Impacts of 9/11 on US Airline Performance

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US Airline Industry Before 9/11

• Current industry “crisis” began before 9/11:
  ▪ Dot.com bubble burst, stock market slide, and softening economy
  ▪ Industry losses forecast for 2001 even before 9/11 attacks

• Other airline industry concerns at the time:
  ▪ Air transportation system capacity constraints led to record flight delays in 2000
  ▪ Consumer perceptions of poor service and airline indifference, exacerbated by delays
  ▪ Dominance of large network airlines, accusations of anti-competitive actions vs. new entrants
Impacts of 9/11 Attacks

• Unprecedented use of aviation for terror:
  ▪ Hijacking by suicide terrorists
  ▪ Aircraft as missiles flown into buildings

• Most airlines reduced operations almost immediately after 9/11:
  ▪ 80,000 layoffs by US airlines alone, many more since then
  ▪ US airline capacity (ASMs) cut by 25%, hundreds of aircraft retired/parked
  ▪ US airline traffic (RPMs) initially dropped by 45% due to passenger fears, security hassles
Post-9/11 Setbacks

- Invasion of Afghanistan (Oct 01)
- Iraq War (Mar 02)
- SARS epidemic (Spring 03)
- US Terror Alerts keep security concerns in passengers’ minds
- Airline fuel prices soared to record levels (2004-05)
Cost Impacts of 9/11

• Operating costs increased substantially:
  ▪ Lower aircraft utilization due to schedule cuts increased unit costs
  ▪ Added security requirements and associated delays further affected productivity
  ▪ Higher aircraft and liability insurance costs

• New security fees also imposed:
  ▪ Passenger Security Fee added to passenger tickets
  ▪ Airlines pay Aviation Security Infrastructure Fee to cover TSA screening costs ($315 million in FY04)
Daily Aircraft Utilization by Legacy Carriers Plunged After 9/11 (not for Southwest)
Aircraft Insurance Costs Doubled after 9/11

Source: ATA data

AIRCRAFT INSURANCE COSTS
% of Hull Net Book Value

Source: ATA data
Other Insurance Costs Increased by 400%

NON-AIRCRAFT INSURANCE COSTS
Cents per RPM

Source: ATA data
Jet Fuel Prices Up 100% Since Q3 2001

FUEL COSTS
Cents per Gallon

Source: ATA data
4 Years Later, Traffic Has Recovered

- **US airline RPMs returned to 2001 levels in mid-2004**
  - But August 2005 US airline capacity still 6% lower than August 2001
  - Average load factors are now above pre-9/11 levels – 85.1% ALF in July 2005 is highest month on record

- **No expectation of US industry profits in 2005:**
  - Revenue mix of traffic is weak, despite recovery of traffic and load factors
  - Average fare (yield) is still running about 15% lower than in 2000
  - Record fuel prices have wiped out hopes for profits
Traffic Returned to 2001 Levels in 2004

TRAFFIC: Revenue Passenger Miles

Source: ATA data

Billions

January February March April May June July August September October November December

Source: ATA Monthly Passenger Traffic Report
Load Factors are at Historical Record Levels

**LOAD FACTOR**
4 Qtr Moving Average

Source: ATA data
US Industry Losses Over $30 Billion Since 2001

[Bar chart showing US Industry Losses from 1986 to 2004 with values in USD Millions as a natural text representation]

- US Industry Losses Over $30 Billion Since 2001
- Bar chart showing annual losses from 1986 to 2004 with values in USD Millions.
Revenue Challenges: “The Perfect Storm”

• Revenue power of legacy airlines has disintegrated, with little relation to 9/11:
  ▪ Business passengers no longer willing to pay 5 to 8 times the lowest available fare
  ▪ Internet distribution channels give more passengers more information about air travel options
  ▪ Cutbacks have reduced service quality differences between network and low-cost carriers

• Low-fare airlines have taken advantage:
  ▪ LFA share of domestic passengers increased to 25% in 2004, from 16% in 2000 and only 5% in 1990
Domestic Unit Revenues Are Down 15%  

RASM (¢) -- Mainline Domestic  
12 Months Ended  

Source: ATA data
Recent conditions favorable for low-fare airlines:
- Less business travel overall, reduced willingness to pay for premium services
- More stable demand for price-sensitive leisure travel
- Leisure travel demand less affected by post 9/11 “hassle factor”

Low-fare carriers threaten the viability of legacy network carriers:
- Desperate search for new “business models” to respond and compete with low-fare airlines
Total industry revenues dropped by almost 20% and are still 12% lower than in 2000.
Yields began decreasing prior to 9/11 and have shown little sign of recovery
While 4 out of 6 network carriers have lost market share since 1999, all low-fare airlines gained market share during this period, led by Southwest and JetBlue.
All Legacy carriers have lost revenues; UA and US revenues down by over 30%
Low fare group has maintained or increased revenues – led by JetBlue, AirTran
Summary: Revenue Challenges

• Pricing actions increased unit revenues, but not to previous levels:
  ▪ Price cuts to stimulate leisure demand have led to record load factors but did not improve revenue quality
  ▪ Efforts to “simplify” fares by removing restrictions have likely re-attracted some business passengers
  ▪ But, fare simplification still leaves unit revenues 10-15% below levels of 2000

• Conclusion: Pricing actions alone cannot return the network airlines to profitability
Cost and Productivity Challenges

• Given revenue shortfall, legacy airlines must cut costs and increase productivity:
  ▪ Low-cost carriers often used as “benchmark” for unit costs
  ▪ Changing work rules, reducing workforce and cutting wage rates are all options for reducing labor unit costs
  ▪ Unit cost differences also due to aircraft productivity:
    ➔ Point-to-point vs. hub-spoke networks
    ➔ Seating density
    ➔ Scheduling and aircraft ground turn-around times
Unit Costs differences between network carriers and LCCs remain despite cost-cutting efforts.
Travel Agency Commissions All But Eliminated – Down 85% Since 1994

Source: ATA data
Food and Beverage Costs Cut in Half

FOOD & BEVERAGE COSTS
Cents per RPM

Source: ATA data
Lowfare carriers have lowest CASM across all average stage lengths
US Airline Performance Since 9/11

- US airline industry is in the midst of its greatest transition in history
  - Fundamental shifts in airline business models
  - More efficient new entrants with much lower costs
  - Changes envisioned by architects of deregulation more than 25 years ago

- 9/11 was not the primary cause of this “crisis”
  - It did lead to increased operating costs
  - Subsequent unfortunate events have not helped
  - But new competition is transforming the industry
Key Questions for the Future

• What industry structure will emerge?
  - Will (most) network carriers be able to adapt and survive?

• What are the new revenue/operating paradigms for network carriers?
  - Are LCC pricing and operating models broadly applicable?

• What will be the impact on small markets?
  - Most domestic O-D pairs can only be served with a hub network

• Should the government intervene?
  - Disruption of “re-structuring” process spurred by market forces
Questions for This Forum

• Are we ready for another 9/11?
  ▪ Even if we are, unlikely that the next major terror attack will mirror the events of September 2001

• Can airlines survive another terror attack?
  ▪ Return of traffic worldwide after 9/11 and subsequent setbacks illustrates the tremendous resiliency of air transportation
  ▪ But, not all airlines (both US and elsewhere) will survive the current industry restructuring, and this has little to do with 9/11