

Impact of Global Economic Crisis on Airline Industry

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Abstract -- One of the significant objectives of the world economy has been to achieve high rate of economic growth. The global economic downturn in 2008 has severely affected many sectors of the world. In this paper, the airline sector has been discussed as the sector has huge potential for economic growth with the increasing number of middle class people, their rising disposable income levels and willingness to spend on air travel. The methodology used in this paper is based on secondary data sources which include the existing literature in the form of books, journals, magazines, newspapers, published reports and the articles and newsletters available through electronic media. In this paper, the authors have tried to focus on how global recession has impacted the airline industry and thereby suggest directions for future course of action which would be useful to the policymakers, regulators and researchers. It can be concluded in this paper that the global recession is not solely responsible for poor performance in the airline sector. There are many other contributory factors which are responsible for such downturn in the industry.

Keywords: economic downturn, airline industry

I. INTRODUCTION

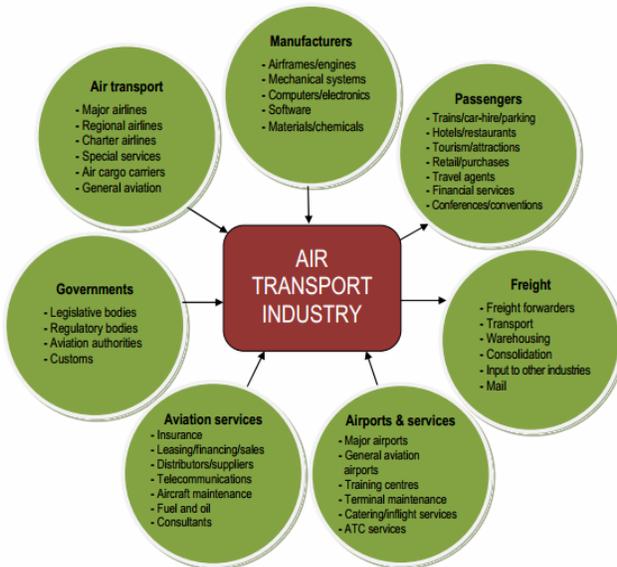
Civil aviation industry contributes to the social and economic growth across the world. It not only forms an important and most efficient mode of transportation system but also affects the lives of numerous household people and is a key employment generator (35 million jobs world-wide) and contributes heavily to the gross domestic product (GDP) of the world economy. The failure of the major financial institutions in the past few years led to the global financial crisis which drastically impacted the world economy. The aviation, one of the fastest growing industries, got heavily affected by such crisis.

“The recent cyclical downturn was the deepest experienced by the commercial airline industry since the 1930s. Early 2009 marked the low point for international air travel markets. From the early-2008 peak to the early-2009 trough, premium travel fell 25%. Economy travel fell 9%, the decline softened by a shift to cheaper seats.”¹ Fall of the Lehman Brothers was the last straw on the camel’s back and since then an economic and financial crisis has been witnessed by the world. The airline industry and its associates have not been immune to the same. The nature of the industry makes it vulnerable to global economic developments.

The previous aviation catastrophe the industry faced was owing to the 9/11 attacks and the subsequent collapse of air traffic and passenger revenues led to shutdowns and caused severe economic uncertainty. Ongoing global financial crisis has led the industry into recessionary environment a second time within a decade. The crisis directly struck employment in the aviation industry, recording huge job losses in the millions and accompanying social upheaval among other effects it has had. The economic downturn has seen a significant drop of investments in the aviation market. Airport ground handlers and airplane part manufacturers have also had to retrench their workers in order to counterbalance the poor market. The amount of air traffic is likely to decrease as well, as people are travelling lesser and choosing cheaper alternatives. In fact the crisis has changed the way aviation industry conducts its business. It has brought about a boom in low-cost carriers, which has made travelling by air cheaper for the masses. Services offered by airlines and airports are also of higher standards in order to attract new segments of travelers. Figure 1 shows the different actors in the air transport industry.

¹IATA 2010 annual report

The air transport industry today



Source: ATAG: *The economic benefits of air transport*, op. cit.

Figure 1: An Overview of Airline Industry

(Source: Civil aviation and its changing world of work, International Labour Organization, GDFCAI/2013)

II. IMPACT OF GLOBAL ECONOMIC CRISIS ON THE INDUSTRY

The global economic impact on civil aviation is estimated to be around US\$ 3.5 trillion, equivalent to 7.5 percent of world GDP and revenues fell by 7 percent post 2001.

