

WORKSHOP SUMMARIES

INTERNATIONAL AVIATION

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To review significant events and trends in global air transportation the International Panel premised their deliberations on six concepts. These concepts allowed the group to channel discussion of present and future trends and to develop an evolutionary scenario for international air transport. The group concluded by listing major unknown, or as yet unquantifiable, factors that could have significant impact on future international air transportation.

Premise No. 1. *As time goes on, air transportation will become more and more like any other business. This means that industry/government interface will decrease, national ownership requirements will diminish, and the industry will be managed more by strong generic marketers and financiers than by industry specialists.*

Participants noted the recent spate of hiring of non-airline specialists for top positions in several carriers such as British Airways and Lufthansa and the recent trend toward leveraged buy-outs among U.S. carriers by new owners without previous experience in air transportation (e. g., Northwest, Trump Air, TWA).

It was also asserted that, as time goes on airlines would have to compete more and more for market funds with companies from other lines of business. However, the reputation of airlines as a glamour stock (perhaps attributable to the asset value implicit in airline fleet ownership) may give air carriers an edge over other types of companies in the short term. As supplies of aircraft exceed demand in any future downturn, this edge may be lost.

New types of managers entering the airline industry will bring with them new methods transplanted from other industries. For example, the concept of franchising has been introduced by both passenger and cargo carriers over the last 12-18 months. Product branding, strong product segmentation, and new hybrid financing mechanisms are beginning to permeate the industry. Contra-cyclical strategies of diversification into both airline-related and non-related areas are additional tools that are seeing a higher rate of application.

As the global industry moves away from a strictly regulated "public convenience and necessity" credo

towards a much stronger "fit, willing and able" commercialized "for-profit" motive, the key to future success will be to obtain and manage new profitable growth. Thus, the search for innovative ideas and the need for fresh management perspectives will continue unabated.

While airlines cannot be entirely like any other business, because of technical and infrastructural peculiarities, management methods and the experience of other industries will see increased application to air transport. Thus, forecasting future trends may have to make greater use of methods that are conventional to other economic sector but unfamiliar in aviation.

Premise No. 2. *In a world where air transport ceases to be a protected industry, a new kind of industry structure will evolve.*

More and more international air carriers are being privatized. Foreign ownership in indigenous flag carriers is increasing. Economic regulation is abating. It seems reasonable to assume that differently structured carriers will continue to evolve. Participants identified several types of carriers that will populate the international industry in coming years:

1. The Multinational MegacARRIER, analogous to multinational companies in other sectors, will be formed by the alliance of several large international carriers from different continents. This multimega carrier is then jointly positioned to absorb global growth in virtually any international market and participate in several domestic markets simultaneously.
2. The large conventional international carrier is an airline that will seek to grow by building and extending its network from a single country base.
3. The niched carrier is an airline that will seek to serve a single market segment (i.e. luxury-business or cheapleisure). This type of carrier will seek growth both by expanding geographically and by serving its specialized niche better than any other supplier.
4. The brand name carrier that has its own strong product and service specifications and has an established brand name. All of the actual operating services such as aircraft, technical services, pilots, catering, airport handling, and so forth are all subcontracted to other independent suppliers. A possible variant of this scenario would be development

of large service companies that are expert in providing services to airline clients. The actual air carriers with this type of structure would be pure marketing and finance organisms that leased everything else.

The overall pace of evolution among the present international air carriers toward one of these structures will be conditioned by a trade-off of risk, return on investment, and corporate independence. Carriers seeking new growth but unable to find it in their traditional markets will forge links to share in growth from nontraditional markets. Other carriers will try to attain global network coverage by growing through their own independent means. The profit to be attained in each case will determine the structure. The political need to maintain an independent national air transport entity will undoubtedly also be a factor for many of the current flag carriers. The transition to newly structured multimega carriers could proceed as follows: a) a cooperative marketing alliance between carriers, b) an exchange of minority equity share, c) development of a joint identity (service standard, market brand name), and d) a fully merged identity (with a joint equity base).

Given the less protected nature of the global air transport business and its greater vulnerability to the extremes of the economic cycle, it was felt that many new entrant and niche carriers would continue to have the opportunity to enter and co-exist in the marketplace.

