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GENERAL MANAGER, OPERATIONS,
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TOP BUSINESS TRENDS IN THE GLOBAL AIRLINE INDUSTRY

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INTRODUCTION

The global airline industry has a lot to cheer about. Despite some headwinds, the industry continued its profitable streak for the fifth consecutive year in 2015. Declining fuel prices, consolidation and offshoring helped airlines rein in costs, improve efficiencies and drive growth.

In 2016, nearly 3.8 Billion passengers are expected to fly over 54,000 routes, and the profitable run is set to continue. In 2014, the global airline industry had an operating margin of 4.3 percent, and recorded profits of USD 30.4 Billion in the U.S. During the same period, profits for the North American (NAM) region stood at USD 17.2 Billion, Europe at USD 5.9 Billion and Asia-Pacific (APAC) at USD 3.3 Billion. The industry saw profits of USD 2.1 Billion in the Middle East (ME), USD 1.7 Billion in the Latin American (LATAM) region and USD 0.2 Billion in Africa. (The Indian sub-continent bucked the global profitable trend.)

In a statement brimming with optimism, IATA's Director General and CEO summed up the state of the industry succinctly: "The airline industry is delivering solid financial and operational performance. Passengers are benefiting from greater value than ever — with competitive airfares and product investments. Environmental performance is improving. More people and businesses are being connected to more places than ever. Employment levels are rising. And finally our shareholders are beginning to enjoy normal returns on their investments."

With profits picking up, airlines are now seeking new levers to drive growth. They are looking for global partners to collaborate on high-end work such as analytics, network planning, pricing and revenue management. This is a new facet for the airline industry. Until recently, airlines were looking at outsourcing to reduce costs and improve efficiencies. As a result, they focused on outsourcing non-core, non-strategic, process- and people-intensive tasks to partners. But now they are looking to achieve enhanced profits and higher valuation by outsourcing more complex work.

In other trends, Low-cost Carriers (LCC) continue to eat into the market share of larger, full-service rivals. Mainline carriers, meanwhile, are seeking to become more competitive by increasing investments in technology and fleet renewal, and going after new sources of revenues.

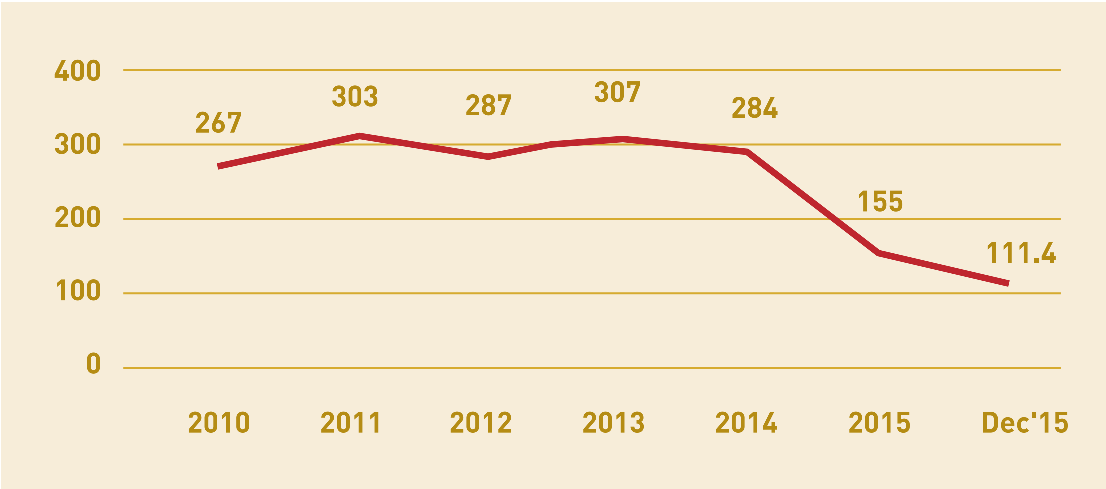
At the other end of the spectrum, Global Distribution Systems (GDSes) and travel agents are losing ground to Internet-based sales of tickets. With air travelers becoming tech-savvy, airlines have the opportunity to leverage the digital medium to further optimize costs and improve customer experience.

Our airline industry experts cue you in on the top trends in the industry and analyze the impact of these trends for the year ahead.

