



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

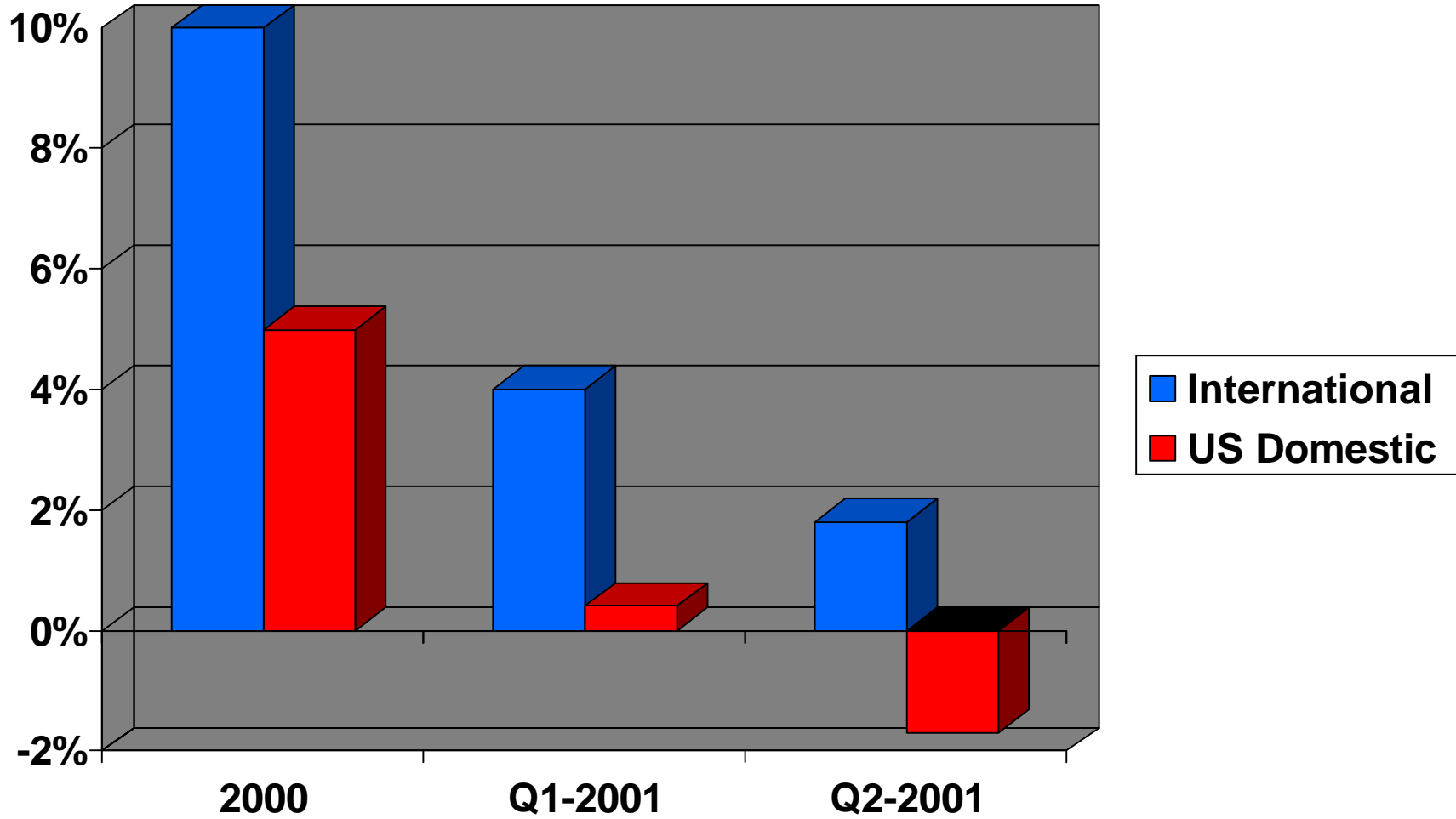


Airline Performance Before 9/11