Premise No. 3. *As the trend towards large global air carriers evolves and government regulatory involvement diminishes, airlines will also begin to own and/or manage the operating infrastructure they use to do business.*

Participants recognized certain critical infrastructure issues:

1. Since many of the basic components of an airline's product are directly linked to on-time performance, it could be said that air carriers are to some extent losing control over their product.
2. Many carriers have already made significant investments, either directly or via a subsidiary company, in building and managing various component pieces (terminals) of the infrastructure but have no ultimate control or ownership in the system.
3. Ownership and management methods vary greatly between nations making intercountry development of infrastructure (e.g., Eurocontrol) difficult.

Given these inequities in the present system, what are the alternatives to improve the situation? Clearly the system must be efficient and have the capacity to fund timely improvements and grow apace with airline requirements in order to serve the market. Finally, it should be an unbiased system that does not favor one air carrier over another. In the case of international air transport the principle of nondiscrimination against foreign carriers and the mandatory provision of equal access to the infrastructure and services are key issues.

The panel discussed the issue of air carrier ownership of the infrastructure. With the current push for enhanced profitability and the corresponding search for improvements in productivity and efficiency, it was generally felt that air carrier ownership of infrastructure was probably not the answer. By the same token the shift in many countries away from government ownership to an unbiased independent, private "for-profit" organization could lead to an improvement in responsiveness. Given uniformly high standards of system safety and compliance with security requirements of the nation in question, this third party management approach was felt to be preferable to the existing processes in many nations.

Finally, participants agreed that more accurate reporting of the financial costs of delays and other system shortfalls could lead to timely corrective action being taken. In some zones the lack of new system capacity has had the net effect of actually reregulating the system and blocking competitive carrier access. This is a major worldwide problem that could significantly alter future industry future growth trends.

Premise No. 4. *If air transportation becomes like any other industry, it will no longer be protected from the extremes of the economic cycle. This could have significant management and performance implications.*

So far, only U.S. carriers had gone through a deregulated recession. The experience proved to be a significant learning opportunity for U.S. domestic airlines. Participants felt that U.S. carriers had in fact learned a great deal from the last recession and would be less likely to get involved in the same cyclical errors committed last time around. Similarly, the international panelists felt that, having witnessed and analyzed the U.S. carrier strategies and tactics during the last downturn, they had also learned from past errors. If both of these assertions prove accurate, the opportunity for new entrants to emerge in the next downturn appear to be more limited than they were in the U.S. domestic market in 1981-1984.

North American air traffic growth for the coming 12-24 months was projected to be lower than the previous 24 months, however no recessionary pattern is presently projected. North American yields are close to peaking, and during the course of the next 3-24 months fare wars may emerge as traffic growth slows.

In Europe heightened competition is already having a negative impact on average yields in what have been traditionally high yielding internal European markets. It was also felt that European markets were also going to experience a reduced traffic growth rate caused primarily by a significant reduction in bulk leisure segment growth over the next 12-24 months.

Japan is projecting continued strong domestic and international traffic growth with an average of 5 percent per year on domestic services and up to 15 percent per year on international routes to and from Japan over the next 12-24 months.

Participants also remarked upon the different methods of growth that were available to international carriers.

U.S. carriers have been able to introduce a greater flexibility into the management of their human and mechanical factors of production. U.S. labor, bankruptcy, and certain aircraft tax and leasing laws have helped in this respect. Foreign carriers have a more onerous social commitment to labor groups and thus less flexibility in trimming unproductive labor resources.

Non-U.S. carriers seem to have a more cautious attitude toward growth and are more comfortable with small, well-spaced chunks of growth. U.S. carriers, on the other hand, have this enhanced flexibility to add and drop resources and so are willing to add growth in bigger chunks even if they must subsequently retrench. Over the longer term, this has led to different attitudes towards managing the risk of growth and overgrowth. The more cautious European attitude may mean a first cycle of economic deregulation in the post-1993 EEC that will be less tumultuous than that experienced in post-1978 US domestic markets.