Trend 1: Fall of Fuel

The declining cost of Aviation Turbine Fuel (ATF) has been heartening news for airlines around the world. By December 2015, the prices had declined by almost 45 percent and were at the same level as they were in 2005. As fuel is the second highest overhead for airlines behind staff costs, the decline in fuel prices has enabled them to increase their operating margins. The profit from this has been used to increase investments in IT and fuel-efficient aircraft, and improve ancillary revenues.

Figure 1 **Fuel Prices (US cents per US gallon)**



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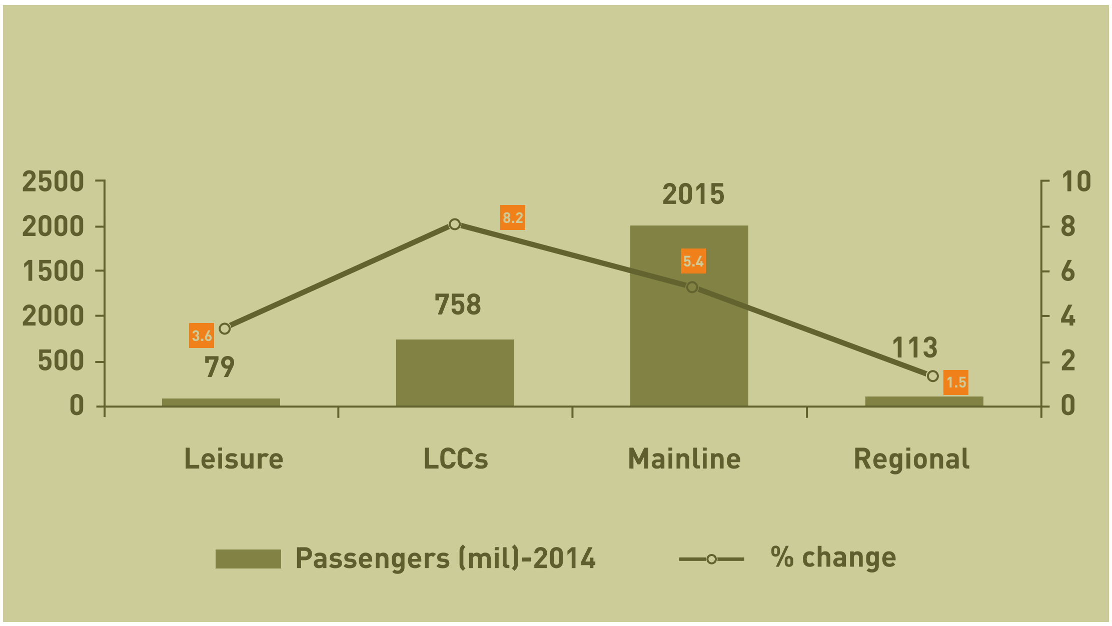
However, not all airlines benefited from the fall. The industry lost billions of dollars in hedges against the rising price of oil. But as oil prices have settled, carriers across the world have begun scaling back on their hedging strategies.

Trend 2: LCCs Outpacing Mainline Carriers

The market share of mainline carriers is on the decline as more travelers fly with LCCs. However, mainline airlines still corner 79 percent of the market in terms of capacity. LCCs have a market share of 17 percent, but are growing at a faster rate than the industry. In 2013-14, LCCs grew their market share at 8.4 percent. They are expected to surpass mainline carriers (4.1 percent) in the next 10 years. In 2010, LCCs had only 16 percent of the global market share. Today, they have 25 percent. With LCCs offering more value for money in the short-haul market, they are expected to clock a higher rate of growth. In India, the market share of LCCs leads the world average. Indian LCCs have over 60 percent of the domestic market!

Figure 2 LCCs had the Highest Growth



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Mainline carriers, however, continue to focus on long-haul markets leaving the short-haul markets for LCCs to compete. For mainline carriers, the business traffic on long-haul flights is critical for their success. Their revenue is driven by business and executive class passengers. This is a category that LCCs don't cater to.