A. Fall in Demand

There is a synergy between the global economy and demand for air transportation i.e. in any economic downturn, civil aviation will also be the most suffered. The demand for air transport is pro-cyclical. As per IATA's data, the Asia-Pacific region appears to have been hardest hit with a loss of 14.5 percent between June 2008 and June 2009 whereas there has been a drop of 4.7 percent and 5.9 percent in Latin America and Africa respectively. Chart 1 depicts that there is a significant shift in demand for air travel between 2008 and 2009 and then there is a persistent rise except between 2010 and 2011 whereas in air cargo, there is a significant shift in demand between 2008 and mid-2010 and then it has been flat for three years.



Chart 1: Demand for air travel and air cargo

Similarly, Chart 2 shows that the air travel growth has closely followed the ups and downs of business confidence. There has been a significant fall in business confidence in the year 2009 but in the recent years the acceleration of air travel followed an improvement of business confidence in the economic outlook.

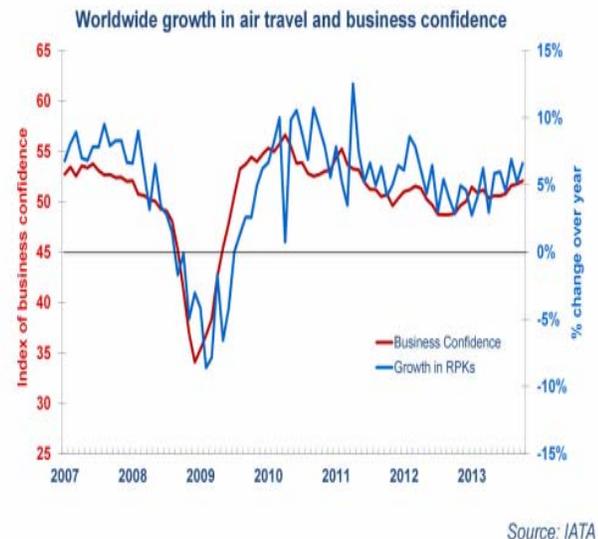


Chart 2: Trends of air travel and business confidence

B. Reduced Capacity

Leading airlines across the world such as Air France-KLM and Lufthansa started reducing

capacities since 2008 in the face of the deepening world recession. Airlines around the globe were hit by the crisis in the aviation sector. Many of them deferred delivery of new aircraft, undermining the outlook for production at makers Airbus and Boeing. In Ireland Aer Lingus, which fought off a second hostile takeover bid from Ryanair, also fell into loss last year as passenger fares and cargo volumes fell sharply. To counter the recession, airlines such as Cathay cut capacity, grounded flights, delayed construction of a cargo terminal. German carrier Lufthansa reduced planned capacity growth, as it reported a two-thirds fall in net profit in 2008 due in part to the impact of troubled investments. Figure 2 shows a series of large commercial aircraft backlog delivery schedule region-wise.

Large commercial aircraft backlog delivery schedule by region

	2009	2010	2011	2012	2013+	Total
North America backlog	161	172	162	166	325	1,087
European backlog	341	265	237	184	297	1,324
Asian backlog	401	407	368	297	698	2,271
Middle East backlog	91	87	61	111	430	799
Other backlog	133	128	112	97	355	904
% North American	14%	16%	17%	19%	15%	16%
% European	30%	25%	25%	22%	14%	22%
% Asian	36%	38%	39%	35%	33%	35%
% Middle Eastern	8%	8%	6%	13%	20%	13%
% Other	12%	12%	12%	11%	17%	14%

Source: JP Morgan: All about Aerospace & Defense 2009

Figure 2

C. Increased Fuel and Operating Costs

As per IATA reports, the global airline industry’s fuel bill has been forecasted to total \$214 billion in 2013. There has been an increase of \$4 billion over 2012 and is almost 5 times 2003’s fuel bill of \$44 billion. Figure 3 highlights that sharp rise in fuel costs of airline industry has significantly impacted the net profit levels in the same year.