- **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

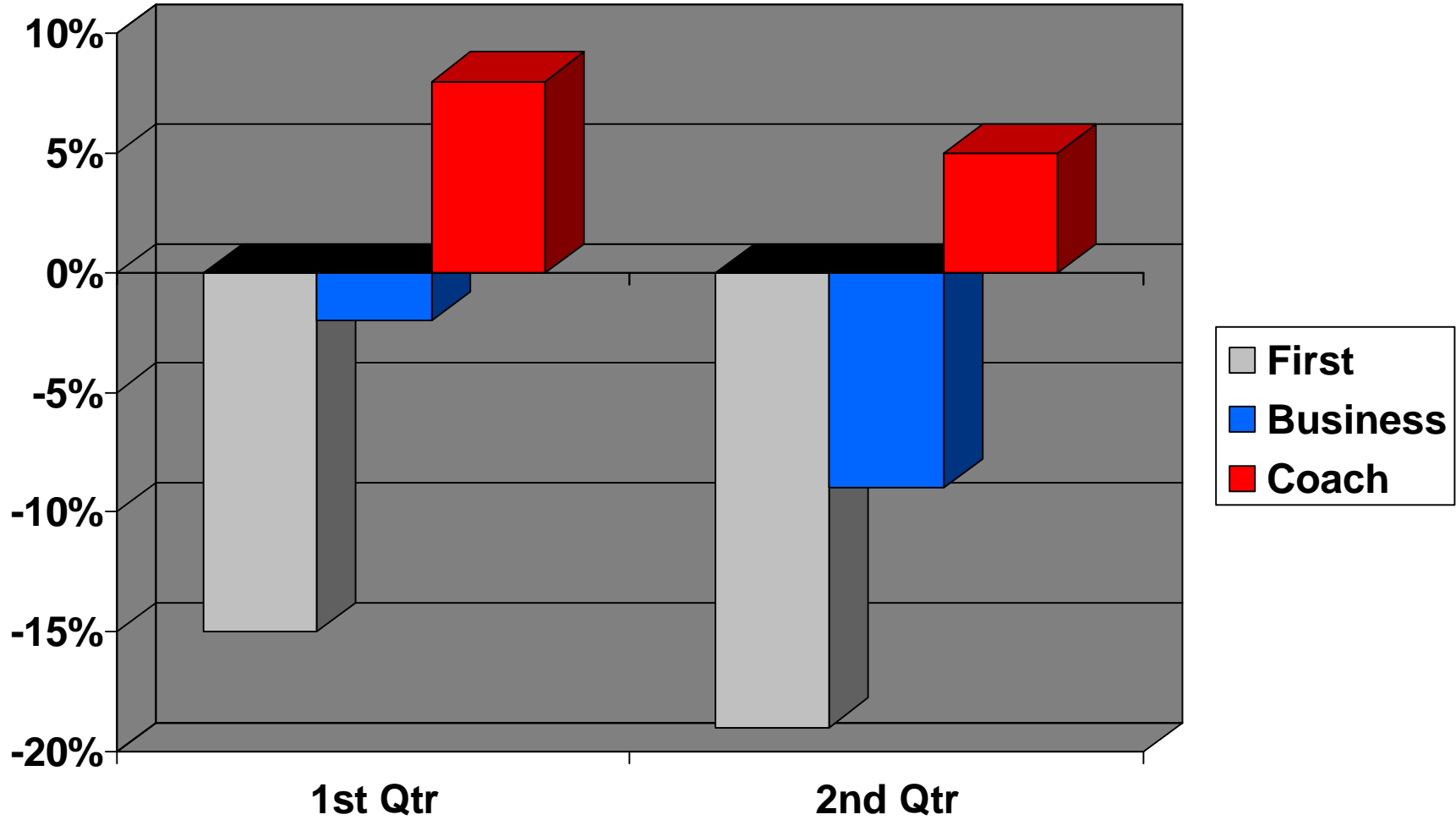


IATA Passenger Traffic Growth (RPM)





