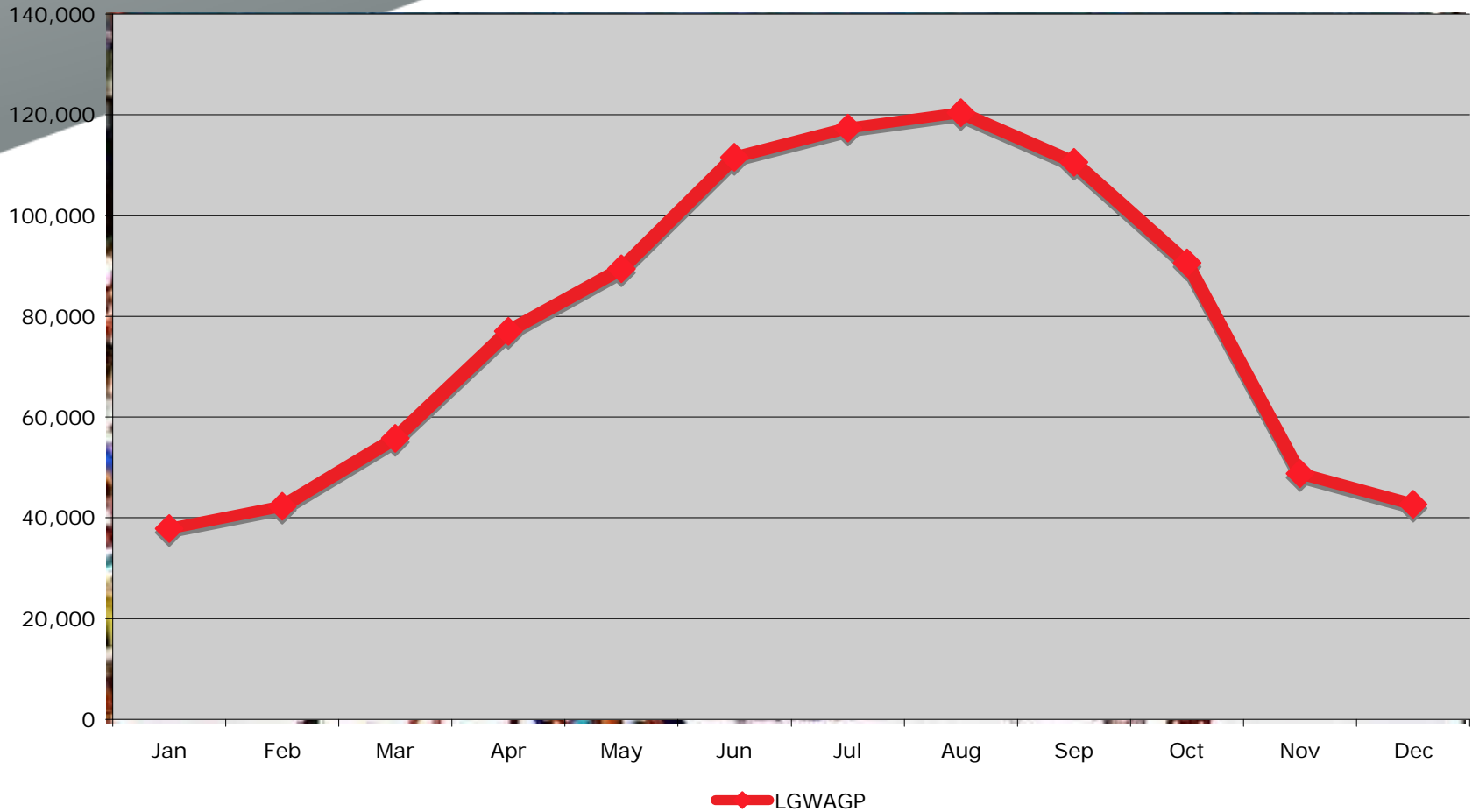
Av. Annual Growth: 2006/7 to 2025/6

	Airbus	Boeing
Intra-Europe	5.6%	3.5%
Europe - N. America	3.7%	4.7%
Asia - N. America	5.5%	6.2%
Europe - Asia	5.3%	5.6%
Domestic China	10.8%	8.8%
Domestic India	9.8%	9.9%
Total World	6.0%	5.0%

- Variable costs (escapable in short-term):
 - approx. 40% of total
- Indirect costs (escapable in medium-term):
 - approx. 40%
- Fixed aircraft-related costs (escapable medium-term):
 - approx. 20%
- **High Operational Gearing = Large Swings in Profitability**

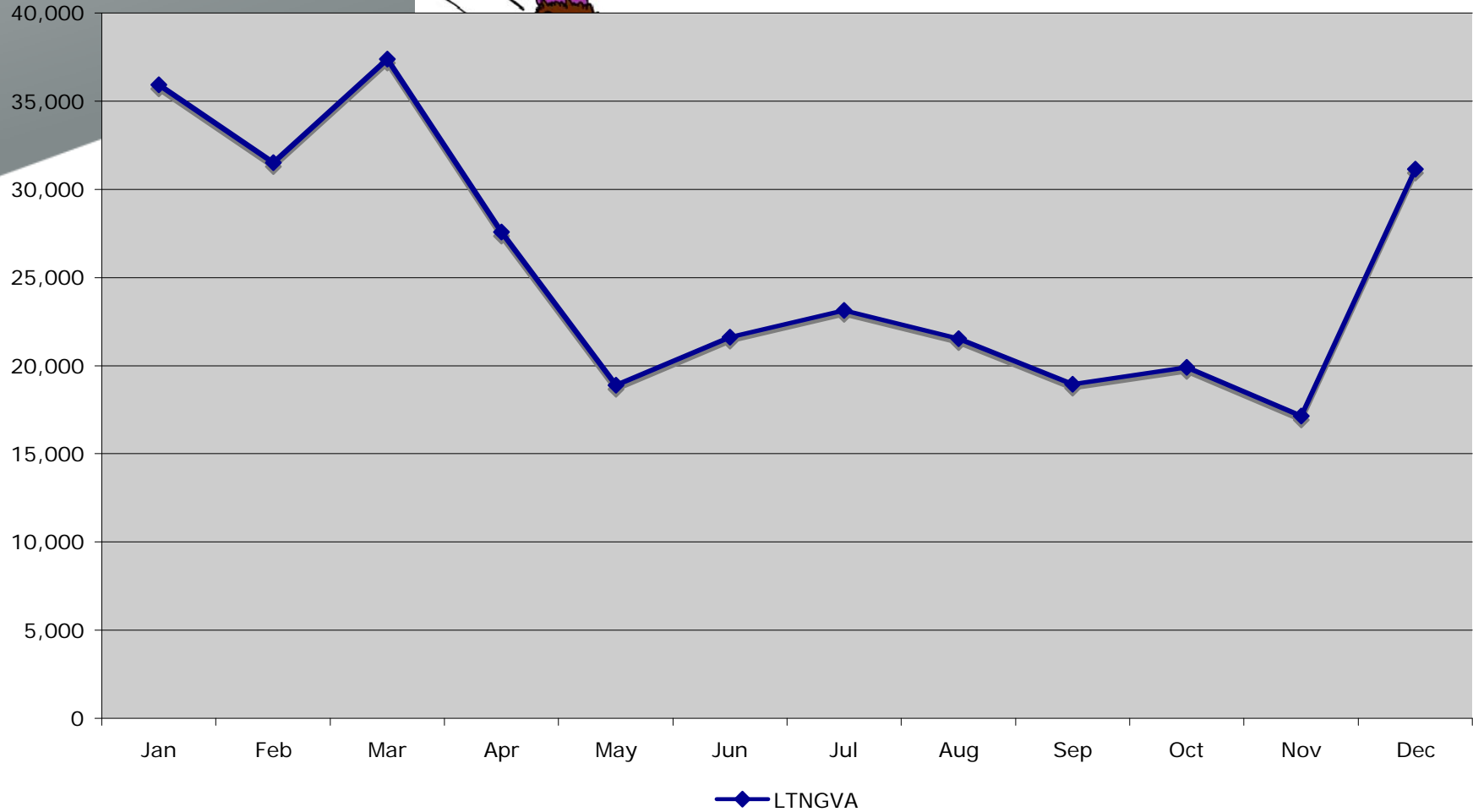
Route Seasonality (Summer)