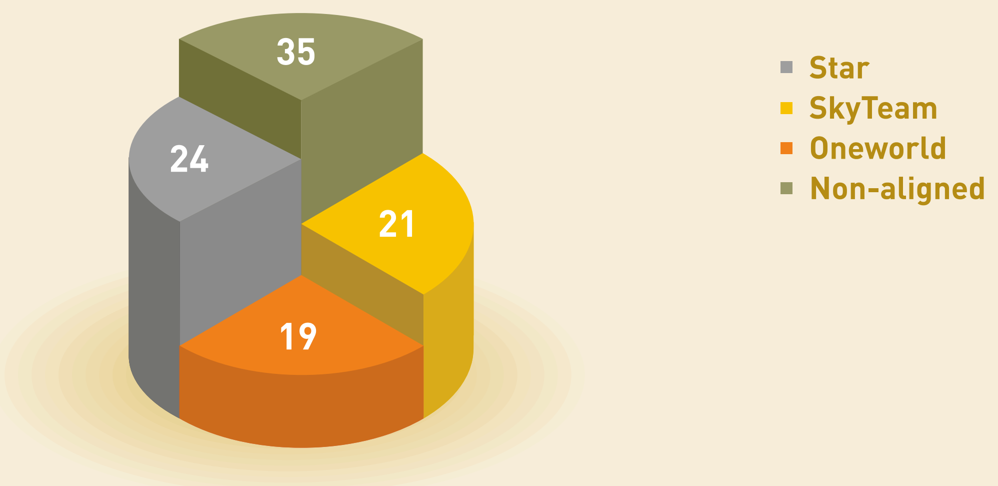
There are other reasons why LCCs have not penetrated the long-haul market. Long-haul flights depend on interlining (agreements between carriers that allow travelers to take multiple flights across airlines using just one ticket). To do this, carriers have to be members of the IATA Clearing House. LCCs prefer not to join the IATA Clearing House because there's a lag when payments are routed through them and thus it becomes expensive. Moreover, for long-haul flights, carriers need to rely on the hub-and-spoke model, whereas LCCs are modeled on the characteristics of point to point flights.

Trend 3: Change through Consolidation and Alliances

The bottom lines of American and European airlines have significantly improved after a wave of consolidation and alliances across the industry. The market has seen mergers between United and Continental, Delta and Northwest, and American Airlines and US Airways in the U.S., and Air France and KLM, and British Airways and Iberia in Europe. Consolidation has also helped these airlines drive up load factors. Airlines in the U.S. and European Union (EU) reported load factors of 83.4 percent and 82.3 percent, while the APAC and ME markets, which are still fragmented, had load factors of 77.9 percent and 78.2 percent.

In NAM and EU markets, the top three airlines corner 55 percent of the region's total revenues, while the top three in APAC account for only 24 percent. This is primarily due to lack of consolidation among airlines in the APAC region. However, in APAC and ME, airlines are reaping the benefits of alliances. Except for Emirates, the 25 leading legacy airlines of the world have joined one of the three alliances. The combined market share of the three alliances is 64 percent, leaving 36 percent to non-aligned airlines, mainly Emirates, LCCs and smaller airlines.

Figure 3 **Market Share**



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Alliances offer ample benefits to both customers and airlines. Consumers want an anywhere-to-anywhere service, but network economics does not allow a single airline to provide such a seamless experience. Alliances allow airlines to integrate their resources and provide travelers a more satisfying experience. Customers can accumulate and redeem more points across multiple airlines. Airlines can reduce costs by using a common pool of manpower and infrastructure for Maintenance and Engineering (M&E) operations, flight operations, airport operations and sales and marketing.

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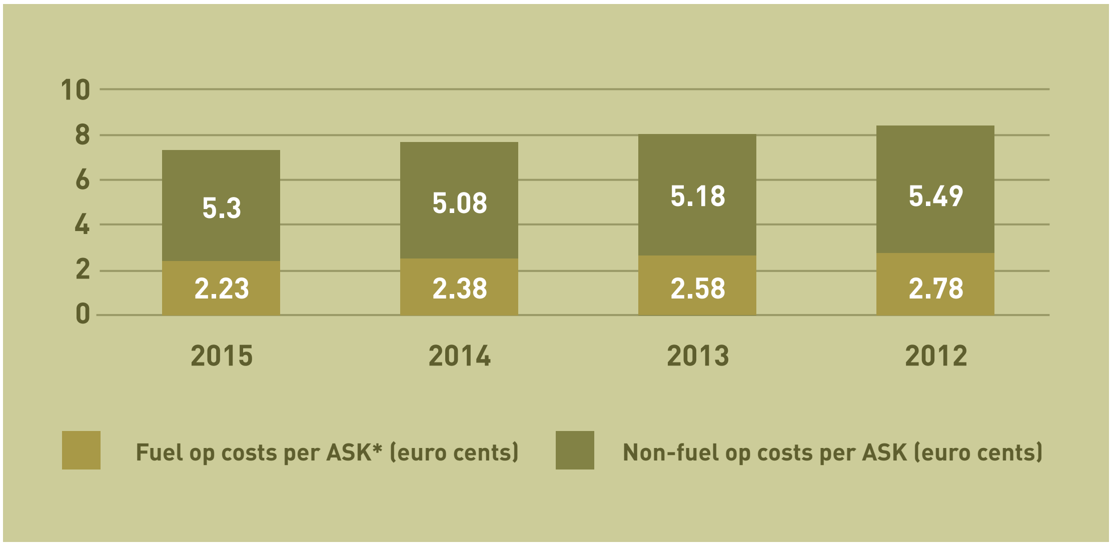
Trend 4: The Offshore Route for High–end Tasks