IATA Traffic by Category 2001 vs. 2000





Other Industry Concerns Before 9/11

- **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



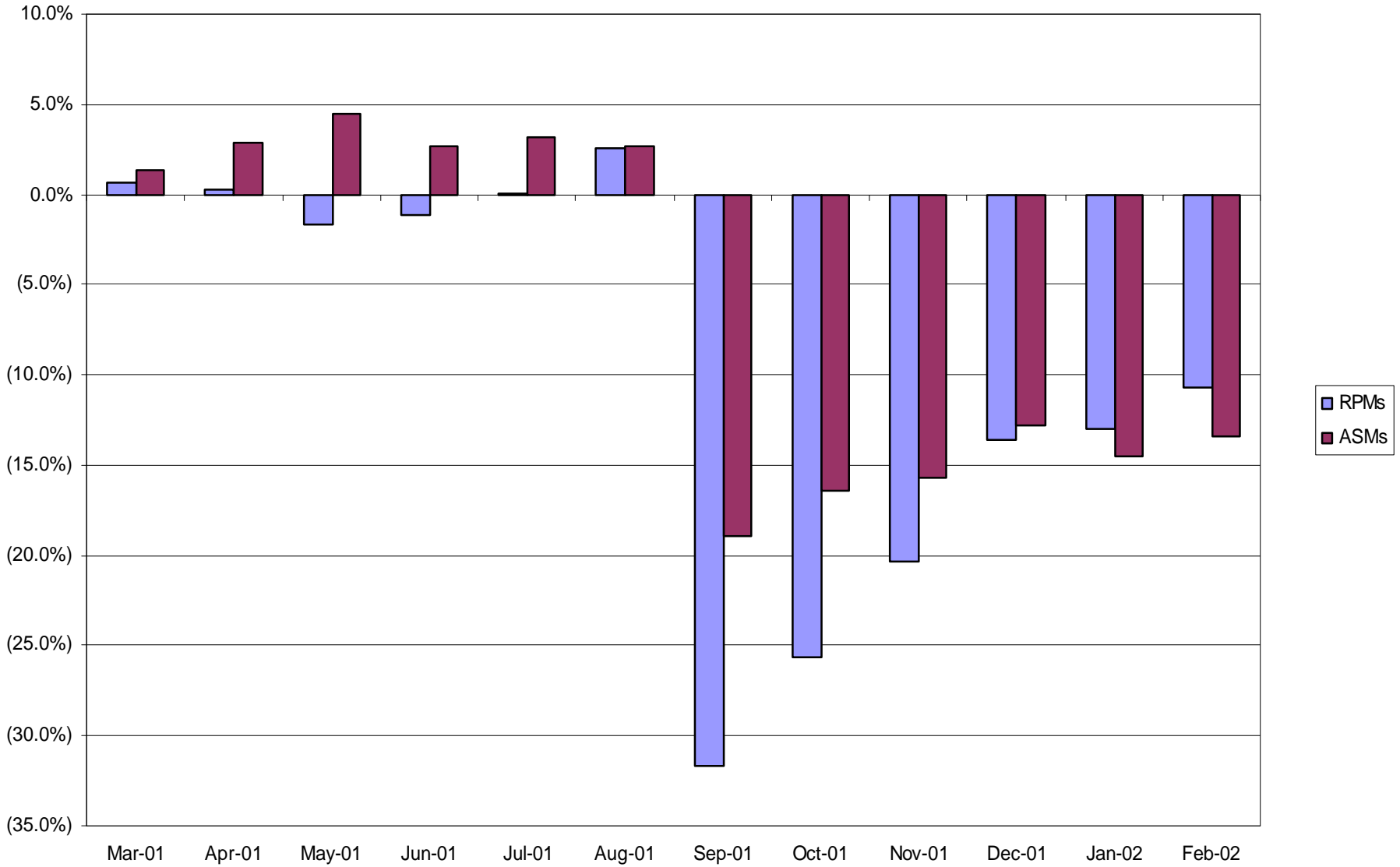
Impacts of 9/11 Attacks