Gatwick - Malaga: Schedule and Charter combined (2006)



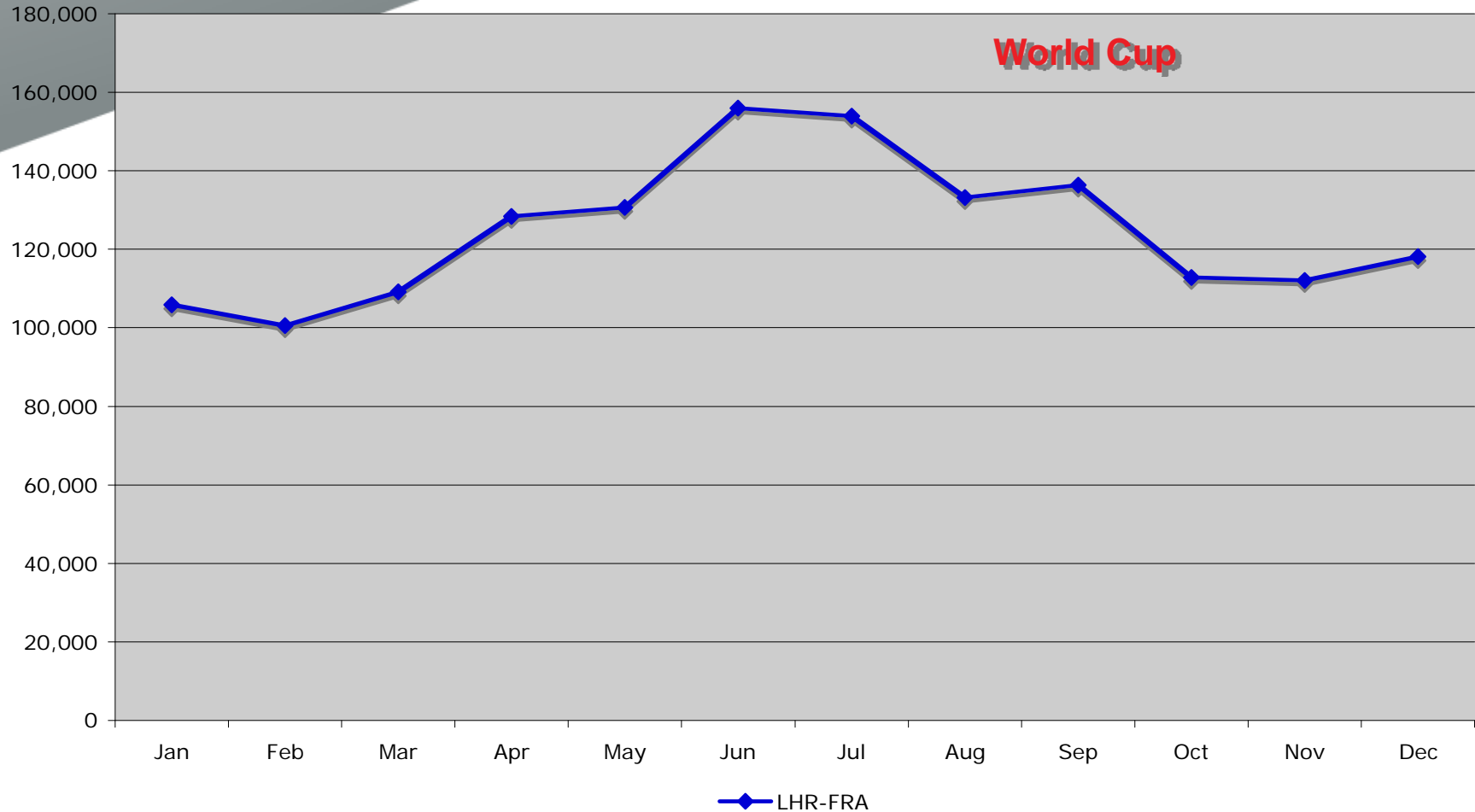
Route Seasonality (Winter)

Luton - Geneva (2006)

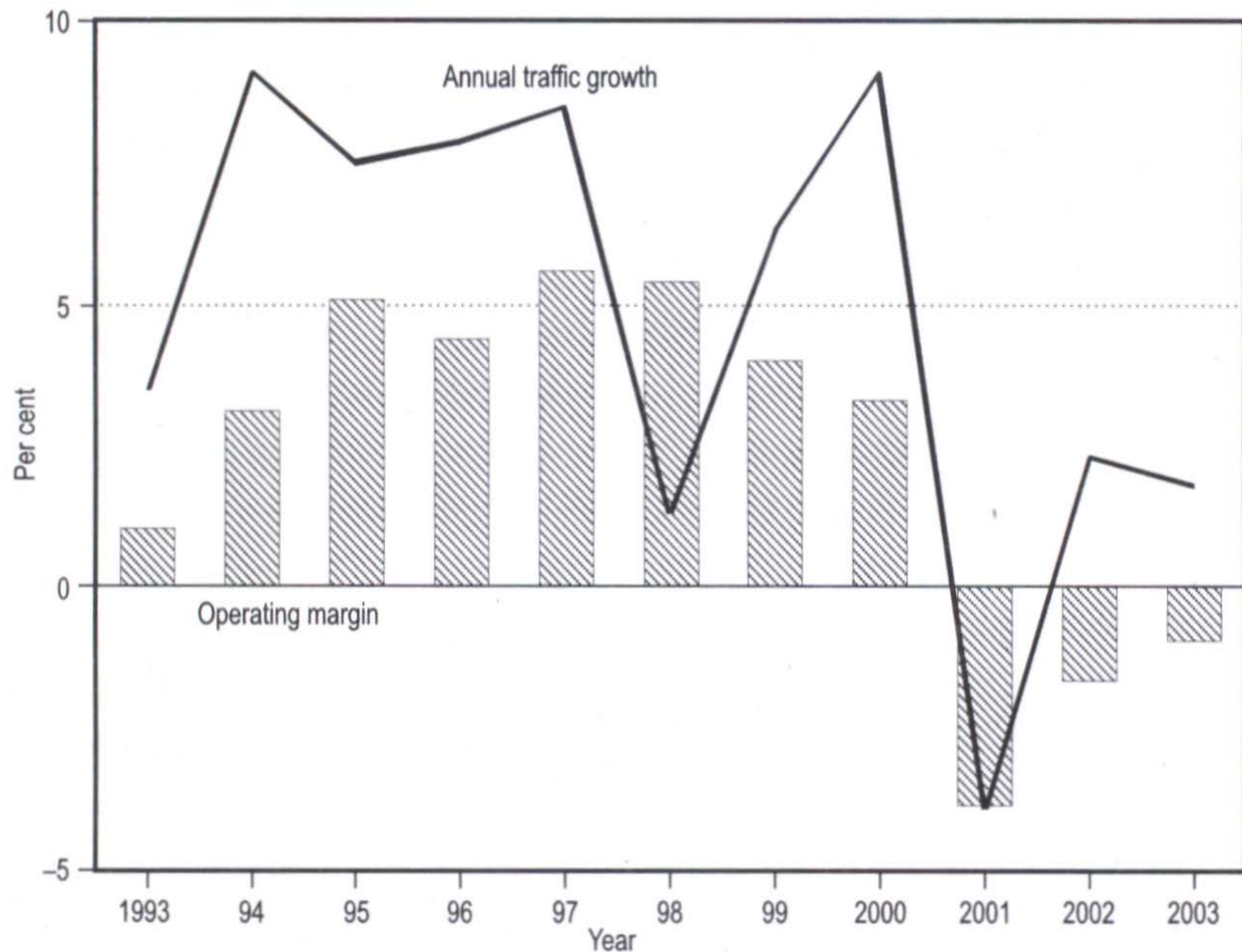


Route Seasonality (Business)

