The Airline Industry Since 9/11: 
Overview of Recovery and Challenges Ahead

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Outline

Airline Performance 2001
- Weakening economy and air traffic before 9/11
- Impacts of 9/11 on traffic and capacity into early 2002

The Challenges Ahead
- Prospects for industry profitability
- Operating cost and revenue obstacles

Working Towards Recovery
- Airline security issues
- Impacts on airline operations
- Labor/management relations
- Overview of today’s program
Airline Performance Before 9/11

- ATA forecasted $1.5 billion net loss for US airlines in 2001 after “disastrous” second quarter reports.

- Softening economy had a substantial revenue impact:
  - Average yield in August down 12.5% over previous year
  - Revenues from business-type fares down by almost 30%

- US airlines’ capacity was up 2.6%:
  - Average load factors were about 2 points lower than in 2000
  - Impacts cushioned by discount and web fares to fill seats

- Operating expenses climbed due to labor and fuel:
  - Labor costs increased by 9.7% on average among US majors
  - Fuel prices up an average of 8.9% through July
IATA Passenger Traffic Growth (RPM)

-2% 0% 2% 4% 6% 8% 10%

2000 Q1-2001 Q2-2001

International
US Domestic
• **Air transportation system capacity constraints**
  – Aircraft delays peaked in 2000, still 80% higher in 2001 vs. 1997
  – Forecasts of continued traffic growth, limited capacity increases

• **Customer dissatisfaction with airline service**
  – Growing perceptions of “poor service” and airline indifference
  – Exacerbated by operational problems associated with congestion and delays
  – Some calls for re-regulation of selected airline competitive practices

• **Difficult labor/management environment**
  – Labor demands for share of airline profits from late 1990s
  – Employee morale and impacts on customer service
  – Prolonged contract negotiations and strike threats
Impacts of 9/11 Attacks

• Most North American and European airlines reduced capacity and staffing almost immediately:
  – 80,000 layoffs by US airlines alone
  – February US airline capacity down by 13% from previous year
  – Traffic has “rebounded”, but still 11% lower than in February 2001

• US airlines posted 2001 net losses of $7+ billion.

• Few expectations of industry profits in 2002:
  – Revenue mix of traffic is extremely weak, despite some recovery of traffic and load factors
  – Average load factors were actually 2 percentage points higher than last February, on reduced capacity
  – But, average fare (yield) is at least 13% lower than in 2001
System Load Factor Year-over-Year
Source: ATA Monthly Passenger Traffic Report

Mar-01 Apr-01 May-01 Jun-01 Jul-01 Aug-01 Sep-01 Oct-01 Nov-01 Dec-01 Jan-02 Feb-02
2000/01
2001/02
Annual Change in Average Domestic Fare

Source: ATA Monthly Airfare Report
Prospects for Profitability

• **Industry profitability depends heavily on US economic recovery:**
  – Return of business travel to improve revenue performance
  – Recent evidence that economic recession is over is encouraging

• **Passenger confidence in airline security is also key:**
  – Absence of new terrorism and stabilizing military situation
  – Increased security measures and uncertainty about associated passenger delays affect business travelers most

• **Implications for airline operating costs**
  – Increased security costs and impacts on aircraft turn-around times and utilization
  – Uncertainty about future fuel, labor and insurance costs
Airline Profitability Model

$/ASM

Security costs

CASM

RASM

9/11-9/13

Time

Quick Recovery

Slow Recovery

Insolvency
• US airline annual net profits averaged $3.5 billion during 1995-2000 period of economic boom:
  – Minor fluctuations in fuel prices before major jump in 2000
  – Airline labor cost index increased by 13.5% over 5 years
  – Record profits have been driven by improved distribution efficiency, along with aircraft utilization and productivity gains

• Post 9/11 operating costs raise substantial questions:
  – Lower aircraft utilization due to schedule cuts will affect productivity and increase unit costs
  – Added security requirements and associated delays
  – Increasing labor costs introduce tremendous uncertainty
  – Last fall’s fuel price decreases were an unexpected bonus, but fuel prices are on the rise again
Bigger Obstacles to Recovery: Revenues

• Recent profitability driven by improved revenue generation through pricing and distribution:
  – Fare structures in which business travelers pay 5 to 10 times the lowest leisure discount fares
  – Revenue management systems used to maximize network revenues and increase overall load factors to a record 72.4% in 2000
  – Expanding e-commerce channels to fill empty seats with incremental traffic and revenue

• Business demand is estimated to be down by 30%:
  – Current “recovery” of traffic and load factors appears to be driven by leisure travelers paying extremely low fares
  – Profitability of “traditional” airlines depends on return of business travelers willing to pay premium class and full economy fares
Return of Business Travel is Key

• Several factors have limited business travel recovery:
  – Overall economic downturn and corporate cutbacks
  – Inconvenience and uncertainty caused by increased security measures is a major concern
  – Also, some evidence that willingness to pay premium fares has eroded

• Reducing business travel inconvenience is key:
  – Most traditional network airlines cannot survive on high load factors and low yields
  – Lower business fares will not stimulate enough traffic and revenue to cover increased operating costs
  – Without high-fare business travelers, an alternative business model could well be required for airline profitability
“Working Towards Recovery”

- Cross-section of industry stakeholders assembled here today to discuss progress toward recovery --
  
- How has airline security improved?
  - Customer perceptions, reality, and future directions

- What impacts on airline operations and efficiency?
  - Impacts of security changes – operating expenses and safety
  - How quickly will the system return to previous levels of congestion and delay

- Will labor/management relations adapt?
  - How can employee morale, customer service and productivity be improved, given pressures to reduce operating expenses?
Overview of Today’s Program

• Developing A Perspective
  – Recent Passenger Booking Trends

• Airline Security – What’s Next?

• Airline Operations – Return to Previous Levels?

• Airline Management/Labor Relations – Helping or Hindering Recovery?

• Future Outlook – The Airline Industry Tomorrow
  – Implications for Industry Structure and Competition
  – Role of Low-Cost Carriers
  – Market Outlook for Air Travel