- **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



Annual Change in System RPM and ASM

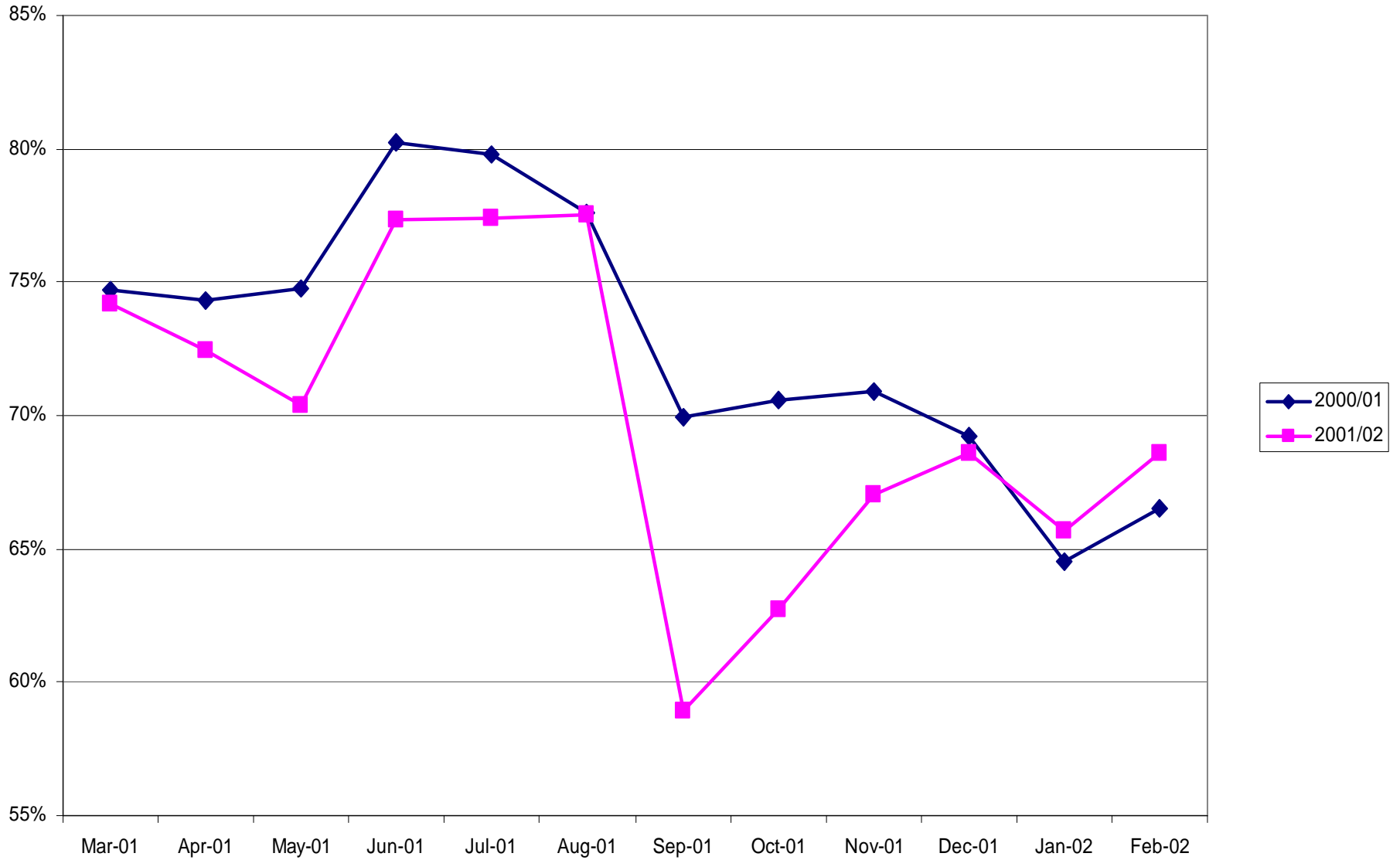
Source: ATA Monthly Passenger Traffic Report