Heathrow - Frankfurt Main (2006)



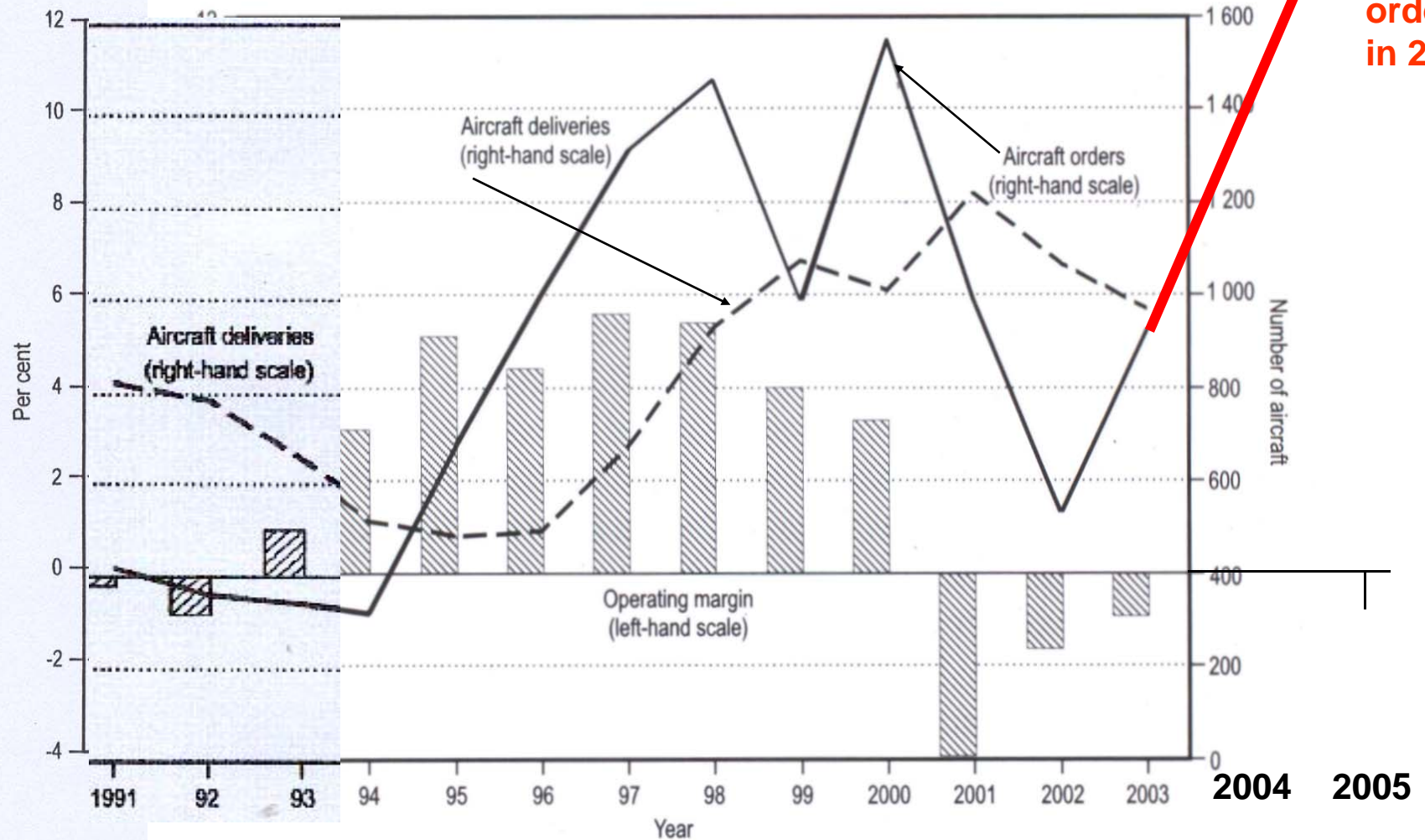
Financial return & traffic growth



Source: ICAO Air Transport Reporting Forms A and EF.

Financial return & aircraft supply

2000+ orders in 2005



Source: ICAO Air Trc

Source: ICAO Air Transport Reporting Form EF and aircraft manufacturers.

Recent jet orders

Boeing and Airbus

- 2005
 - Boeing = 1004
 - Airbus = 1055
- 2006
 - Boeing = 1044
 - Airbus = 790

What strategy are airlines pursuing?

Higher yield passengers

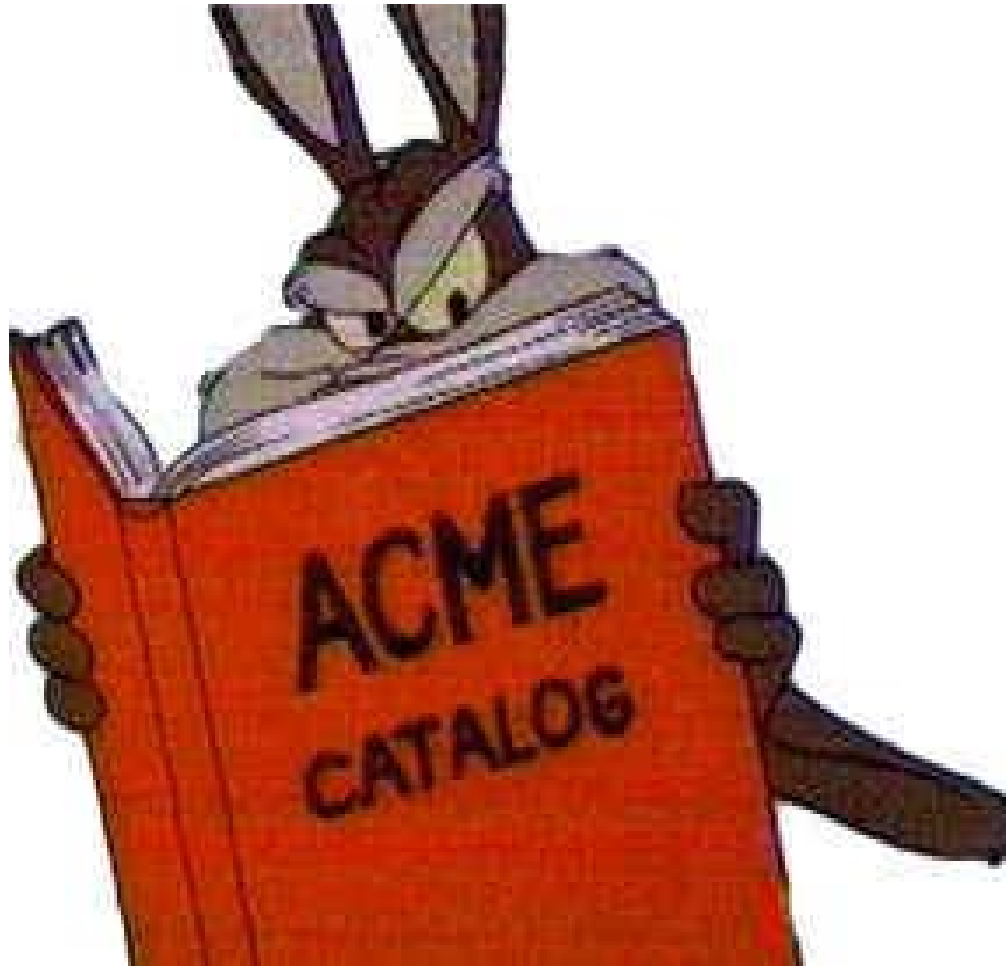
v.

