The challenges of change

Industry commentator, consultant and Director of JLS Consulting John Strickland looks at the current challenges facing the industry and the strategies regional airlines are using to continue to succeed

Not quite what the Hollywood legend Bette Davis said, but the aviation industry ain't for the faint-hearted. That's certainly proving very evident as 2017 plays out. Airlines are having to be ever more resourceful to navigate the twists and turns of the world around them, to seek and exploit opportunities and even to survive. Whilst the industry as a whole faces a number of challenges, the regional sector is perhaps the most vulnerable, yet amongst ERA's members there are numerous examples of determination in making this important part of the industry a success.

Political uncertainty

Brexit is perhaps the biggest ongoing uncertainty with which the industry is having to grapple. After 2016's surprise vote for the UK to leave the European Union, the political process to negotiate the exit terms has shown limited progress so far. Airlines are affected in multiple ways. In the immediacy of the vote, as the pound tumbled against the dollar and the euro, British carriers found themselves facing cost increases with both fuel and leases being dollar denominated. On top of this, the cost of travel to both the EU and the US became more expensive for the British outbound market. Whilst this doesn't appear to have manifested itself dramatically as yet in the reported results of most airlines, there has certainly been pressure on yields as many airlines have tussled for business in a crowded market. EU Open Skies has fostered positive developments in air transport amongst member states with more competition and a greater choice of air services for consumers, and to go backward would be a retrograde step. There needs to be some constructive and urgent negotiation to ensure that this doesn't happen, especially as airlines begin to consider their 2019 schedules. Similarly, the issue of ownership and control is of the utmost importance for airlines. With the UK outside of the EU, some airlines could find themselves no longer owned by a majority of EU shareholders and their traffic rights under threat as a consequence. It is logical to assume that the questions of traffic rights and ownership issues should be resolved, but nothing can be taken for granted. Ultimately it is in everyone's interest to avoid these problems arising but there could be some political brinkmanship, and midnight oil is likely to be burned before a sensible solution is reached. In the meantime, there is a real need to lobby heavily to ensure a sense of urgency amongst the negotiators.

Security challenges

Security has proved to be another ongoing challenge. An increasing number of European cities have experienced tragic attacks with an inevitable impact on people's willingness to travel and a consequent effect on airline bookings. Sadly, this appears to be becoming the new normal and at least the evidence shows that typically, within a relatively short time period, traffic recovers. It is not something which can be planned for but there is an ever-increasing need for flexibility and agility in network planning and revenue management to minimise the impact and seek alternative uses for disrupted capacity. This is doubly challenging with some markets having become off limits whilst others, such as Spain, become oversupplied, causing yields to tumble.

Oil price effects

One broadly positive factor has been the continued low price of fuel, although this too is something of a double-edged sword. Most airlines have benefited from lower costs, unless locked in on higher price hedges, but overcapacity means that much of the savings have been given back in the form of lower yields. Soft oil prices have had a negative effect on the petroleum industry and this has depressed demand for air travel by the historically lucrative extraction sector. A number of key European markets have been hit, including Norway as well as routes in and out of Aberdeen, Scotland. This has had a significant impact on the financial performance of a number of ERA member airlines.

Industry in flux

The shape of the European industry is very much in a state of flux with the overriding theme of consolidation continuing to make itself felt. At the time of writing, bids are being considered for Alitalia and it seems probable that the company will be sold in pieces. Similarly,

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Air Berlin has declared insolvency and Lufthansa is likely to be successful in bidding to take the largest share of the spoils with easyJet amongst the other possible contenders. The outcome of each case will speed market concentration in Italy and Germany. Whether bidding or not, Ryanair can be expected to put a sizable dose of additional capacity into both markets. Whilst these moves could prove tough for the regional sector, opportunities may emerge for certain niche operations to replace the smaller jet or turboprop capacity provided by both Alitalia and Air Berlin.

The rise of LCCs continues, along with an increased blurring of the lines between this model and the conventional approach of the legacies. Deliveries from the massive outstanding orders placed by the LCCs continue to work their way into the market and while demand is currently buoyant and financial results strong in the LCC segment, there have to be questions as to what will happen to all the capacity in the event of an economic downturn or a sharp spike in fuel prices. At some point a shakeout seems likely, not all LCCs are equal.

In the political arena the industry still has a full plate of issues requiring action. New airport infrastructure approvals and the SESAR (Single European Sky) ATC initiative continue to move forward at a creakingly slow pace, while many questions remain about taxation and consumer legislation. Brexit won't help in speeding political resolution of the many agenda items!

Regional outlook

Looking specifically at the regional sector, there is a broad spectrum of experience. Some airlines have done well just to survive, faced with geopolitical challenges in their home markets which have dislocated economies and dampened demand. Others have seen the opportunity or had the necessity to restructure their businesses, modify their operating strategies and re-equip fleets. It is noticeable that while regional carriers have continued to grow both their capacity and traffic this year, this has been focussed on domestic markets. Reflecting the broader challenges of international markets, regional operators have seen an overall fall in capacity against the onslaught of growth by LCCs.

For many regional airlines life is about wrestling with immediate pressures to improve efficiency and to redefine their role as the shape of the industry continues to metamorphose. Yet as part of the industry consolidation process there is increasing evidence of interesting partnership developments by a number of regional operators. Some continue to provide in-house feed capacity to their parent groups whilst others are finding new ways to develop commercial relationships with legacy carriers to provide lower cost production through capacity purchase agreements. Still others are exploiting their smaller aircraft size to advantage by tapping into specific market niches where a price premium can be achieved or where the needs of a particular industry can be met profitably on a tailor-made basis.

One broadly, but not wholly, positive factor for regional airlines has been the rise in average aircraft size. ERA members are seeing an increase in typical capacity to around 80 seats per flight. This particularly reflects the introduction of larger and more efficient regional jets which have reduced seat costs and improved route economics for many routes served by regional carriers. Newer versions of existing turboprops are also leading to improvements in operating costs for that aircraft segment. The biggest challenge is for those airlines operating at the small capacity end of the market. Many of these aircraft, whist continuing to give reliable service, are old and require more intensive and costly maintenance support, and there seems to be little evidence of interest in producing new models. Thus the challenge here is going to increase over time and more operators will have to evaluate the viability of up gauging to larger equipment.

The airline business has always had its challenges and the last year has offered plenty. It is equally an industry of enthusiasm, passion, energy and determination. With that spirit in mind we can expect the strongest players led by the sharpest leaders to succeed in navigating the continued turbulence ahead whilst turning it to their advantage. This is certainly the case for many regional airlines where nimbleness, flexibility, adaptability and using local market expertise in a way that larger players cannot, is providing new opportunities. ■