

WORKING GROUP REPORTS*

SMALL COMMERCIAL OPERATORS

Discussion Leaders

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The purpose of the working group was to develop a better understanding of the economics of operating helicopters by examining the major elements of operating cost and the economic factors that drive or influence them, particularly as they affect small commercial operators. The working group also attempted to identify corrective measures and program that could control costs and improve the economics of operating helicopters commercially.

GENERAL OBSERVATIONS AND FINDINGS

Technical issues and infrastructure concerns do not appear to be the determining factors. The group felt that current helicopters, with their existing operational capabilities, would still be the major part of the fleet operating into the next century. While the helicopter transportation industry could always use more heliports, it was generally agreed that the current inventory of heliports, with a few notable exceptions, is adequate for the current needs of the industry.

The major factor that will determine the future of the industry is understanding and controlling the economics associated with operating helicopters so as to provide an acceptable return on investment and assure the long-term financial health of individual operators.

Small operators utilize different methods to determine costs, with little, if any, consideration to the use of standard and accepted accounting practices and procedures. In an attempt to establish a framework for discussion of cost, the working group distinguished between two basic types of operating cost: direct and indirect. Direct (variable) costs are those associated with the actual flight of aircraft, e.g., fuel, time-change components, or maintenance. Indirect (fixed) costs are costs incurred whether or not the aircraft flies—hanger rent, aircraft financing, staff, insurance, and so on.

It is essential that operators realistically determine their true operating costs and use them to establish correct pricing that provides an adequate profit margin.

The basic formula to determine actual fixed and

variable costs (adjusted to provide adequate reserves and profit margin) is well known and should be the cornerstone of fiscal integrity. Unfortunately, it is not commonly used by small helicopter operating firms today. Instead, their pricing formulas seem to be driven by undercutting competitors, even if such pricing has a built in loss factor.

It is equally important to know how to calculate profit—both operating profit and return on investment. The view of the working group was that operators should aim for a return on investment of 8-10 percent and calculate their operating profit margin accordingly.

The profitability of small operators is conditioned by several factors that are unique to their scale of activity. Maintenance services are usually performed outside the firm by special contractors. Small operators usually do not have back-up aircraft to support the few that they operate. Fuel is normally purchased at retail price from a third party, such as a fixed base operator. Parts and equipment are purchased without the advantage of volume discount. Calendar limits are reached before flight time limits on many components. Outside marketing and accounting services are utilized.

MAJOR COST FACTORS

Maintenance

Maintenance costs are critical to the economic success of any operation, but they are especially important to small operators. A major consideration is whether to establish an internal maintenance department or utilize the services of an outside maintenance firm. Some of the parameters involved in making such a decision are the number of aircraft involved, the number of hours flown, and the time (night or day) when maintenance must be performed. In many cases small operators cannot afford the loss of the aircraft during normal operating hours and thus must do all their maintenance at off hours.

Another factor is whether there are third-party maintenance facilities available in the firm's operating area. Lack of such facilities may force small operators to set up an internal maintenance operation, which might not be economically reasonable at their level of activity. Assuming that the quality of maintenance is equal, the deciding factor between internal or external maintenance is how the per-hour costs break down between the two options. Internal maintenance is usually the more costly

* Working group participants are listed in Appendix B.

alternative for a small operator because it adds to indirect (fixed) cost for such items as required spares inventory, tools, facilities, insurance, and staffing. It is generally not economically practical for small operators to establish an internal maintenance department.

The variable and unscheduled nature of helicopter maintenance tends to destroy even the best thought out financial planning. One way to compensate for the variability and unpredictability of helicopter maintenance costs is through a power-by-hour program that covers all items on the aircraft from nose to tail. Such a program might be offered by the manufacturer or it could be administered by a third party. An essential element of a power-by-hour program is accurate information from the operators themselves about the performance and maintenance history of their aircraft. This information is needed for manufacturers to make a realistic determination of expected operating costs.

Fuel

Another major element of direct operating cost is fuel. The cost per gallon varies dramatically by geographic region and point of purchase. An operator might be able to reduce the direct cost of fuel by bulk buying and or establishing his own fuel farm, allowing purchase of fuel at wholesale rates. Most small operators, however, do not have enough volume to justify bulk purchase in advance or the available funds to set up a fuel farm of their own and bear the maintenance and insurance expenses. The costs of regulatory compliance and insurance against financial liability are formidable problems for small operators.

Insurance

Insurance cost (medical coverage for employees and aircraft hull and liability insurance) is one of the most important factors affecting the economic viability of small operators. The volatile nature of insurance costs make business forecasting and pricing difficult tasks at best. Organizations such as HAI, lenders, or insurance associations could be catalysts in establishing insurance cooperatives to allow small operators to obtain advantage of group rates.

Regulation

Regulatory compliance can impose heavy costs on helicopter operators. Current Federal Aviation Regulations (FAR) do not give adequate recognition to the special capabilities and operating environment of helicopters.