Low seat cost

Non-stop, hub bypass

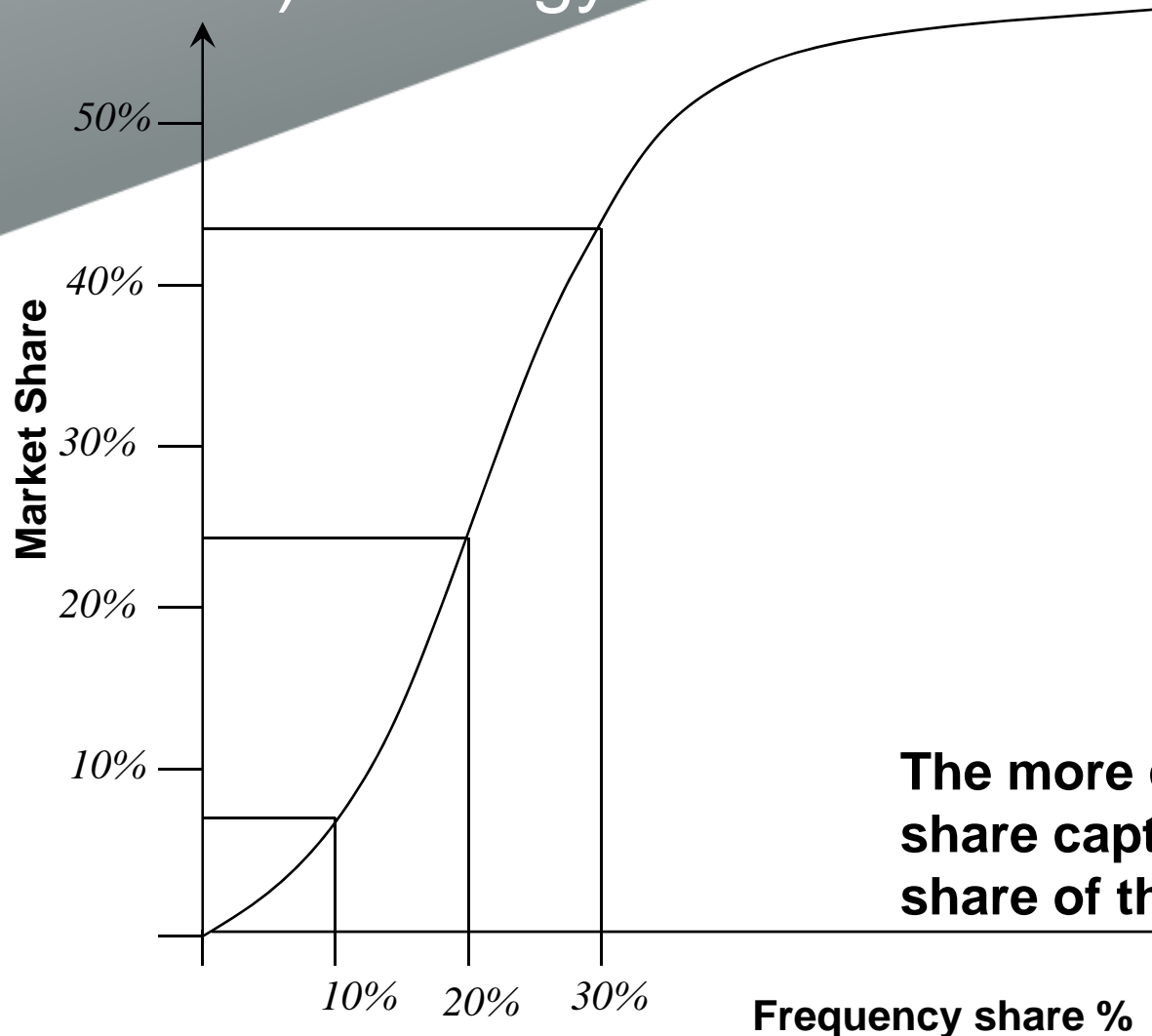
v.