In general, the infrastructure of the airline industry has been able to handle growth only in small, well-spaced chunks that allow time to catch up. Some participants felt that many of the current problems with system capacity can be directly traced to the relatively extreme pace of growth in global air traffic over the last 3-5 years.

The global commercial realities of the future will force all international carriers to build more flexibility into their corporate structures to cater to the extremes of the economic cycle and the profit expectations of stakeholders. Subcontracting and foreign labor sourcing are becoming increasingly popular methods in this area.

Premise No. 5. *Several trends over the next three to five years will affect the air carrier industry and the development of aviation infrastructure.*

Participants felt that the following were probably the key trends:

1. All carriers will need to seek profitable new growth.
2. Given reduced domestic growth rates in many countries and the maturing of some other post-deregulation zones, much of the future growth seems likely to come from international markets and services.
3. Newly structured carriers will emerge, and the industry will see multinational airlines in the future. These carriers will have diversified ownership bases and use marketing and financing methods borrowed from other deregulated industrial sectors.
4. Growth projections seem to indicate a slowing of traffic and yield growth in most markets with the exception of Japan. No imminent recession is projected.
5. Infrastructure issues will continue to be a constraint on free market forces until such time as airport and airspace capacity can catch up to air carrier needs. A slower projected pace of traffic growth over the next 12-24 months in many markets could facilitate this catch-up.
6. Future business success of air carriers will be consumer-driven, not internally (corporately) driven.
7. Whatever corporate structure an airline adopts, it will have to be highly flexible to cope with the extremes of the economic cycle from which it is no longer immune.
8. To the greatest extent possible, management of the infrastructure should be put into the hands of a third-party, independent, and unbiased "for-profit" organization that can assure the viability and growth of the system.

9. Since air transportation will become much more like businesses in other sectors, the methods used to project future trends in other industries will become germane to air transport.

Premise No. 6. *There are several major unknowns that will affect international air transport and any projections of its future.*

The panel concluded that the following were probably the pivotal questions:

1. How much outside ownership by foreign interests or corporations not previously affiliated with aviation will be allowed in the airline industry?
2. What form will Europe take in 1993?
3. How will other rules of the game change? (For example, will there be a new Chicago Convention that allows cabotage?)
4. How fast and how effectively will infrastructure constraints on free-market industry growth be resolved? Will the resolution of these issues be the ultimate controller of the pace of global air transport growth?
5. Where will the big new markets of tomorrow be discovered or created?
6. To what extent will air transport become a business like any other? Will the rules of the game

U.S. DOMESTIC MAJORS

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This panel was made up of a broad range of interests in the U.S. domestic airline industry --airlines, consultants, government, the financial community, manufacturers, airline labor, and users of the air transport system. Rather than producing a specific forecast, the panel concentrated on several of the critical issues that would have a major influence on the airlines over the coming years. These included the changing industry structure, pricing trends, people issues, and government relations.

allow the industry to develop on its own, or will regulatory actions interfere?

Information Problems and Needs

As international competition between carriers heats up, it is likely that commercial information will become more sensitive and consequently less available.

Government-mandated extraction of information from foreign carriers by local regulatory requirement is not a positive development, and only equal access by all market participants to any information gathered would seem equitable.

Faster decision-making processes that mimic the increased pace of change in the industry mean less time for analysis and reduced use of information.

Increased global antitrust vigilance also means that exchange of data between carriers is in question. Everyone would like to have as much accurate competitive information as possible without having to give up any of their own sensitive market data.

Overall, it seems that, while the need for exchange of data between air carriers and other elements of the international aviation system has never been greater, competitive pressure between international carriers may not prove to be the ideal environment for enhanced exchange of data among various parties.

A Conservative Industry

The domestic industry is showing signs of becoming increasingly conservative, and risk-averse in the area of market development. The industry is in a period of considerable internal stress relating to takeovers, real and threatened; and this adds to a tendency to direct corporate energies away from the kind of innovations that produced vigorous traffic growth a few years ago. If continued, this path might lead to a return of the economic stagnation that characterized the latter years of Civil Aeronautics Board regulation.

In those years the industry was obsessed with the minutiae of rate and route decision. This rigid