Flying through the storm

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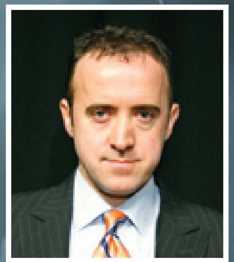

The lethal cocktail of a global recession, higher oil prices, and a drop in demand for expensive seats has hit the airline industry hard. Budget carriers aside, airline companies traditionally make the most of their money from business and first class passengers and commercial cargo. Recently air freight volumes have declined and the industry has been rocked by corporate cutbacks and a decline in consumer spending. This has prompted many to question how certain airlines will survive.

Premium travel (first and business class) has borne the brunt of the recessionary impact. Premium passenger numbers have plummeted during the last year by about 20%, which led to a drop in revenue of 35-40% since the beginning of 2009. This fall is a crucial contributor to the 30% overall decline in industry revenue announced by the International Air Transport Association in May 2009.

On some routes, first class cabins are virtually empty. It is not hard to understand the reasons. If you were sitting in a British Airways (BA) lounge at Heathrow two years ago, probably eight out of every twenty premium class passengers flying to New York would have worked in the financial sector. With each paying around £4,000 return, these customers constituted the lifeblood of airlines and ensured that transatlantic routes such as London to New York were the cash cows of global airlines like BA. The recent decimation of the financial markets and industry titans in the City of London, Wall Street and other financial centres around the world has clearly had a huge impact on the revenues and profit margins of many airlines. BA's record profit of £922 million in 2007 became a huge loss of £401 million in 2009.

The other reality that this recession has highlighted is the need for many long established companies to get their cost bases in order and ultimately transform into more efficient and adaptable organisations. In this respect, there are many parallels between the automotive and the air transport industries. Former 'national champions' such as General Motors and BA face an uphill struggle in the face of: strong and fractious unions; large legacy and structural costs; and generous pay and conditions that are often far above industry norms.

The rising economic 'tide' has lifted all the 'boats' but now that the tide has gone out, the heavier, more bloated vessels remain stuck in the silt. In the air transport sector, these companies are typically 'flag carriers' or 'legacy airlines'. These tend to be former or current state-owned airlines, often burdened by accumulated cost obligations and long-standing societal commitments. Unlike their leaner and more agile low-fare or budget airline competitors, these companies have largely failed to get control of their costs.

The world we now live in means that for those who can no longer rely on state support – and even for many of those who still can – cost management and the strategic allocation of resources is a must.

As legendary airline boss and Southwest Airlines founder, Herb Kelleher, commented: "If the Wright brothers were alive today, Wilbur would have to fire Orville to reduce costs". By contrast, budget airlines are founded on the principle of streamlining costs so as to maintain low prices.

Cost consciousness is at the core of organisational culture and central to market success. Take the example of Malaysian-based AirAsia. Founded in 2001 by former music executive turned entrepreneur Tony Fernandes, AirAsia focused on ensuring a very low cost structure as a cornerstone of its business strategy. It was able to achieve a cost per average-seat-kilometer (ASK) early in its development of 2.5 cents, half that of Malaysia Airlines and Ryanair and a third that of easyJet. Research indicated that AirAsia had become the lowest cost airline in the world by 2007.

Growth of budget airlines

There is still money to be made in commercial air transport, as witnessed by the continued strong growth of budget airlines such as easyJet, Ryanair, Southwest Airlines and AirAsia. These companies have inevitably felt the affect of the recession, as well as being hit badly by high oil prices. Profits have risen, fallen and risen again. For instance, AirAsia's profits surged 26% during the first quarter of 2009 and passenger numbers increased by 21%, following a loss in the previous two quarters and record growth the previous year. They continue to expand aggressively, growing by increasing the overall size of the air passenger market, as well as poaching customers from more expensive rivals. AirAsia X, the long haul arm of AirAsia, recently placed an order with Airbus for ten new A350 aircraft. They intend to expand their routes to and from Australia and have also announced plans to launch services to Korea and Japan in late 2009.

Uncertain future

The unstoppable growth and expansion of budget airlines across the globe leads many observers to ponder the future of legacy carriers.

BA's CEO, Willie Walsh, has already made his decision. He sees a structural shift in the industry, away from high fixed costs and the reliance of legacy carriers on price neutral premium traffic. He faced these same challenges when boss of Irish carrier Aer Lingus, and oversaw its transition from a state-owned, high service loss-maker to a publicly listed, lower cost and occasionally profitable company. The challenge this time around is much greater given BA's size and status and its often militant ground staff and cabin crew trade unions.

Legacy carriers everywhere have to wake up to the new reality. Many still refuse to do so or are hampered by governmental or military demands that are divorced from commercial reality (as is the case in many developing countries). However, some carriers faced up to reality several years ago. These success stories provide some indication of how mature airlines can remain competitive and forge their own strategic pathways in this era of budget airline dominance.