Industry Fuel Costs and Net Profits

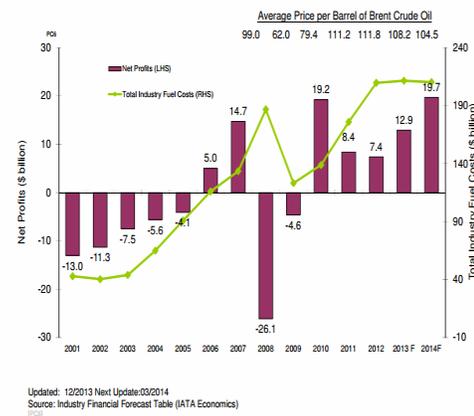


Figure 3

Similarly, figure 4 shows the impact of fuel on operating costs in the airline industry. With the significant rise in total fuel cost to \$ 187 billion in 2008, the total operating costs has increased to 33% in the same year.

Fuel Impact on Operating Costs

Year	% of Operating Costs	Total Fuel Cost
2003	14%	US\$44 billion
2004	17%	US\$65 billion
2005	22%	US\$91 billion
2006	26%	US\$116 billion
2007	27%	US\$133 billion
2008	33%	US\$187 billion
2009	26%	US\$123 billion
2010	25%	US\$139 billion
2011	28%	US\$176 billion
2012	32%	US\$210 billion
2013 F	31%	US\$211 billion
2014 F	30%	US\$210 billion

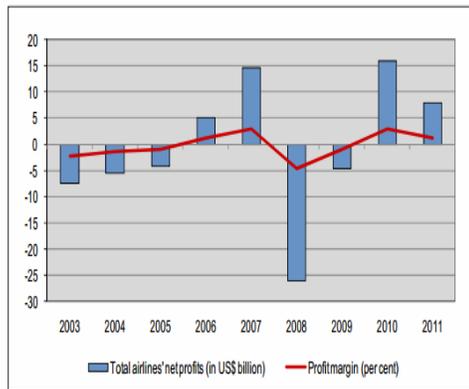
Updated: 12/2013 Next Update: 03/2014
Source: Industry Financial Forecast Table (IATA Economics) [P16]

Figure 4

D. Fall in Profitability Growth

The main source of airlines income is from tickets and freight. Figure 5 shows that there is significant fall in the total profits of the airlines in 2008.

Total airlines' net profits and profit margins 2003-11



Source: International Air Transport Association, 2012.

Figure 5

E. Fall in the Employment Level and Poor Labour Relations

Recent falls in employment can be attributed to several factors: firstly, outsourcing; secondly the growing share of LCCs, which fly newer planes and employ fewer workers; and thirdly, technology has substituted human labour in tasks such as ticketing and luggage handling.²

Between May 2008 and 2009, jobs were cut at several of the major airlines across the world such as United Airlines (6,600), American Airlines (4,900), Northwest Airlines (4,300), Delta Airlines (3,300), US Airways (1,900), and Continental Airlines (1,500). UK-based airline XL Airways and Russian carrier Dalavia ceased trading. Other carriers such as Aer Lingus, Air France-KLM and Scandinavian Air Services introduced job reduction programmes (of 1,500, 3,000 and 9,000, respectively). In Asia Pacific, the Australian airlines Qantas and Virgin Blue announced 1,750 and 400 job losses, respectively, while Air New Zealand planned to retrench 200 jobs. Apart from job losses, employees were affected by reduced working time, for example, Lufthansa reduced the hours of 2,600 air freight division employees. Pay freezes were also implemented, for example, at Singapore Airlines, British Airways and Virgin. However, most commonly, workers were offered unpaid leave and asked to work without pay such as in Kingfisher Airlines in India. These policies were evident even at British Airways, where

² United States Department of Transportation, 2011

employees were asked to work for one month without pay; at Air India, where 15,000 employees were asked to take leave without pay for between 3 and 5 years; at Cathay Pacific, where 17,000 employees were asked to take up to four weeks holiday without pay; and at Japan Airlines, where 16,000 employees were asked to take two months unpaid leave. The industrial relations have also seriously deteriorated. Employment relations affect company performance. Good employment relations, as measured by a positive workplace culture, seem to result in good quality of service, high levels of labour and aircraft productivity, and contributing to a sustainable industry. Employees play a critical role in improving productivity of aircrafts and gates, and improving customer service and satisfaction.³