Multi-stop, hub to hub consolidation

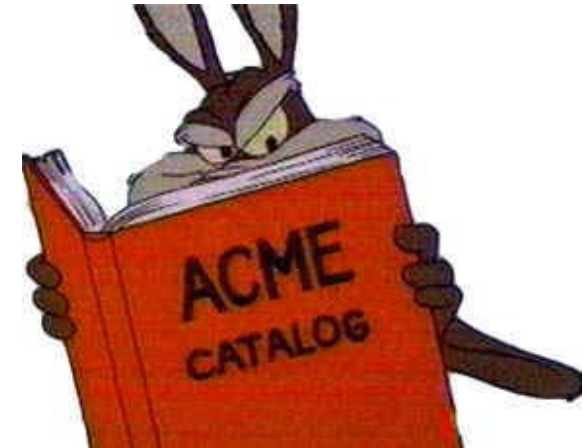


***ACME: Airlines Collective Management Effect**

ACME Market Share (S-Curve) Strategy



NB: Both the X & Y scales are the same



***ACME: Airlines' Collective
Management Effect**

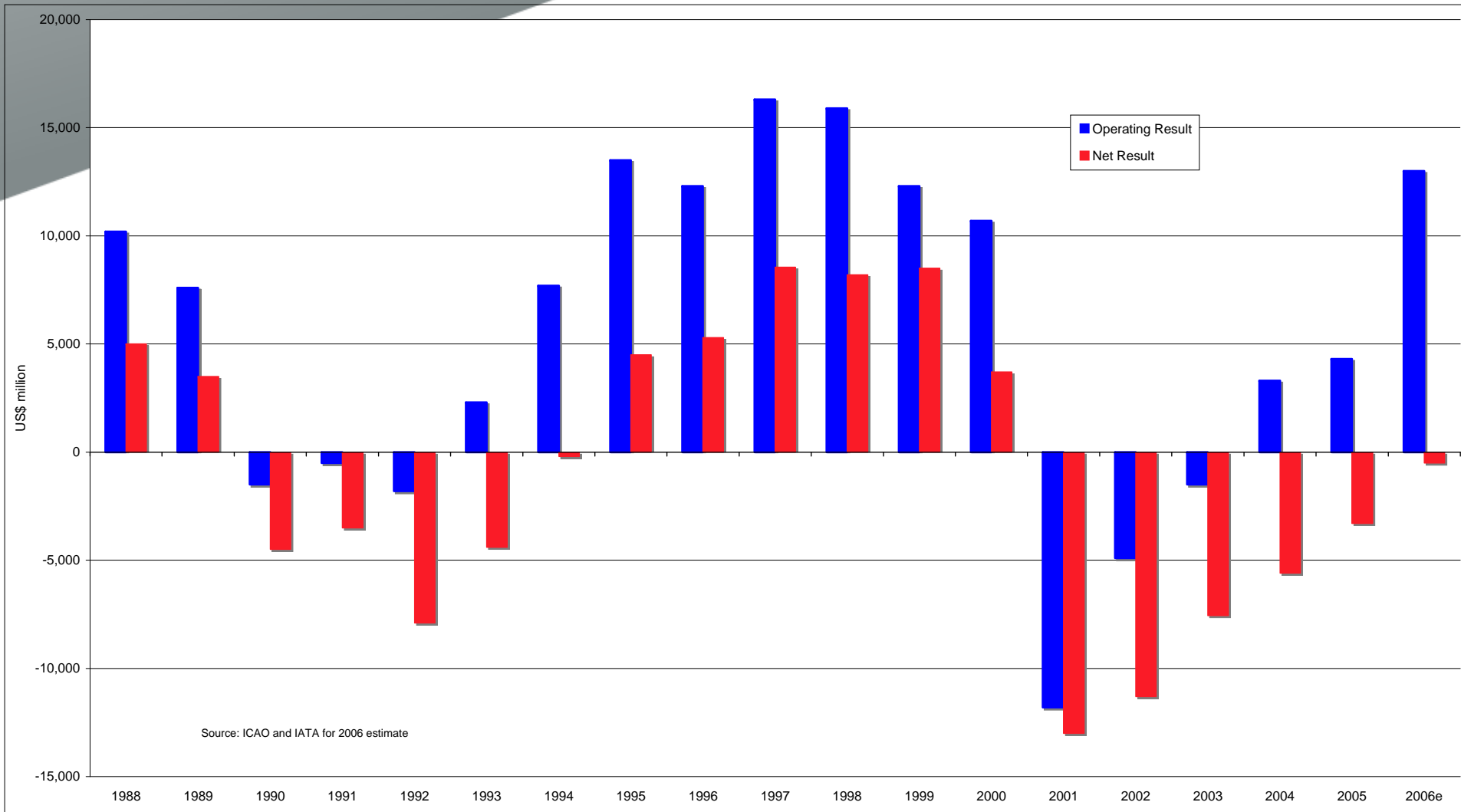
**The more capacity/frequency
share captured, the greater the
share of the market achieved**

- Implicit assumption that all passengers along the Y-axis are of the same value
- Model is predicated on desire to gain market share to
 - Capture best traffic
 - Frequency dominance will bring high yield business traffic
 - Deter entrants
 - Dominate distribution channels
 - FFP
 - Earn abnormal profits
- But on long haul routes the various routings (e.g LON-SYD via DXB, BKK, HKG, SIN, etc.) mean that market share cannot be protected

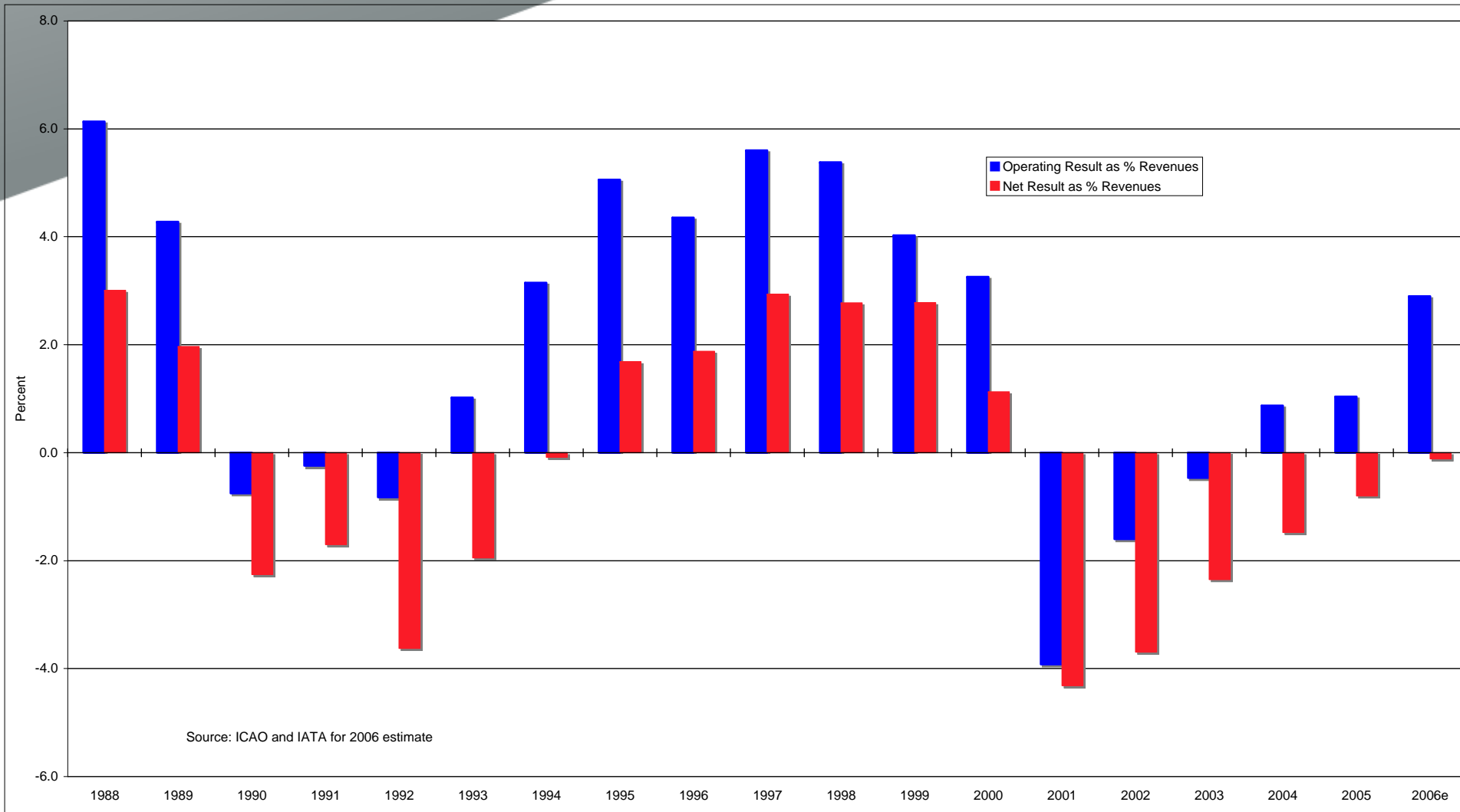
So to review...

- In growth phase of cycle airlines tend to adopt a market share strategy
 - An indirect service at low seat cost can afford to carry lower value traffic and will capture market share (but at increasingly lower yields) perhaps enabling market dominance in some markets.
 - This strategy has higher exposure and the defence of the market position is more difficult in today's airline environment
 - But a carrier that puts a direct service or restricts capacity is likely to capture yield although costs may be higher
- In a downturn airlines tend to adopt a market share strategy
 - Again the carrier with the smaller aircraft and the more direct service is going to capture better yielding passengers
 - The carrier with the larger aircraft may lose passengers unless they drop fares further. Low seat costs are not very worthwhile if you have no one sitting in the seat.