System Load Factor Year-over-Year

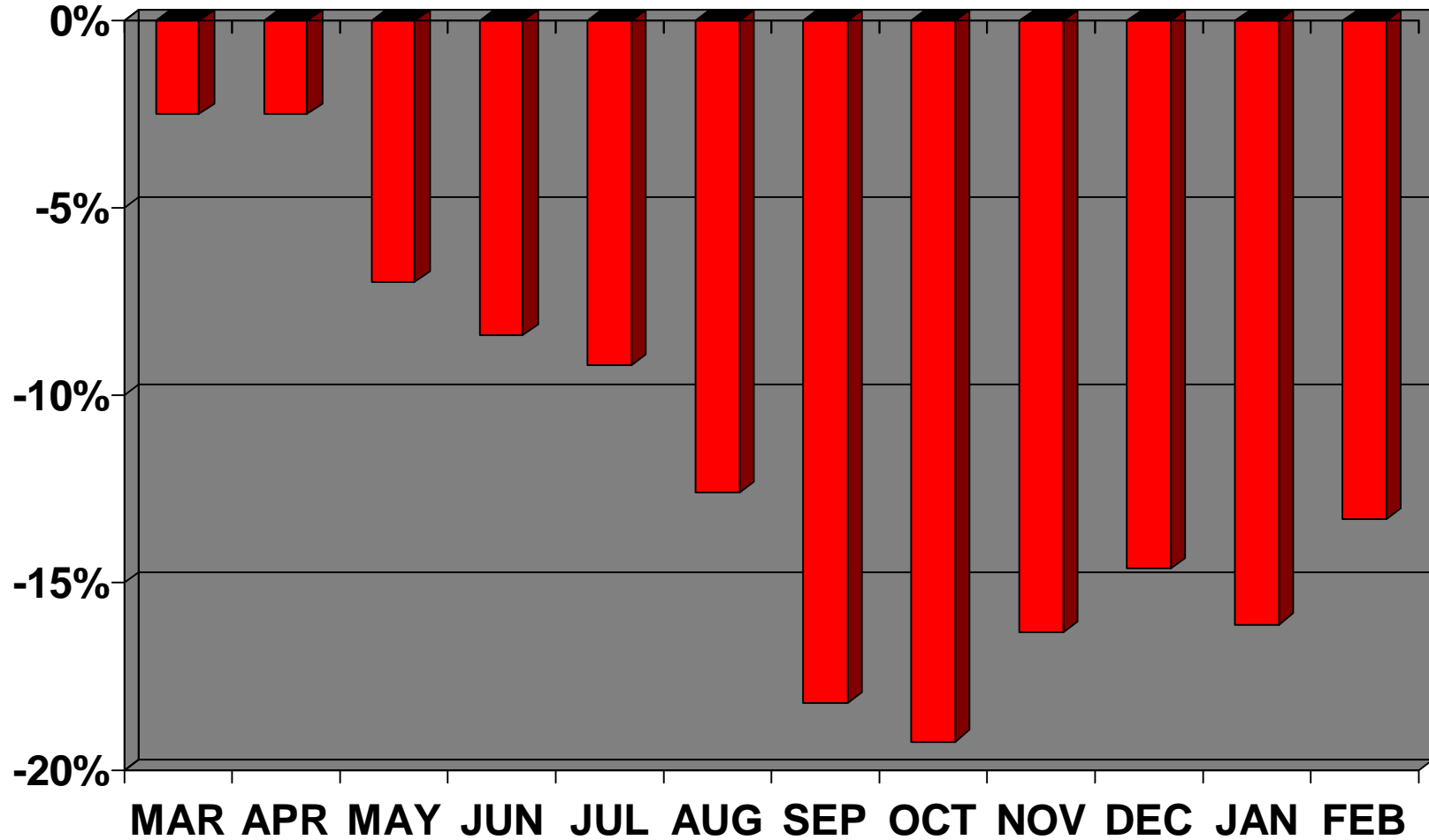
Source: ATA Monthly Passenger Traffic Report