F. Increase in Low Cost Carriers (LCCs):

Low cost carriers (LCCs) are frequently defined as the airlines that supply no-frills flights for which passengers pay low fares.⁴ LCCs are usually characterized by lower ticket distribution costs, common fleet type, increased aircraft utilization, use of secondary airports, point-to-point route structure with non-stop flights and no-frills service.⁵ The first low-cost carrier, Southwest Airlines, was established in 1971, gradually gained importance after the deregulation in the United States in 1978 followed by the European Union in 1990. In the recent years, LCCs have taken passengers from full-service airlines and created new demand in the world economy. They have been able to grab 41 percent share in the European market, 50 percent in Brazil and 70 percent in India. Some of the legacy carriers have also imitated LCCs by cutting their costs (reducing food service, charging for luggage and entertainment and reconfiguring plane layouts) and boosting productivity.⁶ LCCs share of globally available seat capacity is around 25 per cent and 15 per cent of available seat kilometers (ASK). Some LCCs are venturing into long-haul flights and increasing code-shares.

III. LACK OF GOVERNANCE AND MISMANAGEMENT IN THE AIRLINE SECTOR

Besides external factors, there were many internal factors which were responsible in the economic

³ Bamber, G.J., Gittell, J.H., Kochan, T.A. and von Nordenflycht, A., 2009

⁴ C.F. Alves, C. Barbot, Journal of Air Transport Management, 13, 2007, 116-120

⁵ Civil Aviation and its changing world of work, International Labour Organization Report, 2013

⁶ Vasigh, B., Fleming, K. and Tacker, T., 2008

crisis. Lack of governance and mismanagement in the airline industry has impacted a lot. The failure of private Indian carrier, Kingfisher is very well-known. The first Chief Executive Officer (CEO) of the airline was appointed in 2005 when it was launched and the next was appointed after a long period of time on September 30, 2010. Till then, the airline was running on liquor baron's decisions while he was busy with other businesses that he had. The auditors of the company didn't seem active. Financial mismanagement has also been responsible for the failure of the beleaguered airline. Despite the crisis in Kingfisher, top executives were paid handsome pay hikes by the company and the CEO pay package was the second highest amongst all his peers at Mallya-led UB Group and the second highest amongst the country's listed three airlines in 2011-12. Corporate Affairs Minister Veerappa Moily blamed bad governance and absence of professional management as the reasons for the perils of the carrier. He said, "I want that company (Kingfisher) to survive. The government is always there but the major initiative should come from a person who has to provide that kind of atmosphere. As a corporate affairs minister, we want corporate bodies to build and come up and not wound up. Something has to be done. Mallya has to work out a strategy. The entrepreneur has to take proactive measures so that it is acceptable to banks and others".⁷

IV. CONCLUSION

While global commercial aviation industry has not been immune to the economic crisis, the long-term outlook is definitely good. Forecasts for next 0-15 years foresee 5% Year on year growth in revenues which is twice the growth rate of the global economy as a whole. Growth is expected from maturing economies and Asia. All traffic including business, tourism and freight is expected to rise dramatically with the increase in disposable income in developing countries and maturing of low cost carriers. Several examples of new practice emerged during the crisis. AirFrance-KLM announced that the 3,000 job cuts required will be achieved through suspending hiring, not renewing temporary contracts and not replacing retiring members of staff, thereby avoiding redundancies. In the UK, consultation between British Airways and the British Air Line Pilots Association (BALPA), the trade union for pilots in the UK, led to agreement over a cost reduction package that saved the airline £26million per year. Similarly, Thomson airways cut 5 per cent pay for

pilots employed at the airline in order to save up to 100 pilot jobs.

But above all aviation was seen as a luxury and travelling by air was something only rich could afford earlier. During the economic slowdown most airlines transformed and started to make airfares more affordable so much so that everyone had a chance to travel cheap. Still people would try not travel by air as far as possible, but if there were a need, would try to travel as cheap as possible. The aviation industry has to evolve and remain relevant to suit these needs of travellers, and in time to come aviation would become even cheaper and have backward and forward integration with airport to end destination travel providers in order to recover from the current economic crisis. Furthermore, it has been observed that the economic crisis is not solely responsible for the poor performance of the airline industry. Besides economic recovery, professional team and good governance is required to give a push to this sector so that it can contribute significantly to the world economy.

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