World scheduled airline financial results: US\$

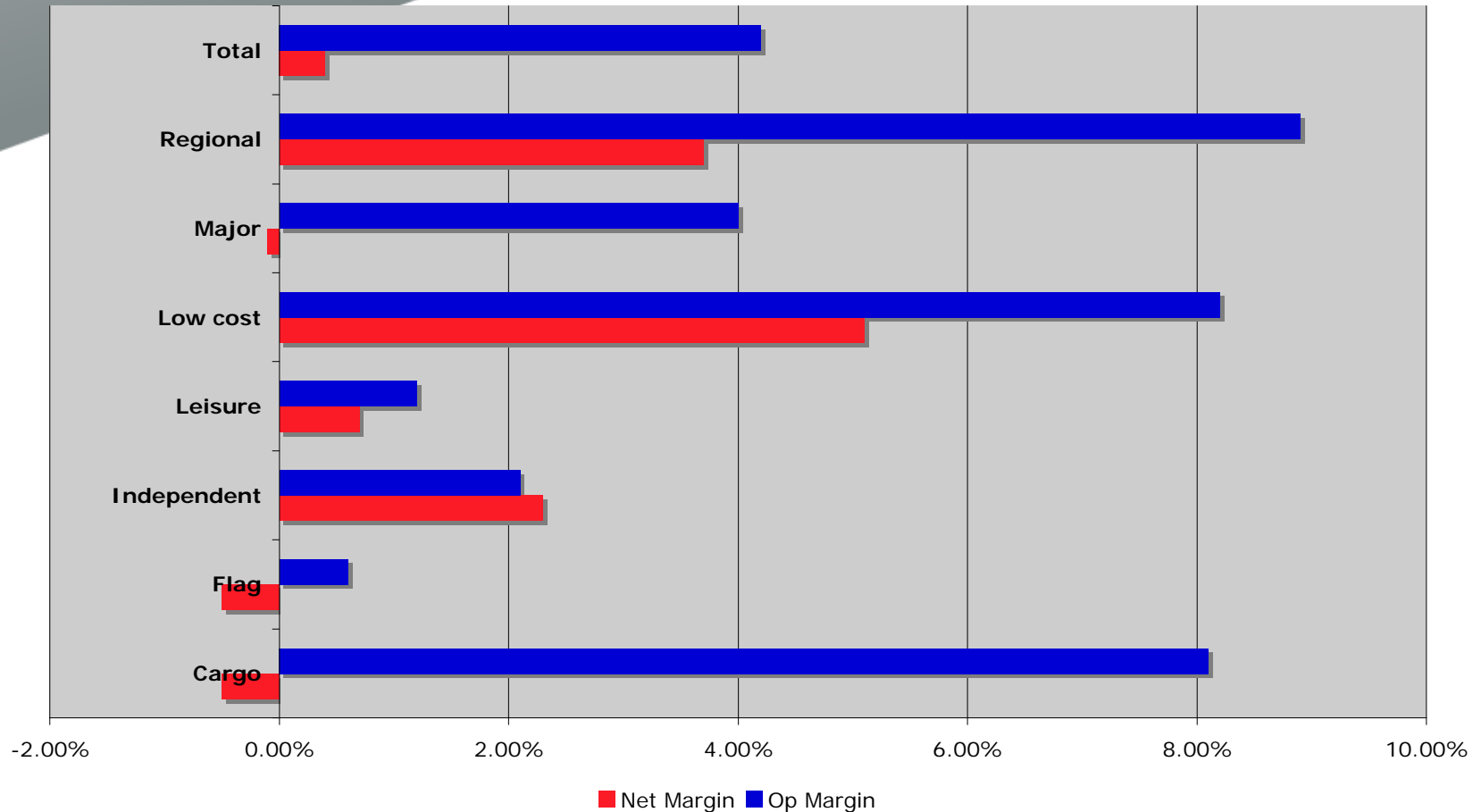


World scheduled airline financial results: margins



Profitability by sector (2006)

Top 150 Airline Profitability



Major = Pax airline with revenues of \$2bn, Flag = Mainline National Carrier

(Top 150 airlines, Airline Business, Aug 2007)

Top 150 airline groups - six year record

	2001	2002	2003	2004	2005	2006
Revenues (\$bn)	320.7	318.8	340.6	392.3	439.9	486.6
Operating Results (\$bn)	-5.7	-0.4	2.8	9.6	10.3	20.3
Operating Margin	-2.0%	-0.1%	0.9%	2.6%	2.5%	4.2%
Net Results (\$bn)	-12.6	-8.8	-6.8	-3.1	-20.7	2.1
Net Margin	-5.2%	-2.8%	-2.2%	-0.8%	-5.1%	0.4%

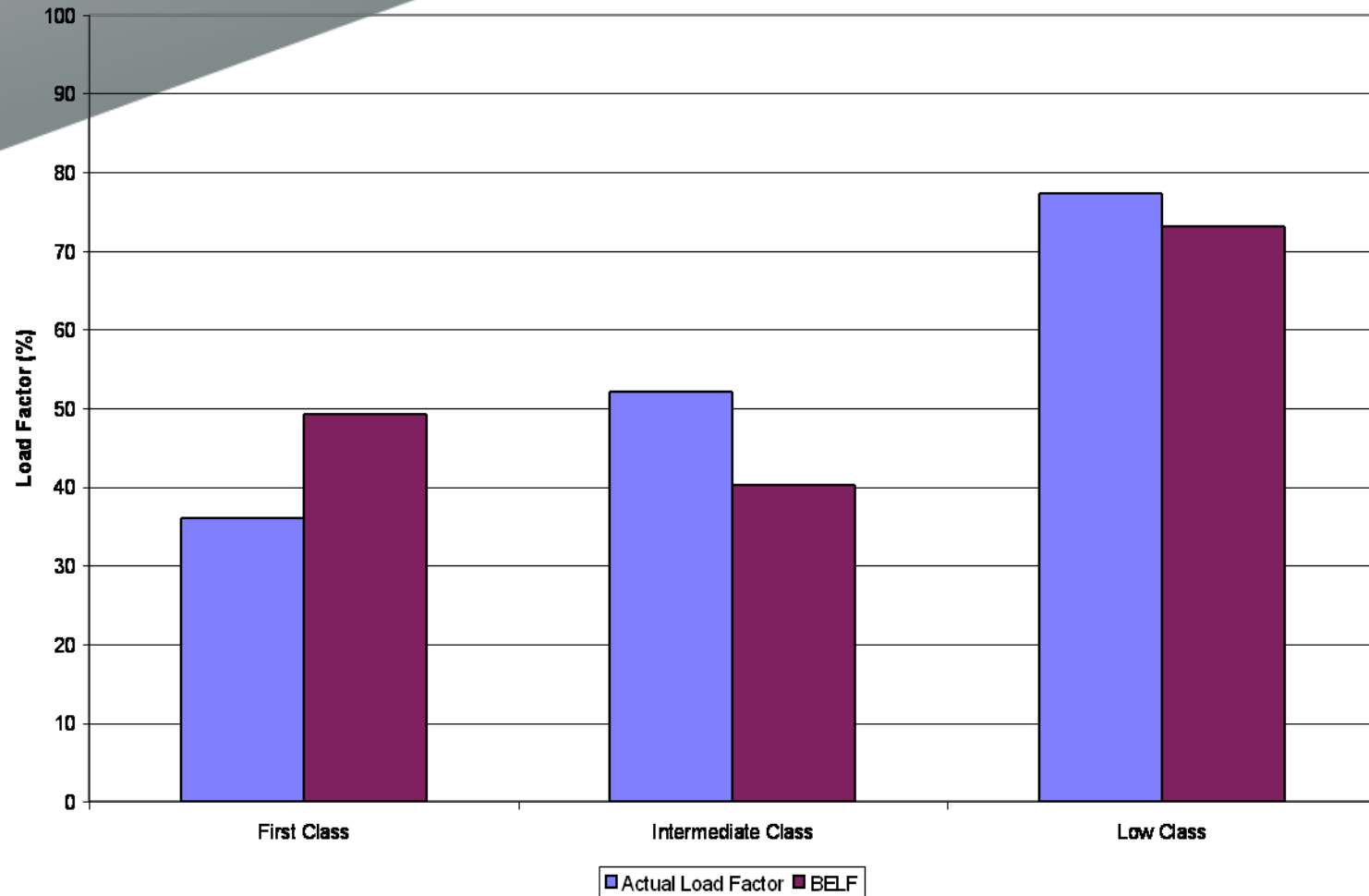
(Airline Business, Aug 2007)