The nimble, ultra-lean business models of the low-fare competitors often make the legacy carriers look cumbersome, old-fashioned and financially unappealing. This raises legitimate questions: is there a future for the mature legacy carrier in an industry which is undergoing rapid change; and where further consolidation is predicted by some as the only way mature airlines can hope to survive? Can the legacy carrier survive by organic growth alone? If so, what strategy can they adopt, not only to survive, but to once again be forerunners in a very crowded market?

To answer these questions, we conducted a research project to identify and analyse mature airlines that have moved from disappointing financial performance to consistent growth and, in doing so, have managed to remain powerful competitive forces in liberalised markets. We examined five prominent airline turnarounds that occurred prior to the current recession. The airlines were Aeroflot (Russia), Air Canada, All Nippon Airways (Japan), LAN Airlines (Chile) and TAM Airlines (Brazil). We also drew insights from the successful strategies of Thai Airways International and Turkish Airlines. All of the turnaround airlines we looked at had engaged in simplifying their businesses by reducing costs as much as possible across all aspects of the airline. This appears to have been a universal approach in response to high oil prices and increased industry rivalry from low-fare airlines. However, none of the airlines studied had chosen to reposition themselves as a low-fare carrier. All five continue to operate as full service airlines known primarily for quality of service over bargain basement pricing.

Six steps to successful airline turnaround

Our research identified six common observations which formed the basis of reviving the performance of mature legacy carrier airlines.

1. Maximise profits

A focus on profit maximisation is the foundation of turnaround. This may seem like a simplistic conclusion and a business 'no-brainer' but it has often been rather neglected by legacy carriers in favour of political and social concerns. The airlines we considered did not act like 'flag carriers'. 'Flag carriers' typically behave as unofficial representatives of their home countries and maintain loss-making routes for political reasons.

The airlines we studied were motivated by generating as much profit as possible. This involves aggressive cost-cutting exercises (referred to by some of the airlines as 'simplifying the business'), revenue-maximising initiatives and strategic investment in IT.

2. Quality of service

Quality of service should not be compromised. All of the turnaround airlines in our study were committed to high service standards and placed reliability and quality as central to their brand's identity. Although cost-cutting has taken place at all of these airlines, this has not usually directly affected the level of service offered to customers. The cost-cutting is limited to 'behind the scenes' activities not directly facing the customer. Indeed, rather than cutting back on service, the airlines studied are constantly trying to raise their standards through innovation and greater customer focus. Clearly, morphing into a budget carrier has not been the preferred turnaround strategy.

3. New leadership

New leadership plays a key role in achieving successful turnaround. In the study, all the airline improvements were shaped by strong and effective leadership. For four out of five of the cases, new leadership was brought in to turn around the whole organisation. This impacted the airline in respect of both technical and cultural aspects of the business. For the other turnaround airline (LAN), focused and innovative leadership helped define its success.

Most of the airlines' leadership teams have adopted clear vision statements that help define and embed their strategic objectives across the company. Excellent communication and people skills were evident in the leadership teams of the airlines studied. This is not 'ivory tower' leadership conducted from a distance and in a very hierarchical fashion, as has often been the case at legacy airlines.

4. Alliance network

Membership of an alliance network acts as a turnaround catalyst. Four out of the five airlines studied were members of one of the three big global alliances and spoke of membership in very positive terms. Membership of an alliance has the potential to assist turnaround by cutting costs through economies of scale generated by the alliance's purchasing power and the sharing of good practices and information technology. It also enhances the customer value proposition by providing increased routes and global service and boosting the reputation of member airlines' brands through association. It should be noted of course that joining an alliance is not a guarantee of business success.

5. Regional consolidation

Regional consolidation can contribute to turnaround. Two of the airlines studied (LAN and Aeroflot) claimed that regional consolidation was a key aspect of their strategy - overwhelmingly so in the case of LAN. New markets can be served and therefore new revenues generated by pursuing liberalisation of the regional industry and moving into lucrative but poorly served territories.

6. Staff training and communications

Investment in staff development and management-employee relations underpins turnaround. All of the turnaround airlines studied invested in improving relations with their staff and in providing comprehensive training for employees in technical skills, customer service and change management, especially revised corporate culture and strategic aims. Several have dedicated training academies, exclusively devoted to training and staff development. Excellent communication between airline management and staff during times of strategic change within the airline characterised the turnaround airlines.

Together, these six observations provide a powerful set of principles and practices that can be weaved together into a successful turnaround strategy. With or without the recession, air transport competition is intense across the world and legacy carriers have struggled to adapt to cost pressures, increased customer expectations and new competitor threats. Some have successfully managed this transition, providing a ray of hope for legacy airline managers everywhere and illustrates how not only to keep pace with but move ahead of budget airlines and other new entrants in the struggle for passengers, markets and profits. MF

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