One of the issues to be addressed is consistency in regulatory interpretations by FAA officials. In some instances some operators are encumbered with unnecessary and constraining regulatory compliance because of arbitrary or incorrect interpretation and application by FAA inspectors or regional and national offices. This has an adverse economic effect and may affect safety in some cases.

Authorization for properly trained and certified pilots to perform minor maintenance away from base on items not critical to safety of flight should be reviewed and perhaps expanded to allow them to handle normal day-to-day operational requirements.

The costs and time required to obtain FAA approval for a system type certificate or other aircraft modification can be excessive.

The playing field for commercial operators is not level. There is a disparity between operators conducting passenger transport activities and those conducting other types of revenue-producing operations (sightseeing, photography, training etc.). The former are subject to FAR Part 135; the latter are not. A more equitable arrangement would be to apply FAR Part 135 to any and all operations where the carrier charges a fee or receives revenue.

RECOMMENDATIONS

Government and Industry Resources

The emphasis and commitment of resources by the government and manufacturers on future vertical lift vehicles such as the tiltrotor should be tempered with an appreciation of the current rotary wing helicopter industry and its problems. To plan for the future, and to foster new vehicle technology are commendable. However, attention should also be focused on, and resources directed to, the present health and long-term survival of the vertical-flight industry. If not, vehicles such as the tiltrotor will not have a marketplace, infrastructure, or qualified personnel to operate them when they become a commercial reality.

Public Acceptance of Helicopter Aviation

Public acceptance of helicopters and heliports is critical to the future economic viability of the industry. There is a clear lack of support of helicopter aviation by the general public. For example, many communities have put in place prohibitive zoning laws, and new ones are being proposed daily.

The philosophy of creating a heliport, regardless of location or actual need, just to have another heliport is

not sound. The establishment of any heliport should be based on a true need of the industry or the public and not on the philosophy of "build the heliport and the helicopters will come".

Time and again, heliports have been established without any demonstration of real need or assurance that they will be used. Subsequently when they fail and must be closed, helicopter aviation receives negative publicity. The funds, community resources, and goodwill expended for these facilities might have been better spent somewhere else.

Cooperative Efforts

Cooperation and joint programs are needed. Interaction among all segments of the industry, operators in particular, is essential for the survival and long-term growth of the industry as a whole and operators as individuals.

In the area of maintenance small operators should seek to form cooperatives to provide central spares inventories and labor pools to meet their maintenance requirements. Such an arrangement could provide each member operator with qualified technicians and mechanics and spare parts as needed without incurring the full overhead cost of having their own maintenance organization.

Withholding of resources (i.e., aircraft) from each other is not beneficial to operators. This is especially true with regard to subchartering or brokering to another firm trips that an operator cannot handle. If the trip is lost, it harms each operator and creates a negative perception of the industry on the part of customers, actual or potential.

Education Programs

Education of new owners and operators needs to be improved. Any commercial or private operator should have available, a central source of realistic cost and operational information and reference material on good business practice. Customers and other users of helicopter transportation services also must be educated on matters such as safety, cost of product, and operational parameters. Operators, manufacturers, industry associations (HAI and AHS), and FAA should undertake joint programs to educate operators and the public alike about helicopter transportation.

Accreditation

Consideration should be given to an accreditation program to identify and acknowledge those operators

who are exemplary in meeting or exceeding an established industry standard. The criteria of award should be established with industry participation through an organization such as HAI. Participation in the program would be voluntary, with those operators seeking the accreditation making application and satisfactorily completing an examination and accreditation process.

The rationale for such a program is that most customers assume that any operator advertising services and claiming to be FAA-certified meets all operational and safety standards. This is unfortunately not the case throughout the helicopter transport industry. What is needed is a standard or measure of quality that can be used with confidence by the customer to identify those operators that do, in fact, maintain safety standards and sound operating practices.

Among the criteria that could be factored into accreditation are staff (flight crews, maintenance, operations), training program, safety program, equipment and facilities, operational performance history, management, and code of ethics compliance.

Adjustment to Economic Hardship

There are several immediate practical actions that small operators could take to get through the current period of economic difficulty:

- Defer maintenance on items that are cosmetic or not related to safety of flight.
- Reduce or eliminate training not required by regulation.
- Reduce spare inventory.
- Reduce or eliminate hull insurance by negotiating a lay-up credit for inactive aircraft.
- Use part-time instead of full-time staff.
- Freeze or reduce payroll.
- Defer nonessential purchases.
- Discount the receivables account.
- Increase credit checks and payment or deposit requirements for customers.

In addition to cost-cutting measures, operators should explore alternate revenue sources to supplement income from commercial helicopter operations. These sources include aircraft management services for other owners, consulting services, aircraft brokerage, food service, repair station services to other operators, asset sales or transfer, retail sales of aviation affiliated products, conducting FAR Part 61 flight training.