Changes in Demand

Change in business market

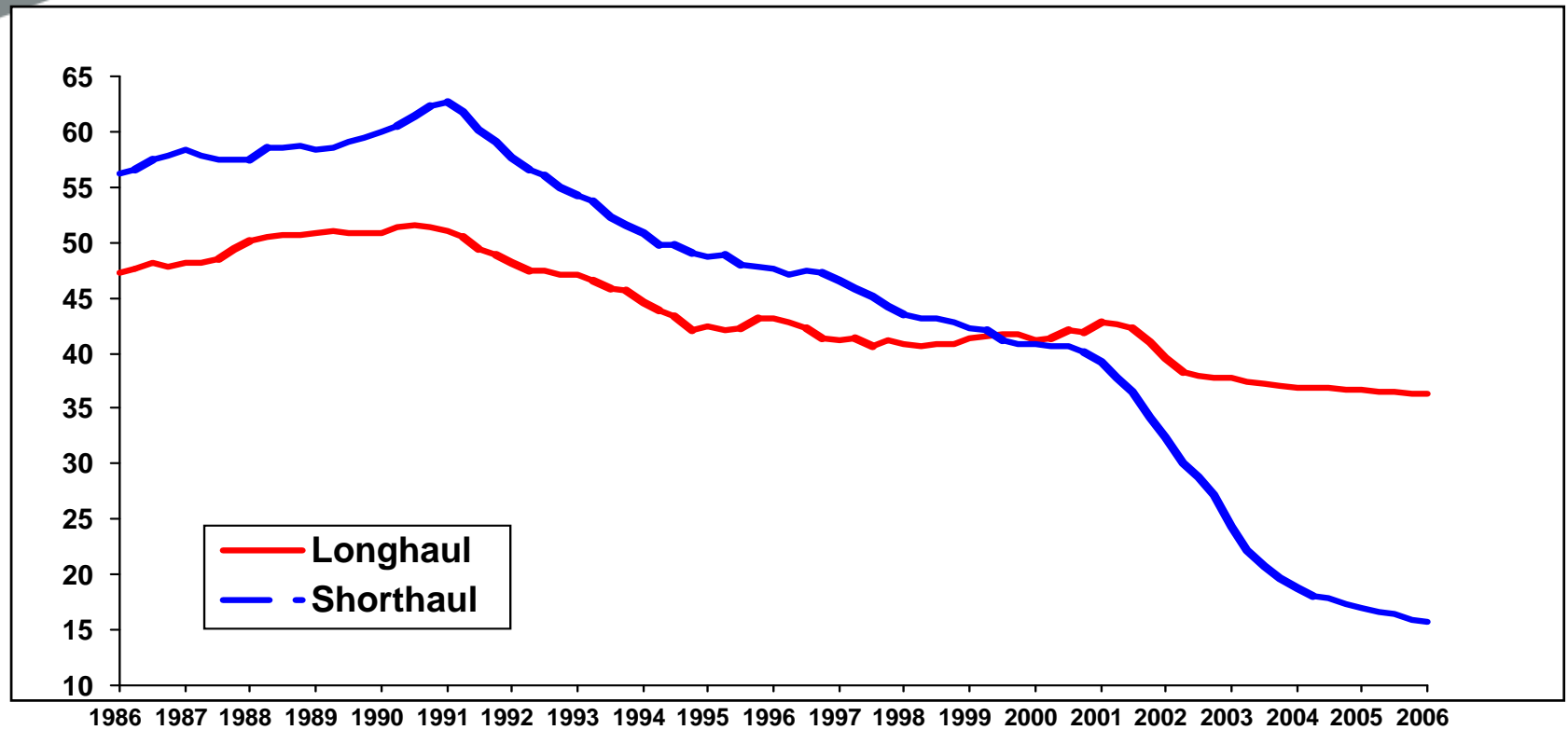
- Downgrading
- Adoption of low cost airlines
- Change in booking behaviour
 - Increase in fare transparency
 - As fares have fallen route deals have been less attractive
 - No longer prepared to pay high multiples for business class
 - Increase in price elasticity
 - Increase in “value for money” purchasing
- Use of other forms of communication
 - 45% of US business travellers working for firms with managed travel programmes report that they had substituted at least one trip with tele or web-conference while 25% of those who worked for companies with unmanaged travel policy (NBTA Annual survey 2004)

Profitability by class of passenger service



Propensity to fly premium

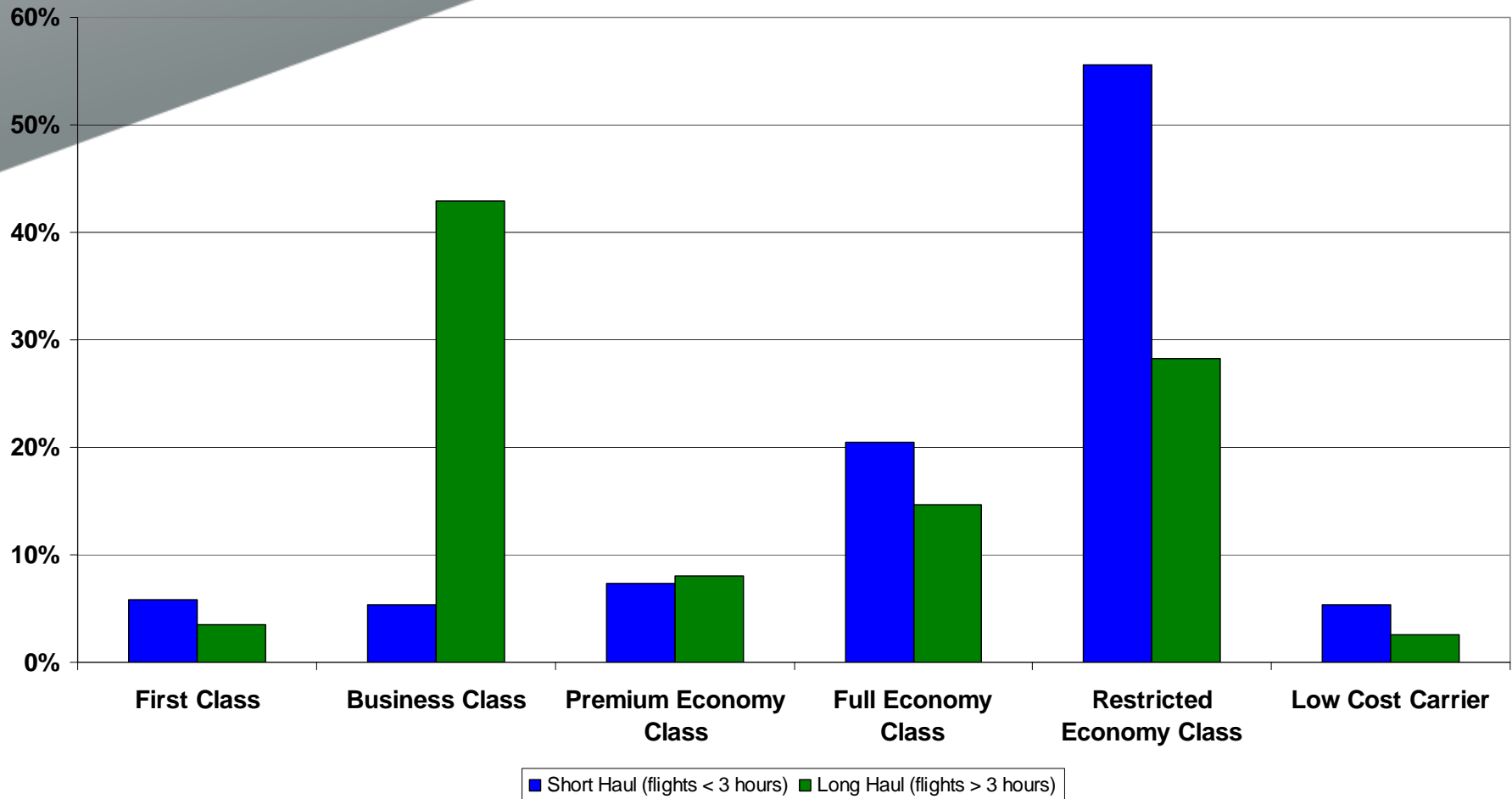
% of business travellers in premium cabins, 4 quarter moving average



