

REGIONAL AVIATION

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Introduction

The panel was comprised of experts in regional aviation from North America and Europe. The task of the panel was, through the use of specifically assigned discussion topics, to attempt to determine the long-term issues confronting regional aviation over the next 10 to 12 years. Approximately half of the panel members researched and presented information relevant to the future of regional aviation.

Regional airlines have been one of the fastest growing and most profitable segments of the air transportation system for several years. However, their fate and success continue to be inextricably tied to that of their marketing partners (almost always major airlines).

Regional airlines are currently at a crossroads, with record growth and new opportunities brought on with revolutionary aircraft in many size categories. Despite the recent success, there is uncertainty concerning the long-term prospects for the industry considering the world economic malaise, the financial condition of major airline partners, and doubt about the future structure of the air transport system (hub-and-spoke networks, airline

industry concentration, and competition from alternative modes such as high-speed rail and teleconferencing)

Short-term changes in the major airline arena, such as another round of new-entrant airlines in the United States, add uncertainty to an already dynamic environment. Since the regional airlines are so closely linked to major airlines, any move by major airlines to change the operating structure would affect regional airlines. Frequent fare adjustments, usually downward, during the past two years illustrate this relationship.

General Economic Environment

Very few factors have such a profound influence air transportation as the economic environment, which affects both business and leisure travel. As long as worldwide economic recovery is slow, or perceived as such, airlines will experience mediocre growth. This situation benefits regional airlines, in that they can pick up routes than might otherwise be served by major airlines, but it also directly affects the operational and planning psychology of the regional airlines. Although

most regional airlines are profitable while major airlines are not, there remains an uncertainty about the economic recovery worldwide and the level of sustained growth which will follow. Any uncertainty, despite current success, leads to doubt in the minds of regional airlines.

With the current *en-vogue* position of Southwest, Morris, and other successful low-cost, low-fare airlines, questions have arisen about the maturity of the market for air travel at a constant yield. Is the market mature or can volume be stimulated by fare elasticity? All theories are probably correct under different circumstances. What ever the answer, regional airlines are adversely affected by the instability caused by industry restructuring and experimentation.

Hand in hand with this is concern about the continuing threat of new-entrant airlines that focus on short-haul, rather than long-haul, services.

These three factors combined produce a high-level of uncertainty despite facts the historic success of regional airlines and their potential to serve small markets.

Major Airline Operating Philosophy

Unlike the profitable regional airlines, major airlines continue to be troubled with unhealthy balance sheets, aging aircraft, and higher than acceptable costs. This situation has forced major airlines to speed up the process of transferring short-haul routes to their regional partners. However, this process has been sporadic and without a strategic rationale and regard for long-term impacts. It is shocking to see how many short-haul markets are currently served by major airlines with cost structures and equipment that are not suited to the short-haul mission.

Data presented to the panel to indicate the ongoing presence of major airlines in short-haul markets is shown in Table 4.

These data clearly show that, despite the trend of route transfers from major to regional airlines, there is still much progress to be made. Why do major airlines continue to operate such a large number of obviously unprofitable routes at a time when costs, traffic, and the need for revenue are creating such pressure? There appear to be four factors used by major airlines to justify their continued presence in markets that could be better and more economically served by regional airlines:

- market, competition, and passenger acceptance,
- yield,
- fleet utilization, scheduling, and maintenance, and
- political considerations and "sacred cow" routes.

TABLE 4 MAJOR AIRLINE SHORT-HAUL HUB SEGMENTS (<400 MILES)

<u>Major Airline</u>	<u>Segments with Load Factors Under 50%</u>		
	<u>City Pairs</u>	<u>Number</u>	<u>Percent</u>
American	59	28	47
Continental	32	19	59
Delta	84	48	57
Northwest	52	27	52
TWA	21	6	29
United	39	2	5
USAir	186	100	54
	—	—	—
TOTAL	473	230	49

The economic pressure of the past two years is catching up with the major airlines on their short-haul routes. Major airlines are beginning to reevaluate their short-haul services, the structure of their hubs, and cost containment. In some cases point-to-point services are under consideration. These responses can be viewed as a double-edged sword: advantageous to regional airlines if transfers increase or disadvantageous if there are rapid structural changes that affect the business philosophy of regional feed services.