Mainline airlines are driving down operating costs by outsourcing a number of non-core operations. For example, almost all large and mid-sized airlines have phased out their own Centralized Reservation System (CRS) for Passenger Sales System (PSS) from GDSes. As a result, their fixed costs on CRS is now converted into transactional and variable costs per passenger boarded. Legacy airlines typically have a 30:70 ratio between fuel and non-fuel costs (it should ideally be 40:60). Offshoring is helping them bring down non-fuel costs to more manageable levels. For instance, EU-based airlines' reduced their overall costs by 9 percent. They brought down their non-fuel operating costs from 5.49 euro cents to 5.08 euro cents between 2012 and 2014.

Figure 4 Non-fuel Unit Costs Down in 2012-2015



Airlines' Financial Results (Europe)
*ASK - Available Seat Kilometers

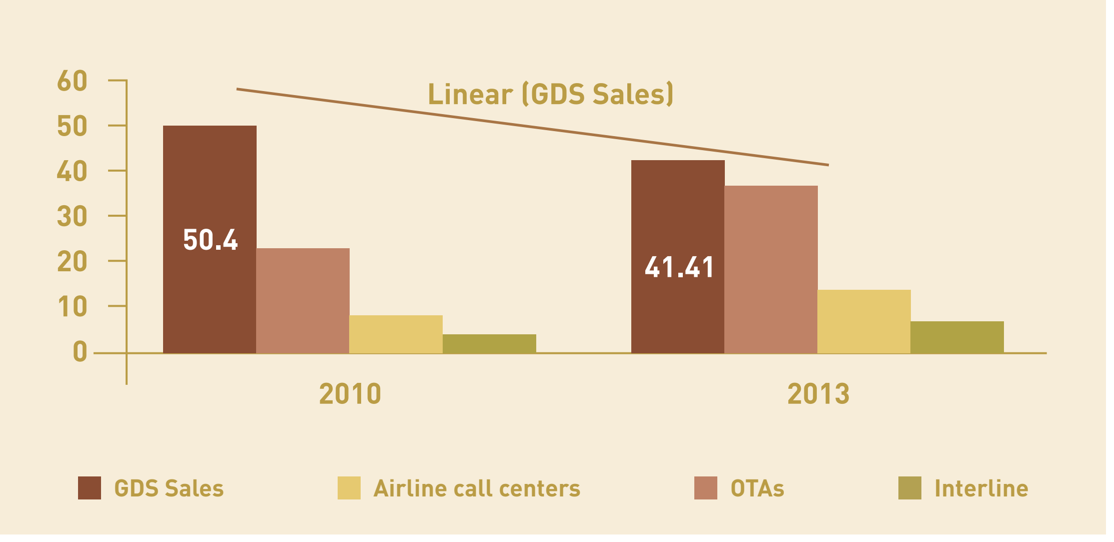
But the big story from this trend is that airlines are increasingly looking at offshoring for strategic insights to enable better decision-making and superior customer service based on social media analytics. They are also looking at high-end solutions akin to those in banking and insurance industries for revenue accounting and management, pricing and network planning.

Trends 5: Spreading Online

Though GDSes and travel agents still book 40-45 percent of the total tickets, online sales of tickets through online travel agencies and airline Websites have grown steadily and eaten into the market share of traditional channels. Before online ticketing took off, GDSes and travel agents booked almost 75 percent of the tickets.

