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Commercial Aviation

# Long-term Profitability Strategy Critical To Air France-KLM's Future

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New [Air France-KLM](#) CEO Ben Smith managed to calm a long-running, disruptive and costly labor conflict with impressive speed, but there is no resting: A long-term strategy to improve profitability is vital, with the context worsening for European airlines.

Smith, celebrating his first anniversary in September, inherited the union mess from former CEO Jean-Marc Janillac, who lost a gamble over a pay deal with staff last year.

The [Lufthansa](#) Group's June 16 warning that profitability would be lower than expected, with pressure on yields in a "challenging" European market only partially offset by strength in long-haul routes, is the latest sign to highlight the seriousness of the situation for European airlines.

More strategy details expected at investor day in November

Competing with IAG and Lufthansa is CEO Smith's goal

Air France-KLM is already on its back foot—Janailac’s attempts to boost profitability, close the gap with airline peers and in particular better face up to competition from Gulf carriers, were at the heart of the conflict with his workforce.

Smith wants Air France-KLM to improve its performance to be able to compete financially with International Airlines and Lufthansa, a goal the former [Air Canada](#) executive believes is “definitely achievable: five years is the timeline we’ve given ourselves.”

JLS Consulting Director John Strickland agrees, saying “It should be feasible for Air France-KLM to compete financially with IAG and Lufthansa: After London, Paris is the richest air market in Europe in terms of density, wealth profile and the amount of point-to-point traffic as opposed to transfer traffic. If you combine that with the already strong performance of KLM, then it should be possible. But that’s in an ideal world, without the French factors.”

Smith will have his work cut out making the structural changes and cost reductions necessary to bring Air France-KLM in line with its European counterparts. Smith may have resolved the immediate conflict with unions, but he can expect pushback as he seeks to get his longer-term strategy implemented.

And not just from staff. Tensions developed between Air France and its smaller partner KLM culminating in the Dutch government’s surprise move earlier this year to buy a stake in the group, leaving it with 14% compared with the French state’s 14.3%.

But Smith said at the Paris Air Forum June 14 that modifications to the group’s governance had evened up the balance between Air France and KLM and paved the way for smoother functioning of the group.

“The challenge is getting the company into the same shape that Willie Walsh has got IAG into,” Strickland says. “That means heavy negotiation with unions to achieve structural change and cost levels that match the kind of revenues they’re able to achieve in the marketplace, and being able to deliver sustainable profitability.”

**Smith is considering how long the Airbus A380s will remain in the fleet.**  
Credit: [joeprisesaviation.net](#)

Air France-KLM Executive Vice President Strategy Angus Clarke told the forum that under Smith’s leadership the group’s priorities were simplicity around the fleet, efficiency of aircraft layouts, consistency of product, employee engagement and balance sheet strength. “These things take time,” Clarke said. “It’s a five-plus year mission to get Air France to the same operating margin as KLM, which is the aspiration and having a strong group that can compete very effectively with [Ryanair](#), [EasyJet](#), IAG and Lufthansa. That’s the ambition.”

Smith is set to give a more detailed strategy update at a capital markets day planned for November, and setting out how Air France-KLM can better compete in the face of stiff competition from the Middle East is sure to be a big part of it.

**Transavia could be a key tool in Air France-KLM’s long-term strategy.**  
Credit: [joeprisesaviation.net](#)

“[The] Gulf carriers are the No. 1 threat that we have at Air France-KLM. We’re not really competing against airlines,” Smith said. “We’re competing against governments. And these governments have policies to fully support their airlines. Their expectations and what they believe they are entitled to is full access to our markets in the Netherlands and France in return for access to markets that are really not interesting. The trade deal is not

balanced.”

Fleet simplicity will be a key improvement for the group. Air France-KLM will consider [Boeing 737 MAX](#), [Airbus A320neo](#) and Airbus A220 types as it prepares to renew its short- and medium-haul fleet, Smith told Aviation Week on the sidelines of the same event. The group is also considering how long the Airbus [A380](#) will remain part of its fleet.

On short- and medium-haul, Smith said, “We’re in no rush; we are evaluating all three major options out there, the MAX, the Neo and the 220.”

Low-cost subsidiary Transavia also looks set to be an important tool in improving the group’s performance on the challenging European short-haul market, and talks with unions over increasing the Transavia France fleet, currently capped at 40 aircraft, are going well, Smith said.

Air France-KLM said June 28 that Air France and KLM would swap their remaining firm orders for [Boeing 787s](#) and Airbus [A350s](#) as they seek to gain fleet efficiencies through harmonization and accelerated growth of similar aircraft at both airlines.

Air-France KLM is also considering the future of its Airbus A380s, of which it has 10, with three already due to exit the fleet. “The other seven have older seats, and we’re in the middle of making the decision on how long those A380s will be staying in the Air France fleet and whether we should invest €30-40 million [\$35-45 million] per aircraft in upgrading those seats,” Smith said at the Paris Air Forum.

A more modern, more streamlined fleet will help improve performance, especially in the French market where intensifying low-cost competition is upping the pressure. But for Strickland, it’s not just about the aircraft. Air France will need to improve the consistency of its network and timetables.

“The schedule has to be strong for business customers,” he says. “With new aircraft like the Boeing 787 and Airbus A350 coming through, they’ll be able to serve new and emerging markets more efficiently.”

Editor's Note: This article has been updated to include a new AF-KLM fleet announcement.

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