Panelists expressed a certain amount of frustration with the evaluation processes now under way at the major airlines. With the majors considering low-cost subsidiaries or other solutions to the short-haul problem, they are ignoring a readily available solution: increasing services with a regional partner with whom they already have a relationship. This lack of communication is prevalent in most of the major-regional relationships, with a few notable exceptions.

In an attempt to clarify and explain the structural relationship among major, national, and regional carriers over the past eight to ten years, the panel suggested that it might be helpful to consider the shift of a route from a major to a regional carrier not as a transfer but as a route return. In many cases the routes turned over to a regional airline are routes that were operated by a local service carrier prior to deregulation. The local service carriers had structurally different philosophies and cost

levels. During the consolidation phase, when majors bought or merged with smaller national airlines, the majors brought along with them a long-haul operating philosophy and a cost structure that were inappropriate to these short-haul routes. Return of routes such as these to a regional partner will provide a carrier that is properly structured to operate them profitably.

Evolution of Regional Airlines

The short-haul airlines are evolving into an industry with a different structure. While questions remain as to the number of hubs, their role, and the reemergence of direct point-to-point service, a larger role for cost-conscious regional airlines seems assured.

This evolution and growth will undoubtedly challenge regional airlines in a way many of them have never experienced. A notable aspect of this change will be the general transfer of the 75- to 100-seat class aircraft to large regionals by the middle of the next decade. This, in turn, is likely to result in the transfer of the smallest category of regional services to a new class of commuter-regional carriers specifically adapted to operating 19- to 25-seat aircraft. (Table 5)

TABLE 5 STRUCTURAL CHANGES IN AIRLINES BY 2000

	<u>Major</u>	<u>National</u>	<u>Regional</u>
Average Aircraft Seats	135	130	44
Stage Length (nautical miles)	885	453	338
Percent Growth in Available Seat Miles, 1993-2000	3.5	8.0	20.5

Source: BRAD prediction, *Regional Airlines in the Year 2000*

During this evolutionary process it will be of utmost importance that regional airlines give full attention to the issues of maturation in their fleets, cost, structure, and operating practice if they are to survive and prosper.

Globalization

Partnerships resulting from the ongoing trend toward globalization trend will probably take longer to implement than planned, and may not meet expectations. Regional airlines are beginning to experience the globalization process first hand, especially following the implementation by British Airways of a regional air service structure across several countries in Europe. Mike Ambrose of the European Regional Airlines Association gave the panel a valuable overview of the European environment that explained the inherent reasons for present and future difficulties.

The primary obstacles are cultural, but differing operating environments, planning philosophies, and airport capacities also play a part. The multiplicity of European regulatory authorities is a prime example:

<u>Regulatory Authorities</u>	<u>Member Countries</u>
European Community	12
ECAC (ICAO)	32
Eurocontrol (air traffic control)	18
Joint Airworthiness Authority	18
National Airworthiness Authorities	32

The United States is lucky that it has a common language, currency, and data reporting requirements. As U.S. airlines begin or continue their move toward globalization, they will encounter these types of issues head on.

Closer to home, NAFTA could present similar challenges to aviation, and business in general. Information presented to the panel suggested that the impact of NAFTA on air travel demand would be slight—fewer than 10 new regional aircraft added to the three-nation fleet and only a small increase in load factors over a period of several years.

Consolidation

There will be a need for continued consolidation by major and regional airlines, as well as in the regional aircraft manufacturing sector, which is overburdened by competing products. Although there has been some corporate consolidation with the Bombardier acquisition

of de Havilland and the DASA acquisition of Fokker, the of products offered remains about the same. In the short term, the hope of product rationalization is slight; all manufacturers are investigating additional products. While some of these announcements are believed to be simply political posturing, new products are a dangerous proposition until the total number of product offerings is reduced.

Conclusion

The general outlook for the regional airlines is upbeat, perhaps even more so than at the TRB Future Aviation Activities Workshop two years ago. Most regional carriers have come through the slow economic recovery with record traffic and profits, positioning them to build on their success in the coming years. Success, however, remains inextricably tied to the fortunes of the major carriers with which they are marketing partners. Doubts about the financial health of the majors, the structure of the air transport industry, and the competitive environment here and abroad cloud the skies ahead.