Flying in the face of adversity

In the first of our new series focusing on sector-specific business hurdles, Annie Makoff looks at the challenges and opportunities shaping the airline industry.

In many ways, the airline industry is booming. Such is the favourable price of oil, increased global mobility, the emergence of low-cost carriers attracting more customers than ever before and the consolidation of key airlines across the world, much of the industry is currently enjoying increased revenue streams.

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Not everyone agrees. Loizos Heracelous, professor of strategy at Warwick Business School told *economia* the industry is one of the most volatile in the world, with at least 30 airlines going bankrupt every year, making it a "significant risk" for investors. Looking at the performance of the European airline industry in 2017 alone, it's easy to see why.

Delays, disruptions and downfalls

In May, British Airways experienced problems with its IT systems, leading to flight disruptions and cancellations, while in September, Ryanair was forced to cancel 40 to 50 flights per day for several weeks because of pilot roster issues. Then there was the collapse of Air Berlin and Alitalia during the summer and following that Monarch, the UK's fifth biggest airline, ceased trading in October, resulting in the biggest peacetime repatriation of people – 110,000 – and the loss of jobs for many of its 2,100 staff. And easyJet has not been without its problems either, having seen profits plunge despite record passenger numbers.

Yet despite both Ryanair and easyJet's issues in 2017, both continue to do well. Ryanair's profits in particular have been largely unaffected by the company's rostering fiasco: it recently reported an 11% rise in half-year profits and has announced 130 new routes.

But, says Jim McAuliffe, finance director at Bristol Airport and a chartered accountant, with the exception of long-term major players like these, most airlines "find it difficult" to make money from flying. Overcapacity, For airlines and airports operating between Britain and the EU, Brexit is another potential risk factor. “Under the Open Skies Arrangement, any EU member of any airline can fly anywhere within the EU and other associated countries,” says McAuliffe. “But what will happen post-Brexit? There’s a whole raft of regulatory issues around safety, security and passenger rights and no one knows how these will be affected. There’s a complete lack of clarity.”

McAuliffe points to several other issues that are likely to affect the industry as a result of Brexit: a downgraded British economy; exchange rate issues; fewer passengers due to fewer EU migrants; and people’s overall propensity to fly.

Supply and demand

Brexit aside, the cyclic nature of the industry as a whole continues to create opportunities as well as challenges. The consolidation of the European airline industry is one such opportunity, which, as McAuliffe explains, is driven by the “mismatch” between supply and demand.

“Airlines are not very good at matching the supply of seats and aircraft to existing demand,” he explains. “Very recently, the industry experienced a significant imbalance but that’s been rectified by the demise of airlines

"Fewer, stronger airlines will emerge from the most recent wave of consolidation as these airlines capture market share from the weaker players who exit the market," he says. "The European market will slowly look more like the American market where control is in the hands of four dominant players."

According to Matters, consolidation is no bad thing. Fewer but healthier competitors can lead to more – not less – competition, drive lower fares and create greater benefits for consumers. Yet while the European market is consolidating, in other parts of the world, the opposite is happening.

"Consolidation has primarily been a feature of mature markets such as North America, the North Atlantic and now to an increasing degree, Europe," says Matters. "But in fast-growing emerging markets, the industry is fragmenting rather than consolidating, with considerable new entry to regions like Asia Pacific, China and Africa."

In fact, IATA says it's seen the centre of gravity in air transport "shift eastwards", due in part to customer demand. In its 2016 annual review, IATA predicted that by 2024, China will displace the US as the world's largest aviation market, while India is set to take the UK's third place by 2025. It's no surprise then, that IndiGo, India's biggest carrier and the third largest low-cost airline outside Europe and North America, has become the world's fastest growing airline, according to industry analysts, OAG. Such is its growth, and despite recent tarnishes to its reputation, experts are predicting the Indian airline will be a genuine challenger to Ryanair, particularly as it recently hinted it may soon expand into long-haul flights.

unique routes, creating demand where there was none before. It's a clever strategy and one that Monarch could only dream of. For Monarch, it was precisely the competitiveness of existing routes that ultimately spelled its demise.

The price of competitive disadvantage

Blair Nimmo, partner at KPMG and joint administrator for Monarch Airlines, told *economia* that recent activities in Tunisia, Turkey and Egypt closed off routes for the small airline, forcing it to focus on already competitive routes, making them "even more" competitive. Coupled with the significant devaluation of the pound as well as fuel costs, it meant that "revenue and cost were all headed in the wrong direction at the same time".

News of the insolvency broke at 4am in October. From an employee point of view, it was far from ideal, especially as staff had no prior warning of the company's imminent demise. Yet, as Nimmo points out, it was impossible to do anything else. Warning employees even just days beforehand that Monarch was filing for insolvency would set off a catastrophic chain of events resulting in aeroplanes being impounded by leasing companies and airports, customers stranded and insurers ending policies.

"Insolvency creates additional challenges for airline carriers," says Nimmo. "Usually we speak to staff first, then the wider media, but airlines are a consumer-related business so consumers are inevitably affected. Monarch already had 110,000 customers overseas and 14,000 about to fly, so we had no choice but to inform

Chris Phillips, CEO and co-founder of Just Develop It, who also invested in private charter service Xclusive Jets in 2016, doesn't agree. "Xclusive has provided the perfect opportunity to get a piece of the market while it's booming," he says. "It's back on the up. We're seeing a wealth of aviation businesses making their way to the UK again whereas during the recession it was heading away from the UK, towards the US."

It's partly why Kazi Shafiqur Rahman, CEO of airline start-up Firnas Airlines, decided to launch his own carrier. Focusing on unserved and underserved routes, the soon-to launch carrier aims to evolve the economy-style offering into something more akin to premium, but at affordable prices. "Our research indicates that customers want some kind of hybrid or tailored service that sits in between these two extremes while still offering premium levels of comfort."

Although Firnas Airways intends to eventually operate in the long-haul market, connecting underserved countries that present "strong, commercial demand" such as Bangladesh, Pakistan, Ghana and Iran, the carrier plans to focus initially on charter and ACMI (aircraft, crew, maintenance, insurance) leasing work using current assets. It will allow customers flexibility to pay only for what they need through fare unbundling policies. This pricing structure, although by no means unique, is the future of the industry. IATA says there is a services with more airlines exploring bolt-on extras, unbundling fares and ancillary revenues.

"Business models are evolving and incumbent airlines are responding to demand," says Matters. "People now appear to value frequency and choice more than price, so it's no longer just business travellers who are happy airline as efficient as Ryanair then you can make money, but there's only room for one Ryanair in the world."

For people like AirAsia's Fernandes, it's a risk he's prepared to take – and has done, even when AirAsia first launched in 2001. "Everything touches airlines," he admits. "Politics, regulation, oil prices, forex movements, weather, natural disasters, contagious diseases, terrorism. You name it, we've been through it – 9/11 happened three days after we launched. Then there was high oil, the SARS virus, bird flu, tsunamis, earthquakes..." But Fernandes remains confident over AirAsia's future. The success of an airline, he says, is down to having a great brand, a strong value proposition and a strict cost discipline so customers continue to fly "no matter what".

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