According to a report by SITA, over 60 percent of air travelers are comfortable with technology and the use of self-service channels such as websites and mobile applications. By 2018, mobile phones will become the most popular method of check-ins.

Figure 5 **Global Airline Ticket Sales**



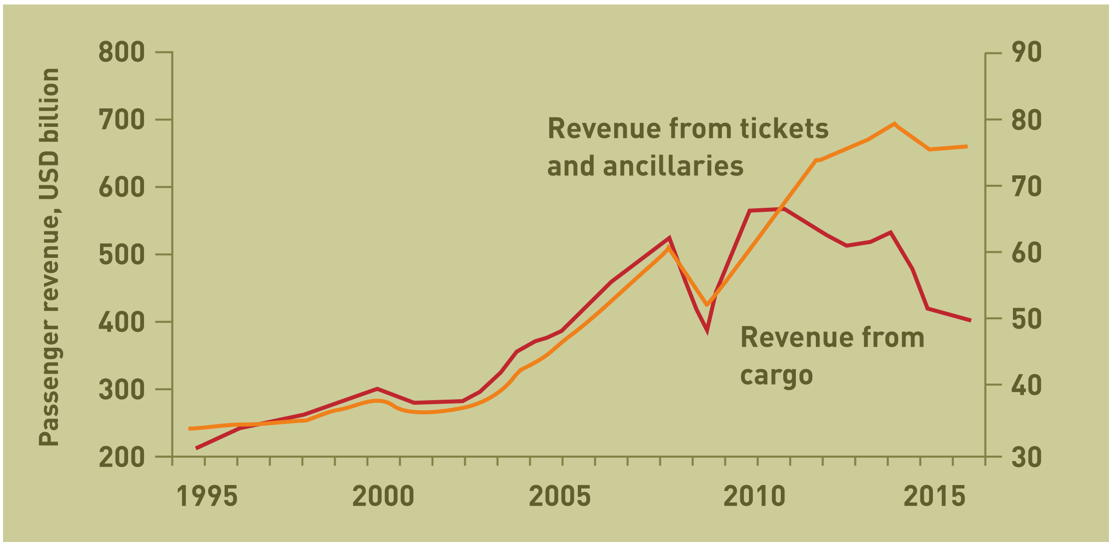
SITA Annual IT Trends Survey

For airlines, the digital medium offers a slew of opportunities. Through Websites and mobile apps, they can increase the proliferation of self-service channels. This will help them reduce costs significantly (such as GDS fees and travel agent commissions). In addition, online ticketing allows airlines to go after ancillary revenues through personalized and contextual services and offers. By leveraging the best practices of other industries such as retail and e-commerce, airlines can innovate their campaign management skills.

Trend 6: Tapping into Cargo

Despite rising passenger ticket sales, cargo revenues have declined from USD 64 Billion in 2011 to USD 50 Billion in 2015. Though weak international trade is cited as the main reason for this decline, mainline carriers should leverage their ample cargo space to carry more cargo. This is one place where they have a huge advantage over LCCs. LCCs, as a practice, do not sell their cargo space as it is limited. For legacy airlines, express cargo opens the door to new opportunities, and the Internet offers a great way for airlines to streamline the business processes involved in managing express cargo.

Figure 6 Airlines' Revenues from Passengers and Cargo



Trend 7: Going Private

Many governments in the Organization of Economic Cooperation and Development (OECD) countries have disinvested ownership in their national airlines and listed them as private entities on stock exchanges for greater transparency. In most regions, governments have also liberalized bilateral agreements for air services. Governments in APAC are likely to disinvest their holdings in airlines as well.

Conclusion

This is an exciting time for the airline industry. The combination of low fuel prices and advances in digital technologies are allowing carriers to not only shore up their profits and reduce costs, but also innovate on customer experience and service. This is the right time for airlines to invest and partner with experienced business process management companies who can provide the right solution to drive growth and address business challenges.

Collaborative partners can help airlines with the technology expertise and manpower to:

- Provide a seamless experience to customers across multiple touch points such as call centers, Web and mobile
- Mine consumer insights from social media data to improve service and campaign strategies
- Use big data and analytics for pricing strategies and network planning
- Plug revenue leaks through best-in-class revenue accounting and management
- Develop effective hedging strategies
- Pursue new sources of non-ticketing revenue

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