Source: BA

Class of travel

Class of travel booked for last trip



Business Travel in good economic times

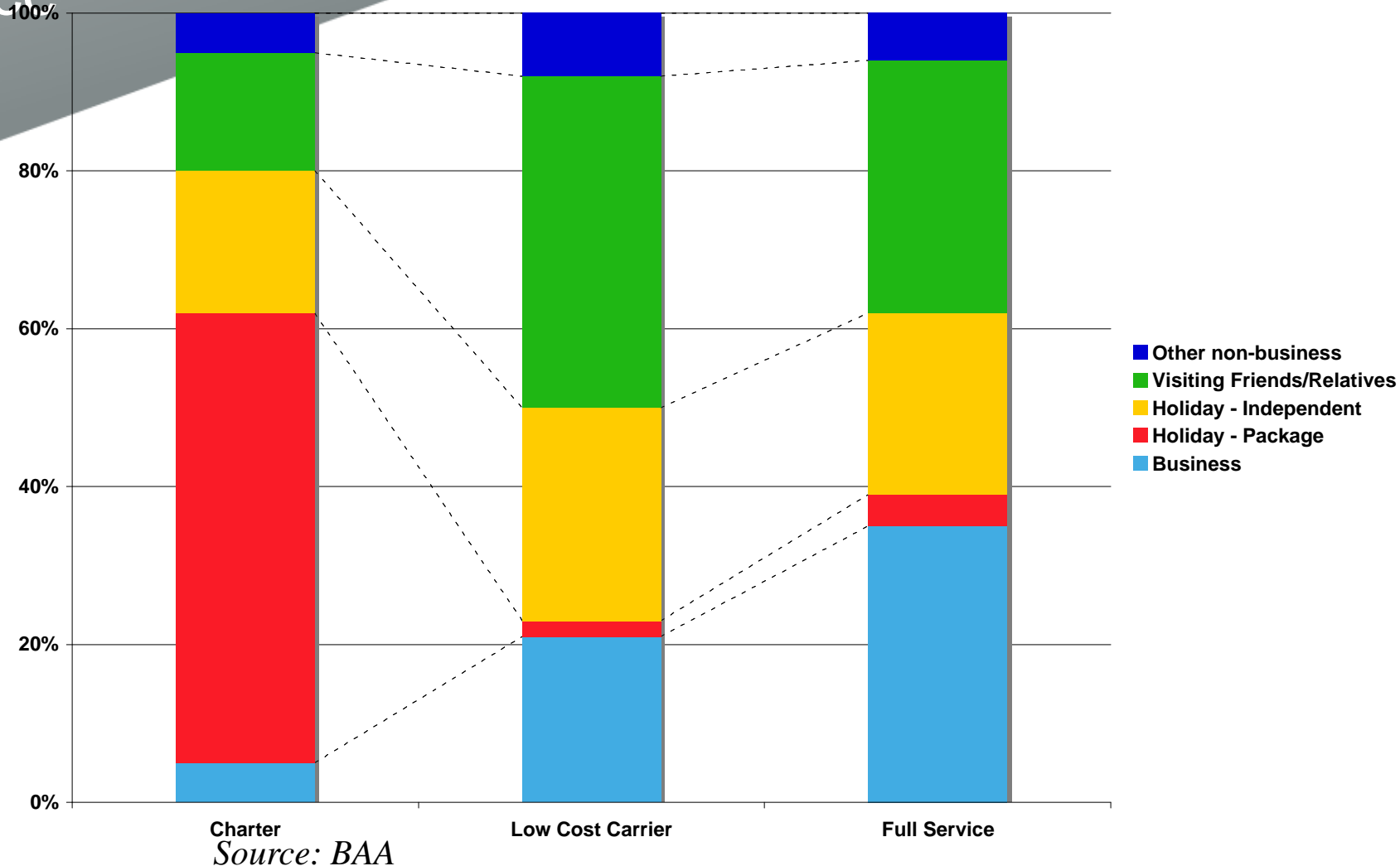
- In economic good times we would expect the market to be price inelastic and demand increased service.
- However the market seems to be splitting into:
 - A diminishing proportion of business class and first class customers
 - Corporates define when business class can be used and this definition is getting more strict and more effectively controlled
 - The proportion left will be likely customers for business class only services (e.g. EOS), hub-bypass direct (LH - PrivateAir) etc.
 - Can A380 interiors/sleeper cabins attract these travellers away from direct services?
 - And an increasing proportion of “downgraders”, premium economy users, and LCC adopters.
 - Corporates are getting tools (online SBTs) that enable real-time appraisal of the best fare and can use these systems to ensure travel policy compliance
 - Seeking greater choice/flexibility from airlines - unbundling
 - SME customers tend to choose the budget option

- In economic downturns business travel market shows increased price elasticity and downgrading activity.
 - Business class in short haul has become virtually extinct.
 - Increased use of premium economy services in long haul
 - Greater management of the decision to travel on ROI basis
 - Increasing substitution of less essential travel by other forms of communication
 - Greater management of the travel selection decisions using real time systems that incorporate value of time/well being of traveller
 - Can A380 interiors/sleeper cabins attract travellers away from direct services and avoid extra hotel accommodation?.

Leisure traveller - Lifestyle changes

- Lengthier and more flexible holiday entitlements
- Increased job and educational mobility
- Rise of the 'grey panthers'
- The Gap Year phenomenon
- 2nd Homes overseas
- Sporting, cultural events

Reason for travel influences airline choice



Leisure travel in good economic times

- Increasing disposable income, low interest rates and reduced incentive to save means:
 - Increasing number of leisure trips (shorter duration)
 - Increasing dramatically in European short haul market
 - Leading to significant orders for B737s and particularly A320s
 - Of the 2000+ aircraft ordered in 2005 over 70% were A320/B737 types
 - Growing long haul demand
 - Markets in India and China with a growing monied middle class
- Limits to growth are amount of free time, surface mode substitutes (esp. rail) and other ways of spending money (new iPods and iPhones, HDTV, “experience events”, etc.)

- With falling disposable incomes, job insecurity, saving for rainy days means:
 - When economy turns down hasn't been a decrease in number of leisure trips. But not sure that will continue in future
 - Will environmental taxes reduce demand?
 - Quicker consolidation in LCC sector
 - Leading to cancellations and lower uptake of options
 - Weaker demand for long haul services and people seeking best prices – airlines will have to fight harder to protect markets
 - Market protection and retrenchment from network carriers

Thank you for your participation