Annual Change in Average Domestic Fare

Source: ATA Monthly Airfare Report



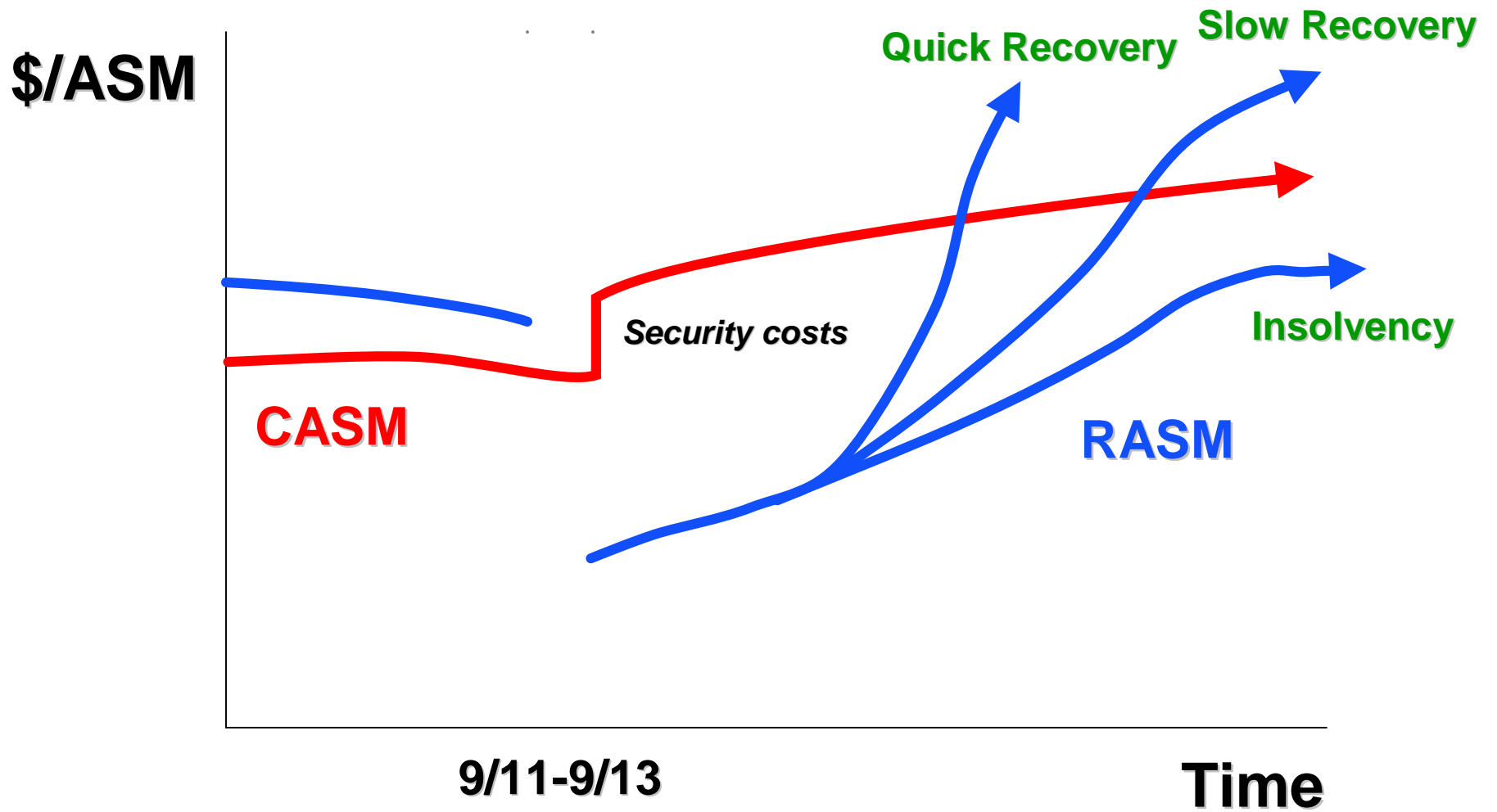


Prospects for Profitability

- **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





Obstacles to Recovery: Costs

- **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